FHA

FEDERAL HOUSING ADMINISTRATION

ANNUAL MANAGEMENT REPORT

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FISCAL YEAR 2017

Your Door to FHA HOMEOWNERSHIP

This Annual Management Report (AMR) for the fiscal year ending September 30, 2017 provides the Federal Housing Administration's (FHA) financial and summary performance information in accordance with OMB Circular A-136, Financial Reporting Requirements.

FHA's AMR is available on the following website. FHA welcomes feedback on the form and content of this report. https://www.hud.gov/sites/documents/FHAFY2017ANNUALMGMNTRPT.PDF

This report is divided into four sections:

- ***A Message from the Acting Federal Housing Commissioner and General Deputy Assistant Secretary for Housing,*** which provides a welcome message and introduction to the report.

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

- ***Financial Statements*** include the four principal statements: Balance Sheet; Statement of Net Cost; Statement of Net Position; and Statement of Budgetary Resources; as well as the Notes to the principal statements.

- ***Auditor's Report*** on FHA's fiscal year 2017 financial statements, internal controls and compliance with laws and regulations.

A MESSAGE FROM THE ACTING FEDERAL HOUSING COMMISSIONER AND GENERAL DEPUTY ASSISTANT SECRETARY

November 15, 2017

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

For 83 years, FHA has provided opportunities for Americans to build equity and climb the economic ladder. It has also been called upon throughout its history to provide a critical backstop during times of market stress. FHA Single Family mortgage insurance programs have assisted millions of first-time and low-to-moderate income homebuyers. FHA Multifamily and Healthcare insurance programs have supported over 48,000 projects, delivering affordable rental housing and quality healthcare to underserved markets and communities. And the Office of Housing Counseling has worked with partner organizations to help millions of Americans make successful homeownership decisions.

As we look to the future, FHA must balance the important mission to serve with the responsibility to ensure that its portfolio is financially and structurally viable. FHA Single Family initiatives will aim to help homeowners build equity in the homes they can afford, aided by sound risk management practices. We will take steps to provide more transparency, consistency, and accountability to Congress and the American public in our financial reporting. We will review our underwriting guidelines, lending standards, and servicing protocols. And we must modernize an outdated technology infrastructure to provide ourselves and our partners with systems that deliver enhanced processing and reporting capabilities. All of this will, in turn, support sustainable homeownership and safeguard the taxpayers who stand behind the over $1.2 trillion FHA Single Family book of business.

FHA's Multifamily insurance programs continue to provide stability, liquidity, and affordability to the multifamily housing market by financing the preservation and production of affordable and market-rate housing. FHA Multifamily programs also play an important role in providing credit during countercyclical times and in small markets. Multifamily production must balance its growth while performing comprehensive asset management and risk mitigation. And as we face budgetary pressures and an aging affordable housing stock, our efforts will also continue to leverage private financing to address the critical capital needs of existing properties.

FHA's Office of Healthcare Programs facilitates healthcare for thousands of communities across the country by financing eligible hospitals and residential care. We must execute this mission while keeping a close eye on each portfolio to ensure quality care and financial stability, using a tailored approach to prevent defaults and claims on insured properties.

Importantly, FHA will also continue to respond to the needs of homeowners and communities trying to recover from the devastation caused by Hurricanes Harvey, Irma, and Maria, and the wildfires in California. Our hearts go out to them as we work on longer-term relief efforts.

As we carry out our objectives for the coming year, we look forward to engaging Congress to ensure that FHA insurance programs are managed prudently, while continuing to meet the needs of the nation's renters, homebuyers, and communities.

Enclosed please find the Federal Housing Administration's (FHA) financial and summary performance information for fiscal year 2017, along with our management team's discussion and analysis.

Dana T. Wade

Dana T. Wade
Acting Federal Housing Commissioner and General Deputy Assistant Secretary

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FEDERAL HOUSING ADMINISTRATION AT A GLANCE

The Federal Housing Administration (FHA) was established by the National Housing Act of 1934. Headquartered in Washington, D.C., with field offices throughout the United States, FHA was integrated into the United States Department of Housing and Urban Development (HUD) in 1965.

FHA provides mortgage insurance for Single Family, Multifamily, and Healthcare loans financed by FHA-approved lenders throughout the United States and its territories, backed by the full faith and credit of the U.S. government. This guarantee of payment enables lenders to provide loans to eligible borrowers who may not otherwise receive mortgage credit in conventional and private markets. Lenders are protected against losses should borrowers default on their mortgage loans. To help protect against potential default losses, FHA collects upfront mortgage insurance premiums at the time of origination, as well as monthly premiums.

FHA is the largest provider of mortgage insurance in the world. Since its inception, FHA has insured over 47.5 million single family homes and 48 thousand multifamily and healthcare project mortgages. Through its insurance programs, FHA supports the homeownership goals of qualified individuals and families, and enables multifamily and hospital production that meets the needs of communities across the country. Over the course of its history, FHA has been a critical player in the U.S. housing market, including serving millions of first-time and low-to-moderate income homebuyers; stepping in as a countercyclical backstop during times of economic stress; and providing relief to borrowers affected by disasters. In addition, through housing counseling programs, FHA also offers assistance to individuals and families to help them make independent financial decisions that can lead to greater long-term financial success.

FHA's VISION FOR THE FUTURE

- Continue to evaluate the Single Family credit box and risk tolerance, and adjust programs and policies as necessary to manage an appropriate level of risk while serving qualified individuals and families.
- Continue to increase the number of public housing units that can be converted under the Multifamily Rental Assistance Demonstration program, to ensure that more residents have access to decent, safe housing.
- Maintain low claim rates in FHA's Healthcare Programs through quality underwriting and proactive asset management, while enabling access to capital for healthcare projects nationwide.
- Implement strategic changes to Housing Counseling Certification, so that by August 2020, all housing counseling under HUD programs must be performed by HUD-certified housing counselors.
- Maintain vigilant monitoring of, and quarterly reporting on, the General and Special Risk Insurance (GI/SRI) and Mutual Mortgage Insurance (MMI) Funds to enhance the transparency of the fund's performance.

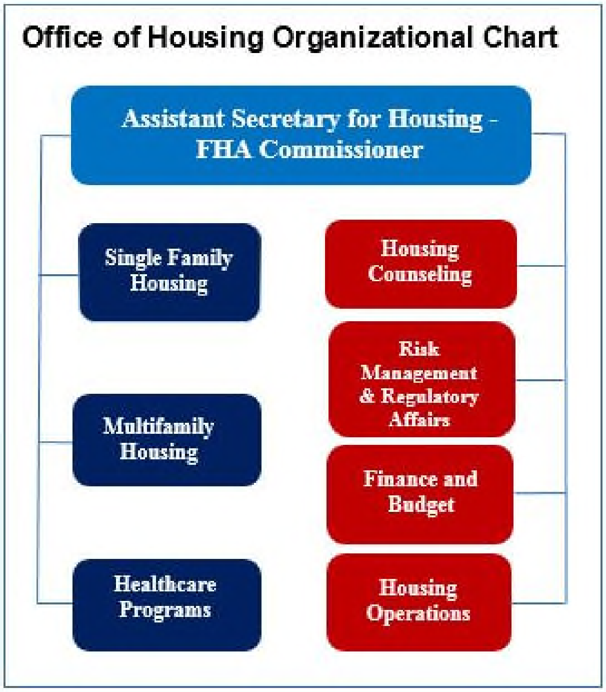
Notably, FHA has worked with the rest of the Department of Housing and Urban Development to offer special relief to address the needs of those impacted by Hurricanes Harvey, Irma, and Maria, as well as the recent wildfires in California, which caused significant destruction and dislocated thousands of families. FHA has granted an extended foreclosure moratorium for certain areas; is working with industry partners to assist borrowers struggling to make mortgage payments; and is working closely with the Federal Emergency Management Agency (FEMA), other federal agencies that serve the housing market, state and local officials, and multifamily project owners. FHA is currently assessing the longer-term impact of these storms on its portfolio.

Given FHA's total portfolio of over $1.38 trillion in insurance-in-force, it will work to maintain a strong financial management strategy to manage the exposure of taxpayers' risk who stand behind its programs. Doing so necessitates balancing its mission to serve homeowners, provide affordable rental housing, and bring healthcare to underserved markets with measures that ensure financial viability and sustainability for years to come.

MISSION AND ORGANIZATIONAL STRUCTURE

FHA provides mortgage insurance that facilitates the financing of homes, rental housing, and healthcare facilities, while seeking to mitigate taxpayer risk and provide stability for homeowners, renters, and patients. Its mission has been defined in various ways throughout the years, with a focus on enabling first-time homeownership and facilitating the availability of mortgage credit to qualified borrowers when private or conventional financing may not be available. FHA is led by the Assistant Secretary for Housing-FHA Commissioner who is responsible for ensuring effective execution of its programs and policies.

Within the Office of Housing-FHA, several core support and program offices, depicted below, play a key role in administering these programs, and providing financial management and accountability.



FHA administers mortgage insurance programs through its Single Family, Multifamily and Healthcare Program Offices. For each of its insurance programs, FHA collects insurance premiums, pays claims, assesses risks, and predicts future liabilities for its portfolio of insured loans. The Office of Housing Counseling (OHC) supports FHA in achieving its mission by awarding grants to expand access to counseling for tenants and homeowners seeking to achieve their housing goals, and helps homeowners avoid foreclosure.

Among the support offices, the Office of Risk Management and Regulatory Affairs (ORMRA) leads FHA in measuring, monitoring, and managing operational and credit risk to ensure FHA is achieving its strategic objectives. The Office of Finance and Budget (FAB) is responsible for Housing-FHA's financial stewardship activities, which include: financial management, budget formulation and execution activities, and the overall integrity of FHA's accounting records. Additionally, FAB oversees the competitive sale and disposition of mortgage notes, the preparation of the Annual Management Report, and the consolidated annual financial statements. The Office of Housing Operations supports all divisions with a variety of services, including contracting and procurement.

RECOVERY EFFORTS FOR HURRICANES HARVEY, IRMA & MARIA

The disasters resulting from Hurricanes Harvey, Irma and Maria at the end of fiscal year 2017 and early fiscal year 2018 have impacted the lives and properties of thousands of FHA-insured homeowners living in the Presidentially Declared Major Disaster Areas (PDMDAs) of Alabama, Florida, Georgia, Louisiana, South Carolina, Texas, Puerto Rico, and the United States Virgin Islands. FHA anticipates future claims and losses in these areas, but is unable to provide an exact accounting as of the publication date of this report.

The Department of Housing and Urban Development (HUD) is the lead federal coordinating agency for long-term disaster-related housing needs. FHA plays a major role within the Agency, and has taken several important actions, including providing guidance to lenders and servicers handling mortgages within the PDMDAs, extending its foreclosure moratorium for single family properties in affected areas, and offering insurance on special loan programs for disaster victims. The following information provides more detail on these specific actions.

Foreclosure Relief. FHA has granted a 90-day moratorium on foreclosures for FHA-insured home mortgages located within the geographic boundaries of the PDMDAs, and has extended this moratorium for an additional 90 days for certain impacted areas. A borrower can also qualify for foreclosure relief if he or she is a household member of someone who is deceased or injured by the disaster; or if he or she has otherwise been directly or substantially affected by the disaster and cannot make mortgage payments.

Mortgage Insurance. Homeowners with FHA-insured mortgages in PDMDAs are eligible for a variety of relief measures, including the 203(h) Mortgage Insurance for Disaster Victims program, which allows for 100 percent mortgage financing for disaster victims whose previous residence – whether owned or rented – was destroyed. FHA's 203(k) Rehabilitation Mortgage Insurance Program allows mortgage financing or refinancing for everything from major structural repairs to smaller repairs including roofing and gutters. These two mortgage insurance programs can help those in affected areas recover, rebuild, or purchase a new home.

MUTUAL MORTGAGE INSURANCE (MMI) CAPITAL RATIO

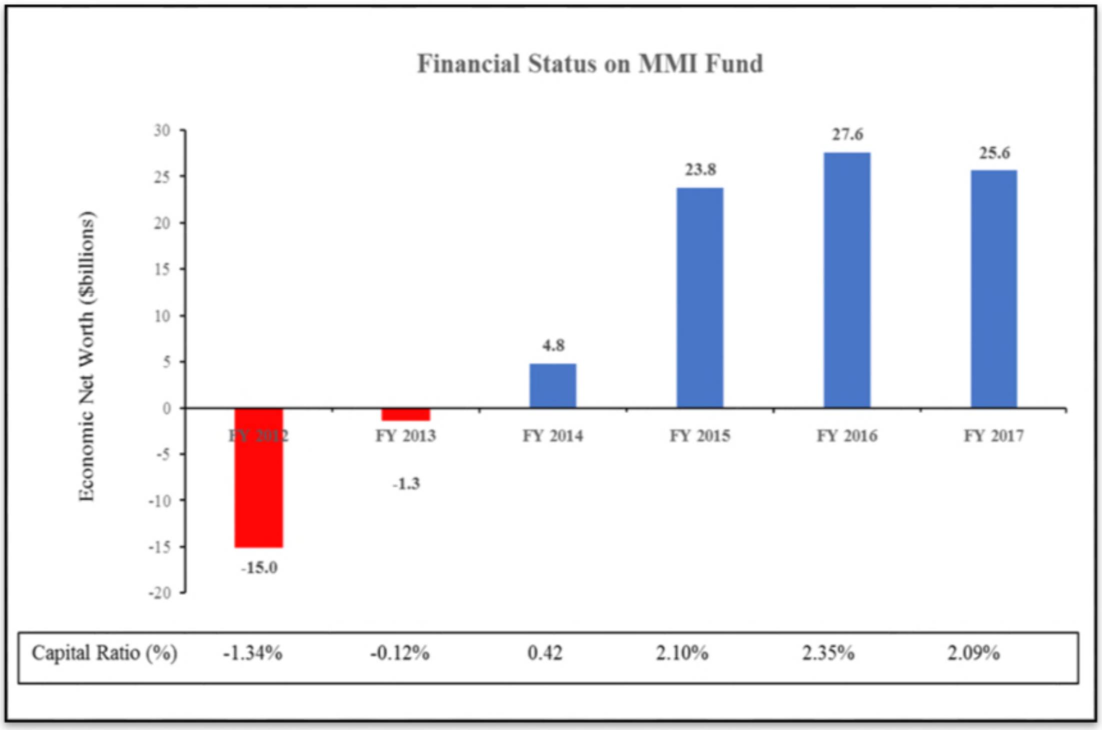
In the National Affordable Housing Act of 1990, Congress introduced a capital-ratio requirement for gauging the financial status of FHA's Mutual Mortgage Insurance (MMI) Fund (12 USC 1711(f)(4)). Today, the MMI Fund encompasses nearly all of FHA's single family business including, since fiscal year 2009, reverse mortgages insured through FHA's Home Equity Conversion Mortgage (HECM) program. The capital ratio compares the "economic net worth" of the MMI Fund to the dollar balance of active, insured loans, at a point in time. Economic net worth is defined as a net asset position, where the present value of expected future revenues and net claim expenses is added to current balance sheet positions. The capital ratio computation presented below combines the Fund's actual capital resources as of September 30, 2017 with the net present value of future cash flows from outstanding books of business.

Capital resources of the MMI Fund are in two types of accounts: a financing account and a capital reserve account. Funds in the financing account cover expected losses over the life of each insurance cohort, while capital reserve balances are accumulated for unanticipated losses.

The financial crisis and economic recession that began in fiscal year 2008 strained the Fund – resulting in a negative economic net worth in fiscal year 2012. In response to the crisis and throughout the recovery FHA undertook a number of actions to protect and strengthen the value of the Fund. In fiscal year 2015, the MMI Fund once again exceeded its statutorily required 2 percent capital reserve ratio, reaching 2.10 percent.

In fiscal year 2017, the MMI Fund's economic net worth decreased by $2.0 billion from last year from $27.6 billion for fiscal year 2016 to $25.6 billion for fiscal year 2017. Similarly, the capital ratio decreased from 2.35 percent to 2.09 percent between fiscal year 2016 and fiscal year 2017. The MMI Fund's economic net worth has improved by $40.6 billion since fiscal year 2012. The MMI Fund capital ratio similarly improved by 3.4 percentage points over that time, from negative 1.34 percent to positive 2.09 percent.

The portfolio valuation underlying the statutory capital ratio calculation is performed by an independent contractor, using FHA data and applying the economic assumptions for the President's Fiscal Year 2018 Budget. That valuation is subject to uncertainty both from future economic conditions and from borrower behavioral patterns that could vary from underlying assumptions built into forecasting equations. As required by law, FHA engaged an independent actuarial firm to produce an independent estimate of the net present value of the future cash flows from the MMI Fund's current book of business. The independent actuary's estimate was negative $12.3 billion versus negative $14.1 billion for FHA's estimate. The difference between the two estimates of $1.8 billion is 0.15 percent of insurance-in-force.



SOURCE: U.S. Department of HUD/FHA

Note: Prior year data was updated to be consistent with the FHA Annual Financial Statements

Improved underwriting requirements have significantly increased the credit quality of the FHA portfolio, increased home retention, and reduced claims against the MMI Fund, helping to rebuild its value. FHA will continue to look for ways to reduce overall risk to the MMI Fund capital position to ensure that the Fund's economic net worth remains above the statutory minimum of 2.0 percent and portfolio performance remains strong.

PERFORMANCE GOALS AND OBJECTIVES

HUD STRATEGIC PLAN

The Government Performance and Results Act (GPRA) requires that Federal agencies develop multi-year strategic plans that include program goals and performance measures, the results of which are reported to the public. Under Secretary Carson's leadership, HUD is working on a new strategic plan. One of the main goals of HUD's plan is to reimagine how HUD itself works, which includes how the Agency can deliver services more efficiently and effectively. It also means that as stewards of the public trust, HUD must be accountable as the public's servant.

FHA will continue to play a leading role in implementing this strategic plan. Its mortgage insurance platform will engage FHA's capabilities to responsibly support homeownership opportunities, allow private capital to play a substantial role in housing markets, and deliver FHA products and programs with more efficiency, clarity and certainty for industry partners and the borrowers served.

Performance Reporting

FHA is in the process of developing a comprehensive Management Action Plan to address the strategic goals and sub goals that will be identified as part of the larger strategic plan. Ongoing and significant objectives and achievements are presented in the following program sections of this document. Targets and actual achievements as of September 30, 2017 will be reported in HUD's Annual Performance Report (APR) to be published in February 2018 and will be available on the following website: https://www.hud.gov/program_offices/spm/pmd.

Note on Forward-Looking Information

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." While the agency does have reasonably reliable processes, procedures, and systems to collect performance data and their supporting attributes, there are inherent limitations to the completeness and reliability of performance information. 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. Additionally, economic and legislative factors outside of FHA's control may affect its ability to influence key performance goals.

FHA PROGRAMS AND PERFORMANCE SECTION

Office of Single Family Housing

"The Office of Single Family Housing oversees the daily administration of a portfolio of over 7.9 million forward home mortgages, with a combined unpaid principal balance of approximately $1.2 trillion. As careful stewards of taxpayer dollars, the office continually evaluates its mortgage insurance programs and the performance of the mortgages it insures, and makes adjustments when necessary. This rigorous oversight allows Single Family Housing to fulfill its statutory obligations to help qualified individuals and families achieve home ownership, while mitigating risks to FHA's Mutual Mortgage Insurance Fund."

Gisele Roget, Deputy Assistant Secretary
Office of Single Family Housing

The Federal Housing Administration (FHA) has provided affordable homeownership and refinancing opportunities for all Americans for the past 83 years, by making loans more readily available through the mortgage insurance programs of its Office of Single Family Housing (OSFH). These programs insure mortgage lenders against losses from default, which encourages lenders to provide mortgage financing on favorable terms to homebuyers. FHA's Single Family Housing mortgage insurance programs make significant contributions to the rate of sustainable homeownership nationwide. The success of our programs is visible across underserved, growing, and stable communities in the nation.

FHA's single family mortgage insurance progams strengthen the nation's housing market, which in turn bolsters the economy. In fiscal year 2017, FHA endorsed 1,246,440 single family forward mortgages totaling $251 billion. Our purchase business continues to primarily support first-time homebuyers. In fiscal year 2017, 82.2 percent of FHA purchase-loan endorsements were for first-time homebuyers. In addition, the unpaid principal balance on total active loans at year-end was $1.16 trillion on 7,982,070 endorsed loans.

FHA has the authority to establish and collect an up-front mortgage insurance premium (MIP), as well as monthly premiums. This up-front premium may be financed by including it in the mortgage loan balance. Because the maximum mortgage amount for forward mortgages that FHA will insure is based on the median home price for the county or Metropolitan Statistical Area (MSA) where the property is located, FHA's loan limits may change annually. In fiscal year 2017, the loan limit for a forward mortgage on an FHA-insured Single Family property in a low cost area was $275,665, and in a high cost area was $636,150. Higher maximum loan limits are available for properties in Alaska, Hawaii, Guam, and the Virgin Islands. In fiscal year 2017, there were slight upward adjustments in certain counties experiencing market increases and no area limit reductions.

Single Family Housing Insurance Programs

FHA offers a variety of insurance programs to meet a wide range of borrower needs.

Single Family Insurance Profile

Table 1 reflects FHA's Single Family insurance portfolio profile in fiscal years 2015 through 2017:

Single Family FHA Portfolio	FY2015*	FY2016*	FY2017
Total Forward Endorsements	**1,116,231**	**1,258,053**	**1,246,440**
Total 203(b)	1,100,218	1,241,074	1,230,774
203(b) Purchase	738,471	836,854	867,655
203(b) Refinance	361,747	377,320	363,119
Total 203(k)	16,013	16,979	15,666
203(k) Purchase	14,917	15,760	14,424
203(k) Refinance	1,096	1,219	1,242
Total Reverse Endorsements (HECM)	**57,990**	**48,868**	**55,291**
HECM Adjustable Rate	48,859	43,669	48,371
HECM Fixed Rate	9,131	5,199	6,920
Total Single Family Endorsements	**1,174,221**	**1,306,921**	**1,301,731**
Total Active Loans at Year-end (forward)	**7,742,143**	**7,838,495**	**7,982,070**
Total Active Loans at Year-end (forward & reverse)	**8,357,011**	**8,430,315**	**8,548,921**
Total Title I	**5,711**	**4,621**	**3,906**
Manufactured Homes	690	861	814
Property Improvements	5,021	3,760	3,092

**Prior year data was updated to reflect small changes in volume.*

Forward Mortgage Insurance Portfolio

The FHA forward mortgage insurance programs continue to be a critically important source of home financing for many families who are underserved by the private sector home mortgage market. In fiscal year 2017, 82.2 percent of home purchasers under FHA's forward mortgage program were first-time homebuyers, and 33.7 percent of all borrowers (both home purchase and refinance) were minority borrowers. In addition, the number of FHA forward mortgage borrowers in fiscal year 2017 classified as low or moderate-income households represented 56.4 percent of all such households purchasing or refinancing their homes nationwide.

Table 2 provides information on the profile of borrowers served through the FHA Single Family mortgage insurance portfolio.

Borrowers Served- Single Family Mortgage Loans	FY2015	FY2016	FY2017
Forward Mortgage Market			
Average Loan Amount	$190,929	$195,068	$201,337
Average Credit Score of Borrowers*	680	680	676
First-Time Homebuyers	614,314	722,071	725,233
% of SF FHA Forward Purchasers	81.5%	82.1%	82.2%
Minority Borrowers	286,942	340,707	365,644
% of all SF FHA Forward Mortgage Borrowers*	32.5%	32.5%	33.7%
Low/Mod Income Borrowers	514,842	600,705	612,369
% of all Forward Mortgage Borrowers*	58.3%	57.4%	56.4%
Reverse Mortgage Market			
Average Initial Principal Limit (amount available)	$163,859	$179,290	$191,027
Average Maximum Claim Amount	$278,147	$300,000	$319,955
Minority Borrowers	11,099	7,996	8,519
% of all SF FHA Reverse Mortgage Borrowers	19.1%	16.4%	15.4%
Average Age of Borrowers	75	75	74

**The calculation excludes streamline refinances.*

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

FHA insures loans made by private financial and non-bank institutions of new or existing single family (one-to four-unit) residences, including manufactured homes and individual condominium units, with loan terms up to 30 years.

Homebuyers may obtain FHA-insured mortgages from FHA-approved lenders to purchase homes, including condominium units, with down payments as low as 3.5 percent on purchase transactions. By insuring FHA-approved lenders against losses, FHA encourages them to provide affordable access to capital in the home mortgage market. The program is open to borrowers who meet FHA eligibility criteria such as residency requirements; down payment (equity) requirements, including mortgage debt-to-income and total debt-to-income requirements; credit history eligibility; and property and appraisal requirements. Under certain circumstances, a borrower may also use the Section 203(b) to finance a secondary residence. The program is also available for use on a limited basis by FHA-approved nonprofit entities and governmental agencies.

Title I and Title II Programs: Manufactured Housing and Property Improvement

The mortgage insurance and loan programs for manufactured housing are governed under the Title I and Title II sections of the National Housing Act. Title I loans are available for financing manufactured homes that are secured solely by the dweller and are classified as personal property. These are also referred to as "chattel" loans. Title I loans are available for property improvements and can be either first or second lien mortgages, as well as unsecured loans, to finance the cost of the improvements. During fiscal year 2017, FHA insured 814 Manufactured Homes and 3,092 Property Improvement loans under the Title I program. Title II loans are also available for manufactured homes that are placed on permanent foundations and classified as real estate under Section 203(b). FHA endorsed 32,496 Title II manufactured home loans during fiscal year 2017.

Reverse Mortgage Insurance Portfolio

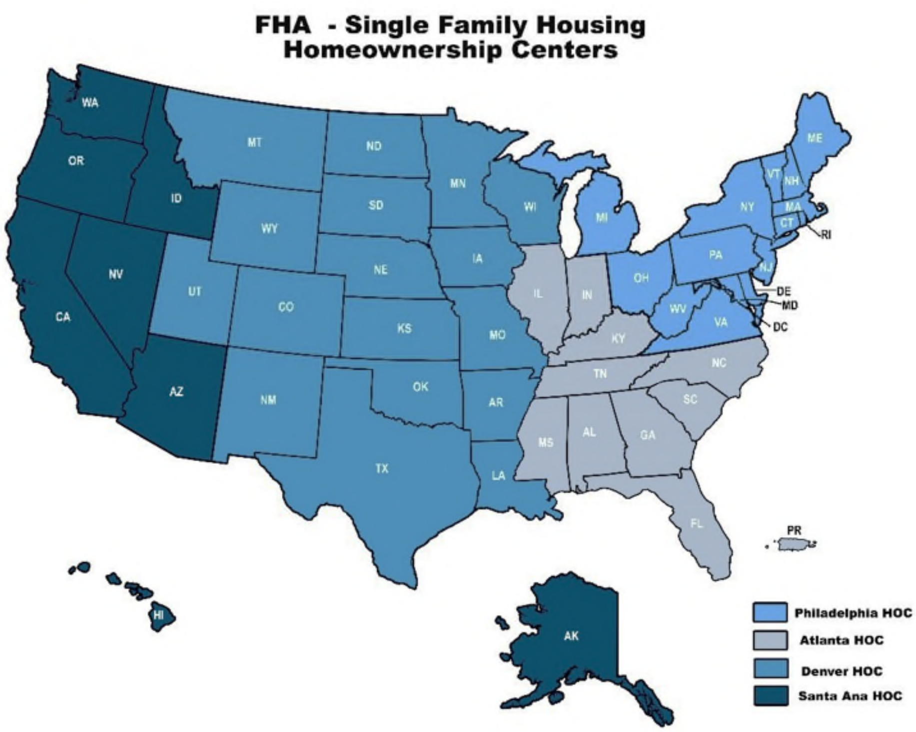
Section 255: Home Equity Conversion Mortgage (HECM)

The Home Equity Conversion Mortgage (HECM) program provides eligible homeowners, age 62 and older, access to the equity in their homes through debt for which repayment is delayed for as long as the borrower lives in the residence. The reverse mortgage program provides homeowners with a fixed rate one-time initial draw and adjustable mortgage options with a number of payment options, including a lump sum payment of mortgage proceeds, line of credit, and term or tenure monthly payments, or a combination thereof.

FHA endorsed 55,291 HECM mortgages in fiscal year 2017, which is an increase from the 48,868 loans endorsed in fiscal year 2016. FHA has taken important steps in the past three fiscal years to strengthen requirements for the HECM program, including initial disbursement limits and financial assessment of the borrower to ensure the security of the insurance fund relative to reverse mortgages.

Office of Single Family Housing Organization

Headquartered in Washington, DC, the Office of Single Family Housing comprises a central administrative office and three program offices, one of which includes the National Servicing Center (NSC) in Oklahoma City/Tulsa. Additionally, there are four regional Homeownership Centers (HOCs) located in Atlanta, Denver, Philadelphia, and Santa Ana, respectively, each supporting the operational aspects of FHA mortgage insurance for a designated geographic area. The core functions of the HOCs are: implementing underwriting and insuring standards; monitoring the origination and servicing practices of FHA-approved single family mortgagees and Title I lenders; overseeing the disposition of HUD-owned properties; monitoring the performance of other field management contracts; and promoting FHA single family programs to the industry and the public. Case-specific issues are also handled by the appropriate HOC.



Key Objectives Accomplished in Fiscal Year 2017

The following discussion summarizes some of the key accomplishments of the Office of Single Family Housing in fiscal year 2017:

- **Play a Significant Role in Disaster Recovery**

  In the wake of Hurricanes Irma, Harvey, and Maria, and wildfires in California, in fiscal year 2017 and the first part of fiscal year 2018, FHA has played a significant role in relief and recovery efforts in affected areas, while taking immediate actions to protect its Single Family assets and financial exposure. To assist homeowners with FHA-insured mortgages who live or work in Presidentially-Declared Major Disaster Areas (PDMDAs), FHA provided an initial 90-day moratorium on foreclosures, and subsequently extended the moratorium for an additional 90 days for properties located in Individual Assistance Areas within the Hurricane Harvey, Irma, and Maria PDMDAs. FHA also reinforced to mortgagees that they must extend to eligible homeowners with FHA-insured mortgages forbearance and other appropriate loss mitigation options. FHA continues to actively review additional options to provide relief to borrowers who wish to remain in their home while assessing the impact to the MMIF.

  To assist both lenders and borrowers with mortgages in process who have been unable to complete the closing and endorsement of mortgages due to the extended period of time before the closing of the incident period by FEMA, FHA waived its requirement in Florida, certain municipalities in Puerto Rico, and certain counties in California affected by wildfires, that property inspections be performed after the incident period closes. FHA is currently reviewing its policy to determine whether an alternative date should be used to determine when property inspections can be conducted in PDMDAs. For HUD, real-estate owned assets in affected areas, FHA moved quickly to conduct inspections and continues these efforts to secure properties, assess damage and safeguard these assets.

  To assist in longer-term recovery efforts, FHA continues to educate homeowners, home buyers, and mortgagees about FHA products available for borrowers impacted by disasters, including the 203(h) Mortgage Insurance for Disaster Victims program, which allows for 100 percent mortgage financing for disaster victims whose previous residence – whether owned or rented – was located in a PDMDA and was destroyed or damaged to such an extent that reconstruction or replacement is necessary. FHA also anticipates that its 203(k) Rehabilitation Mortgage Insurance Program, which insures mortgage financing or refinancing for a range of repairs, will continue to play a role in recovery efforts in both PDMDAs and other areas affected by severe events.

- **Make Necessary Changes to the Home Equity Conversion Program (HECM)**

  During FY 2017, FHA revised the HECM initial and annual Mortgage Insurance Premiums (MIPs), and Principal Limit Factors (PLFs). These revisions were necessary to enable FHA to continue to endorse HECM loans in FY 2018, protect the program for seniors, and balance serving FHA's mission with taxpayer protection. FHA also published and implemented policies contained in its HECM Final Rule. The HECM Final Rule codified significant changes to FHA's HECM program previously issued and implemented under the authority granted to HUD in the Housing and Economic Recovery Act of 2008 and the Reverse Mortgage Stabilization Act of 2013. The Final

Rule also announced numerous changes in origination policy, HECM servicing policy, and the assignment and claims processes. The HECM changes implemented in fiscal year 2017 did not affect existing loans, and the impact of these program changes and performance of the existing portfolio require ongoing monitoring and management.

- **FHA Technology Modernization**

FHA aims to update its systems over the coming years to allow the agency to work more effectively with its lender partners, while operating FHA with greater efficiency and control. The loan origination systems of FHA's Single Family business have an average age of more than 18 years, with the Computerized Homes Underwriting Management System (CHUMS) exceeding 40 years. Similarly, the systems supporting the servicing, default, claims and REO areas have an average age of 14 years. FHA's systems have been maintained, modified and enhanced over the years, but it has become fundamentally difficult and exceedingly expensive to maintain systems beyond their usable life. FHA's outdated systems make it more difficult to work with lenders and to collect and manage important data. FHA remains a largely paper-processing entity while the rest of the industry has increasingly migrated to digital processes. FHA needs systems that can capture and effectively process the extensive volumes of data now in use, with enhanced storage and processing capabilities to handle the migration from paper forms to digital ones, and needs the ability to analyze and manage insured loans comprehensively over the many phases of the mortgage life cycle.

As part of this overall effort, FHA continues to move toward a broad-based electronic case binder (E-Case Binder) solution to replace the paper case binders that FHA has required for decades from the majority of FHA-approved lenders. An E-Case Binder solution will significantly streamline operations for both lenders and FHA, increase efficiencies and reduce operational costs, and will bring FHA processes in line with comparable mortgage industry practices. In fiscal year 2017, FHA accomplished the first component necessary to move forward with E-Case Binder: 100 percent lender migration to its Electronic Appraisal Delivery (EAD) portal. The EAD portal enables electronic transmission of appraisal data and reports from lenders to FHA. This reduced the number of hard copy pages submitted to FHA by an estimated 33 million pages annually. This also reduced FHA's appraisal review cycle timeframes and improved the quality of documentation for reviewers.

Leveraging the progress made with EAD portal automated appraisal submissions, FHA will continue to build out both the technology and operational components of an E-Case Binder solution in fiscal year 2018. In its end state, E-Case Binder will reduce operational costs and enhance quality control and compliance processes, which in turn will reduce risk to the MMIF.

- **Develop FHA's Condominium Project Approval Final Rule**

FHA is continuing to develop its Condominium Project Approval Final Rule after posting a proposed rule for public comment in late FY 2016. When published, the Final Rule will significantly revise FHA's policies for condominium project approval. FHA anticipates that its updated guidance in the Final Rule and subsequent policy implementation documents will be more flexible, less prescriptive, and more reflective of the current market than existing condominium project approval provisions. Further, the Final Rule is intended to ensure the financial soundness and viability of condominium projects submitted for FHA approval, but will allow flexibility in certain instances for FHA to respond quickly to changing market conditions. Consistent, consolidated Condominium Project Approval guidance is anticipated to reduce burden associated with Condominium project approval, while appropriately managing risk to the MMIF. FHA also continued to ease the regulatory burden for lenders in FY 2017 with the issuance of Mortgagee Letter 2017-13, which extended the temporary waiver of certain burdensome Condominium project approval provisions that were issued in previous years. This extension allows time for FHA to complete and implement the updated condominium project approval guidance and rulemaking process.

Clarity and Consistency for Mortgagees

- **Implementation of the Loan Review System (LRS)**

As part of its quality control processes, FHA seeks to provide clarity and consistency to lenders. FHA implemented its new Loan Review System (LRS) on May 15, 2017. Lenders interact with FHA through the LRS for a majority of FHA's quality control processes, including post-endorsement loan reviews, Direct Endorsement test cases, lender monitoring reviews, and self-reporting of fraud and violations of FHA policy. This consolidation of multiple quality control processes into a single, unified system allows FHA to better organize and track its interactions with lenders on these critical issues, and significantly enhances loan quality reporting and analytics. This will help FHA better manage its quality control processes and quickly identify risks to its portfolio. FHA intends to further review its loan and lender-level certification requirements, and the framework of its Loan Quality Assessment Methodology (Defect Taxonomy) to identify potential areas where FHA can provide lenders greater clarity and certainty, resulting in increased confidence to make FHA mortgages available to borrowers.

- **Continue Updates to the Single Family Housing Policy Handbook 4000.1 (SF Handbook)**

With a consolidated view of end-to-end FHA policies, the SF Handbook contributes to FHA's goal of transparency, provides a more effective working mechanism to improve both loan quality and compliance, and is a key tool in FHA's monitoring and management of counterparty risk. Over the past few years, FHA has combined hundreds of policy documents, Mortgagee Letters, and Housing Notices into a single source of housing policy – the Single Family Housing Policy Handbook 4000.1 (SF Handbook). FHA continues to work towards providing a consolidated, consistent, and comprehensive handbook for FHA stakeholders.

Single Family Loan Sales

The goal of the Single Family Loan Sales program (SFLS) is to maximize returns to the Mutual Mortgage Insurance Fund (MMIF) while providing another disposition alternative for all defaulted single family mortgages, rather than having these assets conveyed to FHA as foreclosed properties. By developing the infrastructure to market and sell these loans in bulk, the agency is positioned to benefit from today's unique market dynamics where investor demand is very high.

SFLS includes the sale of forward mortgage notes as well as the sale of Home Equity Conversion Mortgage (HECM) notes. In fiscal year 2017 most of FHA's SFLS notes sales focused on vacant properties through the sale of HECM notes. FHA conducted two HECM notes sales of Secretary-held, due and payable, vacant HECM loans; consisting of 10 pools of notes. The notes were sold through competitive auctions to qualified bidders. In these sales, HUD awarded 2,535 loans with an unpaid principal balance of $321.6 million and an updated loan balance of $493.6 million, respectively. The first HECM note sale marked the first time FHA had offered this type of note and all pools were won by a single for-profit bidder at a Bid/BPO of 53.0 percent. In the second HECM note sale, pools were won by four bidders, including one non-profit bidder, and the average Bid/BPO increased to 57.3 percent, which also surpassed the average Bid/BPO in FHA's three preceding forward mortgage note sales. Notes sold in the two HECM sales were dispersed across the United States, with the highest concentrations in California, Florida, Illinois, New York, and Texas.

Office of Multifamily Housing

"The mission of the Office of Multifamily Housing is to produce and preserve affordable rental housing while providing liquidity in countercyclical real estate finance markets. Our programs provide mortgage insurance to HUD-approved lenders to facilitate the construction, substantial rehabilitation, purchase and refinancing of multifamily housing sites."

Robert Iber, Acting Deputy Assistant Secretary
Office of Multifamily Housing Programs

FHA's Office of Multifamily Housing Programs (OMHP) provides insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartments and cooperatives. FHA offers risk sharing on loans originated by state Housing Finance Agencies (HFAs), Freddie Mac and Fannie Mae for multifamily rental properties. During fiscal year 2017, FHA initially endorsed 949 multifamily apartment loans totaling $13.9 billion and 90 risk sharing loans totaling $896 million (Table 1), which continues to support thousands of private sector jobs in the construction, property management, service provision, and administrative fields. In fiscal year 2017, FHA also continued to incentivize the rehabilitation and construction of energy efficient rental housing in tight markets through the Green Preservation Plus initiative, a partnership with Fannie Mae and Government Sponsored Entities (GSEs) to increase energy efficient upgrades in older affordable properties; and continued a partnership with Treasury's Federal Finance Bank to help increase the number of affordable units created.

Multifamily Housing Programs

Administered through the FHA General Insurance and Special Risk Insurance (GI/SRI) Fund, FHA's broad range of programs and loan terms bring down the cost of credit and induce developers to produce needed housing, providing individuals and families with a wide array of housing options for all life stages. In combination with HUD's rental assistance programs, FHA Multifamily mortgage insurance programs help to meet the nation's need for affordable, quality rental housing.

Table I provides information on FHA's Multifamily mortgage insurance portfolio, by program, in fiscal year 2017.

Table 1: Multifamily Endorsements by Program

	Endorsements for Fiscal Year 2017		
Section of the Act	**Dollars (millions)**	**Percentage**	**# of Mortgages**
Section 221(d)(4): New Construction and Substantial Rehabilitation Program	$4,053	27%	194
Sections 223(f) and 223(a)(7): Purchase/Refinancing Program of Existing MHP Projects	$9,820	67%	755
Section 542(b) and 542(c): Risk-Sharing with QPEs & HFAs	$896	6%	90
Totals	$14,769	100%	1,039

***Percentages are based on the total mortgages endorsed.** The Multifamily endorsements shown in Table 1 are based on available data for initially endorsed projects in the Development Application Processing (DAP) system. DAP is used to track and monitor Multifamily basic FHA and Risk Share loan applications. Sections 213, 220 and 231 not included.

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

These programs provide mortgage insurance on market-rate loans to facilitate new construction or substantial rehabilitation of rental housing and cooperatives; and they can also be combined with federal and state housing initiatives such as Low-Income Housing Tax Credits (LIHTC), tax exempt bonds, and rental subsidies for low and moderate income families.

Sections 223(f) and 223(a) (7) and Section 241(a): Purchase/ Refinancing Program of Existing Multifamily Housing Projects

The Section 223(f) program insures loans for the purchase or refinancing of existing rental properties financed with conventional or FHA loans. The Section 223(a)(7) program offers a streamlined refinancing option for multifamily properties already insured by FHA, and can reduce debt service and free up operating income. The Section 241(a) program provides insurance on loans to finance repairs, additions and improvements on projects already insured by FHA.

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

Under these programs, FHA shares risk on loans originated, underwritten and serviced by Qualified Public Entities, primarily Fannie Mae and Freddie Mac in the case of Section 542(b), or state Housing Finance Agencies under 542(c). FHA assumes a loss percentage on these loans and pays the agencies when they dispose of the defaulted loans, providing an incentive for these agencies to fund multifamily housing. All multifamily housing funded under this program must be affordable, as defined for Low Income Housing Tax Credits.

Additional details on these and other Multifamily loan programs are available at:
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh

Office of Production

FHA's Multifamily Office of Production provides direction and oversight for FHA mortgage insurance and risk-sharing loan origination. FHA Multifamily insurance programs insure non-recourse financing with high loan-to-value ratios and favorable debt service coverage for a variety of housing loans. Demand for FHA multifamily programs remains strong, with increased volume of approximately 11 percent from the prior fiscal year. FHA has increased its focus on mission-driven, affordable lending, while continuing to provide financing for borrowers who want the stability of long-term, fully-amortized debt.

The Office of Production has enhanced its policies and implemented initiatives to continue serving the community while maintaining financial viability, including:

- **Second Highest Annualized FHA Volume Plus Faster Processing.** The percentage of firm commitments issued within timeframes has increased in Multifamily's production programs following FHA's Multifamily Transformation initiative.

Office of Recapitalization

The Office of Recapitalization (Recap) is responsible for the recapitalization and long-term preservation of federally assisted affordable housing units. Recap processes financial transactions that ensure the long-term physical and financial viability of these affordable rental housing units. Long-term rental use agreements and project based rental assistance contracts ensure the housing will remain affordable to those most in need.

Key Objectives Accomplished in Fiscal Year 2017

Rental Assistance Demonstration (RAD). RAD allows proven financing tools to be applied to at-risk public and assisted housing. RAD is a central part of HUD's rental housing preservation strategy.

- **RAD First Component.** RAD first component allows public housing agencies to leverage public and private debt and equity to reinvest in public housing stock. In fiscal year 2017, 300 RAD first component applications were closed, covering 32,257 units with transactions valued at $4.05 billion. Of this amount, $1.89 billion was in construction cost. Also in fiscal year 2017, RAD first component achieved a new milestone by reaching $4.43 billion in construction work generated since the program's inception.

- **Notices Published Clarifying Program Requirements**. Two Notices were published in fiscal year 2017 that clarified RAD program requirements for public housing agencies and all other RAD participants:
  - RAD Fair Housing, Civil Rights and Relocation Requirements Notice (Notice H 2016-17; PIH 2016-17) published November 10, 2016
  - RAD Notice PIH 2012-32 REV-3 (1/12/17) published January 17, 2017.

- **RAD Cap Increased**. New authorizing language in the fiscal year 2017 Appropriations Act increased the number of public housing units that could be converted under RAD by 40,000 to a new total of 225,000 units. As a result of this increase, HUD published a *Federal Register Notice on August 29, 2017* that provides information to RAD applicants who were on the waiting list, but could not be issued awards unless the cap was increased.

- **RAD Second Component.** RAD second component gives owners of multifamily housing properties with rent supplement and rental assistance payments contracts, Section 8 moderate rehabilitation assistance contracts, and Section 8 moderate rehabilitation single room occupancy assistance contracts the opportunity to enter into long-term project based rental assistance contracts that facilitate the financing of improvements. A total of 26,795 units representing 217 projects have been converted through RAD second component since the program's inception through September 30, 2017.

Table 2: Rental Assistance Demonstration
Second Component by Program

RAD Second Component Programs	**Number of Units**
Rent Supplement	1,427
Rental Assistance Payments	3,951
Section 8 Moderate Rehabilitation	873

RAD Conversion – Project Renovate

Project Renovate is comprised of 279 units on six noncontiguous properties located in Boulder, Colorado. This project-based voucher RAD tax credit conversion resulted in the substantial rehabilitation of RAD units and 144 tax credit units, with the average of rehabilitation per unit exceeding $98,000 and a total development budget of nearly $90 million. Primary funding sources included a first mortgage and 4% tax credits. Read more about this project here.

- **Section 236 Preservation.** This program allows project owners and purchasers to submit applications for prepayment approval, regulatory waivers, and continuation of interest reduction payments after refinancing directly to Recap through its centralized processing application system. As of September 30, 2017, Recap has preserved 22 projects representing 3,555 units of affordable rental housing.

- **Mark-to-Market and Post Mark-to-Market (M2M).** These programs preserve affordability and availability of low-income rental multifamily properties with federally insured programs by reducing rents to market levels through restructuring of existing debt to levels supportable by these rents. Post Mark-to-Market (Post M2M) addresses the processing of an owner's request to refinance or to sell a property that has received the benefits of a debt restructuring under the M2M Program or M2M's predecessor program, the Portfolio Reengineering Demonstration Program. In fiscal year 2017, M2M processed six transactions, of which two were full debt restructures, with 211 units. Post M2M processed 33 transactions with 2,496 units, and with privately funded rehabilitation costs that averaged $42,000 per unit. Further, Post M2M collected $4.42 million in paydowns of the HUD-held M2M debt.

Office of Asset Management and Portfolio Oversight

The Office of Asset Management and Portfolio Oversight (OAMPO) is responsible for the portfolio of multifamily project assets after the development phase. The core roles are to develop supporting policies and to provide interpretation of set policies; control participation in the multifamily asset programs; provide oversight of lender and field asset servicing activities; monitor the physical and financial health of FHA-insured and assisted stock of 2.5 million units; and manage relationships with internal and external partners. As of September 30, 2017, FHA's Multifamily-insured portfolio totaled 11,191 mortgages with a total outstanding principal balance of approximately $83 billion.

Key Objectives Accomplished in Fiscal Year 2017

OAMPO has continued to maintain the overall health of the portfolio and ensure fiscal accountability with the following initiatives:

- **Property Disposition (PD) New Foreclosure Process.** In fiscal year 2017, FHA sold nine multifamily properties to successful bidders and has begun foreclosure action on nine other multifamily properties, in addition to working with 12 troubled assets in the pre-disposition stage that will be proceeding to either an asset sale, foreclosure sale, or work out agreement. Gross proceeds on the closed properties totaled $614,300, which represents a 16 percent rate of return for FHA based upon the unpaid principal balance. Moreover, in fiscal year 2017, FHA closed multiple post-closing incidents at 10 properties with owners/developers who purchased, refinanced, redeveloped or revitalized previously sold properties with active Foreclosure Sale Use Agreements/Deeds. The Agency collected $227,131 in equity participation that was returned to the U.S. Treasury. FHA also administered over $51.5 million in active Upfront Grants on redevelopment or rehabilitation activities, creating or restoring affordable housing assets for five post-sale properties.

Risk Management

Risk management is integrated into all Office of Multifamily Housing programs and processes. During fiscal year 2017, Multifamily continued to improve processes with a goal of better identifying and managing risk within its programs. Delinquencies on FHA-insured Multifamily mortgages remained low, and when a property shows signs of trouble, HUD staff engage a variety of stakeholders to ensure all tenants are receiving quality housing.

Rapid Response and Recovery Team. To improve HUD's response to troubled assets, a team of subject matter experts from across HUD met in late fiscal year 2016 and early 2017. The team thoroughly reviewed HUD's processes related to troubled projects, and made a series of recommendations for improvement. Several recommendations were implemented in fiscal year 2017, including improvements to the Real Estate Assessment Center (REAC) inspection process, closer scrutiny of the transfer of Housing Assistance Payment (HAP) contract transfers, and improvements to the previous participation review regulations. The Office of Multifamily Housing continues to work on implementing the Rapid Response and Recovery Team's long-term recommendations.


EFFINGHAM
HEALTH SYSTEM

Office of Healthcare Programs

"FHA's Office of Healthcare Programs consistently provides support to America's much needed healthcare facilities through its highly successful mortgage insurance program. At no cost to the American taxpayer, these active initiatives enable the affordable financing of needed residential care facilities and hospitals throughout the USA while reducing the cost of care; increasing access; and strengthening communities in support of HUD's mission."

Roger Lukoff, Deputy Assistant Secretary
Office of Healthcare Programs

The Office of Healthcare Programs (OHP) administers FHA's programs that provide mortgage insurance to residential care facilities and hospitals under Section 232 and Section 242 of the National Housing Act. Section 232 was established by Congress in 1959 to support the critical care needs of a vulnerable aging population in residential care facilities across the country. Section 242 was enacted in 1968 to support capital financing for urgently needed hospitals.

FHA's programs serve and support healthcare facilities across the nation. With FHA mortgage insurance, private lenders are encouraged to increase their capital investment in the healthcare capital market. Hospitals, nursing homes, and assisted living facilities can access capital at lower interest rates, resulting in significant cost savings. The lower cost of capital financing encourages facilities to invest in construction, improvement, and/or refinancing projects that ultimately strengthen the quality of, access to, and affordability of care. Healthcare facilities are also major employers within their communities and support trillions of dollars in economic activity, making these programs integral to the agency's community development mission.

OHP's hallmark is to continuously improve business practices and processes while preventing claims. OHP has embraced the concept of Lean Processing, which focuses on continuously improving and creating more value for customers with fewer resources, while reducing waste. Since 2008, OHP has utilized Lean methodologies to redesign and streamline processes. The Office has reduced processing times, improved customer service, and strengthened risk analysis, ensuring that risk management starts at origination and continues throughout the life of every loan insured. Lean has become OHP's standard operating principle as an organization, and team members are continually encouraged to push critical thinking skills to solve problems and improve work processes.

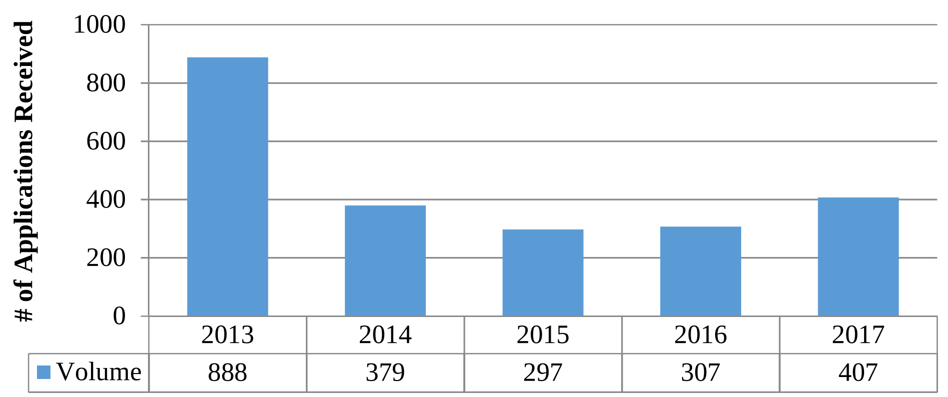
As of September 30, 2017, the total FHA-insured Healthcare loan portfolio consists of 3,536 loans with an unpaid principal balance of $33.6 billion. The programs maintain low claim rates, operating at no cost to taxpayers and contributing credit subsidy receipts to the General Insurance (GI) Fund.

Healthcare Insurance Programs

Section 232 Mortgage Insurance for Residential Care Facilities

The Section 232 Residential Care Facilities mortgage insurance program insures loans to finance the construction, substantial rehabilitation, acquisition, or refinancing of nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. During fiscal year 2017, a total of 407 applications were received, and OHP issued 315 commitments totaling $3.7 billion. At the end of fiscal year 2017, the Section 232 portfolio contained 3,432 loans with an unpaid principal balance of $26.5 billion. The chart below presents OHP's Residential Care volume over time. Fiscal year 2017 volumes reflect a trend of increasing interest and demand for FHA mortgage insurance in the healthcare industry.

Chart I
Residential Care Application Volume



In addition to providing insurance on mortgages for important healthcare facilities, FHA-insured construction and rehabilitation projects have a significant economic impact on local communities, including a substantial impact on employment. In fiscal year 2017, the Section 232 Program insured projects that involve construction created over 2,095 full-time equivalent construction jobs with a total economic impact of $665 million. Once the projects are fully built, the residential healthcare facilities will create over 986 full-time equivalent jobs in healthcare and related fields, and provide a total annual economic benefit of $304 million to the local communities.

Key Objectives Accomplished in Fiscal Year 2017

In fiscal year 2017, the Office of Residential Care Facilities continued to monitor portfolio risk, as well as streamline Section 232 loan application procedures.

- **DEC/REAC/ORCF Memorandum of Understanding (MOU)**. ORCF updated its MOU with the Departmental Enforcement Center (DEC) and Real Estate Assessment Center (REAC) to streamline coordination, reduce backlog, ensure consistency and reflect current regulations.

- **Analysis of State-level Regulatory and Funding Risks.** ORCF improved its analysis at the state level of threats to licensure/eligibility and to funding, considering overall budget constraints or state-specific shifts to other service delivery types-including shifts driven by the 1999 Olmstead decision. ORCF also enhanced its State Risk Monitoring Tool, which is used to identify risk factors and mitigation strategies at the project level.

The Foley Center at Chestnut Ridge

The Foley Center at Chestnut Ridge in Blowing Rock, North Carolina, completed its first year of successful operation as a new post-acute care center for Appalachian Regional Health-care System in fiscal year 2017. The new construction project was financed with a $10.6 million FHA-insured loan under the Section 232 Program.

The 112-bed healthcare facility has 92 skilled nursing beds and 20 assisted living beds, and serves as a cost-saving alternative for patients healthy enough to be discharged from the hospital but not quite ready to safely return home. Situated high atop a 68-acre tract of land, the 87,500 square-foot facility was designed with the patient in mind and functions as a modern patient-centered neighborhood. The Foley Center also features a unique Activity of Daily Living (ADL) Cottage that is used to assist residents with developing of daily living activity skills.

Section 242 Mortgage Insurance for Hospitals

Mortgage insurance for hospitals facilitates access to affordable financing for capital projects, including new construction or modernization. Additionally, the Section 223(f) program provides mortgage insurance for hospitals wishing to refinance loans without new construction or major rehabilitation. Clients range from small rural hospitals to major medical centers. Hospitals with FHA-insured loans serve as community anchors, providing jobs as well as healthcare services. FHA currently has 104 active hospital loans with unpaid principal balances totaling $7.1 billion. In fiscal year 2017, FHA issued or approved eight insurance commitments and three loan interest rate modifications totaling $427.5 million.

Kirby Medical Center

Kirby Medical Center, an award-winning critical access hospital in Monticello, Illinois, has been serving the healthcare needs of its community since 1941. In November 2010, FHA insured a $31.25 million loan under Section 242 to construct a new hospital to replace an outdated facility built in the early 1970s

The new facility has expanded the hospital's ability to serve surrounding communities beyond Monticello. In August 2017, HUD issued a commitment for a $7.9 million supplemental Section 241 loan to expand the hospital's surgery, therapy, laboratory, and imaging departments, in addition to building nine new exam rooms. The new addition is expected to be complete in early 2019.

Key Objectives Accomplished in Fiscal Year 2017

In fiscal year 2017, the Office of Hospital Facilities focused on providing customer service and education for Section 242 staff and stakeholders, as well as efforts to improve underwriting and asset management of FHA's insured facilities.

- **Fiscal Year 2017 National Lender Training.** OHF held a national, full-day lender training event for all lenders, industry partners, and program participants interested in the Section 242 Hospital Mortgage Insurance Program at HUD Headquarters on June 14, 2017. Topics covered included recent program policy updates such as revised application documents, loan servicing requirements, underwriting updates, and architecture and engineering review requirements.

Management Initiatives and Program Improvements

In fiscal year 2017, OHP focused on enhancing portfolio monitoring by improving risk analysis and reporting capabilities. Enhancements were designed to quantify the performance of facilities in the OHP portfolio and facilitate an intuitive interpretation of the results.

- **Development of a Risk Rating and Ranking System.** In the Section 242 program, a risk rating and ranking system was developed and is currently being tested.

- **Lean Continuous Improvement and Franklin Covey Training.** ORCF conducted several internal staff trainings; internal and external process improvement sessions; collaborations, Kaizens, and Lender Dialogue sessions to continuously improve its business practices and customer service. The sessions were conducted effectively and efficiently utilizing in-house resources including a certified Lean Six Sigma, Green Belt facilitator and Franklin Covey trainer on staff.

Risk Management

With an outstanding portfolio balance of over $33.6 billion, managing risk is an important focus of the OHP programs. OHP mitigates risk upfront during the underwriting process, after loan closing, through the identification and monitoring of troubled properties, and through actions to reduce claim payments.

OHP continues to work to improve underwriting standards and to ensure consistent applications while reducing processing time. Utilization of Lean Processing in the Section 232 program has improved business practices by standardizing nationwide submission and underwriting. This process has allowed for greater focus on the creditworthiness of the operator and its principals.

Proactive asset management also plays an important role in risk management and loss prevention. In 2017, OHP actively engaged lenders and servicers to improve strategies to coordinate asset functions and responsibilities. Open communication with industry stakeholders improves the quality of risk management and helps OHP strengthen asset management and avoid insurance claims.

Other approaches to loss prevention include working with state agencies on early notification of potential adverse action; expediting refinancing; working with lenders who have identified potential owners, operators or equity providers; and using available options to supplement funds until a property is stabilized.

Options for minimizing losses on HUD-held loans include partial payment of claims, positioning notes for re-assignment, modifying mortgages and identifying equity providers and purchasers. By working in concert with internal and external stakeholders, OHP maximizes asset management outcomes for the benefit of the General Insurance/Special Risk Insurance (GI/SRI) Fund.

Continuing into the next fiscal year, other OHP risk management initiatives will include more proactive collaboration with industry groups to identify appropriate candidates for healthcare mortgage insurance to diversify the Sections 232/242 portfolio.

HOUSING-FHA OTHER CONTRIBUTING OFFICES

Office of Housing Counseling

"The mission of HUD's Office of Housing Counseling is to provide individuals and families with the knowledge they need to obtain, sustain, and improve their housing. We will accomplish this mission by supporting a strong national network of HUD-approved housing counseling agencies and counselors."

Sarah Gerecke, Deputy Assistant Secretary
Office of Housing Counseling

Through the Office of Housing Counseling (OHC), HUD supports a national network of nonprofit and government housing counseling agencies, that in turn provide tools to current and prospective homeowners and renters so that they can make responsible choices to address their housing needs in light of their financial situation. The Housing Counseling Program is authorized by Section 106 of the Housing and Urban Development Act of 1968, as amended (12 U.S.C. 1701x). The network consists of nearly 1,850 housing counseling agencies that are trained and approved to provide guidance to current and prospective homeowners and renters so they can make responsible choices to address their housing needs. Although Housing Counseling activities are not funded through FHA resources, they have a significant impact on FHA programs.

OHC contributes to FHA's mission by supporting and monitoring a nationwide network of agencies that provide consumers the information they need to make wise housing decisions. Housing counseling ranges from responding to the crisis of homelessness, to overcoming barriers to successfully renting or owning a quality, affordable home, to planning for the first-time home purchase, or helping avoid eviction or foreclosure. By teaching consumers basic principles of housing and money management, housing counselors help increase consumers' residual income and savings, improve their housing conditions, provide access to credit, and give them greater stability and confidence. Housing counselors also serve as a gateway to legitimate state, local, federal and private housing assistance programs; and housing counselors provide an important safeguard against discrimination, scams and fraud.

HUD awards grants annually to HUD-approved housing counseling agencies through a competitive process. In fiscal year 2017, HUD awarded more than $50 million in housing counseling grants to 254 agencies. More than $47 million in grants were allocated to support the full spectrum of housing counseling services, including homeless, rental, pre-purchase, post-purchase, reverse mortgage, and foreclosure prevention counseling. The remaining funding was awarded to four national organizations to train housing counselors to effectively assist families with their housing needs.

CHART I: HOUSING COUNSELING SERVICES

Housing Counseling Partnerships

HUD's housing counseling program works closely with other HUD programs in addition to those of the Federal Housing Administration, including the Community Development Block Grant (CDBG), CDBG Disaster Recovery, Fair Housing and Equal Opportunity, and HOME Investment Partnerships programs. OHC also partners with numerous federal, state and city programs as well as private initiatives to leverage dollars and resources that improve families' housing situations. OHC has reached out to several hundred counseling agencies through listening tours or meetings in nearly every state and territory to continually improve the program. Industry partnerships are a critical part of the success of housing counseling, and HUD meets regularly with industry representatives from lending institutions, HOPE NOW, the Financial Services Roundtable, various real estate trade associations and professionals, academics, and other experts in financial and housing education. Through OHC, HUD also provides technical assistance to federal, state and local regulators in the lending, consumer protection and housing fields. The Bridge newsletter highlights success stories, model programs, and technical assistance to more than 19,000 subscribers each month.

Key Objectives Accomplished in Fiscal Year 2017

In fiscal year 2017, the Office of Housing Counseling worked to elevate the visibility of housing counseling services and support the capacity of the housing counseling industry.

- **Housing Counselor Certification Rule.** On December 14, 2016, OHC published a final rule requiring housing counselors participating in HUD programs to be certified in order to offer counseling services to consumers. To become certified, housing counselors must pass a standardized written examination and work for a HUD-approved housing counseling agency. The exam launched August 1, 2017, and the requirement that all housing counseling under HUD-FHA programs to be conducted by HUD-certified housing counselors will go into effect in August 2020.

- **$50 Million in Grant Awards.** OHC awarded more than $50 million in housing counseling grants to hundreds of national, regional and local organizations to help families and individuals with their housing needs and to prevent future foreclosures.

- **Housing Counseling Federal Advisory Committee (HCFAC).** HUD convened the first meeting of the HUD Housing Counseling Federal Advisory Committee (HCFAC) on November 1, 2016, and has since held two additional meetings. This new committee will help OHC improve upon its efforts to provide consumers with the knowledge they need to make informed and lasting housing decisions.

- **Housing Counseling Agency Eligibility Tool.** In January 2017, OHC launched the Housing Counseling Agency Eligibility Tool, which allows organizations to determine if they meet the basic requirements to apply to become a HUD-approved Housing Counseling Agency.

- **Awareness and Visibility.** In November 2016, OHC distributed full color "Beat the Odds" posters to all HUD-approved housing counseling agencies to increase public awareness of housing counseling services. The poster highlighted data from independent research demonstrating the benefits of housing counseling. HUD also distributed flyers advising people affected by a disaster of the services offered by HUD-approved housing counseling agencies.

Piedmont Housing Authority Pre-Purchase Counseling

After three years of working with the HUD-approved housing counseling agency Piedmont Housing Alliance, this summer, Shawn and Nathaniel Wells used an FHA-insured mortgage to purchase a place for their growing family to call home. To realize their dream of homeownership, the Wells worked hard with guidance from a housing counselor who helped them develop a realistic budget, rebuild their credit scores through responsible use of credit, and apply for a matched savings program to increase their savings for a down payment.

Office of Risk Management and Regulatory Affairs

"Office of Risk Management and Regulatory Affairs (ORMRA) measures, monitors and manages credit and operational risk related to each program area as part of a comprehensive enterprise risk management strategy across the entire Office of Housing."

Nandini B. Rao, Associate Deputy Assistant Secretary
Office of Risk Management & Regulatory Affairs

The Office of Risk Management and Regulatory Affairs (ORMRA) measures, monitors and manages credit and operational risk related to each program area as part of a comprehensive Office of Housing enterprise-wide risk management strategy. Risk management's role is to ensure that FHA realizes its mission and objectives with strategies that support the long-term financial health of the insurance funds. Since its inception, ORMRA has initiated strategies, governance and partnerships across all program areas to support the Agency's mission goals in Single Family, Multifamily and Healthcare programs.

ORMRA manages risk through conducting analyses and making risk management recommendations based on independent research, as well as collaboration with program areas. Formal credit committees within each program area, comprised of senior level ORMRA and program area leadership, are forums where recommendations are presented, discussed, and debated in a transparent manner. Mitigation strategies are often developed and refined by incorporating various risk and mission perspectives and partnering with the program offices to support enhanced risk management elements of program policies and practices. Examples include evaluating "best execution" asset management transactions to strengthen the portfolio risk profiles, governance related to underwriting policy, and economic modeling to provide quantitative, data-driven solutions to support recommendations related to risk appetite and impact of program policy objectives.

Certain risk factors exist in FHA's portfolio. The Single Family portfolio delinquency rate is at a pre-crisis low but still has a seriously delinquent balance of approximately $45 billion. The movement of lending partners in the Single Family Program from well-capitalized banks to smaller non-banking institutions increases FHA's counterparty risk exposure. The HECM portfolio continues to present volatility within the MMIF. The FHA Multifamily and Healthcare portfolio contains large loans with concentration risk among lenders. ORMRA is working with the program areas to continually identify and mitigate these emerging risks.

To better manage programmatic and financial risk in fiscal year 2017, ORMRA continued to execute the following courses of action: Senior leadership continued its commitment to, and participation in, regularly scheduled credit risk meetings. ORMRA established the Credit Reform Board, to provide oversight to the economic modeling process. Loan reviews were conducted using an agreed-upon schedule, sampling methodology, and loan size with findings and recommendations provided to management. ORMRA provided comprehensive housing market analyses as well as discussions of trends and key performance indicators (KPIs) to Office of Housing programs and senior management. External events that impact Housing's financial risk were identified and evaluated. These actions ensure that triggers and Housing's portfolio are adequately monitored. By benchmarking results against other financial institutions, ORMRA is able to provide lessons learned and best practices.

Key Objectives Accomplished in Fiscal Year 2017

- **Single-Family Risk Management.** The Office of Risk Management and Regulatory Affairs Office of Evaluation (OE) continued to build upon its momentum in fiscal year 2017. Providing specific detailed policy information allowed FHA Housing to adjust and improve current policy positions. Strength was added to the Risk Management information systems through enhanced portfolio performance reporting. OE continually monitored the single family portfolio through risk management narratives and dashboard reporting. This reporting included monthly, quarterly and annual reports to Congress, as well as support and guidance to the Annual Actuarial Review. OE also conducted monthly and quarterly Single Family Credit Risk and Counterparty Risk Committee meetings to discuss appropriate risk strategies such as asset disposition management and front-end credit underwriting.

  Throughout fiscal year 2017, OE provided assistance in the calculation of reserve prices for the Claims Without Conveyance of Title (CWOCT) and Distressed Asset Stabilization Program (DASP) programs, responded to internal and external requests from agencies such as Government Accountability Office, Department of Justice, Federal Reserve Board, and delivered the fiscal year 2018 budget and budget re-estimates.

  OE implemented a model risk governance structure and improved its modeling of risk to the Mutual Mortgage Insurance Fund (MMIF) HECM program, which resulted in updating HECM mortgage insurance premiums and Principal Limit Factors to protect seniors and preserve the program's viability.

  OE strengthened the independent valuation of the MMIF by requiring the independent actuarial review be prepared by, or under the direct supervision of, one or more qualified actuaries. Also, all valuation methods and techniques used in the review must comply with requirements of the Federal Credit Reform Act as implemented through OMB Circulars A-11 and A-129, and with all applicable Actuarial Standards of Practice as promulgated by the U.S. Actuarial Standards Board.

- **Commercial Risk Management.** In cooperation with the program offices, the Commercial Mortgage Risk team has made great progress in advancing productive working relationships and active participation in the National Loan Committee (NLC). By presenting valuable credit risk analyses of new loan commitments before the NLC, it allows for more informed decision making on approval or rejection on loans presented to the NLC.

  The Commercial Mortgage Risk Team, in conjunction with the creation of the Credit Review Board, continues to refine the Loan Performance Model (LPM) and Cash Flow Model (CFM) process. The LPM and CFM forecast the FHA insurance premiums received, loan balances that will claim, and the recovery upon sale of the notes or assets as required by the Federal Credit Reform Act of 1990 (FCRA). FHA's commercial loan portfolio's ability to provide affordable housing and access to residential care facilities and hospitals are governed by the CFM's Credit Subsidy Rate measurements reported in the annual President's Budget, and the annual re-estimate of the actual results of the entire existing commercial loan portfolio that's reported to the Office of Management and Budget (OMB).

  Geospatial analysis reporting for all FHA commercial properties has become a staple for senior FHA management decision making. By utilizing the geospatial tools available, the Commercial Mortgage Risk team is able to report to senior management on the impacts to the portfolio from economic and financial dynamics, local and state budgetary constraints, and naturally occurring events.

- **Operational Risk Management.** The Operational Risk Management team collaborated with the HUD's Chief Risk Officer, Public and Indian Housing, Ginnie Mae, and Community Planning and Development in the development of an Enterprise Risk Management (ERM) framework. The Operational Risk Management team has also been working with Housing program areas to manage their risks and develop a road map for ERM implementation. Tools and techniques were developed to capture and mitigate risks, such as: The Risk Assessment Questionnaires, 25-block heat map, Dashboards, Key Risk Indicators, Risk Metrics, and an automated risk management register. These tools allow the program area to assess and track risks. The Operational Risk team has adopted the "Green Book" principles of Internal Control to ensure that Housing continues to comply with OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. In addition, the Operational Risk Management team continues to apply the National Institute of Standards and Technology (NIST) guide in evaluating and managing Information Technology (IT) risks. Monthly and quarterly risk meetings are held with stakeholders to discuss current and emerging risks and provide senior management with an updated Risk Profile.


MAY
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ANALYSIS OF FINANCIAL STATEMENTS

This section presents a summary analysis of FHA's financial statements. The financial statements in this report were prepared using General Accepted Accounting Principles (GAAP) for federal entities, the Federal Credit Reform Act of 1990 and in accordance with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements.* FHA's management is responsible for the integrity and objectivity of the financial information presented in the financial statements.

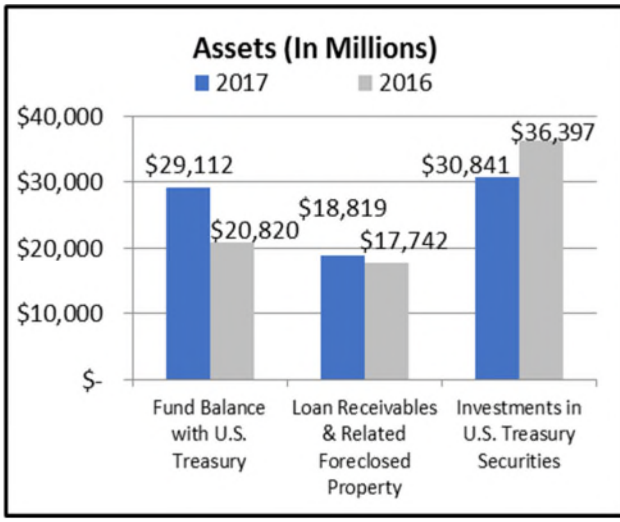
FHA restated its fiscal year 2016 Financial Statements Note 7 to correct the reported balance of the Single Family Guaranteed Loans Outstanding and Disbursed, HECM Current Year Endorsements, and the allocation of FHA's technical re-estimate between subsidy and interest expense. Note 12 was also restated to reflect the change between the subsidy and interest expenses on Gross Cost. The details of the restatement are reflected in Note 21.

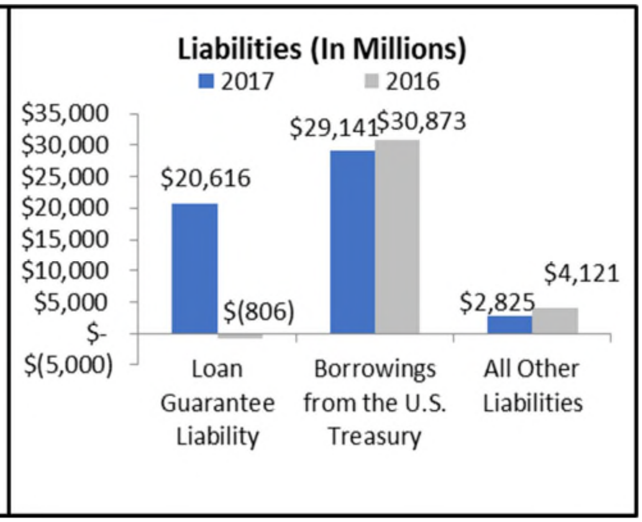
Overview of Financial Position

A summary of FHA's change in financial position from fiscal year 2016 to fiscal year 2017 is presented in the following sections on Assets and Liabilities, Net Cost and Budgetary Resources.

Assets and Liabilities

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





During fiscal year 2017, there was an increase of $8,292 million in fund balance with U.S. Treasury primarily attributable to a decrease in MMI/CMHI investments in U.S. Treasury securities and an increase in cashflows from insurance operations (increased premiums and decreased claims in fiscal year 2017 compared to fiscal year 2016).

Loan Guarantee Liability

The loan guarantee liability (LGL) is comprised of two components, the liability for loan guarantee (LLG) for post-1991 loan guarantees and the loan loss reserves (LLR) for pre-1992 loan guarantees. FHA's portfolio of pre-1992 loan guarantees has significantly decreased, as such the LLR represents an insignificant value of the LGL.

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, premium refunds, property expense for on-hand properties and sales expense for sold properties; less the present value of anticipated cash inflows, such as premium receipts, proceeds from property and note sales, and principal and interest on Secretary-held notes.

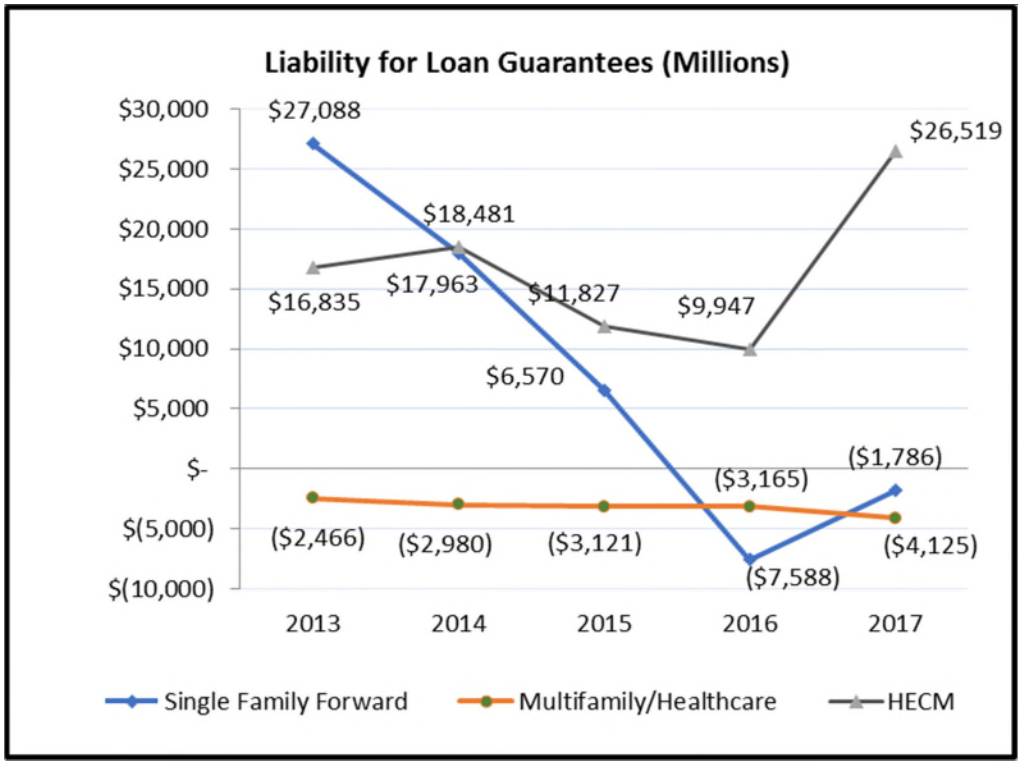
Schedule of Liability for Loan Guarantees
(Dollars in Millions)

	FY 2017	FY 2016	Difference	% Change
Single Family Forward	$ (1,786)	$ (7,588)	$ 5,802	-76%
HECM	26,519	9,947	16,572	167%
Multifamily/Healthcare	(4,125)	(3,165)	(960)	30%
Total	**$ 20,608**	**$ (806)**	**$ 21,414**	**-2657%**

The $5,802 million single family forward LLG increase is mainly due to the inclusion of the 2017 book-of-business in negative liability and change in projected future cash flows from the existing pre-2017 portfolio to the MMI fund.

The $16,572 million HECM LLG increase is primarily due to recent Upward MMI and GI/SRI HECM re-estimate for cohorts 2006, 2007 and 2008 due to a decrease in the future performance of the loan portfolio.

The $960 million multifamily LLG decrease can be attributed to decreases in several multifamily programs. The Section 223(f) liability decreased due to lower prepayment expectations as well as increased insurance-in-force. The Section 221(d)(4) liability decreased due to lower claims and prepayments being predicted. The Section 232 Refinance liability decreased due to a decrease in claims expectations.



Net Cost/ (Surplus)

In fiscal year 2017, FHA reported a net loss. The most important facet of FHA's cost and revenue activity is the treatment of loan guarantee subsidy cost. Loan guarantee subsidy cost is the estimated long-term cost to FHA of a loan guarantee calculated on a net present value basis, excluding administrative costs. The cost of a loan guarantee is the net present value of the estimated cash flows paid by FHA to cover claims, interest subsidies, and other requirements as well as payments made to FHA, including premiums, penalties, and recoveries also included in the calculation.

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

	FY 2017	FY 2016	Difference	% Change
Program Cost	$ 20,859	$ (17,758)	$ 38,617	-217%
Less: Program Revenues	1,752	1,218	534	44%
Net Cost (Surplus)	**$ 19,107**	**$ (18,976)**	**$ 38,083**	**-201%**

FHA had a net program loss in fiscal year 2017. Single Family and HECM Gross Costs with the Public increased by $17,845 million and $22,213 million, respectively. The program cost difference is primarily due to the increases in the re-estimates and interest expenses relating to Single Family and HECM. Re-estimates are the recalculation of subsidy costs and are performed annually. The increases in re-estimate and interest expenses were the primary drivers for the over-all program cost increase in fiscal year 2017, compared to fiscal year 2016.

Budgetary Resources

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

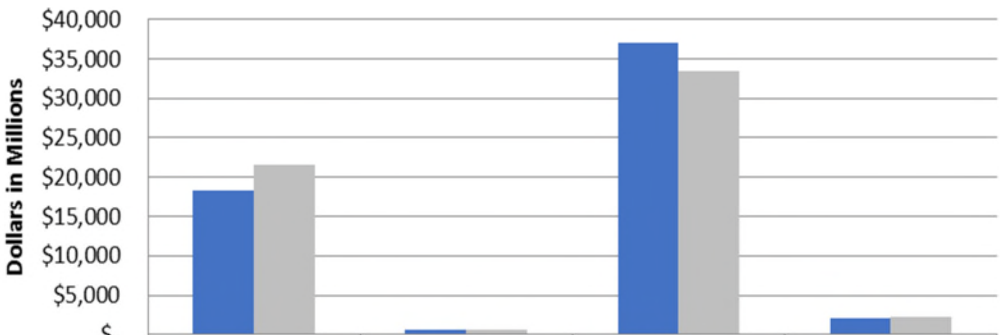
Offsetting collections include collections of premiums, fees, sales proceeds of credit program assets and credit subsidy transferred between different FHA accounts. FHA's budgetary resources are reduced by repayments of borrowings, the return of the unobligated GI/SRI liquidating account balances to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

Budgetary Resources
(Dollars in millions)

	FY 2017	FY 2016	Difference	% Change
Unobligated balance from prior year budget authority, net	$ 54,070	50,739	$ 3,331	7%
Appropriations (discretionary and mandatory)	4,473	3,431	1,042	30%
Borrowing authority (discretionary and mandatory)	8,376	13,077	(4,701)	-36%
Spending authority from offsetting collections (discretionary and mandatory)	47,954	44,810	3,144	7%
Total budgetary resources	**$ 114,873**	**$ 112,057**	**$ 2,816**	**3%**

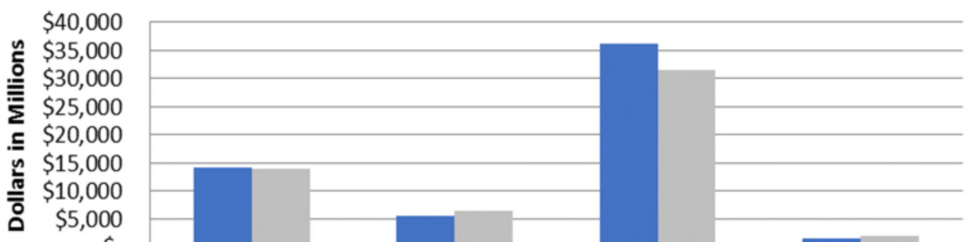
These resources were used to cover the fiscal year 2017 obligations totaling $58,192 million. These obligations included: subsidy/re-estimate costs, claim payments on defaulted guaranteed loans, the cost of maintaining and disposing of foreclosed properties, and other. FHA collections totaled $57,744 million and included: premiums, notes, property, interest earned, subsidy/re-estimate, and other.

Obligations



	Claims	Property Expenses	Subsidy and Reestimate	Other
FY 2017	$18,371	662	37,035	2,124
FY 2016	$21,550	649	33,467	2,221

Collections



	Premiums	Notes/Property	Subsidy and Reestimate	Interest Earned/Other
FY2017	$14,298	5,656	36,240	1,550
FY2016	$14,055	6,526	31,436	2,001

SYSTEMS, CONTROLS, AND COMPLIANCE

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

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

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

- Is in compliance with Sections 2 and 4 of the Federal Manager's Financial Integrity Act
- Systems generally comply with the requirements of the Federal Information Security Management Act (FISMA) requirements, Appendix III of OMB's Circular A-130, "Management of Federal Information Resources", and FFMIA Appendix D of OMB Circular A-123.

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 provides qualified assurance that its internal controls over financial reporting were operating effectively as of September 30, 2017 with the exception of two material weaknesses (Section 2) in the areas of cashflow modeling processes and controls over financial reporting. Other than the noted exceptions, no other material weaknesses were found in the design or operation of the internal controls over financial reporting.

Fiscal Year 2017

Annual Assurance Statement on Internal Control over Financial Reporting

The Federal Housing Administration's (FHA) management is responsible for establishing and maintaining effective internal control over financial reporting, which includes the 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 Enterprise Risk Management and Internal Control. Based on the results of this evaluation, FHA provides a qualified assurance that internal controls over financial reporting were operating effectively as of September 30, 2017 with the noted exception of two material weaknesses in the areas of cashflow modeling processes and controls over financial reporting. Other than the noted exceptions, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls over financial reporting.

Acting Federal Housing Commissioner and General Deputy Assistant Secretary for Housing

FHA Compliance with OMB Circular A-123, Financial Management Systems

FHA's management has reviewed FHA's core financial system and seventeen financial and mixed financial systems for compliance with the OMB Circular A-123 "Management's Responsibility for Enterprise Risk Management and Internal Controls," and the Federal Financial Management Improvement Act (FFMIA) Compliance Determination Framework. Management has concluded that FHA's core financial system complies with the Federal Financial Management system requirements and applicable accounting standards, and implements the U.S. Standard General Ledger at the transaction level. FHA's seventeen financial and mixed financial and program systems are integrated with the core financial system through extensive electronic interfaces. Operating interdependently, these financial systems taken together are substantially in compliance with FFMIA and OMB Circular A-123 requirements.

The Office of the Housing FHA Comptroller continuously monitors all FHA accounting and financial operations through weekly management meetings and through exception reporting for operational problems identified by managers and staff. FHA has sustained program operations with its current systems through significant changes in its mortgage insurance operations to implement the goals of FHA's multi-year strategic plan: sustainable growth, stabilizing housing markets and increasing availability of funding.

FHA management considers the existing systems capable of sustaining operation of the FHA insurance programs for the foreseeable future. FHA management also recognizes that its systems must continue to meet advancing standards and new expectations for efficiency and flexibility of operation. In fiscal year 2017 FHA enhanced system security and implemented new data processing capabilities to better manage risk to the FHA insurance portfolio.

- FHA continued to improve information system security practices and documentation to enhance the overall level of compliance with National Institute of Standards and Technology (NIST) and HUD standards
- FHA continued to support the departmental initiative to centralize interfaces with Treasury's transition from the Open Collections Interface (OCI) services, to the Trusted Collection Services (TCS), a web-based service for secure collections. The HUD Pay.gov Common Services (HPCS) shared service will be used to eliminate the need for individual upgrade and maintenance costs for existing legacy systems.
- FHA and HUD's Office of the Chief Information Officer implemented the Loan Review System to support improved quality control processes for Single Family mortgage insurance underwriting.

HUD has requested information technology funding for automation of FHA business processes and system modernization as part of the budget process.

Fiscal Year 2017 Financial Statement Audit Findings

Fiscal Year 2017 Financial Statement Audit Findings

The Office of the Inspector General (OIG) has identified two material weaknesses in the Internal Control Report for FHA's FY 2017 financial statement audit. The OIG noted in its findings that FHA used inaccurate and inconsistent data within the cash flow models, and had weaknesses in controls over financial reporting. Specifically, the OIG noted inconsistent discounting methodologies, incorrect rates, coding and dataset errors, and improvements needed in the model governance framework. In addition, OIG noted delays in the recording of new Multifamily endorsements and credit subsidy, inaccurate allocation of re-estimate subsidy and interest expenses, missing accruals related to property expenses and supplemental claims, and incomplete deobligation of invalid obligations which was carried over from a FY 2016 finding.

Management has already taken steps to resolve these findings, and will continue working to address the remaining auditor recommendations in the coming fiscal year.

Status of Fiscal Year 2016 Financial Statement Audit Findings

The status of the two material weaknesses identified in the fiscal year 2016 financial statement audit are below:

A. *Cash Flow Modeling Errors Were Not Detected*

This material weakness resulted because FHA incorrectly included accrued expenses in its Home Equity Conversion Mortgage (HECM) Maintenance and Operating (M&O) expense rate model assumption, resulting in an overstatement of FHA's Liability for Loan Guarantees (LLG) for fiscal years 2014 and 2015. In addition, FHA did not have sufficient controls over the review of significant changes in the M&O expenses input data. In fiscal year 2016, FHA excluded the accrued M&O expenses and recalculated its LLG for fiscal year 2014 and 2105 and restated its fiscal year 2015 financial statements to correct the reported balance of the LLG in the FY 2016 audited comparative financial statements. FHA also developed and implemented a new data extract-transfer-load process to detect and report any data inconsistencies that would need to be resolved, prior to the start of the annual estimation process. This process includes identifying all data elements used to estimate future M&O expenses and a review of the elements with appropriate management staff, to ensure non-cash items are not included to estimate M&O expenses.

As a result of these actions, FHA was able to close this material weakness finding this fiscal year.

B. *FHA's Controls Over Financial Reporting Relating to Budgetary Resources Had Weaknesses*

The second material weakness was comprised of several issues relating to the financial reporting of budgetary resources. Proprietary and Budgetary tie-point variances were not detected at the fund level across all accounting areas; there were variances between accounts payable and unpaid expended authority, individual Undelivered Orders (UDO) balances were inaccurate for contracts;

invalid obligations for fiscal years 2015 and 2016 were not deobligated appropriately, and weaknesses were identified in the annual review of unliquidated obligated balances. FHA resolved three auditor recommendations by implementing process improvements to the monthly tie-points reconciliation, correctly adjusting and agreeing balances between accounts payables and budgetary unexpended authority, and strengthening oversight of the annual review of unliquidated obligated balances.

FHA coordinated with the Office of Housing procurement management team to develop a SharePoint site to process and track the status of the deobligation of invalid obligations and to implement management elevation protocols to ensure sufficient effort is made to complete the deobligations timely, going forward.

Despite FHA's efforts, two recommendations pertaining to deobligations could not be closed and were carried over and included with other items in the material weaknesses related to financial reporting identified this year.

Improper Payments Elimination and Recovery Improvement Act of 2012

In accordance with the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA) and the OMB Memorandum M-15-02 dated October 20, 2014, FHA complied with the requirements and determined which of its program activities required review this year. Pursuant to the Act, FHA has analyzed the dollar volumes of each disbursement program for fiscal year 2016. Based on a three-year cycle, FHA has reviewed the following disbursements programs for fiscal year 2017:

- Single Family Insurance Claims (SFIC)
- Single Family Acquired Asset Management System (SAMS) Disbursement Program
- Single Family Notes
- Title I Claims
- Title I Notes
- Direct Loans
- Other Disbursements
- Contracts and Grants

During fiscal year 2017, limited risk assessments were conducted on all programs to determine whether the programs are of low risk. Our risk assessment revealed that there were no significant changes to processes by which the disbursements were processed, leading us to conclude that systems are not susceptible to improper payments. We conducted the Risk Assessment Survey and Mangers Interviews, which included OMB prescribed nine risk factors. The findings of the survey revealed that FHA disbursements programs are of low risk except for Single Family, which is rated high risk. We also analyzed "Do Not Pay" initiatives and found no significant incidence of erroneous payments.

In fiscal year 2017, we also included reviews of Title I Claims, Title I Notes, Single Family Notes, Single Family Acquired Asset Management System (SAMS), Direct Loan Program, Other Disbursements and Contract/Grants. We created Risk Matrix and Managers Interview Response Matrix and concluded that Single Family is high risk and other housing programs are low risk. In addition, we conducted limited review of OIG audit findings and GAO audit recommendations in fiscal year 2017 and previous years to assess their impacts on improper payments. We have performed random statistical sampling and analyses of Title I Claims, Title I Notes, Single Family Notes and SAMS case files. We have also conducted statistical testing of SFIC disbursements in fiscal year 2017. The findings from case files review have confirmed that these programs are not susceptible to significant risk of improper payments for the fiscal year 2017. In addition, FHA's internal control review required by OMB Circular A-123, Appendix C, concluded that each of these programs has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse.

IPERIA requires agencies that enter into contracts worth more than $1 million in a fiscal year to complete a cost-effective program for identifying errors made in paying contracts and grants and recovering any improper payments. In fiscal year 2017, we estimated total contract disbursements of $111 million.

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

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

Limitations of Financial Statements

The following limitations apply to the preparation of the fiscal year 2017 financial statements:

- The principal financial statements have been prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 U.S.C.3515 (b).
- The statements are prepared from the books and records of the entity in accordance with GAAP and the formats prescribed by OMB. Reports used to monitor and control budgetary resources 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.

PRINCIPAL FINANCIAL STATEMENTS

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PRINCIPAL FINANCIAL STATEMENTS

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MESSAGE FROM THE DEPUTY ASSISTANT SECRETARY FOR FINANCE AND BUDGET

November 15, 2017

The Federal Housing Administration (FHA) is pleased to receive an unmodified audit opinion on its fiscal year (FY) 2017 Financial Statement Audit. FHA is also pleased that it exceeded the two percent Mutual Mortgage Insurance (MMI) fund Capital Ratio requirement mandated by Congress for the third consecutive year.

In FY 2017, FHA's business remained strong. Single family forward mortgage endorsements decreased slightly from 1,258,053 in FY 2016 to 1,246,440 in FY 2017, while Home Equity Conversion Mortgage (HECM) endorsements increased from 48,868 to 55,291 in the same period. Multifamily new endorsements increased from 873 to 1,039. Healthcare also saw an increase in applications for insurance from 307 applications in FY 2016 to 407 in FY 2017. Overall, FHA saw a reduction in claim payments in FY 2017, specifically in single family conveyance claims, as well as a reduction in our single family real estate owned properties from 23,176 at the end of FY 2016 to 11,205 at the end of FY 2017.

In FY 2017, FHA conducted two HECM vacant note sales of 2,535 HECM loans, with a total loan balance of $493.6 million. The first such sale marked the first time that FHA had offered HECM loans through its asset sales program process. Recovery from the first sale was at 53.0 percent of the total loan balance and 57.3 percent for the second sale, both of which surpassed FHA's estimated reserve pricing.

FHA's Office of Finance and Budget continued to place its focus on strong financial management and internal controls. During FY 2017, FHA implemented an Enterprise Risk Management (ERM) framework, to comply with OMB new Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. The implementation of an ERM framework will ensure that FHA's approach to risk and internal control is integrated throughout the organization.

Through improvements to its internal control over financial reporting, FHA resolved several prior year financial statement recommendations and made substantial progress on the others. FHA also improved model risk governance by establishing a Credit Reform Board to provide oversight of the economic modeling process and by finalizing model risk management guidelines. Additionally, FHA made improvements to its controls surrounding partial claims documentation, as well as improving controls over its financial systems.

As part of the FY 2017 financial statement audit, FHA was cited for two material weaknesses and two significant deficiencies. The material weaknesses are due to a need for further improvements in FHA's modeling processes and for further improvement in controls over financial reporting. The first significant deficiency relates to a deficiency carried over from FY 2015, related to the partial claims billing and collecting process. While FHA has made significant progress on this deficiency, there is still additional work to be done in terms of the new policy being fully implemented. The second significant deficiency relates to FHA's weaknesses in selected FHA information technology systems. FHA management has already taken steps to resolve these findings and will continue working to address remaining auditor recommendations in the coming fiscal year. Going forward, FHA will continue to operate with a high degree of public and fiscal accountability, while providing more transparency and consistency.

In closing, I would like to thank my staff for their contributions and dedication to FHA's mission. I am proud of the commitment and effort exhibited by all towards advancing FHA's financial management and stewardship responsibilities.

Susan a Betts

Susan A. Betts
Deputy Assistant Secretary for Finance and Budget

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2017, and 2016
(Dollars in Millions)

		FY 2017		FY 2016
ASSETS				
Intragovernmental				
Fund Balance with U.S. Treasury (Note 3)	$	29,112	$	20,820
Investments (Note 5)		30,841		36,397
Total Intragovernmental	$	59,953	$	57,217
Cash and Other Monetary Assets (Note 4)	$	40		53
Investments (Note 5)	$	44		31
Accounts Receivable, Net (Note 6)		220		242
Loans Receivable and Related Foreclosed Property, Net (Note 7)		18,819		17,742
TOTAL ASSETS	**$**	**79,076**	**$**	**75,285**
LIABILITIES				
Intragovernmental				
Accounts Payable (Note 8)	$	2	$	7
Borrowings (Note 9)		29,141		30,873
Other Liabilities (Note 10)		1,673		2,765
Total Intragovernmental	$	30,816	$	33,645
Accounts Payable (Note 8)	$	514	$	495
Loan Guarantee Liability (Note 7)		20,616		(806)
Other Liabilities (Note 10)		636		854
TOTAL LIABILITIES	**$**	**52,582**	**$**	**34,188**
NET POSITION				
Unexpended Appropriations (Note 16)	$	459	$	415
Cumulative Results of Operations		26,035		40,682
TOTAL NET POSITION	**$**	**26,494**	**$**	**41,097**
TOTAL LIABILITIES AND NET POSITION	**$**	**79,076**	**$**	**75,285**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET COST
For the Periods Ended September 30, 2017 and 2016
(Dollars in Millions)

	FY 2017		FY 2016	
Single Family Forward				
Intragovernmental Gross Costs	$	765	$	791
Less: Intragovernmental Earned Revenue		805		662
Intragovernmental Net Costs	$	(40)	$	129
Gross Costs With the Public	$	(919)	$	(18,764)
Less: Earned Revenues		10		14
Net Costs With the Public	$	(929)	$	(18,778)
Single Family Forward Net Cost (Surplus)	$	(969)	$	(18,649)
HECM				
Intragovernmental Gross Costs	$	235	$	234
Less: Intragovernmental Earned Revenue		830		403
Intragovernmental Net Costs	$	(595)	$	(169)
Gross Costs With the Public	$	21,908	$	(305)
Less: Earned Revenues		-		1
Net Costs With the Public	$	21,908	$	(306)
HECM Net Cost (Surplus)	$	21,313	$	(475)
Multifamily				
Intragovernmental Gross Costs	$	114	$	111
Less: Intragovernmental Earned Revenue		23		32
Intragovernmental Net Costs	$	91	$	79
Gross Costs With the Public	$	(1,512)	$	(389)
Less: Earned Revenues		67		52
Net Costs With the Public	$	(1,579)	$	(441)
Multifamily Net Cost (Surplus)	$	(1,488)	$	(362)
Healthcare				
Intragovernmental Gross Costs	$	40	$	85
Less: Intragovernmental Earned Revenue		16		53
Intragovernmental Net Costs	$	24	$	32
Gross Costs With the Public	$	(322)	$	(129)
Less: Earned Revenues	$	1	$	1
Net Costs With the Public	$	(323)	$	(130)
Healthcare Net Cost (Surplus)	$	(299)	$	(98)
Salaries and Administrative Expenses				
Intragovernmental Gross Costs	$	27	$	17
Less: Intragovernmental Earned Revenue		-		-
Intragovernmental Net Costs	$	27	$	17
Gross Costs With the Public	$	523	$	591
Less: Earned Revenues		-		-
Net Costs With the Public	$	523	$	591
Adminstrative and Contracts Net Cost (Surplus)	$	550	$	608
Net Cost of Operations	**$**	**19,107**	**$**	**(18,976)**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET POSITION
For the Periods Ended September 30, 2017 and 2016
(Dollars in Millions)

CUMULATIVE RESULTS OF OPERATIONS (Note 16)	**FY 2017**	**FY 2016**
Beginning Balance	**$ 40,682**	**$ 19,046**
Adjustments		
Corrections of Errors	-	835
Beginning Balance, As Adjusted	**$ 40,682**	**$ 19,881**
Budgetary Financing Sources:		
Appropriations Used	4,429	3,393
Non-Exchange Revenue	2	-
Other Financing Sources (Nonexchange)		
Transfers In/Out Without Reimbursement	426	480
Imputed Financing From Costs	13	15
Other	(412)	(2,063)
Total Financing Sources	**$ 4,458**	**$ 1,825**
Net Cost of Operations	(19,107)	18,976
Net Change	(14,647)	20,801
Cummulative Results of Operation	**$ 26,035**	**$ 40,682**
Unexpended Appropriations (Note 16)		
Beginning Balance	**415**	**$ 871**
Budgetary Financing Sources		
Appropriations Received	4,473	3,437
Other Adjustments (Recissions, etc)	-	(500)
Appropriations Used	(4,429)	(3,393)
Total Budgetary Financing Sources	**$ 44**	**$ (456)**
Unexpended Appropriation	**$ 459**	**$ 415**
Net Position	**$ 26,494**	**$ 41,097**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2017
(Dollars in Millions)

	FY 2017 Budgetary	FY 2017 Non-Budgetary	FY 2017 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	$ 37,758	$ 16,411	$ 54,169
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	234	234
Unobligated balance brought forward, October 1, as adjusted	37,758	16,645	54,403
Recoveries of prior year unpaid obligations	11	82	93
Other changes in unobligated balance (+ or -)	(425)	-	(425)
Unobligated balance from prior year budget authority, net	37,343	16,727	54,070
Appropriations (discretionary and mandatory)	4,473	-	4,473
Borrowing authority (discretionary and mandatory)	-	8,376	8,376
Spending authority from offsetting collections (discretionary and mandatory)	13,289	34,665	47,954
Total budgetary resources	**$ 55,105**	**$ 59,768**	**$ 114,873**
Status of Budgetary Resources:			
Obligations incurred	$ 23,217	$ 34,975	$ 58,192
Unobligated balance, end of year:			
Apportioned	69	6,272	6,341
Unapportioned	31,761	18,521	50,282
Unexpired unobligated balance, end of year	31,830	24,793	56,623
Expired unobligated balance, end of year	58	-	58
Total unobligated balance, end of year	31,888	24,793	56,681
Total budgetary resources	**55,105**	**59,768**	**114,873**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	$ 346	$ 2,650	$ 2,996
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(35)	-	(35)
Obligated balance, start of year (net), before adjustments (+ or -)	311	2,650	2,961
Obligated balance, start of year (net), as adjusted	311	2,650	2,961
Obligations incurred	23,217	34,975	58,192
Outlays (gross) (-)	(23,160)	(34,181)	(57,341)
Change in uncollected customer payments from Federal sources (+ or -)	(13)	-	(13)
Recoveries of prior year unpaid obligations (-)	(11)	(82)	(93)
Unpaid obligations, end of year (gross)	393	3,362	3,755
Uncollected customer payments from Federal sources, end of year	(48)	-	(48)
Obligated balance, end of year (net)	**$ 345**	**$ 3,362**	**$ 3,707**

The accompanying notes are an integral part of these statements

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2016
(Dollars in Millions)

	FY 2016 Budgetary	FY 2016 Non-Budgetary	FY 2016 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	$ 16,733	$ 33,986	$ 50,719
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	(3)	(3)
Unobligated balance brought forward, October 1, as adjusted	16,733	33,983	50,716
Recoveries of prior year unpaid obligations	241	463	704
Other changes in unobligated balance (+ or -)	(681)	-	(681)
Unobligated balance from prior year budget authority, net	16,293	34,446	50,739
Appropriations (discretionary and mandatory)	3,431	-	3,431
Borrowing authority (discretionary and mandatory)	-	13,077	13,077
Spending authority from offsetting collections (discretionary and mandatory)	25,010	19,800	44,810
Total budgetary resources	**$ 44,734**	**$ 67,323**	**$ 112,057**
Status of Budgetary Resources:			
Obligations incurred	$ 6,976	$ 50,911	$ 57,887
Unobligated balance, end of year:			
Apportioned	70	5,574	5,644
Unapportioned	37,648	10,838	48,486
Unexpired unobligated balance, end of year	37,718	16,412	54,130
Expired unobligated balance, end of year	40	-	40
Total unobligated balance, end of year	37,758	16,412	54,170
Total budgetary resources	**$ 44,734**	**$ 67,323**	**$ 112,057**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	$ 564	$ 2,485	$ 3,049
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(15)	-	(15)
Obligated balance, start of year (net), before adjustments (+ or -)	549	2,485	3,034
Adjustment to obligated balance, start of year (net) (+ or -)	-	3	3
Obligated balance, start of year (net), as adjusted	549	2,488	3,037
Obligations incurred	6,976	50,911	57,887
Outlays (gross) (-)	(6,953)	(50,286)	(57,239)
Change in uncollected customer payments from Federal sources (+ or -)	(20)	-	(20)
Recoveries of prior year unpaid obligations (-)	(241)	(463)	(704)
Unpaid obligations, end of year (gross)	346	2,650	2,996
Uncollected customer payments from Federal sources, end of year	(35)	-	(35)
Obligated balance, end of year (net)	**$ 311**	**$ 2,650**	**$ 2,961**
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	$ 28,441	$ 32,876	$ 61,317
Actual offsetting collections (discretionary and mandatory) (-)	(24,991)	(29,027)	(54,018)
Change in uncollected customer payments from Federal sources	(20)	-	(20)
Recoveries of prior year paid obligations (discretionary and mandatory)	1	-	1
Budget authority, net (discretionary and mandatory)	3,431	3,849	7,280
Outlays, gross (discretionary and mandatory)	6,953	50,286	57,239
Actual offsetting collections (discretionary and mandatory) (-)	(24,991)	(29,027)	(54,018)
Outlays, net (discretionary and mandatory)	(18,038)	21,259	3,221
Less Distributed offsetting receipts (-)	(2,000)	-	(2,000)
Agency outlays, net (discretionary and mandatory)	**$ (20,038)**	**$ 21,259**	**$ 1,221**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2017

Note 1. Significant Accounting Policies

Entity and Mission

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

FHA 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, healthcare facilities, property improvements, manufactured homes, and reverse mortgages, also referred to as Home Equity Conversion Mortgages (HECM). The objectives of activities carried out by FHA relate directly to the development of affordable housing.

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

FHA supports its insurance operations through five funds. The Mutual Mortgage Insurance fund (MMI), FHA's largest fund, provides basic Single Family mortgage insurance and is a mutual insurance fund, whereby mortgagors, upon non-claim termination of their mortgages, share surplus premiums paid into the MMI fund that are not required for operating expenses and losses or to build equity. The Cooperative Management Housing Insurance fund (CMHI), another mutual fund, provides mortgage insurance for management-type cooperatives. The General Insurance fund (GI), provides a large number of specialized mortgage insurance activities, including insurance of loans for property improvements, cooperatives, condominiums, housing for the elderly, land development, group practice medical facilities, nonprofit hospitals, and reverse mortgages. The Special Risk Insurance fund (SRI) provides mortgage insurance on behalf of mortgagors eligible for interest reduction payments who otherwise would not be eligible for mortgage insurance. To comply with the FHA Modernization Act of 2008, activities related to most Single Family programs, including HECM, endorsed in Fiscal Year 2009 and going forward, are in the MMI fund. The Single Family activities in the GI fund from Fiscal Year 2008 and prior remain in the GI fund. The HOPE for Homeowners (H4H) program began on October 1, 2008 for Fiscal Year 2009 as a result of *The Housing and Economic Recovery Act of 2008*. This legislation required FHA to modify existing programs and initiated the H4H program and fund, which guaranteed loans for three years. No new H4H loans have been guaranteed since FY 2011.

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

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/SRI	234(c), HECM	N/A
MMI	203(b)	203(b), 234(c), HECM

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

Basis of Accounting

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

Basis of Consolidation

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

Fund Balance with U.S. Treasury

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

Investments

FHA investments include investments in U.S. Treasury securities, Multifamily Risk Sharing debentures, and Securities Held Outside of Treasury. Under current legislation, FHA invests available MMI/CMHI capital reserve fund resources, in excess of its current needs, in non-marketable market-based U.S. Treasury securities. These U.S. Treasury securities may not be sold on public securities exchanges, but do reflect prices and interest rates of similar marketable U.S. Treasury securities. Investments are presented at acquisition cost net of the amortized premium or discount. Amortization of the premium or discount is recognized monthly on investments in U.S. Treasury securities using the interest method in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 1 *Accounting for Selected Assets and Liabilities*, paragraph 71.

Multifamily Risk Sharing Debentures [Section 542(c)] is a program available to lenders where the lender shares the risk in a property by issuing debentures for the claim amount paid by FHA on defaulted insured loans. Securities Held Outside of Treasury represent marketable stock received as part of a settlement and held outside of the U.S. Treasury through a Treasury authorized broker.

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 Statement of Budgetary Resources. The Budgetary accounts include the program, capital reserve and liquidating accounts. The Non-Budgetary accounts consist of the credit reform financing accounts.

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

FHA has two general fund receipt accounts. FHA's receipt accounts are general fund receipt accounts and these amounts are not earmarked for the FHA's credit programs. The first 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. They are available for appropriations only in the sense that all general fund receipts are available for appropriations. Any assets in these accounts are non-entity assets and are offset by intragovernmental liabilities. At the end of the fiscal year, the fund balance in this general fund receipt account is transferred to the U.S. Treasury general fund.

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

Negative subsidy and downward reestimates in the MMI/CMHI fund are transferred to the Capital Reserve account. Capital Reserve balances are accumulated for unanticipated losses.

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

Loans Receivable and Related Foreclosed Property, Net

FHA's loans receivable include mortgage notes assigned (MNA), also described as Secretary-held notes, purchase money mortgages (PMM), notes related to partial claims, and direct loans relating to the Federal Financing Bank Risk Share program. 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. The majority of MNAs are HECM notes. HECM loans, while not in default, are assigned to HUD when they reach 98% of their maximum claim amount. In addition, Multifamily and Single Family performing notes insured pursuant to Section 221(g)(4) of the National Housing Act may be assigned automatically to FHA at a pre-determined point. Partial claims notes arise when FHA pays a loss mitigation amount to keep a borrower current on their loan. FHA, in turn, records a loan receivable which takes a second position to the primary mortgage.

In accordance with the FCRA and SFFAS No. 2, Credit Reform direct loans, defaulted guaranteed loans and related foreclosed property are reported at the net present value of expected cash flows associated with these assets, primarily from estimated proceeds less selling and maintenance costs. The difference between the cost of these loans and property and the net present value is called the Allowance for Subsidy. Pre-Credit Reform loans receivable and related foreclosed property in inventory are recorded at net realizable value which is based on recovery rates net of any selling expenses (see Note 7).

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 sheet. 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 7).

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

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

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

Use of Estimates

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

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

To estimate the Allowance for Subsidy associated with loans receivable and related 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 7, 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 7, 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 has several procurement actions in place and incurred expenses for software development are transferred to HUD to comply with departmental policy.

Appropriations

FHA receives appropriations for certain operating expenses for its program activities. Additionally, FHA receives appropriations for GI/SRI positive subsidy, upward re-estimates, and permanent indefinite authority to cover any shortage of resources in the liquidating account.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards* and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts* to account for costs assumed by other Federal organizations on their behalf, require that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. HUD allocates each responsibility segment's share of the program costs or resources provided by other federal agencies. As a responsibility segment of HUD, FHA's portion of these costs was $13 million for fiscal year 2017 and $15 million for fiscal year 2016, and it was included in FHA's financial statements as an imputed cost in the Consolidated Statement of Net Cost, and as imputed financing in the Consolidated Statement of Changes in Net Position.

Distributive Shares

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

Liabilities Covered by Budgetary Resources

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

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, 2017 and 2016 are as follows:

(Dollars in millions)

	FY 2017	FY 2016
Intragovernmental:		
Fund Balance with Treasury	$ 19	$ 35
Total Intragovernmental	19	35
Cash and Other Monetary Assets	26	29
Total Non-Entity Assets	45	64
Total Entity Assets	79,030	75,221
Total Assets	**$ 79,075**	**$ 75,285**

FHA's non-entity assets consist of escrow monies collected by FHA from the borrowers of its loans.

Cash and other monetary assets that are collected from FHA borrowers consist of escrow monies that 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 maintenance expenses on behalf of the borrowers.

In FY 2016, escrow monies deposited at minority-owned banks were reported as other assets in Note 2 – Non-Entity Assets and in Note 7 – Other Assets.

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, 2017 and 2016:

(Dollars in millions)	FY 2017	FY 2016
Fund Balances:		
Revolving Funds	$ 28,000	$ 19,699
Appropriated Funds	269	245
Other Funds	843	876
Total	**$ 29,112**	**$ 20,820**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance		
Available	$ 6,044	$ 5,643
Unavailable	19,314	12,180
Obligated Balance Not Yet Disbursed	3,754	2,997
Total	**$ 29,112**	**$ 20,820**

Revolving Funds

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

Appropriated Funds

FHA's appropriated funds consist of annual or multi-year program accounts that expire at the end of the time period specified in the authorizing legislation. For the subsequent five fiscal years after expiration, the resources are available only to liquidate valid obligations incurred during the unexpired period. Adjustments are allowed to increase or decrease valid obligations incurred during the unexpired period that were not previously reported. At the end of the fifth expired year, the annual and multi-year program accounts are canceled 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 and the deposit funds for the receipt of bid deposits for asset sales. Additionally, the capital reserve account is included with these funds and is used to retain the MMI/CMHI negative subsidy and downward credit subsidy re-estimates transferred from the financing account. If subsequent upward credit subsidy re-estimates 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. Cash and Other Monetary Assets

(Dollars in millions)

	FY 2017	FY 2016
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	$ 26	$ 29
Deposits in Transit	14	24
Total	**$ 40**	**$ 53**

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 renovation expenses. These escrow monies are deposited at the U.S. Treasury (see Note 2), invested in U.S. Treasury securities (see Note 5 - GI/SRI Investments) or deposited at minority-owned banks.

Deposits in Transit

Deposits in Transit is cash that has not been confirmed as being received by the U.S. Treasury. Once the U.S. Treasury has confirmed that this cash has been received, the cash will be moved from Deposits in Transit to Fund Balance with U.S. Treasury.

In FY 2016, Escrow Monies Deposited at Minority-Owned Banks were reported as Other Assets in Note 2 – Non-Entity Assets and with Deposits in Transit in Note 7 – Other Assets.

Note 5. 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, 2017 were as follows:

(Dollars in millions)

FY 2017	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 30,744	$ 51	$ 30,795	$ 30,747
MMI/CMHI Accrued Interest			46	46
Total	**$ 30,744**	**$ 51**	**$ 30,841**	**$ 30,793**

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2016 were as follows:

FY 2016	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 36,311	$ 54	$ 36,365	$ 36,389
MMI/CMHI Accrued Interest			32	32
Total	**$ 36,311**	**$ 54**	**$ 36,397**	**$ 36,421**

Investments in Private-Sector Entities

Investments in Private Sector Entities as of September 30, 2017 and 2016 were as follows:

(Dollars in millions)	Beginning Balance	New Acquisitions	Redeemed	Ending Balance
FY 2017				
Securities Held Outside of Treasury	$ -	$ 13	$ -	$ 13
Risk Sharing Debentures	$ 31	$ -	$ -	$ 31
Total	**$ 31**	**$ 13**	**$ -**	**$ 44**
FY 2016				
Risk Sharing Debentures	$ 31	$ -	$ -	$ 31
Total	**$ 31**	**$ -**	**$ -**	**$ 31**

Note 6. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2017 and 2016 are as follows:

	Gross		Allowance		Net	
(Dollars in millions)	FY 2017	FY 2016	FY 2017	FY 2016	FY 2017	FY 2016
With the Public:						
Receivables Related to Credit Program Assets	$ 12	$ 9	$ (1)	$ (1)	$ 11	$ 8
Premiums Receivables	-	1	-	-	-	1
Partial Claims Receivables	18	77	(8)	(23)	10	54
Generic Debt Receivables	301	264	(300)	(264)	1	-
Settlements Receivables	109	141	-	-	109	141
Miscellaneous Receivables	89	38	-	-	89	38
Total	$ 529	$ 530	$ (309)	$ (288)	$ 220	$ 242

Receivables Related to Credit Program Assets

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

Premium Receivables

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

Partial Claim Receivables

Partial Claim receivables represents partial claims paid by FHA to mortgagees as part of its loss mitigation efforts to bring delinquent loans current for which FHA does not yet have the promissory note recorded.

Generic Debt Receivables

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

Settlement Receivables

FHA receives signed consent judgments that are approved by the courts but which funds have not been received.

Miscellaneous Receivables

Miscellaneous receivables include late charges and penalties receivables on delinquent premium receivables, refund receivables from overpayments of claims, distributive shares, and other immaterial receivables.

Allowance for Loss

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

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

Direct Loan and Loan Guarantee Programs Administered by FHA include:

Single Family Forward Mortgages
Multifamily Mortgages
Healthcare Mortgages
Home Equity Conversion Mortgages (HECM)

FHA reports its insurance operations in four overall program areas: Single Family Forward mortgages, Multifamily mortgages, Healthcare mortgages, and Home Equity Conversion Mortgages (HECM). FHA operates these programs primarily through four insurance funds: Mutual Mortgage Insurance (MMI), General Insurance (GI), Special Risk Insurance (SRI), and Cooperative Management Housing Insurance (CMHI), with the MMI fund being the largest. There is a fifth fund, Hope for Homeowners (H4H), which became operational in fiscal year 2009 which contains minimal activity.

FHA encourages homeownership through its Single Family Forward programs (Section 203(b), which is the largest program, and Section 234) with its mortgage insurance programs. These programs insure mortgage lenders against losses from default, enabling those lenders to provide mortgage financing on favorable terms to homebuyers. Multifamily Housing Programs (Section 213, Section 221(d)(4), Section 207/223(f), and Section223(a)(7)) provide FHA insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals, and cooperatives. Healthcare programs (Section 232 and Section 242) enable low cost financing of healthcare facility projects and improve access to quality healthcare by reducing the cost of capital. The HECM program provides eligible homeowners who are 62 years of age and older access to the equity in their property with flexible terms.

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and Loan Guarantee Liability as of September 30, 2017 and 2016 are as follows:

Direct Loan Programs:

Starting in FY 2015, FHA began a Federal Financing Bank (FFB) Risk Share program, an inter-agency partnership between HUD, FFB and various Housing Finance Authorities (HFAs). The FFB Risk Share program provides funding for multifamily mortgage loans insured by FHA. Under this program, FHA records a direct loan with the public as an asset on its balance sheet, and conversely, borrowing from FFB as a liability. The program does not change the basic structure of Risk Sharing; it only substitutes FFB as the funding source. The HFAs originate and service the loans, and share in any losses.

In FY 2017, FHA changed the way it estimates its direct loan allowance for subsidy and credit subsidy re-estimates for these risk share loans. The cash flow model for FFB direct loan program is developed by collecting and consolidating data from FHA's program and accounting systems. The model is based upon trends and assumptions of historical data and analysis but, where necessary, management's judgment. The model uses actual data through August of the current fiscal year and projections are used to estimate the direct loan cash flows for the following month of September. The model estimates total loan commitments and the percentage of commitments that will be disbursed prior to the end of the fiscal year.

Previously, FHA used the estimated direct loan values from its models to calculate the allowance for subsidy and credit subsidy re-estimates. In FY 2017, FHA analyzed the estimated direct loans disbursed compared to actual loans disbursed at September 30th. Based on this information, management determined that an adjustment was necessary to better estimate the Direct Loan value. FHA calculated the ratio of the allowance for subsidy to the direct loan unpaid principal balance per the cash flow models and applied that ratio to the actual direct loans disbursed to estimate the allowance for subsidy and credit subsidy re-estimate.

Direct Loans Obligated (Pre-1992):
(Dollars in Millions)

	GI/SRI - Multifamily	Total
September 30, 2017		
Loan Receivables	$ 8	$ 8
Interest Receivables	13	13
Allowance	(4)	(4)
Total Value of Assets	$ 17	$ 17

September 30, 2016	**GI/SRI - Multifamily**	**Total**
Loan Receivables	$ 8	$ 8
Interest Receivables	12	12
Allowance	(4)	(4)
Total Value of Assets	$ 16	$ 16

Direct Loans Obligated (Post-1991):
(Dollars in Millions)

	MMI/CMHI - Single Family	GI/SRI - Multifamily	Total
September 30, 2017			
Loan Receivables	$ -	$ 1,193	$ 1,193
Interest Receivables	-	4	4
Allowance	-	37	37
Total Value of Assets	$ -	$ 1,234	$ 1,234

September 30, 2016	**MMI/CMHI - Single Family**	**GI/SRI - Multifamily**	**Total**
Loan Receivables	$ -	$ 554	$ 554
Interest Receivables	-	1	1
Allowance	(3)	27	24
Total Value of Assets	$ (3)	$ 582	$ 579

Total Amount of Direct Loans Disbursed (Post- 1991):
(Dollars in Millions)

Direct Loan Programs	FY 2017	FY 2016
GI/SRI		
Multifamily/Healthcare	$ 639	$ 451
GI/SRI Subtotal	$ 639	$ 451

Subsidy Expense for Direct Loans:

September 30, 2017

	GI/SRI	Total
Multifamily/Healthcare		
FFB		
Financing	$ (76)	$ (76)
Defaults	1	1
Fees and Other Collections	(18)	(18)
Other	21	21
Subtotal	$ (72)	$ (72)

September 30, 2016

	GI/SRI	Total
Multifamily/Healthcare		
FFB		
Financing	$ (68)	$ (68)
Defaults	4	4
Fees and Other Collections	(9)	(9)
Other	21	21
Subtotal	$ (52)	$ (52)

Subsidy Expense for Re-estimates:

(Dollars in millions)

FY 2017		Technical Reestimate	
	MMI/CMHI	$	(6)
	GI/SRI		67
Total		$	61
FY 2016			
	GI/SRI		64
Total		$	64

Total Direct Loan Subsidy Expense:

Direct Loan Programs	FY 2017		FY 2016	
MMI/CMHI	$	(6)	$	-
GI/SRI	$	(5)	$	13
Total	$	(11)	$	13

Subsidy Rates for Direct Loans by Program and Component

September 30, 2017	Finance	Default	Fees and Other Collections	Other	Total
GI/SRI					
Multifamily					
FFB	-13.92%	0.01%	-0.97%	3.69%	-11.19%

September 30, 2016	Finance	Default	Fees and Other Collections	Other	Total
GI/SRI					
Multifamily					
FFB	0.00%	2.61%	-7.06%	0.00%	-4.45%

Schedule for Reconciling Subsidy Cost Allowance Balances:

Beginning Balance, Changes, and Ending Balance		FY 2017		FY 2016
Beginning balance of the subsidy cost allowance	$	(24)	$	(30)
Add: subsidy expense for direct loans disbursed during the reporting years by component				
-Financing		(76)		(68)
- Default costs (net recoveries)		1		4
- Fees and other collections		(18)		(9)
- Other subsidy costs		21		21
Total of the above subsidy expense components	$	(72)	$	(52)
Adjustments:				
- Fees received		3		1
- Subsidy allowance amortization		(4)		28
- Other		(4)		-
ding balance of the subsidy cost allowance before reestimat	$	(101)	$	(53)
Add or subtract subsidy reestimates by component:				
- Technical/default reestimate				
-Subsidy Expense Component		110		46
-Interest Expense Component		3		2
-Total of the above reetimate components		113	$	48
Adjustment of prior years' credit subsidy reestimates		(49)		(19)
Total Technical/Default Reestimate	$	64	$	29
Ending balance of the subsidy cost allowance	**$**	**(37)**	**$**	**(24)**

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

(Dollars in Millions)

FY 2017	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	$ 19	$ -	$ 19
Foreclosed Property	5	9	14
Allowance for Loan Losses	(4)	(4)	(8)
Subtotal	**$ 20**	**$ 5**	**$ 25**
Multifamily/Healthcare			
Loan Receivables	$ -	$ 1,614	$ 1,614
Interest Receivables	-	231	231
Allowance for Loan Losses	-	(682)	(682)
Subtotal	**$ -**	**$ 1,163**	**$ 1,163**
HECM			
Loan Receivables	$ -	$ 3	$ 3
Interest Receivables	-	1	1
Foreclosed Property	-	(2)	(2)
Allowance for Loan Losses	-	(1)	(1)
Subtotal	**$ -**	**$ 1**	**$ 1**
Total Guaranteed Loans	**$ 20**	**$ 1,169**	**$ 1,189**

(Dollars in Millions)

FY 2016	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	$ 21	$ -	$ 21
Foreclosed Property	7	9	16
Allowance for Loan Losses	(5)	(3)	(8)
Subtotal	**$ 23**	**$ 6**	**$ 29**
Multifamily/Healthcare			
Loan Receivables	$ -	$ 1,780	$ 1,780
Interest Receivables	-	230	230
Foreclosed Property	-	1	1
Allowance for Loan Losses	-	(818)	(818)
Subtotal	**$ -**	**$ 1,193**	**$ 1,193**
HECM			
Loan Receivables	$ -	$ 4	$ 4
Interest Receivables	-	2	2
Foreclosed Property	-	(2)	(2)
Allowance for Loan Losses	-	(5)	(5)
Subtotal	**$ -**	**$ (1)**	**$ (1)**
Total Guaranteed Loans	**$ 23**	**$ 1,198**	**$ 1,221**

*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 2017	MMI/CMHI	GI/SRI	H4H	Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	$ 11,160	$ 416	$ 5	$ 11,581
Interest Receivables	-	-	-	-
Foreclosed Property	1,437	35	-	1,472
Allowance	(6,133)	(225)	(5)	(6,363)
Subtotal	**$ 6,464**	**$ 226**	**$ -**	**$ 6,690**
Multifamily/Healthcare				
Loan Receivables	$ -	$ 645	$ -	$ 645
Interest Receivables	-	(1)	-	(1)
Foreclosed Property	-	1	-	1
Allowance	-	(272)	-	(272)
Subtotal	**$ -**	**$ 373**	**$ -**	**$ 373**
HECM				
Loan Receivables	$ 6,992	$ 3,701	$ -	$ 10,693
Interest Receivables	4,176	1,981	-	6,157
Foreclosed Property	36	79	-	115
Allowance	(5,052)	(2,597)	-	(7,649)
Subtotal	**$ 6,152**	**$ 3,164**	**$ -**	**$ 9,316**
Total Guaranteed Loans	**$ 12,616**	**$ 3,763**	**$ -**	**$ 16,379**

(Dollars in Millions)

FY 2016	MMI/CMHI	GI/SRI	H4H	Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	$ 10,320	$ 350	$ 5	$ 10,675
Interest Receivables	5	-	-	5
Foreclosed Property	2,817	74	1	2,892
Allowance	(7,326)	(241)	(5)	(7,572)
Subtotal	**$ 5,816**	**$ 183**	**$ 1**	**$ 6,000**
Multifamily/Healthcare				
Loan Receivables	$ -	$ 735	$ -	$ 735
Foreclosed Property	-	1	-	1
Allowance	-	(365)	-	(365)
Subtotal	**$ -**	**$ 371**	**$ -**	**$ 371**
HECM				
Loan Receivables	$ 4,472	$ 3,593	$ -	$ 8,065
Interest Receivables	2,351	1,830	-	4,181
Foreclosed Property	36	132	-	168
Allowance	(1,580)	(1,279)	-	(2,859)
Subtotal	**$ 5,279**	**$ 4,276**	**$ -**	**$ 9,555**
Total Guaranteed Loans	**$ 11,095**	**$ 4,830**	**$ 1**	**$ 15,926**

*HECM loans, while not defaulted, have reached 98% of the maximum claim amount and have been assigned to FHA.

Guaranteed Loans Outstanding:

(Dollars in Millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed	
Guaranteed Loans Outstanding (FY 2017):			
MMI/CMHI			
Single Family Forward	$ 1,272,515	$ 1,153,875	
Multifamily/Healthcare	640	605	
MMI/CMHI Subtotal	**$ 1,273,155**	**$ 1,154,480**	
GI/SRI			
Single Family Forward	$ 8,120	$ 5,414	
Multifamily/Healthcare	128,163	117,604	
GI/SRI Subtotal	**$ 136,283**	**$ 123,018**	
H4H			
Single Family - 257	$ 81	$ 74	
H4H Subtotal	**$ 81**	**$ 74**	
Total	**$ 1,409,519**	**$ 1,277,572**	
Guaranteed Loans Outstanding (FY 2016): RESTATED			
MMI/CMHI			
Single Family Forward	$ 1,210,295	$ 1,100,046	Restated
Multifamily/Healthcare	617	590	Restated
MMI/CMHI Subtotal	**$ 1,210,912**	**$ 1,100,636**	Restated
GI/SRI			
Single Family Forward	$ 9,310	$ 6,482	Restated
Multifamily/Healthcare	118,319	108,744	
GI/SRI Subtotal	**$ 127,629**	**$ 115,226**	Restated
H4H			
Single Family - 257	$ 90	$ 83	
H4H Subtotal	**$ 90**	**$ 83**	
Total	**$ 1,338,631**	**$ 1,215,945**	Restated

New Guaranteed Loans Disbursed (FY 2017):

(Dollars in Millions)

		Outstanding Principal of Guaranteed Loans, Face Value		Amount of Outstanding Principal Guaranteed	
MMI/CMHI					
Single Family Forward	$	250,904	$	248,286	
Multifamily/Healthcare		22		22	
MMI/CMHI Subtotal	**$**	**250,926**	**$**	**248,308**	
GI/SRI					
Single Family Forward	$	98	$	97	
Multifamily/Healthcare		16,786		16,710	
GI/SRI Subtotal	**$**	**16,884**	**$**	**16,807**	
Total	**$**	**267,810**	**$**	**265,115**	
New Guaranteed Loans Disbursed (FY 2016): RESTATED					
MMI/CMHI					
Single Family Forward	$	245,466	$	242,905	Restated
Multifamily/Healthcare		85		85	
MMI/CMHI Subtotal	**$**	**245,551**	**$**	**242,990**	
GI/SRI					
Single Family Forward	$	107	$	106	
Multifamily/Healthcare		12,117		12,062	
GI/SRI Subtotal	**$**	**12,224**	**$**	**12,168**	
Total	**$**	**257,775**	**$**	**255,158**	Restated

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 1,052,332 HECM loans with a maximum claim amount of $252 billion. Of these 1,052,332 HECM loans insured by FHA, 580,093 loans with a maximum claim amount of $148 billion are still active. As of September 30, 2017, the insurance-in-force (the outstanding balance of active loans) was $105 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	Current Outstanding Balance	Maximum Potential Liability	
FY 2017	MMI/CMHI		$ 17,691	$ 72,968	$ 110,252	
	GI/SRI		-	$ 30,629	$ 37,330	
		Total	**$ 17,691**	**$ 103,597**	**$ 147,582**	
RESTATED						
FY 2016	MMI/CMHI		$ 14,659	$ 70,375	$ 105,196	Restated
	GI/SRI		-	34,294	42,948	
		Total	**$ 14,659**	**$ 104,669**	**$ 148,144**	Restated

Loan Guarantee Liability, Net:

(Dollars in Millions)

FY 2017	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 9	$ -	$ -	$ 9
Multifamily/Healthcare	-	(1)	-	(1)
Subtotal	**$ 9**	**$ (1)**	**$ -**	**$ 8**
LLG				
Single Family Forward	$ (2,143)	$ 339	$ 18	$ (1,786)
Multifamily/Healthcare	(17)	(4,108)	-	(4,125)
HECM	15,187	11,332	-	26,519
Subtotal	**$ 13,027**	**$ 7,563**	**$ 18**	**$ 20,608**
Loan Guarantee Liability Total	**$ 13,036**	**$ 7,562**	**$ 18**	**$ 20,616**

FY 2016	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 1	$ -	$ -	$ 1
Multifamily/Healthcare	-	(1)	-	(1)
Subtotal	**$ 1**	**$ (1)**	**$ -**	**$ -**
LLG				
Single Family Forward	$ (7,683)	$ 79	$ 16	$ (7,588)
Multifamily/Healthcare	(24)	(3,141)	-	(3,165)
HECM	3,460	6,487	-	9,947
Subtotal	**$ (4,247)**	**$ 3,425**	**$ 16**	**$ (806)**
Loan Guarantee Liability Total	**$ (4,246)**	**$ 3,424**	**$ 16**	**$ (806)**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

FY 2017	MMI/CMHI	GI/SRI	Total
Single Family Forward			
Defaults	$ 6,073	$ 5	$ 6,078
Fees and Other Collections	(19,523)	(8)	(19,531)
Other	2,359	-	2,359
Subtotal	**$ (11,091)**	**$ (3)**	**$ (11,094)**
Multifamily/Healthcare			
Defaults	$ 1	$ 208	$ 209
Fees and Other Collections	(2)	(882)	(884)
Subtotal	**$ (1)**	**$ (674)**	**$ (675)**
HECM			
Defaults	$ 1,250	$ -	$ 1,250
Fees and Other Collections	(1,308)	-	(1,308)
Subtotal	**$ (58)**	**$ -**	**$ (58)**
Total	**(11,150)**	**(677)**	**(11,827)**

FY 2016	MMI/CMHI	GI/SRI	Total
Single Family Forward			
Defaults	$ 5,585	$ 5	$ 5,590
Fees and Other Collections	(16,457)	(8)	(16,465)
Other	1,791	-	1,791
Subtotal	**$ (9,081)**	**$ (3)**	**$ (9,084)**
Multifamily/Healthcare			
Defaults	$ 2	$ 176	$ 178
Fees and Other Collections	(5)	(653)	(658)
Subtotal	**$ (3)**	**$ (477)**	**$ (480)**
HECM			
Defaults	$ 844	$ -	$ 844
Fees and Other Collections	(945)	-	(945)
Subtotal	**$ (101)**	**$ -**	**$ (101)**
Total	**$ (9,185)**	**$ (480)**	**$ (9,665)**

Subsidy Expense for Modification and Re-estimates:

(Dollars in millions)

FY 2017	Total Modifications	Technical Reestimate
MMI/CMHI	$ -	$ 21,112
GI/SRI	-	3,693
Total	$ -	$ 24,805
FY 2016		
MMI/CMHI	$ -	$ (7,897)
GI/SRI	-	(289)
Total	$ -	$ (8,186)

Total Loan Guarantee Subsidy Expense:

Total Loan Guarantee Subsidy Expense:
(Dollars in millions)

	FY 2017	FY 2016
MMI/CMHI	$ 9,962	$ (17,082)
GI/SRI	3,017	(769)
Total	$ 12,979	$ (17,851)

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(Percentage)	Defaults	Fees and Other Collections	Total
Budget Subsidy Rates for FY 2017 Loans Guarantees:			
MMI/CMHI			
Single Family			
SF - Forward	2.42	(7.78)	(5.36)
SF - HECM	7.06	(7.39)	(0.33)
SF - Neg Equity Refi/ Short Refinance	8.27	(8.27)	-
GI/SRI			
Multifamily			
Apartments - NC/SC	1.49	(4.25)	(2.76)
Apartments- Refinance	0.52	(4.31)	(3.79)
Healthcare			
FHA Full Insurance - Health Care	2.52	(8.37)	(5.85)
Hospitals	1.14	(6.66)	(5.52)

(Percentage)	Defaults	Fees and Other Collections	Total
Budget Subsidy Rates for FY 2016 Loan Guarantees:			
MMI/CMHI			
Single Family			
SF - Forward	2.27	(6.07)	(3.80)
SF - HECM	5.76	(6.45)	(0.69)
SF - Neg Equity Refi/ Short Refinance	10.02	(10.02)	-
GI/SRI			
Multifamily			
Apartments - NC/SC	2.42	(5.15)	(2.73)
Apartments - NC/SC 04/01/2016	1.91	(4.29)	(2.38)
Apartments Refinance	0.29	(4.96)	(4.67)
Apartments Refinance - 04/01/16	0.31	(3.92)	(3.61)
Healthcare			
FHA Full Insurance - Health Care	4.00	(7.43)	(3.43)
Hospitals	3.23	(6.45)	(3.22)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2017 LLR	FY 2017 LLG	RESTATED FY 2016 LLR	RESTATED FY 2016 LLG	
Beginning Balance of the Loan Guarantee Liability	$ -	$ (806)	$ 7	$ 15,276	
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:					
Default Costs (Net of Recoveries)	-	7,537	-	6,612	
Fees and Other Collections	-	(21,723)	-	(18,068)	
Other Subsidy Costs	-	2,359	-	1,791	
Total of the above subsidy expense components	**-**	**(11,827)**	**-**	**(9,665)**	
Adjustments:					
Fees Received	$ -	$ 14,567	$ -	$ 14,018	
Foreclosed Property and Loans Acquired	-	8,743	-	11,148	
Claim Payments to Lenders	-	(21,185)	-	(22,423)	
Interest Accumulation on the Liability Balance	-	274	-	(189)	
Other	-	47	-	814	
Ending Balance before Reestimates	**$ -**	**$ (10,187)**	**$ 7**	**$ 8,979**	
Add or Subtract Subsidy Reestimates by Component:					
Technical/Default Reestimate					
Subsidy Expense Component	$ 7	$ 3,400	$ (7)	$ (5,062)	Restated
Interest Expense Component		1,579		1,549	Restated
Adjustment of prior years' credit subsidy reestimates	-	25,817	-	(6,272)	
Total Technical/Default Reestimate	7	30,796	(7)	(9,785)	
Ending Balance of the Loan Guarantee Liability	**$ 7**	**$ 20,609**	**$ -**	**$ (806)**	

Administrative Expense:

(Dollars in Millions)	FY 2017	FY 2016
MMI/CMHI	534	586
GI/SRI	-	-
H4H	-	
Total	534	586

Other Information on Foreclosed Property:

Additional information on FHA foreclosed property as of September 30, 2017 and 2016 is as follows:

	FY 2017	FY 2016
Average number of days in inventory for Sold Cases	146	134
End of Fiscal Year active inventory	11,205	23,176

The above chart references the average holding period for FHA foreclosed property, and the total number of foreclosed properties on-hand as September 30, 2017. Foreclosed properties are primarily Single Family properties.

Defaulted Guaranteed Loans (Pre-92 and Post-91)

Restrictions on the use/disposal of foreclosed property:

The balance relating to foreclosures as of September 30, 2017 is comprised of only Single Family properties. There are no Multifamily properties currently in inventory.

The Secretary has the authority under the National Housing Act (12 U.S.C 1710 (g)) to manage or dispose of eligible HUD-owned property assets in a manner that will provide affordable, safe and sanitary housing to low-wealth families, preserve and revitalize residential neighborhoods, expand homeownership opportunities, minimize displacement of tenants residing in rental or cooperative housing, and protect the financial interest of the Federal government.

Single Family properties may be sold to eligible entities (24 CFR 291.303) through public asset sales. Eligibility of bidders will be determined by the Secretary and included in the bid package with a notice filed in the Federal Register. In addition, HUD must ensure that its policies and practices in conducting the single family property disposition program do not discriminate on the basis of disability (24 CFR 9.155(a)).

Credit Reform Valuation Methodology

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

To apply the present value computations, FHA divides loans into cohorts and "risk" categories. Multifamily and Health Care 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 into product groupings, which are referred to as risk categories in federal budget accounting. Each risk category has characteristics that distinguish it from others, including loan performance patterns, 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. That second category is for HECM loans, which joined the MMI Fund group of programs in 2009. The single family GI/SRI loans are grouped into four risk categories. There are 15 different multifamily risk categories and three health care categories.

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

Significant Assumptions – FHA developed economic and financial models in order to estimate the present value of future program cash flows. The models incorporate information on the expected magnitude and timing of each cash flow. 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 the start of that year.
- Claim Amount: The estimated amount of the claim payment relative to the unpaid principal balance at the time the claim occurs.
- Recovery Rates: The estimated percentage of a claim payment or defaulted loan balance that is recovered through disposition of a mortgage note or underlying property.

In FY 2017, FHA implemented a change in its discounting methodology used to estimate the net present value of the Single Family and HECM cash flows. This change in estimate was due to FHA's analysis of the timing of cash flows that supported using the Middle of the Year (MOY) discount factor with the single effective rate. Previously, FHA used End of Year (EOY) discounting to estimate the net present value of Single Family and HECM cash flows.

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 internal business systems.

Economic assumptions: Independent forecasts of economic conditions are used in conjunction with loan-level data to generate Single Family, Multifamily, and Health Care claim and prepayment rates. OMB provides the central economic assumptions used, such as interest rates, house price appreciation and the discount rates used against the cash flows. Other sources are used to distribute the central assumptions geographically.

Reliance on historical performance: FHA relies on the historical performance of its insured portfolio to generate behavioral response functions that are applied to economic forecasts to generate future performance patterns for the outstanding portfolio. Changes in legislation, program requirements, tax treatment, and economic factors all influence loan performance. FHA assumes that its portfolio will continue to perform consistently with its historical experience, respecting differences due to current loan characteristics and forecasted economic conditions.

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

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

Analysis of Change in the Liability for Loan Guarantees

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

Described below are the programs that comprise the majority of FHA’s loan guarantee business. These descriptions highlight the factors that contributed to changing LLG estimates for FY 2017. Overall, FHA’s liability increased from the fiscal year 2016 estimates.

Mutual Mortgage Insurance (MMI) – On net, the MMI Fund LLG increased to $13,053 million at the end of fiscal year 2017. The increase in liability can be attributed to HECM loans. The major factor affecting the HECM LLG estimate is house price appreciation through its impacts on claim and recovery rates.

***MMI Single Family Forward (SFF)*:** In FY2016, the SFF LLG was modeled first by using actuarial models to estimate the conditional claim and prepayment rates for each loan. The models use a spread of historical data to generate claim and prepayment probabilities based on various borrower and loan-specific factors. A Monte Carlo simulation framework was used to generate the stochastic loan performance output; 100 equally likely paths were constructed, each resulting in a single estimate of the expected claim and prepayment likelihood. The average of these 100 paths for claim and prepayment were used when calculating LLG in the Cash Flow Model (CFM). The CFM discounts all cohort years using the latest Single Effective Rate (SER) specific to each cohort; in accordance with Federal Credit Reform Modeling guidelines. Compared with the FY16 LLG, the FY17 LLG estimate uses a single path (President’s Economic Assumption released in March 2017) to compute the expected net present value of the future cash flows. In addition, the FY17 LLG includes Single Family Loan Sale (SFLS) as one of the exit options when claims occur, while in the FY16, SFLS was not considered in the LLG calculations.

***MMI Home Equity Conversion Mortgage (HECM)*:** Like the SFF program, in FY2016, the HECM LLG was modeled first by using actuarial models to estimate the "termination" probability for each loan. A HECM termination event was grouped into three (3) categories; borrower death, borrower move out of subject property or borrower refinance of subject property. A Monte Carlo simulation framework was used to generate the stochastic loan performance output; 100 equally likely paths were constructed, each resulting in a single estimate of the expected termination rate for each HECM loan. The average of these 100 paths for termination rates was used when calculating LLG in the Cash Flow Model (CFM). The CFM discounts all cohort years using the latest Single Effective Rate (SER) specific to each cohort; in accordance with Federal Credit Reform Modeling guidelines. Compared with the FY16 LLG, the FY17 LLG estimate uses a single path (President's Economic Assumption released in March 2017) to compute the expected net present value of the future cash flows.

GI/SRI (HECM) - HECM endorsements from fiscal years 1990-2008 remain in the GI/SRI Fund. Estimation of the GI/SRI HECM LLG is consistent with that of the MMI HECM LLG estimation. The liability for these loans increased to $11,671 million at the end of FY 2017. This liability is driven more by long term house price appreciation forecasts than short term forecasts. The majority of the remaining GI/SRI HECM loans have adjustable interest rates which impacts the LLG through its influence on unpaid balances, claim and recovery rates.

GI/SRI Section 223(f) - Section 223(f) of the National Housing Act permits FHA mortgage insurance for the refinance or acquisition of existing multifamily rental properties consisting of five or more units. Under this program, FHA may insure up to 85 percent of the lesser of the project's appraised value or its replacement cost. Projects insured under the program must be at least three years old. The Section 223(f) program is the largest multifamily program in the GI/SRI fund with an insurance-in-force of $35.1 billion. The Section 223(f) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(f) liability decreased this year by $489 million, from ($1,075) million to ($1,563) million, due to lower claim expectations as well as increased insurance-in-force.

GI/SRI Section 223(a)(7) - Section 223(a)(7) gives FHA authority to refinance FHA-insured loans. Under this program, the refinanced principal amount of the mortgage may be the lesser of the original amount of the existing mortgage or the remaining unpaid principal balance of the loan. Loans insured under any sections of the National Housing Act may be refinanced under 223(a)(7), including those already under 223(a)(7). The Section 223(a)(7) program has an insurance-in-force of $19.9 billion. The Section 223(a)(7) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(a)(7) liability decreased this year by $26.2 million, from ($604) million to ($630) million.

GI/SRI Section 221(d)(4) - Section 221(d)(4) of the National Housing Act authorizes FHA mortgage insurance for the construction or substantial rehabilitation of multifamily rental properties with five or more units. Under this program, FHA may insure up to 90 percent of the total project cost. This is the third largest multifamily program in the GI/SRI fund with an insurance-in-force of $16.9 billion. The Section 221(d)(4) liability decreased by $222.5 million this year, from ($110.5) million to ($333) million.

GI/SRI Section 232 Health Care New Construction - The Section 232 NC program provides mortgage insurance for construction or substantial rehabilitation of nursing homes and assisted-living facilities. FHA insures a maximum of 90 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 NC program has an insurance-in-force of $3.1 billion. The Section 232 NC liability decreased by $14.8 million this year, from ($83) million to ($98) million due to lowered claim expectations.

GI/SRI Section 232 Health Care Purchasing or Refinancing - The Section 232 Refinance program provides mortgage insurance for two purposes: purchasing or refinancing of projects that do not need substantial rehabilitation, and installation of fire safety equipment for either private, for-profit businesses or non-profit associations. For existing projects, FHA insures a maximum of 85 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 Refinance program has an insurance-in-force of $25 billion. The Section 232 Refinance liability decreased by $64.6 million this year, from ($743.1) million to ($807.7) million due to an increase in insurance-in-force and a decrease in claim expectations.

GI/SRI Section 242 Hospitals - The Section 242 Hospitals program provides mortgage insurance for the construction, substantial rehabilitation, or refinance of hospitals and/or the purchase of major hospital equipment to either private, for-profit businesses or non-profit associations. FHA insures a maximum of 90 percent of the estimated replacement cost of the hospital, including the installed equipment. The Section 242 program has an insurance-in-force of $7.3 billion. The Section 242 liability decreased by $27 million this year from ($179) million to ($206) million due to higher premium revenue caused by decreased prepayment expectations as well as lower claims expected.

Risks to LLG Calculations

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

The uncertainty built into Monte Carlo forecasts is only for economic risk, and not for model risk. All LLG values are fundamentally dependent upon forecasts of insured-loan performance. Those forecasts are developed through models that apply statistical, economic, financial, or mathematical theories, techniques, and assumptions to create behavioral-response functions from historical data. All such models involve risk that actual behavior of borrowers and lenders in the future will differ from the historical patterns embedded in the forecasting models. Model risk also emanates from the possibility that the computer code used to create the forecasts has errors or omissions which compromise the integrity and reliability of projections.

Each year, HUD works with its contractors to evaluate the forecasting models for reasonableness of results on a number of dimensions. Model risk is also addressed through a continuous cycle of improvement, whereby lessons learned from the previous round of annual portfolio valuations—in the independent actuarial studies, LLG valuations, and President's Budget—are used as a basis for new research and model development in the current year.

For Multifamily programs, LLG risk comes from claims, recoveries and premiums. Claims and recoveries are dependent on continued rental-income trends and rental-price growth. Premiums are driven by FHA policy and industry demand for FHA products. Generally, risk comes from market, economic, and demographic influences such as changes in local employment conditions, the supply of rental housing in each market where FHA has a presence, population growth, and household formation. FHA's policy of insuring loans pre-construction in its 221(d)(4) program subject LLG calculations to risk from their capability to operate post-construction.

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

For the SFF mortgage programs, LLG risk comes from claims, recoveries and premiums. Claims and recoveries are largely dependent on house price appreciation and local market conditions such as demand to supply ratio, the proportion of foreclosure properties. Premiums are driven by FHA policy, industry demand for FHA products and interest rate outlook which determines the incentive of refinances. Generally, risk comes from portfolio characteristics, market and prevailing economic conditions.

For both HECM programs (GI/SRI and MMI cohorts), LLG risk comes from claims, recoveries and premiums. Claims and recoveries are largely dependent on house price appreciation and borrower behavior such as home maintenance and ability to meet property tax and insurance obligations. Premiums are driven by FHA policy and interest rates which determine the growth of HECM unpaid principal balances (UPB). Generally, risk comes from portfolio characteristics, market and prevailing economic conditions.

Pre-Credit Reform Valuation Methodology

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

MMI Single Family LLR - For the single-family portfolio, the aggregate liability for the remaining pre-credit reform loans in FY 2017 is $9.0 million.

GI/SRI Multifamily & Healthcare LLR - For the multifamily and healthcare portfolio, the remaining insurance-in-force for pre-credit reform loans is $197.6 million. The aggregate liability for the remaining pre-credit reform loans in FY 2017 is ($847) thousand, which is a $153 thousand increase from the ($1) million estimate in FY 2016. The year-over-year increase in aggregate liability is due to a $55 million decline in insurance-in-force as both measures move closer to zero.

Note 8. Accounts Payable

Accounts Payable as of September 30, 2017 and 2016 are as follows:

(Dollars in millions)

	FY 2017	FY 2016
Intragovernmental:		
Claims Payable to Ginnie Mae	$ 1	$ 7
Miscellaneous Payables to HUD	1	-
Total	**$ 2**	**$ 7**

	FY 2017	FY 2016
With the Public:		
Claims Payable	$ 284	$ 311
Premium Refunds Payable	124	141
Single Family Property Disposition Payable	28	21
Miscellaneous Payables	78	22
Total	**$ 514**	**$ 495**

Claims Payables

Claims payables represent 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 Payables

Premium refund payables are refunds of previously collected Single Family premiums that will be returned to the borrowers resulting from prepayment of the insured mortgages.

Single Family Property Disposition Payables

Single family property disposition payables includes management and marketing contracts and other property disposition expenses related to foreclosed property.

Miscellaneous Payables

Miscellaneous payables include interest enhancement payables, interest penalty payables for late payment of claims, generic debt payables and other payables related to various operating areas within FHA.

Note 9. Debt

The following tables describe the composition of Debt held by FHA as of September 30, 2016 and 2017:

(Dollars in millions)

	FY 2016			FY 2017		
	Beginning Balance	Net Borrowings	Ending Balance	Beginning Balance	Net Borrowings	Ending Balance
Other Debt:						
Borrowings from FFB	102	452	554	554	633	1,187
Borrowings from U.S. Treasury	26,921	3,398	30,319	30,319	(2,364)	27,954
Total	**$ 27,023**	**$ 3,850**	**$ 30,873**	**$ 30,873**	**$ (1,731)**	**$ 29,141**

	FY 2016	FY 2017
Classification of Debt:		
Intragovernmental Debt	$ 30,873	$ 29,141
Debt Held by the Public	-	$ -
Total	**$ 30,873**	**$ 29,141**

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 re-estimates 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 2017, FHA's U.S. Treasury borrowings carried interest rates ranging from 1.67 percent to 7.36 percent. The maturity dates for these borrowings occur from September 2018 – September 2030. Loans may be repaid in whole or in part without penalty at any time prior to maturity.

Borrowings from Federal Financing Bank:

Starting in FY 2015, FHA began a Federal Financing Bank (FFB) Risk Share program, an inter-agency partnership between HUD, FFB and the Housing Finance Authorities (HFAs). The FFB Risk Share program provides funding for multifamily mortgage loans insured by FHA. Under this program, FHA borrows from the FFB to disburse direct loans.

Note 10. Other Liabilities

The following table describes the composition of Other Liabilities as of September 30, 2017 and 2016:

(Dollars in millions)

FY 2017		Current
Intragovernmental:		
Receipt Account Liability	$	1,673
Total	**$**	**1,673**
With the Public:		
Trust and Deposit Liabilities	$	46
Multifamily Notes Unearned Revenue		250
Premiums collected on unendorsed cases		243
Miscellaneous Liabilities		97
Total	**$**	**636**

FY 2016		Current
Intragovernmental:		
Receipt Account Liability	$	2,765
Total	**$**	**2,765**
With the Public:		
Trust and Deposit Liabilities	$	64
Multifamily Notes Unearned Revenue		247
Premiums collected on unendorsed cases		345
Miscellaneous Liabilities		198
Total	**$**	**854**

Receipt Account Payable Liability

The receipt account payable liability is created from downward credit subsidy re-estimates in the GI/SRI 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 maintenance expenses on behalf of the borrowers. The earnest money becomes part of the sale proceeds or is returned to any unsuccessful bidders.

Multifamily Notes Unearned Revenue

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

Premiums Collected on Unendorsed Cases

Premiums collected on unendorsed cases are mortgage insurance premium amounts collected by FHA for cases that have yet to be endorsed.

Miscellaneous Liabilities

Miscellaneous liabilities mainly include disbursements in transit (cash disbursements pending Treasury confirmation), unearned premium revenue, and any loss contingencies that are recognized by FHA for past events that warrant a probable, or likely, future outflow of measurable economic resources.

Note 11. Commitments and Contingencies

Litigation

FHA is party in various legal actions and claims brought by or against it. In the opinion of management and general counsel, the ultimate resolution of these legal actions will not have an effect on FHA's consolidated financial statements as of September 30, 2017.

Activity with Ginnie Mae

As of September 30, 2017, the Government National Mortgage Association ("Ginnie Mae") held defaulted FHA-insured mortgage loans. These loans, acquired from defaulted mortgage-backed securities issuers, had the following balances:

	FY 2017 (in Millions)	FY 2016 (in Millions)
Mortgages Held for Investment & Foreclosed Property (Pre-claim)	3,137	3,950
Short Sale Claims Receivable	47	94

"Ginnie Mae" may submit requests for claim payments to FHA for some or all of these loans. Subject to all existing claim verification controls, FHA would pay such claims to Ginnie Mae, another component of HUD, upon conveyance of the foreclosed property to FHA. Any liability for such claims, and offsetting recoveries, has been reflected in the Liability for Loan Guarantees on the accompanying financial statements based on the default status of the insured loans.

Impact of Hurricanes Harvey, Irma and Maria

As the result of damages incurred by hurricanes Harvey, Irma and Maria, FHA expects claims and losses in those areas. While immediate department efforts have been focused on providing relief to displaced residents, HUD is continuing to assess what impact the storms will have on FHA's financial position.

The President declared major disaster declarations in the areas that were directly affected by the hurricanes. In response, the Federal Emergency Management Agency (FEMA) is operating an Individual Assistance Program to assist residents with accessing available housing and addressing other immediate needs while recovering from the devastation.

HUD has implemented several policies and programs to assist lenders, property owners and residents. Homeowners in FHA-insured loans are eligible for a variety of relief measures including FHA Section 203(h) loans for disaster victims. For the Single Family portfolio, HUD Handbook 4000.1, Section III.A.3.c.ii authorizes an initial moratorium on foreclosures of properties within a Presidentially-Declared Major Disaster Area (PDMDA) for a ninety (90) day period from the date of each PDMDA declaration. The initial moratorium applies to the initiation of foreclosures and foreclosures already in process. HUD Mortgagee Letter 2017-15 extends the initial 90-day foreclosure moratorium for FHA-insured homeowners for an additional 90 days due to the extensive damage and continuing needs in hard-hit areas. In addition, HUD recently announced an additional 19 regulatory and administrative waivers to further assist communities accelerate recovery efforts.

At this time, the expected loss from the damage caused by hurricanes Harvey, Irma and Maria cannot be reasonably estimated. FHA has identified approximately 923,982, Single Family Forward and Home Equity Conversion

Mortgage (HECM) properties within the affected areas that account for 10.7 percent of FHA's total active Single Family insured portfolios. The largest concentration of potentially affected properties is 551,283 in Florida, with the remaining 257,952 and 124,747 in Texas and Puerto Rico, respectively.

As HUD assesses the status of each project and case with lenders, additional guidance may be issued and legislative relief may be sought, if necessary, to mitigate the claims and losses against the insurance funds.

Note 12. Gross Costs

Gross costs incurred by FHA for the period ended September 30, 2017 and 2016 are as follows:

(Dollars in millions)

FY 2017	Single Family Forward	HECM	Multifamily	Healthcare	Administrative Expenses	Total
Intragovernmental:						
Interest Expense	$ 765	$ 235	$ 114	$ 40	$ -	$ 1,154
Imputed Cost	-	-	-	-	13	13
Other Expenses	-	-	-	-	15	15
Total	**$ 765**	**$ 235**	**$ 114**	**$ 40**	**$ 28**	**$ 1,182**
With the Public:						
Salary and Administrative Expense	$ -	$ -	$ -	$ -	$ 520	$ 520
Subsidy Expense	(11,093)	(58)	(547)	(201)	-	(11,899)
Re-estimate Expense	9,358	16,286	(686)	(91)	-	24,867
Interest Expense	997	5,112	(117)	(7)	-	5,985
Interest Accumulation Expense	(213)	569	(62)	(23)	-	271
Bad Debt Expense	5	(2)	(136)	-	-	(133)
Loan Loss Reserve	8	-	-	-	-	8
Other Expenses	19	1	36	-	3	59
Total	**$ (919)**	**$ 21,908**	**$ (1,512)**	**$ (322)**	**$ 523**	**$ 19,678**
Total Gross Costs	**$ (154)**	**$ 22,143**	**$ (1,398)**	**$ (282)**	**$ 551**	**$ 20,860**

FY 2016 RESTATED	Single Family Forward	HECM	Multifamily	Healthcare	Administrative Expenses	Total	
Intragovernmental:							
Interest Expense	$ 791	$ 234	$ 115	$ 81	$ -	1,221	
Imputed Cost	-	-	-	-	15	15	
Other Expenses	-	-	(4)	4	2	2	
Total	**$ 791**	**$ 234**	**$ 111**	**$ 85**	**$ 17**	**$ 1,238**	
With the Public:							
Salary and Administrative Expense	$ -	$ -	$ -	$ -	$ 584	$ 584	
Subsidy Expense	(9,083)	(102)	(400)	(131)	-	(9,716)	
Re-estimate Expense	(7,970)	(300)	49	(10)	-	(8,231)	Restated
Interest Expense	(1,474)	(60)	7	41	-	(1,486)	Restated
Interest Accumulation Expense	(254)	157	(74)	(28)	-	(199)	
Bad Debt Expense	(3)	-	8	-	-	5	
Loan Loss Reserve	(6)	-	-	(1)	-	(7)	
Other Expenses	26	-	21	-	7	54	
Total	**$ (18,764)**	**$ (305)**	**$ (389)**	**$ (129)**	**$ 591**	**$ (18,996)**	
Total Gross Costs	**$ (17,973)**	**$ (71)**	**$ (278)**	**$ (44)**	**$ 608**	**$ (17,758)**	

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 re-estimates.

Interest Accumulation Expense

Interest accumulation expense is calculated as the difference between interest revenue and interest expense. For guaranteed loans, the liability for loan guarantees is adjusted with the offset to interest accumulation expense.

Imputed Costs/Imputed Financing

Imputed costs represent FHA's share of the departmental imputed cost calculated and allocated to FHA by the HUD CFO office. Federal agencies are required to report imputed costs under SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts to account for costs assumed by other Federal organizations on their behalf*. The HUD CFO receives its imputed cost data from the Office of Personnel Management (OPM) for pension costs, federal employee health benefits (FEHB) and life insurance costs. It also receives Federal Employees' Compensation Act (FECA) costs from the Department of Labor (DOL). Subsequently, using its internally developed allocation basis, HUD CFO allocates the imputed cost data to each of its reporting offices. The imputed costs reported by FHA in its Statements of Net Cost are equal to the amounts of imputed financing in its Statements of Changes in Net Position.

Salary and Administrative Expenses

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

Re-estimate Expense

Re-estimate expense captures the cost associated with revisions to the liability for loan guarantee. A re-estimate is calculated annually.

Subsidy Expense

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

Bad Debt Expense

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

Loan Loss Reserve Expense

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

Other Expenses

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

Note 13. Earned Revenue

Earned revenues generated by FHA for the period ended September 30, 2017 and 2016 are as follows:

(Dollars in millions)

FY 2017	Single Family Forward	HECM	Multifamily	Healthcare	Total
Intragovernmental:					
Interest Revenue from Deposits at U.S. Treasury	$ 552	$ 804	$ 23	$ 16	$ 1,395
Interest Revenue from MMI/CMHI Investments	253	26	-	-	279
Total Intragovernmental	**$ 805**	**$ 830**	**$ 23**	**$ 16**	**$ 1,674**
With the Public:					
Insurance Premium Revenue	$ -	$ -	$ 1	$ -	$ 1
Income from Notes and Properties	9	-	43	1	53
Other Revenue	1	-	23	-	24
Total With the Public	**$ 10**	**$ -**	**$ 67**	**$ 1**	**$ 78**
Total Earned Revenue	**$ 815**	**$ 830**	**$ 90**	**$ 17**	**$ 1,752**

FY 2016	Single Family Forward	HECM	Multifamily	Healthcare	Total
Intragovernmental:					
Interest Revenue from Deposits at U.S. Treasury	$ 537	$ 391	$ 32	$ 53	$ 1,013
Interest Revenue from MMI/CMHI Investments	125	12	-	-	137
Total Intragovernmental	**$ 662**	**$ 403**	**$ 32**	**$ 53**	**$ 1,150**
With the Public:					
Insurance Premium Revenue	$ 1	$ -	$ 1	$ -	$ 2
Income from Notes and Properties	11	-	42	1	54
Other Revenue	2	1	9	-	12
Total With the Public	**$ 14**	**$ 1**	**$ 52**	**$ 1**	**$ 68**
Total Earned Revenue	**$ 676**	**$ 404**	**$ 84**	**$ 54**	**$ 1,218**

Interest Revenue

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

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. Premiums for post-1991 guarantee loans are included in the balance of the LLG. The FHA premium structure includes both up-front premiums and annual periodic premiums.

Up-front Premiums

The up-front premium rates vary according to the mortgage type and the year of origination. The FHA up-front premium rates in fiscal year 2017 were:

Upfront Premium Rates	
10/01/2016 - 9/30/2017	
Single Family	1.75%
Multifamily	0.25%, 0.50%, 0.65%, 0.80% or 1.00%
HECM Standard	2.50% (Based on Maximum Claim Amount)
HECM Saver	0.50% (Based on Maximum Claim Amount)

Annual Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums. These rates also vary by mortgage type and program. The FHA annual periodic premium rates in fiscal year 2017 were:

Annual Periodic Premium Rates	
Single Family	
10/01/2016 -1/25/2017	0.80%, 0.85%, 1.00% or 1.05%
01/26/17 to present	1.30%,1.35%, 1.50% or 1.55%
Multifamily	0.45%, 0.57%, 0.65% or 0.70%
HECM (Standard and Saver)	1.25%

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

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 In and Other Financing Sources

Transfers In and Other Financing Sources incurred by FHA for the periods ended September 30, 2017 and 2016 are as follows:

(Dollars in millions)

FY 2017	Cumulative Results of Operations	Unexpended Appropriations	Total
Transfers In:			
HUD	$ 426	$ -	$ 426
Non Exchange Revenue			
HUD	$ 2	$ -	$ 2
Other Financing Sources:			
Treasury	$ (412)	$ -	$ (412)

FY 2016	Cumulative Results of Operations	Unexpended Appropriations	Total
Transfers In:			
HUD	$ 480	$ -	$ 480
Non Exchange Revenue			
HUD	$ -	$ -	$ -
Other Financing Sources:			
Treasury	$ (2,063)	$ -	$ (2,063)

Transfers In from HUD

FHA does not receive an appropriation for salaries and expense; instead the FHA amounts are appropriated directly to HUD. To recognize these costs in FHA's Statement of Net Cost, a Transfer In from HUD is recorded based on amounts computed by HUD.

Non Exchange Revenue

Non Exchange revenue consist of late fees incurred on Multifamily and Single Family premiums. Non-Exchange Revenue was not reported in FY 2016.

Other Financing Sources

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

Note 16. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2017 and 2016 are as follows:

(Dollars in millions)

FY 2017	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 2	$ -	$ -	$ -	$ -	$ 2
Contract Expenses	$ 233	$ 130	$ -	$ (108)	$ -	255
Reestimates	$ -	$ 4,318	$ -	$ (4,318)	$ -	-
GI/SRI Liquidating	$ 180	$ 25	$ -	$ (3)	$ -	202
Total	**$ 415**	**$ 4,473**	**$ -**	**$ (4,429)**	**$ -**	**$ 459**

FY 2016	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 454	$ -	$ (452)	$ -	$ -	$ 2
Contract Expenses	260	130	(48)	(109)	-	233
Reestimates	-	3,282	-	(3,282)	-	-
GI/SRI Liquidating	157	25	-	(2)	-	180
Total	**$ 871**	**$ 3,437**	**$ (500)**	**$ (3,393)**	**$ -**	**$ 415**

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

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

Note 17. Budgetary Resources

The SF-133 and the Statement of Budgetary Resources for fiscal year 2016 have been reconciled to the fiscal year 2016 actual amounts included in the Program and Financing Schedules presented in the fiscal year 2018 Budget of the United States Government. In FY 2016, FHA recorded $234 million in borrowing authority in the President's Budget that was not included in the Statement of Budgetary Resources. The resources were recorded as an adjustment to the beginning balance in FY 2017 SBR. Information from the fiscal year 2017 Statement of Budgetary Resources will be presented in the fiscal year 2019 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2018 and will be available from the Government Printing Office and online at that time.

Obligated balances as of September 30, 2017 and 2016 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders	**FY 2017**	**FY 2016**
MMI/CMHI	$ 1,895	$ 1,598
GI/SRI	912	597
H4H	1	1
Undelivered Orders Subtotal	**$ 2,808**	**$ 2,196**
Accounts Payable		
MMI/CMHI	$ 752	$ 670
GI/SRI	195	130
Accounts Payable Subtotal	**$ 947**	**$ 800**
Total	**$ 3,755**	**$ 2,996**

Note 18. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2017 and 2016:

(Dollars in Millions)

FY 2017	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 13,431	$ 866	$ 1	$ 14,298
Notes	1,269	806	-	2,075
Property	3,385	196	-	3,581
Interest Earned from U.S. Treasury	1,193	471	-	1,664
Subsidy	11,151	-	-	11,151
Reestimates	20,369	4,720	-	25,089
Collections from settlements	150	-	-	150
Other	104	(368)	-	(264)
Total	**$ 51,052**	**$ 6,691**	**$ 1**	**$ 57,744**

FY 2016	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 13,201	$ 853	$ 1	$ 14,055
Notes	1,584	574	1	2,159
Property	4,134	232	1	4,367
Interest Earned from U.S. Treasury	730	390	-	1,120
Subsidy	9,185	-	-	9,185
Reestimates	18,969	3,282	-	22,251
Collections from settlements	679	-	-	679
Other	185	16	1	202
Total	**$ 48,667**	**$ 5,347**	**$ 4**	**$ 54,018**

Note 19. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2017 and 2016:

(Dollars in Millions)

September 30, 2017	MMI/CMHI	GI/SRI	H4H	Total
Obligations				
Claims	$ 15,694	$ 2,676	$ 1	$ 18,371
Property Expenses	613	49	-	662
Interest on Borrowings	904	230	-	1,134
Subsidy	11,152	800	-	11,952
Downward Reestimates	1,672	402	-	2,074
Upward Reestimates	18,691	4,318	-	23,009
Administrative Contracts	133	-	-	133
FFB Direct Loans	-	951	-	951
Other	9	(103)	-	(94)
Total	**$ 48,868**	**$ 9,323**	**$ 1**	**$ 58,192**

September 30, 2016	MMI/CMHI	GI/SRI	H4H	Total
Obligations				
Claims	$ 18,567	$ 2,981	$ 2	$ 21,550
Property Expenses	605	44	-	649
Interest on Borrowings	931	278	-	1,209
Subsidy	9,184	569	-	9,753
Downward Reestimates	15,461	1,463	-	16,924
Upward Reestimates	3,508	3,282	-	6,790
Administrative Contracts	121	-	-	121
FFB Direct Loans	-	688	-	688
Other	98	105	-	203
Total	**$ 48,475**	**$ 9,410**	**$ 2**	**$ 57,887**

Note 20. Reconciliation of Net Cost of Operations to Budget

This note (formerly the Statement of Financing) links the proprietary data to the budgetary data. Most transactions are recorded in both proprietary and budgetary accounts. However, because different accounting bases are used for budgetary and proprietary accounting, some transactions may appear in only one set of accounts. The Reconciliation of Net Cost of Operations to Budget is as follows for the period ended September 30, 2017 and 2016:

(Dollars in Millions)	**FY 2017**	**FY 2016**
Resources Used to Finance Activities:		
Obligations Incurred	**58,192**	**57,890**
Less: Spending Authority from Offsetting Collections	(57,850)	(54,742)
Obligations Net of Offsetting Collections and Recoveries	**342**	**3,148**
Less: Distributed Offsetting Receipts	(1,078)	(2,000)
Net Obligations	(736)	1,148
Other Resources:		
Transfers In/Out Without Reimbursement	**426**	**481**
Imputed Financing Sources	13	15
Other	(412)	(2,063)
Net Other Resources Used to Finance Activities	26	(1,567)
Total Resources Used to Finance Activities	(710)	(419)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided	(611)	(150)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	**58,835**	**56,036**
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(53,062)	(50,134)
Appropriations for prior Year Re-estimate	**(4,318)**	**(6,829)**
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	413	1,567
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	1,256	490
Total Resources Used to Finance the Net Cost of Operations	**546**	**71**
	-	
Components of the Net Cost of Operations that will Not Require or Generate Resources in the Current Period:	-	
Upward Reestimate of Credit Subsidy Expense	23,214	5,561
Downward Reestimate of Credit Subsidy Expense	7,662	(15,297)
Reduction of Credit Subsidy Expense	**(11,857)**	**(9,716)**
Changes in Loan Loss Reserve Expense	9	(7)
Changes in Bad Debt Expenses	**(133)**	**5**
Gains or Losses on Sales of Credit Program Assets	40	25
Other	(375)	382
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**18,561**	**(19,047)**
Net Cost of Operations	19,107	(18,976)
Net Cost of Operations from SNC	**19,107**	**(18,976)**

Note 21. Restatement of FHA's Fiscal Year 2016 Financial Statement Notes

In FY 2017, discrepancies were noted in the presentation of FHA's FY 2016 Note 7 Direct Loans and Loan Guarantees and Note 12 Gross Costs that required correction of balances reported in the FY 2017 comparative financial statements. Corrections were made in Note 7 to HECM current year endorsements, cumulative Current Outstanding Balance and Maximum Potential Liability and the Single Family Forward Guaranteed Loans Outstanding and New Guaranteed Loans Disbursed. For Note 12, updates were made to Gross Cost with the Public to adjust the allocation of Re-estimate and Interest expenses.

The HECM Current Year Endorsements amount of $14,612 million reported in FY 2016 did not include 153 active cases due to the 2016 cohort year field not being populated on the HECM Cohort Summary Report that caused the reported endorsement amount to be understated by $48 million. The associated HECM cumulative Current Outstanding Balance and Maximum Potential Liability, were also understated by $20 million and $47 million, respectively. The cases associated with the missing cohorts have been corrected to include the proper cohort for future reporting.

The source report for the cumulative Single Family Forward Guaranteed Loans Outstanding and New Guaranteed Loans Disbursed is run monthly from the Single Family Housing Enterprise Data Warehouse (SFHEDW) to obtain the cumulative and year-to-date balances of Outstanding Principal of Guaranteed Loans (face value) and the Amount of Outstanding Principal Guaranteed as of the end of the period. The report for FY 2016 as of September 30th was inadvertently run prior to the SFHEDW being updated with the activity for the month of September so the amounts reported for FY 2016 only captured the cumulative and fiscal year to date balances through August. This caused the cumulative amounts reported for both Single Family Forward Outstanding Principal of Guaranteed Loans and the Amount of Outstanding Principal Guaranteed for the Mutual Mortgage Insurance (MMI) Fund to each be understated by $3 billion and for the General Insurance/Special Risk Insurance to be overstated by $108 million and $93 million, respectively. The Outstanding Principal of Guaranteed Loans and the Amount of Outstanding Principal for FY 2016 New Guaranteed Loans Disbursed were also understated by $24 billion and $23 billion, respectively. The $23 billion understatement for the Amount of Outstanding Principal is based on the ratio of FY 2017 Amount of Outstanding Principal to Outstanding Principal of Guaranteed Loans to provide a reasonable estimate in the absence of report actual. An alternate report from the SF insurance system will be used to report these balances going forward.

The discount factor used to calculate the FY 2016 financial statement re-estimate for Single Family Forward loans was inconsistent with the discount factor used for other programs. The discount factor for SF Forward loans used an end of year (EOY) vice middle of year (MOY) discount factor causing the subsidy expense component to be understated by $110 million and the interest expense component to be overstated by the same amount in the Schedule for Reconciling Loan Guarantee Liability Balances. Since both the subsidy and interest expenses are reported as gross costs, these amounts were also understated and overstated respectively, in Note 12 costs reporting. The discount factor for SF Forward loans was updated to MOY which will be used for future re-estimate calculations to be consistent with all other programs.

Due to the imminent publishing of the FY 2017 audited financial statements, the FY 2016 notes restatements will be presented comparatively.

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intra-governmental assets, by Federal entity, are as follows on September 30, 2017 and 2016:

(Dollars in Millions)

FY 2017	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	$ 29,112	$ 30,841	$ -	$ -	$ 59,953
Total	**$ 29,112**	**$ 30,841**	**$ -**	**$ -**	**$ 59,953**

FY 2016	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	$ 20,820	$ 36,397	$ -	$ -	$ 57,217
Total	**$ 20,820**	**$ 36,397**	**$ -**	**$ -**	**$ 57,217**

Schedule B: Intragovernmental Liabilities

FHA's Intra-governmental liabilities, by Federal entity, are as follows on September 30, 2017 and 2016:

(Dollars in Millions)

FY 2017	Accounts Payable	Borrowings	Other Liabilities	Total
Federal Financing Bank	$ -	$ 1,187	$ -	$ 1,187
U.S. Treasury	-	27,954	1,673	29,627
HUD	2	-	-	2
Total	**$ 2**	**$ 29,141**	**$ 1,673**	**$ 30,816**

FY 2016	Accounts Payable	Borrowings	Other Liabilities	Total
Federal Financing Bank	$ -	$ 555	$ -	$ 555
U.S. Treasury	$ -	$ 30,318	$ 2,765	$ 33,083
HUD	7	-	-	7
Total	**$ 7**	**$ 30,873**	**$ 2,765**	**$ 33,645**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2017:

Dollars in Millions	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 37,220	$ 80	$ -	$ 458	$ 37,758
Unobligated balance brought forward, October 1, as adjusted	37,220	80	-	458	37,758
Recoveries of prior year unpaid obligations	-	8	-	3	11
Other changes in unobligated balance (+ or -)	(18,698)	18,691	-	(418)	(425)
Unobligated balance from prior year budget authority, net	18,522	18,779	1	41	37,343
Appropriations (discretionary and mandatory)	-	130	4,318	25	4,473
Spending authority from offsetting collections (discretionary & mandatory)	13,112	-	-	177	13,289
Total budgetary resources	**$ 31,635**	**$ 18,909**	**$ 4,319**	**$ 242**	**$ 55,105**
Status of Budgetary Resources:					
Obligations incurred	-	18,824	4,318	75	23,217
Apportioned	-	46	1	22	69
Unapportioned	31,635	1	-	125	31,761
Unexpired unobligated balance, end of year	31,635	47	1	147	31,830
Expired unobligated balance, end of year	-	39	-	19	58
Total unobligated balance, end of year	31,635	47	1	205	31,888
Total budgetary resources	**$ 31,635**	**$ 18,909**	**$ 4,319**	**$ 242**	**$ 55,105**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	138	1	207	346
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(34)	-	-	(1)	(35)
Obligated balance, start of year (net), before adjustments (+ or -)	(34)	137	1	207	311
Adjustment to obligated balance, start of year (net) (+ or -)	-	-	-	-	-
Obligated balance, start of year (net), as adjusted	(34)	137	1	207	311
Obligations incurred	-	18,824	4,318	75	23,217
Outlays (gross) (-)	-	(18,797)	(4,318)	(45)	(23,160)
Change in uncollected customer payments from Federal sources (+ or -)	(14)	-	-	1	(13)
Recoveries of prior year unpaid obligations (-)	-	(8)	-	(3)	(11)
Unpaid obligations, end of year (gross)	-	156	1	236	393
Uncollected customer payments from Federal sources, end of year	(48)	-	-	-	(48)
Obligated balance, end of year (net)	**$ (48)**	**$ 156**	**$ 1**	**$ 236**	**$ 345**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	13,112	130	4,318	202	17,762
Actual offsetting collections (discretionary and mandatory) (-)	(13,099)	-	-	(176)	(13,275)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(14)	-	-	1	(13)
Budget authority, net (discretionary and mandatory)	-	130	4,318	25	4,473
Outlays, gross (discretionary and mandatory)	-	18,797	4,318	45	23,160
Actual offsetting collections (discretionary and mandatory) (-)	(13,099)	-	-	(176)	(13,275)
Outlays, net (discretionary and mandatory)	(13,099)	18,797	4,318	(131)	9,885
Distributed offsetting receipts (-)	-	-	-	(1,070)	(1,070)
Agency outlays, net (discretionary and mandatory)	**$ (13,099)**	**$ 18,797**	**$ 4,318**	**$ (1,201)**	**$ 8,815**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2016:

Dollars in Millions	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 15,963	$ 98	$ 6	$ 666	$ 16,733
Unobligated balance brought forward, October 1, as adjusted	15,963	98	6	666	16,733
Recoveries of prior year unpaid obligations	-	11	-	230	241
Other changes in unobligated balance (+ or -)	(3,514)	3,468	-	(635)	(681)
Unobligated balance from prior year budget authority, net	12,449	3,577	6	261	16,293
Appropriations (discretionary and mandatory)	-	130	3,276	25	3,431
Spending authority from offsetting collections (discretionary and mandatory)	24,771	1	-	238	25,010
Total budgetary resources	**$ 37,220**	**$ 3,708**	**$ 3,282**	**$ 524**	**$ 44,734**
Status of Budgetary Resources:					
Obligations incurred	-	3,629	3,282	65	6,976
Apportioned	-	58	-	12	70
Unapportioned	37,220	-	-	428	37,648
Unexpired unobligated balance, end of year	37,220	58	-	440	37,718
Expired unobligated balance, end of year	-	21	-	19	40
Total unobligated balance, end of year	37,220	79	-	459	37,758
Total budgetary resources	**$ 37,220**	**$ 3,708**	**$ 3,282**	**$ 524**	**$ 44,734**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	133	1	430	564
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(14)	-	-	(1)	(15)
Obligated balance, start of year (net), before adjustments (+ or -)	(14)	133	1	429	549
Obligated balance, start of year (net), as adjusted	(14)	133	1	429	549
Obligations incurred	-	3,629	3,282	65	6,976
Outlays (gross) (-)	-	(3,613)	(3,282)	(58)	(6,953)
Change in uncollected customer payments from Federal sources (+ or -)	(20)	-	-	-	(20)
Recoveries of prior year unpaid obligations (-)	-	(11)	-	(230)	(241)
Unpaid obligations, end of year (gross)	-	138	1	207	346
Uncollected customer payments from Federal sources, end of year	(34)	-	-	(1)	(35)
Obligated balance, end of year (net)	**$ (34)**	**$ 138**	**$ 1**	**$ 206**	**$ 311**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	24,771	131	3,276	263	28,441
Actual offsetting collections (discretionary and mandatory) (-)	(24,751)	-	-	(240)	(24,991)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(20)	-	-	-	(20)
Recoveries of prior year unpaid obligations (-)	-	-	-	1	1
Budget authority, net (discretionary and mandatory)	-	131	3,276	24	3,431
Outlays, gross (discretionary and mandatory)	-	3,613	3,282	58	6,953
Actual offsetting collections (discretionary and mandatory) (-)	(24,751)	-	-	(240)	(24,991)
Outlays, net (discretionary and mandatory)	(24,751)	3,613	3,282	(182)	(18,038)
Distributed offsetting receipts (-)	-	-	-	(2,000)	(2,000)
Agency outlays, net (discretionary and mandatory)	**$ (24,751)**	**$ 3,613**	**$ 3,282**	**$ (2,182)**	**$ (20,038)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September30, 2017:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 10,609	$ 6,012	$ (210)	$ 16,411
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	-	234	234
Unobligated balance brought forward, October 1, as adjusted	10,609	6,012	24	16,645
Recoveries of prior year unpaid obligations	65	15	2	82
Unobligated balance from prior year budget authority, net	10,674	6,027	26	16,727
Borrowing authority (discretionary and mandatory)	6,500	812	1,064	8,376
Spending authority from offsetting collections (discretionary and mandatory)	28,972	5,661	32	34,665
Total budgetary resources	**$ 46,146**	**$ 12,499**	**$ 1,123**	**$ 59,768**
Status of Budgetary Resources:				
Obligations incurred	30,019	3,887	1,069	34,975
Apportioned	3,568	2,664	40	6,272
Unapportioned	12,559	5,949	13	18,521
Unexpired unobligated balance, end of year	16,127	8,612	54	24,793
Total unobligated balance, end of year	16,127	8,612	54	24,793
Total budgetary resources	**$ 46,146**	**$ 12,499**	**$ 1,123**	**$ 59,768**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	1,985	422	243	2,650
Obligated balance, start of year (net), before adjustments (+ or -)	1,985	422	243	2,650
Obligated balance, start of year (net), as adjusted	1,985	422	243	2,650
Obligations incurred	30,019	3,887	1,069	34,975
Outlays (gross) (-)	(29,597)	(3,829)	(755)	(34,181)
Recoveries of prior year unpaid obligations (-)	(65)	(15)	(2)	(82)
Unpaid obligations, end of year (gross)	2,342	466	554	3,362
Obligated balance, end of year (net)	**$ 2,342**	**$ 466**	**$ 554**	**$ 3,362**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	35,472	6,473	1,095	43,040
Actual offsetting collections (discretionary and mandatory) (-)	(37,943)	(6,485)	(41)	(44,469)
Budget authority, net (discretionary and mandatory)	(2,472)	(12)	1,055	(1,429)
Outlays, gross (discretionary and mandatory)	29,597	3,829	755	34,181
Actual offsetting collections (discretionary and mandatory) (-)	(37,943)	(6,485)	(41)	(44,469)
Outlays, net (discretionary and mandatory)	(8,346)	(2,656)	714	(10,288)
Agency outlays, net (discretionary and mandatory)	**$ (8,346)**	**$ (2,656)**	**$ 714**	**$ (10,288)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2016:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 27,597	$ 6,360	$ 29	$ 33,986
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	-	(3)	(3)
Unobligated balance brought forward, October 1, as adjusted	27,597	6,360	26	33,983
Recoveries of prior year unpaid obligations	409	54	-	463
Unobligated balance from prior year budget authority, net	28,006	6,414	26	34,446
Borrowing authority (discretionary and mandatory)	11,021	1,536	520	13,077
Spending authority from offsetting collections (discretionary and mandatory)	16,405	3,381	14	19,800
Total budgetary resources	**$ 55,432**	**$ 11,331**	**$ 560**	**$ 67,323**
Status of Budgetary Resources:				
Obligations incurred	$ 44,823	$ 5,319	$ 769	$ 50,911
Apportioned	2,784	2,783	7	5,574
Unapportioned	7,825	3,229	(216)	10,838
Unexpired unobligated balance, end of year	10,609	6,012	(209)	16,412
Total unobligated balance, end of year	10,609	6,012	(209)	16,412
Total budgetary resources	**$ 55,432**	**$ 11,331**	**$ 560**	**$ 67,323**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	$ 2,042	$ 440	3	$ 2,485
Obligated balance, start of year (net), before adjustments (+ or -)	2,042	440	3	2,485
Adjustment to obligated balance, start of year (net) (+ or -)	-	-	3	3
Obligated balance, start of year (net), as adjusted	2,042	440	6	2,488
Obligations incurred	44,823	5,319	769	50,911
Outlays (gross) (-)	(44,471)	(5,283)	(532)	(50,286)
Recoveries of prior year unpaid obligations (-)	(409)	(54)	-	(463)
Unpaid obligations, end of year (gross)	1,985	422	243	2,650
Obligated balance, end of year (net)	**$ 1,985**	**$ 422**	**$ 243**	**$ 2,650**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	$ 27,426	$ 4,917	$ 533	$ 32,876
Actual offsetting collections (discretionary and mandatory) (-)	(23,905)	(5,106)	(16)	(29,027)
Budget authority, net (discretionary and mandatory)	3,521	(189)	517	3,849
Outlays, gross (discretionary and mandatory)	44,471	5,283	532	50,286
Actual offsetting collections (discretionary and mandatory) (-)	(23,905)	(5,106)	(16)	(29,027)
Outlays, net (discretionary and mandatory)	20,566	177	516	21,259
Distributed offsetting receipts (-)	-	-	-	-
Agency outlays, net (discretionary and mandatory)	**$ 20,566**	**$ 177**	**$ 516**	**$ 21,259**

Other Accompanying Information

Summary of Financial Statement Audit and Management Assurances

For FY 2017, two material weaknesses were identified by the Office of Inspector General in its audit of FHA's Principal Financial Statements and accompanying Notes. Table 1 provides a summary of financial audit findings with regard to the audit opinion. Table 2 is a summary of FHA's FMFIA management assurances.

Table 1. Summary of Financial Statement Audit

Audit Opinion	Unmodified				
Restatement	Yes				
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Cash Flow Modeling Errors Were Not Detected	1	0	1	0	0
Controls Over Financial Reporting Had Weaknesses	1	1	0	1	1
Weaknesses in FHA Modeling Processes	0	1	0	0	1
Total Material Weaknesses	2	2	1	1	2

Table 2. Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA section 2)					
Statement of Assurance	Unmodified				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Cash Flow Modeling Errors Were Not Detected	1	0	1	0	0
Controls Over Financial Reporting Had Weaknesses	1	1	0	1	1
Weaknesses in FHA Modeling Processes	0	1	0	0	1
Total Material Weaknesses	2	2	1	1	2

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AUDITOR'S REPORT

This report was issued separately in November 2017 by the HUD Office of Inspector General entitled, "Federal Housing Administration, Washington, DC, Fiscal Years 2017 and 2016 (Restated) Financial Statements Audit" (2018-FO-0003). The report is available at HUD, OIG's internet site at: http://www.hudoig.gov.

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To: Dana Wade, General Deputy Assistant Secretary for Housing, H

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

Subject: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2017 and 2016 (Restated)

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of the Federal Housing Administration's fiscal years 2017 and 2016 (restated) financial statements.

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

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

If you have any questions or comments about this report, please do not hesitate to call me at 202-402-8216.

Audit Report Number: 2018-FO-0003
Date: November 15, 2017

Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2017 and 2016 (Restated)

Highlights

What We Audited and Why

The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended, requires the Office of Inspector General to audit the financial statements of the Federal Housing Administration (FHA) annually. We audited the accompanying financial statements and notes of FHA as of and for the fiscal years ending September 30, 2017 and 2016 (restated), which are composed of the balance sheets, and the related statements of net cost and changes in net position, and the combined statements of budgetary resources for the years then ended. Additionally, we audited the restatement adjustments made by FHA in fiscal year 2017 to restate its fiscal year 2016 financial statement notes. We conducted these audits in accordance with U.S. generally accepted government auditing standards.

What We Found

In our opinion, FHA's fiscal years 2017 and 2016 financial statements were presented fairly, in all material respects, in accordance with the U.S. generally accepted accounting principles for the Federal Government. Our opinion is reported in FHA's Fiscal Year 2017 Annual Management Report. The results of our audit of FHA's principal financial statements and notes for the fiscal years ending September 30, 2017 and 2016, including our report on FHA's internal control and test of compliance with selected provisions of laws and regulations applicable to FHA are presented in this report. Our audit disclosed two material weaknesses, two significant deficiencies in internal controls, and no instances of noncompliance with applicable laws and regulations, which are discussed further in the body of this report.

What We Recommend

To support reliable financial reporting, we recommend that FHA strengthen its existing system of internal control processes, and policies, and procedures to (1) ensure effective model governance implementation and (2) prevent or detect material misstatements occurring in the financial statements and notes in a timely manner. Additionally, we recommend that FHA deobligate $270.7 million to recapture funds with invalid obligations.

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U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

Independent Auditor's Report

General Deputy Assistant Secretary
Federal Housing Administration

In our audit of the fiscal years 2017 and 2016 (restated) financial statements of the Federal Housing Administration (FHA), a component of the U.S. Department of Housing and Urban Development (HUD), we found

- The financial statements and notes were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.
- There were two material weaknesses in internal control over financial reporting.
- There were two significant deficiencies in internal control over financial reporting.
- There were no instances of reportable noncompliance with certain provisions of laws and regulations that apply to FHA.

The following sections and appendixes discuss in more detail (1) our conclusions, including additional information, (2) management's responsibilities, (3) our responsibilities, (4) management's response to findings, (5) the current status of prior-year findings, and (6) a schedule of funds to be put to better use.

Report on the Financial Statements

We audited the accompanying financial statements of FHA, which are composed of the balance sheets as of September 30, 2017 and 2016 (restated), and the related statements of net cost and changes in net position, the combined statements of budgetary resources for the years then ended, and the related notes to the financial statements.

Management's Responsibilities

FHA management is responsible for preparing and fairly presenting these financial statements in accordance with U.S. generally accepted accounting principles. These responsibilities include designing, implementing, and maintaining internal control to ensure that FHA prepares and fairly presents financial statements that are free from material misstatement, whether due to fraud or error.

Management is also responsible for (1) evaluating the effectiveness of internal control over financial reporting; (2) providing a statement of assurance on the overall effectiveness of internal control over financial reporting, including providing reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met; and (3) ensuring compliance with other applicable laws and regulations.

Auditor's Responsibilities

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. We also conducted our audits in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, Audit Requirements for Federal Financial Statements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to FHA's preparation and fair presentation of the financial statements to design audit procedures that are appropriate in the circumstances but not to express an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management as well as evaluating the overall presentation of the financial statements.

We are also responsible for (1) obtaining a sufficient understanding of internal control over financial reporting to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and applicable laws for which OMB Bulletin 17-03 requires testing, and (3) applying certain limited procedures with respect to the required supplementary information (RSI) and all other accompanying information included with the financial statements.

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

We did not test compliance with all laws and regulations applicable to FHA. We limited our tests of compliance to certain provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB Bulletin 17-03 that we deemed to be applicable to FHA's financial statements for the fiscal years ending September 30, 2017 and 2016. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We believe that the audit evidence we have obtained was sufficient and appropriate to provide a basis for our audit opinion.

Opinion on Financial Statements

In our opinion, the financial statements referred to above presented fairly, in all material respects, the financial position of FHA as of September 30, 2017 and 2016 (restated), and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in notes 1 and 7 to the financial statements, the loan guarantee liability (LGL) is an estimate of the net present value of future claims, net of future premiums, and future recoveries from loans insured as of the end of the fiscal year. This estimate is developed using econometric models that integrate historical loan-level program and economic data with regional house price appreciation forecasts to develop assumptions about future portfolio performance. In 2017, FHA made a few model methodology changes. These changes included changing the methodology for (1) calculating for the net present value of the future cash flows using a single path (President's Economic Assumption released in March 2017) instead of using an average of 100 paths for claim and prepayments, which was the methodology used in 2016, and (2) discounting the timing of the cash flows from the end of the year to the middle of the year for certain programs. We caution our readers to be cognizant of the fact that the comparability of the LGL numbers in 2017, when compared to those in 2016, could be impacted because of the changes. Our opinion was not modified with respect to this matter.

Other Matters

Fiscal Year 2016 Financial Statements and Notes

In our report, dated November 14, 2016, we expressed an opinion that FHA's financial statements for fiscal year 2016 fairly presented the financial position of FHA's financial statements as of September 30, 2016, and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with generally accepted accounting principles. However, in fiscal year 2017, as discussed in note 21 to the financial statements, a material error was identified in the 2016 Note 7 - Direct Loans and Loan Guarantees and Note 12 - Gross Costs, which required correction of the balances in fiscal year 2017. With the exception of the differences that FHA attributed to the timing of information being transferred between systems as discussed in finding 2, note 7 was restated to correct balances reported for the home equity conversion program (HECM) current-year endorsements, the cumulative current outstanding balance, and maximum potential liability, and the single family forward guaranteed loans outstanding and new guaranteed loans disbursed. Note 7 was also restated to correct the allocation of the technical/default reestimates between the subsidy expense and interest expense components. Additionally, note 12 was restated to correct gross cost with the public to adjust the allocation of reestimate and interest expenses. For these reasons, the opinion expressed in the 2016 audited financial statements was no longer appropriate because the accompanying notes to the financial statements as published at that time contained material misstatements. Accordingly, our opinion on the audited financial statements for 2016 is withdrawn because it can no longer be relied upon and is replaced by the auditor's report on the restated financial statements.

Required Supplementary Information

U.S. generally accepted accounting principles require that FHA management's discussion analysis and other required supplementary information be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal

Accounting Standards Advisory Board, which considers it to be an essential part of financial reporting for placing the financial statements into an appropriate operational, economic, or historical context. We have applied certain limited procedures to the management discussion and analysis and other required supplementary information in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide assurance.

Other Information

The message from the FHA Commissioner is presented for additional analysis is are not a required part of the financial statements or required supplementary information. This information has not been subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we do not express an opinion or provide assurance on it.

Report on Internal Control Over Financial Reporting and Compliance Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered FHA's internal control over financial reporting to determine the appropriate audit procedures for expressing our opinion on the financial statements but not for expressing an opinion on the effectiveness of FHA's internal control. Accordingly, we do not express an opinion on the effectiveness of FHA's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of FHA's financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Therefore, other deficiencies in internal control that might be material weaknesses or significant deficiencies may exist that were not identified. We identified four deficiencies in internal control, described below. We consider two to be material weaknesses and two to be significant deficiencies.

Weaknesses Were Identified in FHA's Modeling Processes

In 2017, we identified a number of weaknesses in FHA's modeling processes. Specifically, these weaknesses were related to FHA's ineffective model documentation, model governance, and modeling practices. All of these weaknesses were a direct result of FHA's failure to ensure that well-controlled modeling processes were implemented. As a result, FHA failed to prevent or detect

$631.8 million in total errors to its model output results, which support FHA's LGL line item in its financial statements. Further, given unresolved concerns regarding the predictive capability of the single-family model, along with not following established policies and procedures and best practices for model coding, all of these concerns could impact the reliability of FHA's liabilities for loan guarantees (LLG) estimates.

FHA's Controls Over Financial Reporting Had Weaknesses

In fiscal year 2017, some of the control deficiencies in financial reporting identified in 2016 continued, and new control deficiencies were identified. Specifically, these new control deficiencies included issues related to the timing of the recognition of the credit subsidy expense and unrecorded accruals. In addition, FHA had material note disclosure errors in note 7 of the financial statements. These note errors included (1) inaccurate disclosure of the loan endorsement amounts for the 2017 and 2016 single-family and HECM programs and (2) incorrect allocation of LGL reestimates between the subsidy expense and interest expense components in fiscal year 2016. These conditions occurred because FHA did not have effective monitoring and processes in place to ensure (1) that accounting events were recorded in a timely manner, (2) that accrual methodologies were reviewed on a regular basis for completion and accuracy, and (3) the accuracy of data reported in the financial statements. As a result, $382 million in accounting adjustments had to be made to correct the errors in FHA's accounting records, and $23.7 billion in restatements were made to fiscal year 2016 endorsement amounts in note 7. Additionally, FHA may have missed an opportunity to put $270.7 million of its unobligated funds to better use because invalid obligations were not always deobligated on time.

FHA's Controls Related to Partial Claims Had Improved, but Weaknesses Remained

In fiscal year 2017, FHA began billing noncompliant lenders for partial claims when the lenders had not provided FHA with the related promissory note (second mortgage note) when the note was not provided within 60 days of executing the partial claim. FHA began billing lenders between 2 and 59 days after the 60-day expiration period. While this was a marked improvement from waiting until 6 months after the expiration period, it was not always immediately after as we had previously recommended. A delay in FHA management's reaching agreement to change the billing policy and procedures was a contributing factor in FHA's delay in fully implementing the controls in a timely manner. Unnecessary delays in implementing the collection process from noncompliant lenders with unsupported partial claims is not a good cash management practice and does not help improve the health of the Mutual Mortgage Insurance fund. FHA should continue to implement its policy and ensure that the implementation is fully carried out.

Weaknesses Were Identified in Select FHA Information Technology Systems

The Asset Disposition and Management System (ADAMS) application and the source applications used in the credit reform estimation and reestimation process contained security vulnerabilities. These conditions occurred because of a lack of contract oversight and insufficient coordination between the Office of the Chief Information Officer (OCIO) and FHA. As a result, the confidentiality, integrity, and availability of critical information may be negatively impacted. In addition, the information used to provide input to the FHA financial statements could be adversely affected. We also determined that remediation of weaknesses previously reported with the Single Family Premium Collection Subsystem – Periodic (SFPCS-P), Single Family Acquired Asset Management System (SAMS), Single Family Insurance System (SFIS), and Single Family

Insurance System – Claims Subsystem (Claims) are in progress and expected to be fully remediated within the agreed-upon timeframes.

Report on Compliance

As part of obtaining reasonable assurance about whether FHA's financial statements were free from material misstatement, we performed tests of their compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on determining financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance.

This report is intended for the information and use of the management of FHA, OMB, the U.S. Government Accountability Office, and Congress and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited. The purpose of the Report on Internal Control Over Financial Reporting and the Report on Compliance sections of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing and not to provide an opinion on the effectiveness of FHA's internal control or compliance. These reports are an integral part of an audit performed in accordance with Government Auditing Standards in considering FHA's internal control and compliance. Accordingly, these reports are not suitable for any other purpose. In addition to this report and providing specific recommendations to FHA management, we noted other matters involving internal control over financial reporting and FHA's operation that we are reporting to FHA management in a separate management letter.

Kimberly R. Randall

Kimberly R. Randall
Acting Assistant Inspector General for Audit
Washington, DC

November 14, 2017

Material Weaknesses

Finding 1: Weaknesses Were Identified in FHA's Modeling Processes

In 2017, we identified a number of weaknesses in FHA's modeling processes. Specifically, these weaknesses were related to FHA's ineffective model documentation, model governance, and modeling practices. All of these weaknesses were a direct result of FHA's failure to ensure that well-controlled modeling processes were implemented. As a result, FHA failed to prevent or detect $631.8 million in total errors to its model output results, which support FHA's LGL line item in its financial statements. Further, given unresolved concerns regarding the predictive capability of the single-family model, along with not following established policies and procedures and best practices for model coding, all of these concerns could impact the reliability of FHA's LGL estimates.

Current-Year Status of Prior-Year Audit Matters

In fiscal year 2016, we reported that FHA had not fully implemented an effective model risk management governance framework. Specifically, FHA had not established or finalized policies and procedures related to its modeling processes. In our fiscal year 2017 audit follow-up, we noted that in response to our finding, FHA finalized its Credit Reform Board Charter and Model Risk Management Guidelines in August 2017,[1] and addressed some of the model governance deficiencies noted last year. However, due to late completion, we have not validated FHA's full implementation of the model governance framework. Additionally, none of the prior-year issues had been fully remediated. The current-year status of each of the prior year findings are noted below:

- In fiscal year 2016, FHA's model assumption documentation for the single-family and HECM programs was not consolidated into a single document, and FHA did not have a model risk rating policy that included a model scoring or prioritization process. In fiscal year 2017, FHA consolidated the assumption documentation for the single-family and HECM programs into one document. FHA also established a model risk rating policy in fiscal year 2017, but FHA did not implement the policy by scoring and prioritizing its models according to their relative level of risk.

- During our fiscal year 2016 audit, we also cited FHA for not having defined requirements for performing sensitivity analyses. In addition, FHA did not perform sensitivity analyses on all of the assumptions made for the single-family, HECM, and multifamily programs, contrary to Federal Accounting Standards Advisory Board, Technical Release 6, requirements. In 2017, while FHA had established policies and procedures for performing sensitivity analyses, FHA was not following them.[2] Additionally, as in 2016,

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[1] The charter and guidelines, which were dated June 28, 2017, were signed by the General Deputy Assistant Secretary for Housing on August 1, 2017.

[2] FHA's Model Risk Management Guidelines states that "The sensitivity of model results to each assumption must be tested to determine materiality and reasonableness."

FHA did not perform a sensitivity analysis on the assumptions used in the single-family, HECM, and multifamily recovery on assets models and on all assumptions in the HECM LLG model.

- Finally, in fiscal year 2016, FHA had not established policies and procedures for data management and validation. For example, FHA did not have policies and procedures to address the steps to be taken when inconsistent data are noted, or policies and procedures for verifying the accuracy of data inputs. In fiscal year 2017, FHA developed policies and procedures for data management and validation, which require statistics and trend analysis to be performed to ensure the accuracy of data. However, for the single-family and HECM programs, FHA had performed only a very small number of statistics on a small subset of data and had not performed any trend analyses until we brought this issue to its attention. For the multifamily program, FHA had not performed data validation on all data that were used in the multifamily models.

Modeling Errors Not Detected or Prevented

In fiscal year 2017, we identified a number of errors in the modeling processes for the single-family, HECM, and multifamily programs. FHA was unaware of these errors until we brought them to its attention or the errors were identified as a result of our inquiry. Examples of errors identified included using (1) an incorrect input dataset for the single-family model, (2) an incorrect methodology for discounting the net present value of future cash flows for the HECM program, (3) an incorrect housing price index-variable in the single-family and HECM models, and (4) incorrect single effective rates for healthcare programs.

<u>Incorrect Fair Isaac Corporation dataset used in the single-family LLG model</u>. FHA inadvertently loaded the incorrect Fair Isaac Corporation (FICO) dataset into the single-family LLG model when it initially ran its final single-family LLG estimates. This data error came to light in October 2017 when we could not replicate FHA's model output results. After research, FHA confirmed that the OIG's model output results could not match up with FHA because FHA had (1) provided OIG with an incorrect dataset, and (2) imported an incomplete loan FICO dataset into its own estimates, which it attributed to an oversight. When FHA realized its loan FICO import error in late October 2017, it reran its model to rectify the situation. This model processing error, if not corrected, would have caused the single-family LLG amount to be understated by $323.4 million, according to FHA.

<u>Incorrect discounting methodology used in the HECM LLG model</u>. When FHA initially ran the final HECM LLG model in fiscal year 2017, FHA used the end-of-year period for discounting the cash flows despite the fact that methodology used for all other programs in 2017 was based on the middle of the year.[3] FHA acknowledged to us that an error had been made and it reran the HECM models using the middle-of-year period. FHA attributed the use of the incorrect discounting period to miscommunication. Had we not identified this error, the HECM LLG would have been overstated by $280 million.

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[3] FHA used the end-of-year convention for both the HECM and single-family programs in fiscal year 2016.

Incorrect housing price index values used in the single-family and HECM LLG models. FHA entered incorrect housing price index values into some of the single-family and HECM LLG models. Had we not identified the error, the liability for loan guarantee for the single-family program would have been understated by $7.8 million, based on FHA's calculation.[4] FHA did not measure the impact of the error for the HECM program, but based on our analysis, the LLG for the HECM program would have been understated by approximately $13.7 million.

Incorrect single effective rates were used for the healthcare programs. FHA used the incorrect single effective rates (SER)[5] for the healthcare programs when it initially ran the LLG and recovery on assets models. According to FHA, its policy is to use a different single effective rate for the healthcare programs than the rate for the multifamily programs. However, instead of using the single effective rate designated for the healthcare programs, FHA inadvertently used the rate designated for the multifamily programs. This occurred because FHA inadvertently copied the single effective rate for multifamily to healthcare programs. After we brought this error to FHA's attention, FHA corrected the rates for the healthcare programs. Had we not identified this error, the LLG for the healthcare programs would have been overstated by $6.9 million.

Relationships of Certain Variables Used in the Single-family Model Not Consistent With Our Expectations

FHA may not have fully evaluated the reasonableness of certain relationships in the single-family model, causing us concern. This concern was based on our observation that the relationships of certain variables used in the model were not consistent with our expectations. These inconsistencies, if not fully addressed, could significantly impact FHA's ability for its model to reliably predict future performance of the single-family portfolio. When developing a model, random samples of loans are used to develop a model's specifications. There is typically a trade-off between how precisely the model is fit, or trained, using historical loan experience and the ability of the model to reliably predict future outcomes for the loan portfolio. A significant amount of professional judgement is needed to refine the model and establish an appropriate balance between model complexity and model predictability. While FHA generally appeared to exercise professional judgement in developing certain assumptions, there were some instances in which it appeared that FHA did not fully evaluate the reasonableness of certain relationships in the single-family model. Two examples are cited below.[6]

- One of the key future cash flows taken into account is the likelihood that a borrower will prepay the loan. Generally, there is a positive relationship between a borrower's FICO score and the likelihood of prepayment. Borrowers with higher FICO scores are more likely to prepay when compared to borrowers with lower FICO scores. However, FHA used the opposite relationship in the model for borrowers with a FICO score in the

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4 Based on our independent assessment, this amount appears to be reasonable.

5 The single effective interest rate is the disbursement-weighted average discount rate for substantially disbursed cohorts.

6 We also identified other unreasonable relationships, which we have provided to FHA.

ranges of 550 to 650 and 725 to 750 and did not provide a reasonable explanation of why the identified relationships were logical and to be expected.

- The loan-to-value ratio captures the original equity position of each borrower and is a key factor in determining the likelihood of prepayment. The single-family model had unintuitive relationships for certain loan-to-value ratio ranges. In the model, the direction of the likelihood of prepayment changed back and forth for adjacent loan-to-value ratio ranges in an unintuitive manner that was not in line with what would reasonably be expected. In addition, FHA did not incorporate the 97.5 cut-off for the maximum loan-to-value ratio, which is a key design feature of the single-family program.

Due to these unreasonable relationships, we have concerns regarding the reliability of the single-family model in predicting the future performance of the single-family portfolio. Our concerns are supported by the analysis that we performed. We tested FHA's single-family model using different randomly selected groups of loans used to develop relationships, while keeping everything else the same. Simply changing the "training" data over six different model runs produced LLG estimates that changed by $638 million. Although we did not have sufficient time to perform a full statistical analysis on a much larger number of model runs, this variation in the LLG estimates was larger than we would normally expect for randomly generated samples of loans.

FHA's Increased Susceptibility to Modeling Errors Due to Ineffective Modeling Practices
In addition to the modeling errors and the use of unreasonable assumptions in the single-family model, we identified a number of modeling practices, which could significantly increase FHA's risk of continued modeling errors if they are not appropriately addressed. Specifically, we found that (1) modeling documentation did not include necessary information and contained errors, (2) correct datasets were not readily provided upon request so we could replicate the single-family model results, and (3) some of FHA's coding practices were contrary to best practices.

Ineffective model documentation. FHA's model documentation did not contain necessary information and contained errors. Our efforts to replicate model results were hindered because FHA's modeling documentation was incomplete and contained errors and not all required datasets were provided. Federal Accounting Standards Advisory Board, Technical Release 6, requires model documentation to be complete and stand on its own so that an independent person could perform the same steps and replicate the same results with little or no outside explanation or assistance. However, we spent a considerable amount of time attempting to replicate FHA's modeling results because we encountered the following problems:[7]

- Information that should have been included in the model documentation was not included. For example, documentation for the single-family and HECM models did not include (1) the timing of developing certain assumptions and the time when data were extracted to develop assumptions, (2) the values for the macro variables needed to execute the main cash flow programs, (3) all input files and datasets required to run the models, (4) an outline of which programs should be executed during each phase of model

[7] We provided a detailed list of the problems that we encountered to FHA management during our audit.

execution, and (5) descriptions of all of the variables used in the single-family logistic regression models.

- Inconsistent information was also included in model documentation for the single-family and HECM programs. For example, the naming convention for variables listed in the HECM model documentation did not agree with the naming convention used in the model. For the single-family program, variables were incorrectly referenced on certain pages of the model documentation.

- Model documentation for the single-family program contained errors. Specifically, we found that (1) model documentation did not specify the correct computer specifications for running the model, (2) the variable names in the model documentation did not always agree with the variable names in the model code, and (3) model documentation incorrectly stated that variables were used in a specific model when they were not.

Correct datasets for the single-family model were not initially provided. Our efforts to replicate the single-family model results were hindered because required datasets were not provided upon our initial request. For the single-family program, FHA did not initially provide us multiple datasets needed to run the model, and in other cases, we were provided incorrect datasets. In addition, the format of a file was changed within the model code between the interim and final model versions, but the updated file was not provided to us when we were attempting to replicate the results. We believe some of these conditions occurred because FHA did not have adequate controls in place for ensuring that updated or correct files were maintained in a centralized location.

Industry best model coding practices were not adopted. Adopting leading industry best coding practices could minimize user error, and increase reliability, and reduce maintenance of FHA's programming code. For the single-family and HECM programs, we identified a number of model coding practices and techniques which significantly increased FHA's risk of modeling errors. Specifically, we found that

- The single-family model had large sections of duplicated code. This coding practice could lead to errors if the programmer or developer makes a change to the code in one section of the model but not the other sections. Best coding practices suggest that duplicate code be consolidated into one routine that can be called multiple times.

- The single-family program code referenced a specific file location in a risky manner. This coding practice introduces increased risk of broken file references when file locations are changed or code is moved to another system. This increases the difficulty of maintaining the code since any update would require that the user identify and change each reference to that specific file location throughout the code. In instances in which the references point to data that are updated regularly, there is a risk that stale data will be used and errors will go undetected since the model would not produce processing errors or warnings. Best coding practices suggest using non-specific ("relative") file path structures that are independent of a particular file directory structure and can be updated easily by changing as few lines of code as possible.

- For the HECM program area, the model's output filenames changed depending on the date of execution, and the model could not be executed without making manual adjustments to the code that referenced those files. This practice requires significant user intervention. The user has to verify the filenames before running each stage of the model and then update the code to match the filenames. If the filename changes at a later point, an error could be introduced without warning or detection. In addition to increasing the risk of error, this practice lengthens the time that it takes to run the model. Best coding practices suggest that programs be seamlessly executed from start to finish ("end to end") without significant user intervention along the way.

- When values and references were updated in the single-family and HECM programs, FHA had to search throughout the entire program and make conforming changes. This increases the risk of error if the user does not update every value or reference in the programs. Best coding practice is to assign these types of "global" values or references one time and group them together at the beginning of the code to enhance code usability and minimize the risk of user error.

Conclusion

FHA should continue striving to improve its model governance to ensure the reliability of the LLG estimates. In 2017, FHA developed a model governance framework. While this is a step in the right direction, FHA needs to continue to monitor its activities to ensure full implementation of the model governance framework. With regard to FHA's controls over its models, we noted that although FHA had some policies and procedures in place to ensure that modeling errors are minimized, it needs to ensure that established policies and procedures are followed. In addition, FHA can benefit from (1) performing additional analysis to identify assumptions that may skew the LLG estimates, (2) improving its modeling documentation, and (3) following best coding practices.

Recommendations

We recommend that the Director of the Office of Evaluation

1A. Establish and implement an effective quality control process to prevent or detect model processing errors cited in our report and prevent other similar model processing errors in the future.

1B. Reevaluate FHA's existing model documentation for single-family, HECM, and multifamily models to determine whether their current state is acceptable, so that it provides the intended users a thorough understanding of how the model works and also allows new users to assume responsibility for the model's use (operational procedures). Based on this review, FHA should make adjustments as needed to the model documentation. At a minimum, these adjustments should include appropriate actions taken to address model documentation deficiencies cited in our report.

1C. Review FHA's existing model coding for single-family, HECM, and multifamily models and make necessary changes to make them consistent with industry's best practices in model coding. At a minimum, FHA should implement actions to address model coding deficiencies cited in our report.

1D. Establish and implement policies and procedures for assessing and monitoring the reliability of the work performed by FHA's modeling contractors.

1E. Revisit the model's ability to predict future performance of the single-family portfolio, based on our concerns expressed in this report regarding relationships of certain variables (such as loan-to-value ratio and FICO scores to prepayment) that are not consistent with our expectations. FHA should provide us an analysis to support its position if it believes that a model design change is not warranted.

1F. Correct the impact of all the modeling errors that we identified in this report.

Finding 2: FHA's Controls Over Financial Reporting Had Weaknesses

In fiscal year 2017, some of the control deficiencies in financial reporting identified in 2016 continued, and new control deficiencies were identified. Specifically, these new control deficiencies included issues related to the timing in the recognition of the credit subsidy expense and unrecorded accruals. In addition, FHA had material note disclosure errors in note 7 of the financial statements.[8] These note errors included (1) inaccurate disclosure of the loan endorsement amounts for the 2016 and 2017 single-family and HECM programs and (2) incorrect allocation of LGL reestimates between the subsidy expense and interest expense components in fiscal year 2016. These conditions occurred because FHA did not have effective monitoring and processes in place to ensure (1) that accounting events were recorded in a timely manner, (2) that accrual methodologies were reviewed on a regular basis for completion and accuracy, and (3) the accuracy of data reported in the financial statements. As a result, $382 million[9] in accounting adjustments had to be made to correct the errors in FHA's accounting records, and $23.7 billion[10] in restatements were made to fiscal year 2016 endorsement amounts in note 7. Additionally, FHA may have missed an opportunity to put $270.7 million of its unobligated funds to better use because invalid obligations were not always deobligated on time.

Current-Year Status of Prior-Year Audit Matters

Weaknesses in Deobligation of Unliquidated Balances Continued

In fiscal year 2016, we reported that FHA's unliquidated balance review process had weaknesses. Specifically, contracts with invalid obligations were not identified clearly and in a timely manner, and excess funds were not deobligated for completed contracts. In connection with our fiscal year 2017 audit follow-up, we noted that although there is now an effective process to identify invalid contract obligations, challenges continued in deobligating these funds. Of the $276.5 million identified as invalid deobligations during the fiscal year 2016 audit, $71.9 million had not been deobligated at the end of fiscal year 2017. In addition, during FHA's fiscal year 2017 unliquidated balance review, the program offices identified 158 contracts and projects with invalid obligations totaling $299.2 million, but only $28.5 million had been deobligated at the end of fiscal year 2017. The remaining $270.7 million was awaiting action from FHA or the Office of Contracting and Procurement for deobligation.

Challenges in Clearing Discrepancies in the Undelivered Order Balances for Management and Marketing Contracts Continued

In fiscal year 2016, we reported that FHA's individual contract undelivered order balances for single-family management and marketing contracts were not accurate on the report used for financial reporting.[11] We found discrepancies in the expenditure amounts for 131 contracts and discrepancies in the obligation amounts for 41 contracts. Before the end of our fiscal year 2016

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[8] Note 7 was formerly note 6 in the fiscal year 2016 financial statements.

[9] The adjustments included $138,000 for management and marketing contracts, $71.7 million for multifamily credit subsidy expense, $14.4 million for property contracts, $75.2 million for supplemental claims and $220.6 million (absolute value of $110.3 million) for reestimates.

[10] FHA made restatements in the amount of $47 million for discrepancies for the HECM program and $23.7 billion for discrepancies for single-family program endorsements.

[11] The undelivered order balance is the difference between the obligated amount and the expenditure amount.

audit, FHA informed us that it had identified another report that contained the accurate undelivered order balances. There was a $2.3 million difference between the total undelivered order balance on the report used for financial reporting and the report that FHA identified as containing the correct balances. During our fiscal year 2017 audit, FHA reported that it had made significant progress in correcting the discrepancies on the report used for financial reporting. According to FHA, as of September 30, 2017, there was only a $138,000 difference between the report used for financial reporting and the report that FHA identified as containing the correct balances.

Timing Differences in the Obligation and Disbursement Processing of Multifamily Guaranteed and Direct Loans

FHA did not record the subsidy costs associated with the multifamily loan guarantees and direct loans in a timely manner in accordance with generally accepted accounting principles.[12] Specifically, FHA failed to recognize the multifamily loan guarantee and direct loan subsidy costs in the proper period. Additionally, due to manual recording of transactions in several systems by various groups, the risk of inconsistent recording of accounting events among the systems increased.

We audited 15 loan guarantee loans with an unpaid principal balance and calculated subsidy costs of $194.5 million and $7.8 million, respectively, and 11 Federal Financing Bank (FFB) direct loans with an unpaid principal balance and calculated subsidy costs of $63.8 million and $7.0 million, respectively, all endorsed between October 1, 2016, and June 30, 2017.

> Multifamily loan guarantee. The credit subsidy expense for 12 of 15 (85 percent) loan guarantees was not recorded in the period when these loans were endorsed. The subsidy costs of the 12 loans with exception totaled $6.7 million. The delay in recognizing the credit subsidy expense averaged 72 days, including one delay of 269 days. Additionally, the credit subsidy obligation for 4 of the 15 loans (27 percent) was not in the appropriate period. We noted that the delay in recording the obligation for the subsidy cost averaged approximately 49 days, including one delay of 104 days.
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> Multifamily direct loans. The credit subsidy expense for all of the direct loans was not recorded in the period when the loan was disbursed by FFB. We noted that the delay in recognizing the credit subsidy expense for the subsidy cost averaged 71 days, including one delay of 208 days. Additionally, the credit subsidy obligation for 3 of 11 loans (27 percent) was not in the appropriate period, which was when the firm approval was signed. The delay in recording the obligation for the subsidy cost averaged approximately 20 days, including two delays of 29 days.
>
> Other issues. FHA did not have an effective process to ensure consistent tracking and recording of loan information between the Development Application Processing System (DAP) and the FHA Subsidiary Ledger (FHASL) Revenue Management (Revenue

[12] When FHA issues a firm commitment, the commitment authority is reduced by the loan amount and a subsidy obligation is created against the annual allotment of credit subsidy. When the loan is endorsed, a subsidy cost is recognized. For direct loans, when FHA issues a firm commitment, both the direct loan and subsidy obligations are created against the annual allotment of direct loans and credit subsidy. When the loan is disbursed, a subsidy cost is recognized.

Management) system. Nine of the 15 loan guarantees and 9 of the 11 direct loans showed as being endorsed in various periods. DAP is used by the multifamily production field offices and is a comprehensive, automated underwriting system that supports processing and tracking of FHA multifamily housing applications from pre-application through final closing, and it is where all loan characteristics are recorded. Revenue Management is used by the headquarters Office of Multifamily Housing Programs, Financial Operations Division, to track and record the loan history, including financial transactions, such as payments, interest, etc, which are not recorded in DAP.

A combination of things contributed to these conditions. Although information was available to FHA, the timing of completion to process the loan package[13] prevented FHA from recording the accounting events at the point of recognition. Obtaining the information from several systems and keying the obligation and expense information, a labor-intensive process, was another contributing factor. FHA did not have controls in place to ensure that proper cut-offs and accruals were established to record accounting events in the proper periods. In addition, as the multifamily production field offices entered loan information into DAP and the Financial Operations Division also entered loan information into Revenue Management, both of which are used to recognize accounting events in the general ledger, there was no process in place to ensure that loan information was consistent among DAP, Revenue Management, and the general ledger.

As of September 30, 2017, $71.7 million in credit subsidy expense was accrued on 126 loans that were endorsed and disbursed as of the end of the fiscal year but had not had the expense recognized in the general ledger. As part of the process to identify the loans to include in the accrual, FHA had identified inconsistencies between DAP and Revenue Management and was following up on the differences.

Omission of Accrued Liabilities on Property Contracts

FHA, as a practice, did not estimate accrued liabilities for expenses incurred but not yet billed by its contractors on its single-family and multifamily property contracts. This was not in accordance with generally accepted accounting principles.[14]

We attributed FHA's omission of the accruals to an oversight. When we brought the issue to FHA's attention, FHA developed a methodology for estimating an accrual for single-family property expenses, and it was implemented in July 2017. In response to our finding, FHA reported that it booked $14.4 million in accruals for single-family contract expenses in July 2017. FHA currently does not have a plan to estimate an accrual for the multifamily contracts because it believes this amount is immaterial. We will be

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[13] The Financial Operations Division reviews the loan package and manually enters more than 30 data points from the package into the Revenue Management module of FHASL for loan guarantees and more than 125 data points for direct loans.

[14] Paragraph 19 of Statement of Federal Financial Accounting Standards 5, Accounting for Liabilities of The Federal Government, states that a liability is a probable future outflow or other sacrifice of resources as a result of past transactions or events and general purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from transactions and events that are unpaid amounts due as of the reporting date.

monitoring the activities of the multifamily property contracts in fiscal year 2018 to determine whether FHA's assessment on multifamily contracts needs to be revisited.

Supplemental Claims Not Accurately Accrued

Besides the accrual on property contracts, we also found issues on the accrual of supplemental claims. FHA failed to (1) account for the backlog of unopened, paper-based supplemental claims and (2) properly estimate the average paid supplemental claim amount to use in its quarterly accrual methodology. FHA failed to properly account for the backlog of unopened paper-based supplemental claims in its supplemental claims accrual estimation process. Before March 2016, paper-based supplemental claims received by FHA were opened regularly and imaged into the A43C system by a contractor for review, processing, and payment. However, when FHA's contract expired in March 2016, boxes of supplemental paper claims remained unopened because FHA was not properly staffed to handle the volume of supplemental claims in-house at the same rate as the previous contractor, thus creating a backlog. These backlogged claims were excluded from the quarterly accrual because the accrual includes the count of the paper-based supplemental claims that have been opened. Based on FHA's estimate, approximately 4,000 paper-based supplemental claims were being filed with FHA each month, and there was a backlog of approximately 6 months at the end of the first quarter, 4 months at the end of second quarter, and 5 months at the end of third quarter. As a result, FHA's supplemental claims count used in the accrual estimation process was off by the amount of the backlog at the end of each of the first three quarters of fiscal year 2017.

In addition to using the incorrect supplemental claims count, the average quarterly supplemental claims amount used in FHA's calculation was also incorrect. Although the Single Family Post Insurance Division had taken over the work previously performed by its contractor, FHA was unable to catch up to pay the number of supplemental claims at the pre-March 2016 level. In an effort to catch up on paying claims, FHA was able to process and pay claims for only those under $2,000. Claims of $2,000 and over were not processed or paid and were only opened and imaged. As a result of paying only claims under $2,000 at a pace slower than the pre-March 2016 level, the average claim amount used in the calculation by the Single Family Claims Servicing Branch no longer accurately reflected the true average claim amount during the post-March 2016 period. In August 2017, in response to our inquiry, FHA developed a methodology to account for unopened supplemental claims resulting from the backlog and calculated the average claim amount as $1,421. This average amount is based on the claims paid for the first 6 months of fiscal year 2016, which would also include claim payments of $2,000 and above.

The understatement of the quarterly accruals, as a result of FHA's failure to update the calculation for the unopened claims and the correct average claim, is calculated in the following table.

Table 1: Variances noted in quarterly supplemental claims accrual

	Per books[15]			Per audit			Variance (understatement) (G = C-F)
Fiscal year 2017 reporting period	Unpaid claims count (A)	Average claim amount (B)	Accrual per FHA (C =A*B)	Unpaid claims count (D)	Average claim amount (E)	OIG accrual calculation (F=D*E)	
Q1	13,090	$622.25	$8,145,253	37,090[16]	$1,421.81	$52,734,933	$(44,589,680)
Q2	12,025	621.70	7,475,943	28,025[17]	1,421.81	39,846,225	(32,370,283)
Q3	16,423	584.62	9,601,214	36,423[18]	1,421.81	51,786,586	(42,185,371)

As of the fourth quarter of 2017, FHA reported that it had almost cleared the backlog of the unopened claims and processed most of the claims under $2,000 for payment. Claims $2,000 and over, which made up the majority of the unpaid claims, were expected to be processed once a new contract is awarded and is in place. Since the majority of the unprocessed claims were over $2,000, the average claim amount used by FHA in the fourth quarter was $2,600. Therefore, FHA's estimated accrual for the fourth quarter based on 37,386 unprocessed claims was $97.2 million. FHA also accrued $813,000 for 572 unopened supplemental claims, using the $1,421 average claim amount, for a total accrual of $98.0 million as of September 30, 2017.

Discrepancies Identified in FHA Systems Loan Endorsement Amounts

There were errors in FHA's reporting of the required financial note disclosures related to its loan guarantees. For the HECM and single-family programs, we found discrepancies in the current-year loan endorsement amounts between the systems that FHA used for financial reporting and the Computerized Home Underwriting Mortgage System (CHUMS), which is the system of record for current-year endorsements for these two loan programs.[19]

- Discrepancies for HECM program. For notes reporting, FHA relied on the HECM current year endorsement amount recorded in the Home Equity Reverse Mortgage Information Technology (HERMIT) system, but this number did not agree with the current year

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15 Obtained from the general ledger division's quarterly accrual calculation.

16 Calculated by multiplying the 4,000 claims received per month by the 6 months of the backlog of unopened claims (24,000) and adding the known unpaid claims of $13,090 as of the first quarter.

17 Calculated by multiplying the 4,000 claims received per month by the 4 months of the backlog of unopened claims (16,000) and adding the known unpaid claims of $12,025 as of the second quarter.

18 Calculated by multiplying the 4,000 claims received per month by the 5 months of the backlog of unopened claims (20,000) and adding the known unpaid claims of $16,423 as of third quarter.

19 The endorsement amount for HECM loans is the maximum claim amount and the endorsement amount for single-family loans is the outstanding principal.

endorsement amount recorded in the CHUMS. We noted the following differences for fiscal years 2016 and 2017.

Table 2. Current year endorsement amounts in CHUMS and HERMIT

System	Current year endorsement amount fiscal year 2016	Current year endorsement amount as of second quarter fiscal year 2017	Current year endorsement amount fiscal year 2017
CHUMS	$14,668,583,075	$8,448,068,569	$17,700,507,981
HERMIT	14,611,593,307	8,440,449,189	17,690,646,482
Difference	**56,989,768**	**7,619,380**	**9,861,499**

After our inquiry, FHA conducted research and determined the 2016 endorsement amount was underreported by $47.7 million because the HERMIT Cohort Summary Report did not include 153 mortgages in the 2016 cohort year.[20] FHA stated that the remaining $9.2 million difference for fiscal year 2016 and the differences for fiscal year 2017 can be attributed to the timing of information being transferred between the two systems. FHA did not provide supporting documentation for us to validate its explanation regarding timing differences as the cause of the variance.

- Discrepancies for single-family program. For notes reporting, FHA relied on a Single Family Housing Enterprise Data Warehouse (SFHEDW) query to report the single-family current-year endorsement amount, but this number did not agree with the current-year endorsement amount recorded in CHUMS. We noted the following differences for fiscal years 2016 and 2017.

Table 3. Current year endorsement amounts in CHUMS and on SFHEDW query

	Current year endorsement Amount fiscal year 2016	Current year endorsement amount as of second quarter fiscal year 2017	Current year endorsement amount fiscal year 2017
CHUMS	$245,466,130,380	$128,073,490,984	$251,010,304,706
SFHEDW Query	221,755,681,201	245,403,356,141	250,903,805,698
Difference	**23,710,449,179**	**117,329,865,157**	**106,499,008**

FHA attributed discrepancies between CHUMS and SFHEDW to timing differences. According to FHA, CHUMS does not transmit new endorsement amounts to the data warehouse until the second weekend of the following month. Therefore, endorsements that occur in September would not be transmitted to the data warehouse until October. After we identified the fiscal year 2016 and second quarter fiscal year 2017

[20] We did not perform any test work to verify that these loans belonged in the 2016 cohort year.

discrepancies, FHA decided to run the fiscal year 2017 year-end query later than it had done in the past. However, there was still a difference between CHUMS and SFHEDW, although it was much smaller than the $23.7 billion difference for fiscal year 2016. Additionally, FHA did not provide supporting documentation for us to validate FHA's explanation regarding timing differences as the cause of the variance.

With respect to the $117.3 billion difference for the second quarter of fiscal year 2017, FHA acknowledged that it ran an incorrect database access query for 2017, which contributed to the larger difference. FHA had controls in place to ensure that the loan endorsement amounts on the queries agreed with the reported amounts. However, FHA management failed to detect that the query done in fiscal year 2017 was for the incorrect period.[21]

OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, requires agencies to establish and maintain internal control to ensure the reliability of financial reporting. The Government Accountability Office's Standards for Internal Control in the Federal Government states that management should design control activities to ensure that transactions are accurately recorded to maintain their relevance and value to management in controlling operations and making decisions. FHA's failure to reconcile discrepancies in the loan endorsement amount among various FHA systems resulted in the agency's reporting inaccurate information.

Inconsistent Methodology Used To Allocate Reestimates in Fiscal Year 2016

In fiscal year 2016, FHA used an inconsistent methodology to allocate the loan guarantee liability reestimates amount between the subsidy expense and interest expense components. FHA used the end-of-year convention to allocate the reestimates for the single-family 2010-2016 cohorts, while it used the middle-of-year convention for the HECM and multifamily programs and for the single-family 1992-2009 cohorts.

OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, requires agencies to establish and maintain internal control to ensure the reliability of financial reporting. FHA used an inconsistent methodology to allocate the reestimates because it did not have an effective process to ensure that management reviewed and approved formula changes in its reestimates workbook before they were implemented. There was no audit trail to support the formula changes, and FHA could not provide a definitive explanation for the changes.

Because FHA used the end-of-year convention instead of the middle-of-year convention for the single-family 2010-2016 cohorts, the subsidy expense component was understated by $110 million, and the interest expense component was overstated by the same amount on the fiscal year 2016 financial statements.

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[21] The incorrect queries were run for the first three quarters of fiscal year 2017. Had we not identified the error, the same error would have likely occurred in at year-end.

Conclusion

While considerable progress was made to address the control deficiencies identified last year, FHA should continue striving to improve its controls over financial reporting to minimize the risk of material misstatements in its financial reporting.[22] Additionally, although FHA had developed and implemented procedures to record accounting events via various accrual entries, these procedures and methodologies need to be reviewed on a regular basis to confirm that their uses are still appropriate and reasonable.

Recommendations

We recommend that the Deputy Assistant Secretary for Finance and Budget

2A. Ensure that the $270.7 million identified as invalid obligations in fiscal year 2017 is deobligated as appropriate.[23]

2B. Develop and implement policies, procedures, and controls to ensure that he obligation is recognized when the loan guarantee commitment or the direct loan obligation is made and the subsidy cost expense is recognized when the loan is endorsed for loan guarantees and when the loan is disbursed for direct loans.

2C. Develop and implement a reconciliation process to ensure that the information in various systems is consistent for all accounting events.

2D. Develop and implement (1) a methodology to estimate accrued liabilities for property contracts to account for expenses that had been incurred by contractors but not billed and (2) a process to ensure that an audit trail exists for identifying accruals in the general ledger.

2E. Develop and implement policies and procedures to ensure that the reasonableness and appropriateness of the quarterly supplemental claims accrual estimation methodology is periodically reviewed.

2F. Develop and implement policies, procedures, and controls to ensure that the reported current-year endorsements in HERMIT and SFHEDW agree with the current-year endorsements in CHUMS.

2G. Strengthen existing internal control to ensure that amounts reported on the financial statements agree with the appropriate supporting documentation.

2H. Restate the fiscal year 2016 financial statement notes to correct the inaccurate loan guarantee amounts reported by FHA.

2I. Develop and implement procedures and controls to ensure that management reviews and approves changes in the reestimate workbook before they are

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[22] Before issuance of this report, in mid-November 2017, OIG identified another financial reporting error related to Note 7. FHA inadvertently posted $187 million of the LGL estimate amount in the multifamily General Insurance/Special Risk Insurance Fund (GI/SRI) instead of single-family GI/SRI. FHA attributed the error to an oversight and properly adjusted the note disclosure error after the issue was brought to FHA's attention.

[23] The final deobligation amount may be less than $270.7 million if final invoices need to be paid for the contracts.

implemented and maintains documentation to support the rationale for making changes in the reestimate workbook.

2J. Correct the presentation error related to the allocation of reestimates in FHA's fiscal year 2017 financial statements.

2K. Assess whether prior-year financial statements need to be restated to correct the impact of the presentation error in the allocation of reestimates identified in fiscal year 2017.

Significant Deficiencies

Finding 3: FHA's Controls Related to Partial Claims Had Improved, but Weaknesses Remained

In fiscal year 2017, FHA began billing noncompliant lenders for partial claims when the lenders had not provided FHA with the related promissory note (second mortgage note) when the note was not provided within 60 days of executing the partial claim.[24] FHA began billing lenders between 2 and 59 days after the 60-day expiration period. While this was a marked improvement from waiting until 6 months after the expiration period, it was not always immediately after as we had previously recommended. A delay in FHA management's reaching agreement to change the billing policy and procedures was a contributing factor in FHA's delay in fully implementing the controls in a timely manner. Unnecessary delays in implementing the collection process from noncompliant lenders with unsupported partial claims is not a good cash management practice and does not help improve the health of the Mutual Mortgage Insurance fund.[25] FHA should continue to implement its policy and ensure that the implementation is fully carried out.

FHA Had Made Considerable Improvement in Pursuing Partial Claim Promissory Notes, but Challenges Remained

We reported in the fiscal year 2014 audit report that 57,164 partial claims, representing $1.5 billion of the gross loans receivable balance reported on FHA's balance sheet as of September 30, 2014, were not supported with second mortgage notes within 60 days after the date of execution of the partial claim. By the end of fiscal year 2015, the number of unsupported partial claims had decreased to 12,057, representing $376 million of the gross loans receivable balance. As of fiscal year-end 2016, there were 2,798 partial claims unsupported by second mortgage notes, representing $76 million, and as of fiscal year-end 2017, the number had been reduced to 695 partial claims unsupported by second mortgage notes within 60 days after the date of execution, with a total claim amount of $18 million.

In response to our fiscal year 2014 audit recommendations, FHA developed a number of policies and procedures and updated Mortgagee Letter 2015-18[26] with the goal of identifying partial claims with promissory notes missing beyond the prescribed submission period and appropriately billing noncompliant lenders for the amount of partial claims paid plus the incentive fee for failure to submit the required documentation to FHA. Based on FHA's policy under the Mortgagee Letter and the regulatory requirements, FHA is to send the first reimbursement letter to a noncompliant lender if the promissory note has not been provided

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[24] The lender must deliver to HUD's loan servicing contractor, no later than 60 days from the execution date of the partial claim, the original partial claim promissory note and, no later than 6 months from the execution date, the recorded subordinate mortgage.

[25] Collecting the amounts for unsupported partial claims in a timely manner improves the status of the Mutual Mortgage Insurance fund by restoring funds paid out as loss mitigation claims.

[26] Mortgagee Letter 2015-18 has been superseded by Housing Handbook 4000.1, FHA Single Family Housing Policy Handbook, which was effective September 30, 2016.

within 60 days of partial claim execution. However, the process designed as a result did not ensure that FHA sent a reimbursement letter until 6 months after execution of the partial claim.

As the issue continued to exist in fiscal year 2015, four causes were reported in our finding in the fiscal year 2015 audit report under Finding 1: Controls To Prevent Misclassification of the Receivables Had Not Been Fully Implemented. One cause related to the untimely document processing by FHA's loan servicing contractor. The other three causes were related to the timely billing of and collection from noncompliant lenders.

In our review for fiscal year 2016, we determined that none of the four causes reported in the fiscal year 2015 audit report had been fully addressed. The cause that related to FHA's contractor's not processing documents in a timely manner continued to be a problem. FHA planned to resolve the issue in fiscal year 2017 by procuring three new contracts in place of a single contract. The other three causes related to billing and collection efforts toward noncompliant lenders also continued in fiscal year 2016. When testing the designed process in fiscal year 2016, we noted additional delays in the implementation. We identified two factors that led to delays in collecting partial claims with missing documents. One factor was that FHA made changes to its billing and collection process during fiscal year 2016, and therefore, the new process had not been fully implemented as of the end of fiscal year 2016. The other factor was that FHA sent an extension letter to lenders at the request of the HUD Office of General Counsel and the FHA Commissioner following the issuance of the two reimbursement letters, which further delayed the process. Because of the delays embedded in the process, there was a need to strengthen controls to ensure timely referral for collection of loans receivable with missing promissory notes.

Policies and Procedures Had Been Updated To More Closely Align With Regulatory Requirements

FHA had improved its policies and procedures for the partial claim promissory note process. FHA is to send letters to lenders requesting reimbursement in the amount of the partial claim plus the incentive fee if they have not provided FHA with partial claim promissory notes within 60 days of executing the partial claim or the recorded secondary mortgage within 6 months of executing the partial claim. FHA is to send these letters to noncompliant lenders at 61-, 91-, 181-, and 211-day intervals.

We reviewed five of the 61-day letters, noting that FHA no longer waited 6 months to send the letters. The letters requested payment in the amount of the claim plus the incentive fee. However, the letters were not always sent within a reasonable period after the 60 days expired, as letters were sent between 2 and 59 days after the 60-day expiration period. We also reviewed three of the 91-day letters for lenders that did not send the note or payment after they were billed in the 61-day letter. Although FHA sent the letters relatively close to 30 days after the 61-day letters, they were sent between 24 and 71 days after the 90 days expired. Lastly, we reviewed five of the 181-day letters sent to lenders that did not send to FHA the promissory note, payment, or recorded mortgage within 6 months. These letters were sent between 29 and 45 days after the expiration dates noted in the letter.[27] Although requested, FHA did not provide evidence to show that it sent the 211-day letters or referred noncompliant lenders to the Office of Program Enforcement (OPE) under the new policy.

In 2017, during the audit resolution process for fiscal year 2016 and as mentioned above, FHA management agreed to send notices 61 and 91 days after the partial claim paid date for missing promissory notes, and reimbursement letters after 181 and 211 days after the claim paid date for missing notes or mortgages to request payment in the amount of the claim plus the incentive fee. FHA also changed from referring noncompliant lenders to the Mortgagee Review Board after exhausting the use of the letters to referring them to OPE. FHA began implementing this new process in May 2017, sending the first 61-day letters requesting payment. Even though FHA had not yet procured three new contracts or fully implemented the new policies and was still experiencing delays in sending the letters, it has experienced a significant decrease in noncompliant lenders. Since the initial finding was reported in fiscal year 2014, which included 57,164 partial claims representing $1.5 billion, FHA's number of partial claims unsupported by second mortgage notes within 60 days after execution has decreased to 695 partial claims with a total claim amount of $18 million, of which 498 with a total claim amount of $15 million are considered collectible as of fiscal yearend 2017.

Conclusion

FHA is no longer waiting until 6 months after execution of partial claims to begin requesting payment from lenders that do not provide the supporting promissory note; however, FHA is not always requesting payment immediately following the expiration periods. Internal controls to rectify the weaknesses in FHA's controls related to claims that were originally identified in fiscal year 2014 were partially implemented in fiscal year 2017. As of yearend 2017, 498 collectible partial claims with a total claim amount of $15 million were missing promissory notes at least 60 days after the partial claim was executed. Collecting the amounts for unsupported partial claims in a timely manner improves the status of the Mutual Mortgage Insurance fund by restoring funds paid out as loss mitigation claims. As the recommendations from the prior-year audits remain open, we will review the results of the implementation when FHA has fully implemented the management decision.

Recommendations

No recommendations are made as the prior-year recommendations have not been closed.

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[27] The 181-day letters noted that FHA was requesting reimbursement for the list, when (1) the 6 months from the date of execution expired during a certain period (expiration dates) and (2) HUD had not previously billed the lender.

Finding 4: Weaknesses Were Identified in Selected FHA Information Technology Systems

The ADAMS[28] application and the source applications used in the credit reform estimation and reestimation process[29] contained security vulnerabilities. These conditions occurred because of a lack of contract oversight and insufficient coordination between OCIO and FHA. As a result, the confidentiality, integrity, and availability of critical information may be negatively impacted. In addition, the information used to provide input to the FHA financial statements could be adversely affected. We also determined that remediation of weaknesses previously reported with the SFPCS-P, SAMS, SFIS, and Claims are in progress and expected to be fully remediated within the agreed-upon timeframes.

ADAMS Software Maintenance Was Not Adequate

FHA did not properly oversee its contractor to ensure that it provided proper software maintenance support for its ADAMS application system. Specifically, the contractor (1) used one software product that was no longer supported, (2) used different versions of another software product on the production and disaster recovery servers, and (3) did not properly maintain system security documentation. The deficiencies occurred because FHA did not adequately review the contractor-submitted monthly reports and security documents detailing the software in use and, therefore, was unable to identify, address, and resolve the noted issues. In addition, the contract for ADAMS support did not specify a requirement for the service provider to monitor, manage, maintain, and refresh the ADAMS software environment at an industry-established best practice of the software vendor's current level of general availability[30] minus one generation or better. The ADAMS contractor also indicated that the servers hosting the production website using the unsupported software product were not upgraded sooner because the relevant website framework was not compatible with the new operating system. The contractor completed the upgrade to the servers on August 18, 2017. Also, the contractor stated that the reason for the different software product versions was an oversight on its part and agreed that the software versions should be in sync between the production and the disaster recovery environments. Lastly, the contractor did not maintain accurate system documentation because it did not meet the contract obligation to comply with National Institute of Standards and Technology, Special Publication 800-53, and HUD Information Technology Security Policy[31]

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[28] ADAMS is a comprehensive data application that receives, stores, and displays case-level information about properties acquired by HUD or already managed by HUD. It allows users to track events and information describing the status of real property from the date of conveyance to HUD through several stages of management, marketing, and disposition to final reconciliation of sale proceeds.

[29] Beginning in fiscal year 1992, the Federal Credit Reform Act (FCRA) required that the ultimate cost of credit programs be calculated and the budgetary resources be obtained before new direct loan obligations are incurred or new loan guarantee commitments are made. In meeting the FCRA requirement, FHA estimates the LGL and recovery on assets. FHA's Office of Evaluation (OE) is responsible for the development, maintenance, and improvement of all program area cash flow models (CFM) used for credit subsidy estimation and reestimation. Annually, OE collects and consolidates data from FHA's program and accounting systems for use in the CFMs. Data are mainly sourced from Housing Multifamily On-Line Property Integrated Information Suite Data Mart and the Single Family Housing Enterprise Data Warehouse.

[30] In the software release life cycle, general availability refers to the marketing phase when all commercialization activities pertaining to the software product have been completed and it is available for purchase.

[31] HUD Handbook 2400.25, REV-4.1

requirements to accurately document an inventory of information system components. As a result, computer systems running unsupported software are exposed to an elevated risk of cybersecurity dangers, such as malicious attacks or electronic data loss.

Servers Used in FHA Credit Subsidy Reform Estimation and Reestimation Process Vulnerable

The multifamily and single-family data sources for the credit reform estimation and reestimation process had not been properly protected. Vulnerability scans performed on both applications' servers identified vulnerabilities requiring remediation. Specifically, five vulnerabilities were identified in the June 2017 scan of the Housing Multifamily On-Line Property Integrated Information Suite Data Mart[32] (HM-OPIIS) servers, and three vulnerabilities were identified in the February 2017 and July 2017 scans of the SFHEDW[33] servers. While OCIO had addressed and remediated two of the five vulnerabilities identified within HM-OPIIS, three remained outstanding. These vulnerabilities have not been addressed because the OCIO and FHA do not agree on who is responsible for addressing and remediating the vulnerabilities. OCIO stated that the remediation for the remaining vulnerabilities falls at the application level. However, HM-OPIIS management believes that the remaining three vulnerabilities fall under the purview of OCIO. Although FHA attempted to remediate the three SFHEDW vulnerabilities identified in the February 2017 scan, the same vulnerabilities were identified in the July 2017 scan. The vulnerabilities identified in July have not been fixed because the SFHEDW information technology support contractor has not been able to determine the cause of the problems. As a result, the confidentiality, integrity, and availability of the data required for the credit reestimation process could be at serious risk if the vulnerabilities identified with HM-OPIIS and SFHEDW are not remediated in a timely manner.

Followup on Information System Control Weaknesses Previously Identified in FHA's SFPCS-P and SAMS

In an audit we conducted in fiscal year 2016,[34] we found that the general and application controls over SFPCS-P and SAMS did not fully comply with Federal requirements and HUD's own security policies. FHA classified SFPCS-P as a low-impact instead of a moderate-impact system, and some software used by SFPCS-P was outdated. In addition, some interface reconciliations of the data between the source system and SFPCS-P and SAMS were insufficient, and SFPCS-P application release documents were not processed and maintained properly by the

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32 HM-OPIIS is a data repository, which consolidates and standardizes data from multiple internal and external sources. It is used by field office asset managers, appraisers, and underwriters to more accurately focus default prevention, loss mitigation, and other risk management activities and to prioritize workloads so as to address the highest risk properties first.

33 SFHEDW is an integrated data warehouse that contains critical data from 21 originating source systems, which are mostly owned by the offices within the Office of Single Family Housing. SFHEDW is a key source for HUD employees and contractors who require access to single-family mortgage and insuring data. The system allows queries for reporting to support oversight activities, market and economic assessment, public and stakeholder communication, planning and performance evaluation, policy and guideline promulgation, monitoring, and enforcement.

34 Audit report 2017-DP-0002, Review of Information Systems Controls Over FHA's Single Family Premiums Collection Subsystem – Periodic and the Single Family Acquired Asset Management System, issued February 9, 2017. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

HUD Application Release Tracking System. Further, HUD had not included SFPCS-P in its disaster recovery exercise for more than 4 years. Also, segregation of duties for SFPCS-P developers and least privilege[35] and segregation of duties requirements for SAMS users were not fully implemented, and SFPCS-P security documents were inaccurate.

We followed up on the status of these weaknesses during fiscal year 2017. HUD was addressing the weaknesses identified and implementing appropriate corrective actions. These actions are scheduled to be completed by the end of the first quarter of fiscal year 2019.

Followup on Information System Control Weaknesses Previously Identified in FHA's SFIS and Claims Systems

In an audit we conducted in fiscal year 2016,[36] we found that the general and application controls over SFIS and Claims did not fully comply with Federal requirements and HUD's own security policies. There were inconsistencies between soft error codes identified for claims submitted in May 2015 and the soft error code list maintained by FHA. In addition, for claims reported in the June 2015 suspense report, there were inconsistencies in 341 claims with errors in the initial case data and 2,018 claims with errors in the fiscal data of the application for single-family insurance benefits. OCIO also did not retain the history of software modifications, including the related approvals made throughout the development and life of the Claims system, for more than 5 years.[37] Further, user access controls for SFIS and Claims were not adequately managed. SFIS and Claims management did not adequately implement effective application configuration management for the SFIS and Claims systems.

We followed up on the status of these weaknesses during fiscal year 2017. HUD was addressing the weaknesses and implementing appropriate corrective actions. These actions are scheduled to be completed by the end of the first quarter of fiscal year 2018.

Conclusion

FHA must improve its contract oversight of its application service provider and information security controls over the data sources used in its credit reform estimation and reestimation process to comply with Federal requirements and its own security policies to prevent an increased risk of unauthorized disclosure or modification of FHA system data.

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[35] HUD's Information Technology Security Policy requires that program offices and system owners employ the concept of least privilege, allowing only authorized accesses for users (and processes acting on behalf of users), which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.

[36] Audit report 2016-DP-0003, Additional Review of Information System Controls Over FHA Information Systems, issued August 31, 2016. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

[37] OCIO used the National Archives and Records Administration General Records Schedule 3.1 for General Technology Management Records as a guide to limit the retention of operational history of system changes to 5 years. However, the schedule also states that when the business need requires longer retention of the information, it should be saved and protected. The FHA Office of Finance and Budget requires operational change and configuration history for all system configuration and changes during the life cycle of the Claims system.

Recommendations

Recommendations are included in a separate Office of Inspector General (OIG) audit report. Therefore, no recommendations are reported here.

Scope and Methodology

In accordance with the Chief Financial Officers Act of 1990, as amended, OIG is responsible for conducting the annual financial statement audit of FHA. The scope of this work includes the audit of FHA's balance sheets as of September 30, 2017 and 2016, and the related statements of net costs and changes in net position, the combined statements of budgetary resources for the years then ended, and the related notes to the financial statements. We conducted this audit in accordance with U.S. generally accepted government auditing standards and OMB Bulletin 17-03, Audit Requirements for Federal Financial Statements. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To fulfill these responsibilities, we

- Examined, on a test basis, evidence supporting the amounts and disclosures in the principal financial statements.
- Assessed the accounting principles used and the significant estimates made by management.
- Evaluated the overall presentation of the principal financial statements.
- Obtained an understanding of internal controls over financial reporting (including safeguarding assets) and compliance with laws and regulations (including the execution of transactions in accordance with budget authority).
- Tested and evaluated the design and operating effectiveness of relevant internal controls over significant cycles, classes of transactions, and account balances.
- Tested FHA's compliance with certain provisions of laws and regulations; governmentwide policies, noncompliance with which could have a direct and material effect on the determination of financial statement amounts; and certain other laws and regulations specified in OMB Bulletin 17-03, including the requirements referred to in FMFIA.
- Considered compliance with the process required by FMFIA for evaluating and reporting on internal controls and accounting systems.
- Performed other procedures we considered necessary in the circumstances.

We considered internal controls over financial reporting by obtaining an understanding of the design of FHA's internal controls, determined whether these internal controls had been placed into operation, assessed control risk, and performed tests of controls to determine our auditing procedures for expressing our opinion on the principal financial statements. We also tested compliance with selected provisions of applicable laws, regulations, and government policies that may materially affect the principal financial statements.

With respect to internal controls related to performance measures to be reported in FHA's Fiscal Year 2017 Annual Management Report, we obtained an understanding of the design of significant internal controls as described in OMB Bulletin 17-03. We performed limited testing procedures as required by the American Institute of Certified Public Accountants' auditing standards at AU-C, section 730, Required Supplementary Information, and OMB Bulletin 17-03. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We did not evaluate the internal controls relevant to operating objectives as broadly defined by FMFIA. We limited our internal controls testing to those controls that are material in relation to FHA's financial statements. Because of inherent limitations in any internal control structure, misstatements may occur and not be detected. We also caution that projection of any evaluation of the structure to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal controls over financial reporting that might be significant deficiencies. We noted certain matters in the internal control structure and its operation that we consider significant deficiencies under OMB Bulletin 17-03.

Followup on Prior Audits

The current fiscal yearend status of open recommendations from prior-year reports on FHA's financial statements are provided below. Specifically, we identified seven unimplemented recommendations from prior-year reports. FHA should continue to track these recommendations under the prior-year report numbers in accordance with departmental procedures. Each of these open recommendations and its status is shown below.

Federal Housing Administration Fiscal Years 2016 and 2015 Financial Statements Audit, 2017-FO-0002

With respect to FHA not having effective monitoring and processing controls over its unliquidated obligation balances and using inaccurate data to report on its undelivered orders, we recommend that the Acting FHA Comptroller

1.a. Establish and implement policies and procedures to ensure that accurate data are used to report the undelivered order balances for management and marketing contracts. (Final action target date is November 30, 2017; reported in the Audit Resolution and Corrective Actions Tracking System (ARCATS) as 2017-FO-0002-002-C.)

1.b. Ensure that the $276.5 million identified as invalid obligations in fiscal years 2015 and 2016 are deobligated as appropriate. (Final action target date is November 30, 2017; reported in ARCATS as 2017-FO-0002-002-D.)

With respect to FHA not fully implementing controls to collect the amounts for unsupported partial claims, we recommend that the Office of Single Family Housing

1.c. Revise FHA's internal control procedures to realign with its regulatory requirements so that the first reimbursement letter is sent immediately after 60 days instead of after 6 months and establish a timeframe for collection once partial claims are referred to the Mortgagee Review Board. (Final action target date is December 28, 2017; reported in ARCATS as 2017-FO-0002-003-B.)

1.d. Request payment in the amount of the claims paid, plus incentive, from mortgagees that have not provided the original note within the prescribed deadline for the $55.3 million. (Final action target date is December 28, 2017; reported in ARCATS as 2017-FO-0002-003-C.)

Federal Housing Administration Fiscal Years 2015 and 2014 Financial Statements Audit, 2016-FO-0002

With respect to FHA not fully implementing controls to prevent misclassification of the receivables, we recommend that the Office of Single Family Housing

2.a. Start the billing process for the claims paid, plus incentive, in which the lender has not provided the original note and security instrument within the prescribed deadlines for the $291 million. (Final action target date is November 30, 2016; reported in ARCATS as 2016-FO-0002-001-C.)

Federal Housing Administration Fiscal Years 2014 and 2013 Financial Statements Audit, 2015-FO-0001

With respect to FHA's not establishing appropriate receivables for legal settlements and partial claims notes, we recommended that the Director of Single Family Asset Management

3.a. Initiate the billing process for the claims paid, plus incentive, where the lender has not provided the original of the note and security instrument within the prescribed deadlines for the $1.5 billion. (Final action target date was October 31, 2015; reported in ARCATS as 2015-FO-0001-001-F.)

Federal Housing Administration Fiscal Years 2013 and 2012 Financial Statements Audit, 2014-FO-0002

With respect to undelivered orders for property-related contracts being reviewed annually and deobligated promptly, we recommended that the FHA Comptroller

4.a. Review and deobligate, as appropriate, the $43 million in expired property-related contracts once they have been closed out by the contracts office. (Final action target date was October 15, 2015; reported in ARCATS as 2014-FO-0002-001-C.)

Appendixes

Appendix A

Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
2.A.	$270,747,281
Totals	**270,747,281**

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	**Auditee Comments**

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

OFFICE OF HOUSING

November 13, 2017

MEMORANDUM FOR: Thomas R. McEnanly, Director, Financial Audits Division, GAF

FROM: Susan A. Betts, Housing, Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to Fiscal Year 2017 FHA Audit Report

Thank you for providing us the opportunity to respond to FHA's Independent Audit Report. FHA continues to place a primary focus on improvements in internal controls and made significant progress towards resolving prior year findings and will work with the OIG to resolve the findings identified in this report.

Report on Internal Control

Comment 1

Finding 1: Weaknesses Identified in FHA's Modeling Processes

FHA concurs with the findings and associated recommendations with respect to modelling processes and will develop corrective action plans for implementation this fiscal year.

Comment 2

Finding 2: FHA's Controls Over Financial Reporting Had Weaknesses

FHA concurs with the findings and associated recommendations. FHA has already implemented many of the recommendations in its FY 2017 financial statements.

Weaknesses in Deobligation of Unliquidated Balances Continued

With regards to this finding, FHA implemented process improvements during FY 2017 and will continue working to complete deobligations for the remaining invalid obligations associated with this finding this fiscal year.

Discrepancies Identified in FHA Systems Loan Endorsement Amounts and Inconsistent Methodology Used to Allocate Reestimates in FY 2016

FHA followed OIG's advice and restated its FY 2016 financial statement Note 7 Direct Loans and Loan Guarantees and Note 12 Gross Cost to reflect the correct balances in the comparative financial statements.

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Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

In addition, FHA agrees that a process is needed to reconcile endorsement balances between the CHUMS and HERMIT systems and to be able to explain any variances at the case level, at the end of each reporting period. As of September 30th, the endorsement balance in HERMIT was less than CHUMS by $9,861,499 due to timing differences of pending updates between the two systems. FHA coordinated with the CHUMS contractor to identify the cases associated with the difference and has already taken the necessary steps to appropriately process these adjustments.

To address this finding, FHA has developed a monthly process to reconcile timing differences at the case level, and will ensure effective follow-up and tracking to resolve the differences timely going forward.

Finding 3: FHA's Controls Related to Partial Claims Improved, But Weaknesses Remain

Comment 3

The Office of Single Family Asset Management agrees with the recommendations contained in the previous audit findings and recommendations (there were no additional recommendations in this audit) and continues to work towards full implementation by the end of the first quarter FY 2018, as agreed to in the previous Management Decision.

Finding 4: Weaknesses Were Identified in Selected FHA Information Technology Systems

Comment 4

FHA concurs with the additional findings and will continue to work to address the previous OIG recommendations in FY 2018.

OIG Evaluation of Auditee Comments

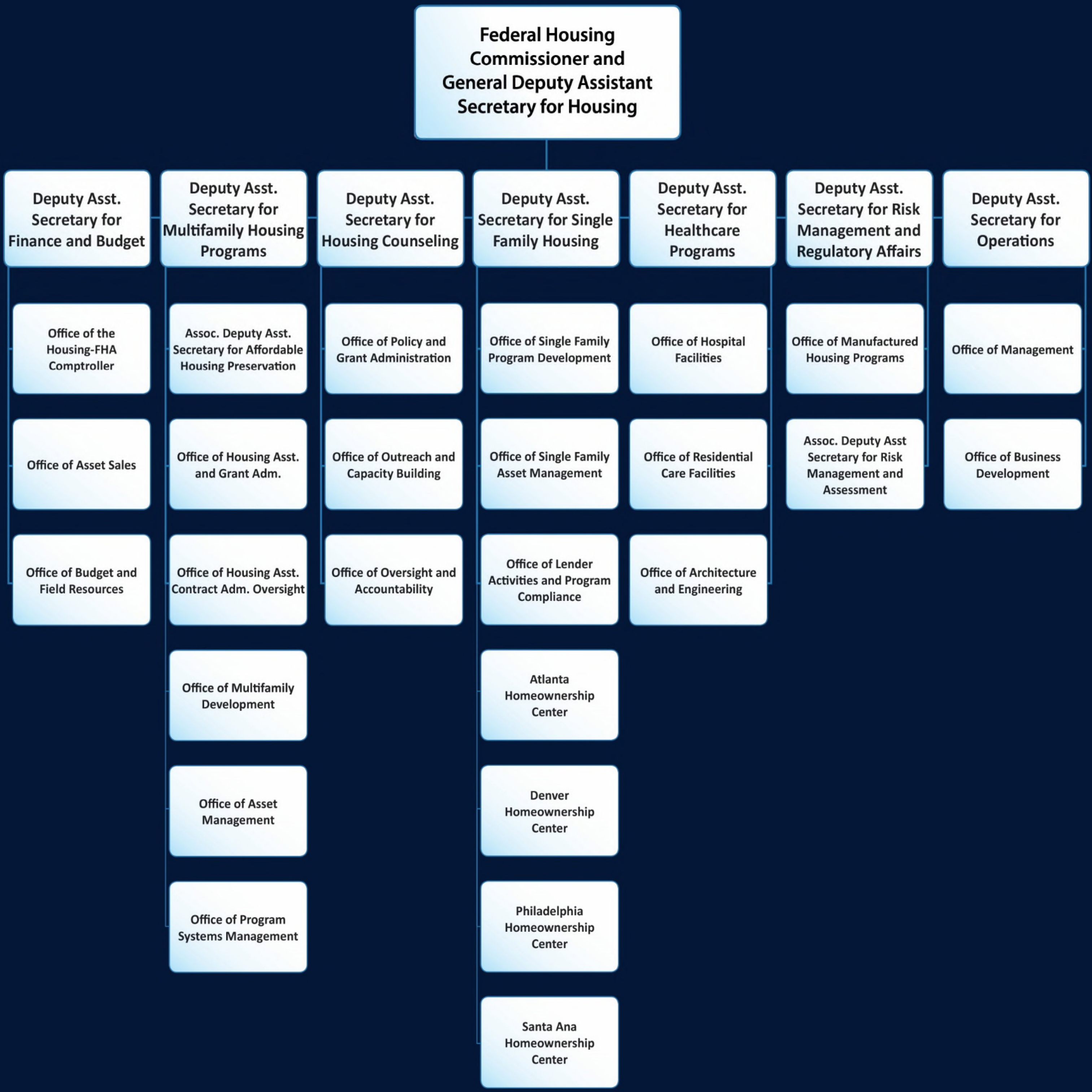
Comment 1 OIG accepts the response of concurrence with the recommendations. FHA's continued efforts in improving its controls over the modeling process will improve the reliability of the estimation process and reliability of financial information related to the loan guarantee liability.

Comment 2 OIG accepts the response of concurrence with the recommendations. FHA should continue their efforts to improve their internal controls over financial reporting in order to improve the reliability of the financial statements.

Comment 3 OIG accepts the response of concurrence with the finding and previous year's recommendations. FHA's continued efforts to bill noncompliant lenders will continue to improve the status of the MMI fund.

Comment 4 OIG accepts the response of concurrence with the finding and recommendation and looks forward to working with FHA to reach a mutually acceptable management decision to close out the recommendations during the audit resolution process.

FHA ORGANIZATIONAL CHART



https://www.hud.gov/sites/documents/FHAFY2017ANNUALMGMNTRPT.PDF

ANNUAL MANAGEMENT REPORT

Your Door to
FHA
HOMEOWNERSHIP