



FHA

FEDERAL HOUSING ADMINISTRATION



ANNUAL MANAGEMENT REPORT



FISCAL YEAR 2016

FHA'S MISSION

To contribute to sustainable communities
by facilitating the financing of homes,
rental housing and healthcare facilities and
providing quality affordable housing options
in a manner that mitigates taxpayer risks
and protects consumers.





This Annual Management Report (AMR) for the fiscal year ending September 30, 2016 provides the Federal Housing Administration's financial and summary performance information in accordance with OMB Circular A-136, Financial Reporting Requirements.

The Agency's AMR is available on the website below. FHA welcomes feedback on the form and content of this report. <http://portal.hud.gov/hudportal/documents/huddoc?id=fhafy16annualmgmnrpt.pdf>.

This report is divided into four sections:

- ***A Message from the Principal Deputy Assistant Secretary for Housing*** is a letter that highlights FHA's mission, vision, achievements for the year and communicates the direction and priorities of the Agency.
- ***Management's Discussion and Analysis (MD&A)*** defines the organization's mission, program activities, performance goals and objectives, and includes management's assurances regarding compliance with relevant financial management legislation.
- ***Principal Financial Statements*** includes Financial Statements and Notes to the Financial Statements.
- ***Auditor's Report*** on the Federal Housing Administration's (FHA) fiscal year 2016 financial statements, internal controls and compliance with laws and regulations.



A MESSAGE FROM THE PRINCIPAL DEPUTY ASSISTANT SECRETARY

November 15, 2016

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

In its 82-year history FHA has helped more than 46 million families purchase a home, produced and preserved hundreds of thousands of units of affordable rental housing, and created access to critical healthcare facilities. This work helps give millions of Americans access to appropriate housing of their choice and build a strong financial future.

In fiscal year 2016 we made substantial progress toward accomplishing a number of goals. FHA continued to implement important initiatives that have been under development, provided support for the market, improved risk management processes, and increased access to credit for consumers while continuing to manage the Mutual Mortgage Insurance and General Insurance-Special Risk Insurance Funds. This report outlines FHA's important achievements and metrics including:

- **Single Family: Strengthening the MMI Fund**

Ongoing risk management and thoughtful policy implementation continue to protect and strengthen the value of the MMI Fund. As a result, this fiscal year the Fund's economic net worth improved by \$3.8 billion, and is now valued at \$27.6 billion in fiscal year 2016. Overall, the Fund has improved by \$43.9 billion dollars since fiscal year 2012. The Capital Reserve ratio continued to meet statutory requirements, rising from 2.07 to 2.32 percent.

Improvements were present both in portfolio performance and value. This ongoing recovery is indicative of FHA's strong fundamentals as a program and of the Agency's commitment to serving the market well. FHA continues to monitor the impact of HECM volatility on the health and strength of the Fund.

■ **Multifamily: Mission & Execution**

Multifamily Accelerating Processing (MAP) guidelines allow approved lenders to perform most underwriting activities and submit an underwriting summary and recommendation to HUD in order to expedite and better manage the development process. This year, the Office of Multifamily Housing Programs published a revised MAP Guide, implementing various underwriting changes and updates that will speed processing and insure consistent application of program requirements and credit standards across all offices.

FHA also announced a targeted Multifamily Mortgage Insurance Premium (MIP) reduction for mission-focused properties—those that are broadly affordable or those committed to sustainability and energy efficiency standards. FHA estimates this will encourage capital financing of an additional 12,000 units each year for the next three years – directly responding to the rental affordability crisis in many areas of the country. These changes are expected to leverage over \$400 million in new mortgage financing for affordable housing/energy-efficient development without significantly decreasing overall revenue and are made possible by the ongoing strong health of the Multifamily portfolio.

■ **Healthcare: Continuous Improvement**

Risk management and continuous improvement remain at the forefront of the Office of Healthcare Programs' (OHP) efforts. By implementing two new industry standard risk management tools for its Hospitals Portfolio, OHP can now better assess initial risk and monitor ongoing risk for the facilities that it insures. OHP also continued to work on streamlining, updating, and reforming its documentation across all programs. In conjunction with the Office of General Counsel, OHP completed the revision and processing of the documents required for administration of the Section 242 Hospital Mortgage Insurance Program. The Section 232 Program Handbook is also in the process of being updated which will help ensure consistency throughout the program.

■ **Housing Counseling: Protecting Consumers**

While not a part of the FHA, the Office of Housing Counseling(OHC) provides critical support to the housing market by protecting and educating the American people and ensuring that qualified housing counseling services are available across the country. OHC awarded \$42 million in grant funding in fiscal year 2016 to support the full spectrum of housing counseling services, including homeless, rental, pre-purchase, post-purchase, reverse mortgage, and foreclosure prevention counseling.

OHC continued to focus on fulfilling the statutory requirements of the Dodd-Frank bill that require the creation of a certification process for individual counselors. OHC also announced the creation of its Housing Counseling Federal Advisory Committee and held its first administrative committee meeting.



FHA remains committed and prepared to provide everyday Americans with access to homeownership opportunities, affordable rental housing, and critical healthcare facilities throughout the country. Across the board, FHA continues to make critical progress that supports the housing market, and the broader economy—helping to create opportunity for all.

A handwritten signature in black ink, appearing to read "E. Golding". The signature is stylized and cursive.

Edward Golding
Principal Deputy Assistant Secretary for Housing





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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 made by FHA approved lenders throughout the United States and its territories, backed by the full faith and credit of the U.S. government. As a result, lenders assume less risk, and are protected against losses from property owners defaulting on their mortgage loans. This guarantee of payment enables lenders to provide market rate loans to all eligible purchasers.

The FHA is the largest issuer of mortgage insurance in the world. Since its inception, FHA has insured over 46 million single family homes and 47 thousand multifamily and healthcare project mortgages. Through its insurance programs, FHA continues to originate loans, ensuring that low and moderate income families can still buy a home and that multifamily and hospital production can meet communities' needs.

Over the course of its history, FHA has provided essential benefits to the U.S. housing market including: countercyclical stabilization, disaster relief, housing counseling, and mission driven product innovation and standardization. It shaped the modern housing finance system. More recently, FHA has implemented valuable foreclosure prevention programs designed to prevent qualified homeowners from defaulting on their loans and refinance programs that provide access to affordable interest rates mortgages.

Today, FHA is working to establish a sustainable housing finance system with increased access to credit for homebuyers underserved by the current mortgage market. Additionally, FHA continues to serve the nation by stabilizing the housing market; promoting sound, sustainable and affordable housing options; assisting homeowners at risk of foreclosure to stay in their homes; ensuring that affordable rental housing is preserved and produced; and providing critical healthcare facilities with access to capital.

FHA ACCOMPLISHMENTS

- *Continued to rebuild FHA's Capital Reserve and maintained the 2 percent MMI Fund Capital Ratio.*
- *Expanded credit for responsible borrowers and those impacted by the great recession by insuring more loans with an average size of \$190,000 and an average credit score of 680.*
- *Completed the Multifamily Transformation (MFT). Enabling OMHP to accomplish more mission-related work with higher quality, improved risk management and better customer service.*
- *Issued \$4.1 billion in mortgage insurance commitments for hospitals and residential care facilities in FY 2016, while maintaining a low annual claim rate on a portfolio of \$32.6 billion in insured healthcare loans.*
- *Announced more than \$42 million in Grant and Training awards for FY 2016; formed the first Housing Counseling Federal Advisory Committee.*

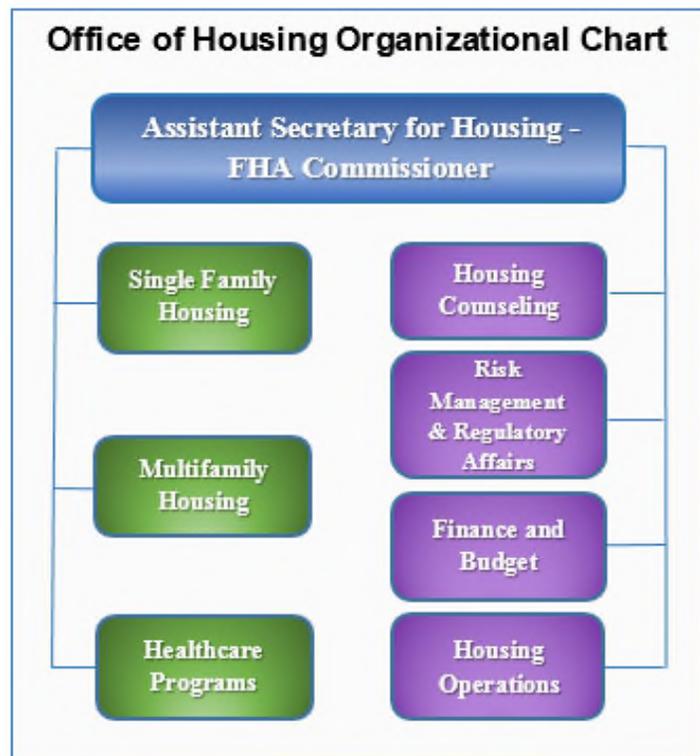
YOUR PARTNER IN OPPORTUNITY



MISSION AND ORGANIZATIONAL STRUCTURE

FHA’s mission is to contribute to sustainable communities, in support of the housing market and broader economy, by facilitating the finance of homes, rental housing, and healthcare facilities, and providing quality affordable housing options in a manner that mitigates taxpayers’ risks and protects consumers. FHA achieves its mission through a variety of paths, including insuring loans, consumer education, legislative action, and administrative rulemaking. Through its multifaceted programs, FHA has served its public mission well, and has acted as a catalyst for healthy communities and economic development throughout our nation. Contained within the Office of Housing, FHA is led by the Assistant Secretary for Housing-FHA Commissioner in ensuring effective execution of its mission. Currently, the position is held by the Principal Deputy Assistant Secretary, Edward L. Golding. Within the Office of Housing-FHA, several core departments, depicted below, play a key role in administering its programs and ensuring FHA maintains the highest standards of 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 assesses risks, collects insurance premiums, pays claims and predicts future liabilities. The Office of Housing Counseling awards grants to expand access to counseling for tenants and homeowners seeking to address their housing goals. This supports tenant and homeowner education, and helps homeowners avoid foreclosure. The Office of Risk Management and Regulatory Affairs 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 budget formulation and execution activities. FAB is also responsible for the overall integrity of FHA’s accounting records; the sale and disposition of mortgage assets; the preparation of the Annual Audit Report; the FHA Subsidiary Ledger (FHASL); and timely and accurate financial management reports on all FHA activity. The Office of Housing Operations supports all divisions with a variety of services, including contracting and procurement.



Today, FHA continues to emphasize its mission of serving its target population. Through its program operations, FHA remains an access point for homeownership for first-time homebuyers and those that would not otherwise be served by traditional markets. FHA will continue to work with the President and Congress to provide effective programs that support its mission and mitigate taxpayer risk.

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, 2015, with the net present value of future cash flows from outstanding books of business as calculated in the Annual Actuarial Review.

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

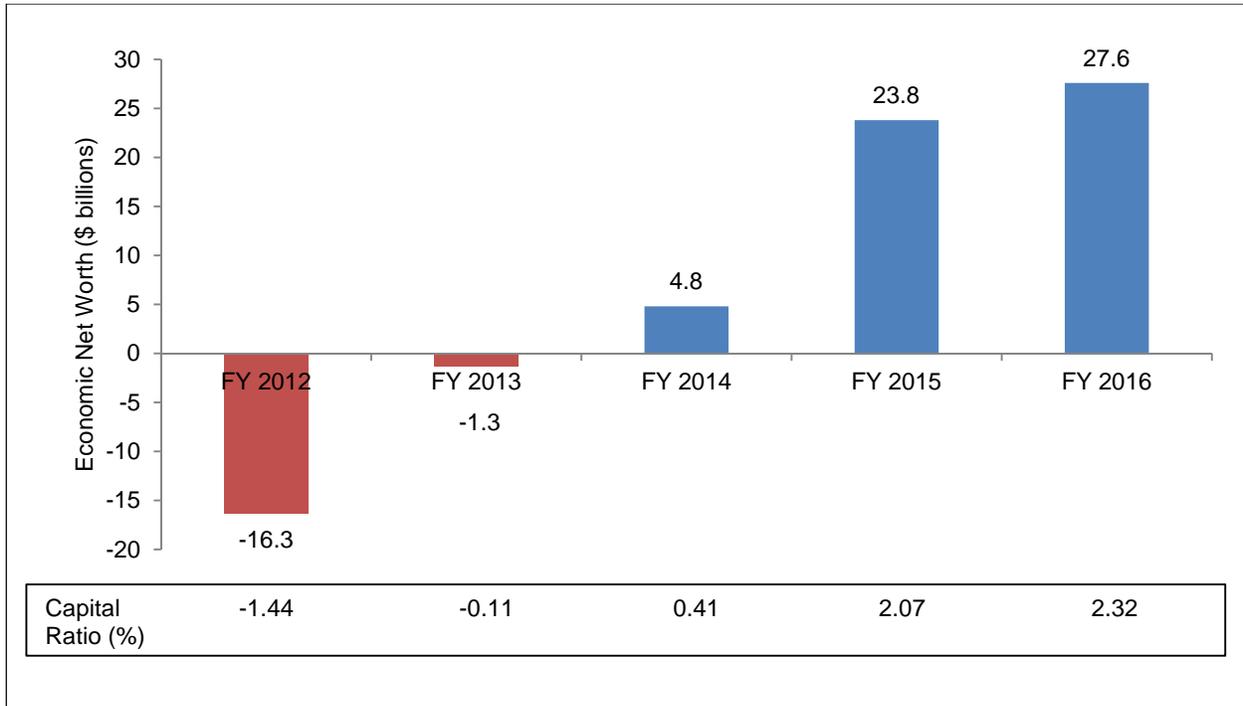
The financial crisis and economic recession that began in fiscal year 2008 strained the Fund – resulting in a negative economic net worth in fiscal year 2012. In response to the crisis and throughout the recovery FHA undertook a number of actions to protect and strengthen the value of the Fund. In fiscal year 2015, the MMI Fund once again exceeded its statutorily required 2 percent capital reserve ratio, reaching 2.07 percent.

In fiscal year 2016, the independent actuary reports that the MMI Fund's economic net worth improved by \$3.8 billion from last year's actuarial result—increasing from \$23.8 billion for fiscal year 2015 to \$27.6 billion for fiscal year 2016. Similarly, the capital ratio increased from 2.07 percent to 2.32 percent between fiscal year 2015 and fiscal year 2016. The MMI Fund has improved by \$43.9 billion since fiscal year 2012. The MMI Fund capital ratio similarly improved by 3.8 percentage points over that time, from negative 1.44 percent to positive 2.32 percent.

The portfolio valuation underlying the statutory capital ratio calculation is performed by an independent contractor, using FHA data and applying an independent economic forecast. 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. The particular portfolio value used for the capital ratio estimate is a statistical (arithmetic) mean across 100 potential economic paths. Using the mean value provides some measure of reserving against adverse outcomes. This approach creates a higher threshold of required net income from FHA loan guarantee operations before reaching the two percent capital ratio target



Results of the Independent Actuarial Study



SOURCE: FY 2012–FY 2016 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

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 rebuilding its value. The positive effects of streamlining the loss mitigation process, strategically deploying alternative disposition strategies, and responsibly expanding access to credit through the *Blueprint for Access* have been a critical part of the MMI Fund’s ongoing improved performance. These initiatives have laid the groundwork for FHA to be even better equipped to ensure affordable access to credit for future generations of borrowers. FHA also continued to work with the President and Congress to provide effective programs that support FHA’s mission, mitigate risk and restore FHA’s financial health.

As a result of policy changes and prudent risk management, FHA’s performance and financial health remains strong. 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 positive and portfolio performance remains strong.

PERFORMANCE GOALS AND OBJECTIVES

HUD STRATEGIC PLAN

The Government Performance and Results Act (GPRA) require that Federal agencies develop multi-year, strategic plans that include program goals and performance measures, the results of which are reported to the public. The HUD strategic plan for fiscal years 2014 through 2018, both defines and expands HUD's strategy for the future. This ambitious plan is the roadmap for HUD to achieve specific, measurable goals. Additionally, it defines areas of accountability and actions needed to transform HUD and reemphasize its mission *"to create strong, sustainable, inclusive communities and quality, affordable homes for all."* FHA is responsible for achieving substantial portions of the multi-year strategic plan and contributes to achieving the goals and sub-goals discussed below.

FHA's Strategic and Performance Goals





Contributing Programs

FHA is the key supporting office for Strategic Goal 1, *sub-goal 1A*, Establishing a Sustainable Housing Finance System; *sub-goal 1B*, Ensuring Equal Credit Access to Sustainable Housing Finance; and *sub-goal 1C*, Restoring FHA's Financial Health. This performance goal involves every FHA program that produces, manages, or finances FHA's insurance programs. In particular, the Office of Single Family Housing is responsible for achieving a substantial portion of these goals. The office of Housing Counseling also supports FHA in achieving these sub-goals.

FHA Multifamily programs facilitate the development and preservation of affordable housing to support the Department's Rental Assistance, Strategic Goal 2, *sub-goal 2A and 2B*. The Rental Assistance Demonstration Program (RAD) leverages FHA-insured financing and strengthens public and other FHA-assisted housing. Through fiscal year 2016, the program has brought nearly a billion dollars of investment into public and assisted rental housing while preserving over 42,000 deeply affordable units. FHA's multifamily programs also expanded and preserved the supply of affordable rental homes.

Additionally, FHA Office of Healthcare Programs is responsible for managing the progress towards Strategic Goal 3, *sub-goal 3C*, to promote the health and housing stability of vulnerable populations through quality, insured nursing homes. Finally, FHA Single Family Housing programs contribute to the Department's Energy Efficiency Goal 4, *sub-goal 4B*, by increasing the health and safety of homes, embedding comprehensive housing energy efficiency and healthy housing criteria across all programs.

Performance Reporting

FHA has developed a comprehensive Management Action Plan to address the strategic goals and sub goals identified. The significant targets and achievements for each of FHA's reporting sub-goals are presented in the following program sections of this document. Actual achievements for each sub-goal are reported as of June 30, 2016. Additional performance and volume data throughout this document are presented as of September 30, 2016. Targets and actual achievements as of September 30, 2016 will be reported in HUD's Annual Performance Report (APR), published in February 2017.

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 may affect its ability to influence key performance goals.





FHA PROGRAMS AND PERFORMANCE SECTION

Office of Single Family Housing



“Every day, the Office of Single Family Housing strives to seek the right balance between maximizing access to credit to single family homebuyers while mitigating risk to the Mutual Mortgage Insurance (MMI) Fund. In fiscal year 2016, the rate of delinquencies and defaults on both new mortgage loans and the overall loan portfolio dropped to historic lows, while the number of endorsements for FHA insurance increased by more than 10 percent, to roughly 4,000 single family home settlements every business day of the year.”

Bob Mulderig, Acting Deputy Assistant Secretary
Office of Single Family Housing Programs

The Federal Housing Administration (FHA) has provided affordable homeownership and refinancing opportunities for all Americans for the past 82 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, enabling those 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 programs strengthen our nation’s housing market, which in turn bolsters the economy. In fiscal year 2016, FHA endorsed 1,258,063 single family forward mortgages totaling \$245.4 billion. Our purchase business continues to primarily support first-time homebuyers. In fiscal year 2016, 82.1 percent of FHA purchase-loan endorsements were for first-time homebuyers. In addition, the unpaid balance on total active loans at year-end was \$1.1 trillion on 7,838,495 endorsed loans.

FHA has the authority to establish and collect an up-front mortgage insurance premium (MIP), as well as annual premiums. This up-front premium may be financed into the mortgage. 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 2016, the limit for a forward mortgage on an FHA-insured single family property in a low cost area was \$271,500, and in a high cost area was \$625,500. Higher maximum loan limits are available for properties in Alaska, Hawaii, Guam, and the Virgin Island. In fiscal year 2016, 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 loan programs to meet a wide range of borrower needs. Additionally, FHA-insured mortgages are attractive to investors because they can be packaged into mortgage-backed securities, which are then guaranteed by Ginnie Mae and backed by the full faith and credit of the United States Government.

Single Family Insurance Profile

Table 1 reflects FHA's Single Family insurance profile in fiscal years 2014 through 2016:

Single Family FHA Portfolio	FY2014	FY2015	FY2016	Trend
Total Forward Endorsements	786,353	1,116,232	1,258,063	
Total 203(b)	771,733	1,100,228	1,241,083	
203(b) Purchase	581,387	738,480	863,759	
Manufactured Homes (Title II)	12,806	16,914	20,367	
203(b) Refinance	190,346	361,748	377,324	
Manufactured Homes (Title II)	6,251	7,619	9,010	
Total 203(k)	14,620	16,004	16,980	
203(k) Purchase	13,610	14,909	15,762	
203(k) Refinance	1,010	1,095	1,218	
Total Reverse Endorsements (HECM)	51,617	57,990	48,868	
HECM Adjustable Rate	41,979	48,852	43,658	
HECM Fixed Rate	9,638	9,138	5,210	
Total Single Family Endorsements	837,970	1,174,222	1,306,931	
Total Active Loans at Year-end	7,787,092	7,742,143	7,838,495	
Total Title I	6,012	5,596	4,471	
Manufactured Homes	464	645	785	
Property Improvements	5,548	4,951	3,686	

Forward Mortgage Insurance Portfolio

The FHA forward mortgage insurance products 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 2016, 82.1 percent of home purchasers under the FHA's forward mortgage program were first-time homebuyers, and 32.6 percent of all borrowers (both home purchase and refinance) were minority borrowers. In addition, the number of FHA forward mortgage borrowers in fiscal year 2016 classified as low or moderate income households represented 47.7 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	FY2014	FY2015	FY2016	Trend
Forward Mortgage Market				
Average Loan Amount	\$171,954	\$190,928	\$195,068	
Average Credit Score of Borrowers	682	679	680	
First-Time Homebuyers	483,050	614,309	722,075	
% of SF FHA Forward Purchasers	81.2%	81.5%	82.1%	
Minority Borrowers	216,738	287,019	340,310	
% of all SF FHA Forward Mortgage Borrowers	32.3%	32.5%	32.6%	
Low/Mod Income Borrowers	389,391	518,414	599,540	
% of all Forward Mortgage Borrowers	57.8%	58.7%	47.7%	
Reverse Mortgage Market				
Average Initial Principal Limit (amount available)	\$154,777	\$164,855	\$180,055	
Average Loan Amount	\$261,943	\$278,146	\$300,002	
Minority Borrowers	10,105	11,103	8,006	
% of all SF FHA Reverse Mortgage Borrowers	19.6%	19.1%	16.4%	
Average Age of Borrowers	72	72	73	

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. The Section 203(b) is FHA's largest Single Family program, covering 97.9 percent of total Single Family Insurance-in-Force, 98.7 percent of forward mortgage loans insured, and 95 percent of all mortgage loans insured (including reverse mortgages) in fiscal year 2016

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 non-profit agencies and governmental entities.

Highlighted: Hardy Street Single Family Redevelopment Project



The Tarrant County Housing Partnership (TCHP), the City of Fort Worth, TX Neighborhood Housing Services, and HUD/FHA partnered to build nine new single family homes in the Diamond Hill-Jarvis neighborhood in Fort Worth on the site of a former nursing home that had been demolished by the city. The development is part of a citywide effort to increase the availability of affordable housing while rebuilding and stabilizing neighborhoods. The new homes are located on Hardy Street, and sold quickly to low and moderate income families who are working toward financial sustainability and earning less than 80 percent of area median income. The six homebuyers who utilized FHA-insured financing to purchase their home also received down payment and closing cost assistance to help with their purchase.

Section 203(k): Rehabilitation Loan

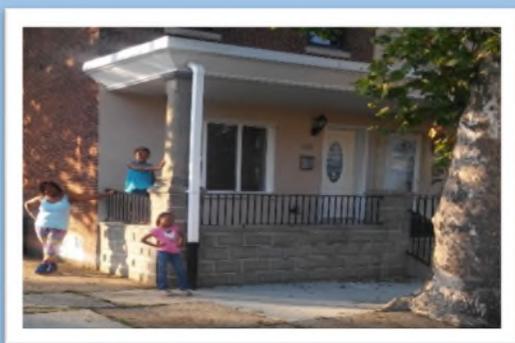
FHA's Section 203(k) Program is designed to finance both property acquisition and improvement costs into a combined mortgage loan. The program offers purchase and refinance options that may be used to make repairs necessary to meet minimum property standards or to increase functional utility. Section 203(k) is available in both Standard and Limited forms based on the amount necessary to make the desired improvements and the complexity of improvements to be financed. FHA endorsed 16,980 Section 203(k) loans in fiscal year 2016; the program remains a vital tool for making functional enhancements to housing as well as for revitalizing aging housing stock.



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 2016, FHA insured 785 Manufactured Homes and 3,686 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).

Highlighted: First Time Homeownership Success Story



A single mom’s road to homeownership has been a remarkable achievement and a true testament to the ability to overcome life’s challenges. This first-time homebuyer achieved her dream of homeownership through an unusual combination of HUD programs: A Section 8 homeownership voucher; HUD-approved housing counseling; a municipal closing costs grant funded by HUD block grant assistance; and

an FHA-insured loan. While sharing her journey with an audience of over 50 residents at a recent housing event held at the housing counseling agency that supported her, the new homeowner excitedly reported that she is the first person she knows at her age to become a homeowner, and thanked all those responsible for helping her achieve her American dream.

Reverse Mortgage Insurance Portfolio

Section 255: Home Equity Conversion Mortgages (HECM)

FHA was the first organization to insure reverse mortgages on a national scale. 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 program fills a special niche in the national mortgage market, offering critical opportunities for seniors to access home equity to support financial and housing needs as they age. The 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.

Since the program's inception, FHA has endorsed 997,330 HECM loans, with peak utilization in fiscal year 2009 but lower—and more stable—levels of activity in recent years. FHA endorsed 48,868 HECM mortgages in fiscal year 2016, which is a 15.7 percent decrease from fiscal year 2015. FHA has taken important steps in the past two 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.

Performance Goals and Objectives

The Office of Single Family Housing is responsible for critical activities outlined in the fiscal year 2014-2018 HUD Strategic Plan to maintain or restore FHA's financial health and stabilize a recovering housing market. Below are the Management Action Plan activities that address Single Family's Sub-Goals, along with fiscal year 2016 achievements.

FHA is committed to ensuring the health of its Mutual Mortgage Insurance (MMI) fund. Policies for asset management have been promulgated to ensure that homeowners experiencing difficulty making their mortgage payments are afforded effective loss mitigation retention options. The Loss Mitigation Uptake Goal of greater than 20 percent measures the percentage of borrowers in default that are receiving an FHA-Home Affordable Modification Program (HAMP) loan. The modification re-default goal of less than 10 percent assesses the effectiveness of FHA-HAMP. In the event that Loss Mitigation Retention Options are not viable, the Portfolio Recovery measures FHA's effectiveness in disposing of single family notes and properties through its various disposition strategies.



Strategic Goal (G1) Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers			
G1 Sub-Goal			
1C Restore the Federal Housing Administration's financial health, while supporting the housing market recovery and access to mortgage financing.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	2016 Status
Achieve greater than 48% Single Family Recovery Rate for All Dispositions (Note sales, Pre-Foreclosure sales, REO conveyances and other third-party sales).	48%	49%	✓
Achieve greater than 20% of permanent loss mitigation actions for loans delinquent 90 days or more.	>20%	37%	✓
Reduce the re-default rate of modification recipients (within the first 3 months) to 10% or less.	<10%	6%	✓
Strategic Goal (G4) Build Strong, Resilient and Inclusive Communities			
G4 Sub-Goal			
4B Increase the health and safety of homes and embed comprehensive housing energy efficiency and healthy housing criteria across HUD programs.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	FY 2016 Status
Endorse 275 Energy Efficient Mortgages	275	160	✗

**Achievements are presented as of June 30, 2016

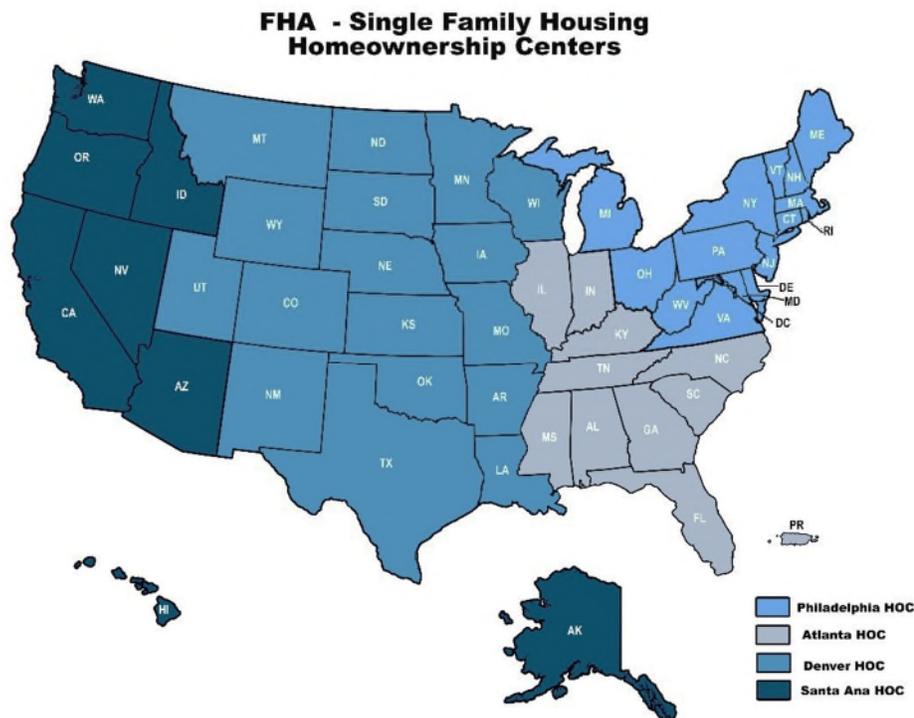
✓ Target met ✗ Target not met

✗ Explanation of Performance Measure not meeting target:

Energy Efficient Mortgages (EEM): The numbers during fiscal year 2016 continued to shift from the specialized Energy Efficient Mortgage (EEM), which limits mortgagors to specific energy improvements, to the more versatile 203(k) with an energy component. The latter allows for energy enhancements, along with other improvements that would not be permitted in a standard EEM. Currently in fiscal year 2016 and through June 30, 2016, FHA has endorsed 5,006 203(k) loans with completed repairs and reporting an energy component.

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 as a subsidiary. 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.





Highlighted: Atlanta Homeownership Center (AHOC)



On June 22, 2016, the Atlanta Homeownership Center's (AHOC) Program Support Division partnered with the Atlanta Legal Aid Society and FHA's Office of Housing Counseling to provide training to 46 HUD-approved, Georgia-based housing counselors and nonprofit organizations. The session received positive feedback with many request for similar training.

Key Accomplishments in Fiscal Year 2016

The following discussion summarizes some of the key accomplishments of the Office of Single Family Housing in fiscal year 2016:

■ **FHA Resource Center Management and Operations**

In fiscal year 2016, the FHA Resource Center and HUD staff processed and closed 805,936 inquiries. The volume of inquiries process by HUD staff increased by 7.7 percent over fiscal year 2015. Timely responses were made by either Homeownership Center staff or the staff of the Resource Center contractor, under the jurisdiction of the Philadelphia Homeownership Center. In addition to responding to external inquiries, the Resource Center also manages and regularly updates approximately 2,000 internal and external FHA Frequently Asked Questions (FAQs) that supplement the *Single Family Housing Policy Handbook 4000.1* (SF Handbook) and other policy regulations.

■ **Electronic Appraisal Delivery**

As part of Single Family Housing's business transformation initiative, the Electronic Appraisal Delivery (EAD) portal—a web-based technology system—was designed to eliminate the paper appraisal submission process. This electronic appraisal submission system became effective for mandatory use for most single family property appraisals on June 27, 2016.

The system was first released and operable at the beginning of fiscal year 2016, allowing mortgagees to begin the onboarding process. By the end of the fiscal year, more than 90 percent of lenders (based on volume) had been on boarded, and more than 1,600 FHA-approved lenders had successfully migrated to the EAD portal by the mandatory implementation date. As of September 30, 2016, 474,964 appraisals have been successfully submitted through the EAD portal

- **Handbook 4000.1, Single Family Housing Policy**

The goal of the FHA *Single Family Policy Handbook* 4000.1 (SF Handbook) is to create a single authoritative source of single family housing policy that aligns the SF Handbook to the mortgage process while making it easier to understand by using clear, consistent, and direct language. Handbook 4000.1 replaces dozens of prior HUD Handbooks, hundreds of mortgagee letters, and housing notices, as well as other sources of policy guidance. By the end of fiscal year 2016, the majority of the SF Handbook had been published and the policy information contained within was effective. Major sections currently in progress include Title I, Condo Project Approval, and the Home Equity Conversion Mortgage program. There were five updates this year: two general policy updates, an incorporation of loan servicing changes, and two publications to include previously announced guidance.

- **Property Assessed Clean Energy (PACE) Guidance**

The Office of Single Family Housing (OSFH) was asked to help increase the ability of homeowners to adopt energy efficient improvements and resilience measures through Property Assessed Clean Energy (PACE), while helping consumers with PACE obligations sell their homes. OSFH developed a policy that would allow borrowers to purchase a property with a residential PACE assessment using FHA-insured financing.

OSFH created a team that developed eligibility requirements for the borrower, property, and PACE assessment as well as guidelines on the application of FHA appraisal policy for properties with PACE assessments. After the publication of the Mortgagee Letter on July 19, 2016, OSFH posted Frequently Asked Questions (FAQs) for potential FHA borrowers, conducted an industry call and participated in a Department of Energy (DOE) webinar. OSFH provided significant input and helped refine the DOE's best practice recommendations for PACE program design and operation. In addition, OSFH assisted DOE in the planning of a White House convening on PACE in October 2016 to include industry and government participation. For monitoring PACE loans, FHA Connection has been updated to identify FHA loans with PACE obligations, and additional work on identifying such loans in the Single Family Data Warehouse will be required over the next year.

- **Improving the Effectiveness of the Single Family Property Disposition Program**

In March 2016, Single Family published the inaugural version of the Claims and Disposition section in the new FHA *Single Family Housing Policy Handbook* 4000.1. The section consolidated existing disposition guidance found in the 1994 Property Disposition Handbook—One to Four (HUD Handbook 4310.5), subsequent mortgagee letters, relevant housing notices, and other disposition policies and regulations published since 1994.

On August 11, 2016, HUD issued a final rule to revise the property disposition regulations. This rule consolidates and reorganizes regulations to better reflect industry standards and allows HUD to conduct the Single Family Property Disposition Program more efficiently and effectively, to ensure that it obtains the greatest value for REO properties in fluctuating market conditions.



In September 2016, Single Family procured and awarded for the first time in FHA's history a Best Execution Contract to help determine the best strategy and execution for maximizing returns to the FHA Mutual Mortgage Insurance (MMI) fund once an FHA-insured mortgage goes into default. The goal of the "Best-Execution" initiative is to ensure that FHA targets assets for the best possible disposition strategy and eliminates inefficiencies within the disposition process while mitigating financial risk to the MMI fund. This strategy will allow for the disposition of properties at optimal value at any point during the delinquency, loss mitigation, or REO process, resulting in an increased rate of return and a reduction of risk.

- **New Guidelines for HECM Program**

The Office of Single Family Housing issued a proposed rule updating Federal regulations for the Home Equity Conversion Mortgage (HECM) program that codifies years of changes authorized by the Housing and Economic Recovery Act of 2008 and the Reverse Mortgage Stabilization Act of 2013, as well as proposing other policy changes. HECM regulations had not been substantially updated for over 20 years. In fiscal year 2016, Single Family Housing took major strides to ensure the program remains viable as a sustainable resource for seniors, while at the same time safeguarding the Mutual Mortgage Insurance (MMI) fund. On July 13, 2016, Single Family issued Mortgagee Letter 2016-10 that updated and revised the HECM Financial Assessment and Property Charge Set Aside policies, originally published in November 2014.

Single Family Portfolio Management

Single Family Notes Inventory

Single Family Notes are assigned to the Secretary when FHA pays a claim to a lender, prior to foreclosure, and takes possession of the mortgage note for servicing. As of September 30, 2016, Secretary-held notes totaled \$22.9 billion. This total includes assigned HECM first mortgages, partial claim notes on FHA-insured forward mortgages, and other notes held by HUD in connection with various forward mortgage programs. Of the aforementioned notes, HECM assigned notes as of September 30, 2016 represent \$12.2 billion. In addition, there is approximately \$104 billion in principal limit of HECM insured loans outstanding for which HUD holds a second note or mortgage.

Partial claim notes are created when a lender advances funds on behalf of FHA-insured homeowners for an amount necessary to reinstate a delinquent loan. Upon acceptance of the advance, the borrower executes a promissory note creating a secondary mortgage payable to FHA. This promissory note or “partial claim” is not due and payable until the borrower pays off the first mortgage or no longer owns the property. The balance of Single Family partial claim notes increased by 6.5 percent, from 382,166 notes at the end of fiscal year 2015, to 408,867 at the end of September 2016. The increase is primarily due to the FHA Home Affordable Modification Program (HAMP), which combines a partial claim with a loan modification.

Single Family Loan Sales

FHA continued Single Family loan sales under the Distressed Asset Stabilization Program (DASP), which sells defaulted FHA-insured loans through a competitive auction to qualified bidders. The goal of the program is to maximize returns to the Mutual Mortgage Insurance (MMI) Fund while providing another disposition alternative for defaulted single family mortgages, rather than having these assets conveyed to FHA as foreclosed properties. By developing the infrastructure to market and sell these non-performing loans in bulk, the agency is positioned to benefit from today’s unique market dynamics where investor demand is very high.

The DASP sales are part of a broader effort to reduce losses and increase recoveries to the MMI Fund. By reducing claim expenses and improving recoveries, FHA is able to rebuild its reserves at a time when the MMI Fund is still recovering from the impact of the mortgage crisis. Since 2012, due in part to the DASP program, overall losses on defaulted assets has declined. As FHA has worked to improve the recovery on these pools, loan sales bids have improved from an average of approximately 35 percent of the unpaid principal balance in fiscal year 2010 to 51 percent in fiscal year 2016 for loans sold. In fiscal year 2016, FHA conducted four sales of defaulted Secretary-held loans. In these sales, HUD awarded 23,116 loans with an unpaid principal balance of \$4 billion. DASP sales have reduced claims losses by \$2.4 billion or approximately \$16,346 per unit.

Risk Management

FHA continues to enhance its risk management framework and strengthen its lender network by implementing new policies, refining existing processes, and developing additional technological capacity. These enhancements will protect the health of the FHA insurance fund as well as make FHA more efficient and effective in serving its mission.

- **Lender Insight Quarterly Newsletter.** June 2016 marked the three-year anniversary of “*Lender Insight*” and the publication of its twelfth issue. The newsletter was created to offer insight to lenders about what FHA is seeing in lender approval, recertification, monitoring and compliance, and enforcement actions. Each issue contains core information designed to help lenders better understand the trends FHA is observing, improve quality control and risk management practices, and alleviate many of the common problems encountered early on in the process before FHA intervention is necessary. In fiscal year 2016, the newsletters highlighted FHA’s lender and loan review processes, recertification requirements, and enhanced quarterly findings results focusing on the most prevalent unacceptable findings.



- **Quality Assurance Loan Review Findings Reports.** On December 31, 2015, FHA expanded its issuance of lender-specific Quarterly Loan Review Findings Reports to its top 75 lenders. The reports provide a quarter-by-quarter snapshot of the results of FHA's quality control review of a specific company's loan production over the previous 24 months.
- **Mortgagee Review Board: Administrative Actions Posted in Federal Register.** On May 11, 2016, FHA published all completed administrative actions taken by the Mortgagee Review Board during the period from October 1, 2014 to September 30, 2015. The *Federal Register* Notice (Docket No. FR-5948-N-01) identified the cause and provided a description of the administrative actions taken by HUD's Mortgagee Review Board against HUD mortgagees in 14 fact-based cases and 48 mortgagee recertification violations.
- **Lender-Level Certifications.** On August 1, 2016, HUD issued final revisions to the certification statements included in the Online Application for Lender Approval and the Annual Certification for FHA-approved lenders (collectively, "lender-level certifications"). HUD initially published a Notice in the *Federal Register* at 81 FR 13816 on March 15, 2016 requesting public comment on initial changes to the lender-level certifications. The final version incorporates changes made as a result of the Departmental Clearance and the public comment period. The final published revisions bring the lender-level certifications up to date with HUD Handbook 4000.1, improve the clarity of HUD policy related to lender-level certifications, and reinforce HUD's lender enforcement capabilities.
- **Loan Review System.** The Loan Review System (LRS)—one of Single Family Housing's highest technology priorities—is designed to manage all aspects of FHA's loan- and lender-level quality control processes in a single system, providing FHA-approved lenders with consolidated results across review types and Homeownership Centers. It will also allow FHA to implement its Loan Quality Assessment Methodology (Defect Taxonomy), issued on June 18, 2015, which is a key part of HUD's Strategic Objective 1B: Credit Access. The Defect Taxonomy was designed to provide greater clarity and transparency on loan review results, thereby, reducing market uncertainty and encouraging lending to qualified borrowers across the credit spectrum. Once the Defect Taxonomy is implemented in the LRS, lenders will be able to more easily identify specific problem areas and reduce errors that could harm borrowers or pose a risk to the MMI fund. On April 8, 2016, Single Family completed the business requirements for the Loan Review System, and on June 24, 2016, the task order was issued to begin the design and development phase for the system. Final Delivery for Single Family Housing's LRS is expected in March 2017.





Office of Multifamily Housing



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

Priya Jayachandran, 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 2016, FHA initially endorsed 793 multifamily apartment loans totaling \$9.8 billion and 80 risk sharing loans totaling \$877.6 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 2016, 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 started a partnership with Treasury’s Federal Finance Bank to help increase the number of affordable units created.

Office of Multifamily Housing Transformation

The Office of Multifamily Housing has successfully implemented the Multifamily for Tomorrow (MFT) initiative in Headquarters and in all five regions. Through this initiative, Multifamily modernized and improved its business model for partners and stakeholders, while cultivating an exceptional environment for employees and realizing cost savings. MFT was announced in April 2013 and expanded work that began under previous initiatives to increase efficiencies and minimize risk, provide employees with new tools, and promote employee engagement.

The Northeast Region was fully implemented in May 2016; and the fifth and final region, the West Region, was completed in August 2016.

Table 1: Multifamily Endorsements by Program

Section of the Act	Endorsements for Fiscal Year 2016		
	Dollars (millions)	Percentage	# of Mortgages
Section 221(d)(4): New Construction and Substantial Rehabilitation Program	\$3,572	33%	202
Sections 223(f) and 223(a)(7): Purchase/Refinancing Program of Existing MHP Projects	\$6,271	59%	591
Section 542(b) and 542(c): Risk-Sharing with QPEs & HFAs	\$877	8%	80
Totals	\$10,720	100%	873

*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.

Multifamily Housing Programs

Administered through the FHA General Insurance (GI) and Special Risk Insurance (SRI) Funds, FHA's broad range of programs and loan terms bring down the cost of credit and induce developers to produce needed housing, providing consumers with a wide array of 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.

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 loans to finance repairs, additions and improvements on already FHA-insured projects.



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

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 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 of which must be affordable per the definition given for LIHTCs).

Additional details on these and other Multifamily loan programs are available at:

http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh

Performance Goals and Objectives

The Office of Multifamily Housing Programs (OMHP) has adopted Multifamily Performance Goals (MPGs), a set of sub-goals to assist in meeting the strategic plan and other MHP objectives. The MPGs align directly with the HUD Strategic Plan, specifically with its four strategic goals and its strategic management objectives.

Strategic Goal 2 (G2): Meet the Need for Quality Affordable Rental Homes			
G2 Sub-Goals			
2B Preserve quality affordable rental housing, where it is needed most, by simplifying and aligning the delivery of rental housing programs.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	FY 2016 Status
Ensure 75% of properties rated troubled during the fiscal year have an active action plan developed.	75%	81%	✓
Ensure 50% of properties with Rent Supplement or RAP contracts expiring in the fiscal year are to complete a RAD conversion.	50%	27%	✗
Preserve 35% of all Section 236 properties (that have mortgages maturing this fiscal year) with a 20-year HAP contract or a 20-year use agreement.	35%	42%	✓
Ensure 43,388 units with firm commitments issued during the fiscal year will be restricted through new or existing LIHTC or TE bonds.	43,388	33,184	✗

** Achievements are presented as of June 30, 2016

✓ Target met ✗ Target not met

✗ Explanation of Performance Measure not meeting target:

Achievements are presented as of June 30, 2016. Targets are for the entire fiscal year. OMHP is on track to meet the performance goals by the end of fiscal year 2016.

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 offer 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 five percent from the prior fiscal year, though at a lower level of volume than during the peak impact of the credit crisis when our countercyclical role was especially important for the economy and renters.

FHA has increased its focus on mission-driven, affordable lending and energy efficient design, while continuing to provide financing for borrowers who want the stability of long-term, fully-amortizing debt. Additionally, FHA supports special initiatives directed towards the elderly and underserved areas with high concentrations of low-income families. For instance, in fiscal year 2016, the Office of Production issued a notice that will expand the Risk-Share Program to allow Community Development Financial Institutions (CDFIs) and other mission-oriented lenders to utilize the program. This should increase the flow of credit to small multifamily properties (5-49 units), and demonstrate the effectiveness of providing Federal credit enhancement for refinancing and rehabilitation of such housing.

Highlighted: Second and Delaware Residences



Second and Delaware is a 276-unit multifamily development with an FHA insured loan located in the north end of the River Market district of downtown Kansas City, Mo. The project will be the largest passive house certified structure in the world and consume 90 percent less energy than comparable buildings in the area. The building will feature rooftop gardens, EV charging stations, triple glazed windows and polished concrete floors. This affordable project will be located in a highly walkable neighborhood known for its open-air farmers' market, many restaurants, and laid-back lifestyle. The transit-oriented project is one block north of the new streetcar and a five-minute walk from the Park and Ride terminal of the Kansas City Area Transportation Authority.



Office of Production Accomplishments

The Office of Production has enhanced policies and implemented initiatives in an effort to continue serving the community while maintaining financial viability. The initiatives include:

- **Multifamily Accelerated Processing (MAP).** MAP allows approved lenders to perform most of the underwriting activities that were once performed by HUD staff and submit an underwriting summary and recommendation to HUD in order to expedite and better manage the development process. A revised MAP Guide was published in fiscal year 2016, implementing various underwriting changes and updates to relevant processing standards. The updates incorporate all mortgagee letters, housing notices, administrative guidance and other changes based on operational experience in order to streamline the development process. Currently, 95 lenders are approved to process loans under MAP, with oversight by FHA's Multifamily Asset Counterparty Oversight (MACO) Division.
- **Mortgage Interest Premium Reduction.** In fiscal year 2016, FHA announced a reduction in the Multifamily Mortgage Interest Premium (MIP) rate for properties meeting affordability and/or energy efficiency guidelines. These rate reductions will facilitate the rehabilitation of an estimated 12,000 additional units of affordable housing per year nationally, meaning over the next three years nearly 40,000 families could benefit from higher quality affordable housing. These changes reflect the health of the FHA Multifamily portfolio and FHA's commitment to promote its mission initiatives.
- **Partnership with the Federal Financing Bank.** FHA has strengthened the link between the Federal Financing Bank (FFB) and the Small Building Risk Share (SBRS) Program. SBRS lenders may access, but are not required to use, FFB financing as a source of capital. FFB Risk Sharing Initiative is currently open to qualified housing finance agencies under 542(c) risk-sharing and SBRS lenders under 542(b) risk-sharing. FFB financing addresses the lack of low cost, fixed-rate long-term capital for affordable housing, which is particularly prevalent in rural and secondary markets.

Highlighted: Wood Ridge Homes



Wood Ridge Homes in North Andover, Mass., is a 230-unit, mixed-income apartment complex and has the first FHA multifamily loan in New England to combine LIHTC in partnership with MassHousing Finance Agency and FFB. All 230 units in the development receive project-based Section 8 subsidies. As part of the financing agreement, the property will have affordability restrictions on the units for 30 years. MHFA submitted an application for FHA mortgage

insurance on a \$34.5 million loan under the 542(c) Risk-Share program in which MHFA agrees to reimburse HUD 50 percent of any loss that may occur due to default. The tax credits are expected to generate approximately \$12 million in equity investment.

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.

Office of Recapitalization Accomplishments

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 the Department's rental housing preservation strategy.

- **RAD First Component.** RAD first component allows public housing agencies to leverage public and private debt and equity in order to reinvest in public housing stock. Through September 2016, 388 RAD first component applications were closed, covering 42,296 units and representing \$2.6 billion in new investment.
- **RAD Second Component.** RAD second component gives owners of multifamily housing properties with rent supplement and rental assistance payments project-based rental assistance contracts, Section 8 moderate rehabilitation, and Section 8 moderate rehabilitation single room occupancy properties the opportunity to enter into long-term project based rental assistance contracts that facilitate the financing of improvements. A total of 20,491 units representing 175 projects have been converted through RAD second component as of September 30, 2016.

RAD Second Component Programs	Number of Units
Rent Supplement	11,785
Rental Assistance Payments	7,603
Section 8 Moderate Rehabilitation	1,103

- **Section 236 Preservation.** This 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, 2016, Recap has preserved 58 projects representing 9,712 units of affordable rental housing.
- **Preservation Clinics.** Recap, in conjunction with the Office of Asset Management and Portfolio Oversight (OAMPO), began conducting one day “mini-clinics” to encourage HUD-assisted (Section 236 and Section 202) multifamily project owners to begin a path towards developing and implementing a preservation and recapitalization strategy for their affordable multifamily project prior to mortgage loan maturity. During fiscal year 2016, seven of the 10 preservation mini-clinics were held in San Francisco, California; Los Angeles, California; Chicago, Illinois;



Columbus, Ohio; Washington, D.C. and Atlanta, Georgia. Previous mini-clinics were held in Portland, Oregon; New York, New York; and Boston, Massachusetts.

- **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. The Green Initiative, which encourages owners and purchasers of affordable, multifamily properties to use sustainable green building principles, is also available through this program. In fiscal year 2016, Recap processed 25 projects in M2M; 9 of these properties, with 740 units, were full debt restructurings; 11 projects, with 1,073 units, were completed as rent restructurings. Additionally, 9 projects with 746 units elected to participate in M2M's Green Initiative program.
- **Senior Preservation Rental Assistance Contract (SPRAC).** This 20-year project-based rental assistance contract prevents displacement of income-eligible elderly residents who reside in Section 202 direct loan projects with original interest rates of six percent or less in the case of refinancing or recapitalization of the project. SPRAC is an important preservation tool for affordable multifamily properties for the seniors. In the Section 202 Supportive Housing for the Elderly Act of 2010, \$16 million was made available for SPRAC funding. As of September 2016, 11 projects representing 1,523 units have been preserved with a SPRAC using these funds.

Highlighted: American Gold Star Manor



American Gold Star Manor (AGSM) was developed in 1975. The 348-unit project was originally financed with a HUD Section 236 mortgage, with 139 units subsidized under a HUD rent supplement contract. AGSM has been converted through the RAD program to preserve affordability and allow recapitalization and rehabilitation of the

property. The property is restricted to senior and veteran residents aged 62 years or older earning between 30 - 60 percent of area median income. There is a waiting list preference for American Gold Star mothers and fathers, and U.S. veterans.

AGSM and its developer-partner, Abode Communities, are undertaking a major recapitalization and rehabilitation. Approximately \$58 million in renovations are planned at the project, including energy efficiency improvements, structural upgrades, new bathrooms and kitchens, windows and sliding doors, roofs, balcony railings, appliances and flooring. Work on the non-residential buildings include ADA upgrades. Renovation and construction are anticipated to be completed in January 2018.

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 2.48 million units; and manage relationships with internal and external partners. As of September 30, 2016, FHA's Multifamily-insured portfolio totaled 10,909 mortgages with a total outstanding principal balance of approximately \$78.5 billion.

Office of Asset Management and Portfolio Oversight Accomplishments

- **Property Disposition (PD) New Foreclosure Process.** In fiscal year 2016, FHA sold five Multifamily properties to successful bidders and has begun foreclosure action on 14 other multifamily properties, in addition to working with 15 troubled assets in the pre-disposition stage that will be proceeding to either an asset sale, foreclosure sale, or work out agreement. Many of these troubled assets represent former Group Homes affected by the Olmstead decision. Gross proceeds on the closed properties totaled \$3.1 million which represent a 38 percent rate of return for FHA based upon the unpaid principal balance. Moreover, in fiscal year 2016, FHA addressed multiple incidents at 67 properties with owners/developers who purchased, refinanced, redeveloped or revitalized previously sold properties with active Foreclosure Sale Use Agreement/Deeds. The Agency collected \$7.1 million in equity participation that was returned to the U.S. Treasury. FHA also administered over \$51.4 million in active Upfront Grants on redevelopment or rehabilitation activities, creating or restoring affordable housing assets for five post-sale properties. In fiscal year 2016, FHA's Multifamily Property Disposition Division adopted a new, improved process to continue the program's success and commitment to preserving the long-term viability of affordable multifamily housing assets.
- **Reinstitution of Management and Occupancy Reviews.** OMHP reinstated Management and Occupancy Reviews (MORs) in fiscal year 2016 for the 42 Performance Based Contract Administration (PBCA) that had ceased performing MORs due to budget constraints and litigation. The PBCAs were asked to prioritize properties that have been identified as posing the highest risk to the portfolio. MORs are a critical tool for asset oversight. MORs are designed to assess the management and oversight of multifamily housing projects and to determine the level of compliance with HUD's business agreements.



- **Improvements to New Policy Roll-Out.** During fiscal year 2016, OAMPO began improving the way policy is rolled out to the field, based on the recommendations of a design council of field and headquarters staff. The recommendations were based on a survey of asset management employees (with a 62 percent response rate) that asked about employees' experiences and preferences related to policy dissemination and training, and the processes for applying and clarifying new policies. Improvements include:
 - ❑ Establishing a consistent and predictable policy communication protocol including direct communication to all asset management staff via an "Asset Management Policy" email address
 - ❑ Emphasis on in-person follow-up by field office management, to help staff understand the priority level and impact on individual staff portfolios of new policies
 - ❑ Strategic targeting of training to those staff mostly likely to need the information, using training methods that fit the priority level and complexity of the policy
 - ❑ New online training site open to all staff that lists upcoming training and provides links to training documents and recordings of past events
 - ❑ New searchable, centralized policy library on OAMPO's online document storage platform, containing more than 1,700 fully searchable files, some of which were not previously available online
 - ❑ New online Q&A site that clarifies policies and procedures based on questions from the field staff

The recommendations are aimed at broadening policy expertise throughout the organization, enabling asset management staff to provide more accurate and timely service to customers. Additional recommendations will be implemented in fiscal year 2017.

Risk Management

Risk management is imbedded in all Office of Multifamily Housing programs and processes. During fiscal year 2016, Multifamily continued to introduce initiatives with a goal of better managing risk within its programs. The improvements from this issuance increased the net worth requirements for FHA-approved lenders, thereby ensuring that FHA lenders are sufficiently capitalized.

Troubled Asset Oversight Improvement. To mitigate risk of financial loss to the FHA insurance fund and to ensure continued availability of quality, affordable housing in the market, OAMPO has developed new procedures to monitor troubled assets and resolve issues affecting the physical and financial health of FHA-insured and assisted projects. Monthly check-ins and the assignment of troubled assets are now assigned to dedicated Troubled Asset Resolution Specialists, and the procedure for transferring Housing Assistance Payment Contracts has been tightened to ensure that new owners have capacity to effectively manage the project. In addition, increased follow-up will be performed for projects with low physical inspection scores.





Office of Healthcare Programs



“FHA’s Office of Healthcare Programs is the leading federal program that supports America’s healthcare infrastructure for hospital inpatients and outpatients, the frail elderly requiring affordable residential care, and building healthy communities throughout the USA.”

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 are able to 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, 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.

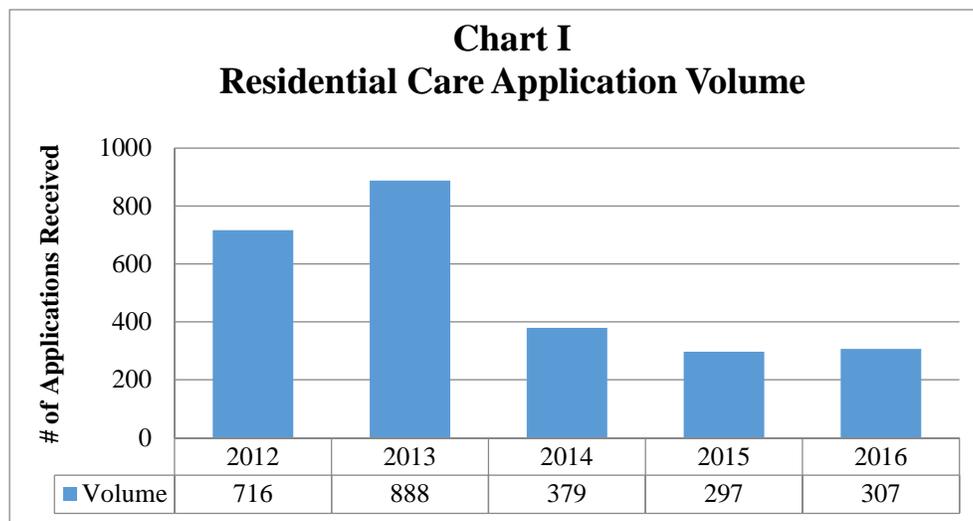
OHP’s hallmark is to continuously improve business practices and processes while preventing claims. OHP has embraced the concept of Lean Processing, which focuses on continuously improving and creating more value for customers with fewer resources, while reducing waste. Since 2008, OHP has adopted Lean methodologies to redesign and streamline processes. As a result, the Office has cut processing times, improved customer service, and strengthened risk analysis. Risk management starts at origination and continues throughout the life of every loan. Using Lean methods, OHP has developed improved risk management processes that better respond to changing industry needs. Above all, Lean has become OHP’s mode of operation 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, 2016, the total FHA-insured healthcare loan portfolio consists of 3,416 loans with an unpaid principal balance of \$32.6 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 Residential Care Facilities 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 2016, OHP issued 306 commitments totaling \$2.84 billion for 30,839 units. At the end of fiscal year 2016, the Section 232 portfolio contained 3,309 loans with an unpaid principal balance of \$25.1 billion. Additionally, a total of 307 applications were received in fiscal year 2016. The chart below presents OHP's Residential Care volume over time. Fiscal year 2016 volumes are slightly above the fiscal year 2015 volumes, thus shifting the recent downward trend and suggesting that applications are reaching a steady-state.



In addition to providing important healthcare facilities, FHA construction and rehabilitation projects have a significant economic impact on local communities, including a substantial impact on employment. In fiscal year 2016, the Section 232 Program insured 22 projects in 13 states, creating over 2,049 full-time equivalent construction jobs with a total economic impact of \$617.2 million. Once the projects are fully built, the residential healthcare facilities will create over 1,777 full-time equivalent jobs in healthcare and related fields and provide a total annual economic benefit of \$231.6 million to the local communities.



Highlighted: Elizabeth Seton Pediatric Center



The Elizabeth Seton Pediatric Center is an FHA-insured, faith-based, not-for-profit, nursing home for children located in Yonkers, New York. The Center provides long and short-term pediatric, rehabilitative, and palliative care to the most vulnerable physically and neurologically challenged

children in the New York metropolitan area. Residents range from infants as young as two weeks old to adolescents up to the age of 21.

On March 16, 2016, HUD completed an initial closing of a Section 232/241(a) supplemental loan in the amount of \$18.3 million for the Center. The loan finances the addition of 32 units with pediatric ventilator beds to the existing facility. This project will meet increasing demand for pediatric nursing home placements and address New York State's efforts to repatriate children currently residing in out-of-state facilities.

The subject property resides on a 6.5-acre site. With the additional units, the total beds at the facility will increase to 169. The facility serves solely as a pediatric long-term care facility that operates with an average 99.5 percent Medicaid resident population. The facility has consistently received the highest level STAR quality rating from the Centers of Medicaid and Medicare Services.

Section 232 Office of Residential Care Facilities (ORCF) Accomplishments

In fiscal year 2016, the Office of Residential Care Facilities worked to improve coordination with other federal agencies to monitor portfolio risk, as well as update and streamline Section 232 loan application policies.

- **Early Notification from Centers for Medicare and Medicaid Services (CMS).** In fiscal year 2016, ORCF established a collaboration with CMS to immediately receive results of any surveys conducted by CMS on Section 232 facilities that incur significant enforcement actions. The information sharing and early notification enables HUD Account Executives to immediately and proactively contact lenders and facilities to address deficiencies.
- **Section 232 Program Handbook Revisions.** ORCF completed revisions to the Section 232 Program Handbook and submitted the document for Departmental Clearance in fiscal year 2016. The Section 232 Program Handbook was first published in May 2014, covering all aspects of

production and asset management. In fiscal year 2015, ORCF began a thorough process to review and update the Handbook to ensure consistency with all ongoing policies, as well as provide opportunities for public stakeholders to provide feedback.

Section 242 Mortgage Insurance for Hospitals

Mortgage insurance for hospitals provides 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 107 active hospital loans with unpaid principal balances totaling \$7.5 billion. In fiscal year 2016, FHA issued or approved five insurance commitments and four loan interest rate modifications totaling \$1.3 billion.

Highlighted: Medical University Hospital Authority



Medical University Hospital Authority (MUHA) in Charleston, South Carolina was granted a \$316.4 million mortgage insurance commitment under the Section 241 supplemental loan program. MUHA is a multidimensional 709-bed healthcare system. It is a principal diagnostic and treatment referral center for the State of South Carolina, and operates the Ashley River Tower Hospital, the Children's Hospital, University

Hospital, Institute of Psychiatry, and Storm Eye Institute. It provides critically needed medical and hospital care to the residents of South Carolina while fulfilling a public mission of teaching and training medical professionals.

The loan will allow MUHA to construct a new Children's Hospital and Women's Pavilion. The estimated total cost of construction is approximately \$383.8 million. The Pavilion will consist of a seven story, 225 patient tower atop a four story diagnostic and treatment center. It will allow MUHA to replace and consolidate pediatric and perinatal services and expand its ability to meet the high regional demand for Neonatal Intensive Care Services and Obstetric Services.

Section 242 Office of Hospital Facilities (OHF) Accomplishments

In fiscal year 2016, the Office of Hospital Facilities updated and improved documentation, policies, and tools for processing Section 242 mortgage insurance and performing ongoing asset management of FHA insured facilities.

- **Section 242 Document Reform.** OHP, in conjunction with the Office of General Counsel, completed the revision and processing of a comprehensive information collection of documents required for administration of the Section 242 Hospital Mortgage Insurance Program in fiscal year 2016. HUD published, in accordance with Paperwork Reduction Act requirements, two Federal



Register notices seeking comments from the public during the fiscal year. OHP responded to hundreds of public comments and prepared a final, revised collection of documents that comprehensively supports FHA's Section 242 hospital mortgage insurance program and is consistent with current regulations and policy (Handbook 4615.1). Thirty-nine closing and transactional documents were approved by the Office of Management and Budget in August 2016.

- Implementation of Moody's Risk Analyst.** In fiscal year 2016, Section 242 implemented two risk analysis tools developed by Moody's Analytics, RiskAnalyst and RiskCalc. The tools were deployed to capture portfolio financial data and provide enhanced analytics support for risk management. The RiskAnalyst financial package combines financial statement spreading, credit analysis, and robust data storage. RiskCalc Plus draws on RiskAnalyst data to produce a forward-looking default probability. Implementing the two platforms provide Section 242 with industry standard tools to review and assess the financial status of its portfolio hospitals. Specifically, Section 242 now has the ability to develop Uniform Credit Analysis (UCA) cash flow statements, expected default frequencies, and shadow ratings to bolster its risk monitoring capabilities.

Performance Goals and Objectives

FHA's Office of Healthcare Programs is responsible for critical activities within the FHA Strategic Plan. Listed below are the Management Action Plan goals, along with fiscal year 2016 achievements.

<i>Strategic Goal (G2) Meet the Need for Quality, Affordable Rental Homes</i>			
G2 Sub-Goal			
2B Preserve quality, affordable rental housing, where it is needed most, by simplifying and aligning the delivery of rental housing programs.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	FY 2016 Status
Achieve enough initially endorsed Section 232 Residential Care Facility mortgages to preserve 1,110 occupied affordable assisted living facility dwelling units for Medicaid-eligible tenants.	1,110	1,125	✓
<i>Strategic Goal (G3) Use Housing as a Platform to Improve Quality of Life</i>			
G3 Sub-Goal			
3C Promote the health and housing stability of vulnerable populations.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	FY 2016 Status
Maintain the average Centers for Medicare/Medicaid Services (CMS) STAR quality rating of the FHA residential care facility portfolio by issuing skilled nursing home commitments with an average CMS rating of 2.8 or higher to monitor the quality of FHA's insured facilities and promote health of residents.	2.8	2.7	✗

**Achievements are as of June 30, 2016

✓ Target met ✗ Target not met

✘ Explanation of Performance Measure not meeting target:

The fiscal year 2016 status in the charts above reflect three quarters of information (through June, 30, 2016). All performance targets were met or exceeded in the fourth quarter. As of September 30, 2016, 1,378 occupied affordable assisted living facility units were preserved, and the average CMS STAR quality rating of commitments issued was 2.8 percent.

Management Initiatives and Program Improvements

In fiscal year 2016, 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 232 program, a risk rating and ranking system was developed and is currently being tested. This system uses financial, quality of care, HUD compliance, and several other indicators to assign a risk ranking, one-ten, to each project in the portfolio. HUD Account Executive resources will be spent first and foremost on projects with poor risk rankings.
- **Development of Dashboard Reports.** Section 242, in collaboration with the Office of Risk Management, developed a set of portfolio-level dashboard reports based on Moody's RiskAnalyst and RiskCalc data. The Portfolio Reports rely on financial ratios, cash flow metrics, and the forward looking estimated default frequencies to evaluate the individual hospital performance and assess the overall portfolio.

Risk Management

With an outstanding portfolio balance of over \$32.6 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 working 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 2016, 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 management initiatives include more proactive collaboration with industry groups to identify appropriate candidates for healthcare mortgage insurance to diversify the 232/242 portfolio, and identifying additional activities to enhance OHP employee engagement within the Office of Housing.





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 2,000 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 their 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 2016, HUD awarded over \$42 million in housing counseling grants to 234 agencies. More than \$40 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 assist families effectively with their housing needs.

Chart 1: 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 our 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 over 16,000 subscribers each month.



Performance Goals and Objectives

Despite the ongoing economic recovery, creditworthy borrowers in underserved communities continue to have difficulty accessing affordable mortgage financing. These challenges disproportionately affected first-time, minority, and low-to-moderate income homebuyers and homeowners. The Office of Housing Counseling is responsible for critical activities within the HUD Strategic Plan to address these challenges.

To help achieve these goals, OHC implemented several initiatives in fiscal year 2016, including systems changes to improve how HUD tracks the number of FHA borrowers who receive housing counseling before loan origination; and continuing to lay the groundwork for the mandatory housing counselor certification process, which will officially launch once the final rule is published. The Management Action Plan target activities that address OHC's Sub-Goals are listed below.

Strategic Goal (G1) Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers			
G1 Sub-Goals			
1B Ensure equal access to sustainable housing financing and achieve a more balanced housing market, particularly in underserved communities.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	FY 2016 Status
Track the number of clients counseled through the HUD Housing Counseling program.	1,400,000	945,096	✗
Track the percentage of housing counseling clients who gain access to resources to improve their housing situation.	25%	23.2%	✗
Track the percentage of housing counseling clients with whom a counselor developed a sustainable household budget.	50%	41.5%	✗
G1 Sub-Goals			
1C Restore the Federal Housing Administration's financial health, while supporting the housing market recovery and access to mortgage financing.			
Performance Goals and Objectives	FY 2016 Target	**FY 2016 Achievements	FY 2016 Status
Track the number of FHA-insured mortgages benefitting from housing counseling.	70,000	42,185	✗

**Achievements are as of June 30, 2016

✓ Target met ✗ Target not met

✘ Explanation of Performance Measure not meeting target:

The Housing Counseling Program is not currently on track to meet the ambitious goal of serving 1.4 million clients during fiscal year 2016. The program is expected to fall short of the fiscal year 2016 target due to decreases in funding from major sources such as the National Foreclosure Mitigation Counseling program (reduced by \$12 million from fiscal year 2014 to 2015, and by another \$10 million from fiscal year 2015 to 2016). This decline in funding accompanied by increases in costs due to greater complexity of cases, limits the capacity of housing counseling agencies and caused a number of counseling programs to close down.

The percentage of clients gaining access to housing resources and the percentage of clients with whom a counselor developed a sustainable household budget are also currently below target levels. This is likely due to the fact that these are new data points that HUD started collecting in fiscal year 2015; some client management systems have had difficulty tracking and reporting the new data points to HUD. OHC is currently working with housing counseling agencies to improve data and report quality.

Finally, the number of FHA-insured mortgages benefitting from housing counseling is also not currently on pace to meet the fiscal year 2016 target. FHA implemented systems changes to better capture this data point from lenders in the second quarter of fiscal year 2016, and OHC hopes to see positive results from those changes beginning in the fourth quarter of fiscal year 2016.

Office of Housing Counseling Accomplishments

In fiscal year 2016, the Office of Housing Counseling worked to elevate the visibility of housing counseling services and support the capacity of the housing counseling industry.

- **\$42 Million in Grant Awards.** OHC awarded more than \$42 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 named 12 individuals who will constitute the first-ever HCFAC, which will help OHC improve upon its efforts to provide consumers with the knowledge they need to make informed and lasting housing decisions.
- **New OHC Website.** HUD's Housing Counseling Website moved to a new HUD Exchange platform, which provides resources, assistance and information to support the work of HUD's partners in local communities.
- **Housing Counseling on the Uniform Residential Loan Application (URLA).** OHC provided substantial input for the new URLA, which will permit collection of data on housing counseling and education and will inform loan applicants that HUD-approved housing counseling services are available if they have trouble making payments.



- **First-Ever White House Homeownership Month Event.** The White House’s “Dare to Own the Dream” special event celebrated Homeownership Month and shared stories of how homeownership has changed lives. The event featured talks from first-time homebuyers, housing counselors, Secretary Julián Castro, and PDAS Edward Golding. OHC distributed the link to the livestream and taped event and a toolkit for promoting similar events in local communities.

Highlighted: White House’s “Dare to Own the Dream” Event



A pastor leading a small church in Woodbridge, Virginia arrived in the United States five years ago with a family of four, earning a very low wage. He connected with a HUD-approved counseling agency, Centro de Apoyo Familiar, through its network of faith-based organizations, hoping that he could achieve his dream of homeownership. His housing counselor helped him establish a savings and credit rebuilding plan, and in less than six months he was able to purchase his first home with an FHA loan and \$5,000 in down payment assistance. He has since inspired a number of other families from his congregation and his community to do the same. This story highlights the success of OHC working in partnership with a HUD-approved housing counseling agency to help working families achieve their homeownership dream.





Office of Risk Management and 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 enterprise risk management strategy across the entire Office of Housing. The role of risk management is to ensure that FHA continues to deliver on its mission 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. Strategies are often developed 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.

One area of particular focus is ORMRA's role in advancing policies to address the unprecedented economic challenges facing the Single Family portfolio as a result of the Great Recession, while concurrently supporting continued access to mortgage credit for American families. Part of this strategy is to align pricing and credit policies to promote sustainable lending by systematically contributing a capital cushion to support the FHA mission.

Another core strategy is to increase the value of poorly performing legacy loans by diversifying FHA's asset management approach. Use of Real Estate Owned (REO) alternatives, such as Note Sales and Claims Without Conveyance of Title (CWCOT), has expanded to approximately 50 percent of FHA's disposition volume; and this overall disposition strategy has significantly reduced losses on distressed assets. FHA is positioned to increase focus on access to credit as a result of these key strategic credit initiatives in the aftermath of the recent crisis.

Although ORMRA has successfully mitigated many of the risks inherent to the Mutual Mortgage Insurance (MMI) Fund, certain risk factors remain. The Single Family portfolio delinquency rate is at a pre-crisis low but still has a seriously delinquent balance of approximately \$50 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 MMI Fund. 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.

In order to better manage programmatic and financial risk in fiscal year 2016, ORMRA continued to implement the following courses of action. Senior leadership continued its commitment to, and participation in, regularly scheduled credit risk meetings. 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. Results were benchmarked against other financial institutions to help establish lessons learned and best practices. Internal roles and responsibilities continue to be well-defined, and a clear and transparent communication channel has been established with all stakeholders. Support has been provided to Housing staff on market and data issues. Staff training on credit risk management was provided as well as access to financial systems and tools. ORMRA continued to evaluate risk responses and whether they are meeting objectives and are aligned with the Office of Housing's mission.

Office of Risk Accomplishments

- **Single-Family Risk Management.** The Office of Risk Management and Regulatory Affairs Office of Evaluation (OE) achieved substantial milestones in fiscal year 2016. One spotlight achievement was to successfully implement an information system designed to value the MMI Fund on a monthly basis, which will allow “real-time” programmatic risk recommendations appropriate to a given risk-appetite level. In addition, throughout the year, 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 through which we informed and suggested appropriate risk strategies such as asset disposition management and front end credit underwriting. Within FHA Housing, OE collaborated with the program offices to monitor and revise risk strategies in systems such as the TOTAL Scorecard and Supplemental Performance Metric.

Throughout fiscal year 2016, OE influenced and assisted with reserve prices for the Claim Without Conveyance of Title (CWOCT) and Distressed Asset Stabilization Program (DASP) programs, responded to internal and external requests from agencies such as GAO, DOJ, FRB, and delivered the fiscal year 2017 budget and budget re-estimates.

- **Commercial Risk Management.** The creation of a Commercial Asset Disposition Committee was a milestone achievement for the Commercial Mortgage Risk team. This committee established a uniform disposition process across all of the commercial program areas in order to determine the best disposition strategy for a defaulted commercial mortgage in alignment with HUD's mission. The FHA Commercial Mortgage Portfolio—a monthly report on multifamily, residential care facilities, and hospital facilities—was created and first made available to the public on March 21, 2016, in the Office of Housing Reading Room. A risk rating site for Residential Care Facilities was developed. This facilitates a streamlined assessment of a facility's financial performance and the loan's risk position by presenting a defined set of metrics. Geospatial analysis was integrated



into the research, evaluation, and monitoring of the commercial portfolio, and in-depth analyses were conducted of various regional conditions impacting FHA's portfolio. ORMRA collaborated with program offices to get policy changes approved by the Office of Management and Budget on key initiatives such as National PACE, 232 Handbook, and others. The office also collaborated with commercial mortgage programs to increase transparency into program data collection, management, and analysis as part of the commercial portfolio performance, for example, the analysis of early payment defaults as a predictor of claims.

- **Operational Risk Management.** The Operational Risk team continue to mitigate the Office of Housing's IT Risk by evaluating the IT systems in terms of age, capacity, and support. The National Institute of Standards and Technology (NIST) guide on risk management is used to evaluate and manage IT risks. The likelihood and impact of IT risks was defined to ensure that risk ratings are reasonable. The IT risk register continue to be updated with action plans, mitigation strategies, and milestones. IT subcommittee meetings were held with all stakeholders. ORMRA met with OCIO members during monthly IT risk subcommittee meetings to discuss IT risks and to develop mitigation strategies.

ORMRA played a significant role in the Office of Housing's collaboration with the OCIO to improve the IT environment and performance. Key collaborative initiatives include: implementation of New Core, FHA Modernization, cloud computing and strategies to mitigate cyber security risk.



National Transfer Accounts

1999-2019

Lainya Dulu

Consumption

Less: Labor Income

Total

1999-2019

1999-2019

1999-2019

1999-2019

1999-2019

1999-2019

1999-2019

1999-2019



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) in the United States for Federal entities, the Federal Credit Reform Act of 1990 and in accordance with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. FHA's management is responsible for the integrity and objectivity of the financial information presented in the financial statements.

FHA restated its fiscal year 2015 Financial Statements to correct the reported balance of the LLG in the current period. The restatement is reflected in the following areas (see Note 21 for additional detail):

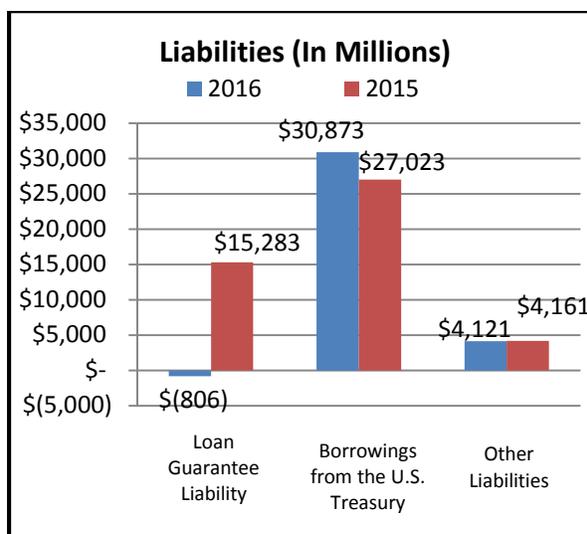
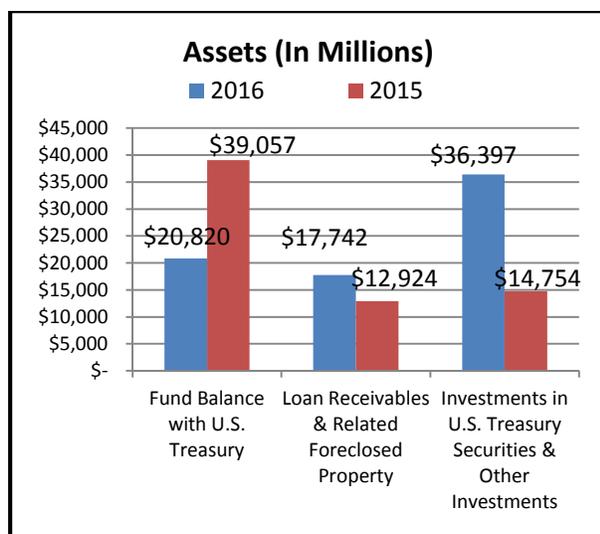
- Balance Sheet - Loan Receivables and Related Foreclosed Property, Other Liabilities, LLG and Current Year Results of Operations
- Statement of Net Cost - HECM Gross Cost with the Public
- Statement of Changes in Net Position - Beginning balance for Cumulative Results of Operations, Other Financing Sources and Net Costs of Operations
- Related Footnotes

Overview of Financial Position

A summary of FHA's change in financial position from fiscal year 2015 to fiscal year 2016 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. 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. 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 2016, there was an \$18,237 million decrease in fund balance with U.S. Treasury primarily attributable to an increase in MMI/CMHI investments in U.S. Treasury securities offset by an increase of in borrowings.

Loan Guarantee Liability

The loan guarantee liability (LGL) is comprised of two components, the liability for loan guarantee (LLG) for post-1991 loan guarantees and the loan loss reserves (LLR) for pre-1992 loan guarantees.

Post-1991 LLG

The LLG related to Credit Reform loans (made after September 30, 1991), is comprised of the present value of anticipated cash outflows, such as claim payments, 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)

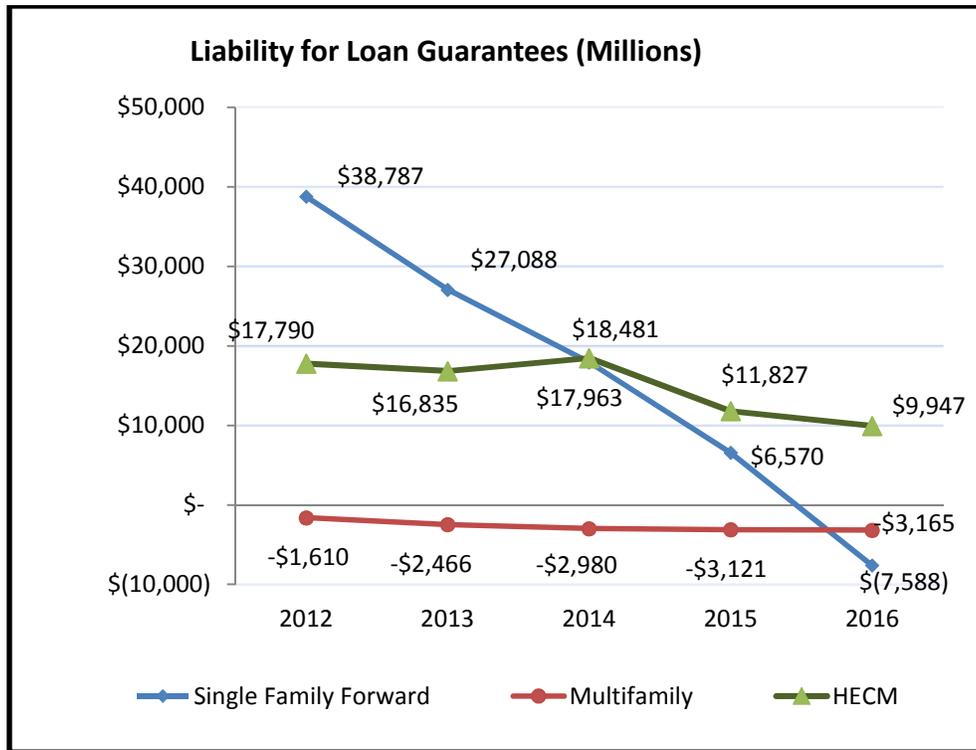
	Restated		Difference	% Change
	FY 2016	FY 2015		
Single Family Forward	\$ (7,588)	\$ 6,570	\$ (14,158)	-215%
HECM	9,947	11,827	(1,880)	-16%
Multifamily	(3,165)	(3,121)	(44)	1%
Total	\$ (806)	\$ 15,276	\$ (16,082)	-105%

The (\$14,158) million single family forward LLG decrease is mainly due to the inclusion of the 2016 book-of-business in negative liability and change in projected future cash flows from the existing pre-2016 portfolio to the MMI fund.



The (\$1,880) million HECM LLG decrease is primarily due to long term house price appreciation forecasts and an increase in the present value of HECM Notes in the GI/SRI.

The (\$44) 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.



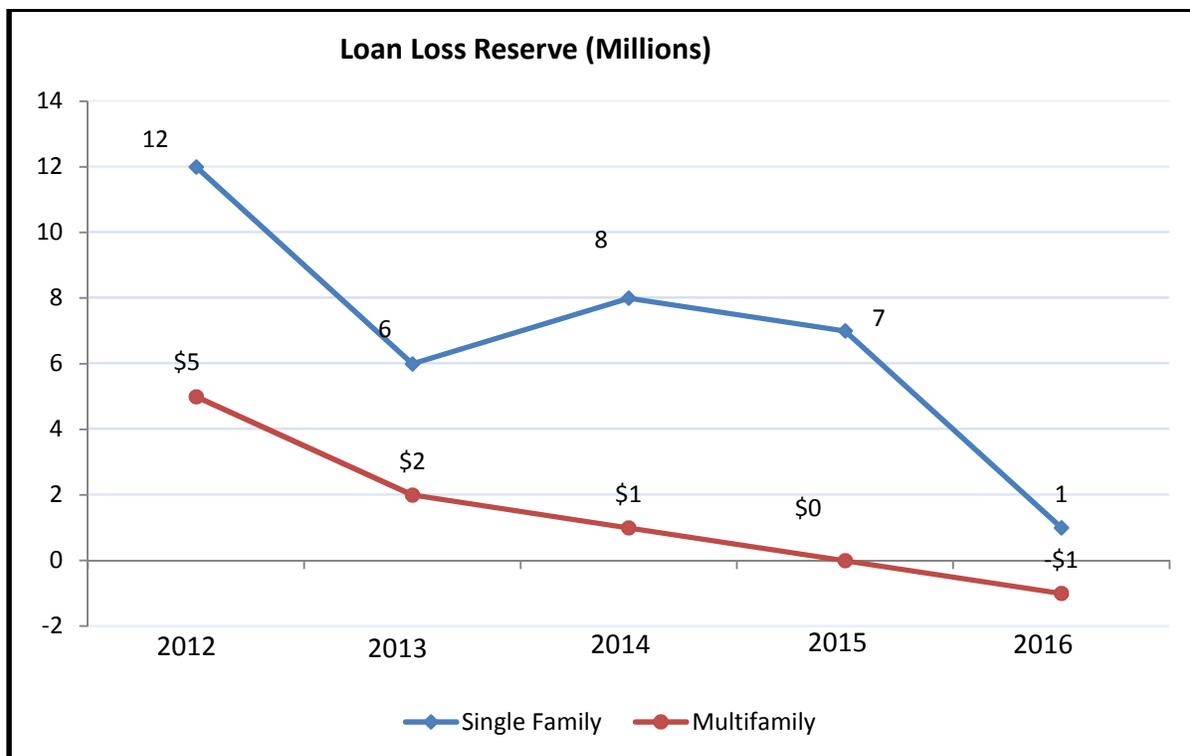
Pre-1992 Loan Loss Reserve (LLR)

FHA maintains loss reserves for the estimated costs of future mortgage insurance claims resulting from defaults that have occurred or are likely to occur among insured Single Family, Multifamily and Title I loan guarantees made prior to September 30, 1991. FHA records a loss reserve for its pre-Credit Reform insured mortgages to provide for anticipated losses which may occur on claims for defaults that have taken place but have not yet been filed.

Schedule of Loan Loss Reserve (Dollars in Millions)					
	FY 2016	FY 2015	Difference	% Change	
Single Family	\$ 1	\$ 7	\$ (6)	-86%	
Multifamily	(1)	-	(1)	-100%	
Total	\$ -	\$ 7	\$ (7)	-100%	

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

Overall, loss reserve decreased by \$7 million. The majority of the decrease can be attributed to a decrease in pre-credit reform single family loans outstanding.



Net Cost/ (Surplus)

In fiscal year 2016, FHA reported a net profit (surplus). 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)

	Restated			
	FY 2016	FY 2015	Difference	% Change
Program Cost	\$ (17,758)	\$ (16,202)	\$ (1,556)	10%
Less: Program Revenues	1,218	1,849	(631)	-34%
Net Cost (Surplus)	\$ (18,976)	\$ (18,051)	\$ (925)	5%

FHA had a net program surplus in fiscal year 2016. The program cost difference is primarily due to the decreases in the re-estimates, an increase in the negative subsidy, and decrease in interest expense in the Single Family, HECM, and Healthcare gross costs with the public in the MMI and GI/SRI funds. At the time of endorsement, future cash flows for single family guaranteed loans are projected to have positive cash flows over the life of the loans, which results in a negative subsidy. This is a primary driver for the over-all program cost decrease in fiscal year 2016, compared to fiscal year 2015; an increase in the negative subsidy expense. In addition, program costs decreased due to an increase in the downward re-estimate in GI/SRI fund.

Budgetary Resources

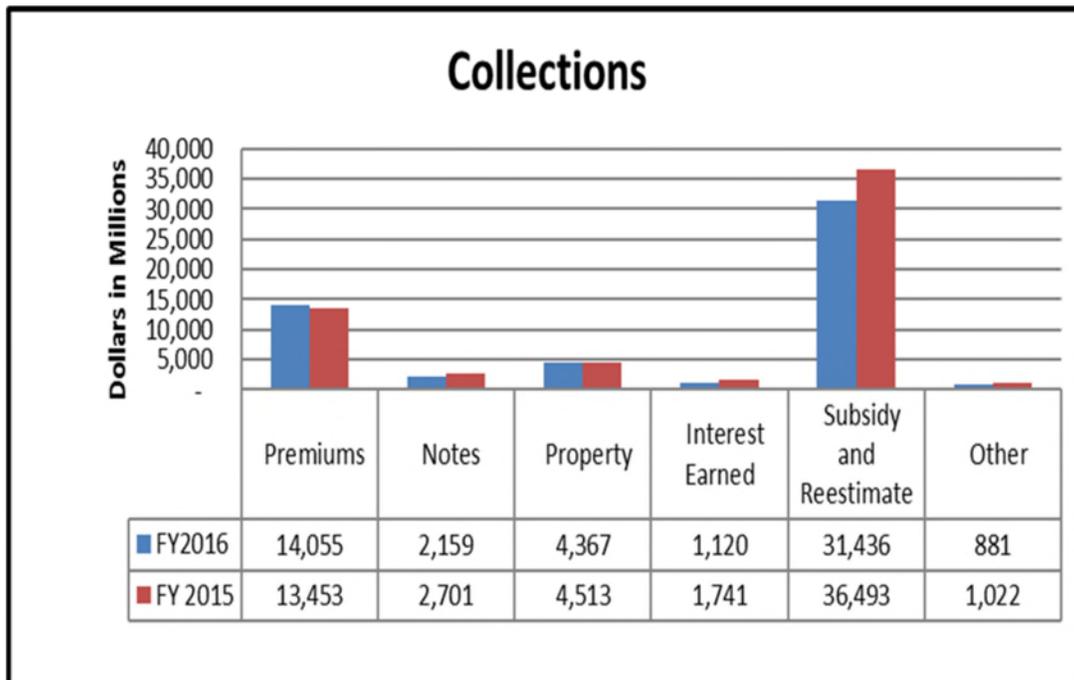
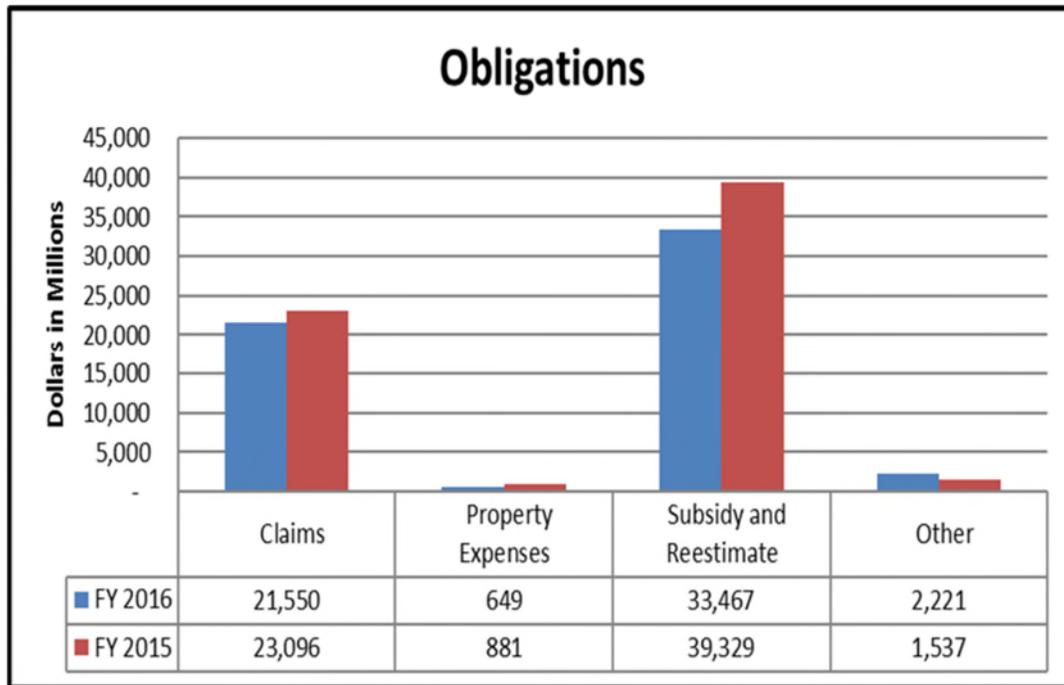
FHA finances its operations primarily through appropriations, borrowings from the U.S. Treasury, spending authority from offsetting collections, and prior year unobligated balances carried forward.

Offsetting collections include collections of premiums, fees, sales proceeds of credit program assets and credit subsidy transferred between different FHA accounts. 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 2016	FY 2015	Difference	% Change
Offsetting Collections	\$ 44,810	\$ 47,279	\$ (2,469)	-5%
Unobligated Balance Carried Forward	50,716	53,721	(3,005)	-6%
Appropriations	3,431	2,225	1,206	54%
Borrowing Authority	13,077	12,146	931	8%
Recoveries, Transfers, and Other	23	191	(168)	-88%
Total Budgetary Resources	\$ 112,057	\$ 115,562	\$ (3,505)	-3%

These resources were used to cover the fiscal year 2016 obligations totaling (\$57,887) million. These obligations included: subsidy/re-estimate costs, claim payments on defaulted guaranteed loans, the cost of acquiring, maintaining and disposing of foreclosed properties, and other. FHA collections totaled (\$54,018) million and included: premiums, notes, property, interest earned, subsidy/re-estimate, and other.





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, 2016 with the exception of two material weaknesses (Section 2) in the areas of erroneous data inclusion in the HECM cash flow model and weaknesses in the reconciliation and reporting of budgetary resources. 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 2016

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, 2016 with the noted exception of two material weaknesses in the areas of erroneous data inclusion in the HECM cash flow model and weaknesses in the reconciliation and reporting of budgetary resources. 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.

Edward Golding

Principal 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 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 2016 FHA enhanced system security and implemented new data processing capabilities to better manage risk to the FHA insurance portfolio.

- FHA improved 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 upgraded its system security documents to the latest level of federal compliance adopted by HUD (NIST SP 800-53 Revision 4).
- FHA continued to support a departmental initiative to centralize interfaces with Treasury, avoiding separate FHA investments in four systems that currently rely upon Treasury's Open Collection Interface service, which Treasury is replacing with a new Trusted Collection Service.
- FHA and HUD's Office of the Chief Information Officer began development of a Loan Review System to support improved quality control processes for Single Family mortgage insurance underwriting.

HUD has requested in fiscal year 2017 IT funding for automation of FHA business processes and system modernization.



Fiscal Year 2016 Financial Statement Audit Findings

Fiscal Year 2016 Financial Statement Audit Findings

The Office of the Inspector General (OIG) has identified two material weaknesses in the Internal Control Report for FHA's 2016 financial statement audit. OIG stated in its finding that FHA failed to detect data errors in its HECM cash flow model or to accurately reconcile and report budgetary resources. Specifically, the OIG noted that accrued interest, servicing fees, and mortgage insurance premiums were incorrectly included in the HECM maintenance and operating expenses used to calculate the Loan Liability Guarantees, and that budgetary obligations were not accurately reported, or de-obligated timely.

The OIG also identified three significant deficiencies. The first two relate to the prior year findings pertaining to the misclassification of receivables and weaknesses in Information Technology systems, as discussed below. The third finding relates to weaknesses in internal controls over model governance.

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 2015 Financial Statement Audit Findings

The status of the three significant deficiencies identified in the fiscal year 2015 financial statement audit are below:

A. *Controls to Prevent Misclassification of the Receivables Had Not Been Fully Implemented*

This significant deficiency resulted because FHA was not able to complete the billing process to lenders that had not provided the original promissory note or mortgage security instrument, within the prescribed deadlines. During fiscal year 2016, the Single Family Housing, National Servicing Center issued required demand letter notifications to lenders in efforts to retrieve missing legal documents, or payment of penalty assessments, in accordance with regulatory requirements. Loans associated with lenders who remained noncompliant after the second demand letter, were referred for collection. In October 2015, \$116 million in partial claim debt was referred to the FHA Albany Financial Operations Center (FOC) for billing and collection actions. As of September 30, 2016, \$77.8 million has been collected, \$3million has been written off as uncollectible, \$5 million has been recalled due to receipt of requested legal documents, and \$29 million is in current litigation with the Office of General Counsel (OGC). The Albany FOC will continue collection actions until the remaining referred debt has been satisfied by either the collection of the debt, or other agreed upon resolution.

As the result of the initial debt referral to the Albany FOC, legal challenges from lenders led to further consideration from SF Housing on alternative strategies to address noncompliance. A coordinated agreement was reached between SF Housing, OGC, the Office of Program Enforcement and the Mortgagee Review Board (MRB) that resulted in FHA ceasing the practice

of referring these cases to the Albany FOC for billing and collection. All future cases, where lenders are delinquent in submitting legal documents, will be transferred directly to the MRB for legal action. As of September 30, 2016, there are \$77 million in outstanding receivables associated with missing legal documents over 60 days delinquent. Policy guidance and procedures to document the end-to-end business processes, and changes in enforcement actions, are being updated to close this finding in fiscal year 2017.

B. FHA's Internal Control Over Financial Reporting Had Weaknesses

FHA's actions to develop new and enhanced processes and procedures to recognize and record accrued obligations associated with HECM-assigned notes, identify and review all budgetary abnormal balances, implement effective sensitivity analysis to identify key assumptions and better quality control processes to prevent and detect errors more timely, resolved this significant deficiency during fiscal year 2016.

C. Weaknesses in selected FHA information technology systems

FHA has resolved three of six information technology weaknesses that were reported as a significant deficiency in FHA's fiscal year 2015 financial statement audit. FHA will address the remaining three weaknesses through investment in additional encryption capabilities and with other information technology changes in coordination with the Office of the Chief Information Officer. FHA is working on corrective actions in coordination with information technology support service changes from the Office of the Chief Information Officer.

FHA received a limited distribution report based on additional review of information system controls over FHA's systems in August 2016. FHA is in the process of developing corrective action plans for four findings identified in this report concerning Single Family Claims.



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 the period between May 1, 2015 and April 30, 2016. Based on OMB threshold of \$10 million, the following disbursements programs met or exceeded the threshold:

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

During fiscal year 2016, 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. We conducted a Risk Assessment Survey and Manager's Interviews which included OMB prescribed nine risk factors. Based on the results, we created a Risk Matrix and Managers Interview Response Matrix and concluded that FHA disbursements programs are all of low risk of being susceptible to improper payments with the exception of SF Insurance Claims which is rated as high risk.

In fiscal year 2016, in addition to reviewing the above programs, we also included reviews of MF Property and MF Premium Refunds in our analysis. We also analyzed "Do Not Pay" initiatives and found no significant incidence of erroneous payments. In addition, we conducted limited review of OIG audit findings and GAO audit recommendations in fiscal year 2016 and previous years to assess their impacts on improper payments. We have performed random statistical sampling and analyses of HECM Claims, HECM Notes, MFIC and SAMS case files and statistical testing of SFIC disbursements in fiscal year 2016. The findings from case files review have revealed that programs are not susceptible to significant risk of improper payments for the fiscal year 2016. In addition, FHA's internal control review required by OMB Circular A-123, Appendix A, concluded that each of these programs has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse. An additional analyses of underwriting compliance and post claim reviews identified that SF Insurance Claims are susceptible to a high risk of improper payments.

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 2016, we estimated total contract disbursements of \$93 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 2016 financial statements:

- The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C.3515 (b).
- While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.



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PRINCIPAL FINANCIAL STATEMENTS



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MESSAGE FROM THE DEPUTY ASSISTANT SECRETARY FOR FINANCE AND BUDGET

November 15, 2016

FHA is pleased to report another consecutive year of growth in its Capital Reserve account; as it maintained and surpassed the 2 percent Mutual Mortgage Insurance (MMI) Fund Capital Ratio requirement.

During FY 2016, FHA has successfully closed one of its FY 2015 findings related to weaknesses in internal controls over financial reporting. As part of resolving this finding, FHA developed and enhanced processes and procedures to recognize accrued obligations associated with HECM-assigned notes; identified and reviewed budgetary abnormal balances; and implemented effective sensitivity analysis to identify key assumptions, and better quality control processes to prevent and detect errors more timely.

FHA's financial position improved in FY 2016; its total assets increased from \$67.2 billion to \$75.3 billion, and its loan guarantee liability (LGL) decreased significantly from \$15.3 billion to (\$806) million, from FY 2015 to FY 2016, respectively. The decrease in LGL is primarily due to an increase in projected future cash flows and long-term house price appreciation forecasts. The combined net surplus of all FHA programs has also increased, from \$18.1 billion in FY 2015 to \$19 billion in FY 2016, primarily due to a continued drop in delinquencies and defaults on new and existing mortgage loans.

FHA's Mortgage Insurance Premium (MIP) rate decrease in FY 2015 has continued to have a positive effect on the number of single-family forward mortgages endorsed by FHA; increasing endorsement of such mortgages by almost 14 percent, from 1.1 million in FY 2015, to 1.25 million in FY 2016.

FHA's newly implemented Federal Financing Bank (FFB) Risk Share program, first instituted in FY 2015, grew over 400 percent, to \$451 million. Under this program, FHA, in a risk-sharing partnership with FFB and Housing Finance Authorities (HFAs), provides funding for multifamily mortgage loans for rural and secondary markets, which typically lack low cost, fixed-rate long-term capital financing for affordable housing.

In addition to the overall improvement in the economy and housing market, FHA continued to strengthen the Mutual Mortgage Insurance (MMI) Fund and improve its capital reserve ratio through loss mitigation programs for distressed homeowners, such as the Home Affordable Modification Program (HAMP), as well as through extensive portfolio risk assessments that were used to develop strategies to mitigate risk.



Despite the many accomplishments in FY 2016, FHA was cited for two material weaknesses and three significant deficiencies. The first material weakness is due to FHA incorrectly including accrued expenses in its HECM cash flow models, which caused its LGL to be overstated in both FY 2014 and FY 2015. FHA removed accrued expenses from its FY 2016 model and has restated its prior year financial statements. The second material weakness relates to FHA's controls over financial reporting on budgetary resources, specifically; discrepancies identified between proprietary and budgetary accounts, and monitoring and reporting on unliquidated obligation balances. The first significant deficiency relates to a deficiency carried over from FY 2015, related to the process of billing and collecting claim reimbursements and incentive fees from lenders that are delinquent in providing mortgage security documents, within prescribed deadlines. FHA has made significant progress on this deficiency, collecting over \$101 million in FY 2016. The second and third significant deficiencies relate to FHA's weaknesses in controls over its model risk management governance framework, and 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.

As FHA continues to improve the financial position of its MMI Fund, FHA's Office of Finance and Budget will continue to play a pivotal role in strengthening its internal controls, enhancing its risk management practices, and striving to improve its operations through automation, data analytics, and process reengineering. While FHA's financial practices have continued to strengthen the nation's housing market, which stabilizes the nation's economy, it has not lost sight of its other critical mission; to expand quality affordable housing opportunities to first-time homebuyers, the underserved, and vulnerable communities throughout the United States.

In closing, I would like to thank my staff for their contribution to FHA's mission and their dedication to achieve these considerable accomplishments. I am proud of the commitment and effort exhibited by them towards advancing FHA's excellence in financial management.

George J. Rabil
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, 2016 and 2015
(Dollars in Millions)

	<u>FY 2016</u>	<u>Restated FY 2015</u>
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	\$ 20,820	\$ 39,057
Investments (Note 4)	36,397	14,754
Other Assets (Note 7)	-	1
Total Intragovernmental	<u>\$ 57,217</u>	<u>\$ 53,812</u>
Investments (Note 4)	\$ 31	\$ 31
Accounts Receivable, Net (Note 5)	242	407
Loans Receivable and Related Foreclosed Property, Net (Note 6)	17,742	12,924
Other Assets (Note 7)	53	45
TOTAL ASSETS	<u>\$ 75,285</u>	<u>\$ 67,219</u>
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 8)	\$ 7	\$ 1
Borrowings (Note 9)	30,873	27,023
Other Liabilities (Note 10)	2,765	2,889
Total Intragovernmental	<u>\$ 33,645</u>	<u>\$ 29,913</u>
Accounts Payable (Note 8)	\$ 495	\$ 545
Loan Guarantee Liability (Note 6)	(806)	15,283
Other Liabilities (Note 10)	854	726
TOTAL LIABILITIES	<u>\$ 34,188</u>	<u>\$ 46,467</u>
NET POSITION		
Unexpended Appropriations (Note 16)	\$ 415	\$ 871
Cumulative Results of Operations	40,682	19,881
TOTAL NET POSITION	<u>\$ 41,097</u>	<u>\$ 20,752</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 75,285</u>	<u>\$ 67,219</u>

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, 2016 and 2015
(Dollars in Millions)

	<u>FY 2016</u>	<u>Restated FY 2015</u>
Single Family Forward		
Intragovernmental Gross Costs	\$ 791	\$ 955
Less: Intragovernmental Earned Revenue	<u>662</u>	<u>1,133</u>
Intragovernmental Net Costs	\$ 129	\$ (178)
Gross Costs With the Public	\$ (18,764)	\$ (13,283)
Less: Earned Revenues	<u>14</u>	<u>11</u>
Net Costs With the Public	<u>\$ (18,778)</u>	<u>\$ (13,294)</u>
Single Family Forward Net Cost (Surplus)	<u>\$ (18,649)</u>	<u>\$ (13,472)</u>
HECM		
Intragovernmental Gross Costs	\$ 234	\$ 59
Less: Intragovernmental Earned Revenue	<u>403</u>	<u>584</u>
Intragovernmental Net Costs	\$ (169)	\$ (525)
Gross Costs With the Public	\$ (305)	\$ (3,993)
Less: Earned Revenues	<u>1</u>	<u>1</u>
Net Costs With the Public	<u>\$ (306)</u>	<u>\$ (3,994)</u>
HECM Net Cost (Surplus)	<u>\$ (475)</u>	<u>\$ (4,519)</u>
Multifamily		
Intragovernmental Gross Costs	\$ 111	\$ 104
Less: Intragovernmental Earned Revenue	<u>32</u>	<u>58</u>
Intragovernmental Net Costs	\$ 79	\$ 46
Gross Costs With the Public	\$ (389)	\$ (559)
Less: Earned Revenues	<u>52</u>	<u>45</u>
Net Costs With the Public	<u>\$ (441)</u>	<u>\$ (604)</u>
Multifamily Net Cost (Surplus)	<u>\$ (362)</u>	<u>\$ (558)</u>
Healthcare		
Intragovernmental Gross Costs	\$ 85	\$ 73
Less: Intragovernmental Earned Revenue	<u>53</u>	<u>16</u>
Intragovernmental Net Costs	\$ 32	\$ 57
Gross Costs With the Public	\$ (129)	\$ (140)
Less: Earned Revenues	<u>1</u>	<u>1</u>
Net Costs With the Public	<u>\$ (130)</u>	<u>\$ (141)</u>
Healthcare Net Cost (Surplus)	<u>\$ (98)</u>	<u>\$ (84)</u>
Salaries and Administrative Expenses		
Intragovernmental Gross Costs	\$ 17	\$ 15
Less: Intragovernmental Earned Revenue	<u>-</u>	<u>-</u>
Intragovernmental Net Costs	\$ 17	\$ 15
Gross Costs With the Public	\$ 591	\$ 567
Less: Earned Revenues	<u>-</u>	<u>-</u>
Net Costs With the Public	<u>\$ 591</u>	<u>\$ 567</u>
Administrative and Contracts Net Cost (Surplus)	<u>\$ 608</u>	<u>\$ 582</u>
Net Cost of Operations	<u>\$ (18,976)</u>	<u>\$ (18,051)</u>

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, 2016 and 2015
(Dollars in Millions)

	<u>2016</u>	<u>Restated</u> <u>2015</u>
CUMULATIVE RESULTS OF OPERATIONS (Note 16)		
Beginning Balance	\$ 19,046	\$ 2,013
Adjustments		
Changes in Accounting Principles		
Corrections of Errors	835	1,371
Beginning Balance, As Adjusted	\$ 19,881	\$ 3,384
 Budgetary Financing Sources:		
Appropriations Used	3,393	2,206
 Other Financing Sources (Nonexchange)		
Donations and Forfeitures of Property		
Transfers In/Out Without Reimbursement	480	442
Imputed Financing From Costs	15	15
Other	(2,063)	(4,217)
Total Financing Sources	\$ 1,825	\$ (1,554)
Net Cost of Operations	18,976	18,051
Net Change	20,801	16,497
Cummulative Results of Operation	\$ 40,682	\$ 19,881
 Unexpended Appropriations (Note 16)		
Beginning Balance	\$ 871	\$ 872
Budgetary Financing Sources		
Appropriations Received	3,437	2,235
Other Adjustments (Recissions, etc)	(500)	(30)
Appropriations Used	(3,393)	(2,206)
Total Budgetary Financing Sources	\$ (456)	\$ (1)
 Unexpended Appropriation	\$ 415	\$ 871
 Net Position	\$ 41,097	\$ 20,752

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 (discretionary and mandatory) (+ or -)	(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

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2015
(Dollars in Millions)

	FY 2015 Budgetary	FY 2015 Non-Budgetary	FY 2015 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	\$ 8,152	\$ 45,569	\$ 53,721
Unobligated balance brought forward, October 1, as adjusted	8,152	45,569	53,721
Recoveries of prior year unpaid obligations	50	382	432
Other changes in unobligated balance (+ or -)	(241)	-	(241)
Unobligated balance from prior year budget authority, net	7,961	45,951	53,912
Appropriations (discretionary and mandatory)	2,225	-	2,225
Borrowing authority (discretionary and mandatory)	-	12,146	12,146
Spending authority from offsetting collections (discretionary and mandatory)	21,716	25,563	47,279
Total budgetary resources	\$ 31,902	\$ 83,660	\$ 115,562
Status of Budgetary Resources:			
Obligations incurred	\$ 15,170	\$ 49,673	\$ 64,843
Unobligated balance, end of year:			
Apportioned	56	3,509	3,565
Unapportioned	16,676	30,478	47,154
Total unobligated balance, end of year	16,732	33,987	50,719
Total budgetary resources	\$ 31,902	\$ 83,660	\$ 115,562
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	587	2,229	2,816
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(9)	-	(9)
Obligated balance, start of year (net), before adjustments (+ or -)	578	2,229	2,807
Obligated balance, start of year (net), as adjusted	578	2,229	2,807
Obligations incurred	15,170	49,673	64,843
Outlays (gross) (-)	(15,142)	(49,035)	(64,177)
Change in uncollected customer payments from Federal sources (+ or -)	(6)	-	(6)
Actual transfers, unpaid obligations (net) (+ or -)	(50)	(382)	(432)
Actual transfers, uncollected customer payments from Federal sources (net) (+ or -)	565	2,485	3,050
Recoveries of prior year unpaid obligations (-)	(50)	(382)	(432)
Unpaid obligations, end of year (gross)	565	2,485	3,050
Uncollected customer payments from Federal sources, end of year	(15)	-	(15)
Obligated balance, end of year (net)	\$ 550	\$ 2,485	\$ 3,035
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	23,941	37,708	61,649
Actual offsetting collections (discretionary and mandatory) (-)	(21,710)	(38,213)	(59,923)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(6)	-	(6)
Budget authority, net (discretionary and mandatory)	2,225	(505)	1,720
Outlays, gross (discretionary and mandatory)	15,142	49,035	64,177
Actual offsetting collections (discretionary and mandatory) (-)	(21,710)	(38,213)	(59,923)
Outlays, net (discretionary and mandatory)	(6,568)	10,822	4,254
Less Distributed offsetting receipts (-)	(2,797)	-	(2,797)
Agency outlays, net (discretionary and mandatory)	\$ (9,365)	\$ 10,822	\$ 1,457

The accompanying notes are an integral part of these statements.



NOTES TO THE FINANCIAL STATEMENTS

September 30, 2016

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.

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

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 is for combating mortgage fraud.

Basis of Accounting

The principal financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to federal agencies, as promulgated by the Federal Accounting Standards Advisory Board (FASAB). The recognition and measurement of budgetary resources and their status for purposes of preparing the Combined 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 and Multifamily Risk Sharing debentures. Under current legislation, FHA invests available MMI/CMHI capital reserve fund resources, in excess of its current needs, in non-marketable market-based U.S. Treasury securities. These U.S. Treasury securities may not be sold on public securities exchanges, but do reflect prices and interest rates of similar marketable U.S. Treasury securities. Investments are presented at acquisition cost net of the amortized premium or discount. Amortization of the premium or discount is recognized monthly on investments in U.S. Treasury securities using the interest method in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 1 *Accounting for Selected Assets and Liabilities*, paragraph 71.



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

Credit Reform Accounting

The Federal Credit Reform Act (FCRA) established the use of program, financing, general fund receipt and capital reserve accounts to separately account for transactions that are not controlled by the Congressional budget process. It also established the liquidating account for activity relating to any loan guarantees committed and direct loans obligated before October 1, 1991 (pre-Credit Reform). These accounts are classified as either Budgetary or Non-Budgetary in the Combined 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), and notes related to partial claims. Under the requirements of the FCRA, PMM notes are considered to be direct loans while MNA notes are considered to be defaulted guaranteed loans. The PMM loans are generated from the sales on credit of FHA's foreclosed properties to qualified non-profit organizations.

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

In accordance with the FCRA and SFFAS No. 2, Credit Reform direct loans, defaulted guaranteed loans and related foreclosed property are reported at the net present value of expected cash flows associated with these assets, primarily 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 6).

Loan Guarantee Liability

The net potential future losses related to FHA's central business of providing mortgage insurance are reflected in the Loan Guarantee Liability in the consolidated balance 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 6).

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

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

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

Use of Estimates

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

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

To estimate the Allowance for Subsidy associated with loans receivable and related to foreclosed property and the Liability for Loan Guarantees (LLG), FHA uses cash flow model assumptions associated with loan guarantee cases subject to the Federal Credit Reform Act of 1990 (FCRA), as described in Note 6, to estimate the cash flows associated with future loan performance. To make reasonable projections of future loan performance, FHA



develops assumptions, as described in Note 6, based on historical data, current and forecasted program and economic assumptions.

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

General Property, Plant and Equipment

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

Current HUD policy concerning SFFAS No. 10, *Accounting for Internal Use Software*, indicates that HUD will either own the software or the functionality provided by the software in the case of licensed or leased software. This includes "commercial off-the-shelf" (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, some of which are transferred to HUD. Additionally, FHA receives appropriations for GI/SRI positive subsidy, upward reestimates, and permanent indefinite authority to cover any shortage of resources in the liquidating account.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards* and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts to account for costs assumed by other Federal organizations on their behalf*, require that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. HUD allocates each responsibility segment's share of the program costs or resources provided by other federal agencies. As a responsibility segment of HUD, FHA's portion of these costs was \$15 million for fiscal year 2016 and \$15 million for fiscal year 2015, 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.

FHA funds its programs through borrowings from the U.S. Treasury. These borrowings are authorized through a permanent indefinite authority at interest rates set each year by the U.S. Treasury.



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, 2016 and 2015 are as follows:

(Dollars in millions)	FY 2016	Restated FY 2015
Intragovernmental:		
Fund Balance with Treasury	\$ 35	\$ 26
Total Intragovernmental	35	26
Other Assets	29	37
Total Non-Entity Assets	64	63
Total Entity Assets	75,221	67,156
Total Assets	\$ 75,285	\$ 67,219

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

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

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

Note 3. Fund Balance with U.S. Treasury

FHA’s fund balance with U.S. Treasury was comprised of the following as of September 30, 2016 and 2015:

(Dollars in millions)	FY 2016	FY 2015
Fund Balances:		
Revolving Funds	\$ 19,699	\$ 37,081
Appropriated Funds	245	724
Other Funds	876	1,252
Total	\$ 20,820	\$ 39,057
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance --		
Available	\$ 5,643	\$ 3,565
Unavailable	12,180	32,442
Obligated Balance Not Yet Disbursed	2,997	3,050
Total	\$ 20,820	\$ 39,057

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 reestimates transferred from the financing account. If subsequent upward credit subsidy reestimates are calculated in the financing account or there is shortage of budgetary resources in the liquidating account, the capital reserve account will return the retained negative subsidy to the financing account or transfer the needed funds to the liquidating account, respectively.

Status of Fund Balance with U.S. Treasury

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



Note 4. Investments

Investment in U.S. Treasury Securities

As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30th. The cost, net amortized premium/discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2016 were as follows:

(Dollars in millions)

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

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2015 were as follows:

FY 2015	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	\$ 14,731	\$ 10	\$ 14,741	\$ 14,750
MMI/CMHI Accrued Interest			13	13
Total	\$ 14,731	\$ 10	\$ 14,754	\$ 14,763

Investments in Private-Sector Entities

Investments Risk Sharing Debentures as of September 30, 2016 and 2015 were as follows:

(Dollars in millions)	Beginning Balance	New Acquisitions	Redeemed	Ending Balance
FY 2016				
Risk Sharing Debentures	\$ 31	\$ -	\$ -	\$ 31
Total	\$ 31	\$ -	\$ -	\$ 31

(Dollars in millions)	Beginning Balance	New Acquisitions	Redeemed	Ending Balance
FY 2015				
601 Program and Note Sales	\$ -	\$ -	\$ -	\$ -
Risk Sharing Debentures	\$ 41	\$ 19	\$ (29)	\$ 31
Total	\$ 41	\$ 19	\$ (29)	\$ 31

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2016 and 2015 are as follows:

(Dollars in millions)	Gross		Allowance		Net	
	FY 2016	FY 2015	FY 2016	FY 2015	FY 2016	FY 2015
With the Public:						
Receivables Related to Credit Program Assets	\$ 9	\$ 9	\$ (1)	\$ -	\$ 8	\$ 9
Premiums Receivables	1	-	-	-	1	-
Partial Claims Receivables	77	376	(23)	(124)	54	252
Generic Debt Receivables	264	117	(264)	(117)	-	-
Settlements Receivables	141	114	-	-	141	114
Miscellaneous Receivables	38	32	-	-	38	32
Total	\$ 530	\$ 648	\$ (288)	\$ (241)	\$ 242	\$ 407

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 composed 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 6. 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) by making loans readily available 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 Section 223(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, 2016 and 2015 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 the 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 from the public and borrowing from FFB. The program does not change the basic structure of Risk Sharing; it only substitutes FFB as the funding source. The HFAs would originate and service the loans, and share in any losses.

Prior to fiscal year 2015, FHA’s Direct Loans are as a result of purchase money mortgages (PMMs). The Direct loan receivables are primarily multifamily loans and are in the liquidating fund. In addition, FHA has a small amount of new PMMs that are administered by Single Family Housing. Due to the small size, there is no subsidy associated with these loans.

FHA’s net direct loans receivable is not the same as the proceeds that would be anticipated from the sale of its direct loans.

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

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

	GI/SRI - Multifamily		Total	
September 30, 2015				
Loan Receivables	\$	14	\$	14
Interest Receivables		12		12
Allowance		(6)		(6)
Total Value of Assets	\$	20	\$	20

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

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

	MMI/CMHI - Single Family		GI/SRI - Multifamily		Total	
September 30, 2015						
Loan Receivables	\$	-	\$	102	\$	102
Interest Receivables		-		-		-
Foreclosed Property		-		-		-
Allowance		(3)		33		30
Total Value of Assets	\$	(3)	\$	135	\$	132



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

Direct Loan Programs	FY 2016		FY 2015	
MMI/CHMI				
Single Family Forward	\$	-	\$	1
MMI/CHMI Subtotal	\$	-	\$	1
GI/SRI				
Multifamily/Healthcare	\$	451	\$	103
GI/SRI Subtotal	\$	451	\$	103

Subsidy Expense for Direct Loans:

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)

September 30, 2015

	GI/SRI		Total	
Multifamily/Healthcare				
FFB				
Financing	\$	(5)	\$	(5)
Fees and Other Collections		(3)		(3)
Other		(1)		(1)
Subtotal		(9)		(9)

Total Direct Loan Subsidy Expense:

Direct Loan Programs	FY 2016		FY 2015	
GI/SRI	\$	(52)	\$	(9)
Total	\$	(52)	\$	(9)

Schedule for Reconciling Subsidy Cost Allowance Balances:

Beginning Balance, Changes, and Ending Balance	FY 2016		FY 2015	
Beginning balance of the subsidy cost allowance	\$	(30)	\$	5
Add: subsidy expense for direct loans disbursed during the reporting years by component				
- Financing		(68)		(5)
- Default costs (net recoveries)		4		-
- Fees and other collections		(9)		(3)
- Other subsidy costs		21		(1)
Total of the above subsidy expense components	\$	(52)	\$	(9)
Adjustments:				
- Fees received		1		0
- Subsidy allowance amortization		28		1
- Other		-		(4)
Ending balance of the subsidy cost allowance before reestimates	\$	(53)	\$	(6)
Add or subtract subsidy reestimates by component:				
- Technical/default reestimate				
- Subsidy Expense Component		46		(24)
- Interest Expense Component		2		
- Total of the above reestimate components	\$	48		(24)
Adjustment of prior years' credit subsidy reestimates	\$	(19)		
Total Technical/Default Reestimate	\$	29	\$	(24)
Ending balance of the subsidy cost allowance	\$	(24)	\$	(30)



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

(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

(Dollars in Millions)

FY 2015	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	\$ 22	\$ -	\$ 22
Foreclosed Property	7	9	16
Allowance for Loan Losses	(7)	(4)	(11)
Subtotal	\$ 22	\$ 5	\$ 27
Multifamily/Healthcare			
Loan Receivables	\$ -	\$ 1,947	\$ 1,947
Interest Receivables	-	233	233
Foreclosed Property	-	1	1
Allowance for Loan Losses	-	(808)	(808)
Subtotal	\$ -	\$ 1,373	\$ 1,373
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	\$ 22	\$ 1,377	\$ 1,399

*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 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

FY 2015	Restated MMI/CMHI	Restated GI/SRI	H4H	Restated Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	\$ 8,802	\$ 292	\$ 4	\$ 9,098
Interest Receivables	-	1	-	1
Foreclosed Property	3,130	94	1	3,225
Allowance	(7,053)	(233)	2	(7,284)
Subtotal	\$ 4,879	\$ 154	\$ 7	\$ 5,040
Multifamily/Healthcare				
Loan Receivables	\$ -	\$ 656	\$ -	\$ 656
Foreclosed Property	-	1	-	1
Allowance	-	(272)	-	(272)
Subtotal	\$ -	\$ 385	\$ -	\$ 385
HECM				
Loan Receivables	\$ 2,182	\$ 3,107	\$ -	\$ 5,289
Interest Receivables	992	1,517	-	2,509
Foreclosed Property	11	101	-	112
Allowance	(790)	(1,172)	-	(1,962)
Subtotal	\$ 2,395	\$ 3,553	\$ -	\$ 5,948
Total Guaranteed Loans	\$ 7,274	\$ 4,092	\$ 7	\$ 11,373

*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 2016):		
MMI/CMHI		
Single Family Forward	\$ 1,207,216	\$ 1,097,384
Multifamily/Healthcare	617	590
MMI/CMHI Subtotal	\$ 1,207,833	\$ 1,097,974
GI/SRI		
Single Family Forward	\$ 9,418	\$ 6,575
Multifamily/Healthcare	118,319	108,744
GI/SRI Subtotal	\$ 127,737	\$ 115,319
H4H		
Single Family - 257	\$ 90	\$ 83
H4H Subtotal	\$ 90	\$ 83
Total	\$ 1,335,660	\$ 1,213,376
Guaranteed Loans Outstanding (FY 2015):		
MMI/CMHI		
Single Family Forward	\$ 1,168,002	\$ 1,065,360
Multifamily/Healthcare	558	537
MMI/CMHI Subtotal	\$ 1,168,560	\$ 1,065,897
GI/SRI		
Single Family Forward	\$ 10,716	\$ 7,774
Multifamily/Healthcare	112,682	104,289
GI/SRI Subtotal	\$ 123,398	\$ 112,063
H4H		
Single Family - 257	\$ 98	\$ 92
H4H Subtotal	\$ 98	\$ 92
Total	\$ 1,292,056	\$ 1,178,052

New Guaranteed Loans Disbursed (FY 2016):

(Dollars in Millions)

	<u>Outstanding Principal of Guaranteed Loans,</u>	<u>Amount of Outstanding Principal</u>
MMI/CMHI		
Single Family Forward	\$ 221,756	\$ 219,781
Multifamily/Healthcare	85	85
MMI/CMHI Subtotal	\$ 221,841	\$ 219,866
GI/SRI		
Single Family Forward	\$ 107	\$ 106
Multifamily/Healthcare	12,117	12,062
GI/SRI Subtotal	\$ 12,224	\$ 12,168
Total	\$ 234,065	\$ 232,034

New Guaranteed Loans Disbursed (FY 2015):

MMI/CMHI		
Single Family Forward	\$ 213,056	\$ 211,253
Multifamily/Healthcare	69	69
MMI/CMHI Subtotal	\$ 213,125	\$ 211,322
GI/SRI		
Single Family Forward	\$ 116	\$ 115
Multifamily/Healthcare	11,249	11,196
GI/SRI Subtotal	\$ 11,365	\$ 11,311
Total	\$ 224,490	\$ 222,633



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 997,031 HECM loans with a maximum claim amount of \$235 billion. Of these 997,031 HECM loans insured by FHA, 600,526 loans with a maximum claim amount of \$148 billion are still active. As of September 30, 2016 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)

Loan Guarantee Programs		Current Year Endorsements	Cumulative	
			Current Outstanding Balance	Maximum Potential Liability
FY 2016	MMI/CMHI	\$ 14,612	\$ 70,354	\$ 105,149
	GI/SRI	-	34,294	42,948
	Total	\$ 14,612	\$ 104,648	\$ 148,097
FY 2015	MMI/CMHI	\$ 15,890	\$ 67,739	\$ 101,062
	GI/SRI	-	37,732	48,583
	Total	\$ 15,890	\$ 105,471	\$ 149,645

Loan Guarantee Liability, Net:

(Dollars in Millions)

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)
FY 2015	Restated MMI/CMHI	Restated GI/SRI	H4H	Restated Total
LLR				
Single Family Forward	\$ 7	\$ -	\$ -	7
Subtotal	\$ 7	\$ -	\$ -	7
LLG				
Single Family Forward	\$ 5,937	\$ 610	\$ 23	6,570
Multifamily/Healthcare	(21)	(3,100)	-	(3,121)
HECM	4,205	7,622	-	11,827
Subtotal	\$ 10,121	\$ 5,132	\$ 23	15,276
Loan Guarantee Liability Total	\$ 10,128	\$ 5,132	\$ 23	15,283



Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

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)
FY 2015			
Single Family Forward			
Defaults	\$ 5,684	\$ 5	\$ 5,689
Fees and Other Collections	(18,700)	(7)	(18,707)
Subtotal	\$ (13,016)	\$ (2)	\$ (13,018)
Multifamily/Healthcare			
Defaults	\$ 2	\$ 185	\$ 187
Fees and Other Collections	(6)	(696)	(702)
Subtotal	\$ (4)	\$ (511)	\$ (515)
HECM			
Defaults	\$ 991	\$ -	\$ 991
Fees and Other Collections	(1,056)	-	(1,056)
Subtotal	\$ (65)	\$ -	\$ (65)
Total	\$ (13,085)	\$ (513)	\$ (13,598)

Subsidy Expense for Modification and Reestimates:

(Dollars in millions)

FY 2016	Technical Reestimate
MMI/CMHI	\$ (7,897)
GI/SRI	(225)
Total	\$ (8,122)

FY 2015	Restated
MMI/CMHI	\$ (2,248)
GI/SRI	(1,618)
Total	\$ (3,866)

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)

	FY 2016	Restated FY 2015
MMI/CMHI	\$ (17,082)	\$ (15,333)
GI/SRI	(704)	(2,131)
Total	\$ (17,786)	\$ (17,464)



Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(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			
MF - FHA Full Insurance - Health Care	4.00	(7.43)	(3.43)
MF- Hospitals	3.23	(6.45)	(3.22)

(Percentage)	Defaults	Fees and Other Collections	Total
Budget Subsidy Rates for FY 2015 Loan Guarantees:			
MMI/CMHI			
Single Family			
SF (Forward) -01/27/2015 - present	2.66	(8.01)	(5.35)
SF (Forward) -10/01/2014 - 01/26/2015	2.66	(11.69)	(9.03)
SF- HECM	6.20	(6.60)	(0.40)
SF- Short Refinance	10.06	(10.06)	-
GI/SRI			
Multifamily			
Apartments	2.52	(6.17)	(3.65)
Apartments Refinance	0.30	(4.99)	(4.69)
Healthcare			
MF- Residential Care	3.79	(8.02)	(4.23)
MF- Hospitals	2.61	(7.06)	(4.45)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2016		Restated FY 2015	
	LLR	LLG	LLR	LLG
Beginning Balance of the Loan Guarantee Liability	\$ 7	\$ 15,276	\$ 9	\$ 32,634
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	6,612	-	6,867
Fees and Other Collections	-	(18,068)	-	(20,465)
Other Subsidy Costs	-	1,791	-	-
Total of the above subsidy expense components	-	(9,665)	-	(13,598)
Adjustments:				
Fees Received	\$ -	\$ 14,018	\$ -	\$ 13,274
Foreclosed Property and Loans Acquired	-	11,148	-	13,538
Claim Payments to Lenders	-	(22,423)	-	(26,614)
Interest Accumulation on the Liability Balance	-	(189)	-	564
Other	-	814	-	372
Ending Balance before Reestimates	\$ 7	\$ 8,979	\$ 9	\$ 20,170
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component	\$ (7)	\$ (4,951)	\$ (2)	\$ (4,644)
Interest Expense Component		1,438		782
Adjustment of prior years' credit subsidy reestimates	-	(6,272)	-	(1,032)
Total Technical/Default Reestimate	(7)	(9,785)	(2)	(4,894)
Ending Balance of the Loan Guarantee Liability	\$ -	\$ (806)	\$ 7	\$ 15,276

Administrative Expense:

(Dollars in Millions)	FY 2016	FY 2015
MMI/CMHI	586	556
GI/SRI	-	1
H4H	-	-
Total	586	557



Other Information on Foreclosed Property:

Additional information on FHA foreclosed property as of September 30, 2016 and 2015 is as follows:

	FY 2016	FY 2015
Average number of days in inventory for Sold Cases	134	122
End of Fiscal Year active inventory	23,176	25,109

The above chart references the average holding period for FHA foreclosed property, and the total number of foreclosed properties on-hand as September 30, 2016. 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, 2016 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 LIG 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 Healthcare cohorts are defined based on the year in which loan guarantee commitments are made. Single Family mortgages are grouped into cohorts based on loan endorsement dates for the GI/SRI and MMI funds. 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 healthcare categories.

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

Significant Assumptions – FHA developed economic and financial models in order to estimate the present value of future program cash flows. The models incorporate information on the 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.

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 Healthcare claim and prepayment rates. Sources of forecast data include IHS Global Insight and Moody’s Analytics. OMB provides other economic assumptions used, such as interest rates and the discount rates used against the cash flows.

Actuarial Review: An independent actuarial review of the MMI Fund each year produces conditional claim, prepayment, and loss severity rates that are used as inputs to the Single Family LIG calculation, both for forward and (post-2008) HECM loans.

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 2016.

Mutual Mortgage Insurance (MMI) – On net, the MMI Fund LLG decreased from \$10,434 million at the end of fiscal year 2015 to \$4,226 million at the end of fiscal year 2016. The decrease in liability can be attributed to HECM and Forward loans. There are two primary factors at work this year in the forward-loan portfolio and two in the HECM (reverse mortgage) portfolio. The decrease in liability in Forward loans is mainly due to the inclusion of the 2016 book-of-business which is forecasted to add approximately \$8.3 billion in negative liability to the MMI fund, in addition to a decrease in forecasted claim costs. Aside from economic forecasts, the major factor affecting the HECM LLG calculation is the change to how the model projects maintenance and operations costs for future years.

GI/SRI Home Equity Conversion Mortgage (HECM) - HECM endorsements from fiscal years 1990-2008 remain in the GI/SRI Fund. The liability for these loans decreased from \$ 7,622 million at the end of FY 2015 to \$ 6,487 million at the end of FY 2016. This liability is driven more by long term house price appreciation forecasts than short term forecasts. The HECM loans remaining in the GI/SRI fund benefit from slower UPB (Unpaid Principal Balance) growth. The majority of the remaining GI/SRI HECM loans have adjustable interest rates.

GI/SRI Section 223(f) - Section 223(f) of the National Housing Act permits FHA mortgage insurance for the refinance or acquisition of existing multifamily rental properties consisting of five or more units. Under this program, FHA may insure up to 85 percent of the lesser of the project’s appraised value or its replacement cost. Projects insured under the program must be at least three years old. The Section 223(f) program is the largest multifamily program in the GI/SRI fund with an insurance-in-force of \$31.4 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 increased this year by \$129 million, from (\$1,203) million to (\$1,074) million, due to decreased 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 \$20.4 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 increased this year by \$2.5 million, from (\$607) million to (\$604) 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 \$14.5 billion. The Section 221(d)(4) liability increased by \$1.5 million this year, from (\$112) million to (\$110.5) million.

GI/SRI Section 232 Healthcare New Construction (NC) - The Section 232 NC program provides mortgage insurance for construction or substantial rehabilitation of nursing homes and assisted-living facilities. FHA insures a maximum of 90 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 NC program has an insurance-in-force of \$3 billion. The Section 232 NC liability decreased by \$12.4 million this year, from (\$70.6) million to (\$83) million due to lower claim and prepayment expectations.

GI/SRI Section 232 Healthcare Purchasing or Refinancing - The Section 232 Refinance program provides mortgage insurance for two purposes: purchasing or refinancing of projects that do not need substantial rehabilitation, and installation of fire safety equipment for either private, for-profit businesses or non-profit associations. For existing projects, FHA insures a maximum of 85 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 Refinance program has an insurance-in-force of \$22.9 billion. The Section 232 Refinance liability decreased by \$56.5 million this year from (\$686.6) million to 743.1) million due to an increase in insurance-in-force.

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 \$7.2 billion. The Section 242 liability increased by \$45 million from (\$224) million to (\$179) million due to lower premium revenue caused by increased prepayment expectations.

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 value, 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 that 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. 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. Lastly, because of the critical importance of FHA’s single-family programs for national housing policy and the uncertainty surrounding the final cost of credit expenses resulting from the recent, severe economic recession, HUD has contracted for a second independent actuarial study of that portfolio. This second opinion directly addresses potential model risk by evaluating whether a different modeling approach would produce a reasonably similar economic value. This year, the results of that examination provide a reasonable assurance that any model risk in the LLG calculations is within a tolerable range for accepting the primary contractor’s loan performance projections.

At this point in the economic cycle, with demand for rental units high, and loans refinancing at historically low interest rates, near term risks to the multifamily LLG calculation appear to be low. However, over the longer term, risks come from many sources—changes in population growth and household formation, the supply of rental housing in each market where FHA has a presence, and local employment conditions. Risks also come from FHA’s policy of insuring loans pre-construction in its 221(d)(4) program, though that is a small share of new endorsement activity today. To the extent 221(d)(4) projects come into each new cohort, LLG calculations are subject to risk from their ability to find viable markets when they do come on-line. New construction loans approved in 2007 – 2009 have now gone through several annual rounds of rentals to prove market viability. The combined 2010-2013 cohorts, which are just now starting to come into rent-up, are more than twice as large as 2007-2009, by dollar volume. Valuations of the newer portfolio are dependent upon continued trends in rental vacancy rates and rental-price growth.

For Healthcare programs (Sections 232 and 242), LLG risk comes principally from health-care reimbursement rates from Medicare and Medicaid. In addition, the financial health of state and municipal government entities is also 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 based on the quality of business management at each facility, and from the supply of medical care in each community relative to demand and the ability of facility management to adapt to changing technologies and the competitive landscape. These are factors for which it is difficult to predict future trends.

Pre-Credit Reform Valuation Methodology

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

MMI Single Family LLR - For the single family portfolio, the remaining insurance-in-force for Pre-Credit Reform loans is \$717 million. The aggregate liability for the remaining pre-credit reform loans in FY 2016 is \$1.1 million, which is a \$5.4 million decrease.

GI/SRI Multifamily & Healthcare LLR - For the multifamily and healthcare portfolio, the remaining insurance-in-force for pre-credit reform loans is \$356 million. The aggregate liability for the remaining pre-credit reform loans in FY 2016 is (\$1) million, which is a \$500 thousand increase from the (\$1.5) million estimate in FY 2015. The year-over-year increase in aggregate liability is due to a \$129 million decline in insurance-in-force as both measures move closer to zero.



Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2016 and 2015:

(Dollars in millions)

	FY 2016	FY 2015
Intragovernmental:		
Advances to HUD for Working Capital Fund Expenses	\$ -	\$ 1
Total	\$ -	\$ 1
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	\$ 29	\$ 37
Deposits in Transit	24	8
Total	\$ 53	\$ 45

Advances to HUD for Working Capital Fund Expenses

The Working Capital Fund was established by HUD to consolidate, at the department level, the acquisition of certain property and equipment to be used by different organizations within HUD. Advances to HUD for Working Capital Fund expenses represent the amount of payments made by FHA to reimburse the HUD Working Capital Fund for its share of the fund’s expenses prior to the receipt of goods or services from this fund.

Escrow Monies Deposited at Minority-Owned Banks

FHA holds in trust escrow monies received from the borrowers of its Multifamily mortgage notes to cover property repairs and renovation expenses. These escrow monies are deposited at the U.S. Treasury (see Note 2), invested in U.S. Treasury securities (see Note 4 - GI/SRI Investments) or deposited at minority-owned banks.

Deposits in Transit

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

Note 8. Accounts Payable

Accounts Payable as of September 30, 2016 and 2015 are as follows:

(Dollars in millions)

	FY 2016	FY 2015
Intragovernmental:		
Claims Payable to Ginnie Mae	\$ 7	\$ -
Payables to U.S. Treasury	-	-
Miscellaneous Payables to Other Federal Agencies	-	1
Total	\$ 7	\$ 1

	FY 2016	FY 2015
With the Public:		
Claims Payable	\$ 311	\$ 357
Premium Refunds Payable	141	142
Single Family Property Disposition Payable	21	25
Miscellaneous Payables	22	21
Total	\$ 495	\$ 545

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 10. Other Liabilities

The following table describes the composition of Other Liabilities as of September 30, 2016 and 2015:

(Dollars in millions)

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

FY 2015	Restated Current
Intragovernmental:	
Receipt Account Liability	\$ 2,889
Total	\$ 2,889

With the Public:

Trust and Deposit Liabilities	\$ 63
Multifamily Notes Unearned Revenue	251
Premiums collected on unendorsed cases	326
Miscellaneous Liabilities	86
Total	\$ 726



Receipt Account Payable Liability

The receipt account payable liability is created from downward credit subsidy reestimates 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.

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, 2016.

Activity with Ginnie Mae

As of September 30, 2016, 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 2016 (in Millions)	FY 2015 (in Millions)
Mortgages Held for Investment & Foreclosed Property (Pre-claim)	3,950	5,000
Short Sale Claims Receivable	94	48

"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.



Note 12. Gross Costs

Gross costs incurred by FHA for the period ended September 30, 2016 and 2015 are as follows:

(Dollars in millions)

FY 2016	Single Family				Administrative		Total
	Forward	HECM	Multifamily	Healthcare	Expenses		
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	(7,859)	(300)	49	(10)	-	-	(8,120)
Interest Expense	(1,585)	(60)	7	41	-	-	(1,597)
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)

FY 2015	Restated				Restated		Total
	Single Family Forward	HECM	Multifamily	Healthcare	Administrative Expenses		
Intragovernmental:							
Interest Expense	\$ 955	\$ 59	\$ 104	\$ 73	\$ -	\$ -	1,191
Imputed Cost	-	-	-	-	15	-	15
Total	\$ 955	\$ 59	\$ 104	\$ 73	\$ 15	\$ -	1,206
With the Public:							
Salary and Administrative Expense	\$ -	\$ -	\$ -	\$ -	\$ 557	\$ -	557
Subsidy Expense	(13,018)	(65)	(399)	(125)	-	-	(13,607)
Re-estimate Expense	185	(3,430)	(70)	(6)	-	-	(3,321)
Interest Expense	(604)	(1,028)	(17)	51	-	-	(1,598)
Interest Accumulation Expense	140	526	(39)	(61)	-	-	566
Bad Debt Expense	(2)	3	(44)	-	-	-	(43)
Loan Loss Reserve	(1)	-	(2)	1	-	-	(2)
Other Expenses	17	1	12	-	10	-	40
Total	\$ (13,283)	\$ (3,993)	\$ (559)	\$ (140)	\$ 567	\$ -	(17,408)
Total Gross Costs	\$ (12,328)	\$ (3,934)	\$ (455)	\$ (67)	\$ 582	\$ -	(16,202)

Interest Expense

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

Interest Accumulation Expense

Interest accumulation expense is 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 annual 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 FHA's share of HUD expenses incurred in the Working Capital Fund and expenses from intra-agency agreements.

Note 13. Earned Revenue

Earned revenues generated by FHA for the period ended September 30, 2016 and 2015 are as follows:

(Dollars in millions)

FY 2016	Single Family				Total
	Forward	HECM	Multifamily	Healthcare	
Intragovernmental:					
Interest Revenue from Deposits at U.S. Treasury	\$ 537	\$ 391	\$ 32	\$ 53	1,013
Interest Revenue from MMI/CMHI Investments	125	12	-	-	137
Gain on Sale of MMI/CMHI Investments	-	-	-	-	-
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

FY 2015	Single Family				Total
	Forward	HECM	Multifamily	Healthcare	
Intragovernmental:					
Interest Revenue from Deposits at U.S. Treasury	\$ 1,095	\$ 584	\$ 58	\$ 16	1,753
Interest Revenue from MMI/CMHI Investments	38	-	-	-	38
Gain on Sale of MMI/CMHI Investments	-	-	-	-	-
Total Intragovernmental	\$ 1,133	\$ 584	\$ 58	\$ 16	1,791
With the Public:					
Insurance Premium Revenue	\$ (1)	\$ 1	\$ 2	\$ -	2
Income from Notes and Properties	\$ 11	\$ -	\$ 38	\$ 1	50
Other Revenue	\$ 1	\$ -	\$ 5	\$ -	6
Total With the Public	\$ 11	\$ 1	\$ 45	\$ 1	58
Total Earned Revenue	\$ 1,144	\$ 585	\$ 103	\$ 17	1,849

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.



Gain on Sale of MMI/CMHI Investments

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

Premium Revenue

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

Up-front Premiums

The up-front premium rates vary according to the mortgage type and the year of origination. The FHA up-front premium rates in fiscal year 2016 were:

Upfront Premium Rates	
10/01/2015 - 9/30/2016	
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 2016 were:

Annual Periodic Premium Rates	
Single Family	
10/01/2015 - 1/25/2016	0.80%, 0.85%, 1.00% or 1.05%
01/27/16 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. For guaranteed cases endorsed in fiscal year 2013, the Title I annual insurance premium is 1.00 percent of the loan amount until maturity.

Income from Notes and Property

Income from Notes and Property includes revenue associated with FHA pre-1992 loan guarantees. This income includes revenue from Notes and Properties held, sold, and gains associated with the sale.

Other Revenue

Other revenue includes revenue associated with FHA pre-1992 loan guarantees. FHA's other revenue consists of late charges and penalty revenue, fee income, and miscellaneous income generated from FHA operations.

Note 14. Gross Cost and Earned Revenue by Budget Functional Classification

FHA cost and earned revenue reported on the Statements of Net Cost is categorized under the budget functional classification (BFC) for Mortgage Credit (371). All FHA U.S. Treasury account symbols found under the department code "86" for Department of Housing and Urban Development appear with the Mortgage Credit BFC.



Note 15. Transfers Out and Other Financing Sources

Transfers in/out incurred by FHA for the period ended September 30, 2016 and 2015 are as follows:

(Dollars in millions)

FY 2016	Cumulative Results of Operations	Unexpended Appropriations	Total
Transfers Out:			
HUD	\$ 480	\$ -	\$ 480
Other Financing Sources:			
Treasury	\$ (2,063)	\$ -	\$ (2,063)
FY 2015	Restated Cumulative Results of Operations	Unexpended Appropriations	Restated Total
Transfers Out:			
HUD	\$ 442	\$ -	\$ 442
Other Financing Sources:			
Treasury	\$ (4,217)	\$ -	\$ (4,217)

Transfers In/Out from HUD

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

Other Financing Sources

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

Note 16. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2016 and 2015 are as follows:

(Dollars in millions)

FY 2016	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Ending Balance
Positive Subsidy	\$ 454	\$ -	\$ (452)	\$ -	\$ 2
Working Capital and 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

FY 2015	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Ending Balance
Positive Subsidy	\$ 464	\$ -	\$ (10)	\$ -	\$ 454
Working Capital and Contract Expenses	274	130	(20)	(124)	260
Reestimates	-	2,080	-	(2,080)	-
GI/SRI Liquidating	134	25	-	(2)	157
Total	\$ 872	\$ 2,235	\$ (30)	\$ (2,206)	\$ 871

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

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

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



Note 17. Budgetary Resources

The SF-133 and the Statement of Budgetary Resources for fiscal year 2015 have been reconciled to the fiscal year 2015 actual amounts included in the Program and Financing Schedules presented in the fiscal year 2017 Budget of the United States Government. There were no significant reconciling items. Information from the fiscal year 2016 Statement of Budgetary Resources will be presented in the fiscal year 2018 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2017 and will be available from the Government Printing Office and online at that time.

Obligated balances as of September 30, 2016 and 2015 are as follows:

Unpaid Obligations

(Dollars in Millions)		
Undelivered Orders	FY 2016	FY 2015
MMI/CMHI	\$ 1,598	\$ 1,658
GI/SRI	597	368
H4H	1	1
EI	-	17
Undelivered Orders Subtotal	\$ 2,196	\$ 2,044
Accounts Payable		
MMI/CMHI	\$ 670	\$ 663
GI/SRI	130	343
Accounts Payable Subtotal	\$ 800	\$ 1,006
Total	\$ 2,996	\$ 3,050

Note 18. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2016 and 2015:

(Dollars in Millions)

	MMI/CM	GI/SRI	H4H	Total
FY 2016	HI			
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

	MMI/CM	GI/SRI	H4H	Total
FY 2015	HI			
Collections:				
Premiums	\$ 12,593	\$ 859	\$ 1	\$ 13,453
Notes	2,194	507	-	2,701
Property	4,319	193	1	4,513
Interest Earned from U.S. Treasury	1,362	379	-	1,741
Subsidy	13,086	-	-	13,086
Reestimates	21,327	2,080	-	23,407
Collections from settlements	961	-	-	961
Other	52	9	-	61
Total	\$ 55,894	\$ 4,027	\$ 2	\$ 59,923



Note 19. Budgetary Resources – Obligations

The following table presents the composition of FHA’s obligations for the period ended September 30, 2016 and 2015:

(Dollars in Millions)

	MMI/CM	GI/SRI	H4H	EI/TI	Total
September 30, 2016	HI				
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
Admin, Contract and Working Capital	121	-	-	-	121
FFB Direct Loans	-	688	-	-	688
Other	98	105	-	-	203
Total	\$ 48,475	\$ 9,410	\$ 2	\$ -	\$ 57,887

	MMI/CM	GI/SRI	H4H	EI/TI	Total
September 30, 2015	HI				
Obligations					
Claims	\$ 19,412	\$ 3,680	\$ 4	\$ -	\$ 23,096
Property Expenses	794	86	1	-	881
Interest on Borrowings	937	251	-	-	1,188
Subsidy	13,085	561	-	-	13,646
Downward Reestimates	8,436	2,276	-	-	10,712
Upward Reestimates	12,891	2,080	-	-	14,971
Admin, Contract and Working Capital	130	-	-	-	130
Other	26	193	-	-	219
Total	\$ 55,711	\$ 9,127	\$ 5	\$ -	\$ 64,843

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, 2016 and 2015:

(Dollars in Millions)	FY 2016	Restated FY2015
RESOURCES USED TO FINANCE ACTIVITIES:		
Obligations Incurred - SBR	\$ 57,890	\$ 64,843
Spending Authority from Offsetting Collections and Recoveries - SBR	(54,742)	(60,362)
Offsetting Receipts - SBR	(2,000)	(2,797)
Other Financing Sources - NP	(2,063)	(4,217)
Transfers In/Out Without Reimbursement	481	442
Imputed Financing Sources	15	15
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	\$ (419)	\$ (2,076)
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS:		
Undelivered Orders and Adjustments	\$ (150)	\$ (127)
Revenue and Other Resources	56,036	62,726
Purchase of Assets	(50,134)	(49,188)
Appropriations for prior Year Re-estimate	(6,829)	(14,972)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	1,567	3,761
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	\$ 490	\$ 2,200
Total Resources Used to Finance the Net Cost of Operations	\$ 71	\$ 124
COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Upward Reestimate of Credit Subsidy Expense	\$ 5,561	\$ 12,881
Downward Reestimate of Credit Subsidy Expense	(15,297)	(17,776)
Changes in Loan Loss Reserve Expense	(7)	(1)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	5	(42)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(9,716)	(13,607)
Gains or Losses on Sales of Credit Program Assets	25	15
Other	382	355
COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	\$ (19,047)	\$ (18,175)
Net Cost of Operations	\$ (18,976)	\$ (18,051)

**Note 21. Restatement of FHA's Fiscal Year 2015 Financial Statements**

In FY 2016, FHA corrected material misstatements in the Consolidated Balance Sheet (BS), the Statement of Net Cost (SNC) and the Statement of Changes in Net Position (SCNP) to recognize the reduction of erroneous accrued expenses in the Home Equity Conversion Mortgage (HECM) cash flow model assumptions used to calculate the agency's Liability for Loan Guarantees (LLG). Historically reported property Maintenance and Operating (M&O) management expenses erroneously included accrued costs that resulted in FHA's LLG to be overstated by \$830 million in FY14 and \$833 million in FY 2015. As a result, the overstated total gross cost of HECM expenses reported on the SNC for FY 2014 caused the cumulative results of operations reported on the SCNP to be understated by \$1.4 billion. The same error occurred in the calculation of the FY 2015 model expense rate assumptions however, there was less of a net impact on FY 2015 reporting. The net effect of the error for both years, offset by the adjustment for the annual reestimates, resulted in the overall HECM gross cost reported on the SNC in FY 2015 to be overstated by \$1.4 million and the cumulative result of operations on the SCNP to be understated by \$835 million.

Maintenance and Operating (M&O) expenses represent primarily Management and Marketing contract expenses maintained in the SAMS property management system. FHA uses M&O expenses in the cash flow model assumptions to calculate the LLG. In FY14 and FY15, the M&O expense reports FHA received for HECM showed significant increases in M&O expenses over previous years. FHA initially attributed the increases to an increase in expenses related to HECM property sales and projected the increase to level off and return to previous levels. In FY16, further research of the M&O data found that accrued costs (interest, service fees from assignment to conveyance, and mortgage insurance premiums) were being incorrectly included in the M&O expenses. These activities were inappropriate to include since they do not represent cash flows.

FHA has restated its FY15 financial statements to correct the reported balance of the LLG in the current period. Due to the imminent publishing of the FY16 audited financial statements, the FY15 restatement will be presented comparatively. Recalculation of the FY14 corrected LLG and net costs of operations are reflected in the restated FY15 beginning balance of the Statement of Changes in Net Position. The restatement will affect the line balances of the Loan Receivables and Related Foreclosed Property, Other Liabilities, LLG and Current Year Results of Operations on the Balance Sheet; the HECM Gross Cost with the Public on the Statement of Net Cost; the Changes in Net Position beginning balance, Other Financing Sources and Net Costs of Operations on the Statement of Changes in Net Position; and related footnotes.

Balance Sheet (dollars in millions)	September 30, 2015 Consolidated Financial Statements (without restatement)	September 30, 2015 Consolidated Financial Statements (with restatement)	Change
ASSETS			
Intragovernmental			
Fund Balance with U.S. Treasury (Note 3)	\$ 39,057	\$ 39,057	\$ -
Investments (Note 4)	14,754	14,754	\$ -
Other Assets (Note 7)	1	1	\$ -
Total Intragovernmental	\$ 53,812	\$ 53,812	\$ -
Investments (Note 4)	\$ 31	\$ 31	\$ -
Accounts Receivable, Net (Note 5)	407	407	\$ -
Loans Receivable and Related Foreclosed Property, Net (Note 6)	12,384	12,924	\$ (540)
Other Assets (Note 7)	45	45	\$ -
TOTAL ASSETS	\$ 66,679	\$ 67,219	\$ (540)
LIABILITIES			
Intragovernmental			
Accounts Payable (Note 8)	\$ 1	\$ 1	\$ -
Borrowings (Note 9)	27,023	27,023	\$ -
Other Liabilities (Note 10)	2,351	2,889	\$ (538)
Total Intragovernmental	\$ 29,375	\$ 29,913	\$ (538)
Accounts Payable (Note 8)	\$ 545	\$ 545	\$ -
Loan Guarantee Liability (Note 6)	16,116	15,283	\$ 833
Debentures Issued to Claimants (Note 9)	-	-	\$ -
Other Liabilities (Note 10)	726	726	\$ -
TOTAL LIABILITIES	\$ 46,762	\$ 46,467	\$ 295
NET POSITION			
Unexpended Appropriations (Note 16)	\$ 871	\$ 871	\$ -
Cumulative Results of Operations	19,046	19,881	\$ (835)
TOTAL NET POSITION	\$ 19,917	\$ 20,752	\$ (835)
TOTAL LIABILITIES AND NET POSITION	\$ 66,679	\$ 67,219	\$ (540)



Statement of Net Cost (dollars in millions)	September 30, 2015 Consolidated Financial Statements (without restatement)	September 30, 2015 Consolidated Financial Statements (with restatement)	Change
Single Family Forward			
Intragovernmental Gross Costs	\$ 955	\$ 955	\$ -
Less: Intragovernmental Earned Revenue	1,133	1,133	\$ -
Intragovernmental Net Costs	\$ (178)	\$ (178)	\$ -
Gross Costs With the Public	\$ (13,283)	\$ (13,283)	\$ -
Less: Earned Revenues	11	11	\$ -
Net Costs With the Public	\$ (13,294)	\$ (13,294)	\$ -
Single Family Forward Net Cost (Surplus)	\$ (13,472)	\$ (13,472)	\$ -
HECM			
Intragovernmental Gross Costs	\$ 59	\$ 59	\$ -
Less: Intragovernmental Earned Revenue	584	584	\$ -
Intragovernmental Net Costs	\$ (525)	\$ (525)	\$ -
Gross Costs With the Public	\$ (3,992)	\$ (3,993)	\$ 1
Less: Earned Revenues	1	1	\$ -
Net Costs With the Public	\$ (3,993)	\$ (3,994)	\$ 1
HECM Net Cost (Surplus)	\$ (4,518)	\$ (4,519)	\$ 1
Multifamily			
Intragovernmental Gross Costs	\$ 104	\$ 104	\$ -
Less: Intragovernmental Earned Revenue	58	58	\$ -
Intragovernmental Net Costs	\$ 46	\$ 46	\$ -
Gross Costs With the Public	\$ (559)	\$ (559)	\$ -
Less: Earned Revenues	45	45	\$ -
Net Costs With the Public	\$ (604)	\$ (604)	\$ -
Multifamily Net Cost (Surplus)	\$ (558)	\$ (558)	\$ -
Healthcare			
Intragovernmental Gross Costs	\$ 73	\$ 73	\$ -
Less: Intragovernmental Earned Revenue	16	16	\$ -
Intragovernmental Net Costs	\$ 57	\$ 57	\$ -
Gross Costs With the Public	\$ (140)	\$ (140)	\$ -
Less: Earned Revenues	1	1	\$ -
Net Costs With the Public	\$ (141)	\$ (141)	\$ -
Healthcare Net Cost (Surplus)	\$ (84)	\$ (84)	\$ -
Salaries and Administrative Expenses			
Intragovernmental Gross Costs	\$ 15	\$ 15	\$ -
Less: Intragovernmental Earned Revenue	-	-	\$ -
Intragovernmental Net Costs	\$ 15	\$ 15	\$ -
Gross Costs With the Public	\$ 567	\$ 567	\$ -
Less: Earned Revenues	-	-	\$ -
Net Costs With the Public	\$ 567	\$ 567	\$ -
Administrative and Contracts Net Cost (Surplus)	\$ 582	\$ 582	\$ -
Net Cost of Operations	\$ (18,050)	\$ (18,051)	\$ 1

Statement of Changes in Net Position (dollars in millions)	September 30, 2015 Consolidated Financial Statements (without restatement)	September 30, 2015 Consolidated Financial Statements (with restatement)	Change
CUMULATIVE RESULTS OF OPERATIONS (Note 16)			
Beginning Balance	\$ 2,013	\$ 2,013	\$ -
Adjustments			
Changes in Accounting Principles			\$ -
Corrections of Errors		\$ 1,371	\$ (1,371)
Beginning Balance, As Adjusted	\$ 2,013	\$ 3,384	\$ (1,371)
Budgetary Financing Sources:			
Appropriations Used			
NonExchange Revenue			
Donations and Forfeitures of Cash and Cash Equivalents			
Transfers In/Out Without Reimbursement (Note 15)			
Other Adjustments (Recissions, etc)	2,206	2,206	-
Other Financing Sources (Nonexchange)			
Donations and Forfeitures of Property			
Transfers In/Out Without Reimbursement	442	442	-
Imputed Financing From Costs	15	15	-
Other	(3,680)	(4,217)	537
Total Financing Sources	\$ (1,017)	\$ (1,554)	537
Net Cost of Operations	18,050	18,051	(1)
Net Change	17,033	16,497	536
			-
Cummulative Results of Operation	\$ 19,046	\$ 19,881	\$ (835)
Unexpended Appropriations (Note 16)			
Beginning Balance	\$ 872	\$ 872	\$ -
Budgetary Financing Sources			
Appropriations Received	2,235	2,235	-
Transfers In/Out	-	-	-
Other Adjustments (Recissions, etc)	(30)	(30)	-
Appropriations Used	(2,206)	(2,206)	-
Total Budgetary Financing Sources	\$ (1)	\$ (1)	-
Unexpended Appropriation	\$ 871	\$ 871	\$ -
Net Position	\$ 19,917	\$ 20,752	\$ (835)



Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intra-governmental assets, by Federal entity, are as follows on September 30, 2016 and 2015:

(Dollars in Millions)

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

FY 2015	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	\$ 39,057	\$ 14,754	\$ -	\$ -	\$ 53,811
HUD	-	-	-	1	1
Total	\$ 39,057	\$ 14,754	\$ -	\$ 1	\$ 53,812

Schedule B: Intragovernmental Liabilities

FHA's Intra-governmental liabilities, by Federal entity, are as follows on September 30, 2016 and 2015:

(Dollars in Millions)

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

FY 2015	Accounts Payable	Borrowings	Restated Other Liabilities	Restated Total
Federal Financing Bank	\$ -	\$ 122	\$ -	\$ 122
U.S. Treasury	-	26,901	2,889	29,790
HUD	1	-	-	1
Total	\$ 1	\$ 27,023	\$ 2,889	\$ 29,913

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 & 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 C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2015:

Dollars in Millions	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	\$ 7,337	\$ 94	\$ 16	\$ 705	\$ 8,152
Unobligated balance brought forward, October 1, as adjusted	7,337	94	16	705	8,152
Recoveries of prior year unpaid obligations	-	24	-	26	50
Other changes in unobligated balance (+ or -)	(7,337)	7,317	-	(221)	(241)
Unobligated balance from prior year budget authority, net	-	7,435	16	510	7,961
Appropriations (discretionary and mandatory)	-	130	2,070	25	2,225
Spending authority from offsetting collections (discretionary & mandatory)	15,963	5,554	-	199	21,716
Total budgetary resources	\$ 15,963	\$ 13,119	\$ 2,086	\$ 734	\$ 31,902
Status of Budgetary Resources:					
Obligations incurred	-	13,021	2,080	69	15,170
Apportioned	-	47	6	3	56
Unapportioned	15,963	52	-	661	16,676
Total unobligated balance, end of year	15,963	98	6	665	16,732
Total budgetary resources	\$ 15,963	\$ 13,119	\$ 2,086	\$ 734	\$ 31,902
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	146	1	440	587
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(8)	-	-	(1)	(9)
Obligated balance, start of year (net), before adjustments (+ or -)	(8)	146	1	439	578
Obligated balance, start of year (net), as adjusted	(8)	146	1	439	578
Obligations incurred	-	13,021	2,080	69	15,170
Outlays (gross) (-)	-	(13,010)	(2,080)	(52)	(15,142)
Change in uncollected customer payments from Federal sources (+ or -)	(6)	-	-	-	(6)
Recoveries of prior year unpaid obligations (-)	-	(24)	-	(26)	(50)
Unpaid obligations, end of year (gross)	-	133	1	431	565
Uncollected customer payments from Federal sources, end of year	(14)	-	-	(1)	(15)
Obligated balance, end of year (net)	\$ (14)	\$ 133	\$ 1	\$ 430	\$ 550
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	15,963	5,684	2,070	224	23,941
Actual offsetting collections (discretionary and mandatory) (-)	(21,512)	-	-	(198)	(21,710)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(5)	-	-	(1)	(6)
Budget authority, net (discretionary and mandatory)	(5,554)	5,684	2,070	25	2,225
Outlays, gross (discretionary and mandatory)	-	13,010	2,080	52	15,142
Actual offsetting collections (discretionary and mandatory) (-)	(21,512)	-	-	(198)	(21,710)
Outlays, net (discretionary and mandatory)	(21,512)	13,010	2,080	(146)	(6,568)
Distributed offsetting receipts (-)	-	-	-	(2,797)	(2,797)
Agency outlays, net (discretionary and mandatory)	\$ (21,512)	\$ 13,010	\$ 2,080	\$ (2,943)	\$ (9,365)

Required Supplementary Information

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

	MM/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



Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2015:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	\$ 37,072	\$ 8,474	\$ 23	\$ 45,569
Unobligated balance brought forward, October 1, as adjusted	37,072	8,474	23	45,569
Recoveries of prior year unpaid obligations	333	49	-	382
Unobligated balance from prior year budget authority, net	37,405	8,523	23	45,951
Borrowing authority (discretionary and mandatory)	10,003	2,020	123	12,146
Spending authority from offsetting collections (discretionary and mandatory)	22,856	2,702	5	25,563
Total budgetary resources	\$ 70,264	\$ 13,245	\$ 151	\$ 83,660
Status of Budgetary Resources:				
Obligations incurred	\$ 42,667	\$ 6,884	\$ 122	\$ 49,673
Unobligated balance, end of year:				
Apportioned	2,158	1,333	18	3,509
Unapportioned	25,439	5,028	11	30,478
Total unobligated balance, end of year	27,597	6,361	29	33,987
Total budgetary resources	\$ 70,264	\$ 13,245	\$ 151	\$ 83,660
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	\$ 1,806	\$ 423	-	\$ 2,229
Obligated balance, start of year (net), before adjustments (+ or -)	1,806	423	-	2,229
Obligated balance, start of year (net), as adjusted	1,806	423	-	2,229
Obligations incurred	42,666	6,884	123	49,673
Outlays (gross) (-)	(42,097)	(6,819)	(119)	(49,035)
Recoveries of prior year unpaid obligations (-)	(333)	(49)	-	(382)
Unpaid obligations, end of year (gross)	2,042	439	4	2,485
Obligated balance, end of year (net)	\$ 2,042	\$ 439	\$ 4	\$ 2,485
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	\$ 32,859	\$ 4,721	\$ 128	\$ 37,708
Actual offsetting collections (discretionary and mandatory) (-)	(34,374)	(3,833)	(6)	(38,213)
Budget authority, net (discretionary and mandatory)	(1,515)	888	122	(505)
Outlays, gross (discretionary and mandatory)	42,097	6,819	119	49,035
Actual offsetting collections (discretionary and mandatory) (-)	(34,374)	(3,833)	(6)	(38,213)
Outlays, net (discretionary and mandatory)	7,723	2,986	113	10,822
Agency outlays, net (discretionary and mandatory)	\$ 7,723	\$ 2,986	\$ 113	\$ 10,822

Other Accompanying Information

The Office of Management and Budget (OMB) requires all CFO Act agencies' to include the Schedule of Spending in the Other Accompanying Information section of their Annual Financial Report. The Schedule of Spending presents an overview of how and where agencies are spending money. The statement discloses FHA's resources that were available to spend, services or items that were purchased, with whom the agencies are spending money, and how obligations are issued.



FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
SCHEDULE OF SPENDING
As of September 30 2016
in millions

	<u>FY 2016</u>	<u>FY 2015</u>
<u>What Money is Available to Spend?</u>		
Total Resources	\$112,060	\$115,562
Less Amount Available but Not Agreed to be Spent	5,638	3,565
Less Amount Not Available to be Spent	48,533	47,154
<u>Total Amounts Agreed to be Spent</u>	<u>\$57,889</u>	<u>\$64,843</u>
 <u>How Was the Money Spent?</u>		
Category*		
Claims	\$21,578	\$22,996
Property Expenses	329	385
Interest on Borrowings	1,209	1,187
Subsidy	9,716	13,607
Downward Reestimates	16,924	10,712
Upward Reestimates	6,790	14,972
Admin, Contract and Working Capital	111	128
FFB Direct Loans	470	-
Other	111	190
 Total Spending	 <u>\$57,238</u>	 <u>\$64,177</u>
Amounts Remaining to be Spent	651	666
<u>Total Amounts Agreed to be Spent</u>	<u>\$57,889</u>	<u>\$64,843</u>
 <u>Who Did the Money go to?</u>		
For Profit	\$22,780	\$24,366
Government	35,109	40,477
<u>Total Amounts Agreed to be Spent</u>	<u>\$57,889</u>	<u>\$64,843</u>
 <u>How Was the Money Issued?</u>		
Claims	\$21,550	\$23,096
Property Expenses	649	880
Interest on Borrowings	1,209	1,187
Subsidy	9,754	13,646
Downward Reestimates	16,924	10,712
Upward Reestimates	6,790	14,972
Admin, Contract and Working Capital	121	130
FFB Direct Loans	687	-
Other	205	220
<u>Total on how Money Was Issued</u>	<u>\$57,889</u>	<u>\$64,843</u>

AUDITOR'S REPORT

This report was issued separately in November 2016 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2016 and 2015 (Restated)" (2017-FO-0002). The report is available at HUD, OIG's internet site at: <http://www.hudoig.gov>.

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To: Edward Golding, Principal Deputy Assistant Secretary for Housing, H
//signed//

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

Subject: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2016 and 2015 (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 2016 and 2015 (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 Web site. 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: 2017-FO-0002

Date: November 14, 2016

**Audit of the Federal Housing Administration's Financial Statements for
Fiscal Years 2016 and 2015 (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 (OIG) 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, 2016 and 2015 (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 2016 to restate its fiscal year 2015 financial statements. We conducted these audits in accordance with U.S. generally accepted government auditing standards.

What We Found

In our opinion, except for the effects of FHA's general counsel refusal to sign off on certain matters included in the management representation letter concerning all known actual or possible FHA litigation, claims, and assessments, FHA's fiscal years 2016 and 2015 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 2016 Annual Management Report. The results of our audit of FHA's principal financial statements and notes for the fiscal years ending September 30, 2016 and 2015, 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, three significant deficiencies in internal controls, and one instance of noncompliance with applicable laws and regulations which are discussed further in the body of this report.

What We Recommend

We recommended FHA develop, document, implement or strengthen existing system and internal control processes, policies and procedures to support reliable financial reporting over its receivable, liability for loan guarantee and budgetary balances. Additionally, we recommended FHA deobligate \$277 million for invalid obligations and bill the appropriate parties for the \$55 million in loans receivable that were unsupported as of fiscal yearend.

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

Independent Auditor's Report

Principal Deputy Assistant Secretary
Federal Housing Administration

In our audit of the fiscal years 2016 and 2015 (restated) financial statements of the Federal Housing Administration (FHA), a component of the U.S. Department of Housing and Urban Development (HUD), we found

- Except for the effects of the matter described in the Basis for Qualified opinion paragraph, the financial statements and notes were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- Two material weaknesses in internal control over financial reporting;
- Three significant deficiencies in internal control over financial reporting; and
- One instance 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 other 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 questioned costs.

Report on the Financial Statements

We have audited the accompanying financial statements of FHA, which are composed of the balance sheets as of September 30, 2016 and 2015 (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 on 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. 15-02, as amended, 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 15-02, as amended, 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 15-02, as amended, that we deemed to be applicable to FHA's financial statements for the fiscal years ending September 30, 2016 and 2015. 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 is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

During our fiscal year 2016 audit, FHA's general counsel refused to sign off on certain matters included in the management representation letter concerning all known actual or possible litigation, claims, and assessments related to FHA. OIG believes that FHA's legal counsel is responsible for and knowledgeable about those matters which form part in FHA management's preparation and fair presentation of the financial statements. Due to legal counsel's refusal to sign off on these matters, which is a scope limitation, we lacked assurance that all known actual or possible litigation, claims and assessments related to FHA had been properly accounted for or disclosed in the financial statements in accordance with generally accepted accounting principles.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified opinion paragraph, the financial statements referred to above presented fairly, in all material respects, the financial position of FHA as of September 30, 2016 and 2015 (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 6 to the financial statements, the loan guarantee liability is an actuarially determined 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. This year's estimate is the mean value from a series of projections using many economic scenarios, and FHA's single-family liability for loan guarantee estimates reported as of September 30, 2016, could change depending on which economic outcome prevails. This forecast method helps project how the estimate will be affected by different economic scenarios, but does not address the risk that the models may not accurately reflect current borrower behavior or may contain technical errors. The loan guarantee liability is discussed further in note 6 to the financial statements. Our opinion was not modified with respect to this matter.

As discussed in note 21 to the financial statements, the 2015 financial statements have been restated to correct a misstatement due to improper utilization of the raw data that are being used to establish its maintenance and operating expense rate management assumption. Our opinion is not modified with respect to this matter.

Other Matters

Prior Period Financial Statements

In our reports dated November 16, 2015 and November 14, 2014, we expressed an opinion that FHA's financial statements for fiscal year 2015 and 2014 respectively fairly present the financial position of FHA's financial statements as of September 30, 2015 and 2014, 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 2016, new information concerning material errors affecting the 2015 and 2014 financial statements were identified. For this reason, the opinion expressed in the 2015 and 2014 audited financial statements was no longer appropriate because the financial statements as published at that time contained material misstatements. Accordingly, our opinion on the audited financial statements for 2015 and 2014 is withdrawn because they could 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 and analysis and other RSI 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 in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the management's discussion and analysis and other RSI 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 Commissioner and the schedule of spending are presented for additional analysis and are not a required part of the financial statements or RSI. 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 five deficiencies in internal control, described below. We consider two to be material weaknesses and three to be significant deficiencies.

Cash Flow Modeling Errors Were Not Detected

In fiscal years 2014 and 2015, FHA's home equity conversion mortgage (HECM) net loans receivable and liability for loan guarantee were not reported in accordance with generally accepted accounting principles (GAAP). Specifically, FHA did not estimate its property maintenance and operating management assumption expense rate based on actual historical payments. This condition occurred because FHA failed to isolate the accrued expenses in its input data in modeling its maintenance and operating expense rate management assumption. Additionally, FHA failed to adequately review significant changes observed in its maintenance and operating expense input data until 2016. This failure caused an overstatement of FHA's loan guaranty liability and an understatement of net loans receivable and related foreclosed property line items in fiscal years 2014 and 2015. According to FHA, the overstatement of the liability account and understatement of the asset account was \$833 million and \$540 million respectively in fiscal year 2015, and the overstatement of the liability account and understatement of the asset account was \$830 million and \$542 million respectively in fiscal year 2014.

FHA's Controls Over Financial Reporting Related to Budgetary Resources Had Weaknesses

In fiscal year 2016, we identified financial reporting control deficiencies related to FHA's monitoring of its budgetary resources. Specifically, we found that errors were not prevented or detected in a timely manner. These errors were related to the (1) discrepancies identified between proprietary and budgetary accounts and (2) system-generated accounting report used for financial reporting. Additionally, FHA's monitoring of its unliquidated obligation balances was not effective. We attributed these conditions to FHA's ineffective monitoring and processing controls. As a result, errors with an absolute amount totaling \$680.2 million were not prevented or detected in a timely manner. Finally, FHA missed the opportunity to recapture \$276.5 million in invalid obligations.

FHA's Controls Related to Claims Had Weaknesses

In fiscal year 2016, we found that (1) the designation of two A43C (Claims) system edits, which are used in processing claims, was inappropriate, and (2) FHA continued to have significant delays in billing noncompliant mortgagees for partial claims for which the promissory note was not provided within 60 days. The system edit issue occurred because FHA lacked periodic monitoring to ensure that the designation of the error codes was appropriate. The lack of alignment between FHA's policy and the regulatory requirements and persistent delays in initiating the collection process for noncompliant mortgagees was a contributing factor to FHA not claiming amounts due in a timely manner. The system edit issue creates a significant vulnerability in FHA's systems application controls, and its risk of improper payments is increased because FHA relied heavily on system edits to ensure that hundreds of thousands of single-family claim requests worth more than \$15 billion in fiscal year 2016 were processed correctly. Additionally, delays in implementing the collection

process for noncompliant mortgagees with unsupported partial claims caused unsupported partial claims to remain in the loans receivable inventory longer, which is neither a good cash management practice nor a good strategy to help improve the health of the Mutual Mortgage Insurance fund.

Weaknesses in FHA's Controls Over Model Governance

FHA had not fully implemented an effective model risk management governance framework. Specifically, it had not finalized or implemented policies and procedures relating to (1) model documentation, (2) model assumption sensitivity analysis testing, and (3) data management and validation. This condition occurred because FHA had not made establishing a model governance framework a priority. FHA's failure to fully implement a control mechanism, such as the model risk management governance framework, increased the risk of inconsistencies and errors in financial reporting occurring without being detected or prevented.

Weaknesses Were Identified in Selected FHA Information Technology Systems

Our review of the general and application controls over FHA's Single Family Premium Collection System – Periodic (SFPCS-P) and SAMS found (1) weaknesses in SFPCS-P, which included the system being incorrectly classified as a low-impact system instead of a moderate-impact system; (2) software products used by SFPCS-P were outdated; (3) the interface reconciliation from SFIS to SFPCS-P was not sufficiently performed; (4) SFPCS-P had not participated in HUD's disaster recovery exercise for more than 4 years; (5) segregation of duties for SFPCS-P developers was not effectively implemented; and (6) SFPCS-P security documents contained inaccurate information. Additionally, we found (1) weaknesses in SAMS, which included the interface reconciliations from SFIS to SAMS was not sufficiently performed and (2) least privilege and segregation of duties requirements were not fully implemented for SAMS users. We completed an additional review of the general and application controls over SFIS and the Claims system and determined the information system control weaknesses previously identified in SFIS and Claims were being addressed. However, we found (1) weaknesses in Claims, which included inconsistencies in error code and (2) the configuration information and the history of system changes was not retained for more than 5 years. Furthermore, we found (1) weaknesses in both the SFIS and Claims systems, which included application and user access controls were not effectively implemented or adequately managed and (2) management did not adequately implement effective application configuration management. We also found HUD Application Release Tracking System (HARTS) documents for FHA applications were not processed and maintained properly. These conditions occurred because some application controls were not sufficient. As a result, the appropriate confidentiality, integrity, and availability of critical information may have been negatively impacted. In addition, the information used to provide input to the FHA financial statements could have been adversely affected.

Report on Compliance

As part of obtaining reasonable assurance about whether FHA's financial statements were free from material misstatement, we performed tests of its 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 one instance of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance.

of our tests disclosed one instance of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance.

The audit¹ of HUD's fiscal year 2015 compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA)² found that FHA's annual risk assessment process did not fully comply with OMB guidance. Although FHA performed a risk assessment of its programs, it did not conduct its annual risk assessment activities in accordance with OMB guidance. Specifically, it did not assess all low-risk programs on a 3-year cycle or consider all of the nine required risk factors as required by section 3(a)(3)(B) of IPERA. This occurred because FHA (1) established a threshold, which excluded some programs to be subject to risk assessment process and (2) did not maintain evidence to support that they had considered all required nine required risk factors. In addition, the audit found that FHA improperly assessed the risk of the single family claims program as medium, based on qualitative instead of a quantitative assessment. FHA's non-compliance with requirements for risk assessments may result in programs that are susceptible to significant improper payments not being identified for further review and prevent FHA from identifying improper payments and taking the necessary steps to address and recover significant improper payments.

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.


Randy W. McGinnis
Assistant Inspector General for Audit
November 14, 2016

¹ The IPERA audit conducted by OIG in fiscal year 2016 was for fiscal year 2015 IPERA compliance.

² Audit Report 2016-FO-0005, Compliance With the Improper Payments Elimination and Recovery Act, May 13, 2016. As a component entity, FHA's programs are rolled up in HUD's agencywide IPERA compliance determination.

Material Weaknesses

Finding 1: Cash Flow Modeling Errors Were Not Detected

In fiscal years 2014 and 2015, FHA's home equity conversion mortgage (HECM) net loans receivable and liability for loan guarantee were not reported in accordance with generally accepted accounting principles (GAAP). Specifically, FHA did not estimate its property maintenance and operating management assumption expense rate based on actual historical payments. This condition occurred because FHA failed to isolate the accrued expenses in its input data in modeling its maintenance and operating expense rate management assumption. Additionally, it failed to adequately review significant changes observed in its maintenance and operating expense input data until 2016. This failure caused an overstatement of FHA's loan guaranty liability and an understatement of net loans receivable and related foreclosed property line items in fiscal years 2014 and 2015. According to FHA, the overstatement of the liability account and understatement of the asset account was \$833 million and \$540 million respectively in fiscal year 2015, and the overstatement of the liability account and understatement of the asset account was \$830 million and \$542 million respectively in fiscal year 2014.

Accrued Maintenance and Operating Expenses Were Erroneously Included in Prior Years' Cash Flow Models

Accrued costs from the period of note assignment to conveyance were erroneously included in FHA's default cost estimates for fiscal years 2014 and 2015. In accordance with Statement of Federal Financial Accounting Standards No. 2, paragraph 36, the agency's default cost estimates must be based on "actual" historical loan performance experience. To document actual experience, a database should be maintained to provide historical information on actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Based on our audit, FHA failed to comply with GAAP with regard to the property maintenance and operating expense cash flows. The property maintenance and operating expense rate is one of the assumptions used in the HECM cash flow model to determine the liability for loan guarantee and recovery on assets. It accounts for maintenance expenses associated with HECM conveyed properties. This rate is based on management assumptions that utilized FHA's historical data. The data used to calculate the expense rate are extracted from the Single Family Asset Management System (SAMS), which is the management and accounting system for HUD-owned single-family properties. The contractor that maintains SAMS provides the data to FHA's cash flow modeling team, which uses the data to calculate the maintenance and operating expense rate. This expense rate is used as an input to the HECM cash flow model.

In fiscal years 2014 and 2015, FHA failed to realize that the data used to calculate the maintenance and operating management assumption expense rate contained inappropriate data. Specifically, the inappropriate data that became part of the expense rate included accrued interest, accrued servicing fees, and accrued mortgage insurance premiums. While these accrued costs are considered expenses, they should not be used to calculate the liability for loan guarantee since they do not represent cash outflows. As noted earlier, adding accrued expenses

(that is, noncash outflows) to the maintenance and operating management assumption rate was not consistent with GAAP.

FHA Overlooked the Increase in the Maintenance and Operating Expense Rate

FHA overlooked the significant changes in its maintenance and operating expense input data in 2014 and 2015. In fiscal year 2014, FHA noticed that the maintenance and operating expense rate had significantly increased. FHA believed that the expense rate would return to a level more aligned with what had been observed historically so no action was taken, and FHA used the inflated rate in the 2014 cash flow model. In fiscal year 2015, FHA noticed that the expense rate was still high, chose not to conduct an analysis to determine the reason behind the increase, and used the inflated rate again. In fiscal year 2016, FHA, working with the SAMS contractor, determined that increasing foreclosure costs were the driving force behind the increased maintenance and operating expense rate. For this reason, in August 2016, FHA decided to exclude the foreclosure costs in cash flow estimates. At that time, FHA did not know that the foreclosure costs were all accrued expenses. When we questioned FHA's decision to exclude foreclosure costs from the maintenance and operating expense rate in October 2016, FHA was unable to provide an immediate explanation. FHA did not conduct a thorough analysis of the issue until we questioned the methodology change in October 2016. In its analysis, FHA determined that the foreclosure costs were made up of accrued expenses. Additionally, FHA found that the SAMS contractor combined the foreclosure costs with the other costs in the data file that was provided to FHA's cash flow modeling team, which inflated the maintenance and operating expense rate management assumption in prior years.

FHA officials were not able to explain why the SAMS contractor started combining the costs in fiscal year 2014 when it had not done so in prior years or why they had not performed an analysis in 2014 and 2015 when they noted that the maintenance and operating expense rate had begun to increase. Had FHA conducted an analysis before fiscal year 2016, it would have realized that the rate increased due to the erroneous inclusion of accrued expenses.

Overall, there was a control deficiency in financial reporting. FHA correctly excluded the accrued expenses from the maintenance and operating expense rate in fiscal year 2016. However, due to the materiality of the misstatements affecting previously issued financial statements, an accounting adjustment would be needed to correct them.

Conclusion

FHA needs to improve controls over its cash flow modeling processes. When unusual trends are observed, FHA should conduct an analysis in a timely manner to determine whether the trends are explainable or based on accurate data or whether errors have occurred. Enhancing modeling controls will ensure compliance with GAAP and allow FHA to produce financial statements that are free of material misstatements.

Recommendations

We recommend that the Acting Director of the Office of Evaluation

- 1A. Develop and implement a process to (1) research inconsistent data in a timely manner to prevent errors when calculating the loan guaranty liability and (2) ensure that only cash transactions are included and accrued expenses are not included as part of the maintenance and operating expense rate.

We recommend that the Acting FHA Comptroller

- 1B. Restate the fiscal year 2015 financial statements to correct the impact of using the incorrect maintenance and operating expense rate in the HECM cash flow model.
- 1C. Determine the impact of using the incorrect maintenance and operating expense rate on the fiscal year 2014 financial statements and if material, restate the fiscal year 2014 financial statements to correct the impact of the error.

Finding 2: FHA's Controls Over Financial Reporting Related to Budgetary Resources Had Weaknesses

In fiscal year 2016, we identified financial reporting control deficiencies related to FHA's monitoring of its budgetary resources. Specifically, we found that errors were not prevented or detected in a timely manner. These errors were related to the (1) discrepancies identified between proprietary and budgetary accounts and (2) system-generated accounting report used for financial reporting. Additionally, FHA's monitoring of its unliquidated obligation balances was not effective. We attributed these conditions to FHA's ineffective monitoring and processing controls. As a result, errors with an absolute³ amount totaling \$680.2 million were not prevented or detected in a timely manner. Finally, FHA missed the opportunity to recapture \$276.5 million in invalid obligations.

Proprietary and Budgetary Tie-Point Variances Were Not Detected

In fiscal year 2016, we identified accounting errors in FHA's March 30, 2016, unpaid expended authority account balance. The total absolute value and net value of these accounting errors were \$245.3 million and \$166.2 million, respectively. These errors were the result of FHA's failure to detect significant variances between proprietary accounts payable and the associated budgetary accounts at the fund level. During our audit of unpaid obligations, we found discrepancies between the accounts payable and unpaid expended authority for three of FHA's fund accounts. Variances in tie-points can be an indicator that accounting transactions were not properly posted. After we brought this issue to FHA's attention, FHA conducted research and concluded that the variances were the result of reporting errors in the budgetary accounts. According to FHA, most of these errors occurred when FHA transitioned to its new accounting system.

FHA is responsible for establishing and maintaining internal control to ensure the reliability of financial reporting. While FHA has controls to identify financial reporting errors, these controls were not effectively designed to detect variances between proprietary and budgetary accounts at the fund level across all its accounting areas. These financial reporting errors caused the ending unpaid obligations balance on the statement of budgetary resources to be overstated by \$166.2 million. Additionally, as some errors were carried forward from prior years, the prior years' beginning and ending unpaid obligation balances were also overstated. According to FHA officials, the agency planned to adjust the statement of budgetary resources for fiscal year 2016 to correct the errors.

Individual Undelivered Order Balances for Management and Marketing Contracts Were Inaccurate

In addition to the tie-point errors noted above, FHA's individual contract undelivered order⁴ balances⁵ for single-family management and marketing⁶ contracts were also not accurate. As of August 2016, the total absolute amount of all undelivered order errors for the 131 contracts in

³ The absolute amount is the total of the understatements and overstatements without netting the two.

⁴ The undelivered order balance is the difference between the obligated amount and the expenditure amount.

⁵ Undelivered orders and accounts payable are the components of unpaid obligations listed on the Statement of Budgetary Resources.

⁶ Our review focused on the management and marketing contracts. However, FHA determined that the undelivered order balances for its closing agent contracts were also inaccurate.

question, out of 174, was \$434.9 million and the net amount was \$687,716. Additionally, the ending undelivered order account balance for the 174 management and marketing contracts for the same period was \$1.6 billion.⁷ Our analysis is provided below.

- For 131 of 174 contracts, the undelivered order balances on the ACOBHD01 report,⁸ which is used for financial reporting purposes, did not agree with the T330 contract period report.⁹ We found discrepancies in the expenditure amounts for all 131 contracts and discrepancies in the obligation amounts for 41 of the 131 contracts. Some obligation and expenditure amounts on the ACOBHD01 report were overstated compared to the T330 contract period report, while others were understated. While the dollar impact of the errors on a net basis may not be significant due to offsetting effects of the overstatements and understatements, we found that the errors were pervasive, affecting 75.3 percent of the contracts.
- According to FHA, the ACOBHD01 report contained errors because the report was not programmed to pull the correct information from the appropriate tables in the Single Family Asset Management System (SAMS), which is the management and accounting system for HUD-owned single-family property.
- For years, FHA used the ACOBHD01 report primarily for financial reporting. However, as noted earlier, this report was unreliable. To address this issue, in August 2016, FHA informed us that it had found another table in SAMS (that is, T330 contract period report), which contained the accurate undelivered order balances for management and marketing contracts.

Weaknesses in Unliquidated Balance Review Process Were Identified

FHA's unliquidated balance review process had weaknesses.¹⁰ Specifically, funds were not always deobligated on time for some completed contracts, and program offices were not responsive to the Deputy Assistant Secretary of Finance and Budget's request to identify contracts and projects with invalid obligations.¹¹ HUD Handbook 1830.2, Administrative Control of Funds: Policies and Procedures, requires FHA to perform an annual review of

⁷ As of August 2016, the ending undelivered order account balance for the closing agent contracts was \$94.4 million.

⁸ The ACOBHD01 report refers to the M&M Disbursements with Obligation – Cumulative Summary Report. This report is used to support the balances in the general ledger.

⁹ The T330 contract period report refers to the procurement report that is extracted from the T330 table in the Single family Property Management and Accounting System. FHA asserted that the T330 report contract period report was accurate. Both the ACOBHD01 and T330 reports come from SAMS, but come from different tables within SAMS.

¹⁰ The unliquidated balance is the difference between the obligated amount and the expenditure amount. This term is synonymous with the term undelivered order. HUD's guidance refers to the process of identifying invalid obligations as the unliquidated balances review process and not the undelivered order review process. Therefore, in this subsection, we used the term unliquidated balances as opposed to undelivered orders.

¹¹ Invalid obligations are remaining obligating balances that are available for recapture because the contracts are complete.

unliquidated obligations to accurately determine the status of its budgetary resources, which is an important element of funds control.

- Funds not deobligated for completed contracts. FHA failed to deobligate \$276.5 million in invalid obligations for 193 contracts. In fiscal year 2015, although FHA had already identified 134 completed single-family property management and asset sales contracts, these funds remained obligated in fiscal year 2016. The unliquidated balance for these contracts totaled \$234.5 million as of May 2016.¹² Further, FHA identified 59 additional single-family property management contracts with invalid obligations in fiscal year 2016. As of September 30, 2016, the remaining amount to be deobligated for these additional contracts was \$42 million. The Financial Analysis and Controls Division, which is responsible for recording deobligations for the single-family property management contracts, stated that deobligations were not recorded for the single-family property management contracts because it did not receive documentation showing that the contracts had been closed out.
- Contracts with invalid obligations not identified clearly and in a timely manner. Although program offices were required to respond to the annual review memorandums by a specified date, some program offices did not respond in a timely manner. For example, the program offices had to respond to the 2016 annual review memorandums by June 15, 2016, but the multifamily program office did not respond to the multifamily property management contracts annual review memorandum until August 2016. The Financial Analysis and Controls Division also informed us that the multifamily program office had not responded to prior years' annual review memorandum for multifamily property contracts. Further, the program offices' responses did not always clearly identify which contracts or projects had invalid obligations.

Conclusion

FHA needs to improve its controls over financial reporting to ensure that it produces financial statements that are free of material misstatements. FHA has developed and implemented procedures to identify financial reporting errors, but these procedures need to be strengthened to detect variances between its proprietary and budgetary accounts at the fund level for all accounting areas. Additionally, FHA needs to take measures to ensure that it relies on accurate data to report the undelivered order balances for management and marketing contracts. Further, more robust procedures are needed to ensure that invalid obligations are identified and deobligated in a timely manner so that funds can be put to better use.

Recommendations

We recommend that the Acting FHA Comptroller

- 2A. Establish and implement effective controls to detect variances between proprietary and budgetary accounts at the fund level across all accounting areas.

¹² As of September 30, 2016, FHA reported that \$195.4 million of the \$234.5 million had been deobligated.

- 2B. Determine the adjustments needed to correct the variances between accounts payable and unpaid expended authority for fiscal years 2015 and 2016 and post the adjusting entries accordingly.
- 2C. Establish and implement policies and procedures to ensure that accurate data are used to report the undelivered order balances for management and marketing contracts.
- 2D. Ensure that the \$276.5 million identified as invalid obligations in fiscal years 2015 and 2016 are deobligated as appropriate.¹³
- 2E. Request that the Principal Deputy Assistant Secretary for Housing establish and implement more robust internal control policies and procedures for the annual review process to include (1) a complete narrative of the deobligation process for all obligation types, which specifies the offices responsible for deobligating funds, the required documentation, and the timeframes for providing this documentation, and (b) a process for addressing untimely or unclear responses and presenting the issues to management for resolution.

¹³ The final deobligation amount may be less than \$276.5 million if final invoices need to be paid for the contracts.

Significant Deficiencies

Finding 3: FHA's Controls Related to Claims Had Weaknesses

In fiscal year 2016, we found that (1) the designation of two A43C (Claims) system edits,¹⁴ which are used in processing claims, was inappropriate, and (2) FHA continued to have significant delays in billing noncompliant mortgagees for partial claims for which the promissory note was not provided within 60 days. The system edit issue occurred because FHA lacked periodic monitoring to ensure that the designation of the error codes was appropriate. The lack of alignment between FHA's policy and the regulatory requirements and persistent delays in initiating the collection process for noncompliant mortgagees was a contributing factor to FHA's not claiming amounts due in a timely manner.¹⁵ The system edit issue creates a significant vulnerability in FHA's systems application controls, and its risk of improper payments is increased because FHA relied heavily on system edits to ensure that hundreds of thousands of single-family claim requests worth more than \$15 billion in fiscal year 2016 were processed correctly. Additionally, delays in implementing the collection process for noncompliant mortgagees with unsupported partial claims caused unsupported partial claims to remain in the loans receivable inventory longer, which is neither a good cash management practice nor a good strategy to help improve the health of the Mutual Mortgage Insurance fund.¹⁶

Systems Edits for Two Error Codes Were Not Appropriately Changed

Our audit of FHA's list of soft error codes as of September 29, 2016, found two soft error codes that should have been designated as hard or fatal error codes. We questioned the designation of the error codes as soft based on our knowledge of the program. Claim requests with hard or fatal errors are placed into suspense, while claim requests with only soft errors are processed and paid without suspension or additional review. If these two error codes had been classified as hard or fatal error codes, claim requests with the two error codes would have been placed into suspense. FHA staff acknowledged that the two error codes identified should have been hard errors given their importance in detecting potential improper claims.¹⁷ According to FHA staff, the two error codes were established as soft error codes in 1999. We attributed this condition to a lack of periodic monitoring to assess the appropriateness of system edit code designations by the appropriate level of management. FHA management's failure to change soft edits to hard edits when appropriate increases FHA's risk of improper payments since claim requests with soft error codes are processed and approved for payment without suspension or additional review.

¹⁴ System edits are key controls in processing claims in the Claims system.

¹⁵ As of September 30, 2016, there were 2,798 partial claims with a total claim amount of \$76 million unsupported by promissory notes more than 60 days after the date of execution. The issue continued because of changes made to the billing process during fiscal year 2016 and the decision to continue to delay the billing until 6 months after the date of execution instead of 60 days.

¹⁶ 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.

¹⁷ FHA staff stated in October 2016 that they would change the status of the two error codes in the A43C system from soft to hard.

The Prior Year's Audit Finding Was Not Resolved

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 more than 60 days after the date of execution. By the end of fiscal year 2015, the number of partial claims had decreased to 12,057 partial claims, representing \$376 million of the gross loans receivable balance. As of September 30, 2016, there were 2,798 partial claims unsupported by second mortgage notes more than 60 days after the date of execution with a total claim amount of \$76 million. In our review for fiscal year 2016, we determined that none of the four causes for the finding reported in the fiscal year 2015 audit report under "Finding 1: Controls To Prevent Misclassification of the Receivables Had Not Been Fully Implemented" had been fully addressed. One cause related to the untimely document processing by FHA's loan servicing contractor continued to be a problem in fiscal year 2016, but FHA planned to resolve the issue by procuring three new contracts in place of a single contract in fiscal year 2017. The other three causes, which were related to the timely billing of and collection from noncompliant mortgagees, also continued to be problems in fiscal year 2016. The two factors that prevented further reductions in the number of unsupported partial claims were as follows.

- Alignment of FHA's policy and regulatory requirements with FHA's billing and collection process. In response to our audit recommendations in fiscal year 2014, FHA developed a number of policies and procedures with the goal of identifying partial claims with promissory notes missing beyond their prescribed submission period and appropriately billing noncompliant mortgagees for the amount of claims paid plus the incentive fee for their failure to submit the required documentation to FHA. According to the description of the process provided by FHA in fiscal year 2016, the first reimbursement letter is not sent until 6 months after execution of the partial claim. Based on FHA's policy under Mortgagee Letter 2015-18¹⁸ and the regulatory requirements, the first reimbursement letter should be sent after 60 days if the promissory note is not provided within 60 days of execution. The table below illustrates the lack of alignment between FHA's policy and the regulatory requirements and FHA's billing and collection process as implemented. Starting the billing and collection process earlier may increase mortgagee compliance with the 60-day deadline to submit the promissory note.

Lack of controls to ensure timely referral of loans receivable with missing notes for collection. As of September 30, 2016, FHA had identified 12 separate rounds of partial claims with claim dates through March 31, 2016, and had initiated the notification letter process for 10 rounds with claim dates through January 31, 2016. However, FHA had referred only round 1 and round 2 partial claims, partial claims with claim dates before November 30, 2014, for debt collection. The debt collection process was initiated only for round 1, partial claims with claim dates on or before February 28, 2014. We identified two factors that led to delays in implementing the collection process for partial claims with missing documents in fiscal year 2016. One factor was that based on its

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

experience with the round 1 partial claims, FHA made changes to its billing and collection process in fiscal year 2016. The new process, which had not been fully implemented as of the end of fiscal year 2016, would be applied to round 2 partial claims and later rounds. We noted that under the new process, debts would be referred to the Mortgagee Review Board;¹⁹ however, the new process did not establish a timeframe for collection of debt from noncompliant mortgagees. See the table below for the comparison of the old and new procedures. The other factor was that an extension letter was sent at the request of the HUD Office of General Counsel and the FHA Commissioner following the issuance of the two reimbursement letters. The extension letter delayed the referral of rounds 2 through 8 noncompliant mortgagees under the new process. According to FHA staff, the extension letter was issued to provide notification to the holding mortgagees that the loans would be referred to the Mortgagee Review Board instead of the Financial Operations Center in Albany. Because of the delays embedded in the process, we determined that there was a lack of controls to ensure timely referral of loans receivable with missing notes for collection.

Differences between regulations and procedures implemented

Months	Regulations and mortgagee letter	Procedures implemented (effective before October 2016)	New procedures implemented (effective October 2016)
Months 1 and 2	No action required	No action performed	No action performed
Months 3-6	Mortgagee required to reimburse FHA	No action performed	No action performed
Month 7		No action performed	No action performed
Month 8		Reimbursement request letter 1 sent to mortgagee by contractor	Reimbursement request letter 1 sent to mortgagee by National Servicing Center
Month 9		Reimbursement request letter 2 sent to mortgagee by contractor	Reimbursement request letter 2 sent to mortgagee by National Servicing Center
Month 10		Request for administrative offset letter and package issued to Financial Operations Center - Financial Operations Center initiates debt collection process	Debts referred to Mortgagee Review Board by National Servicing Center - Notice of violation sent by Mortgagee Review Board to mortgagee
Month 11		Financial Operations Center continues debt collection process	Mortgagee Review Board process begins ²⁰

¹⁹ FHA staff made the first referral to the Mortgagee Review Board on October 18, 2016.

²⁰ Under the Mortgagee Review Board process, mortgagees may request a hearing before an administrative law judge if they disagree with the notice of violation.

We determined that of the 2,798 partial claims unsupported by second mortgage notes more than 60 days after the date of execution, 2,167, with a total claim amount of \$66 million on the September 2016 missing documents report, were collectible.²¹ Of the 2,167 collectible partial claims, we identified 1,760 partial claims with a total claim amount of \$55.3 million not included in our previous estimate of unsupported partial claims at the end of fiscal year 2015 that should be billed. FHA had initiated the billing process for only 620 of the partial claims, with a total claim amount of \$17 million, as of September 30, 2016. The remaining 1,547 partial claims, with a total claim amount of \$49 million, were awaiting action by FHA because FHA staff waits 30 days following the six-month period before they send the first reimbursement letter. Of the 1,547 partial claims, 1,233 partial claims, with a total claim amount of \$40 million, were between 60 days and 6 months old.

Conclusion

Weaknesses in FHA's controls related to claims were identified in fiscal year 2016. Two soft error codes in the Claims system were identified that should have been hard or fatal error codes due to a lack of monitoring controls to ensure that the designation of these two system edits as soft error codes was appropriate. Since claim requests with soft error codes are processed and approved for payment without suspension or additional review, FHA was vulnerable to errors and its risk of making improper payments was increased. Our review of the September 2016 missing documents report found that 2,167 collectible partial claims, with a total claim amount of \$66 million, were missing notes after 60 days. Most of these partial claims were between 60 days and 6 months old. Contrary to its policy under Mortgage Letter 2015-18 and its regulations, which require that the promissory note be provided within 60 days of execution, FHA did not send the first reimbursement letter until 6 months after execution of the partial claim. FHA's billing and collection process reduced the incentive for mortgagees to submit the promissory note within 60 days as required. The lack of alignment between FHA's stated policy, which reflects the regulatory requirements, and FHA's billing process and delays in initiating the collection process for noncompliant mortgagees resulted in FHA's not claiming amounts due in a timely manner. 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. Additionally, delays in implementing the collection process caused unsupported partial claims to remain in the loans receivable inventory longer.

Recommendations

We recommend that the Acting FHA Comptroller

- 3A. Strengthen the process for making system edit changes in the Claims system by ensuring that appropriate steps are taken to evaluate the appropriateness of the status of error codes when they are established or changed.

²¹ Some partial claims were uncollectible because they were subject to settlement agreements between FHA and various mortgagees.

We recommend that the Office of Single Family Housing

- 3B. 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.
- 3C. 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.

Finding 4: Weaknesses in FHA’s Controls Over Model Governance

FHA had not fully implemented an effective model risk management governance framework. Specifically, it had not finalized or implemented policies and procedures relating to (1) model documentation, (2) model assumption sensitivity analysis testing, and (3) data management and validation. This condition occurred because FHA had not made establishing a model governance framework a priority. FHA’s failure to fully implement a control mechanism, such as the model risk management governance framework, increased the risk of inconsistencies and errors in financial reporting occurring without being detected or prevented.

Policies and Procedures for Model Documentation Were Not Finalized

FHA policies and procedures for its entitywide governance of its cash flow model documentation were not finalized. For example, assumption documentation for the single-family and HECM programs were not consolidated into a single document. Instead, the assumption documents were included in several documents and were in various formats, including PowerPoint presentations, Excel spreadsheets, and Word documents. All of the assumption documentation, including the sign-off documents, should be consolidated into a single document, which includes the values of the assumptions calculated for fiscal year 2016. Not maintaining documentation in a single document increased the risk that documentation would be misplaced. The assumption documentation for the multifamily program was maintained in a single document. In accordance with the U.S. Government Accountability Office’s Standards for Internal Control in the Federal Government, section 12.03, FHA is responsible for creating policy documentation in the appropriate level of detail to allow management to effectively monitor the control activity.

Additionally, FHA did not have a finalized model risk rating policy that included a model scoring or prioritization process. Implementing a model risk policy will enable FHA to quantify the relative riskiness of each of its cash flow models.

Polices and Policies for Performing Sensitivity Analyses Did Not Exist

FHA had not defined the requirements for performing a sensitivity analysis on its model assumptions. Federal Accounting Standards Advisory Board Technical Release 6 suggests that all assumptions should be tested at least once to identify which assumptions have the greatest impact on the liability for loan guarantee estimate. In fiscal year 2016, FHA performed a sensitivity analysis for only some assumptions. Specifically, it did not perform a sensitivity analysis on the (1) timing and holding period assumptions for the multifamily program; (2) real estate-owned loss assumption, conditional claim rate, and conditional prepayment rate in the mutual mortgage insurance cash flow model for the single-family program; and (3) the acquisition cost assumption and property maintenance expense for the HECM program. Our review found that FHA also did not perform a sensitivity analysis on these assumptions in fiscal year 2015. FHA did not perform a sensitivity analysis on all of the programs’ model assumptions in fiscal year 2015 because it was not made a priority. In FY 2016, we determined that the multifamily cash flow modeling team misinterpreted Technical Release 6 and did not believe a sensitivity analysis needed to be performed on all assumptions. Without performing a sensitivity analysis on all model assumptions, FHA cannot know which assumptions have the greatest impact on the liability for loan guarantee estimates.

Policies and Procedures Were Not Established for Data Management and Validation

FHA had not established policies and procedures for data management and validation. For example, there were no policies and procedures to address the steps to be taken when inconsistent data are noted. In fiscal years 2014 and 2015, accrued expenses were erroneously included as part of the HECM maintenance and operating expense rate, and FHA failed to detect this error in a timely manner, although it noted that the expense rate had significantly increased. (Finding 1 discusses the details of this error.) Had policies and procedures been in place, FHA may have been able to detect the error earlier.

FHA also did not have documented policies and procedures for verifying the accuracy of data inputs. Data inputs can contain errors, while model components are error free, resulting in erroneous model output. Therefore, it is important that FHA has documented data validation procedures that are designed to minimize the likelihood of data errors.

Conclusion

FHA needs to improve its governance over its cash flow models. Finalizing and implementing policies and procedures are necessary to ensure that errors do not occur in the agency's subsidy estimation and reestimation process.

Recommendations

We recommend that the Acting Director of the Office of Evaluation

- 4A. Make it a priority to fully implement a model risk governance structure, which includes finalizing and implementing policies and procedures.

Finding 5: Weaknesses Were Identified in Selected FHA Information Technology Systems

We reviewed the general and application controls over FHA’s Single Family Premium Collection System – Periodic (SFPCS-P)²² and SAMS.²³ We found weaknesses in the SFPCS-P information system relating to system classification, outdated software products, interface reconciliations, segregation of duties, configuration management, and inaccurate documents. We also found weaknesses in the SAMS information system related to interface reconciliations and segregation of duties. These conditions occurred because some application controls were not sufficient. As a result, the appropriate confidentiality, integrity, and availability of critical information may have been negatively impacted. In addition, the information used to provide input to the FHA financial statements could have been adversely affected.

Based on our review of general and application controls over SFPCS-P and SAMS, the following deficiencies were identified in 2016.

The Billing and Collection System for FHA Monthly Mortgage Insurance Payments Was Classified Incorrectly

The billing and collection system for FHA monthly mortgage insurance payments was classified incorrectly. Specifically, SFPCS-P was classified as a low-impact system instead of a moderate-impact system. In addition, according to SFPCS-P system documentation, the system was not classified as a mission-critical system since insurance premium collection was not considered a medium-impact program. This condition occurred because SFPCS-P did not adequately consider the impact on organizational assets. In addition, SFPCS-P did not sufficiently consider interconnected systems when determining mission-critical system status. Federal agencies should classify their non-national security systems according to impact levels for confidentiality, integrity, and availability. When a system is not properly classified, appropriate security controls are not implemented, which could result in disruption of access to our use of information that could have a serious adverse effect on organizational operations, organizational assets, or individuals. SFPCS-P collected and processed approximately \$8 billion in monthly mortgage insurance premiums between October 1, 2015, and August 31, 2016.

Some Software Products Used By SFPCS-P Were Outdated

Some software products used by SFPCS-P were outdated. Specifically, (1) 9 software products were at least 2 generations behind the latest version; (2) 5 software products had reached “end of service,” and 1 software product had reached “end of life”; (3) 1 software product’s vulnerabilities with Common Vulnerabilities and Exposures scores of 7.5 and 9.7 had been known since November 24, 2015, but a plan of action and milestones was not created until April 16, 2016; and (4) 38 software products used by SFPCS-P were not approved by the HUD Configuration Change Management Board (CCMB) to be considered as a departmental standard

²² SFPCS-P is an ongoing, fully operational financial system that supports HUD’s Single Family Insurance Operations Division. SFPCS-P provides an automated system for the billing and collection of monthly premium payments (and any assessed late or interest charges) at the case level and an accounting of all transactions related to the billing, collection, and application of monthly premiums.

²³ SAMS records all data associated with the daily maintenance of case records. SAMS tracks and reports on HUD homes for sale and processes all financial transactions related to the repair, lease, listing, and sale, including payments for contractor services, taxes, and homeowner association and condominium fees

and implemented for use by SFPCS-P. As a result, the installed software products that were at least two generations behind could leave HUD vulnerable in ways that are publically known and posted on the Internet. In addition, by not consistently following its CCMB approval process and ensuring that all software products are approved for testing and use, HUD increased its risk that products would not meet the needs of its users or the intended purpose of the software and that resources would be unnecessarily expended.

Some Interface Reconciliations Were Not Sufficient

Some interface reconciliations of the data between the source system and some of the destination systems were not sufficiently performed; specifically, the interface from SFIS to SFPCS-P and the interface from SFIS to SAMS. This condition occurred because SFIS did not include control totals in the interface file transmitted to SFPCS-P and SAMS. When the system interface was designed in 1999, control totals were not included among the requirements. Without sufficient monitoring and reconciliation, there was no reasonable assurance that transactions would be accurately processed through the interface and that no transactions would be added, lost, or altered during processing.

HUD Application Release Tracking System Documents for FHA Applications Had Not Been Processed and Maintained Properly

HUD Application Release Tracking System (HARTS) documents for FHA applications were not processed and maintained properly. Specifically, (1) the contents of completed FHA applications release documents within HARTS were overwritten by newer release documents; (2) a HARTS release document creator was unable to continue editing a document he created after the document was viewed by another person but before the document was submitted to begin the concurrence process; (3) HARTS was not capable of capturing the correct release date, and users had been using a manual workaround to ensure that the correct release date was recorded; and (4) when HARTS was recently converted to a different platform, the retention period for release documents was reduced, and the SFPCS-P staff was not informed of the change. This condition occurred because (1) the conversion of HARTS was poorly implemented, (2) the Office of the Chief Information Officer (OCIO) considered HARTS to be an internal OCIO tool used to track the progress of release testing through the test center, and (3) HARTS was considered to be under general infrastructure development and maintenance, which does not apply to system data or content. FHA management would be severely hampered when conducting research into the purpose of recent or long-term changes and updates to the system if FHA were to lose the history of releases for its various applications. Because HARTS contains all data concerning the release history of applications, it would be redundant and an inefficient use of resources for program offices to manage and maintain their own applications' release history in a separate repository. Funding would also be unnecessarily diverted to create redundancy when it could be put to better use to support the more than 44 million mortgages that FHA has insured since 1934.

SFPCS-P Had Not Participated in HUD's Disaster Recovery Exercise for More Than 4 Years

SFPCS-P, which is classified as a non-mission-critical application, had not participated in HUD's disaster recovery exercises for fiscal years 2013 through 2016. This condition occurred because disaster recovery testing is no longer completed by the program area and is an inherited control from OCIO. In addition, OCIO stated that non-mission-critical applications participated

in a disaster recovery exercise only under specific circumstances. Ten non-mission-critical applications were randomly selected to be included in the disaster recovery test and system owners must agree to participate but were not required. OCIO customer relationship coordinators and project leads could request any noncritical applications to be added to the 10 randomly selected applications for nonfunctional testing during the disaster recovery exercise. Because SFPCS-P was not properly classified as moderate and therefore was not included in the exercise, SFPCS-P management could not ensure that the steps established to maintain or restore business operations, including computer operations, in the event of emergencies, system failures, or disaster would be effective. Further, without proper testing of the contingency plan based on the appropriate classification, weaknesses in the plan and related supporting activities might not be identified until an event occurred. As a result, OCIO and SFPCS-P management could not proactively address these weaknesses, and the benefits of testing would be lost.

Segregation of Duties for SFPCS-P Developers Was Not Effectively Implemented

Segregation of duties for SFPCS-P developers was not effectively implemented. Specifically, (1) 6 developers were granted above-read access to some mainframe production datasets via improper UserID setup, (2) 15 developers had unnecessary access to some applications via excessive profile linkages, (3) 4 developers were granted above-read access to 5 mainframe datasets by linking to 2 profiles, and (4) 1 user retained read access to the SFPCS-P mainframe production and 1 configuration management tool after the user was reassigned to another application. This condition occurred because (1) the additional profile linkages were from the applications that the developers used to support and were not removed when the developers were transferred to work on other applications, (2) some profile linkages were derived from modeling certain UserIDs when requesting access to the applications, (3) the user access removal process did not include the removal of profile linkage, and (4) the “top secret” administrator did not clean up all of the user’s dataset and profile linkages when an application retired. Without proper control of information system processes and services, FHA management could not ensure the confidentiality, integrity, and availability of user data and, ultimately, the accomplishment of FHA’s mission.

Least Privilege and Segregation of Duties Requirements Were Not Fully Implemented for SAMS Users

SAMS users were granted above-read access to some SAMS screens used for entering, modifying, and authorizing disbursement data, vendor data, and contract data. In addition, some SAMS users were granted access rights to perform incompatible business functions, such as data entry and supervisor authorization, update or approval access to both vendor and disbursement screens, and data entry and verification and reconciliation. These conditions occurred because (1) user access to vendor screens was not reviewed after case management responsibilities were transferred to the Asset Disposition and Management System; (2) SAMS officials had also not performed annual review of the access modes granted to each user profile; and (3) the SAMS user guide had not been updated to reflect the current operations for all sections, including the sections defining disbursement responsibilities for various groups and approval procedures for transmittals created in SAMS. Without adequate access controls and segregation of duty controls for the disbursement, vendor, and contract screens, FHA transmittal or disbursement data could be maliciously or accidentally modified by unauthorized users, and the integrity of FHA financial statements would be at risk. By not properly documenting the high-risk segregation of duty cases for SAMS business processes and limiting access to screens used by

SAMS users to perform these processes, FHA officials could not ensure that users would not be granted complete controls over incompatible functions. Also, FHA officials could not ensure that access to these screens would be properly reviewed during the user profile reviews.

SFPCS-P Security Documents Contained Inaccurate Information

SFPCS-P management had not maintained accurate documents for its security management program. Specifically, the system security plan, configuration management plan, contingency plan, and standard operating procedures contained outdated or conflicting information. These conditions occurred because of an overall lack of oversight by FHA SFPCS-P management to ensure that the documents were adequately updated, contained information consistent with other published documents, and complied with established HUD procedures. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

We completed an additional review of the general and application controls over SFIS and the Claims system. Based on that review, we identified the following deficiencies.

Inconsistencies in Error Codes Caused Uncertainties in Claims Payments

Inconsistencies in error codes caused uncertainties in claims payments. Specifically, 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, supporting documents were not always maintained when error codes were changed from hard error codes to soft error codes to ensure that the changes were programmed correctly in the system. Further, for claims reported in the June 2015 suspense report, there were inconsistencies in 341 claims with errors in part A²⁴ and 2,018 claims with errors in part B²⁵ of form HUD-27011.²⁶ These conditions occurred because of deficiencies in internal controls, including a lack of oversight and monitoring of documents to ensure consistency and accuracy. Without updated documentation and active oversight, FHA management could not be assured that operations and guidance to staff were consistent and accurately complied with policy. As a result of the inconsistencies in the soft, hard, and fatal error codes and the lack of supporting documentation for the changes made to the error codes before 2010, FHA could not ensure, without additional review, that the claims paid in May and June 2015 were paid correctly.

Retention of Software Modifications Was Not Sufficient for the FHA Claims System

OCIO did not retain configuration information and the history of system changes, including the related approvals, made throughout the development and life of the Claims system for more than 5 years. This condition occurred because the OCIO had no agreement with the FHA Office of Finance and Budget to retain the change and configuration history for the Claims system longer

²⁴ Part A on form HUD-27011 provides the initial case data. Part A is the first part of the claim prepared and contains information relating to the mortgage, property, property condition, lender, payment history, and foreclosure or assignment process.

²⁵ Part B on form HUD-27011 contains fiscal data consisting of allowable expenses and accrued interest. It provides summary information relating to receipts and disbursements by the lender, which affects the amount of the insurance claim.

²⁶ Application for Single Family Insurance Benefits

than the established general retention period. Without access to the nature of the software modifications and the history of related approvals of the software and configuration changes made, FHA Claims management and technical staff would not be able to review or reverse those changes if necessary.

Access Controls for SFIS and Claims Were Not Effectively Implemented

Application and user access controls for SFIS and Claims were not effectively implemented or adequately managed. Some contractors were granted excessive file privileges to SFIS production datasets. In addition, SFIS' and Claims' practices for separation of duties and least privilege were not effective. This condition occurred because overall review and maintenance of the user access and privileges granted on the mainframe were inadequate or nonexistent. As a result, unauthorized individuals, including outside intruders and former employees, could read and copy SFIS and Claims sensitive data and make undetected changes or deletions for malicious purposes or personal gain. Therefore, the confidentiality, integrity, and availability of user data and, ultimately, the accomplishment of SFIS' and Claims' mission could not be assured.

Effective Application Configuration Management Was Not Adequately Implemented for SFIS and Claims

SFIS and Claims management did not adequately implement effective application configuration management for the SFIS and Claims systems. Specifically, (1) personal programs were used for release upgrades to the system, and (2) the SFIS configuration management plan was not prepared in accordance with HUD's software configuration management plan template and outline. These conditions occurred because SFIS management did not comply with established National Institute of Standard and Technology²⁷ guidance and received conflicting configuration management guidance from OCIO. Without an adequate SFIS configuration management practice, SFIS management could not ensure that only authorized systems and related program modifications were implemented. As a result, SFIS might not be configured and operating securely as intended.

In fiscal year 2015, we reported on various weaknesses with general system controls and controls over certain applications as well as weak security management.

Information System Control Weaknesses Previously Identified in FHA's SFIS and Claims Systems Were Being Addressed

In an audit conducted in fiscal year 2015,²⁸ we found that improvements were needed to ensure that information security controls over SFIS and Claims fully complied with Federal requirements and HUD's own security policies. Some of the personally identifiable information that was retained in Claims' postmaintenance database files was not encrypted. In addition, five of nine vulnerabilities identified during the fiscal year 2015 vulnerability scan were identified during the fiscal year 2014 scan but had not been corrected. The remaining four vulnerabilities identified had remained uncorrected for longer than 90 days. In addition, SFIS staff had not implemented an effective application contingency planning practice. Further, the risk

²⁷ NIST Special Publication (SP) 800-53, Rev 4, Security and Privacy Controls for Federal Information Systems and Organizations

²⁸ 2016-DP-0002, Review of Information Systems Controls over SFIS and Claims, issued December 21, 2015. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

assessment prepared for SFIS did not accurately document whether SFIS was operating with an acceptable level of risk to information technology resources; information processed, stored, and transmitted in the application; and SFIS' connections to other systems.

We followed up on the status of these weaknesses during fiscal year 2016. HUD had addressed the weaknesses identified during the audit and was implementing appropriate corrective actions. These actions are scheduled to be completed by the end of fiscal year 2017.

Conclusion

As a result of the weaknesses identified in FHA's systems, the appropriate confidentiality, integrity, security, and availability of critical information could have been negatively impacted. An improper system classification could result in the use of inadequate security controls, and the use of outdated software could have left HUD susceptible to security breaches. In addition, the information used to provide input to the FHA financial statements could have been adversely affected. FHA must improve its information security controls over its SFIS, Claims, SFPCS-P, and SAMS systems to comply with Federal requirements and its own security policies to prevent an increased risk of unauthorized disclosure or modification of FHA system data.

Recommendations

Recommendations were included in separate OIG audit reports.²⁹ Therefore, no recommendations are reported here.

²⁹ Audit report 2016-DP-0003, Additional Review of Information System Controls Over FHA Information Systems, issued August 31, 2016, and we expect to issue our final audit report regarding SFPCS-P and Claims systems in fiscal year 2017.

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, 2016 and 2015, 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 15-02, as amended, 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 15-02, as amended, 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; and
- 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 2016 Annual Management Report, we obtained an understanding of the design of

significant internal controls as described in OMB Bulletin 15-02, as amended. We performed limited testing procedures as required by American Institute of Certified Public Accountants' auditing standards at AU-C, section 730, Required Supplementary Information, and OMB Bulletin 15-02, as amended. 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 15-02, as amended.

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 five unimplemented recommendations from prior-year reports. One of the five recommendations was implemented after fiscal yearend but before the date of this report. 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 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

- 1.a. Document FHA's end-to-end business processes and controls associated with the processing, reclassifying, billing and collection, and reporting of activities and transactions related to partial claims. (Final action target date was July 31, 2016; reported in ARCATS as 2016-FO-0002-001-A, closed October 3, 2016.)
- 1.b. Fully implement the policies and procedures created to send demand letters and refer delinquent lenders to FOC within the timeframes prescribed in the policy and in accordance with Mortgagee Letter 2015-18. (Final action target date was November 1, 2016; reported in ARCATS as 2016-FO-0002-001-B.)
- 1.c. 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

- 2.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

- 3.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 Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Unsupported 1/	Funds to be put to better use
2.D.		\$276,567,940
3.B.	\$ 55,350,830	
Totals	\$ 55,350,830	\$ 276,567,940

- 1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (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.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1



OFFICE OF HOUSING

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

NOV - 9 2016

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

FROM: 
Susan A. Betts, Housing-FHA Deputy Comptroller, HWA

SUBJECT: Response to Fiscal Year 2016 FHA Audit Report

Thank you for providing us the opportunity to respond to FHA's Independent Audit Report. While we understand the qualified opinion is the result of a disagreement between the Office of General Counsel and the Office of Inspector General, all matters and representations contained in the management representation letter elsewhere represent a fair and accurate statement of all known, actual and knowable litigation, claims and assessments related to FHA.

FHA continues to place a primary focus on improvements in internal controls. During fiscal year (FY) 2016, FHA resolved one FY 2015 significant deficiency related to FHA's internal control over financial reporting, and made significant progress towards resolving two other significant deficiencies, closing 21 recommendations.

FHA will work diligently to resolve the FY 2016 findings in FY 2017.

Report on Internal Control

Finding 1: Cash Flow Modeling Errors Were Not Detected

FHA concurs with OIG's recommendation to improve its controls over the cash flow modeling process. FHA will take appropriate actions in FY 2017 in order to implement a process that researches large or unusual changes in data when calculating the loan guarantee liability (LGL).

FHA has followed OIG's recommendation regarding restatement of FHA's financial statements and has reflected the impact of the LGL cash flow model changes in its comparative financial statements. However, FHA continues to maintain that the inclusion of certain maintenance and operating expenses in its FY 2014 and FY 2015 HECM liability for loan guarantee (LLG) model, represented the best available data that FHA had at the time those cash flow models were created.

FASAB Technical Release 6 recognizes that agencies might not have the best available data at the time its Credit Reform estimates and reestimates are created, and provides alternative methods for creating estimates and reestimates. Paragraph 17 of the Release specifically states that: "It is important to note that agencies should prepare all estimates and reestimates based upon the best available data at the time the estimates are made."

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Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 2

The nature of the estimate and reestimate process relies on ever-changing data and assumptions, including previously available data that has been further analyzed and refined, and the impact of which becomes known only in later periods. FHA is concerned that the OIG recommendation to restate will set a precedence for future estimates and reestimates.

Finding 2: FHA's Controls Over Financial Reporting Related to Budgetary Resources Had Weaknesses

FHA concurs with the recommendations.

Proprietary and Budgetary Tie-Point Variances Were Not Detected

While FHA does have a monthly process to reconcile proprietary and budgetary balances, FHA agrees to improve this process by incorporating Treasury's tie point edits into its monthly reconciliations, to detect variances between proprietary and budgetary accounts at the fund level across all accounting areas.

As of September 30, 2016, FHA processed manual correcting adjustments to resolve the \$205 million difference in cumulative variances between the 4901 Expended Authority – Unpaid account and associated liability accounts. FHA will update its current reconciliation procedures to include the improved process.

Individual Undelivered Order Balances for Management and Marketing Contracts Were Inaccurate

FHA does not agree with OIG's assertion that individual contract undelivered order balances for single-family management and marketing contracts were not accurate as of August 2016, by the total absolute amount of \$434.9 million. FHA does not concur with the methodology used by OIG to arrive at this dollar amount.

FHA contends that OIG used an inappropriate comparison between two distinct data sources designed for markedly different purposes, to arrive at the conclusion that FHA's individual undelivered order balances for management and marketing contracts were inaccurate.

To determine the absolute amount, the OIG used the sum of all absolute differences between the T330 table individual contract balances and the ACOBHD01 report's individual contract balances, to determine that FHA's individual contract UDO balances were inaccurate and to arrive at the absolute dollar amount of differences in their report. The T330 table and the ACOBHD01 report do not match on an individual contract-by-contract basis, because of a difference in reporting categories, due to the different purposes of these two data sources. The T330 tables were designed for the purpose of individual contract balance monitoring and reporting and the ACOBHD01 was designed for the purpose of summary accounting reconciliation. It is worth noting that the net amount of differences between these two data sources is insignificant and can be explained, as stated in the OIG report.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 3

FHA will continue to improve its reporting and will create a summary report better suited to report on individual contract balances, however it does not believe that there are pervasive errors in individual undelivered order balances for management and marketing contracts as currently stated in the OIG report.

Weaknesses in Unliquidated Balance Review Process Were Identified

FHA agrees that the annual deobligation review process can be improved, and has initiated plans to develop more detailed, formal review guidance, better tracking, and enhanced follow-up actions with management for untimely responses.

During FY 2016, FHA worked aggressively with Housing staff to successfully process deobligations totaling \$291 million. Some of these deobligations included eligible balances associated with the \$276.5 million outstanding contract obligations identified in this finding for FY 2015 and FY 2016. FHA will reconcile all deobligations processed as of September 30, 2016, to determine the status of remaining contracts identified for deobligation, and continue follow-up actions in accordance with process improvements to be implemented in FY 2017.

Finding 3: FHA's Controls Related to Claims Had Weaknesses

Two Error Codes Were Improperly Designated as Soft Error Codes

FHA concurs with this finding and recommendation. However, FHA believes that this finding is also identified in Finding 5, Inconsistencies in Error Codes. To address this finding, FHA has formed the A43C Change Control Board, to meet periodically and document, review, and approve changes to edit codes in the Claims system.

The Prior Year's Audit Finding Was Not Resolved

FHA does not concur with this portion of the finding or the associated recommendations for the Office of Single Family.

Based on FHA's understanding, OIG's reported that the causes of the prior year's finding are as follows: 1) Lack of controls over the timely processing of promissory notes and mortgage instruments in the Single-Family Mortgage Asset Recovery Technology (SMART) system; 2) Lack of controls over timely referral of loans receivable with missing notes to the Financial Operations Center for collection; 3) Lack of controls over FOC's timely billing of receivables from non-compliant lenders; and 4) No alignment of FHA's policy and regulatory requirements for the submission of required documentation for partial claims.

FHA disagrees that the four causes, as stated above, were not resolved this past fiscal year. FHA disagreement is based upon the following facts:

- FHA's loan servicing contractor now has a Scorecard Performance Metric, which requires the contractor (upon receipt of any Partial Claim document/security

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

instrument) to date-stamp the document within 48 hours, log the document into the SMART system, and image it.

- FHA implemented a process in FY15 whereby NSC staff perform monthly reviews of the loan servicing contractor's Missing Documents Report (MDR) to determine those cases that must be referred to FHA's FOC or HUD's Mortgagee Review Board for reimbursement and/or sanctioning;
- In FY16, the FOC implemented a comprehensive process for receiving an encrypted Excel File from the NSC, transferring data regarding non-compliant lenders, billing receivables, notifying mortgagees of an outstanding Partial Claim debt in accordance with the Federal Debt Collect Process, and adjudicating (with the assistance of the NSC and DEC) lender disputes.
- FHA moved swiftly to align its policy and regulatory requirements by first publishing Mortgagee Letter 2015-18 on September 2, 2015. This Mortgagee Letter reminded mortgagees that they are responsible for delivering to HUD's loan servicing contractor the original Promissory Note within sixty (60) days from date of execution and the recorded Mortgage/Deed of Trust instrument no later than six (6) months from the date of execution. The Mortgagee Letter also reiterated that mortgagees would be required to remit the full amount of all partial claim payments and incentive fees (i.e., if applicable) back to HUD if the documents are not delivered within the prescribed deadlines. Likewise, the billing process identified in the A123 Process Narrative demonstrates that FHA's policy and regulatory requirements have been aligned since September 2, 2015.
- This billing/collection process for non-compliant mortgagees has been in effect for well over a year and netted FHA over \$101.1 million during Fiscal Year 2016 alone.

Regarding OIG's assertion that FHA is not collecting in a timely manner, HUD's regulations at 24 CFR 203.371(d) do not prescribe a specific timeframe in which the Secretary must initiate the "collection" process for non-compliant mortgagees, failing to submit the Promissory Note and Mortgage associated with a Partial Claim timely. In fact, 24 CFR 203.371(d) only requires mortgagees to reimburse HUD for the Partial Claim amount associated with the aforementioned missing security instruments. FHA is in compliance with regulations and to request payment immediately after the 60-day missing documents request, would be inefficient, given its current operating resource constraints.

Based on FHA's above-referenced responses, the Office of Single Family disagrees with the audit recommendations since the billing and collection process for missing Partial Claim security instruments was efficiently and effectively implemented prior to the end of FY 2016.

Finding 4: Weaknesses in FHA's Controls Over Model Governance

FHA concurs with this finding and recommendation but believes that it is essentially a duplicate of Finding 1, in terms of the proposed recommendation and the underlying condition that caused the finding.

Comment 4

**Ref to OIG
Evaluation**

Comment 5

Finding 5: Weaknesses Were Identified in Selected FHA Information Technology Systems

FHA concurs with the recommendations and with all but one of the deficiencies identified in this finding. FHA does not agree that the billing and collection system for FHA monthly mortgage insurance payments was classified incorrectly. To determine system classification, FHA considered the items noted by the OIG. FHA complied with NIST policy, followed procedures, and provided documentation to establish the current system categorization and mission criticality.

OIG Evaluation of Auditee Comments

Comment 1 OIG believes that FHA’s legal counsel is responsible for and knowledgeable about all known actual or possible litigation, claims, and assessments related to FHA. Therefore, without FHA’s legal counsel acknowledgement on the correctness of the matters included in the legal representations provided to OIG in the management representation letter raises significant concerns and constitutes scope limitation in our audit work. Accordingly, we qualified our opinion on this respect.

OIG accepts the response of concurrence with the recommendations. FHA argued that it is using the best available data at the time the estimates were made. OIG is taking exception to this statement because, based on our audit evidence, we determined that the best and accurate data were available to FHA at that time but FHA failed to properly use it. Additionally, we have sufficient appropriate evidence to support that errors in the utilization of home equity conversion mortgage operations and maintenance cost data occurred because of a weak entitywide model governance structure and internal controls. FHA’s continued efforts in improving its controls over the cash flow modeling process will improve the reliability of the estimation process and reliability of financial information related to the loan guarantee liability and loans receivable.

Comment 2 OIG accepts the response of concurrence with the recommendations. OIG recognized the net immaterial differences between the T330 and the ACOBHD01 reports. However, OIG calculated and reported the absolute amounts because (1) the differences between the reports significantly varied by both positive and negative amounts on individual contracts for a number of contracts in the population, and (2) for purposes of our audit, we need to consider both the absolute and net differences in assessing the significance of the issue in accordance with the audit standards. FHA’s efforts to improve the monthly reconciliation, obligation reporting, and deobligation review processes will improve the reliability of the financial statements.

Comment 3 We do not agree that the four underlying causes of prior year audit findings mentioned in FHA’s response were fully resolved.

OIG notes that during the course of the audit, evidence was not provided to support the implementation of the Scorecard Performance Metric, the process implemented in FY15 related to the Mortgagee Review Board, or the comprehensive process implemented by Financial Operations Center. We also note that no mortgagees were referred to the Mortgagee Review Board until October 18, 2016, which was outside the scope of our audit, according to the documentation provided by FHA. Additionally, OIG attests that while the Mortgagee Letter intended to align with the regulations, the implementation of the process provides additional time well in excess of the 60 day provision within the regulations.

OIG disagrees that the billing/collection process for non-compliant mortgagees has been in effect for well over a year, as described in the A-123 process narrative. The process included in the fiscal year 2016 A-123 narrative was not fully implemented for all non-compliant lenders identified during fiscal year 2016, because the process was changed from what was included in the narrative.

OIG is aware that the regulations do not prescribe a specific timeframe in which the Secretary must initiate the collection process; however, OIG believes requesting payment immediately after the 60-day deadline for submitting the note, would facilitate more immediate recovery of funds owed to FHA, which is both good business and effective cash management practices. Based upon our review, the majority of the unsupported partial claim notes were between 60 days and six months old. The number of unsupported partial claim notes would be reduced further if FHA sent the first reimbursement letter much earlier than its current process. At present, FHA's process can take about 11 months after partial claims are paid to be referred to the Mortgagee Review Board and is silent on a timeframe for collection after referral. OIG believes that FHA can do better than 11 months and that it needs to protect the interest of the government. We look forward to working with FHA in reaching a mutually acceptable corrective action plan in fiscal year 2017.

Comment 4 OIG accepts the response of concurrence with the finding and recommendation and agrees that they are the underlying condition that caused Finding 1. However, OIG believes that it would be appropriate to separate the finding because there were other governance related issues in this finding that were not related to Finding 1. Our recommendation was adjusted to remove any duplicative language.

Comment 5 Although FHA states that it considered the items noted by the OIG, we found when reviewing HUD documentation for the FIPS 199 category that only one item was considered in the analysis. Other items such as Public Information Integrity, Catastrophic Loss of System Availability, Large and Interconnecting Systems, Critical Infrastructures and Key Resources of the worksheet were not listed as considered during the analysis. The documentation also lists numerous interfaces and states "The systems listed above are important for the successful operation of the system." We continue to believe that minimal analysis was considered and incorporated related to interconnected systems and the low-impact classification. OIG looks forward to working with FHA's Office of Finance and Budget to reach a mutually acceptable management decision to close out the recommendations during the audit resolution process.

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ANNUAL MANAGEMENT REPORT

FISCAL YEAR 2016