FHA

Federal • Housing • Administration

Annual Management Report

Fiscal Year 2013

U.S. Department of Housing and Urban Development

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.

A MESSAGE FROM THE COMMISSIONER

December 16, 2013

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

Throughout its history, FHA has supported access to affordable, sustainable homeownership opportunities for those with limited wealth or who are otherwise underserved. It has also acted as a stabilizing force in the housing market during times of economic distress. At no time has this dual mission been more pronounced than during the recent housing crisis. Since the height of the crisis, FHA has continued to provide access to mortgage credit where the private market was unwilling or unable, while simultaneously improving risk management and overall portfolio performance. In fiscal year 2013, that work continued to support the housing market's recovery and ensured the availability of affordable financing options for the Single Family, Multifamily, and Healthcare markets.

Credit Access

During fiscal year 2013, as the housing market continued to recover, FHA's single family market share continued to decline from its peak level in 2009. While FHA endorsement volume has returned to pre-crisis levels, the private endorsement levels still remain low. FHA insured over 1.3 million single family forward mortgage loans during the year, with a total dollar value of approximately $240 billion. Of the over 700,000 home-purchase mortgages endorsed during the year, 79 percent were for first-time homebuyers, and 31 percent were for minority borrowers. Since its inception, FHA has insured more than 40 million single family mortgages. FHA has also worked diligently with its lender-partners to help improve access for qualified borrowers.

In FY 2013, demand for FHA's Multifamily and Healthcare programs remained high. FHA insured new loans for multifamily properties with a total mortgage amount of nearly $18 billion. This activity not only bolstered the supply of much-needed rental housing, but helped many multifamily owners refinance into more sustainable loans – protecting affordability in communities across the country. This ongoing high volume insured by FHA was made possible by a substantial improvement in processing procedures for multifamily loan applications. FHA also experienced strong demand for its healthcare facilities financing programs in 2013. Together, the Section 232 and 242 endorsed more than $7.3 billion for hospitals and residential care facilities that not only increased access to quality health care in many communities, but created thousands of jobs tied to construction and medical care.

Single Family Portfolio Performance

The recent severe recession put substantial strain on the Mutual Mortgage Insurance Fund (MMIF) as private capital retreated and FHA was called on to play a countercyclical role to support the broader housing market. FHA responded aggressively to the challenge, ensuring access to affordable credit while appropriately managing risk during a crisis. However, FHA was required to take a mandatory appropriation of $1.68 billion from the U.S. Treasury to close its FY 2013 books. Despite this, we are confident that FHA's actions over the past five years are improving the long-term value of the Fund and responding effectively to the recession's effects. Our annual report to Congress, containing the independent actuary's valuation of the Fund, reinforces that the steps we have taken have been impactful.

As a result of making major programmatic changes, improving risk management, and restructuring pricing, the value of the Mutual Mortgage Insurance Fund (MMIF) has improved significantly since last year. These changes are helping to create a turnaround in the fundamental health of the MMIF, improving the overall economic value of the Fund by $15 billion, from *negative* $16.3 billion at the end of FY 2012 to *negative* $1.3 billion at the end of FY2013, according to the independent actuary's valuation. As a result of this positive trajectory, the actuary expects the Fund to accumulate capital at a much faster rate than was projected last year, reaching a 2 percent capital reserve ratio by FY 2015 instead of FY 2017, as was anticipated in last year's report.

These improvements clearly demonstrate that FHA's actions have improved the performance of the Fund and placed it solidly on the right track. FHA is focused on continuing this progress using a number of strategies. This includes continuing aggressive loss mitigation efforts, implementing policies that simultaneously ensure value to the Fund and increase credit access, as well as other changes to better manage ongoing and emerging risks. Our future priorities recognize that while we have made significant progress there is more to do.

Future Priorities

In addition to improving the performance of the MMIF, we continue to identify ways to transform the way we do business with our partners and the people we serve. The Multifamily Transformation is restructuring our multifamily operations to make them more effective and efficient. By improving consistency and having employees specialize in certain types of transactions, the Multifamily unit will better serve its partners, and help build and preserve more affordable housing across the country. Both our Single Family and Healthcare units are making major updates to their handbooks. These are the definitive guides on how to do business with us – and by clarifying guidance and expectations, we will improve the quality of the loans we insure and improve access to affordable mortgage credit.

This commitment to transformation will help us achieve our FY 2014 goals:

- Establish a stronger FHA within the new housing finance system;
- Continue to strengthen risk management practices;
- Enhance programs to ensure availability of affordable housing and needed healthcare facilities;
- Further improve operational and organizational effectiveness; and
- Enhance internal and external communication and create consistent stakeholder engagement.

Finally, I want to thank the entire Office of Housing staff for their hard work and dedication. FY 2013 presented a number of budgetary challenges – and despite those challenges, their unwavering commitment is what allowed us to continue to work effectively and efficiently with our partners, improve the health of the MMI Fund, and most importantly, better serve the American people.

Looking to the future, we remain committed to strengthening all our programs, so that ladders of opportunity are available to all Americans for generations to come. Together, I know we can achieve these goals.

Carol J. Galante
Assistant Secretary for Housing-
Federal Housing Commissioner

This report is divided into four sections:

- *A **Message from the Commissioner*** is a letter from the Assistant Secretary for Housing that highlights FHA's mission, vision, achievements for the year and communicates the direction and priorities of the organization.

- ***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.

- The ***Principal Financial Statements*** includes Financial Statements and Notes to the Financial Statements.

- ***Auditor's Report*** on the Federal Housing Administration's (FHA) fiscal year 2013 financial statements, internal controls and compliance with laws and regulations.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FEDERAL HOUSING ADMINISTRATION AT A GLANCE

PURPOSE AND HISTORY:

The Federal Housing Administration (FHA), a part of the United States Department of Housing and Urban Development (HUD), provides mortgage insurance on Single Family, Multifamily, and Healthcare loans made by FHA-approved lenders throughout the United States (U.S.) and its territories. FHA's headquarters is located in Washington, D.C. with field offices throughout the country, consisting primarily of four Single Family Homeownership Centers (HOCs), 17 Multifamily Hubs, and 47 Multifamily Production Offices.

THE YEAR IN HIGHLIGHTS

FHA Supported The Housing Market by Promoting Programs that:

- ☑ Provide Housing Counseling Oversight to help homeowners improve housing conditions
- ☑ Provide relief to homeowners affected by Hurricane Sandy
- ☑ Expand sales of troubled mortgages to support recovery of communities hit hardest by the housing crisis
- ☑ Assist homeowners avoid foreclosure through third-party lender loss mitigation initiatives

FHA has a rich and diverse history, with its lineage dating back to the Great Depression, of providing opportunities for home ownership and supporting the housing market during periods of instability. During the Great Depression, the failure of the banking system created instability in the housing market and resulted in fewer loans issued. This instability heightened the need for federal programs to alleviate the home ownership crisis and restore the diminished values of loan collateral.

In response, The National Housing Act of 1934 was passed by Congress and signed into law creating the FHA to provide favorable insured financing for long term fixed rate mortgages. The legislation provided a framework for a comprehensive national homeownership platform, bridging the gap between lenders and homeowners to support affordable homeownership.

After World War II, FHA helped finance homeownership for veterans and families of soldiers, both single family and multifamily dwellings. In the 1950s, 1960s and 1970s, FHA helped to spark the production of millions of units of privately-owned apartments for elderly, handicapped and lower income Americans. When soaring inflation and energy costs threatened the survival of thousands of private apartment buildings in the 1970s, FHA's emergency financing helped the homeowners retain their homes. In the 1980s, the FHA introduced flexible programs, such as Streamline Refinance that helped to steady falling housing prices, making it possible for homeowners to finance their mortgages into more competitive interest rates and lower monthly payments. Today, FHA contributes to the future of the Nation by continuing to play its role of stabilizing the housing markets, promoting sound and affordable housing programs and assisting homeowners at risk of foreclosure to stay in their homes.

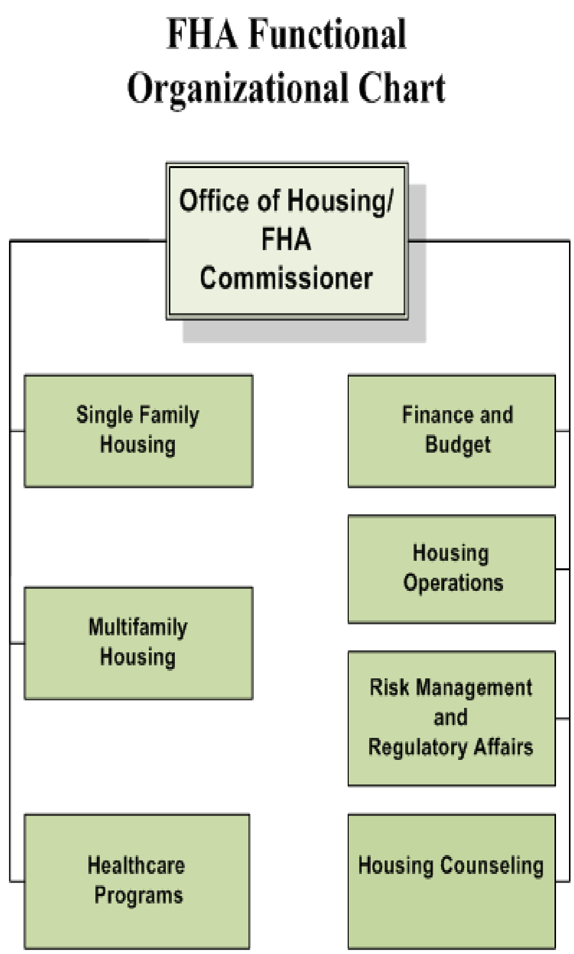
MISSION AND ORGANIZATIONAL STRUCTURE

FHA was created to address a set of economic conditions during the 1930s. Property values were declining, unemployment was rising, incomes were dropping, homeowners were defaulting on their mortgages, and credit markets were contracting. FHA eased the mortgage crisis by facilitating access to long-term affordable mortgages. Today FHA continues to play a critical role in supporting mortgage markets to stimulate the economy, stabilize neighborhoods heavily impacted by foreclosures, and catalyze housing construction and renovation.

For each of its programs, FHA assesses risks, collects insurance premiums, pays claims, and predicts future liabilities. The Loan Guarantee Liability presented on FHA's balance sheet represents the projected liability for FHA's entire insured portfolio for the full life of each loan. As required by the Federal Credit Reform Act, each year FHA must re-estimate its liability on the outstanding loans. The Act also requires FHA to keep sufficient resources equivalent to its projected long-term liability.

FHA provides three basic categories of mortgage insurance – Single Family, Multifamily, and Healthcare. Each of these areas administers different programs under the direction of the Federal Housing Commissioner. These programs are also supported by the offices of Finance and Budget, Housing Counseling, Housing Operations, and Risk Management and Regulatory Affairs. The above organizational chart depicts FHA's current functional areas.

With moderate economic growth and return of private capital to the market, FHA continues to reemphasize its mission to serve its historic target population through its mortgage insurance programs.



ROLE AND RESPONSIBILITY

FHA's role has customarily been to serve borrowers that are not being adequately served by the conventional market, including first-time homebuyers, minorities, low-wealth families and residents of underserved communities. However, during times of economic stress as the nation experienced over the last several years, FHA plays a countercyclical role by serving larger segments of the market. This can be seen through FHA's increased loan business which is a direct result of reduced or constrained activity by private mortgage insurers and private lenders. Since its inception in 1934, FHA has insured over 40 million single family homes and 43,447 multifamily and healthcare project mortgages.

FHA continues to work with the President and Congress to provide effective programs that support FHA's mission and mitigates risk. In fiscal year 2013, FHA remained focused on the following three fundamental priorities:

- Stabilizing the housing market and assisting homeowners at risk of foreclosure
- Protecting FHA's fiscal health and strengthening risk management
- Ensuring responsible access to credit and liquidity to bring private capital back to the market and build a 21st century housing finance system

STABILIZING THE HOUSING MARKET AND ASSISTING HOMEOWNERS

To address the challenges of the recent housing crisis, FHA has developed new programs, modified existing programs, and improved controls. These initiatives align with the Administration's strategy to help responsible homeowners and support the housing market recovery. More specifically, FHA has concentrated on the following:

FHA Streamline Refinance	Modification under HAMP	Extending Forbearance Period
• Allowing eligible homeowners to take advantage of low interest rates • Eliminating additional underwriting for qualified homeowners • Increasing lender participation by modifying Compare Ratio	• Increasing assistance to troubled homeowners through temporary and permanent loan modifications • Increasing lender incentives to encourage investors to utilize program • Expanding borrowers opportunity to rebuild equity	• Extending forbearance period for unemployed homeowners from 4 to 12 months • Allowing borrowers to stay in their homes while they search for a job • Providing families a greater chance of avoiding default and reducing foreclosures

Hurricane Sandy Relief

FHA remains committed to supporting homeowners recovering from the devastating effect of Hurricane Sandy. In addition to ongoing disaster relief efforts, FHA has announced additional measures to provide relief to residents that were displaced as a result of damages incurred to their homes. The FHA put in place foreclosure and eviction moratoriums against homeowners whose properties were damaged or destroyed. In January 2013, the moratoriums, which applied to certain homeowners in presidentially declared major disaster areas, were extended through April 30, 2013. In addition, the FHA expanded forbearance relief for affected borrowers, making them eligible for streamlined modifications. Under the forbearance policy, borrowers have the opportunity to suspend mortgage payments for a year while their homes are repaired from the hurricane disaster.

PROTECTING FHA'S FISCAL HEALTH

As it has since 2009, in 2013 FHA continued to introduce, refine, and continue policies that have improved loan quality, fortified lender enforcement, increased recoveries, and helped protect future loan performance while strengthening the Mutual Mortgage Insurance (MMI) fund. During fiscal year 2013, FHA revised its upfront and periodic premium structure to align with the market conditions and to augment its Capital Reserves. Additionally, in an effort to improve recoveries on delinquent loans, FHA expanded the use of REO alternatives, enhancing use of the Claims Without Conveyance Program to dispose of REO properties and the sale of troubled mortgages through the Distressed Asset Stabilization Program (DASP). The DASP program allows private investors to purchase pools of mortgages headed for foreclosure, to help severely delinquent borrowers find affordable mortgage solutions through re-modification or short sale. It offers a two-pronged opportunity by providing help for struggling homeowners and reducing losses to FHA. With a new premium structure and expanded note sales, FHA is minimizing its losses.

Moreover, FHA understands that managing risk plays an important role in sustaining its future. Throughout fiscal year 2013, FHA continued its commitment to a strong and effective risk management system and has expanded its capacity to assess financial, operational and program risk, under the direction of its risk management office. FHA has set underwriting minimums that combine credit score and down payment requirements to balance risk management with broad access to housing credit for borrowers. It has strengthened its underwriting procedures, eliminated approval for loan correspondents and increased the net worth requirements for lenders wanting to underwrite FHA loans. In addition, it has increased enforcement and eliminated lenders who are involved in fraudulent or abusive practices.

These efforts have resulted in FHA insuring higher credit quality borrowers that will yield a high level of net receipts in the years ahead. While additional risks remain for FHA because of the growing, but still fragile, economic recovery, efforts undertaken by the Administration will put FHA in a much more favorable position moving forward.

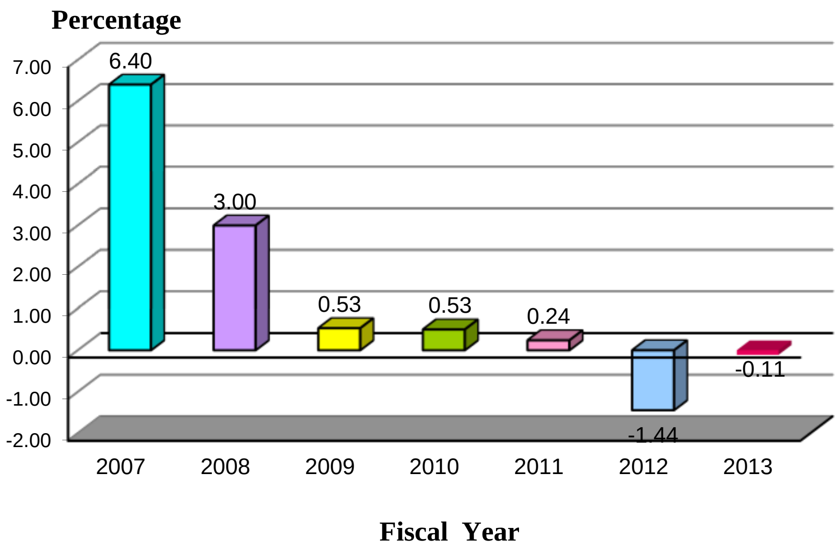
MMI Capital Ratio

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 2009, reverse mortgages insured through FHA's Home Equity Conversion Mortgage 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 is part of an annual valuation of the outstanding portfolio of insured loans at the end of each fiscal year.

Capital resources of the Mutual Mortgage Insurance Fund (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. As of the end of 2013, HUD had transferred all of the accumulated balances of the Capital Reserve to the Financing Accounts to cover anticipated losses stemming from the recent economic recession.

The financial crisis and economic recession that began in fiscal year 2008 resulted in declines in the capital ratio to where a negative position was estimated at the end of last year. This year, the capital ratio, as calculated based on the independent actuary's report, has improved to -0.11 percent and is expected to reach 2.00 percent in 2015. The nearly $15 billion improvement in portfolio value this year came from lower loss rates on insurance claims, revised delinquency servicing rules that are creating more cured delinquencies, and robust streamline refinance actions that saved borrowers an average of $200 per month–even after many paid higher FHA insurance premiums on their new loans. Those newly refinanced loans should have both longer premium-paying lives and lower claims than they would have had they not refinanced. New loan guarantees in fiscal 2014 are expected to provide an additional $16.7 billion in net revenues, according to the independent actuarial estimates. Continued strong, expected net revenues from new books-of-business result in an actuarial forecast of the MMI Fund reaching the 2.0 percent capital ratio in fiscal 2015.

MMI Capital Ratio



Note: The fiscal year 2007 – fiscal year 2008 ratios are based on unamortized insurance in force (original loan balances) and do not include HECM loans. The fiscal year 2009 - 2013 ratio calculations use amortized insurance in force (outstanding balances) and include HECM loans endorsed starting in fiscal year 2009.

The negative capital ratio today reflects an expectation that FHA's current pool of insured loans still has significant foreclosure and claim activity yet to occur, and that additional cost savings or income will be needed to cover those costs. Projected losses are particularly large for the fiscal year 2006 – 2009 cohort loans. Those loan cohorts were negatively impacted by employment disruptions and house price declines during the recession, and by large volumes of so-called seller-assisted down payment loans. In contrast, fiscal year 2010 - 2013 loans are expected to produce significant net revenues that can be used to substantially offset losses from those earlier years.

The portfolio valuation underlying the statutory capital ratio calculation is performed by an independent actuarial 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 year, it adds $2.6 billion to required loss reserves, effectively subtracting that amount from the net economic value used to calculate the capital ratio. This approach creates a higher threshold of required net income from FHA loan guarantee operations before reaching the two percent capital ratio target.

Programmatic changes made since 2009 continue to yield benefits to the MMI Fund. FHA insures loans with much stronger borrower credit quality and higher insurance premiums than was the case prior to 2009. In addition, FHA has aggressively continued a number of initiatives to reduce losses from legacy loans originated during the height of the crisis. Those include new delinquency servicing rules that focus on getting borrowers to affordable payment levels, expanded pre-foreclosure sale eligibility, shortening time-to-claim for defaulted loans in long foreclosure pipelines through note sales (Distressed Asset Sale Program), and making it easier for third-parties to purchase properties at foreclosure auctions and thus reduce the need for costly REO management.

HUD will continue to look for ways to reduce overall risk to the MMI Fund capital position, and to assure that the capital reserve ratio surpasses 2.0 percent in a timely manner, while also ensuring that FHA continues to serve its role of providing access to housing credit for low and moderate income households across the nation.

Note on Forward-Looking Information Presented

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

PERFORMANCE GOALS AND OBJECTIVES

HUD Strategic Plan

The Government Performance and Results Act require Federal agencies to develop multiyear strategic plans that include program goals and performance measures; the results of which are reported to the public. In May 2010, HUD released its new Fiscal Year 2010 – 2015 Strategic Plan which further defines and expands HUD's strategy for the future. This ambitious plan is the roadmap for HUD to achieve specific, measureable goals. In addition, 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 Fiscal Year 2010 – 2015 Strategic Plan and will contribute to achieving each of the goals and sub goals listed below.

Strategic Goal 1: Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers
1A. Stem the foreclosure crisis 1B. Protect and educate consumers when they buy, refinance, or rent a home 1C. Create financially sustainable home ownership opportunities 1D. Establish an accountable and sustainable housing finance system
Strategic Goal 2: Meet the Need for Quality Affordable Rental Homes
2A. Expand the supply of affordable rental homes where they are most needed 2B. Preserve the affordability and improve the quality of federally assisted and private unassisted affordable rental homes 2C. Expand families' choices of affordable rental homes located in a broad range of communities
Strategic Goal 3: Utilize Housing as a Platform for Improving Quality of Life
3A. Utilize HUD assistance to improve educational outcomes and early learning and development 3B. Utilize HUD assistance to increase economic security and self-sufficiency 3C. Utilize HUD assistance to improve housing stability through supportive services for vulnerable populations, including the elderly, people with disabilities, homeless people, and those individuals and families at risk of becoming homeless
Strategic Goal 4: Build Inclusive and Sustainable Communities Free From Discrimination
4A. Catalyze economic development and job creation, while enhancing and preserving community assets 4B. Promote energy-efficient buildings and location-efficient communities that are healthy, affordable, and diverse 4C. Ensure open, diverse, and equitable communities 4D. Facilitate disaster preparedness, recovery, and resiliency
Strategic Goal 5: Transform the Way HUD Does Business

Fiscal Years 2012-2013 Agency Priority Goals

From the outcome measures that support the HUD strategic goals and sub goals, the Secretary identified five Agency Priority Goals (APGs) to focus on during fiscal years 2012 and 2013. These APGs were identified by their respective outcome measure in the HUD Strategic Plan. FHA is the key supporting office for Strategic Goal 1, sub goal 1A, Foreclosure Prevention and plays a critical role in Strategic Goal 2, sub goal 2A, Rental Assistance. FHA also contributes to the Department's energy efficiency goal APG 13 by offering energy efficient loan products through Strategic Goal 4, sub goal 4B.

FHA assisted homeowners avoid foreclosure through its programs as well as through third-party lender loss mitigation initiatives. This goal also projected that additional homeowners would be assisted through joint HUD-Treasury programs. FHA programs facilitated the development and preservation of affordable housing to support the Department's Rental Assistance APG. The Rental Assistance Demonstration Program (RAD) leverages FHA insured financing and strengthen public and other HUD-assisted housing. FHA also expanded the supply of affordable rental homes where they were most needed. FHA's PowerSaver and Energy Efficient mortgages were estimated to support up to 2,150 homeowners in conducting energy efficiency retrofits to their homes over the two year period.

Performance Reporting

FHA developed a comprehensive Management Action Plan to address a substantial number of the strategic goals and sub goals. The significant targets and achievements for each of FHA's program goals are presented in the following sections. Targets and actual achievements for each goal are reported as of June 30, 2013. Targets and actual achievements as of September 30, 2013 will be reported in HUD's Annual Performance Report (APR), published in February 2014.

FHA PROGRAMS

Office of Single Family Housing

Single Family Programs

FHA supports affordable homeownership by making loans more readily available through its Single Family Housing mortgage insurance programs. 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 mortgage insurance programs make substantial contributions to the rate of sustainable homeownership nationwide. These programs are the most visible evidence of FHA's success in providing homeownership and refinancing opportunities for all Americans.

"Single Family is balancing its' Strategic Objectives by managing the long term viability of the Mutual Mortgage Insurance Fund; maintaining the FHA mission to serve the underserved and first-time homebuyer by providing affordable housing options; and providing liquidity in the counter-cyclical role that supports the housing market."

Charles Coulter
Deputy Assistant Secretary
for Single Family Housing Programs

FHA strives to strengthen the nation's housing market, to bolster the economy and to protect and educate consumers through the process of buying, refinancing or renting a home. For fiscal year 2013, FHA endorsed 1.3 million single family forward (non-HECM) mortgages totaling $240 billion. As a result of the housing market crisis, FHA's share of mortgage originations increased from three percent in fiscal years 2005 and 2006 to a high of nearly 29 percent in the fourth quarter of fiscal year 2008. By the end of FY 2013, FHA's share of mortgage originations had fallen to approximately 14.7 percent as a direct result of actions taken to reduce FHA's footprint and encourages the return of the private market. This drop was particularly noticeable for home purchase loans, down almost 62 percent from their 2010 peak. Origination volume continues to drop dramatically as FHA policies take effect and the housing market recovery continues. That FHA's market share remains higher reflects the reduction in size of the overall housing market, in spite of FHA's decreased volume. FHA's purchase business continues to primarily support first-time homebuyers. In fiscal year 2013, 78.7 percent of FHA purchase-loan endorsements were for first-time homebuyers, which is a 1.1 percent increase from fiscal year 2012.

Even with offering loan limits greater than traditional FHA loan limits since February 2009, and seeing increased market share for home purchase loans, FHA has been able to maintain its mission to serve minorities and low-to-moderate income and first-time homebuyers, while also improving the quality of the portfolio.

Single Family Housing Helping Homeowners Stay in Their Homes

FHA has seen tangible results of how its programs have helped distressed borrowers avoid adverse actions to maintain homeownership. A borrower in Illinois who has lived in her home for more than 10 years was in need of assistance working with her lender to obtain payment relief. She contacted the National Servicing Center (NSC) due to an impending foreclosure sale. The NSC Housing Specialist established communications with the borrower and lender. New financial documentation was submitted and the lender was able to approve the borrower for FHA Home Affordable Modification Program (HAMP). This assistance significantly reduced the borrower's interest rate and brought her needed payment relief.

The following table reflects the FHA single family forward insurance profile in fiscal years 2013 and 2012:

Table 1: SF Forward Insurance

	FY 2013		FY 2012		Percentage Change
	Number	Percent	Number	Percent	
Total Insurance-In-Force (EOY)	7,810,422		7,710,745		1.3%
Total Forward Endorsements	1,344,856		1,184,741		13.5%
Average Loan Amount	$178,545		$180,041		(.8 %)
First Time Home Buyers	553,080	78.7%	569,828	77.6 %	1.1%
Minority Borrowers	235,823	28.3%	248,627	27.3 %	1.0%
Low/Moderate Income	490,443	58.6%	554,963	60.7 %	(2.1%)
Average FICO Score	693		698		

Note: Data reflects number of endorsements (not dollar amount), unless preceded by a dollar sign. The First Time Home Buyers percentage is based on the total purchase loans for the year; the minority borrowers' percentage is based on the total of all FHA loans for the year; the Low/Moderate Income percentage is based on all FHA fully-underwritten loans. The minority borrower numbers are obtained from the Home Mortgage Disclosure Act (HMDA) data.

FHA offers a variety of loan programs to meet a wide range of borrower needs. FHA mortgages are attractive to lenders because they can be packaged into mortgage-backed securities, which are guaranteed by the

Government National Mortgage Association and backed by the full faith and credit of the United States Government.

The following table shows loan volume by program for fiscal years 2013 and 2012.

Section of Act	FHA Primary Programs	FY 2013	FY 2012	Percentage Change
203(b)	One-to-Four Family Home Mortgage Insurance	1,326,013	1,162,260	14.1%
	Purchases	685,198	713,030	(3.9%)
	Refinance	640,815	449,230	42.6%
203(k)	Rehabilitation Loan	18,840	22,476	(16.2%)
255	Home Equity Conversion Mortgages	59,918	54,676	9.6%
	HECM Standard	55,728	50,857	9.6%
	HECM Saver	4,190	3,819	9.7%

Note: Data reflects number of loans (not dollar amount)

A more in-depth discussion of the programs highlighted below illustrates the important role FHA plays in providing options to meet a variety of borrower needs.

Additional details on these and other Single Family FHA insured mortgage programs are available on HUD's website at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/insured.

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

The Section 203(b) is FHA's primary program for insuring the financing of new or existing one-to-four family dwellings and individual condominium units. Section 203(b) is the largest of FHA's Single Family programs, covering 97.4 percent of total Single Family Insurance-in-Force and 98.6 percent of fiscal year 2013 insurance issued for homes with up to four housing units excluding HECMs. Homebuyers may obtain FHA-insured mortgages from HUD-approved lenders to purchase homes, including condominium units, with low down payments. The borrower's down payment requirement may be as little as 3.5 percent with a 96.5 percent loan-to-value (LTV) ratio for purchases. By insuring approved FHA lenders against loss, HUD encourages them to invest capital in the home mortgage market. HUD insures loans made by private financial institutions with terms for up to 30 years. FHA loans may finance homes in both urban and rural areas.

FHA has the authority to establish and collect a single up-front mortgage insurance premium, as well as annual premiums. The up-front premium may be financed into the mortgage. The maximum mortgage amount that FHA will insure is based on the median home prices for the county in which the property is located, as well as certain minimum and maximum amounts. The current minimum limit (floor) for a one-unit property is $271,050 while the current maximum limit (ceiling) for a one-unit property is

$729,750. The loan limits change annually based on median home prices. Higher limits also exist for one-to-four unit properties in Alaska, Hawaii, Guam and the Virgin Islands. These same limits apply to other forward mortgage programs insured by FHA under Section 203(b).

The program is open to individuals 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. Although the program is generally limited to primary residences, under certain circumstances, a borrower may use Section 203(b) financing for a secondary residence. The program is also available for use on a limited basis by non-profit or governmental entities.

Section 203(k*):** *Rehabilitation Loan*

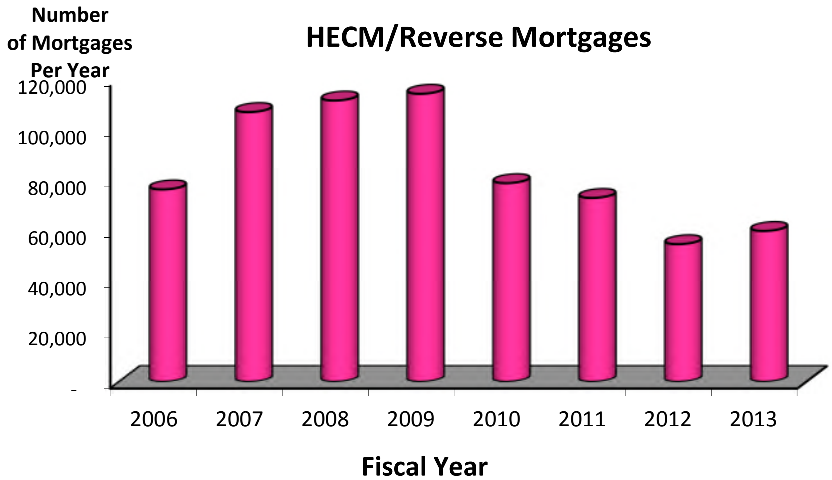
Section 203(k) is FHA's Single Family program designed to finance acquisition costs and the costs of property improvements into one mortgage loan. The program offers purchase and refinance options and may be utilized to make repairs necessary to meet minimum property standards, as well as property improvements to increase functional utility. It is available in two formats, Standard and Streamline based upon the amount of dollars needed to make improvements requested and the complexity of improvements to be financed. This program serves as a vital tool in the revitalization of aging housing stock.

Section 255: *Home Equity Conversion Mortgages (HECM)*

FHA was the first entity to promote and insure reverse mortgages on a national scale. The HECM program provides eligible homeowners, 62 years of age and older, access to the equity in their property. The program provides homeowners with a number of payment options including lump sum payment of mortgage proceeds, term or tenure monthly payments, line of credit or a combination thereof.

Since the program's inception in 1989, FHA has endorsed 838,857 HECM loans. The number of reverse mortgages insured by FHA increased over the fiscal years 2005 to 2009; however, endorsements have been steadily declining since, down from a high of 115 thousand in fiscal year 2009 to 60 thousand in fiscal year 2013. This decline in production reflects market changes and FHA policies to better manage risk to the Mutual Mortgage Insurance Fund (MMIF) and ensure the program is a sustainable program for seniors. In addition, the HECM program is undergoing significant changes to address risk issues reflected in FHA's Fiscal Year 2012 Report to Congress on the financial status of the MMIF, issued November 16, 2012. During fiscal year 2013, the HECM Program offered two distinct sets of borrowing options, the traditional HECM Standard option and the HECM Saver. The HECM Saver, introduced in 2010, allowed for a smaller withdrawal of equity accompanied by a significantly lower upfront Mortgage Insurance Premium (MIP). HECM Saver was designed to encourage borrowers to take less money upfront and instead, access funds over time to help protect the homeowners and the risk to the FHA insurance fund.

However, in spite of these changes, the HECM Program continues to experience challenges with major mortgagor demographic and behavioral changes that have contributed to additional risks to the FHA



Mutual Mortgage Insurance Fund (MMIF). In response to the concerns related to the fiscal year 2012 Report to Congress on the financial status of the MMIF, Congress recently passed, and the President signed, the Reverse Mortgage Stabilization Act of 2013. This Act amends Section 255 (h) of the National Housing Act that authorizes the Secretary to establish by notice or mortgagee letter, any additional or alternative requirements that the Secretary determines necessary, to improve the fiscal health and soundness of the program. In September 2013, FHA published Mortgagee Letters 13-27, 13-28 and 13-33 that include the following provisions that will take affect this fiscal year: (1) limits on initial draws at close and during the first 12 months of the mortgage to support mortgagor access to funds over time, (2) elimination of the existing Standard HECM and Saver HECM programs and a return to a Fixed and Adjustable Rate HECM with new Principal Limit Factors and (3) a new initial Mortgage Insurance Premium structure. The following additional program changes will take effect mid-January, 2014: (1) a Financial Assessment designed to evaluate borrower's capacity and willingness to comply with mortgage obligations for payment of property taxes, flood and hazard insurance and (2) a required property charge set aside for use of HECM proceeds to pay property taxes, flood and hazard insurance based on the results of the financial assessment.

In addition, FHA is continuing its efforts to focus on policies to help address issues related to HECM borrowers who are delinquent on their property taxes and insurance, which places their loans in default. As such, FHA has formed a HECM servicer collaborative working group and is exploring a few loss mitigation options to help these borrowers become current on their mortgages and remain in their homes. FHA will continue to develop and implement origination and servicing policies that will reduce risks to the FHA MMIF and support the continued availability of this important product to seniors.

Title I & Title II: *Manufactured Housing and Property Improvement*

FHA offers loan and mortgage insurance programs for manufactured housing under both Title I and Title II sections of the National Housing Act. Title I loans are available for financing manufactured homes that are to be secured solely by the dwelling; also referred to as "chattel" loans, and are classified as personal property. Title I loans are also 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. Title II loans are available for manufactured homes placed on a permanent foundation that are classified as real estate. The PowerSaver loan program, described below, has been established inside of the Title I program.

While FHA is aware of the contraction of available financing for homebuyers wishing to purchase manufactured homes, FHA does not have the authority to mandate loan products a lender may offer. Historically, manufactured housing has not performed as well as conventional construction housing, especially as it relates to the retained value of the collateral. Due to the ongoing decline in the housing market, many lenders have implemented more restrictive credit guidelines in an effort to help manage and mitigate risk. Thus, the availability of financing for manufactured housing has decreased because of these changes.

Volumes by fiscal year are as shown in the table below:

Table 3: Title I and Title II Endorsements Counts

Loan Type	FY 2013	FY 2012	FY 2011
Title I Manufactured Homes	612	655	986
Title I Property Improvement	6,097	7,050	5,563
Title I Total	6,709	7,705	6,549
Title II Manufactured Housing	24,191	20,479	21,378

FHA PowerSaver

FHA's PowerSaver program offers low-cost loans for energy saving home improvements. This pilot program was implemented in fiscal year 2011 with all loans being guaranteed by FHA. Credit-worthy homeowners can borrow up to $25,000 to make improvements based on a list of proven measures developed by FHA and the U.S. Department of Energy. Unlike FHA's core insurance program for mortgages in first-lien position, PowerSaver insures a lien positioned in first or second place and insures loans without a lien, provided the loan amount is less than $7,500. The volume of PowerSaver loans has been less than anticipated. The program faces challenges with lack of liquidity options.

To increase financing opportunities for home energy retrofit, FHA is modifying certain features of the program in order to remove obstacles cited by participating lenders. These changes are being implemented through a Title I Letter, which was published on September 18, 2013, as listed below:

- Eliminated the property valuation requirement
- Eliminated prohibition on dealer loans
- Eliminated geographic scope defining eligible markets
- Provided flexibility on the conditions for disbursement of loan proceeds, one of which allows PowerSaver lenders to disburse directly to the dealer
- Provided approved lenders a renewed opportunity to participate in the program.

FHA has also expanded PowerSaver to include the Section 203(k) program under Title II insurance. Section 203(k) of the National Housing Act authorizes FHA insurance for first trust mortgages that finance costs to rehabilitate and improve single family homes. A Notice of Funding Availability (NOFA) was published on August 13, 2013, which made available approximately five million dollars of PowerSaver grant funds for the new 203(k) PowerSaver program. As a result, one new lender was approved to participate in the new PowerSaver 203(k) program. Additionally, five lenders that were previously selected under the original PowerSaver program are now approved to participate in the new PowerSaver 203(k) program.

The FHA PowerSaver program was originally scheduled to expire on May 2, 2013; however, the program has been extended to May 4, 2015 per a Federal Register Notice that was published on February 12, 2013.

Section 513: *Energy Efficient Mortgages (EEM) (First-trust mortgages only)*

FHA's Energy Efficient Mortgages program helps homeowners save money on utility bills by enabling them to finance the cost of adding energy efficiency features to new or existing housing as part of their FHA insured home purchase or refinancing mortgage. During fiscal year 2013, FHA insured 599 Energy Efficient Mortgages, totaling $122 million. The volume of EEM loans has declined in recent years. This program is being reviewed to determine if improvements can be made to expand originations as part of the Department's commitment to energy efficient initiatives.

Performance Goals and Objectives

The Office of Single Family Housing is responsible for critical activities within the HUD Strategic Plan. Listed below are the Management Action Plan target activities that address the Office of Single Family Housing's Sub Goals.

Performance Goals and Objectives		
***Strategic Goal 1 (G1)**: Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers*		
G1 Sub Goal **1A** Stem the foreclosure crisis		
FY 2013 Data	**Target**	Assist 200,000 seriously delinquent homeowners through FHA loss mitigation tools in fiscal years 2012 - 2013.
	Achievements	Single Family exceeded this target goal of assisting delinquent FHA borrowers through loss mitigation tools. As of June 30, 2013, Single Family assisted 302,013 FHA borrowers through loss mitigation tools. Single Family is currently at 151% of the goal.
	Target	Assist 500,000 early delinquent homeowners (< 90 days in default) with early intervention tools in fiscal year 2012-2013.
	Achievements	Single Family exceeded its targeted goals for assisting delinquent FHA borrowers through early intervention tools. More than 517,000 FHA borrowers have been assisted through early intervention tools as of June 30, 2013. Single Family is currently at 103% of the goal.
	Target	Achieve or reduce the re-default rate of loss mitigation program participants within the first 6 months following the loss mitigation action to 10% or less. Achieving 10% by the end of fiscal year 2012, and sustaining 10% throughout fiscal year 2013.
	Achievements	The Re-default Rate as of June 30, 2013 was 8.66%. This success can be attributed to the requirement of trial payment plans, as well as the March 2013 implementation of a new loss mitigation waterfall and revised assistance criteria for home retention options. A key change is a new requirement for delinquent borrowers to obtain an FHA-HAMP loan modification that combines a loan modification and a partial claim to receive a targeted 20% payment reduction.
	Target	Achieve a Consolidated Claim Workout (CCW) Ratio of 50% for all FHA borrowers that receive loss mitigation assistance.
	Achievements	The CCW ratio as of June 30, 2013 was 65%. This success can be attributed to HUD's control of property conveyances through the Distressed Asset Stabilization Program (DASP) and the Claims Without Conveyance of Title (CWCOT) Program. These programs provide an alternative method for property disposition that does not result in the conveyance of a property to HUD.

	Target	Reduce the average days to list Real Estate Owned (REO) properties nationally by 2% of the fiscal year 2012 average. The average number of days to list REO properties for fiscal year 2012 was 23 days.
	Achievements	As of June 30, 2013, the average number of days to list REO properties for fiscal year 2013 decreased by 2 days or 8.7%; thus surpassing the goal.
	Target	Reduce by 2% nationally, the average time in inventory for REO properties from the fiscal year 2012 average. Average time in inventory for REO properties for fiscal year 2012 was 136 days.
	Achievements	As of June 30, 2013, the average time in inventory for REO properties for fiscal year 2013 decreased by 15 days or 11.03%; thus surpassing the goal.
	Target	Target 24 of the Single Family REO workshops/meetings being conducted in Neighborhood Stabilization Program (NSP) areas for fiscal year 2012-2013. Conduct 12 workshops in fiscal year 2012 and 12 workshops in fiscal year 2013
	Achievements	As of June 30, 2013, 61 NSP workshops had been conducted in fiscal year 2013; thus surpassing the goal.
Strategic Goal 4 (G4): *Build Inclusive and Sustainable Communities Free from Discrimination*		
G4 Sub Goal **4B** Promote energy-efficient buildings and location-efficient communities that are healthy, affordable, and diverse		
FY 2013 Data	**Target**	Achieve 2,150 PowerSaver loan disbursements in fiscal years 2012-2013. Fiscal year 2012 target was 150 loan disbursements with the remaining 2,000 in fiscal year 2013
	Achievements	As of June 30, 2013 there were 289 loan disbursements. Because of program delays, Single Family does not anticipate that the goals for fiscal year 2013 will be met, but believes that program changes described above (in the PowerSaver section) will increase program volume.

Management Initiatives and Program Improvements

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

Mortgage Insurance for Condominiums

In fiscal year 2013, the condominium home ownership market represented 4.3 percent of all 203(b) endorsements and 2.7 percent of all HECM endorsements. Condominium purchases provide affordable home ownership opportunities for individuals who may not otherwise be able to secure financing. Since implementing baseline guidance for condominium project approvals and loan level requirements, which are mandated by the Housing and Economic Recovery Act (HERA) of 2008, FHA staff routinely meets with industry stakeholders and other parties to discuss current market conditions and further refinement of FHA condominium guidelines. FHA will continue to monitor the performance of condominium loans and market conditions and will issue proposed rules to formalize condominium regulations. This process includes providing industry partners, stakeholders, the public and other interested parties an opportunity to comment on the proposed regulatory content requirements.

Lender Education Initiative

During fiscal year 2013, FHA received a technical assistance funding appropriation from Congress, and was able to carry forward an initiative to educate the housing industry more fully on the proper use of FHA mortgage products. Program Development offered an array of training sessions, available nationwide, through webinar technology. Some of the training topics included the Section 203(k) rehabilitation program, Section 203(h) disaster mortgage program, credit underwriting, and underwriting of an FHA appraisal and Technology Open to Approved Lenders (TOTAL) Scorecard, among others. FHA's 32 webinars in fiscal year 2013, gathered more than 18,600 attendees. Feedback has been largely positive and relevant questions and answers from training attendees have resulted in an upgrade to the Resource Center's Frequently Asked Questions (FAQ) database. Through feedback from the training, we became aware that about 6,777 industry partners are on a waiting list for sessions identified as being in high demand, such as Credit Underwriting-Loan Calculations, How to Manually Underwrite an FHA Mortgage, and Appraisal Requirements A and B.

FHA Support of Refinancing Options to enable borrowers to take advantage of historically low interest rates

FHA continues to implement and enhance policies to enable borrowers to refinance during this period of low interest rates. These new or revised policies include the following programs:

- ***FHA Short Refinance Program***

  On March 26, 2010, HUD and the Department of the Treasury announced enhancements to the existing Making Home Affordable Program and FHA refinance program. This program is designed for borrowers who owe more on their conventional mortgages than the value of their homes. The borrowers were given the opportunity to refinance into affordable FHA loans. This program requires the lender or investor to write-off the unpaid principal balance of the original first lien mortgage by at least ten percent. Lenders are not required to offer this program and it has not been widely adopted by mortgagees because of issues related to forgiving principal and restrictions placed by investors on this, and other loss mitigation programs. The program expires December 31, 2014. Through fiscal year 2013, FHA endorsed 3,552 Short Refinance mortgages with an outstanding principal balance of $568.3 million.

- ***FHA Streamlined Refinance Program***

  FHA's Streamline Refinance program, which has been available since 1986, provides existing FHA borrowers with the opportunity to refinance their current loan while requiring limited documentation. In 2012, this program was further enhanced when FHA significantly reduced the mortgage insurance premiums charged in connection with the refinance of a previous FHA insured loan that was endorsed on or before May 31, 2009. In fiscal year 2013, FHA endorsed 316,401 mortgages for $48.5 billion under these reduced mortgage insurance premiums, representing 61.8 percent of all streamline refinances.

Strengthening the MMI Fund

As part of FHA's initiatives designed to strengthen the capital of the Mutual Mortgage Insurance (MMI) Fund, FHA recently instituted changes to the Mortgage Insurance Premiums (MIP) charged in connection with loans, other than the Streamline Refinances of FHA loans endorsed on or before May 31, 2009. The increases were implemented in two phases. The first phase consisted of an increase of five to ten basis points (0.05 to 0.10 percent) to the annual MIP depending on Loan-to-Value (LTV) and loan amount. The second phase implemented a change to the duration for collection of annual MIP. For all loans with a LTV at or below 90 percent at origination, FHA will collect the annual MIP for the first 11 years of the loan. For all loans with a LTV above 90 percent at origination, FHA will collect the annual MIP for the life of the loan. This change to the duration of MIP collection also removed the exemption from annual MIP for loans with amortization terms of 15 years or less and LTV's of 78 percent or less.

Expansion of Loss Mitigation Tools

FHA assists homeowners facing financial difficulties to remain in their homes through its loss mitigation programs. FHA's loss mitigation program helps reduce losses to the FHA Insurance Fund by requiring servicers to evaluate borrowers for various home retention and disposition options that either keep borrowers in their homes and reinstate their mortgages, or dispose of their homes in a timely manner, thereby reducing costs. Additionally, in November 2012, FHA issued a Mortgagee Letter with revised requirements for its loss mitigation home retention options, in an effort to reduce the number of full claims against the MMI fund by assisting a greater number of qualified, distressed borrowers in retaining their homes. One of the key provisions of this Mortgagee Letter is a requirement that delinquent borrowers obtaining an FHA-HAMP loan modification receive a targeted 20 percent payment reduction. FHA also tracks and evaluates various data that indicate the success of the loss mitigation program.

Single Family Asset Management

FHA acquires single family properties through conveyance claims. HUD utilizes its third generation of Management and Marketing (M&M III) Contractors to sell Single Family Real Estate Owned properties to owner-occupants, and to investors. The M&M III disposition structure streamlines operations to capitalize on the expertise of its contractors and provides flexibility to meet changing market conditions in the REO industry. The performance measurements for M&M III reduce risk to HUD, reduce losses to the Insurance Fund, decrease holding times, and ensure properties are safe and secure from hazardous conditions and maintained in a manner that preserves communities.

HUD structured the M&M III contracts to provide for:

- Centralization of mortgagee compliance functions under a Mortgagee Compliance Manager (MCM) responsible for activity before and after the property is conveyed, including approval of claims for payment, title reviews, and inspection reviews.

- Separation of marketing functions (Asset Managers) from property management functions (Field Service Managers). Field Service Managers provide property maintenance and preservation services consisting of, but not limited to, inspecting the property, securing the property, performing cosmetic enhancements or repairs, and providing on-going maintenance. The Asset Managers are responsible for the marketing and sale of REO properties.

- A centralized REO case management system and centralized property bidding/listing site. This system ensures that HUD receives the highest net return for its sealed bid process and that the Department has an audit trail for oversight of the conveyance and REO processes.

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 notes for servicing. As of September 30, 2013 Secretary-held notes totaled $135.5 billion. This total includes the principal limit of HECM insured loans outstanding for which HUD holds a second Note and Mortgage, 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. Partial claim notes are created when a lender advances funds on behalf of FHA-insured homeowners in 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 HUD. 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. Outstanding Single Family Notes partial claims increased by 41 percent from 119,742 notes at the end of fiscal year 2012, to 168,394 at the end of fiscal year 2013. The increase is primarily due to the FHA-HAMP program, which combines a partial claim with a loan modification. Single Family Notes assigned through HECM comprised $3.7 billion of the total Secretary-held mortgage notes inventory through September 2013.

Single Family Loan Sale

In fiscal year 2013, FHA continued the Single Family Loan Sale Pilot Program that began late in fiscal year 2009. The goal of the program is to reduce costs to the MMI Fund while creating the possibility of a better outcome for affected delinquent borrowers and their communities.

Since September 2012, FHA has conducted three sales of defaulted Secretary-held assets, accepting bids on pools of defaulted mortgages. In these sales, HUD offered 46,100 loans with an unpaid principal balance of $7.7 billion. Claims were paid only after winning bidders were identified, thereby ensuring loans would be in HUD's inventory for a minimal period of time. A total of 35,944 claims have been paid in fiscal year 2013 to date.

Risk Management

Lender Enforcement Activities on Risk and Fraud. 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 in order to protect the health of the FHA insurance fund during this period of economic uncertainty and tentative regrowth in the housing market:

- *Lender Approval and Recertification.* FHA implemented new net worth requirements for its lenders, which were rolled out in two phases on May 20, 2011, and May 20, 2013 as part of Final Rule FR 5356-F-02 "Continuation of FHA Reform—Strengthening Risk Management Through Responsible FHA-Approved Lenders." During 2013, FHA reviewed the fiscal year 2012 audited financial statements of approved lenders to ensure compliance with these now fully-implemented requirements.

  In April 2013, FHA extended its waiver of the requirement that supervised lenders, with less than $500 million in consolidated assets, submit audited financial statements as part of their annual recertification package. Under the waiver, these small supervised lenders are required to submit either a current or fourth quarter Call Report instead. On September 17, 2013, FHA published a Final Rule in the Federal Register that made this waiver permanent, effective October 17, 2013.

  As part of the FHA Transformation Initiative, the Office of Lender Activities and Program Compliance spearheaded the development of the Lender Electronic Assessment Portal (LEAP), which was created to mitigate multiple systems onto one comprehensive platform and to streamline business processes. The first phase of LEAP, the automation of FHA's lender approval application, was implemented in 2012. During fiscal year 2013, work progressed on the second phase of LEAP, the automation of FHA's annual lender recertification process. This will include enhanced financial reporting functionality based on each lender's specific financial reporting structure, which will improve lender usability, as well as FHA's ability to monitor lenders' performance. FHA expects this functionality to be released during fiscal year 2014.

- *Lender Monitoring and Enforcement.* FHA conducts monitoring reviews of FHA-approved lenders to ensure that FHA-insured mortgages are originated, underwritten, and serviced in compliance with the Department's requirements. During fiscal year 2013, the Quality Assurance Division (QAD) conducted 330 monitoring reviews of FHA-approved lenders, evaluating 12,886 loans for compliance with HUD requirements thus exceeding the goal to conduct 300 reviews by ten percent. In addition, 100 percent of all files reviewed by FHA were evaluated for accuracy of the good faith estimates. This year, FHA's Processing and Underwriting Division used its adverse selection criteria, such as risk based rules algorithm, early payment defaults and complaints, to select 23,960 loans for post endorsement technical review, and completed an initial review of 92.3 percent, or 22,133 of those files.

When material deficiencies are discovered on loans in the course of a monitoring review, FHA may seek indemnification from the lender against future insurance claim losses. This fiscal year, FHA received 2,871 indemnifications from lenders, thereby avoiding an estimated $304.8 million in insurance claim losses. FHA's Mortgagee Review Board withdrew the approval of 29 noncompliant lenders during fiscal year 2013.

FHA continued to make significant improvements to its lender and loan review processes during 2013. FHA conducted a comprehensive evaluation of its lending violation criteria in order to standardize the basis for rating loans "unacceptable." FHA also developed improved criteria for selecting loans with material deficiencies for review. This included developing a methodology for reviewing all loans that go to claim within 24 months from the date of endorsement. FHA completed 52 percent, or 471 of these early cohort claim reviews during fiscal year 2013.

- *Credit Watch Termination.* Through the Credit Watch Termination Initiative, FHA continued to exercise its authority to terminate lender approval to originate or underwrite loans for insurance when those lenders default and claim rates in HUD field office jurisdictions exceed the Department's threshold. During fiscal year 2013, FHA reformulated the compare ratio calculation under the Credit Watch Termination Initiative to better measure lender risk. Streamline refinances were removed from lenders compare ratios in October 2012, and proposed Credit Watch Terminations began under this new calculation in May 2013.

- *Loan Review Process Enhancements.* Throughout 2013, FHA continued to update its Basis for Ratings. This included ongoing quarterly reviews and the subsequent recalibration of FHA findings codes in order to periodically align the codes with Departmental business and policy changes. The loan review process was further enhanced by implementing workload and summary reports in the Neighborhood Watch Early Warning System to assist in effectively processing selected files.

  Also during 2013, FHA implemented revisions to the conditional pre-closing test case phase of FHA's Direct Endorsement (DE) Lender Program in order to improve controls and ensure that lenders meet pre-closing requirements before being granted unconditional DE authority. These changes went into effect in July 2013 and included revised review standards, supporting documentation, and procedural instructions designed to promote consistency and efficiency among the four Homeownership Centers that administer the test case phase to DE lenders.

To further promote consistency and efficiency, FHA instituted the Escalation Review Committee. The committee provides a forum for members, including the Office of Lender Activities and Program Compliance, Processing and Underwriting Division, and Single Family's Office of Program Development, to come to a consensus on resolving unclear or disputed lender policies, as well as specific loan issues, as they relate to FHA's loan review processes. In addition, the committee helps to facilitate communication between Headquarters and the Homeownership Centers, promote consistent policy execution, and assist in identifying opportunities to improve risk management for the overall FHA portfolio.

As part of the FHA Transformation Initiative, FHA also completed technical design for a future addition to the LEAP suite, LEAP Loan Review. This effort was focused on replacing and enhancing the legacy Underwriter Review System, a module of the Computerized Home Underwriting Management System. LEAP Loan Review will include a risk-based loan selection engine, skills-based assignment of loans to reviewers, automated workflows, event-driven communications to lenders, "Smart Scripts" checklists for more consistent loan evaluation, and a core set of internal and external reports to provide insight into loan performance trends for each lender. System development is planned for fiscal year 2014, pending funding availability.

- *Lender Outreach*. During fiscal year 2013, FHA's Quality Assurance Division developed a new Quarterly Loan Review Findings Report. This report aggregates the results of FHA's post endorsement technical reviews industry-wide, and breaks down the overall findings by category in order to better illustrate the areas in which loans are being rated unacceptable and/or deficient. Throughout 2013, FHA's Office of Lender Activities and Program Compliance met with representatives from seven of Single Family's top lenders to review individually tailored versions of the report and to discuss risk management practices going forward.

  In June of 2013, the Office of Lender Activities and Program Compliance began publishing the report publicly through its new newsletter, "Lender Insight." The newsletter was created to offer insight to lenders about what FHA sees behind the scenes 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, and is intended for lenders to use in order to improve quality control and risk management practices, and alleviate many of the common problems FHA encounters early on in the process before FHA intervention is necessary.

Appraiser Roster

As of September 30, 2013, there are 50,848 appraisers nationwide listed on the roster. As part of its Risk Management, and to ensure compliance with written guidance and appraisal reporting standards, FHA employed a risk-based algorithm to select appraisers to be reviewed. FHA imposed 1,537 sanctions and terminated 2,333 appraisers from its appraiser roster in fiscal year 2013 as part of its appraisal oversight functions.

Office of Multifamily Housing

Multifamily Housing Programs

FHA's Multifamily Housing Programs (MHPs) provide insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals and cooperatives. FHA also offers risk sharing on loans originated by state Housing Finance Agencies (HFAs), Freddie Mac and Fannie Mae for multifamily rental properties. During fiscal year 2013, FHA initially endorsed 1,807 multifamily apartment loans totaling $17.6 billion through 90 active lenders and 94 Risk Sharing loans totaling $670 million (Table 1). In fiscal year 2013, FHA continued the Green Refinance Plus initiative, a partnership with Fannie Mae and Government Sponsored Entities (GSEs) to increase energy efficient upgrades in older affordable properties.

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. FHA's broad range of programs and non-recourse favorable loan terms induce developers to produce needed housing and provide consumers with a wide array of shelter options for all life stages. Multifamily's most popular programs are described briefly below.

"With the housing market recovery now well underway, middle class and low-income renters are facing unprecedented affordability burdens. That's why, in addition to providing liquidity to the Multifamily marketplace through the mainstream FHA insurance programs, the Office of Multifamily Housing Programs is focused on creating and preserving affordable rental housing by implementing innovative solutions like the Rental Assistance Demonstration (RAD), which facilitates the use of private sector financing tools to recapitalize public housing; the Small Multifamily Building Risk Sharing Initiative which facilitates delegated underwriting on a risk-share basis for 5-50 unit rental properties; and an expanded Low Income Housing Tax Credit (LIHTC) pilot, which facilitates the use of FHA insurance on LIHTC properties."

Benjamin T. Metcalf
Deputy Assistant Secretary
for Multifamily Housing Programs

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

FHA's MHP provide mortgage insurance on loans to facilitate new construction or substantial rehabilitation of rental housing apartments and also cooperatives. The principal difference between these programs is the type of housing being developed. Section 221(d)(4) supports standard rental apartments for moderate-income families while Section 231 is for the creation of housing for seniors age 62 or older. Section 213 is for cooperatives while Section 220 is for rental housing in urban renewal or concentrated development areas. Although all these programs offer market-rate loans, 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. Effective fiscal year 2013, FHA suspended the Section 221(d)(3) program which had been available to non-profits to develop standard rental apartments. This program required positive credit subsidy, which is congressionally appropriated and has higher Mortgage Insurance Premiums (MIP) than Section 221(d)(4). Moreover, Section 221(d)(4) can be utilized by non-profit owners at lower cost and with virtually the same benefits as with Section 221(d)(3), including recognition of a developer's fee.

Highlighted—Villa Vasona Senior Housing

Villa Vasona is a 107-unit senior housing property located in Los Gatos, CA. It was built in 1983 with an FHA 221(d)(4) loan and is restricted to elderly residents. The project serves extremely-low income residents and has a Section 8 contract that covers 100 percent of the units. The borrower is acquiring the property with 9 percent LIHTCs that will provide enough funding for the owner to complete $39,500 per unit of repairs to preserve the property for the long-term.

Villa Vasona located in Los Gatos, CA; LIHTCs will provide funding to repair and preserve the property long-term.

The new owner secured the LIHTCs for the property through the California Tax Credit Allocation Committee, qualifying to take advantage of the higher rehabilitation limits and increased efficiency available under the FHA Housing Tax Credit Pilot Program. This was the first firm commitment given by Multifamily through the pilot, which speeds processing of applications to increase affordable housing availability.

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

Section 223(f) is FHA's Multifamily program that insures loans for the purchase or refinancing of existing rental properties financed with conventional or FHA loans. The program allows for the financing of long-term mortgages by Government National Mortgage Association "Ginnie Mae" Mortgage Backed Securities. The flexibility for purchase in the secondary mortgage market improves the availability of loan funds and permits more favorable interest rates.

The FHA Section 223(a)(7) mortgage insurance program offers a streamline refinancing option for multifamily properties already insured by FHA. In addition to expedited processing, the Section 223(a)(7) program can reduce debt service and free up operating income to property owners for other project needs.

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

Under these programs, FHA shares risk on loans originated, underwritten and serviced by 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. Most often FHA assumes a 50 percent loss risk, but the actual percentage varies depending on the terms of each risk sharing arrangement. By absorbing part of the loss, FHA provides an incentive for these agencies to fund multifamily housing, all of which must be "affordable" per the definition given for LIHTCs, so that 20 percent of units are affordable at 50 percent of Area Median Income (AMI) or 40 percent of units are available at 60 percent of AMI.

Table 1: Multifamily Endorsements by Program

Section of the Act	**Endorsements for Fiscal Year 2013**		
	Dollars (millions)	**Percentage**	**# of Mortgages**
Section 221(d)(4):New Construction and Substantial Rehabilitation Program	$ **2,502**	**14%**	**161**
Sections 223(f) and 223(a)(7): Purchase/Refinancing Program of Existing MHP Projects	**$14,965**	**82%**	**1,633**
Section 542(b) and 542(c): Risk-Sharing with QPEs & HFAs	**$670**	**4%**	**94**
Other Programs	**$166**	**<1%**	**13**
Totals	**$18,303**	**100%**	**1,901**

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

Performance Goals and Objectives

FHA is responsible to meet critical activities within the HUD Strategic Plan. The Management Action Plan target activities that address Multifamily Housing Programs' (MHP's) Sub Goals are listed below.

Performance Goals and Objectives		
Strategic Goal 2 (G2): *Meet the Need for Quality Affordable Rental Homes*		
G2 Sub Goals 2B Expand the supply of affordable rental homes where they are most needed.		
FY 2013 Data	**Target**	Achieve 75% of endorsed multifamily properties that have affordability, preservation or sustainability components. The target is to have 75% of the 1,901 endorsed MF properties in fiscal year 2013.
	Achievements	As of June 30, 2013, Multifamily reported 56% of our Initial Endorsements as having affordability, preservation, and/or sustainability features, against a target of 75%. (Budget constraints due to sequestration have had an impact on this annual target)
G2 Sub Goals 2C Preserve the affordability and improve the quality of federally assisted and private unassisted affordable rental homes.		
	Target	Provide 18,800 Low Income Housing Tax Credit / Tax Exempt (LIHTC/TE) developed units for fiscal years 2012-2013, or 9,200 units in fiscal year 2012 and 9,600 in Fiscal year 2013.
FY 2013 Data	**Achievements**	As of June 30, 2013, Multifamily reported 9,655 new completed LIHTC/TE units for a cumulative total of 24,593 LIHTC/TE units for fiscal years 2012-2013, thus surpassing the two year target as a result of increased multifamily activity.
	Target	Restructure 80% of eligible properties with approvable action plans within the Mark-to-Market (M2M) pipeline. The target is 53 properties per year for fiscal year 2012 and 2013.
	Achievements	As of June 30, 2013, Multifamily exceeded the target of 53 properties with approval action plans within the M2M pipeline. This was due in part because more assets entered and completed the program than originally projected. Through June 30, 2013, the actual number of projects was 56.

Office of MHP Development

FHA's Office of MHP Development provides direction and oversight for FHA mortgage insurance and risk sharing loan origination. During fiscal year 2013, the Office of MHP Development endorsed 1,901 loans. The initial endorsements of FHA-insured and Risk Sharing Apartment loans totaled $18.3 billion and covered 299,257 units, which continues to support thousands of private sector jobs in the construction, property management, service provision and administrative fields that were created during the year.

Because of the continued significant challenges in the housing market during fiscal year 2013, funding for FHA endorsements maintained historic volume and has increased consistently over the most recent five year period, providing significant credit liquidity to the market during the country's major economic downturn. Additionally, FHA supports special initiatives directed towards the elderly and underserved areas with high concentrations of low income or minority families. For instance, in fiscal year 2013 MHP issued a request for comments on an initiative that would expand the Risk Share Program to allow Community Development Financial Institutions (CDFIs) and other mission-oriented lenders to utilize the Risk Sharing Program to increase the flow of credit to small multifamily properties, and to demonstrate the effectiveness of providing Federal credit enhancement for refinancing and rehabilitation of such housing. In fiscal year 2014, MHP expects to implement the program with these lenders.

Highlighted— Silver Springs Apartments

FHA saw success with Silver Springs Apartments, a substantial rehabilitation project under the MHP Section 221(d)(4) program. Originally built in 1996, the 360-unit property is located in Austin, Texas in the Tech Ridge area known for its hi-tech presence. The firm commitment has been issued and was closed in July 2013.

The owner, Silver Springs Affordable Housing, received an allocation of private activity bond volume cap and 4 percent LIHTCs to rehabilitate the building. Amenities include a laundry room, fitness center, basketball court, swimming pool, sand volleyball court, playground, and picnic areas. In addition, the YMCA uses the community room for an after school program and an all-day summer and holiday program, which will continue after the renovations.

Silver Springs Apartments located in Austin, TX; significant renovations in progress to promote energy efficient upgrades and support community outreach.

Renovations will include the addition of carports, refurbishment of the community room and offices, replacement of playground equipment and resurfacing of the basketball court. To improve energy efficiency, the owners will replace all windows and roofs, install new condensers and air handlers, replace water heaters, and add blown insulation of 8-inch depth. In addition, the owners will add solar panels to the community room to power common area electricity. All apartments will benefit from new energy star refrigerators, low flow shower heads and energy star light fixtures for energy efficiency.

Office of Affordable Housing Preservation

HUD's Office of Affordable Housing Preservation (OAHP) was established to assure the smooth continuation of the Mark–to-Market program (M2M) with restructuring authority through fiscal year 2015. Under this program, OAHP administers restructuring of existing debt for certain privately owned, assisted multifamily properties to levels that are supported by comparable market rents that are affordable to tenants. OAHP also provides assistance for oversight and preservation of a wide spectrum of affordable housing programs.

Under the M2M program, OAHP restructures FHA-insured multifamily properties for which Section 8 rents exceed comparable market rents and makes appropriate reductions to the mortgages to allow the project debt to be serviced with reduced subsidy payments, while remaining financially viable with market rate rent schedules. The M2M process involves either a full or partial payment of claim by FHA on the original mortgage, followed by FHA's commitment of a new mortgage that can be supported at market rents. In fiscal year 2013, OAHP completed restructuring on 63 properties, covering 6,310 units under the M2M program, of which 49 properties, or 78 percent, resulted in reduced rents and Section 8 savings. Of the 63 properties, 34 resulted in full debt restructuring, contributing to the long-term preservation of 3,493 units, which represented an annual Section 8 savings of $10.9 million. Additionally, 15 properties consisting of 1,616 resulted in units reduced rents only, representing an annual Section 8 savings of $32.8 million. The restructured units yielded an annual net savings (non-incurrence of cost) to FHA of over $10.6 million.

Highlighted—Meadowbrook Park & Tower Apartments

Another FHA MHP success story involves OAHP's Washington Preservation Office (WPO) who issued a Restructure commitment to Meadowbrook Park & Tower Apartments, San Bernardino, California on June 5, 2013. The deal was very complex and challenging with many factors to be considered.

Built in 1969, the property is comprised of between twenty one and eight-story apartment buildings, with 306 residential units; the leasing office; and four commercial lease spaces. The 306 units include 95 studio one-bath; 155 one bedroom one-bath; 48 two bedroom two-bath, and 8 three bedroom two-bath units. All 95 of the studio units, one three bedroom unit, and the manager's unit, are currently un-subsidized. The remaining 210 units are subsidized under the Housing Assistance Payment (HAP) contract. The 95 market rate studio apartments are functionally obsolete and have a 50 percent unmarketable vacancy rate. The restructure plan for this 306 unit property, 69 percent Section 8 community, includes converting 95 unassisted studio apartments into 47 unassisted one bedroom apartments for a new total of 258 apartments. The Housing Authority of the County of San Bernardino (HACSB) has agreed to issue 47 project-based vouchers to assist in the restructure of this project.

Meadowbrook Park & Tower Apartments located in San Bernardino, CA; restructured to provide additional housing units, which aid the revitalization and safety of the community.

Multifamily Asset Management

As of September 30, 2013, FHA's Multifamily insured portfolio totaled 10,463 mortgages with a total outstanding principal balance of approximately $63.9 billion.

Management Initiatives and Tools for Multifamily Asset Management

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

- *Note Sales*. To dispose of multifamily assets, FHA can either sell a property through foreclosure or sell the mortgage note. Note sales have historically demonstrated a greater return to the FHA Insurance Fund as compared to foreclosures. During fiscal year 2013, FHA sold ten Multifamily first lien mortgage notes with an unpaid principal balance (UPB) of $95 million to successful bidders. The gross proceeds from these sales were $58.3 million. Also in fiscal year 2013 FHA sold seven Healthcare first lien mortgage notes totaling $20 million in UPB. The gross proceeds recovered from these sales were $2.1 million.

- *Computer Integration of data.* The Multifamily Office of Asset Management (OAM) uses a number of tools in its oversight of insured and subsidized properties, mortgage notes, and HUD-owned properties. OAM uses various computer subsystems and integrated systems such as the Physical

Assessment Subsystem (PASS), Financial Assessment Subsystem (FASS), Integrated Real Estate Management System (IREMS), Multifamily Default and Delinquency Reporting System (MDDR), and Online Property Integrated Information Suite (OPIIS), to capture, track, and maintain physical property conditions and financial data of their inventory. Data in the subsystems are integrated to provide management and field personnel financial information and physical property conditions needed for comprehensive monitoring and management of the inventory.

- *Asset Management and Loan Servicing:*
  - *Portfolio Assessment:* OAM created a robust assessment process that rates every insured and non-insured property in the Multifamily portfolio. The rating of the insured portion of the portfolio was completed in December 2012 and the non-insured portfolio was substantially completed by July 2013. In addition, Asset Management worked with the Office of Evaluation to create a dynamic exception reporting tool that analyzes the ratings and compares the rating to definitional criteria to determine if the rating should be further reviewed by supervisory staff.

  - *Portfolio Assessment Hub Calls:* OAM conducts monthly calls with field staff to validate HUD's portfolio rating process. Reviews of all seriously troubled and defaulted loans are performed to ensure steps are taken to protect tenants and HUD interests and to provide direction or assistance.

  - *Implemented Sustaining Our Investments (SOI):* OAM implemented SOI, a project management by risk structure that provides clarity on identifying and prioritizing risk, and provides the knowledge and tools to staff for risk-based portfolio management. SOI resulted in consistent risk-based asset management of the FHA Multifamily Portfolio throughout all offices

  - *Update to HUD Handbook 4350.*1: OAM began a project to re-write HUD Handbook 4350.1, "Multifamily Asset Management and Project Servicing." This update will constitute a complete overhaul of the outdated guidance and results from extensive research into best practices of industry partners, and the development of subject matter experts among FHA staff. This re-write is expected to be completed in fiscal year 2014.

  - *Servicer Watch List Comparison Calls*: Quarterly, OAM holds calls with its largest servicers to compare troubled asset listings and verify that servicers are supporting HUD's Risk Mitigation efforts. An update to the MDDR system is scheduled to allow servicers to input their lists into the system, which will improve communication between servicers and HUD staff in Headquarters and the field.

  - *Monthly Calls between Headquarters and Hub Directors*: The Field Asset Management Division of OAM initiated monthly calls with Hub Directors to facilitate efficient processing of prepayment and waiver requests. These calls ensure expedient processing of all requests and the efficient management of the FHA Multifamily portfolio.

- *Civil Money Penalties (CMPs) Pilot for Owners*: This asset management program will assess CMPs against owners of FHA Multifamily properties if they are found to provide substandard living conditions to their tenants. The pilot will send a message to the industry that FHA will take action if an owner neglects the responsibilities outlined in its HUD business agreements. The pilot is underway and the nationwide roll-out is planned for January 2014.

- *Improved Counterparty Involvement*: In the last year, OAM has made a concerted effort to increase involvement and investment of FHA Multifamily Lenders and Servicers. As a result of these efforts, OAM, in conjunction with the Office of MHP, released a Mortgagee Letter allowing lender and servicers to voluntarily administer the non-critical repair escrow accounts for new 223(a)(7) and 223(f) transactions. This marked the opportunity to increase the role for lender and servicers in the management of FHA Multifamily assets and OAM hopes it serves as a harbinger of greater investment by its lender partners.

- *Property Disposition*: In fiscal year 2013, foreclosure sales resulted in a high rate of return for the department. FHA sold ten Multifamily "properties" to successful bidders with gross proceeds of $20.2 million, representing an 85 percent rate of return for FHA based upon the UPB. Two of the sold properties were market rate properties, Clear Creek I and II; which were sold within 110 days from the date FHA took possession, as Mortgage in Possession, from a Receiver. The rate of return on these two properties was 93 percent of the UPB. While in an MIP status, FHA was able to avoid approximately $90,000 in fees and services proposed by the Receiver and recouped $1.1 million in fees that had been misdirected by the Receiver and applied them to the claims paid. This resulted in over a 100 percent rate of return for these two properties. FHA monitored $185.6 million in required repairs for 84 post-sale properties and ensured successful completion of 42 of those properties. In addition, FHA administered $93.6 million of active Upfront Grants on redevelopment or rehabilitation activities for 12 post-sale properties. Also in fiscal year 2013 FHA relocated or assisted 267 families from six properties with health, safety, or poor physical issues.

Sustaining Our Investments Initiative

OAM staff is taking a prioritized approach to risk management, using a wide variety of tools to enhance their ability to identify troubled projects within their portfolios. Adoption of new workload management techniques, including weekly meetings and the display of cases on a whiteboard, are transforming the way offices communicate, share knowledge and problem solve. For the first time, OAM has rated all of its insured multifamily loans and is currently rating its non-insured portfolio.

Management Initiatives and Program Improvements

MHP initiated a process to review and streamline application processing to be more efficient and to better handle an increased loan volume. This process includes a partial electronic delivery of loan applications and an effort to reengineer MHP's entire business process and update the information technology platform to better manage the insurance fund and meet the future needs of the industry.

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

- *Multifamily Accelerated Processing (MAP*). MAP is the primary tool used by the Office of MHP to expedite and manage the development process. 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. Currently, 90 lenders are approved to process loans under MAP. Participating MAP lenders are required to perform yearly internal control reviews of a sampling of the MAP loans endorsed by HUD. If the reviews disclose weaknesses in processing procedures, FHA's Lender Quality and Monitoring Division (LQMD) works with the lender to improve internal control procedures and ensures that lender's staff receives training on the new processes. In addition, LQMD conducts annual in-depth reviews of loans processed by MAP lenders to provide assurance on the general loan quality. During fiscal year 2013, LQMD has performed reviews on 96 percent of the active MAP lenders. The published MAP Guide was revised in November 2011 and implements various underwriting changes and updates to relevant processing standards. The guide is scheduled for another update in fiscal year 2014. The updates incorporate all Mortgagee Letters, Housing notices, administrative guidance and changes based on operation experience.

- *Credit Risk Management*. For the purpose of aligning Hub and Program Center loan commitment authority with the management of credit risks and to ensure the integrity and stability of the FHA Insurance Fund, FHA created a loan committee approval structure. Credit risk management, as implemented through a Hub and National Loan Committee approval process, provides a method to ensure oversight of Hub and Program Center commitment authority and to ensure consistency in underwriting throughout the nation, as well as to provide a platform to share best practices.

- *Transformation*. In fiscal year 2013, the Office of MHP continued business process reengineering initiatives to increase the percentage of newly constructed or rehabilitated affordable multifamily housing units financed by FHA-insured mortgages, and to generally support increased production levels. Multifamily expects to increase efficiency in its operations, and strengthen front-end risk assessments. The business processing reengineering effort includes:

    - FHA Insurance – Acquire an automated underwriting solution for the modernization of the business process and technical solution that will enhance the efficiency and accuracy for supporting the multifamily housing programs by replacing the current system;

- Risk Sharing – Provide analysis and recommendations for improved process for the insurance and reinsurance for multifamily housing projects whose loans are originated, underwritten, serviced, and disposed of by a Qualified Participating Entity (QPE) or its approved lenders, or by State and local Housing Finance Agencies;

- Preservation - Launched the groundbreaking Rental Assistance Demonstration (RAD) system nationally to preserve and strengthen public and other HUD-assisted housing.

- Asset Management and Loan Servicing – Analysis of the property and loan level data submitted during the application process will be used to populate the asset management and loan servicing database and support future asset management and loan servicing systems as well as:

  - Created a robust portfolio assessment process that rates every insured and non-insured property in the Multifamily inventory. The rating of the insured portion of the portfolio was completed in December 2012 and the non-insured portfolio was substantially completed by July 2013.
  - Worked with Office of Evaluation to create a dynamic exception reporting tool that analyzes the ratings and compares the rating to definitional criteria to determine if the rating should be further reviewed by supervisory staff.
  - Implemented Sustaining Our Investments (SOI), a project management by risk structure that provides clarity to identifying and prioritizing risk, established consistent application throughout all offices, and provides knowledge base and tools for the staff to be successful.

MHP continues to take steps to improve loan processing times immediately. Based on the study by FHA on the workflow of two Hubs, MHP analyzed the findings and implemented the "Breaking Ground" initiative that helped reduce processing times. A modernized, re-vamped IT platform is necessary to sustain and continue that initiative and support continued improvements.

Risk Management

The Office of MHP imbedded risk management in all of its programs and processes. Borrower mortgage credit analysis became central to FHA's underwriting standards. MHP revised program underwriting standards, created both National and Hub loan committees to review and approve loans, and produced new loan closing documents. Working with risk management staff, they developed new credit policies and held monthly reviews of the portfolio performance and of the new production data. In an effort to improve its overall risk management, the Office of MHP is revising lender/underwriter qualifications to further minimize the Department's risk.

During fiscal year 2013, Multifamily continued to introduce initiatives with a goal of managing risk within its programs, given the current state of the housing market. These initiatives originated in June 2010 with Mortgagee Letter 2010-20, Implementation of Final Rule FR 5356-F-02, "Federal Housing

Administration: Continuation of FHA Reform—Strengthening Risk Management through Responsible FHA-Approved Lenders." The improvements from this issuance increased the net worth requirements for FHA-approved lenders, thereby ensuring that FHA lenders are sufficiently capitalized.

In an effort to mitigate risks and ensure continued viability of Multifamily Programs, Mortgagee Letter (ML) 2010-21 and HUD Notice H2010-11 were issued in July 2010. These initiatives: (1) updated core program underwriting standards and processes, (2) adjusted the debt service coverage and loan ratios, (3) enhanced the mortgage credit analysis, and (4) mandated in-depth reviews of principals with FHA-insured debt balances exceeding the threshold.

In addition, Multifamily uses a Multifamily Risk of Claim (MROC) scoring algorithm to measure credit risk and the probability of a loan claiming. A risk management assessment is conducted monthly to review portfolio performance by lender and by loan, for each geographic area, in an effort to determine trends in defaults and delinquency, application sharing and areas of concerns.

Office of Healthcare Programs

Healthcare Programs

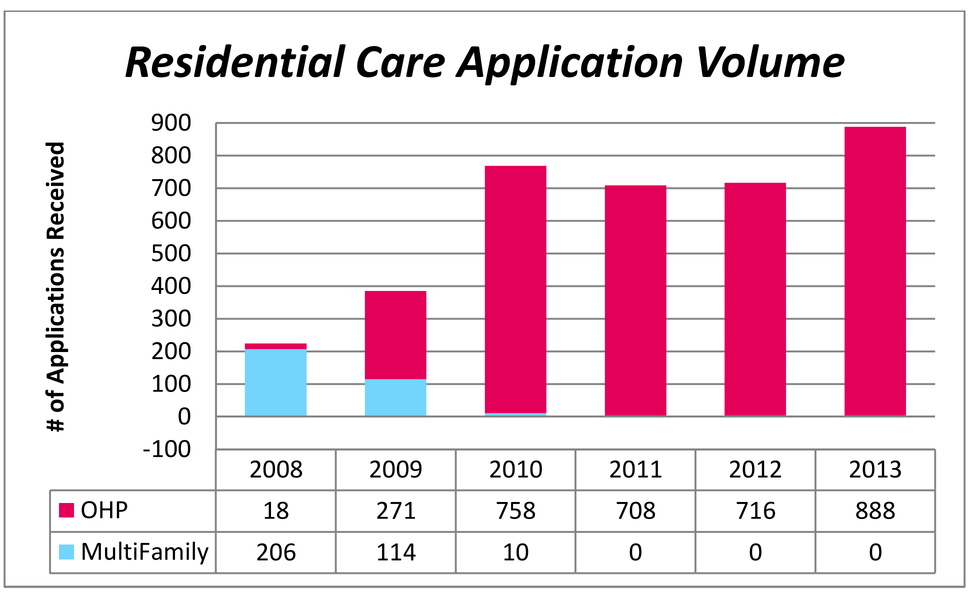
The FHA Office of Healthcare Programs (OHP) administers the following programs that enable low cost financing of health care facility projects and improve access to quality health care by reducing the cost of capital.

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 healthcare facilities. Eligible facilities include nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. During fiscal year 2013, OHP issued 806 commitments totaling $6.4 billion for 94,401 units. At the end of fiscal year 2013, the portfolio contained 2,898 loans with an unpaid principal balance of $20.8 billion. Since fiscal year 2008, industry demand for the program has grown from 224 initial applications received to 888 applications received in fiscal year 2013.

"FHA's Healthcare Programs play a vital role in HUD's community development mission by building and preserving healthy communities, decreasing overall healthcare costs, encouraging private lending, and meeting a need that is not covered by private markets."

Roger Miller
Deputy Assistant Secretary
for Healthcare Programs



	2008	2009	2010	2011	2012	2013
OHP	18	271	758	708	716	888
MultiFamily	206	114	10	0	0	0

The following success stories highlight some of FHA's achievements and ongoing improvement projects recognized through the OHP during fiscal year 2013:

Highlighted 232 Project—Northampton Manor

Northampton Manor, located in Frederick, MD, was originally constructed in 1985 under the Section 232 program. In fiscal year 2013, the facility utilized 223(f) refinancing to (1) construct an addition to an inadequately sized dining room in a wing of the facility and (2) renovate existing dining areas, common patient areas, and shower rooms throughout the facility. The additions and renovations are intended to enhance patient experience and aesthetic appeal, thereby improving the facility's marketability and long-term viability by extending its competitive advantages.

Northampton Manor located in Frederick, MD - Expanded living facility to enhance patient care.

With the property in FHA's existing portfolio, the refinance resulted in a reduced interest rate, increased debt service coverage, and annual principal and interest payment savings. The reduced payments also lowered the risk of default and therefore reduced the risk to the insurance fund.

Highlighted 232 Project—Cadigan Lodge

Cadigan Lodge, located in Topsham, ME, used a Section 232/241 Supplemental loan to add 21-Memory Care units to the existing FHA-insured 44 unit Assisted Living Facility. Cadigan Lodge was constructed in 1995 and is part of the larger Highlands Campus that includes senior independent living apartments financed under the Section 221(d)(4) mortgage insurance program as well as independent cottages. Over the life of these properties, as residents have aged in place, a need for memory care units for some residents has emerged. Proceeds from a Section 232/241 Supplement loan were used to convert five existing assisted living units into seven assisted living units and to construct a 21 bed memory care addition. As completed, the project has a total of 60 beds with 39-assisted living beds and 21-memory care beds.

Cadigan Lodge located in Topsham, ME - Added 21 Memory Care units to the Assisted Living Facility.

The addition and conversion allow residents to continue to age in a familiar setting and provides a unit designed for the specific needs of memory care. The addition also strengthens HUD's risk position by creating additional continuum of care that allows the currently insured property to retain residents in need of these services.

Highlighted 232 Project—Capital Living Nursing and Rehabilitation Centre

The Capital Living Nursing and Rehabilitation Centre project involves the construction of a new 240 bed skilled nursing facility which will replace two existing older skilled nursing facilities (The Avenue Nursing and Rehabilitation Centre, having 154 beds, and The Dutch Manor Nursing and Rehabilitation Centre, having 86 beds). The project will not add new beds to the marketplace; however, by relocating the residents of the existing facilities to the new facility, the building will be approximately 90 percent occupied immediately upon completion of construction. This eliminates any lease-up risk associated with this project.

Capital Living Facility

Replaced Capital Living Facility

In addition to the replacement of the old facility, The Capital Living Nursing Centre has been awarded two Healthcare Efficiency and Affordability Law (HEAL) grants totaling $2.8 million toward the construction of the replacement nursing home. Through HEAL, the New York State Legislature has appropriated $1 billion for restructuring the healthcare delivery system in New York. The Federal government has supplemented the New York appropriation with an additional $1.5 billion through the Federal-State Reform Partnership (F-SHARP).

Economic Impact of 232 New Construction/Substantial Rehabilitation Projects

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 2013, the Section 232 Program has insured 33 projects in 15 states creating over 6,218 full-time equivalent construction jobs with a total construction economic impact of $891.5 million dollars. Once the projects are fully constructed, the residential healthcare facilities will create over 3,609 full-time equivalent jobs and provide a total annual economic impact of $485.9 million to the local communities.

Highlighted 232 Project—Lakeview Lutheran Manor, Cadillac, MI

A substantial rehabilitation loan of $7.6 million was completed on Lakeview Lutheran Manor, a skilled care nursing facility in Cadillac, MI. The hard construction costs of $3 million were used to modernize the 133-bed facility and sprinkler system. Today the facility is fully protected.

Lakeview Lutheran Manor located in Cadillac, MI - FY 2013 rehabilitation to modernize the 133 bed facility.

With the facility improvements, Lakeview Lutheran Manor is positioned to attract both Medicare and private pay residents, thus increasing the residence's quality mix and revenue base. In addition, the facility will be more operationally efficient. Lutheran Social Services of Michigan is the largest faith-based non-profit in Michigan, with vast experience developing, owning, operating and managing senior living and affordable housing facilities.

Section 242 Mortgage Insurance for Hospitals

Mortgage Insurance for hospitals provides access to affordable financing for capital projects, including new construction or modernization and refinancing. Clients range from small rural hospitals to major medical centers. Hospitals with FHA-insured loans serve as community anchors, providing jobs as well as health care services. FHA currently has 109-active hospital loans with unpaid principal balances totaling $8.79 billion. In fiscal year 2013, FHA issued 11 insurance commitments totaling $895 million.

Also during the year, FHA issued a final rule implementing its statutory authority under Section 223(f) of the National Housing Act to insure mortgage loans for refinancing or acquisition of hospitals. This rule enables FHA to insure hospital loans without a requirement for a construction project, providing a way for hospitals to take advantage of today's favorable interest rate environment.

Economic Impact of 242 Mortgage Insurance for Hospitals

In response to the demand among portfolio hospitals to refinance their FHA-insured loans, FHA published handbook guidance for application requests under Section 223(a)(7) of the Act. In fiscal year 2013, FHA issued seven Section 223(a)(7) insurance commitments totaling $253 million. Lenders estimate that these refinancing loans will save FHA hospitals millions in annual debt service.

The benefit of these programs is to keep financially sound hospitals operating in their communities; in addition, refinancing reduces the probability of default. If closure of a hospital were to occur, the negative economic impacts would be substantial because hospitals are among the largest employers in their communities. Moreover, the benefits of FHA's hospital refinancing initiatives are twofold, maintaining needed healthcare services in a community as well as avoiding loss of jobs.

Highlighted 242 Projects-New Orleans East Hospital – New Orleans, LA

On January 11, 2013, seven years after Hurricane Katrina destroyed Pendleton Memorial Methodist Hospital, the city broke ground for New Orleans East Hospital (NOEH). NOEH, which is slated to open for in-patient care in June 2014, will provide a 24/7 emergency department, including medical and surgical services. In the wake of Hurricane Katrina, New Orleans East residents have been forced to seek acute and emergency care services at least 30 minutes away; and over a number of bridges that connect New Orleans East to the New Orleans business and medical districts. Traffic accidents and rush hours on the bridges, coupled with limited ambulance service, regularly delays emergency and critical care. The NOEH project will restore much needed emergency and acute care services to these residents.

New Orleans East Hospital, located in New Orleans, LA scheduled to be completed in June 2014.

The project is remarkable because of the level and intensity of public and private cooperation applied to bring healthcare back to New Orleans East. For example:

- The Hospital Service District for the Parish of Orleans – District A (HSD) was created and is funded through Community Development Block Grant funds from the City of New Orleans and the State of Louisiana.
- Franciscan Missionaries of Our Lady, the largest healthcare system in the state, has no other hospitals in the New Orleans market; and, as part of its mission, has assumed responsibility for providing the management and technical expertise needed to make NOEH financially and clinically successful.
- Daughters of Charity Services of New Orleans, a nationally recognized leader in primary care, are building a health center on the NOEH campus.

Electra Memorial Hospital—Electra, TX

Electra Memorial Hospital, originally opened in 1976, is an acute care facility that includes a 24-hour trauma center, laboratory and radiology imaging, pharmacy, rehabilitation and physical therapy, cardiopulmonary services, and a medical clinic, as well as providing ambulance services in the community. As the delivery of healthcare changed over the years, the need for additional space became critical for efficient hospital operations.

Electra Memorial Hospital located in Electra, TX – Renovated to double its size.

The FHA-insured mortgage loan for $11.4 million will be used to renovate and expand the current facility to double its size and will include a new 19-bed inpatient wing with eight private rooms and additional space designed for patient focused health care services. Also, the mechanical, electrical and plumbing systems of the 35 year old building will be upgraded to meet current codes.

Performance Goals and Objectives

FHA's Office of Healthcare Programs is responsible for critical activities within the HUD Strategic Plan. Listed below are the Management Action Plan goals.

Performance Goals and Objectives		
***Strategic Goal 2 (G2)**: Meet the Need for Quality Affordable Rental Homes*		
G2 Sub Goal **2B** Preserve the supply of affordable rental homes where they are most needed.		
	Target	Achieve sufficient initial endorsements of Section 232 Residential Care Facility mortgages to preserve 558 occupied affordable assisted living facility dwelling units for Medicaid-eligible tenants in fiscal years 2012-2013.
	Achievements	As of June 30, 2013, OHP has preserved 1,591 occupied affordable assisted living facility dwelling units, more than doubling the target number of units.
***Strategic Goal 4 (G4)**: Build Inclusive and Sustainable Communities Free from Discrimination*		
G3 Sub Goal **3B** Utilize HUD assistance to improve health outcomes		
	Target	Increase the average Centers for Medicare/Medicaid Services (CMS) quality rating of the FHA residential care facility portfolio by issuing skilled nursing home commitments with an average CMS rating of 2.2 or higher.
	Achievements	As of June 30, 2013, the average quality CMS rating for new commitments issued for skilled nursing homes was 3.2, substantially exceeding the performance goal.
	Target	Enable 8 hospitals to obtain affordable financing for construction or modernization projects that result in the provision of necessary healthcare to communities through the issuance of Section 242 FHA mortgage insurance.
	Achievements	As of June 30, 2013, FHA enabled 5 hospitals to obtain affordable financing. By the end of fiscal year 2013, commitments were issued for 11 hospitals, thus surpassing the target goal.

Risk Management

With an outstanding portfolio balance of $29.6 billion, managing risk has become an even more important component of the OHP programs. FHA 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.

FHA is 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. FHA Account Executives are assigned to manage each lender portfolio and turnaround teams; working in conjunction with credit risk officers from the Office of Risk Management and Regulatory Affairs (ORMRA) to address and resolve problems early. Identified 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.

Additionally, FHA is developing standard policies for the overall asset management and loss mitigation process. Specifics include reviewing underwriting standards for the Section 242 program and revising Section 232 regulatory agreements and other closing documents to protect HUD's interest.

Office of Housing Counseling

HUD's Housing Counseling Program is authorized by Section 106 of the Housing and Urban Development Act of 1968, as amended by the Dodd-Frank Act, to provide or contract with organizations to offer counseling to tenants and homeowners seeking to improve their housing conditions. More than 2,400 HUD-approved agencies currently provide these services. Although Housing Counseling activities are not funded through FHA resources, they have a significant impact on FHA programs.

"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. In October we celebrated the one-year anniversary of the creation of our new Office."

Sarah Gerecke
Deputy Assistant Secretary
for Office of Housing Counseling

HUD awards grants annually to HUD-approved housing counseling agencies through a competitive process. In fiscal year 2013, HUD awarded over $40 million in housing counseling grants to 337 agencies. More than $38 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. In addition, $2 million was awarded to provide counselors with training to effectively assist families with their housing needs. Subtitle D of Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376) (July 21, 2010) (Dodd-Frank Act), which consists of sections 1440 through 1453, made several amendments to strengthen HUD's Housing Counseling Program. Section 1442 amended section four of the Department of Housing and Urban Development Act (Department of HUD Act) to establish an Office of Housing Counseling within HUD specifically devoted to administration and oversight of housing counseling agencies, individual counselors and the counseling services offered under the program. The Department submitted a plan to establish the Office of Housing Counseling to Congress in January 2012. Congress approved the establishment of this office in May 2012. The Office of Housing Counseling's soft launch was in October 2012, and the White House announced its official launch in April 2013.

~~ It's Been A Banner Year ~~

Housing Counseling making a difference to Distressed Home owners

January 2013 Provided much needed help to super storm Sandy survivors.	**February 2013** FY2013 Housing Counseling Program Notice of Funding Availability (NOFA).	**March 2013** Empowered Housing Counseling agencies through coalitions and alliances.
April 2013 Partnering with the Resident Care Assistance Community to support successes and challenges of rural Housing Counseling agencies.	**May 2013** Worked in partnership with the Department of Veterans Affairs to provide available resources to assist military families and veterans	**June 2013** Awarded more than 40 million in housing counseling grants for housing needs and to prevent foreclosure
July 2013 Conducted feedback sessions with counseling agencies to evaluate the 2013 NOFA and solicit recommendations for the 2014 Housing Counseling NOFA.	**August 2013** Published Mortgagee Letter 2013-26, "Back to Work – Extenuating Circumstances", which makes housing affordable to qualified borrowers who faced financial difficulty and have participated in housing counseling.	**September 2013** Published a proposed rule revising HUD's housing counseling program regulations, certifications and other Dodd Frank Act requirements.

Office of Risk Management and Regulatory Affairs

In 2010, FHA received Congressional approval to establish the Office of Risk Management and Regulatory Affairs (ORMRA) and create the position of Deputy Assistant Secretary for Risk Management and Regulatory Affairs, which reports directly to the Assistant Secretary for Housing – FHA Commissioner. The office functions within the Office of Housing to assess and manage risks in the program areas for Single Family Housing, Multifamily Housing and the Office of Healthcare Programs. Within ORMRA, risk assessment and management functions reside in the Office of Evaluation (OE) and the Office of Risk Management (ORM), respectively. The Office of Manufactured Housing, which creates and enforces the national construction and safety standards for manufactured homes, resides in the Regulatory Affairs side of the Office.

"Risk management is about understanding and explaining our risk well enough to enable the FHA's leadership to make informed choices as we set out to achieve our mission".

Frank Vetrano
Deputy Assistant Secretary
for Office of Risk Management and
Regulatory Affairs

OE oversees the annual independent actuarial studies that determine the net worth of the FHA insurance fund and conducts ongoing portfolio analysis designed to assess risks to the insurance fund. The actuarial studies forecast the effect that various economic risks will have on the fund, including alternative scenarios for volatile interest rates and recoveries and recessions of various degrees. OE also performs ongoing and in-depth analysis to determine the effects of various risks on the portfolio.

ORM establishes the FHA risk appetite for FHA's programs and works in collaboration with the program offices to meet such criteria. A well-defined risk appetite statement helps establish credit risk factors while balancing the mission of the Department to strengthen the housing market to bolster the economy and protect consumers.

One significant initiative of ORMRA is implementing the concept of risk management within FHA program offices through such things as monthly credit risk committee meetings. In addition, ORMRA has begun holding quarterly operational risk committees sessions to assess and remediate operational risks relating to people, processes, and technology, in partnership with the program offices. ORMRA's several top priorities for fiscal year 2013 included: (1) defining and clearly communicating, the management of FHA's risk credit appetite; (2) aligning policy enforcement to FHA's material deficiency standard and improving the feedback loop; and (3) improving the REO disposition activities and loss severity rates.

ANALYSIS OF FINANCIAL STATEMENTS

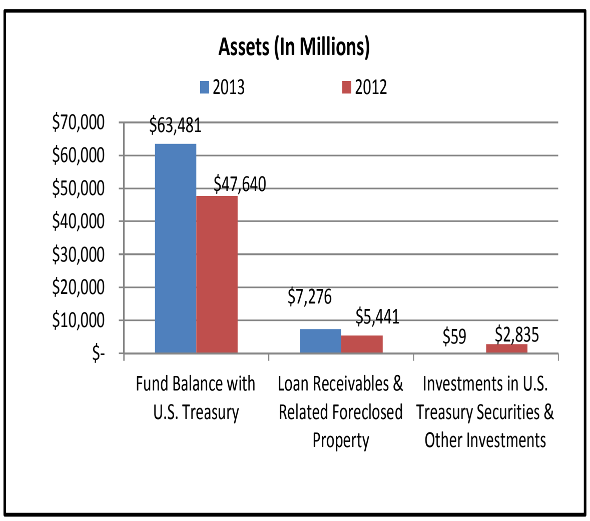
This section presents a summary analysis of FHA's financial statements. The financial statements in this report were prepared using (GAAP) General Accepted Accounting Principles in the United States for Federal entities, the Federal Credit Reform Act of 1990 and in accordance with the Office of Management 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. This is the 21st consecutive year FHA has received an unqualified audit opinion on its financial statements.

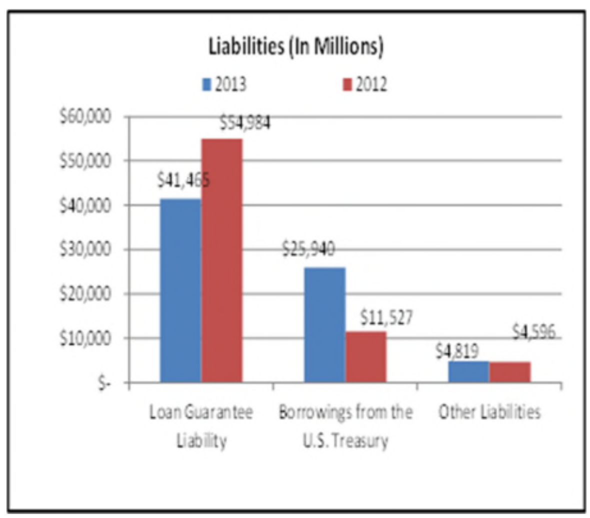
Overview of Financial Position

A summary of FHA's change in financial position from fiscal year 2012 to fiscal year 2013 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 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, market of activity and customer demand.





The increase in assets is primarily attributable to cash accrued from the maturity of investments, cash received from funds borrowed from Treasury, and the interest earned on the cash balances in the financing accounts. In fiscal year 2013, FHA liquidated its investments in order to fund the upward re-estimate in the financing account. FHA had no MMI/CMHI investments in U.S. Treasury securities as of September 30, 2013. Also, during fiscal year 2013, FHA increased its revenues through funds received from premiums.

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

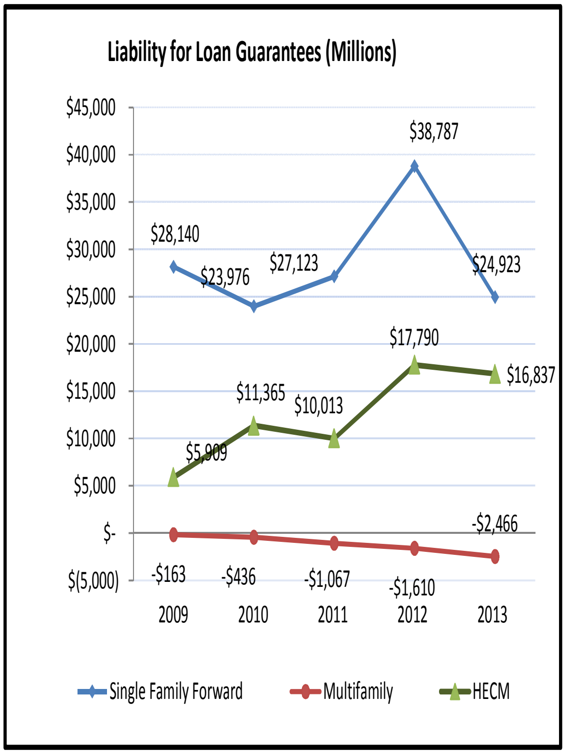
The LLG related to Credit Reform loans (made after September 30, 1991) is comprised of the present value of anticipated cash outflows, such as claim payments, premiums refunds, property expense for on-hand properties and sales expense for sold properties; less anticipated cash inflows, such as premium receipts, proceeds from property sales, and principal and interest on Secretary-held notes.

Schedule of Liability for Loan Guarantees
(Dollars in Millions)

	FY 2013	FY 2012	Difference	% Change
Single Family Forward	$ 27,088	$ 38,787	$ (11,699)	-30%
HECM	16,835	17,790	(955)	-5%
Multifamily	(2,466)	(1,610)	(856)	53%
Total	**$ 41,457**	**$ 54,967**	**$ (13,510)**	**-25%**

The $11,699 million single family forward LLG decrease is primarily caused by greater projected cash inflows based on a change in FHA's mortgage insurance premium (MIP) schedule. In addition, effective June 3, 2013, FHA eliminated the automatic cancellation of annual Mortgage Insurance Premiums (MIP) when loan balances reached 78 percent of the original property value, which increases projected single family forward premiums.

The $955 million HECM LLG decrease is primarily due to the discounting rates published by OMB, which are indicative of the historically-low interest rates. Lower interest rates increase the present value of future cash inflows and outflows. Also, this year's housing price forecast shows a stronger near term recovery in 2013 than was predicted last year.



The $856 million multifamily LLG decrease can be attributed to decreases in several multifamily programs. The Section 223(f) liability decreased by $240 million principally due to lower claim expectations. Section 232 Refinance liability decreased by $6.8 million due to a diminished insurance-in-force and decreased claim expectations. The Section 242 decreased by $33 million due to higher premium revenue caused by decreased prepayment expectations.

Pre-1992 Loan Loss Reserve (LLR)

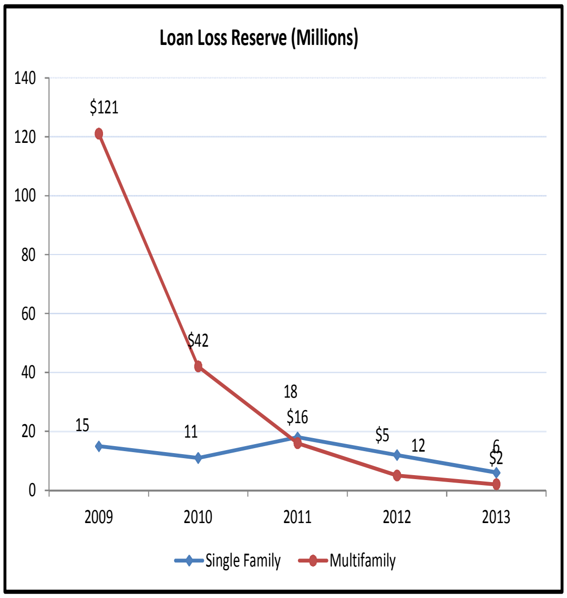
FHA maintains loss reserves for the estimated costs of future mortgage insurance claims resulting from defaults that have occurred or are likely to occur among insured Single Family, Multifamily and Title I loan guarantees. FHA records a loss reserve for its pre-Credit Reform insured mortgages to provide 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 2013	FY 2012	Difference	% Change
Single Family	$ 6	$ 12	$ (6)	-50%
Multifamily	2	5	(3)	-60%
Total	**$ 8**	**$ 17**	**$ (9)**	**-53%**

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 $9 million; from $17 million in fiscal year 2012 to $8 million in fiscal year 2013. The majority of the decrease can be attributed to a decreasing for pre-credit reform multifamily loans outstanding.



Net Cost/ (Surplus)

FHA's program revenues exceeded costs in fiscal year 2013, resulting in 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)

	FY 2013	FY 2012	Difference	% Change
Program Cost	$ (6,717)	$ 23,523	$ (30,240)	-129%
Less: Program Revenues	2,681	3,226	(545)	-17%
Net Cost (Surplus)	**$ (9,398)**	**$ 20,297**	**$ (29,695)**	**-146%**

FHA had a net program surplus in 2013. The program cost difference is primarily due to the decrease in single family gross costs with the public in subsidy expenses in the MMI accounts. In addition, program costs decreased due to an increase in the downward re-estimate in both MMI and GI accounts.

Budgetary Resources

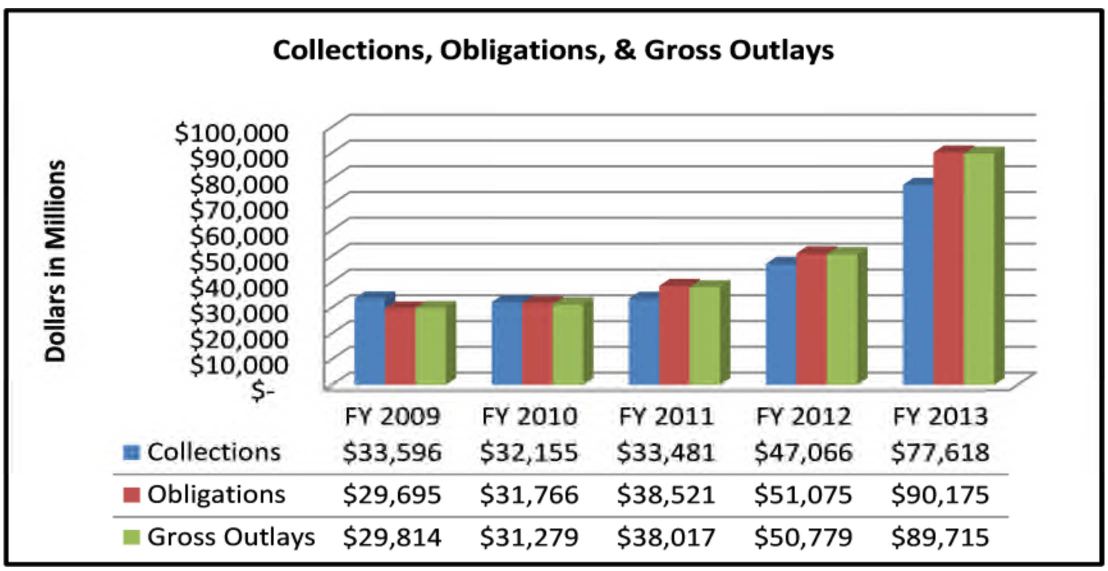
FHA finances its operations primarily through appropriations, borrowings from the U.S. Treasury, spending authority from offsetting collections, and prior year unobligated balances carried forward.

Offsetting collections include collections of premiums, fees, sales proceeds of credit program assets and credit subsidy transferred between different FHA accounts. Additionally, 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 2013	FY 2012	Difference	% Change
Offsetting Collections	$ 77,618	$ 47,066	$ 30,552	65%
Unobligated Balance Carried Forward	44,349	41,814	2,535	6%
Appropriations	7,525	912	6,613	725%
Borrowing Authority	19,093	5,760	13,333	231%
Recoveries, Transfers, and Other	283	(128)	411	-321%
Total Budgetary Resources	**$ 148,868**	**$ 95,424**	**$ 53,444**	**56%**

These resources were used to cover the fiscal year 2013 obligations totaling $90,175 million. These obligations included: subsidy costs, claim payments on defaulted guaranteed loans and the cost of acquiring, maintaining and disposing of foreclosed properties.



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's internal controls support effective operation of the FHA insurance programs, reliable financial reporting, and compliance with laws and regulations.

FHA Compliance with OMB Circular A-123, Management's Responsibility for 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 and Appendix III of OMB's Circular A-130, "Management of Federal Information Resources."
- American Recovery and Reinvestment Act funds are managed and monitored effectively, and used solely for the purpose of the program.

In addition, FHA conducted its assessment of the effectiveness of internal control over financial reporting in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, FHA can provide reasonable assurance that its internal control over financial reporting as of June 30, 2013 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Fiscal Year 2013

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 safeguarding of assets and compliance with applicable laws and regulations. FHA conducted its assessment of the effectiveness of the FHA internal control over financial reporting in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, FHA can provide reasonable assurance that internal control over financial reporting as of June 30, 2013 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

Carol J. Galante

Assistant Secretary for Housing,
Federal Housing Commissioner

FHA Compliance with OMB Circular A-127, Financial Management Systems

FHA's management has reviewed FHA's core financial system and fifteen mixed financial systems for compliance with the OMB Circular A-127, FFMIA Implementation Guidelines, the National Institute of Standards and Technology (NIST) Special Publication 800-53 controls required under the Federal Information Security Management Act, and OMB Circular A-123, "Management's responsibility for Internal Controls." 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 fifteen 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, OMB Circular A-127, and OMB Circular A-123 requirements.

In the fiscal year 2012 financial statement audit, FHA's independent auditors identified a significant deficiency relating to security management, system access, and configuration management. FHA has implemented additional controls during fiscal year 2013 to address these deficiencies.

FHA's independent auditors also noted our responsibility to comply with the OMB Circular A-127 requirement that financial systems "support the most current federal business practices and system requirements." FHA's financial systems vary widely in age and rely upon many different kinds of hardware and software for their operation. The auditors have recommended that FHA assess the sustainability and scalability of these systems to meet future changes in program operations and policy.

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 since 2008, adapting staff and contractor workloads where necessary. Through continuous monitoring, FHA management has validated the continued sustainability and scalability of existing systems to meet operating requirements in the foreseeable future.

Management considers FHA's existing systems can continue to sustain the operation of the FHA insurance programs for the immediately foreseeable future. FHA management recognizes that these systems must eventually be modernized to meet advancing standards and new expectations for efficiency and flexibility. FHA is currently investing in a major systems modernization program that will apply current technologies to:

- Detect and prevent fraud, waste, and abuse
- Prudently manage credit risk at both the portfolio and loan level
- Implementing streamlined business processes and modern information technology infrastructure

The first priorities of the program have been the deployment of a Portfolio Evaluation Tool to monitor and control risk, deployment of a Risk and Fraud tool to detect risk early in the underwriting process, and automation of lender applications and approval. The FHA Transformation program is building a Financial Services Platform using the latest Oracle technology to support future FHA requirements for risk management and to continue to improve FHA's controls over the insurance portfolio. The Financial Service Platform provides FHA with a modern infrastructure to support future improvement of its business applications.

FHA also implemented a new service for HECM insurance accounting and program operations on October 9, 2012. FHA named the service Home Equity Reverse Mortgage Information Technology (HERMIT). The HERMIT service consolidated the operations of the following legacy systems into one platform:

- Collecting Mortgage Insurance Premiums (MIP) through its Insurance Accounting Collection System (IACS);
- Servicing HECM loans assigned to HUD through its Single Family Mortgage Asset Recovery Technology (SMART) system;
- Manually processing Mortgagee's insurance claims.

The HERMIT service improves FHA's monitoring and tracking of the HECM loan portfolio, automates the payment of insurance claims, and add capabilities to identify and mitigate risks to the Insurance Funds. The HERMIT service also improves IT security controls and compliance with current federal security standards.

Fiscal Year 2013 Material Weaknesses

There were no material weaknesses identified for fiscal year 2013.

Improper Payments Elimination and Recovery Act of 2010

In accordance with the Improper Payments Elimination and Recovery Act (IPERA) of 2010, enacted on July 22, 2010, and the OMB Memorandum dated April 14, 2011, 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, 2012 and April 30, 2013. Based on a HUD threshold of $40 million, the following disbursements programs exceeded the threshold:

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

During fiscal year 2013, limited risk assessments were conducted on all programs to determine that the programs are of low risk and there were no changes that might be vulnerable to improper payments. Our risk assessment revealed that there were no significant changes to processes by which the disbursements were processed, leading us to conclude that systems are not susceptible to improper payments. We conducted limited review of OIG audit findings and GAO audit recommendations in fiscal year 2013 to assess their impacts on improper payments. Also this year, we have performed random statistical sampling and analyses of HECM, MFIC and SAMS case files and statistical testing of SFIC disbursements. The findings from case files reviewed have confirmed that programs are not susceptible to significant risk of improper payments for the fiscal year 2013. 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.

Legislation passed in 2010 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 2013, we estimated total contract disbursements of $127.67 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 process 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 2013 financial statements:

- The financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C.3515 (b).
- While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

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PRINCIPAL FINANCIAL STATEMENTS

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MESSAGE FROM THE ACTING DEPUTY ASSISTANT SECRETARY FOR FINANCE AND BUDGET

December 16, 2013

This year, the Federal Housing Administration (FHA) received its 21st consecutive unmodified (formerly referred to as "unqualified") audit opinion on its annual financial statements and has had no material weaknesses for the last six years. This accomplishment is the result of FHA's collective and persistent efforts to: 1) address audit findings and recommendations, 2) further strengthen internal controls over its financial systems to enhance data integrity and reporting, and 3) reduce portfolio risks through a series of measured actions.

During fiscal year (FY) 2013, the FHA continued to focus on corrective actions in addressing audit recommendations relating to prior year's Information Technology (IT) significant control deficiencies; successfully resolving one significant deficiency. FHA has developed an alternative portfolio structure to more accurately align systems with business segments and investments, and designated management officials to track control deficiencies and report on remediation actions. In addition, IT control deficiencies that required more effective analysis and resolution now have clarified roles and responsibilities for all major IT management functions within FHA. Management has also increased monitoring and oversight of systems performance, upgrade capacity and software.

Another key area of focus in FY 2013 was the continued efforts to build up the capital reserve account, while minimizing claims through increased use of the Single Family Notes Sales program. In addition, FHA implemented programmatic changes to increase use of loss mitigation options to reduce asset disposition losses, and increased the annual premium rates it charges. The anticipated impact of these changes, by the end of FY 2014, is an increase in capital of approximately $13 billion. In FY 2013 FHA saw a significant increase in the amount of Single Family insurance premium collections. The total premiums collected increased from $8.76 billion in FY 2012 to $10.64 billion this fiscal year, an increase of 21 percent. Conversely, FHA experienced an increased volume of Single Family forward and reverse mortgage claims this fiscal year. FHA paid 511,948 Single Family forward insurance claims valued at almost $30 billion for fiscal 2013; up from 394,380 claims for $20 billion paid in FY 2012. Reverse mortgage claims paid also increased in fiscal year 2013; FHA paid reverse mortgage insurance claims valued at $2.3 billion, compared to $1.245 billion in FY 2012.

Since September 2012, FHA has conducted three (3) Single Family Note sales of defaulted Secretary-held assets, accepting bids on pools of defaulted assigned mortgages. Claims were paid only after winning bidders were identified, thereby ensuring loans would be in FHA's inventory for a minimal period of time. A total of 35,944 assignment claims were paid in FY 2013. The claims related to these loans ordinarily have a lower claim cost and the recoveries to FHA are more immediate.

Although FHA has increased premium rates and minimized further losses through increases in notes sales, FHA was required to take a mandatory appropriation of nearly $1.7 billion to supplement its reserves for expected future claims. This appropriation is mandated by the Federal Credit Reform Act of 1990. However, this action is not an indication of FHA's cash position, nor is it indicative of FHA's ability to pay claims. Moreover, at the end of the fiscal year FHA had over $48 billion in liquid assets to pay claims and is confident that proactive measures already undertaken will continue to strengthen its reserve. The FHA has also recognized improvement in the areas of asset management, loss mitigation and lender monitoring to improve loan performance and enhance the quality of loans insured, towards meeting this goal of returning the capital reserve account to its mandated level.

While FHA has faced some significant challenges this year, with sequestration and reduced resources, we were able to achieve significant improvements in financial management; specifically around enhancements of our ability to continue delivering quality financial management services in a dynamic housing market and to our stakeholders.

Monica A. Clarke
Acting 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, 2013 and 2012
(Dollars in Millions)

	FY 2013	FY 2012
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 63,481	$ 47,640
Investments (Note 4)	3	2,775
Accounts Receivable, Net (Note 5)	-	-
Other Assets (Note 7)	1	3
Total Intragovernmental	$ 63,485	$ 50,418
Investments (Note 4)	$ 56	$ 60
Accounts Receivable, Net (Note 5)	13	24
Loans Receivable and Related Foreclosed Property, Net (Note 6)	7,276	5,441
Other Assets (Note 7)	379	60
TOTAL ASSETS	**$ 71,209**	**$ 56,003**
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 8)	$ 8	$ 6
Borrowings from U.S. Treasury (Note 9)	25,940	11,527
Other Liabilities (Note 10)	3,983	3,473
Total Intragovernmental	$ 29,931	$ 15,006
Accounts Payable (Note 8)	$ 404	$ 721
Loan Guarantee Liability (Note 6)	41,465	54,984
Debentures Issued to Claimants (Note 9)	-	-
Other Liabilities (Note 10)	424	396
TOTAL LIABILITIES	**$ 72,224**	**$ 71,107**
NET POSITION		
Unexpended Appropriations (Note 16)	$ 869	$ 862
Cumulative Results of Operations	(1,884)	(15,966)
TOTAL NET POSITION	**(1,015)**	**(15,104)**
TOTAL LIABILITIES AND NET POSITION	**$ 71,209**	**$ 56,003**

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, 2013 and 2012
(Dollars in Millions)

	FY 2013	FY 2012
Single Family Forward		
Intragovernmental Gross Costs (Note 12)	$ 727	$ 327
Less: Intragovernmental Earned Revenue (Note 13)	1,720	2,608
Intragovernmental Net Costs	(993)	(2,281)
Gross Costs With the Public (Note 12)	(5,840)	15,455
Less: Earned Revenues (Note 13)	28	50
Net Costs With the Public	(5,868)	15,405
Single Family Forward Net Cost (Surplus)	**$ (6,861)**	**$ 13,124**
HECM		
Intragovernmental Gross Costs (Note 12)	$ 53	$ 52
Less: Intragovernmental Earned Revenue (Note 13)	823	477
Intragovernmental Net Costs	(770)	(425)
Gross Costs With the Public (Note 12)	(565)	8,159
Less: Earned Revenues (Note 13)	2	5
Net Costs With the Public	(567)	8,154
HECM Net Cost (Surplus)	**$ (1,337)**	**$ 7,729**
Multifamily/Healthcare		
Intragovernmental Gross Costs (Note 12)	$ 142	$ 85
Less: Intragovernmental Earned Revenue (Note 13)	62	28
Intragovernmental Net Costs	80	57
Gross Costs With the Public (Note 12)	$ (1,927)	$ (1,244)
Less: Earned Revenues (Note 13)	46	58
Net Costs With the Public	(1,973)	(1,302)
Multifamily/Healthcare Net Cost (Surplus)	**$ (1,893)**	**$ (1,245)**
Administrative Expenses		
Intragovernmental Gross Costs (Note 12)	$ 22	$ 29
Less: Intragovernmental Earned Revenue (Note 13)	-	-
Intragovernmental Net Costs	22	29
Gross Costs With the Public (Note 12)	671	660
Less: Earned Revenues (Note 13)	-	-
Net Costs With the Public	671	660
Adminstrative Expenses Net Cost (Surplus)	**$ 693**	**$ 689**
Net Cost of Operations	**$ (9,398)**	**$ 20,297**

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, 2013 and 2012
(Dollars in Millions)

	FY 2013 Cumulative Results of Operations	FY 2013 Unexpended Appropriations	FY 2012 Cumulative Results of Operations	FY 2012 Unexpended Appropriations
BEGINNING BALANCES	**$ (15,966)**	**$ 862**	**$ 4,569**	**$ 850**
Budgetary Financing Sources				
Appropriations Received (Note 16)	-	7,604	-	983
Other Adjustments (Note 16)	-	(39)	-	(24)
Appropriations Used (Note 16)	7,490	(7,490)	875	(875)
Transfers-Out (Note 15 and Note 16)	-	(68)	(395)	(72)
Other Financing Sources				
Transfers In/Out (Note 15)	550	-	(481)	-
Imputed Financing (Note 12)	18	-	15	-
Other	(3,374)	-	(252)	
Total Financing Sources	**$ 4,684**	**$ 7**	**$ (238)**	**$ 12**
Net (Cost) Surplus of Operations	**9,398**	**-**	**(20,297)**	**-**
ENDING BALANCES	**$ (1,884)**	**$ 869**	**$ (15,966)**	**$ 862**

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, 2013
(Dollars in Millions)

	FY 2013 Budgetary	FY 2013 Non-Budgetary	FY 2013 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	4,074	40,275	44,349
Unobligated balance brought forward, October 1, as adjusted	4,075	40,275	44,350
Recoveries of prior year unpaid obligations	87	404	491
Other changes in unobligated balance (+ or -)	(208)	-	(208)
Unobligated balance from prior year budget authority, net	3,955	40,678	44,633
Appropriations (discretionary and mandatory)	7,525	-	7,525
Borrowing authority (discretionary and mandatory)	-	19,092	19,092
Spending authority from offsetting collections (discretionary and mandatory)	22,922	54,696	77,618
Total budgetary resources	**34,402**	**114,466**	**148,868**
Status of Budgetary Resources:			
Obligations incurred	33,564	56,611	90,175
Unobligated balance, end of year:			
Apportioned	77	24,999	25,076
Unapportioned	761	32,856	33,617
Total unobligated balance, end of year	838	57,855	58,693
Total budgetary resources	**34,402**	**114,466**	**148,868**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	732	2,472	3,204
Obligated balance, start of year (net), before adjustments (+ or -)	732	2,472	3,204
Adjustment to obligated balance, start of year (net) (+ or -)	(1)	-	(1)
Obligated balance, start of year (net), as adjusted	731	2,472	3,203
Obligations incurred	33,564	56,611	90,175
Outlays (gross) (-)	(33,574)	(56,141)	(89,715)
Change in uncollected customer payments from Federal sources (+ or -)	(1)	-	(1)
Recoveries of prior year unpaid obligations (-)	(87)	(404)	(491)
Unpaid obligations, end of year (gross)	634	2,539	3,173
Uncollected customer payments from Federal sources, end of year	(3)	-	(3)
Obligated balance, end of year (net)	631	2,539	3,170
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	30,448	73,788	104,236
Actual offsetting collections (discretionary and mandatory) (-)	(22,921)	(59,375)	(82,296)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(1)	-	(1)
Budget authority, net (discretionary and mandatory)	7,526	14,413	21,939
Outlays, gross (discretionary and mandatory)	33,574	56,141	89,715
Actual offsetting collections (discretionary and mandatory) (-)	(22,921)	(59,375)	(82,296)
Outlays, net (discretionary and mandatory)	10,653	(3,234)	7,419
Less Distributed offsetting receipts (-)	1,442	-	1,442
Agency outlays, net (discretionary and mandatory)	**9,211**	**(3,234)**	**5,977**

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, 2012
(Dollars in Millions)

	FY 2012 Budgetary	FY 2012 Non-Budgetary	FY 2012 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	5,565	36,249	41,814
Unobligated balance brought forward, October 1, as adjusted	5,565	36,249	41,814
Recoveries of prior year unpaid obligations	26	122	148
Other changes in unobligated balance (+ or -)	(276)	-	(276)
Unobligated balance from prior year budget authority, net	5,315	36,371	41,686
Appropriations (discretionary and mandatory)	912	-	912
Borrowing authority (discretionary and mandatory)	-	5,760	5,760
Spending authority from offsetting collections (discretionary and mandatory)	12,737	34,329	47,066
Total budgetary resources	**18,964**	**76,460**	**95,424**
Status of Budgetary Resources:			
Obligations incurred	14,890	36,185	51,075
Unobligated balance, end of year:			
Apportioned	59	18,346	18,405
Unapportioned	4,015	21,929	25,944
Total unobligated balance, end of year	4,074	40,275	44,349
Total budgetary resources	**18,964**	**76,460**	**95,424**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	737	2,320	3,057
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(20)	(1)	(21)
Obligated balance, start of year (net), before adjustments (+ or -)	717	2,319	3,036
Obligated balance, start of year (net), as adjusted	717	2,319	3,036
Obligations incurred	14,890	36,185	51,075
Outlays (gross) (-)	(14,868)	(35,911)	(50,779)
Change in uncollected customer payments from Federal sources (+ or -)	18	1	19
Recoveries of prior year unpaid obligations (-)	(26)	(122)	(148)
Unpaid obligations, end of year (gross)	733	2,472	3,205
Uncollected customer payments from Federal sources, end of year	(2)	-	(2)
Obligated balance, end of year (net)	731	2,472	3,203
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	13,649	40,089	53,738
Actual offsetting collections (discretionary and mandatory) (-)	(12,766)	(34,595)	(47,361)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	18	1	19
Budget authority, net (discretionary and mandatory)	901	5,495	6,396
Outlays, gross (discretionary and mandatory)	14,868	35,911	50,779
Actual offsetting collections (discretionary and mandatory) (-)	(12,766)	(34,595)	(47,361)
Outlays, net (discretionary and mandatory)	2,102	1,316	3,418
Less Distributed offsetting receipts (-)	2,611	-	2,611
Agency outlays, net (discretionary and mandatory)	**(509)**	**1,316**	**807**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2013

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's activities are included in the Housing section of the HUD budget.

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

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

FHA supports its 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	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 Statements of Budgetary Resources (SBR), is based on concepts and guidance provided by Office of Management and Budget (OMB) Circular A-11, *Preparation, Submission, and Execution of the Budget* and the Federal Credit Reform Act of 1990. The format of the SBR is based on the SF 133, *Report on Budget Execution and Budgetary Resources*.

Basis of Consolidation

The accompanying principal financial statements include all Treasury Account Fund Symbols (TAFSs) designated to FHA, which consist of 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 sheets, statements of net cost, and statements of changes in net position. The SBR is prepared on a combined basis as required by OMB Circular A-136, *Financial Reporting Requirements, 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 Statements of Budgetary Resources. The Budgetary accounts include the program, capital reserve and liquidating accounts. The Non-Budgetary accounts consist of the credit reform financing accounts.

In accordance with the 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 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 beginning of the following fiscal year, the fund balance in the 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 beginning of the next 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.

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 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 sheets. As required by SFFAS No. 2, the Loan Guarantee Liability includes the Credit Reform related Liabilities for Loan Guarantees (LLG) and the pre-Credit Reform Loan Loss Reserve (LLR) (see Note 6).

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

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

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

Use of Estimates

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

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

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

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

General Property, Plant and Equipment

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

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

Appropriations

FHA receives 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 $18 million for fiscal year 2013 and $15 million for fiscal year 2012, and was included in FHA’s financial statements as an imputed cost in the Consolidated Statements of Net Cost, and an imputed financing in the Consolidated Statements of Changes in Net Position.

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

Note 2. Non-entity Assets

Non-entity assets consist of assets that belong to other entities but are included in FHA's consolidated balance sheets. To reflect FHA's net position accurately, these non-entity assets are offset by various liabilities. FHA's non-entity assets as of September 30, 2013 and 2012 are as follows:

(Dollars in millions)

	FY 2013	FY 2012
Intragovernmental:		
Fund Balance with Treasury	$ 1,671	$ 2,894
Investments in U.S. Treasury Securities	3	3
Total Intragovernmental	1,674	2,897
Other Assets	47	54
Total Non-Entity Assets	1,721	2,951
Total Entity Assets	69,488	53,052
Total Assets	**$ 71,209**	**$ 56,003**

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

According to the FCRA, FHA transfers 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 beginning of each fiscal 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 property taxes, property insurance or maintenance expenses on behalf of the borrowers.

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was comprised of the following as of September 30, 2013 and 2012:

(Dollars in millions)	FY 2013	FY 2012
Fund Balances:		
Revolving Funds	$ 61,084	$ 43,449
Appropriated Funds	775	790
Other Funds	1,622	3,401
Total	**$ 63,481**	**$ 47,640**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance		
Available	$ 25,075	$ 18,405
Unavailable	35,233	26,030
Obligated Balance Not Yet Disbursed	3,173	3,205
Total	**$ 63,481**	**$ 47,640**

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 cancelled and any remaining resources are returned to the U.S. Treasury.

Other Funds

FHA's other funds include the general fund receipt accounts established under the FCRA. Additionally, 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. FHA has no MMI/CMHI investments in U.S. Treasury securities as of September 30, 2013.

(Dollars in millions)

FY 2013	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ -	$ -	$ -	$ -
GI/SRI Investments	3	-	3	-
Subtotal	3	-	3	-
Total	**$ 3**	**$ -**	**$ 3**	**$ -**

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2012 were as follows:

FY 2012	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 2,771	$ 1	$ 2,772	$ 2,772
GI/SRI Investments	3	-	3	3
Subtotal	$ 2,774	$ 1	$ 2,775	$ 2,775
Total	**$ 2,774**	**$ 1**	**$ 2,775**	**$ 2,775**

Investments in Private-Sector Entities

Investments Risk Sharing Debentures as of September 30, 2013 and 2012 were as follows:

(Dollars in millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Returns of Investment	Redeemed	Ending Balance
FY 2013						
601 Program and Note Sales	$ -	$ -	$ -	$ -	$ -	$ -
Risk Sharing Debentures	57	1	-	-	(2)	56
Total	**$ 57**	**$ 1**	**$ -**	**$ -**	**$ (2)**	**$ 56**
FY 2012						
601 Program and Note Sales	$ 6	$ 21	$ 7	$ (31)	$ -	$ 3
Risk Sharing Debentures	57	-	-	-	-	57
Total	**$ 63**	**$ 21**	**$ 7**	**$ (31)**	**$ -**	**$ 60**

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2013 and 2012 are as follows:

	Gross		Allowance		Net	
(Dollars in millions)	FY 2013	FY2012	FY 2013	FY2012	FY 2013	FY2012
With the Public:						
Receivables related to credit program assets	$ 1	$ 16	$ -	$ -	$ 1	$ 16
Premiums receivable	6	6	-	-	6	6
Generic Debt Receivables	96	79	(96)	(79)	-	-
Miscellaneous receivables	6	2	-	-	6	2
Total	**$ 109**	**$ 103**	**$ (96)**	**$ (79)**	**$ 13**	**$ 24**

Receivables Related to Credit Program Assets

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

Premiums Receivable

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

Generic Debt Receivables

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

Miscellaneous Receivables

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

Allowance for Loss

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

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

Direct Loan and Loan Guarantee Programs Administered by FHA Include:
MMI/CMHI Direct Loan Program
GI/SRI Direct Loan Program
MMI/CMHI Loan Guarantee Program
GI/SRI Loan Guarantee Program
H4H Loan Guarantee Program

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and Loan Guarantee Liability as of September 30, 2013 and 2012 are as follows:

Direct Loan Program

(Dollars in Millions)

FY 2013	Total
Direct Loans	
Loan Receivables	15
Interest Receivables	11
Allowance	(12)
Total Direct Loans	**14**

(Dollars in Millions)

FY2012	Total
Direct Loans	
Loan Receivables	15
Interest Receivables	11
Allowance	(11)
Total Direct Loans	**15**

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

(Dollars in Millions)

FY 2013	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	18	-	18
Allowance for Loan Losses	(24)	(10)	(34)
Foreclosed Property	22	8	30
Subtotal	**16**	**(2)**	**14**
Multifamily/Healthcare			
Loan Receivables	-	2,225	2,225
Interest Receivables	-	228	228
Allowance for Loan Losses	-	(935)	(935)
Foreclosed Property	-	1	1
Subtotal	**-**	**1,519**	**1,519**
HECM			
Loan Receivables	-	5	5
Interest Receivables	-	2	2
Allowance for Loan Losses	-	(2)	(2)
Foreclosed Property	-	7	7
Subtotal	-	12	12
Total Guaranteed Loans	**16**	**1,529**	**1,545**

(Dollars in Millions)

FY2012	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	17	1	18
Allowance for Loan Losses	(35)	(16)	(51)
Foreclosed Property	24	10	34
Subtotal	**6**	**(5)**	**1**
Multifamily/Healthcare			
Loan Receivables	-	2,338	2,338
Interest Receivables	-	219	219
Allowance for Loan Losses	-	(1,362)	(1,362)
Foreclosed Property	-	1	1
Subtotal	**-**	**1,196**	**1,196**
HECM			
Loan Receivables	-	5	5
Interest Receivables	-	1	1
Allowance for Loan Losses	-	(2)	(2)
Foreclosed Property	-	5	5
Subtotal	-	9	9
Total Guaranteed Loans	**6**	**1,200**	**1,206**

*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 2013	MMI/CMHI	GI/SRI	H4H	Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	2,957	67	-	3,024
Interest Receivables	8	2	-	10
Foreclosed Property	4,499	149	1	4,649
Allowance	(4,729)	(147)	1	(4,875)
Subtotal	**2,735**	**71**	**2**	**2,809**
Multifamily/Healthcare				
Loan Receivables	-	619	-	619
Interest Receivables	-	-	-	-
Foreclosed Property	-	1	-	1
Allowance	-	(212)	-	(212)
Subtotal	**-**	**408**	**-**	**408**
HECM				
Loan Receivables	530	2,038	-	2,568
Interest Receivables	155	951	-	1,106
Foreclosed Property	2	67	-	69
Allowance	(228)	(1,015)	-	(1,243)
Subtotal	**459**	**2,041**	**-**	**2,500**
Total Guaranteed Loans	**3,194**	**2,520**	**2**	**5,717**

FY2012	MMI/CMHI	GI/SRI	H4H	Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	1,582	53	-	1,635
Interest Receivables	3	2	-	5
Foreclosed Property	4,888	200	-	5,088
Allowance	(4,410)	(177)	-	(4,587)
Subtotal	**2,063**	**78**	**-**	**2,141**
Multifamily/Healthcare				
Loan Receivables	-	631	-	631
Interest Receivables	-	-	-	-
Foreclosed Property	-	1	-	1
Allowance	-	(382)	-	(382)
Subtotal	**-**	**250**	**-**	**250**
HECM				
Loan Receivables	163	1,775	-	1,938
Interest Receivables	38	805	-	843
Foreclosed Property	-	53	-	53
Allowance	(71)	(934)	-	(1,005)
Subtotal	**130**	**1,699**	**-**	**1,829**
Total Guaranteed Loans	**2,193**	**2,027**	**-**	**4,220**

*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 2013):		
MMI/CMHI		
Single Family Forward	1,167,089	1,086,647
Multifamily/Healthcare	449	432
MMI/CMHI Subtotal	**1,167,538**	**1,087,079**
GI/SRI		
Single Family Forward	14,323	11,265
Multifamily/Healthcare	100,911	93,416
GI/SRI Subtotal	**115,234**	**104,681**
H4H		
Single Family - 257	117	113
H4H Subtotal	**117**	**113**
Total	**1,282,889**	**1,191,873**
Guaranteed Loans Outstanding (FY 2012):		
MMI/CMHI		
Single Family Forward	1,141,279	1,069,003
Multifamily/Healthcare	439	417
MMI/CMHI Subtotal	**1,141,718**	**1,069,420**
GI/SRI		
Single Family Forward	18,094	14,868
Multifamily/Healthcare	93,492	85,852
GI/SRI Subtotal	**111,586**	**100,720**
H4H		
Single Family - 257	124	122
H4H Subtotal	**124**	**122**
Total	**1,253,428**	**1,170,262**

New Guaranteed Loans Disbursed:

(Dollars in Millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
MMI/CMHI		
Single Family Forward	240,089	237,258
Multifamily/Healthcare	187	185
MMI/CMHI Subtotal	**240,276**	**237,443**
GI/SRI		
Single Family Forward	138	137
Multifamily/Healthcare	23,206	23,054
GI/SRI Subtotal	**23,344**	**23,191**
Total	**263,620**	**260,634**
New Guaranteed Loans Disbursed (FY 2012):		
MMI/CMHI		
Single Family Forward	213,159	210,936
Multifamily/Healthcare	108	107
MMI/CMHI Subtotal	**213,267**	**211,043**
GI/SRI		
Single Family Forward	163	161
Multifamily/Healthcare	18,643	18,548
GI/SRI Subtotal	**18,806**	**18,709**
Total	**232,073**	**229,752**

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 766,695 HECM loans with a maximum claim amount of $173 billion. Of these 766,695 HECM loans insured by FHA, 586,138 loans with a maximum claim amount of $146 billion are still active. As of September 30, 2013 the insurance-in-force (the outstanding balance of active loans) was $100 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	Cumulative: Maximum Potential Liability
FY 2013	MMI/CMHI		$ 14,671	$ 56,936	$ 86,305
	GI/SRI		-	43,933	59,613
		Total	**$ 14,671**	**$ 100,869**	**$ 145,918**
FY2012	MMI/CMHI		$ 13,111	$ 48,412	$ 76,220
	GI/SRI		-	45,153	63,639
		Total	**$ 13,111**	**$ 93,565**	**$ 139,859**

Loan Guarantee Liability, Net:

(Dollars in Millions)

FY 2013		MMI/CMHI		GI/SRI		H4H		Total
LLR								
Single Family Forward	$	6	$	-	$	-	$	6
Multifamily/Healthcare		-		2		-		2
Subtotal	**$**	**6**	**$**	**2**	**$**	**-**	**$**	**8**
LLG								
Single Family Forward	$	26,189	$	878	$	21	$	27,088
Multifamily/Healthcare		(20)		(2,446)		-		(2,466)
HECM		6,038		10,797		-		16,835
Subtotal	**$**	**32,207**	**$**	**9,229**	**$**	**21**	**$**	**41,457**
Loan Guarantee Liability Total	**$**	**32,213**	**$**	**9,231**	**$**	**21**	**$**	**41,465**

FY2012		MMI/CMHI		GI/SRI		H4H		Total
LLR								
Single Family Forward	$	11	$	1	$	-	$	12
Multifamily/Healthcare		-		5		-		5
Subtotal	**$**	**11**	**$**	**6**	**$**	**-**	**$**	**17**
LLG								
Single Family Forward	$	37,105	$	1,662	$	20	$	38,787
Multifamily/Healthcare		(17)		(1,593)		-		(1,610)
HECM		5,548		12,242		-		17,790
Subtotal	$	42,636	$	12,311	$	20	$	54,967
Loan Guarantee Liability Total	**$**	**42,647**	**$**	**12,317**	**$**	**20**	**$**	**54,984**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

FY 2013	MMI/CMHI	GI/SRI	H4H	Total
Single Family Forward				
Defaults	7,130	4	-	7,134
Fees and Other Collections	(24,191)	(5)	-	(24,196)
Other	(7)	-	-	(7)
Subtotal	**(17,068)**	**(1)**	**-**	**(17,069)**
Multifamily/Healthcare				
Defaults	6	567	-	573
Fees and Other Collections	(16)	(1,479)	-	(1,495)
Other	-	-	-	-
Subtotal	**(10)**	**(912)**	**-**	**(922)**
HECM				
Defaults	536	-	-	536
Fees and Other Collections	(902)	-	-	(902)
Subtotal	**(366)**	**-**	**-**	**(366)**
Total	**(17,444)**	**(913)**	**-**	**(18,357)**

FY2012	MMI/CMHI	GI/SRI	H4H	Total
Single Family Forward				
Defaults	6,825	5	-	6,830
Fees and Other Collections	(13,194)	(7)	-	(13,201)
Other	992	-	-	992
Subtotal	(5,377)	(2)	-	(5,379)
Multifamily/Healthcare				
Defaults	4	642	-	646
Fees and Other Collections	(9)	(1,035)	-	(1,044)
Other	1	-	-	1
Subtotal	(4)	(393)	-	(397)
HECM				
Defaults	754	-	-	754
Fees and Other Collections	(953)	-	-	(953)
Subtotal	(199)	-	-	(199)
Total	**(5,580)**	**(395)**	**-**	**(5,975)**

Subsidy Expense for Modification and Reestimates:

(Dollars in millions)

FY 2013	Total Modifications	Technical Reestimate
MMI/CMHI	-	9,862
GI/SRI	-	(1,443)
Total	-	8,419
FY2012		
MMI/CMHI	-	16,636
GI/SRI	-	3,993
Total	-	20,629

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)

	FY 2013	FY2012
MMI/CMHI	(7,582)	11,054
GI/SRI	(2,356)	3,599
Total	(9,938)	14,653

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2013 Loan Guarantees:				
MMI/CMHI				
Single Family				
Forward - 06/03/2013 - present	2.96	(12.66)	-	(9.70)
Forward - 04/01/2013 - 06/02/2013	2.96	(9.29)	-	(6.33)
Forward - 10/01/12 - 03/31/2013	2.96	(8.94)	-	(5.98)
HECM	2.42	(6.19)	-	(3.77)
Short Refinance	10.22	(7.65)	(2.57)	-
Multifamily				
Cooperatives - 06/03/2013 - present	2.96	(12.66)	-	(9.70)
Cooperatives - 04/01/2013 - 06/02/2013	2.96	(9.29)	-	(6.33)
Cooperatives - 10/01/12- 03/31/2013	2.96	(8.94)	-	(5.98)
GI/SRI				
Multifamily				
Apartments	4.40	(6.91)	-	(2.51)
Apartments Refinance	1.10	(5.75)	-	(4.65)
Apartments Refinance	1.10	(5.75)	-	(4.65)
Healthcare				
Residential Care	3.08	(7.37)	-	(4.29)
Hospitals	1.31	(7.72)	-	(6.41)

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2012 Loan Guarantees:				
MMI/CMHI				
Single Family				
Single Family - Forward - 06/11/2012 - present	3.65	(6.40)	-	(2.75)
Single Family - Forward - 04/09/2012 - 06/10/2012	3.65	(6.65)	-	(3.00)
Single Family - Forward - 10/01/11 - 04/08/2012	2.67	(5.84)	1.01	(2.16)
Single Family - HECM	5.73	(7.25)	-	(1.52)
Single Family - Short Refi	6.38	(5.99)	(0.39)	-
Multifamily				
Cooperatives - 06/11/2012 - present	3.65	(6.40)	-	(2.75)
Cooperatives - 04/09/2012 - 06/10/2012	3.65	(6.65)	-	(3.00)
Cooperatives - 10/01/11 - 04/08/2012	2.67	(5.84)	1.01	(2.16)
GI/SRI				
Multifamily				
Apartments - Section 221(d)(4)	5.32	(6.41)	-	(1.09)
Apartments Refinance - Section 207/223(f)	3.45	(5.62)	-	(2.17)
Apartments Refinance - Section 223(a)(7)	3.45	(5.62)	-	(2.17)
Healthcare				
Residential Care - Section 232	3.60	(5.56)	-	(1.96)
Hospitals - Section 242	1.79	(5.61)	-	(3.82)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2013 LLR	FY 2013 LLG	FY2012 LLR	FY2012 LLG
Beginning Balance of the Loan Guarantee Liability	$ 17	$ 54,967	$ 34	$ 36,070
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	8,243	-	8,230
Fees and Other Collections	-	(26,593)	-	(15,198)
Other Subsidy Costs	-	(7)	-	993
Total of the above subsidy expense components	**-**	**(18,357)**	**-**	**(5,975)**
Adjustments:				
Fees Received	-	12,022	-	10,733
Foreclosed Property and Loans Acquired	-	11,809	-	5,857
Claim Payments to Lenders	-	(29,386)	-	(20,260)
Interest Accumulation on the Liability Balance	-	1,674	-	1,417
Other	-	(14)	-	(36)
Ending Balance before Reestimates	**17**	**32,715**	**34**	**27,806**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component	(9)	1,705	(17)	14,553
Interest Expense Component		(377)	-	5,616
Adjustment of prior years' credit subsidy reestimates	-	7,414	-	6,992
Total Technical/Default Reestimate	(9)	8,742	(17)	27,161
Ending Balance of the Loan Guarantee Liability	**$ 8**	**$ 41,457**	**$ 17**	**$ 54,967**

Administrative Expense:

(Dollars in Millions)	FY 2013	FY2012
MMI/CMHI	647	646
Total	**647**	**646**

Credit Reform Valuation Methodology

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

To apply the present value computations, FHA divides loans into cohorts and “risk” categories. Multifamily and Health Care cohorts are defined based on the year in which loan guarantee commitments are made. Single Family mortgages are grouped into cohorts based on loan endorsement dates for the GI/SRI and MMI fund. Within each cohort year, loans are subdivided into product groupings, which are referred to as risk categories in federal budget accounting. Each risk category has characteristics that distinguish it from others, including loan performance patterns, premium structure, and the type and quality of collateral underlying the loan. For activity related to fiscal years 1992-2008, the MMI Fund has one risk category and, for activity related to fiscal years 2009 and onward, the MMI Fund has two risk categories. That second category is for HECM loans, which joined the MMI Fund group of programs in 2009. The single family GI/SRI loans are grouped into four risk categories. There are 15 different multifamily risk categories and six health care categories.

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

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

- <u>Conditional Termination Rates:</u> 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.

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

- <u>Recovery Rates:</u> 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:

<u>Sources of data</u>: FHA developed assumptions for claim rates, prepayment rates, claim amounts, and recoveries based on historical data obtained from its internal business systems.

<u>Economic assumptions</u>: Independent forecasts of economic conditions are used in conjunction with loan-level data to generate Single Family, Multifamily, and Health Care claim and prepayment rates. 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.

<u>Actuarial Review</u>: 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 LLG calculation, both for forward and (post-2008) HECM loans.

<u>Reliance on historical performance</u>: 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 2013. Overall, FHA’s liability decreased significantly from the fiscal year 2012 estimates.

Mutual Mortgage Insurance (MMI) – On net, the MMI Fund LLG decreased from $42,652 million at the end of fiscal year 2012 to $31,010 million at the end of fiscal year 2013. This decrease is the result of many factors. There are, however, two primary factors at work this year in the forward-loan portfolio and two in the HECM (reverse mortgage) portfolio. First for forward loans are the updates to FHA’s mortgage insurance premium (MIP) schedule. Effective June 3, 2013, FHA eliminated the automatic cancellation of annual Mortgage Insurance Premiums (MIP) when loan balances reached 78 percent of the original property value. This policy addresses the risk still present in a loan guarantee even as the loan seasons, as FHA does pay claims on loan defaults throughout the entire life of each cohort. The second major factor affecting the portfolio LLG is a new policy requiring major loan servicers to facilitate Third Party Sale sales at foreclosure auctions in order to reduce reliance upon costly REO activities. HUD ran a limited pilot program in 2012 and then began national implementation in 2013.
The first factor affecting the HECM LLG calculation is that the discounting rates published by OMB. The new discounting factors are indicative of the historically-low interest rates. Lower interest rates increase the present value of future cash inflows and outflows. Second, this year’s house price forecast shows a stronger near term recovery than was predicted last year.

Premium revenues continue to reflect the impacts of five increases from April 2010 through June 2012. To address the decline in portfolio value indicated by the 2012 actuarial study and the President’s 2014 Budget, FHA raised forward-loan insurance premiums again in Fiscal Year 2013.

FHA continues to face delayed claim actions. This is a result from lender’s holding properties after foreclosure auctions to assure they have good title to transfer to HUD, and because of significant foreclosure process bottlenecks in so-called judicial States, where court approval is required to schedule foreclosure auctions. Those delays are addressed in the loan performance forecasts. This year, the MMI Fund LLG includes an assumption that 20,000 additional loans will go to conveyance claim in FY 2014, above those otherwise predicted by the forecasting models. While such adjustments in past years have resulted in over-predictions of near term claims, the adjustment number this year is much smaller than what was used in 2011 and 2012. In addition, HUD continues to pursue the clearing of long foreclosure queues through its Distressed Asset Sale Program. That, alone, could account for the 20,000 loans involved in the adjustment noted here.

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 $12,242 million at the end of FY 2012 to $10,796 million at the end of FY 2013. This liability is driven more by long term house price appreciation forecasts than short term forecasts. Although the short-term forecast used (Moody's Analytics, July 2013) is generally more favorable this year in the major states where HECM loans are most concentrated, namely, California, Texas, Florida and New York, the long-term trend is slightly less favorable in California, Texas and Florida. The HECM loans remaining in the GI/SRI fund also benefited from slower UPB (Unpaid Principal Balance) growth due to lower current and future (projected) interest rates for adjustable-rate mortgages. Over 99 percent 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 $24 billion. The Section 223(f) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(f) liability decreased this year by $240 million, from ($526) million to ($766) million, and principally due to lower prepayment expectations.

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 second largest multifamily program in the GI/SRI fund with an insurance-in-force of $11.6 billion. The Section 221(d)(4) liability decreased by $62 million this year, from $14 million to ($48) million. This was principally due to lower claim.

GI/SRI Section 232 Health Care New Construction - The Section 232 NC program provides mortgage insurance for construction or substantial rehabilitation of nursing homes and assisted-living facilities. FHA insures a maximum of 90 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 NC program has an insurance-in-force of $3.6 billion. The Section 232 NC liability decreased by $6.8 million from ($37.8) million in FY 2012 to ($44.6) million in FY 2013 due to a diminished insurance-in-force and decreased claim expectations.

GI/SRI Section 232 Health Care Purchasing or Refinancing - The Section 232 Refinance program provides mortgage insurance for two purposes: purchasing or refinancing of projects that do not need substantial rehabilitation, and installation of fire safety equipment for either private, for-profit businesses or non-profit associations. For existing projects, FHA insures a maximum of 85 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 Refinance program has an insurance-in-force of $19.2 billion. The Section 232 Refinance liability decreased by $279 million from ($258) million in FY 2012 to ($537) million in FY 2013 due to higher premium revenue caused by a significant decrease in prepayment expectations.

GI/SRI Section 242 Hospitals - The Section 242 Hospitals program provides mortgage insurance for the construction, substantial rehabilitation, or refinance of hospitals and/or the purchase of major hospital equipment to either private, for-profit businesses or non-profit associations. FHA insures a maximum of 90 percent of the estimated replacement cost of the hospital, including the installed equipment. The Section 242 program has an insurance-in-force of $8.9 billion. The Section 242 liability decreased by $33 million from ($216) million in FY 2012 to ($249) million in FY 2013 due to higher premium revenue caused by decreased 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, FHA is essentially providing some additional protection in its loss reserves against adverse outcomes. At the same time, booking an LLG based on a mean value results in a better than even chance future revisions will be in the downward direction. Comparisons of mean-value results to indicators of the range of possible outcomes from the Monte Carlo simulations for Single Family forward and HECM mortgages in the MMI LLG are shown in the table below. The representative outcomes shown there are for the inter-quartile range (25th and 75th percentiles), and a standard indicator of "tail" outcomes (95th percentile).

Range of LLG Values Found in Monte Carlo Simulations
(*all dollars in millions*)

Program Area	25th Percentile	Mean	75th Percentile	95th Percentile
MMI Fund				
Single-Family Forward Mortgages	$ 20,717	$ 28,432	$ 34,805	$ 45,666
Single Family Reverse Mortgages (HECM)	$ (878)	$ 2,578	$ 6,082	$ 13,949
Total	$ 19,839	$ 31,010	$ 40,887	$ 59,615

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 the FHA 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. Such a second opinion directly addresses potential model risk by seeing if 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 to 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 abilities 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 also is a source of LLG risk, as many of the FHA-insured projects benefit, in part, from periodic cash infusions from those entities. Risk also varies as does the quality of business management at each facility, and from the supply of medical care in each community relative to demand and the abilities of facility management to adapt to changing technologies and the competitive landscape. These are factors for which it is difficult to predict future trends.

Pre-Credit Reform Valuation Methodology

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

MMI Single Family LLR - For the single family portfolio, the remaining insurance-in-force for pre-credit reform loans is $2.9 billion. The aggregate liability for the remaining pre-credit reform loans in FY 2013 is $6 million, which is a $5 million decrease from the $11.5 million estimate in FY 2012.

GI/SRI Multifamily & Healthcare LLR - For the multifamily and healthcare portfolio, the remaining insurance-in-force for pre-credit reform loans is $846 million. The aggregate liability for the remaining pre-credit reform loans in FY 2013 is ($1.7) million, which is a $200 thousand decrease from the ($1.5) million estimate in FY 2012. The year-over-year decrease in aggregate liability is due to a $363 million decline in insurance-in-force.

GI/SRI Section 223(a)(7) - Section 223(a)(7) gives FHA authority to refinance FHA-insured loans. Under this program, the refinanced principal amount of the mortgage may be the lesser of the original amount of the existing mortgage or the remaining unpaid principal balance of the loan. Loans insured under any sections of the National Housing Act may be refinanced under 223(a)(7), including those already under 223(a)(7). The Section 223(a)(7) program has an insurance-in-force of $19.2billion. The Section 223(a)(7) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(a)(7) liability decreased this year by $169 million, from ($431) million to ($600) million, principally due higher premium revenue expectations resulting from decreased projected prepayment speeds.

Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2013 and 2012:

(Dollars in millions)

	FY 2013	FY2012
Intragovernmental:		
Advances to HUD for Working Capital Fund Expenses	$ 1	$ 3
Total	**$ 1**	**$ 3**
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	$ 47	$ 55
Deposits in Transit	332	5
Total	**$ 379**	**$ 60**

Advances to HUD for Working Capital Fund Expenses

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

Escrow Monies Deposited at Minority-Owned Banks

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

Deposits in Transit

A deposit 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. The majority of Deposits in Transit relates to accelerated claims disposition final asset sales that occurred the last week in September.

Note 8. Accounts Payable

Accounts Payable as of September 30, 2013 and 2012 are as follows:

(Dollars in millions)

	FY 2013	FY2012
Intragovernmental:		
Claims Payable to Ginnie Mae	$8	$6
Total	$8	$6

	FY 2013	FY2012
With the Public:		
Claims Payable	$188	$503
Premium Refunds Payable	143	143
Single Family Property Disposition Payable	49	42
Miscellaneous Payables	24	33
Total	**$404**	**$ 721**

Claims Payable

Claims payable represents the amount of claims that have been processed by FHA, but the disbursement of payment to lenders has not taken place at the end of the reporting period.

Premium Refunds

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

Single Family Property Disposition Payable

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

Miscellaneous Payables

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

Note 9. Debt

The following tables describe the composition of Debt held by FHA as of September 30, 2013 and 2012:

(Dollars in millions)

	FY2012			FY 2013	
	Beginning Balance	**Net Borrowing**	**Ending Balance**	**Net Borrowing**	**Ending Balance**
Agency Debt:					
Debentures Issued to Claimants	$ 10	$ (10)	$ -	$ -	$ -
Other Debt:					
Borrowings from U.S. Treasury	6,032	5,495	11,527	14,413	25,940
Total	**$ 6,042**	**$ 5,485**	**$ 11,527**	**$ 14,413**	**$ 25,940**

	FY 2013	FY2012
Classification of Debt:		
Intragovernmental Debt	$ 25,940	$ 11,527
Total	**$ 25,940**	**$ 11,527**

Debentures Issued to Public

The National Housing Act authorizes FHA, in certain cases, to issue debentures in lieu of cash to settle claims. FHA-issued debentures bear interest at rates established by the U.S. Treasury. There are no debentures outstanding as of September 30, 2013. Lenders may redeem FHA debentures prior to maturity in order to pay mortgage insurance premiums to FHA, or they may be called with the approval of the Secretary of the U.S. Treasury.

Borrowings from U.S. Treasury

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

During fiscal year 2013, FHA's U.S. Treasury borrowings carried interest rates ranging from 1.68 percent to 7.59 percent. In fiscal year 2012, they carried the same interest rates ranging from 1.68 percent to 7.39 percent. The maturity dates for these borrowings occur from September 2017 – September 2030. Loans may be repaid in whole or in part without penalty at any time prior to maturity.

Note 10. Other Liabilities

The following table describes the composition of Other Liabilities as of September 30, 2013 and 2012:

(Dollars in millions)

FY 2013		Current
Intragovernmental:		
Receipt Account Liability	$	3,983
Total	**$**	**3,983**
With the Public:		
Trust and Deposit Liabilities	$	100
Multifamily Notes Unearned Revenue		243
Miscellaneous Liabilities		81
Total	**$**	**424**

FY2012		Current
Intragovernmental:		
Receipt Account Liability	$	3,473
Total	**$**	**3,473**
With the Public:		
Trust and Deposit Liabilities	$	88
Multifamily Notes Unearned Revenue		234
Miscellaneous Liabilities		74
Total	**$**	**396**

Receipt Account Liability

The receipt account liability is created from negative credit subsidy from new endorsements, downward credit subsidy reestimates, loan modifications, and unobligated balances from the liquidating account 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 insurance, property taxes, and maintenance expenses on behalf of the borrowers. The earnest money becomes part of the sale proceeds or is returned to any unsuccessful bidders.

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 unearned premium revenue and may include loss contingencies that are recognized by FHA for past events that warrant a probable or likely future outflow of measurable economic resources.

Note 11. Commitments and Contingencies

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, 2013. As a result, no contingent liability has been recorded.

Related Party

As of September 30, 2013, 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 2013 (in millions)	FY 2012 (in millions)
Mortgages Held for Investment	$ 5,301	$ 6,210
Foreclosed Properties (Pre-Claim)	479	829
Short Sale Claims Receivable	44	15

Ginnie Mae may submit requests for foreclosure on short sale claim payments to FHA for some or all of these loans. The foreclosure properties represent post foreclosure FHA insured loans where properties have not yet been conveyed and the claims filled. Subject to all existing claim verification controls, FHA would pay such claims to Ginnie Mae 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, 2013 and 2012 are as follows:
(Dollars in millions)

September 30, 2013	Single Family Forward	HECM	Multifamily/ Healthcare	Administrative Expenses	Total
Intragovernmental:					
Interest Expense	$ 727	$ 53	$ 142	$ -	$ 922
Imputed Cost	-	-	-	18	18
Other Expenses	-	-	-	4	4
Total	**$ 727**	**$ 53**	**$ 142**	**$ 22**	**$ 944**
With the Public:					
Salary and Administrative Expense	$ -	$ -	$ -	$ 644	$ 644
Subsidy Expense	(17,069)	(366)	(922)	-	(18,357)
Re-estimate Expense	9,462	(636)	(407)	-	8,419
Interest Expense	758	(336)	(99)	(1)	322
Interest Accumulation Expense	985	770	(81)	-	1,674
Bad Debt Expense	(15)	-	(426)	-	(441)
Loan Loss Reserve	(5)	-	(4)	-	(9)
Other Expenses	44	3	12	28	87
Total	**$ (5,840)**	**$ (565)**	**$ (1,927)**	**$ 671**	**$ (7,661)**
Total Gross Costs	**$ (5,113)**	**$ (512)**	**$ (1,785)**	**$ 693**	**$ (6,717)**

September 30, 2012	Single Family Forward	HECM	Multifamily/ Healthcare	Administrative Expenses	Total
Intragovernmental:					
Interest Expense	$ 327	$ 51	$ 85	$ -	$ 464
Imputed Cost	-	-	-	15	15
Other Expenses	-	-	-	14	14
Total	**$ 327**	**$ 51**	**$ 85**	**$ 29**	**$ 492**
With the Public:					
Salary and Administrative Expense	$ -	$ -	$ -	$ 633	$ 633
Subsidy Expense	(5,379)	(200)	(397)	-	(5,976)
Re-estimate Expense	19,733	7,921	(494)	-	27,160
Interest Expense	-	-	1	(2)	(1)
Interest Accumulation Expense	1,048	427	(57)	-	1,417
Bad Debt Expense	(5)	1	(299)	-	(303)
Loan Loss Reserve	(7)	-	(10)	-	(17)
Other Expenses	65	11	12	29	117
Total	**$ 15,455**	**$ 8,160**	**$ (1,244)**	**$ 660**	**$ 23,031**
Total Gross Costs	**$ 15,782**	**$ 8,211**	**$ (1,159)**	**$ 689**	**$ 23,523**

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 the net of interest expense on borrowing and interest revenue in the financing accounts.

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 other than those relating to the H4H program.

Subsidy Expense

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

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, 2013 and 2012 are as follows:

(Dollars in millions)

September 30, 2013	Single Family Forward	HECM	Multifamily/ Healthcare	Total
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 1,712	$ 823	$ 62	$ 2,597
Interest Revenue from MMI/CMHI Investments	8	-	-	8
Total Intragovernmental	**$ 1,720**	**$ 823**	**$ 62**	**$ 2,605**
With the Public:				
Insurance Premium Revenue	$ -	$ -	$ 8	$ 8
Income from Notes and Properties	27	2	38	67
Other Revenue	1	-	-	1
Total With the Public	**$ 28**	**$ 2**	**$ 46**	**$ 76**
Total Earned Revenue	**$ 1,748**	**$ 825**	**$ 108**	**$ 2,681**

September 30, 2012	Single Family Forward	HECM	Multifamily/ Healthcare	Total
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 1,375	$ 478	$ 28	$ 1,881
Interest Revenue from MMI/CMHI Investments	117	-	-	$ 117
Gain on Sale of MMI/CMHI Investments	1,116	-	-	$ 1,116
Total Intragovernmental	**$ 2,608**	**$ 478**	**$ 28**	**$ 3,114**
With the Public:				
Insurance Premium Revenue	$ -	$ -	$ 9	$ 9
Income from Notes and Properties	34	1	47	$ 82
Other Revenue	16	4	1	$ 21
Total With the Public	**$ 50**	**$ 5**	**$ 57**	**$ 112**
Total Earned Revenue	**$ 2,658**	**$ 483**	**$ 85**	**$ 3,226**

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 and of escrow monies collected from borrowers in the GI/SRI liquidating accounts.

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

Gain on Sale of MMI/CMHI Investments

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

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 2013 were:

	Upfront Premium Rates
Single Family:	
10/01/2012 - 9/30/2013	1.75%
Multifamily	0.25%, 0.45%, 0.50%, 0.80% or 1.00%
HECM Standard	2.00% (Based on Maximum Claim Amount)
HECM Saver	0.01% (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 2013 were:

	Annual Periodic Premium Rates
Single Family:	
10/01/2012 - 3/31/2013	1.20%, 1.25% , 1.45% or 1.50%
4/1/2013 - 9/30/2013	1.30%, 1.35%, 1.50% or 1.55%
Multifamily	0.45%, 0.50%, 0.57% or 0.80%
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, 2013 and 2012 are as follows:

(Dollars in millions)

FY 2013	Cumulative Results of Operations	Unexpended Appropriations	Total
Budgetary Financing Sources:			
HUD	-	(68)	(68)
Transfers Out:			
HUD	550	-	550
Other Financing Sources:			
Treasury	$ (3,374)	$ -	$ (3,374)

FY2012	Cumulative Results of Operations	Unexpended Appropriations	Total
Budgetary Financing Sources:			
Treasury	$ (395)	$ -	$ (395)
HUD	-	(72)	(72)
Transfers Out:			
HUD	544	-	544
Other Financing Sources:			
Treasury	$ (1,025)	$ -	$ (1,025)

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, 2013 and 2012 are as follows:

(Dollars in millions)

FY 2013	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 464	$ -	$ -	$ -	$ -	$ 464
Working Capital and Contract Expenses	309	207	(39)	(111)	(68)	298
Reestimates	-	7,367	-	(7,367)	-	-
GI/SRI Liquidating	89	30	-	(12)	-	107
Total	**$ 862**	**$ 7,604**	**$ (39)**	**$ (7,490)**	**$ (68)**	**$ 869**

FY2012	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 465	$ -	$ -	$ (1)	$ -	$ 464
Working Capital and Contract Expenses	317	207	(24)	(119)	(72)	309
Reestimates	-	746	-	(746)	-	-
GI/SRI Liquidating	68	30	-	(9)	-	89
Total	**$ 850**	**$ 983**	**$ (24)**	**$ (875)**	**$ (72)**	**$ 862**

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 MMI/CMHI, 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 2012 have been reconciled to the fiscal year 2012 actual amounts included in the Program and Financing Schedules presented in the fiscal year 2014 Budget of the United States Government. There were no significant reconciling items. Information from the fiscal year 2013 Statement of Budgetary Resources will be presented in the fiscal year 2015 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2014 and will be available from the Government Printing Office and online at that time.

Obligated balances as of September 30, 2013 and 2012 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders	**FY 2013**	**FY2012**
MMI/CMHI	$ 1,870	$ 1,631
GI/SRI	436	403
H4H	-	1
EI	36	40
TI	2	3
Undelivered Orders Subtotal	**$ 2,344**	**$ 2,078**
Accounts Payable		
MMI/CMHI	$ 447	$ 613
GI/SRI	382	514
H4H	-	-
EI	-	-
TI	-	-
Accounts Payable Subtotal	**$ 829**	**$ 1,127**
Total	**$ 3,173**	**$ 3,205**

Note 18. Budgetary Resources - Collections

During fiscal year 2012, FHA collected funds received from the National Servicing Settlement with the Nation's five largest loan servicers, as well as settlements from lenders as a result of increased monitoring and enforcement actions.

The following table presents the composition of FHA's collections for the period ended September 30, 2013 and 2012:

(Dollars in Millions)

FY 2013	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 11,178	$ 842	$ 1	$ 12,021
Notes	2,253	601	1	2,855
Property	8,400	319	-	8,719
Interest Earned from U.S. Treasury	2,002	603	1	2,606
Subsidy	17,444	-	-	17,444
Reestimates	32,913	5,681	-	38,594
Collections from settlements	-	-	-	-
Other	43	13	1	57
Total	**$ 74,233**	**$ 8,059**	**$ 4**	**$ 82,296**

FY2012	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 8,827	$ 803	$ 1	$ 9,631
Notes	41	522	-	563
Property	6,656	322	-	6,978
Interest Earned from U.S. Treasury	2,747	405	1	3,153
Subsidy	5,582	1	-	5,583
Reestimates	19,523	746	-	20,269
Collections from settlements	1,119	-	-	1,119
Other	54	11	-	65
Total	**$ 44,549**	**$ 2,810**	**$ 2**	**$ 47,361**

Note 19. Budgetary Resources – Non-expenditure Transfers

The following table presents the composition of FHA's non-expenditure transfers for the period ended September 30, 2013 and 2012:

(Dollars in Millions)

FY 2013	MMI/CMHI	GI/SRI	H4H	EI	TI	Total
Transfers:						
Working Capital and Contract Expenses	$ (68)	$ -	$ -	$ -	$ -	$ (68)

(Dollars in Millions)

FY2012	MMI/CMHI	GI/SRI	H4H	EI		Total
Transfers						
Working Capital and Contract Expenses	$ (72)	$ -	$ -	$ -	$ -	$ (72)

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2013 and 2012:

(Dollars in Millions)

FY 2013	MMI/CMHI	GI/SRI	H4H	EI/TI	Total
Obligations					
Claims	$ 26,766	$ 2,596	$ 3	$ -	$ 29,365
Property Expenses	1,982	78	-	-	2,060
Interest on Borrowings	710	211	-	-	921
Subsidy	17,446	1,046	-	-	18,492
Downward Reestimates	5,241	529	-	-	5,770
Upward Reestimates	27,673	5,681	-	-	33,354
Admin, Contract and Working Capital	110	-	-	4	114
Other	12	87	-	-	99
Total	**$ 79,940**	**$ 10,228**	**$ 3**	**$ 4**	**$ 90,175**

FY2012	MMI/CMHI	GI/SRI	H4H	EI/TI	Total
Obligations					
Claims	$ 18,104	$ 2,196	$ 1	$ -	$ 20,301
Property Expenses	1,460	80	-	-	1,540
Interest on Borrowings	305	159	-	-	464
Subsidy	5,582	438	-	-	6,020
Downward Reestimates	5,655	2,216	-	-	7,871
Upward Reestimates	13,868	746	-	-	14,614
Admin, Contract and Working Capital	124	-	-	31	155
Other	1	109	-	-	110
Total	**$ 45,099**	**$ 5,944**	**$ 1**	**$ 31**	**$ 51,075**

Note 21. Reconciliation of Net Cost of Operations to Budget

This note (formerly the Statement of Financing) links the proprietary data to the budgetary data. Most transactions are recorded in both proprietary and budgetary accounts. However, because different accounting bases are used for budgetary and proprietary accounting, some transactions may appear in only one set of accounts. The Reconciliation of Net Cost of Operations to Budget is as follows for the period ended September 30, 2013 and 2012:

(Dollars in Millions)	FY 2013	FY 2012
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred - SBR	$ 90,175	$ 51,075
Spending Authority from Offsetting Collections and Recoveries - SBR	$ (82,297)	(47,490)
Offsetting Receipts - SBR	$ (1,442)	(2,611)
Transfers In / Out - NP	$ -	(25,267)
Imputed Financing from Costs Absorbed by Others	$ 18	15
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$ 6,454**	**$ (24,278)**
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS		
Undelivered Orders and Adjustments	$ (266)	$ (154)
Revenue and Other Resources	81,088	46,767
Purchase of Assets	(55,840)	(10,261)
Resources for prior year Re-estimate	(33,354)	(14,614)
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	**$ (8,372)**	**$ 21,738**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$ (1,918)**	**$ (2,540)**
COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Upward Re-estimate of Credit Subsidy Expense	$ 14,777	$ 31,423
Downward Re-estimate of Credit Subsidy Expense	(6,035)	(4,260)
Changes in Loan Loss Reserve Expense	(3)	(3)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	(440)	(303)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(18,358)	(5,977)
Gains or Losses on Sales of Credit Program Assets	19	31
Other	2,560	1,926
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$ (7,480)**	**$ 22,837**
NET COST (SURPLUS) OF OPERATIONS	**$ (9,398)**	**$ 20,297**

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intragovernmental assets, by federal entity, are as follows on September 30, 2013 and 2012:

(Dollars in Millions)

FY 2013	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	$ 63,481	$ 3	$ -	$ -	$ 63,484
HUD	-	-	-	1	1
Total	**$ 63,481**	**$ 3**	**$ -**	**$ 1**	**$ 63,485**

FY2012	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	$ 47,640	$ 2,775	$ -	$ -	$ 50,415
HUD	-	-	-	3	3
Total	**$ 47,640**	**$ 2,775**	**$ -**	**$ 3**	**$ 50,418**

Schedule B: Intragovernmental Liabilities

FHA's Intragovernmental liabilities, by federal entity, are as follows on September 30, 2013 and 2012:

(Dollars in Millions)

FY 2013	Accounts Payable	Borrowings from U.S. Treasury	Other Liabilities	Total
U.S. Treasury	$ -	$ 25,940	$ 3,983	$ 29,923
HUD	8	-	-	8
Total	**$ 8**	**$ 25,940**	**$ 3,983**	**$ 29,931**

FY2012	Accounts Payable	Borrowings from U.S. Treasury	Other Liabilities	Total
U.S. Treasury	$ -	$ 11,527	$ 3,473	$ 15,000
HUD	6	-	-	6
Total	**$ 6**	**$ 11,527**	**$ 3,473**	**$ 15,006**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2013:

	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 3,309	$ 72	$ 41	$ 652	$ 4,074
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	1	-	-	1
Unobligated balance brought forward, October 1, as adjusted	3,309	74	41	651	4,075
Recoveries of prior year unpaid obligations	-	11	3	73	87
Other changes in unobligated balance (+ or -)	(3,309)	3,285	(20)	(164)	(208)
Unobligated balance from prior year budget authority, net	-	3,370	23	561	3,954
Appropriations (discretionary and mandatory)	-	1,814	5,681	30	7,525
Borrowing authority (discretionary and mandatory)	-	-	-	1	1
Contract authority (discretionary and mandatory)	-	-	-	-	-
Spending authority from offsetting collections (discretionary and mandatory)	2	22,694	-	226	22,922
Total budgetary resources	**$ 2**	**$ 27,878**	**$ 5,704**	**$ 818**	**$ 34,402**
Status of Budgetary Resources:					
Obligations incurred	-	27,783	5,681	100	33,564
Unobligated balance, end of year:					
Apportioned	-	34	16	27	77
Exempt from apportionment	-	-	-	-	-
Unapportioned	2	61	7	691	761
Total unobligated balance, end of year	2	95	23	718	838
Total budgetary resources	**$ 2**	**$ 27,878**	**$ 5,704**	**$ 818**	**$ 34,402**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	157	8	567	732
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(1)	-	-	1	-
Obligated balance, start of year (net), before adjustments (+ or -)	(1)	157	8	568	732
Adjustment to obligated balance, start of year (net) (+ or -)	-	(1)	-	-	(1)
Obligated balance, start of year (net), as adjusted	(1)	155	8	569	731
Obligations incurred	-	27,783	5,681	100	33,564
Outlays (gross) (-)	-	(27,780)	(5,682)	(112)	(33,574)
Change in uncollected customer payments from Federal sources (+ or -)	(1)	-	-	-	(1)
Actual transfers, unpaid obligations (net) (+ or -)	-	-	-	-	-
Actual transfers, uncollected customer payments from Federal sources (net) (+ or -)	-	-	-	-	-
Recoveries of prior year unpaid obligations (-)	-	(11)	(3)	(73)	(87)
Unpaid obligations, end of year (gross)	-	147	4	483	634
Uncollected customer payments from Federal sources, end of year	(2)	-	-	(1)	(3)
Obligated balance, end of year (net)	**$ (2)**	**$ 147**	**$ 4**	**$ 482**	**$ 631**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	2	24,508	5,681	257	30,448
Actual offsetting collections (discretionary and mandatory) (-)	(22,695)	-	-	(226)	(22,921)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(1)	-	-	-	(1)
Anticipated offsetting collections (discretionary and mandatory) (+ or -)	-	-	-	-	-
Budget authority, net (discretionary and mandatory)	(22,694)	24,508	5,681	31	7,526
Outlays, gross (discretionary and mandatory)	-	27,780	5,682	112	33,574
Actual offsetting collections (discretionary and mandatory) (-)	(22,695)	-	-	(226)	(22,921)
Outlays, net (discretionary and mandatory)	(22,695)	27,780	5,682	(114)	10,653
Distributed offsetting receipts (-)	-	-	-	1,442	1,442
Agency outlays, net (discretionary and mandatory)	**$ (22,695)**	**$ 27,780**	**$ 5,682**	**$ 1,328**	**$ 12,095**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2012:

	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 4,685	$ 58	$ 51	$ 771	$ 5,565
Unobligated balance brought forward, October 1, as adjusted	4,685	58	51	771	5,565
Recoveries of prior year unpaid obligations	-	10	6	10	26
Other changes in unobligated balance (+ or -)	(4,685)	4,677	(16)	(252)	(276)
Unobligated balance from prior year budget authority, net	-	4,744	41	530	5,315
Appropriations (discretionary and mandatory)	-	135	746	31	912
Spending authority from offsetting collections (discretionary and mandatory)	3,309	9,185	-	243	12,737
Total budgetary resources	**$ 3,309**	**$ 14,064**	**$ 787**	**$ 804**	**$ 18,964**
Status of Budgetary Resources:					
Obligations incurred	-	13,991	746	153	14,890
Unobligated balance, end of year:					
Apportioned	-	-	16	43	59
Unapportioned	3,309	72	25	609	4,015
Total unobligated balance, end of year	3,309	73	41	651	4,074
Total budgetary resources	**$ 3,309**	**$ 14,064**	**$ 787**	**$ 804**	**$ 18,964**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	145	16	576	737
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(19)	-	-	(1)	(20)
Obligated balance, start of year (net), before adjustments (+ or -)	(19)	145	16	575	717
Adjustment to obligated balance, start of year (net) (+ or -)	-	-	-	-	-
Obligated balance, start of year (net), as adjusted	(19)	145	16	575	717
Obligations incurred	-	13,991	746	153	14,890
Outlays (gross) (-)	-	(13,970)	(749)	(149)	(14,868)
Change in uncollected customer payments from Federal sources (+ or -)	18	-	-	-	18
Recoveries of prior year unpaid obligations (-)	-	(10)	(6)	(10)	(26)
Unpaid obligations, end of year (gross)	-	157	8	568	733
Uncollected customer payments from Federal sources, end of year	(1)	-	-	(1)	(2)
Obligated balance, end of year (net)	**$ (1)**	**$ 157**	**$ 8**	**$ 567**	**$ 731**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	3,309	9,320	746	274	13,649
Actual offsetting collections (discretionary and mandatory) (-)	(12,510)	-	-	(256)	(12,766)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	18	-	-	-	18
Budget authority, net (discretionary and mandatory)	(9,183)	9,319	746	19	901
Outlays, gross (discretionary and mandatory)	-	13,970	749	149	14,868
Actual offsetting collections (discretionary and mandatory) (-)	(12,510)	-	-	(256)	(12,766)
Outlays, net (discretionary and mandatory)	(12,510)	13,969	749	(106)	2,102
Distributed offsetting receipts (-)	-	-	-	2,611	2,611
Agency outlays, net (discretionary and mandatory)	**$ (12,510)**	**$ 13,969**	**$ 749**	**$ 2,505**	**$ 4,713**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2013:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 33,167	$ 7,082	$ 26	$ 40,275
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	-	-	-
Unobligated balance brought forward, October 1, as adjusted	33,167	7,082	26	40,275
Recoveries of prior year unpaid obligations	381	23	-	404
Other changes in unobligated balance (+ or -)	-	-	-	-
Unobligated balance from prior year budget authority, net	33,548	7,105	25	40,678
Appropriations (discretionary and mandatory)	-	-	-	-
Borrowing authority (discretionary and mandatory)	17,603	1,488	1	19,092
Contract authority (discretionary and mandatory)	-	-	-	-
Spending authority from offsetting collections (discretionary and mandatory)	47,304	7,389	3	54,696
Total budgetary resources	**$ 98,455**	**$ 15,982**	**$ 29**	**$ 114,466**
Status of Budgetary Resources:				
Obligations incurred	52,121	4,487	3	56,611
Unobligated balance, end of year:				
Apportioned	22,797	2,187	15	24,999
Exempt from apportionment	-	-	-	-
Unapportioned	23,537	9,308	11	32,856
Total unobligated balance, end of year	46,334	11,495	26	57,855
Total budgetary resources	**$ 98,455**	**$ 15,982**	**$ 29**	**$ 114,466**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	1,931	541	-	2,472
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	-	-	-	-
Obligated balance, start of year (net), before adjustments (+ or -)	1,931	541	-	2,472
Adjustment to obligated balance, start of year (net) (+ or -)	-	-	-	-
Obligated balance, start of year (net), as adjusted	1,931	541	-	2,472
Obligations incurred	52,121	4,487	3	56,611
Outlays (gross) (-)	(51,651)	(4,486)	(4)	(56,141)
Change in uncollected customer payments from Federal sources (+ or -)	-	-	-	-
Actual transfers, unpaid obligations (net) (+ or -)	-	-	-	-
Actual transfers, uncollected customer payments from Federal sources (net) (+ or -)	-	-	-	-
Recoveries of prior year unpaid obligations (-)	(381)	(23)	-	(404)
Unpaid obligations, end of year (gross)	2,019	520	-	2,539
Uncollected customer payments from Federal sources, end of year	-	-	-	-
Obligated balance, end of year (net)	**$ 2,019**	**$ 520**	**$ -**	**$ 2,539**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	64,907	8,877	4	73,788
Actual offsetting collections (discretionary and mandatory) (-)	(51,514)	(7,859)	(2)	(59,375)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	-	-	-	-
Anticipated offsetting collections (discretionary and mandatory) (+ or -)	-	-	-	-
Budget authority, net (discretionary and mandatory)	13,393	1,019	1	14,413
Outlays, gross (discretionary and mandatory)	51,651	4,486	4	56,141
Actual offsetting collections (discretionary and mandatory) (-)	(51,514)	(7,859)	(2)	(59,375)
Outlays, net (discretionary and mandatory)	138	(3,373)	1	(3,234)
Distributed offsetting receipts (-)	-	-	-	-
Agency outlays, net (discretionary and mandatory)	**$ 138**	**$ (3,373)**	**$ 1**	**$ (3,234)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2012:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 27,044	$ 9,181	$ 24	$ 36,249
Unobligated balance brought forward, October 1, as adjusted	27,044	9,181	24	36,249
Recoveries of prior year unpaid obligations	103	19	-	122
Unobligated balance from prior year budget authority, net	27,147	9,199	25	36,371
Borrowing authority (discretionary and mandatory)	5,200	560	-	5,760
Spending authority from offsetting collections (discretionary and mandatory)	31,887	2,440	2	34,329
Total budgetary resources	**$ 64,234**	**$ 12,199**	**$ 27**	**$ 76,460**
Status of Budgetary Resources:				
Obligations incurred	31,067	5,117	1	36,185
Unobligated balance, end of year:				
Apportioned	17,169	1,167	10	18,346
Unapportioned	15,998	5,915	16	21,929
Total unobligated balance, end of year	33,167	7,082	26	40,275
Total budgetary resources	**$ 64,234**	**$ 12,199**	**$ 27**	**$ 76,460**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	2,007	313	-	2,320
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	-	(1)	-	(1)
Obligated balance, start of year (net), before adjustments (+ or -)	2,007	312	-	2,319
Adjustment to obligated balance, start of year (net) (+ or -)	-	-	-	-
Obligated balance, start of year (net), as adjusted	2,007	312	-	2,319
Obligations incurred	31,067	5,117	1	36,185
Outlays (gross) (-)	(31,041)	(4,870)	-	(35,911)
Change in uncollected customer payments from Federal sources (+ or -)	-	1	-	1
Recoveries of prior year unpaid obligations (-)	(103)	(19)	-	(122)
Unpaid obligations, end of year (gross)	1,931	541	-	2,472
Obligated balance, end of year (net)	**$ 1,931**	**$ 541**	**$ -**	**$ 2,472**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	37,087	3,000	2	40,089
Actual offsetting collections (discretionary and mandatory) (-)	(32,017)	(2,575)	(3)	(34,595)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	-	1	-	1
Budget authority, net (discretionary and mandatory)	5,070	425	-	5,495
Outlays, gross (discretionary and mandatory)	31,041	4,870	-	35,911
Actual offsetting collections (discretionary and mandatory) (-)	(32,017)	(2,575)	(3)	(34,595)
Outlays, net (discretionary and mandatory)	(976)	2,294	(2)	1,316
Agency outlays, net (discretionary and mandatory)	**$ (976)**	**$ 2,294**	**$ (2)**	**$ 1,316**

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.

SCHEDULE OF SPENDING
As of September 30, 2013
In millions

	FY 2013	FY 2012
What Money is Available to spend?		
Total Resources	$148,867	$95,423
Less Amount Available but Not Agreed to be Spent	$25,075	$18,404
Less Amount Not Available to be Spent	$33,617	$25,944
Total Amounts Agreed to be Spent	**$90,175**	**$51,075**
How was the Money Spent?		
Category*		
Claims	$29,656	$20,270
Property Expenses	$1,414	$1,341
Interest on Borrowings	$921	$464
Subsidy	$18,358	$5,978
Downward Reestimates	$5,770	$7,872
Upward Reestimates	$33,354	$14,614
Admin, Contract and Working Capital	$116	$116
Other	$126	$125
Total Spending	$89,714	$50,780
Amounts Remaining to be Spent	$461	$295
Total Amounts Agreed to be Spent	**$90,175**	**$51,075**
Who did the Money go to?		
For Profit	$31,772	$22,147
Government	$58,403	$28,928
Total Amounts Agreed to be Spent	**$90,175**	**$51,075**
How Was the Money Issued?		
Claims	$29,365	$20,301
Property Expenses	$2,060	$1,539
Interest on Borrowings	$921	$464
Subsidy	$18,491	$6,019
Downward Reestimates	$5,770	$7,872
Upward Reestimates	$33,354	$14,614
Admin, Contract and Working Capital	$114	$155
Other	$100	$111
Total on How Money Was Issued	**$90,175**	**$51,075**

AUDITOR'S REPORT

This report was issued separately in December 2013 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2013 and 2012" (2014-FO-0002). The report is available at HUD, OIG's internet site at: http://www.hudoig.gov/pdf/Internal/2014/ig12f0002.pdf

Issue Date: December 13, 2013

Audit Report Number: 2014-FO-0002

TO: Carol Galante, Acting Assistant Secretary for Housing – FHA Commissioner, H

/s/

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

SUBJECT: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2013 and 2012

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of CliftonLarsonAllen LLP (CLA) to audit the fiscal year 2013 financial statements of the Federal Housing Administration (FHA). The contract required that the audit be performed according to Generally Accepted Government Auditing Standards (GAGAS).

In connection with the contract, we reviewed CLA's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with U.S. GAGAS, was not intended to enable us to express, and we do not express, opinions on FHA's financial statements or internal controls or conclusions on compliance with laws and regulations. CLA is responsible for the attached Independent Auditors' Report dated December 9, 2013 and the conclusions expressed in the report. Our review disclosed no instances where CLA did not comply, in all material respects, with U.S. GAGAS.

This report includes both the Independent Auditors' Report and FHA's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information (RSI) a section devoted to Management's Discussion and Analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. FHA plans to separately publish an annual report for fiscal year 2013 that conforms to FASAB standards.

The report contains two significant deficiencies in FHA's internal control over financial reporting and one instance of reportable non-compliance with laws and regulations. The report contains 11 new recommendations. Within 120 days of the report issue date, FHA is required to provide its final management decision which includes the corrective action plan for each recommendation. As part of the audit resolution process, we will record 11 new recommendation(s) in the Department's Audit Resolution and Corrective Action Tracking system (ARCATS). We will also endeavor to work with FHA to reach a mutually acceptable management decision prior to the mandated deadline. The proposed management decision and corrective action plans will be reviewed and evaluated for OIG concurrence.

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.

Within 60 days of this report, CLA expects to issue a separate letter to management dated December 9, 2013 regarding other matters that came to its attention during the audit.

We appreciate the courtesies and cooperation extended to the CLA and OIG audit staff during the conduct of the audit. If you have any questions or comments about this report, please do not hesitate to call me at 202-402-8216.

December 13, 2013

Federal Housing Administration
Fiscal Years 2013 and 2012
Financial Statements Audit

Highlights

Audit Report 2014-FO-0002

What CLA Audited and Why

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), HUD OIG engaged CliftonLarsonAllen LLP (CLA) to audit the fiscal years 2013 and 2012 financial statements of FHA. CLA have audited the accompanying balance sheets of FHA as of September 30, 2013 and 2012, and the related statements of net cost and changes in net position, and the combined statements of budgetary resources ("financial statements") for the years then ended.

What We Recommend

HUD needs to close-out and deobligate $43 million in expired contracts; implement HUD Handbook 1830.2, *Administrative Control of Funds*, and annually review undelivered orders; record obligations and de-obligations for SAMS contracts and reconcile the procurement system, the source system, and the general ledger; deobligate $57 million from the general ledger; review and assess policies and procedures on closing agent contract invoices; perform and review reconciliations of the HIAMS and SAMS systems; assess periodic reconciliations for sufficiency and frequency to identify potential problems; ensure procedures over data integrity in place and being followed; and ensure policies and procedures to implement new systems that affect the general ledger sufficient.

What We Found

CLA found (1) the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America (U.S.); (2) two significant deficiencies in internal control over financial reporting and compliance with laws and regulations; and (3) one instance of reportable noncompliance with selected provisions of laws and regulations tested.

CliftonLarsonAllen

CliftonLarsonAllen LLP

www.cliftonlarsonallen.com

INDEPENDENT AUDITORS' REPORT

Inspector General
United States Department of Housing and Urban Development

Commissioner
Federal Housing Administration

In our audit of the fiscal years (FY) 2013 and 2012 financial statements of the Federal Housing Administration (FHA), a component of the U.S. Department of Housing and Urban Development, we found:

- The financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America (U.S.);
- Two significant deficiencies in internal control over financial reporting; and
- One instance of reportable noncompliance with certain provisions of laws and regulations tested.

The following sections and Exhibits discuss in more detail: (1) these conclusions including a matter of emphasis related to the potential range of estimate for the Single Family Liability for Loan Guarantee, (2) Management's Discussion and Analysis (MD&A), other required supplementary information (RSI), and other information included with the financial statements, (3) management's responsibilities, (4) our responsibilities, (5) management's response to findings, and (3) the current status of prior year findings.

Report on the Financial Statements

We have audited the accompanying financial statements of FHA, which comprise the balance sheets as of September 30, 2013 and 2012, 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. The objective of our audits was to express an opinion on the fairness of these financial statements.

Management's Responsibilities

FHA management is responsible for the (1) preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the U.S., (2) preparation, measurement, and presentation of the RSI in accordance with the prescribed accounting principles generally accepted in the U.S., (3) preparation and presentation of other information in documents containing the audited financial statements and auditors' report, and consistency of that information with the audited financial statements and the RSI; and (4) design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibilities

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the U.S.; and the standards applicable to financial audits contained in *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. 14-02*, Audit Requirements for Federal Financial Statements* (OMB Bulletin 14-02).

In order to fulfill these responsibilities, we (1) obtained an understanding of FHA and its operations, including its internal control over financial reporting; (2) assessed the risk of financial statement misstatement; (3) evaluated the design and operating effectiveness of internal control based on the assessed risk; (4) considered FHA's process for evaluating and reporting on internal control under the Federal Managers' Financial Improvement Act (FMFIA); (5) tested compliance with certain provisions of laws and regulations (6) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (7) evaluated the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management; (8) evaluated the overall presentation of the financial statements; (9) conducted inquiries of management about the methods of preparing the RSI and compared this information for consistency with management's responses to the auditors' inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from Federal Accounting Standards Advisory Board (FASAB) guidelines, if any, identified by these limited procedures; (10) read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements; and (11) performed such other procedures as we considered necessary in the circumstances.

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

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Housing Administration as of September 30, 2013 and 2012, and its net costs, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the U.S.

Emphasis of Matter

As discussed in Note 6 to the financial statements, the Loan Guarantee Liability (LGL) 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 numerous economic scenarios. This stochastic analysis projects a 25% probability that the Single Family Liability for Loan Guarantee may be lower by $10.2 billion or higher by $9.8 billion, depending on which economic outcome ultimately 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 contain technical errors.

Other Matters

Required Supplementary Information
Accounting principles generally accepted in the U.S. require that FHA's Management Discussion and Analysis (MD&A) and other RSI be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by FASAB, who 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 MD&A and other RSI in accordance with auditing standards generally accepted in the U.S., 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 any assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information
The Message from the Commissioner and the Schedule of Spending are presented for purposes of 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 any assurance on it.

Report on Internal Control over Financial Reporting and on 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 (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of FHA's internal control. Accordingly, we do not express an opinion on 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that were not identified. We identified two deficiencies in internal control, described below and in Exhibit A, that we consider to be significant deficiencies.

<u>Undelivered Orders for Property-Related Contracts Should Be Reviewed Annually and De-obligated Promptly</u>

Undelivered orders (UDOs) are outstanding orders for goods or services where budgeted amounts are obligated but no liability has been accrued because the goods or services have not yet been received. When the goods or services remain undelivered and remaining unspent funds are no longer needed, the contracts should be closed out and the UDOs de-obligated.

We found:

- Open obligations for real estate closing agent contracts obligated between 2002 and 2011 that showed:
    - FHA disbursed over $1 million in excess of the obligated amounts for ten contracts.
    - Approximately $43 million of remaining funds for contracts that had expired during FY2009 through FY2012 but had not been closed and the remaining funds de-obligated.

- In 2012, de-obligations for $57 million related to two marketing and management contracts were recorded in HUD's procurement system but these de-obligations were not reflected in the SAMS system.

If open contracts are not reviewed and closed timely, the obligated balances carried forward may be overstated. In addition, inaccurate contract information may lead to Anti-Deficiency Act violations.

<u>New System Reporting and Reconciliation Capabilities Need Improvement</u>

In FY2013, FHA transitioned to a new system (HERMIT) for managing insured and assigned Home Equity Conversion Mortgage (HECM) loans. During our audit, we identified several discrepancies between the reports generated from the new system and reports from the general ledger and other source systems that could not be adequately explained during the reconciliation process. Specifically, the third quarter general ledger trial balance showed:

1. HECM upfront and periodic premiums of $12 million in excess of the HERMIT transaction files.
2. Paid claims resulting in the assignment of HECM mortgage notes of $54 million less than HERMIT.
3. HECM claims paid of $44 million more than HERMIT.

In addition, we found a $88 million difference in the maximum claim amount (essentially the insurance-in-force) in FHA's endorsement system versus HERMIT.

These differences raise concerns about the completeness and accuracy of the data in the HERMIT system and about the movement of data among various source systems (HERMIT, CHUMS, SFDW) and the general ledger. Failure to ensure data completeness and accuracy among source systems, management information systems, and the general ledger exposes the agency to several risks:

- Inaccuracies in the financial statements
- Faulty information in management reports
- Wasted time needed to reconcile data when differences persist over longer periods

Report on Compliance

As part of obtaining reasonable assurance about whether FHA's financial statements are 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 the determination of 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 or other matters, described below that is required to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

<u>Capital Ratio:</u> The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's Mutual Mortgage Insurance (MMI) Fund maintain a minimum level of capital sufficient to withstand a moderate recession. This capital requirement, termed the Capital Ratio, is defined as capital resources (assets minus current liabilities) less the liability for future claim costs (net of future premiums and recoveries), divided by the value of amortized insurance-in-force. The Act requires FHA to maintain a minimum Capital Ratio of two percent and conduct an annual independent actuarial study to, among other things, calculate this ratio. The Housing and Economic Recovery Act of 2008 requires that the Secretary submit a report annually to the Congress describing the results of the study, assess the financial status of the MMI Fund, recommend program adjustments, and to evaluate the quality control procedures and accuracy of information used in the process of underwriting loans guaranteed by the MMI Fund. As of the date of our audit, this report for FY2013 had not yet been submitted to Congress, but preliminary FHA data indicated that this ratio remained below the required two percent throughout FY2013.

Management's Responsibility for Internal Control and Compliance

Management is 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 to provide reasonable assurance that the broad control objectives of FMFIA are met, and (3) ensuring compliance with other applicable laws and regulations.

Auditors' Responsibilities

We are 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 14-02 requires testing, and (3) applying certain limited procedures with respect to the 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 the 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, losses, or noncompliance may nevertheless 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 14-02 that we deemed applicable to FHA's financial statements for the fiscal year ended September 30, 2013. 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.

Management's Response to Findings

Management's response to the findings identified in our report is presented in Exhibit B. We did not audit FHA's response and, accordingly, we express no opinion on it.

Status of Prior Year's Control Deficiencies and Noncompliance Issues

We have reviewed the status of FHA's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated October 29, 2012. The status of prior year findings is presented in Exhibit C.

INDEPENDENT AUDITORS' REPORT (Continued)

Purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance

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 on 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.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP
Arlington, VA
December 9, 2013

EXHIBIT A
Significant Deficiencies

Undelivered Orders for Property-Related Contracts Should Be Reviewed Annually and De-obligated Promptly

Undelivered orders (UDOs) are outstanding orders for goods or services where budgeted amounts are obligated but no liability has been accrued because the goods or services have not yet been received. UDOs are reported within the annual financial statements as obligated balances carried forward on the Statement of Budgetary Resources. When the goods or services remain undelivered and remaining unspent funds are no longer needed, the contracts should be closed out and the UDOs de-obligated.

The Single Family Acquired Asset Management System (SAMS) is used to manage and account for HUD-owned properties. The status of closing agent and other property-related contracts is tracked in SAMS. Prior to FY2010, disbursements related to these contracts were expensed, and there was no UDO tracking and limited funds control. In FY2010, FHA established a process to record obligations and UDOs relating to these contracts in the general ledger.

Our testing of UDOs revealed the following:

- Open obligations for SAMS closing agent contracts obligated between 2002 and 2011 that showed:
  - FHA disbursed over $1 million in excess of the obligated amounts for seven contracts.
  - Approximately $43 million of remaining funds for contracts that had expired during FY2009 through FY2012 but had not been closed and the remaining funds de-obligated.

- In 2012, de-obligations for $57 million related to two marketing and management contracts were recorded in HUD's procurement system but these de-obligations were not reflected in the SAMS system.

HUD's Administrative Control of Funds Policies and Procedures Handbook No. 1830.2 Rev-5, *Administrative Control of Funds*, requires that the Office of Chief Financial Officer (OCFO) to coordinate a review of obligations whose status has not changed for six months and evaluate the validity of the contracts along with the allotment holders annually as of May 31. Based on that review, the budgeted amounts should be de-obligated or kept in an active status. Furthermore, GAO's *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1, states that *"Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded."*

Annually, the FHA Comptroller's Office reviews the general ledger for contracts with unliquidated obligated balances and then sends a request for follow up on open contracts to the operational areas. Based on feedback from the operational areas, contracts are de-obligated. However, we did not identify any written FHA policies and procedures that provide detailed guidance for FHA's implementation of HUD's annual review of UDOs and obligations. FHA overlooked performing an UDO review on the closing agent contracts since it was a new undelivered order type.

EXHIBIT A
Significant Deficiencies

In early FY2012, the HUD Integrated Acquisition Management System (HIAMS) became the procurement system for Housing. The limited reporting capabilities of this new system made reconciliations between SAMS and HIAMS more difficult. In FY2013, a new interface was developed which may improve the reconciliation process.

If open contracts are not reviewed and closed timely, the obligated balances carried forward may be overstated. In addition, inaccurate contract information may lead to Anti-Deficiency Act violations.

We recommend the FHA Comptroller work with the HUD Office of the Chief Procurement Officer to:

1a. Ensure that all expired property-related contracts are reviewed and properly closed out.

We recommend that the FHA Comptroller:

1b. Ensure HUD Handbook 1830.2, *Administrative Control of Funds*, policies and procedures are fully implemented for property-related contracts, and perform an annual review of all property-related undelivered orders to ensure obligations are still valid.

1c. Review and de-obligate, as appropriate, the $43 million in expired property-related contracts once they have been closed out by the contracts office.

1d. Ensure that obligations and de-obligations for SAMS contracts are recorded and promptly reconciled among the procurement system, the source system and the general ledger.

1e. Research and, as necessary, de-obligate any portion of the $57 million identified as de-obligated in the procurement system but not in SAMS.

1f. Review and assess existing current policies and procedures with regard to the review and approval of SAMS closing agent contract invoices to ensure adequate funding is available.

1g. Perform and review reconciliations between the HIAMS and SAMS systems to ensure the interface between the two systems is operating effectively.

EXHIBIT A
Significant Deficiencies

New System Reporting and Reconciliation Capabilities Need Improvement

In FY2013, FHA transitioned to a new system (HERMIT) for managing insured and assigned Home Equity Conversion Mortgage (HECM) loans. During our audit, we identified several discrepancies between the reports generated from the new system and reports from the general ledger and other source systems. Specifically,

1. The third quarter general ledger trial balance showed HECM upfront and periodic premiums of $659 million for the nine-month period, whereas the transaction files from HERMIT showed $647 million, for a difference of $12 million.

2. The third quarter general ledger trial balance showed paid claims resulting in the assignment of HECM mortgage notes of $966 million for the nine-month period, whereas the HERMIT file showed $1,020 million, for a difference of $54 million.

3. The CHUMS system records the insurance endorsements of HECM mortgages and is a source system for HERMIT. We found that the maximum claim amount (essentially the insurance-in-force) in CHUMS was $10,728 million versus HERMIT's $10,640 million, for a difference of $88 million.

4. The Single Family Data Warehouse (SFDW), which receives data from HERMIT, was the source for the all HECM claims paid of $1,729 million for the nine-month period. That amount compared to the third quarter general ledger trial balance amount of $1,773 million showed a difference of $44 million.

These differences raise concerns about the completeness and accuracy of the data in the HERMIT system and about the movement of data among source systems (HERMIT, CHUMS, SFDW) and the general ledger. Furthermore, they indicate a weakness in internal controls because according to GAO's *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 "Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded."

We worked with management and they were able to explain portions of the differences we identified. However, we were unable to determine whether the remaining differences were caused by timing differences among files or reports, interface issues among systems, conversion problems with HERMIT data, or any combination of these causes. The fact that such questions remain after nine months of experience with the HERMIT system indicates that there were weaknesses in the reconciliation of data among the related systems.

Failure to ensure data completeness and accuracy among source systems, management information systems, and the general ledger exposes the agency to several risks:

- Inaccuracies in the financial statements
- Faulty information in management reports
- Wasted time needed to reconcile data when differences persist over longer periods

EXHIBIT A
Significant Deficiencies

We recommend that the FHA Comptroller:

2a. Complete the reconciliation of the identified differences to determine the causes of those differences.

2b. Determine whether the existing periodic reconciliations are sufficient and frequent enough to identify potential problems.

2c. Consider whether the policies and procedures over data integrity are in place and being followed.

2d. Consider whether the policies and procedures over the implementation of new systems that affect the general ledger are sufficient to ensure that the data in the new system is complete and accurate, and that the system properly interfaces with any related systems.

EXHIBIT B
Management's Response

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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

NOV 22 2013

MEMORANDUM FOR: CliftonLarsonAllen LLP

FROM: Monica Clarke, Acting Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to Fiscal Year 2013 FHA Audit Report

Thank you for providing us the opportunity to respond to FHA's Independent Audit Report.

FHA is pleased that CliftonLarsonAllen LLP has recognized our progress and efforts made to resolve the prior year finding relating to mitigating persistent IT control deficiencies. FHA will continue to work to improve and address the new concerns identified.

Report on Internal Control – Significant Deficiencies

1. Undelivered Orders Should Be Reviewed Annually and De-obligated Promptly.

FHA recognizes the need to improve its processes over reviewing undelivered orders to determine if funds can be de-obligated. In addition, FHA agrees that reconciliation processes can be improved between the procurement system and the source systems, specifically the Single Family Acquired Asset Management System (SAMS). In early FY 2012, HUD Integrated Acquisition Management System (HIAMS) became the procurement system for FHA. Reconciliations between SAMS and the procurement system became challenging due to limited reporting capabilities in HIAMS. In FY 2013, an interface between HIAMS and SAMS was implemented. The new interface should improve controls and the timeliness of recording obligations and de-obligations in SAMS in the future.

FHA concurs with the auditors recommendations.

2. New System Reporting and Reconciliation Capabilities Need Improvement

FHA implemented a new service for HECM insurance, accounting and program operations on October 9, 2012. FHA named the service Home Equity Reverse Mortgage Information Technology (HERMIT). The HERMIT service consolidated the operations of the following legacy systems into one platform:

- Collecting Mortgage Insurance Premiums (MIP) through its Insurance Accounting Collection System (IACS);

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- Servicing HECM loans assigned to HUD through its Single Family Mortgage Asset Recovery Technology (SMART) system;
- Manually processing Mortgagee's insurance claims.

The HERMIT service improves FHA's monitoring and tracking of the HECM loan portfolio, automates the payment of insurance claims, and add capabilities to identify and mitigate risks to the Insurance Funds. The HERMIT service also improves IT security controls and compliance with current federal security standards.

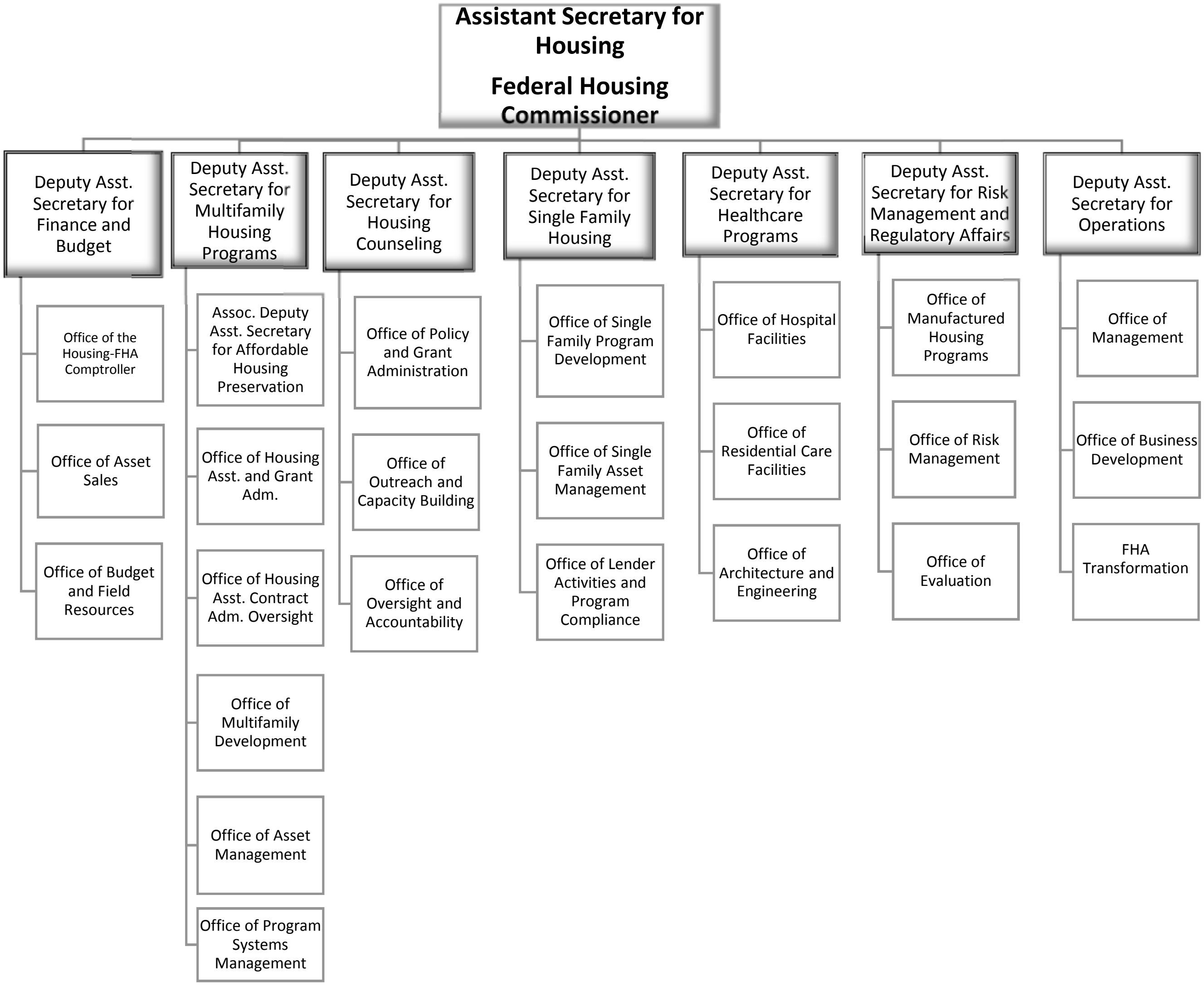
While the new service has improved controls over the HECM program, FHA recognizes that reporting capabilities and reconciliation processes need improvement. FHA concurs with the recommendations.

EXHIBIT C
Status of Prior Year Recommendations

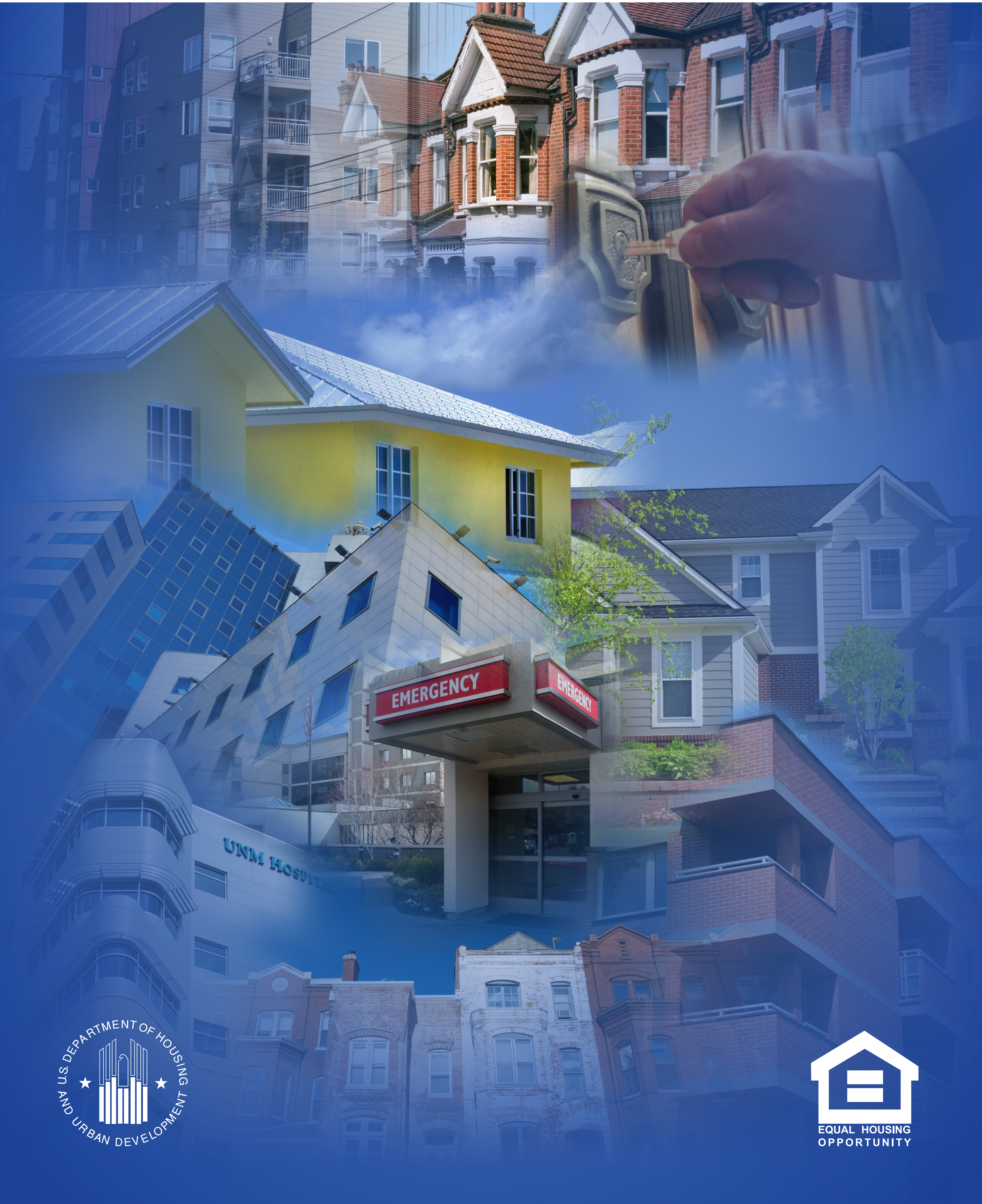
Our assessment of the current status of the recommendations related to significant deficiencies identified in the prior year audit is presented below:

FY 2012 Recommendation	*Type*	*Fiscal Year 2013 Status*
1a. The Assistant Secretary for Housing should work with the HUD CIO to continue the development of the IT portfolio management structure and establish clear roles and responsibilities for remediating the identified control deficiencies in Housing's applications and monitor the effectiveness of that structure in managing IT investment.	Significant Deficiency 2012	Resolved
1b. The Assistant Secretary for Housing should assign a Housing representative to oversee and report on the remediation of control deficiencies in general support systems that affect Housing systems and data.	Significant Deficiency 2012	Resolved
1c. The Assistant Secretary for Housing clarify the future role of Housing's Office of Risk Management and Assessment with regard to the IT risk assessment process for FHA applications.	Significant Deficiency 2012	Resolved
1d. The HUD Chief Information Officer should assign a senior OCIO manager to document the plan of action and to provide regular status reports on the progress toward mitigation of the outstanding control deficiencies reported for the general support systems and the applications affecting Housing data.	Significant Deficiency 2012	Resolved

FHA Organizational Chart



http://portal.hud.gov/hudportal/documents/huddoc?id=fhafy13annualmgmntrpt.pdf



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

EQUAL HOUSING OPPORTUNITY