FHA

Annual Management Report
Fiscal Year 2008

U.S. Department of Housing and Urban Development
Federal Housing Administration

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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

A MESSAGE FROM THE COMMISSIONER

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

FHA has given millions of families the opportunity to pursue the dream of homeownership. Through education, outreach and a commitment to constantly improve its services, FHA aims to insure safe, affordable mortgages to keep this dream alive for the newest generation of homebuyers.

FHA remains financially sound with a capital ratio in its Mutual Mortgage Insurance (MMI) fund that exceeds the statutory minimum requirement of two percent. This financial capacity, as well as significant management initiatives and improvements, has given FHA the ability to successfully carry out its mission.

Current Issues in the Nation's Housing Market

In September 2007, the President announced the formation of *FHASecure*, a program designed to both promote and facilitate subprime to FHA refinances. Since the President announced the launch of *FHASecure*, over 368,000 families have refinanced out of a burdensome mortgage into a safe, affordable FHA product. That number should approach 500,000 by the end of calendar year 2008.

FHA's purchase loan business has also been increasing. In the recently concluded Fiscal Year 2008, FHA endorsed 632,000 purchase loans. The overall numbers tell the story of FHA's rise back to its rightful place in the mortgage market – as a safe, viable option for first-time homebuyers and those with less than perfect credit. In FY 2007, FHA endorsed about 425,000 single-family loans. In FY 2008, FHA endorsed over 1.2 million loans, more than double the previous year. Also, through its loss mitigation programs, FHA helped approximately 101,000 borrowers avoid foreclosure in FY 2008.

FHA Modernization

The Housing and Economic Recovery Act of 2008 (HERA), signed into law in July 2008, contained provisions to modernize FHA that we had long sought, such as higher loan limits and a permanent ban on seller-funded down payment loans. Effective January 1, 2009, the permanent loan limit for high-cost areas will be $625,500, enabling areas such as Coastal California, New York City and Washington D.C. to have access to FHA financing.

HERA also mandated that, as of October 1, 2008, no seller-financed down payment loans could be originated. These loans, with nearly three times the default rate of other FHA loans, were having a serious impact on the MMI fund.

The HOPE for Homeowners Program

The legislation also created the HOPE for Homeowners (H4H) program, designed to help struggling borrowers refinance out of their conventional loans into a new, 30-year, fixed-rate FHA-insured loan, ensuring that the borrower's last payment will be the same as their first.

The H4H program, which began October 1, 2008, runs until September 30, 2011 and is only available to owner-occupants. To avoid what might be an even costlier foreclosure action, lenders must agree to write down the existing mortgage to 90 percent of the new appraised value of the home.

Borrowers are encouraged to contact their current lender to determine their eligibility. Briefly, homeowners may be eligible if: 1) the home is their primary residence, and they have no ownership interest in any other residential property, such as second homes; 2) their existing mortgage was originated on or before January 1, 2008; 3) they have made at least six payments; and 4) they are not able to pay their existing mortgage without help.

Annual Management Report

FHA is committed to providing Americans access to sustainable homeownership, helping families retain their FHA-insured homes during economic hardships, increasing the supply of affordable rental housing, and facilitating the financing of America's healthcare facilities. Since its inception in 1934, FHA has given over 35 million families the opportunity to pursue the dream of homeownership.

The following is the Fiscal Year 2008 Annual Management Report, which presents FHA's accomplishments during the year, and its financial condition.

Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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Certain information contained in this discussion is considered "forward-looking information" 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 discussion.

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

MISSION AND ORGANIZATIONAL STRUCTURE

In 1934, Congress created the FHA under the National Housing Act to expand opportunities for homeownership. The instability in the housing market and the breakdown of the banking system during the Great Depression heightened the need for FHA programs. Congress looked to FHA to boost the depressed economy and solve the nation's housing shortage.

FHA has expanded its mission since its inception and now provides mortgage insurance to private lenders that finance single family homes, multifamily projects, healthcare facilities, property improvements, and manufactured homes. Availability of FHA mortgage insurance stabilizes the provision of mortgage credit in the marketplace and encourages the provision of credit to households not served or underserved by the private sector, most notably first time and minority homebuyers.

With the credit and foreclosure crisis, FHA has played an important role in assisting homeowners. The Congress enacted the Housing and Economic Recovery Act of 2008 that includes a multifaceted approach to dealing with the foreclosure crisis. This new legislation reduces statutory barriers and increases FHA's flexibility to respond to changes in the marketplace. Several major changes were implemented to the FHA Single Family Programs as a result of the enactment of the Act. These changes include:

- Increase in FHA loan limits for high-cost areas to a maximum of $625,500 effective fiscal year 2009.
- Establish a new HOPE for Homeowners Program that allows FHA to insure up to $300 billion in loans for at-risk borrowers who refinance their unaffordable old mortgages into new low-cost fixed-rate loans insured by the FHA.
- Eliminate seller funded down payment assistance.
- Increase the amount of the required down payment for borrowers getting FHA loans.
- Implement a moratorium on risk-based premiums for one year.

- Expand the use of Home Equity Conversion Mortgages ("reverse mortgages").
- Increase access to pre-purchase and post-purchase counseling for low and moderate income homeowners.

As a result, FHA will be able to reach more prospective homebuyers to provide an alternative to sub-prime loans that have high interest rates and closing costs, as well as expensive repayment penalties.

Additionally, FHA continues to greatly improve its business processes and is working with the Administration and Congress to develop new mortgage products and market the benefits of its mortgage insurance to lenders and the general public.

FHA Insurance Funds

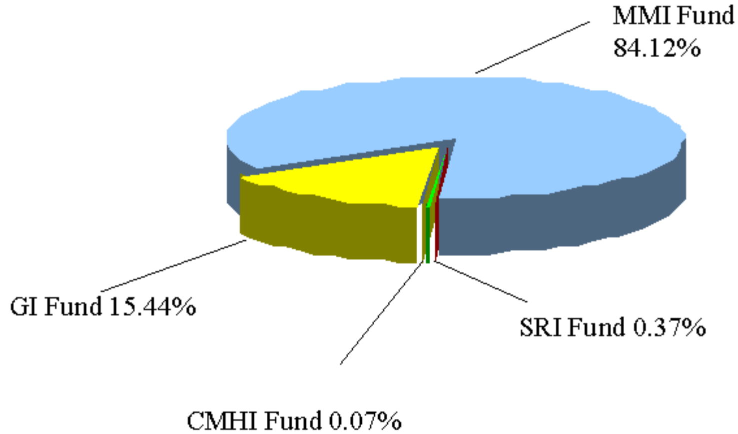
FHA operates its programs through four insurance funds supported by premium, fee and interest income, Congressional appropriations, borrowing from the U.S. Treasury, and other miscellaneous sources. The total mortgage Insurance-In-Force (IIF) in the FHA Insurance Funds was $531.7 billion, an increase of $131.7 billion or 32.9 percent, compared to fiscal year 2007. Specifically, the MMI Fund increased by $125.5 billion, the GI Fund increased by $6.6 billion, the SRI Fund decreased by $372 million, and the CMHI Fund, the smallest of the four, increased by $19 million. Effective in fiscal year 2009, Single Family Programs currently in the GI fund will move to the MMI fund.

The four Insurance Funds are:

- *The Mutual Mortgage Insurance (MMI) Fund*. This fund supports FHA's basic single family homeownership program. This fund is self-sustaining.
- *The General Insurance (GI) Fund*. This fund supports a wide variety of housing programs including rental apartments, cooperatives, condominiums, nursing homes, hospitals, property improvements and manufactured housing (Title I), home equity conversion mortgages, and disaster assistance.
- *The Special Risk Insurance (SRI) Fund*. This fund supports higher-risk single family and multifamily insured mortgages.
- *The Cooperative Management Housing Insurance (CMHI) Fund*. This fund supports insured loans on market-rate cooperatives. Historically this fund has been self-sustaining.

At the end of fiscal year 2008, the Insurance-In-Force in MMI Fund comprised 84.12 percent of all FHA Insurance Funds; the GI Fund 15.44 percent; the SRI Fund 0.37 percent; and the CMHI Fund 0.07 percent as shown below:

FHA Insurance-In-Force by Fund
As of September 2008



FHA's single family mortgage insurance business is 89.20 percent of its total IIF. The multifamily and healthcare insurance is 10.67 percent of IIF. Title I property improvement and manufactured home insurance is 0.13 percent of IIF.

During FY 2008, FHA saw endorsements and overall IIF increased with the decrease in interest rates and the increase in FHA mortgage refinancing due to the crisis in sub-prime mortgage lending and the reset of Adjustable Rate Mortgages (ARMs). Additionally, higher FHA loan limits, decreasing home prices, and tightening of available credit has encouraged low and moderate-income buyers to seek out traditional financing available through FHA Insurance Programs that offer buyers flexible down payment options.

Office of Single Family Housing

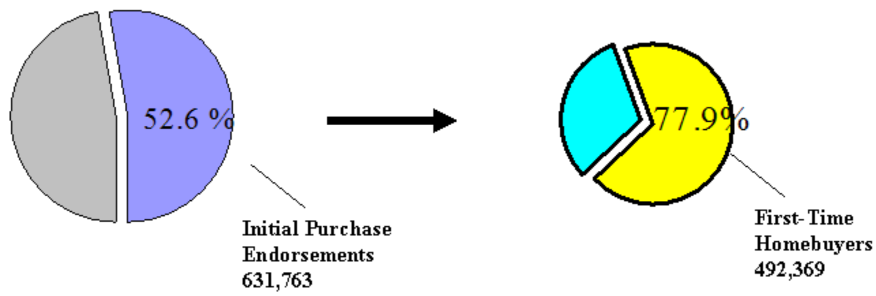
FHA's Office of Single Family Housing administers programs that promote affordable housing. FHA encourages homeownership by making loans more readily available to lower and moderate-income homebuyers through its FHA mortgage insurance programs. HUD-approved mortgage lenders handle all of the HUD/FHA-insured mortgage loan programs.

Single Family Housing Programs

Single Family Housing programs are the most visible evidence of FHA's success in providing expanded homeownership opportunities for all Americans. Through these programs, FHA targets households that otherwise would have difficulty obtaining mortgages. During fiscal year 2008, its programs insured 1,200,111 loans, of which 631,763 were initial purchase endorsements. Of these purchase endorsements, 492,369 were loans to first-time homebuyers and 144,636 were loans to minority first-time homebuyers.

Fiscal Year 2008 Insured Loan Distribution

Total Endorsements 1,200,111 | Initial Purchase Endorsements 631,763



Since inception, FHA's single family housing programs have made substantial contributions to the increase in the national homeownership rate, from 64.7 percent in 1995 to 68.1 percent as of second quarter 2008. The national homeownership rate is down 0.1 percent from 68.2 percent as of the same period in 2007. However, with the decrease in the homeownership rate, FHA saw an increase in market share primarily due to the collapse of the sub-prime mortgage market. Prospective borrowers who had opted for sub-prime loans in recent years are now choosing the dependability and safety of FHA products.

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

Section203 (b)

Section 203(b) is the largest of FHA's single family programs covering 93.7 percent of total single family insurance-in-force. FHA established this program to create a stable mortgage finance market and to serve otherwise underserved borrowers by providing low down payment mortgages. Section 203(b) insures private lenders against loss in the event the borrower defaults on the mortgage. This insurance makes lenders more willing to originate loans to borrowers who do not meet conventional mortgage underwriting requirements. Additionally, lenders are more willing to make loans to underserved borrowers because FHA-insured mortgages can be packaged into mortgage-backed securities. These types of securities are attractive because they are guaranteed by Government National Mortgage Association (Ginnie Mae), a secondary market entity backed by the full faith and credit of the U.S. Government. In fiscal year 2008, FHA insured 1,032,553 Section 203(b) mortgages of which 458,828 were first-time homebuyers and 135,344 were minority first-time homebuyers.

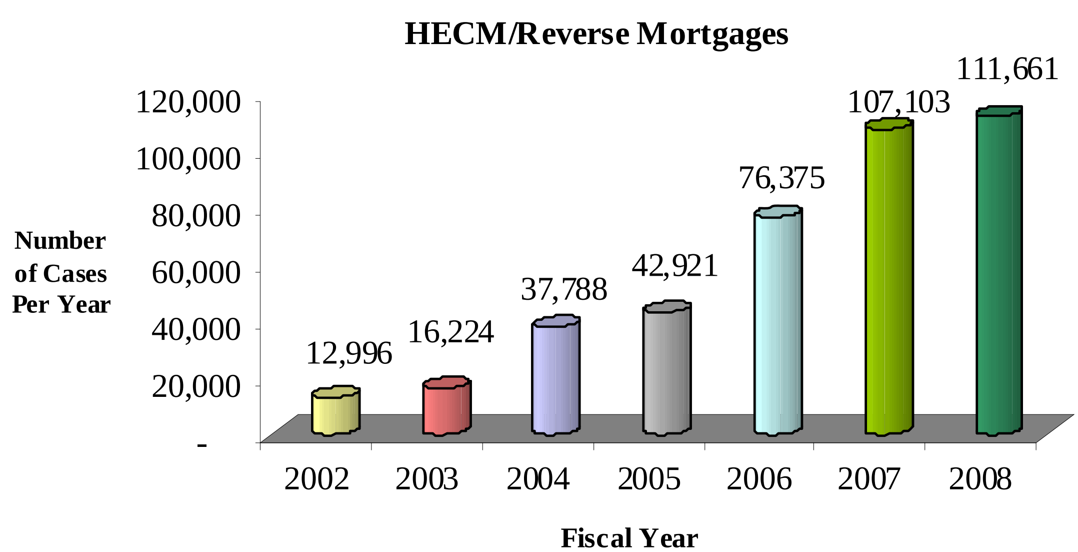
Section 234(c)

Section 234(c) covers 4.8 percent of FHA's total single family insurance-in-force. This program provides mortgage insurance for individual condominium units. A condominium is a single unit owned by an individual or family in a multi-unit project with a shared interest in common areas and facilities. This form of ownership is usually more affordable than other single family housing and often attracts first-time homebuyers who lack the capital for single family homeownership. In fiscal year 2008, FHA insured mortgages for 48,148 condominium units. The FHA Modernization Act under the Housing and Economic Recovery Act of 2008 contains a provision that moves Section 234(c) loans from the General Insurance and Special Risk Insurance Funds to the Mutual Mortgage Insurance Fund. Section 234(c) loans are no longer subject to the more complex requirements of multifamily housing loans, simplifying the origination and underwriting process.

Home Equity Conversion Mortgages (HECM) - Reverse Mortgages

FHA was the first entity to promote and insure reverse mortgages on a national scale. The HECM program provides eligible homeowners access to the equity in their property with very flexible terms. The loan may provide a lump sum payment, monthly payments, a line of credit or a combination thereof. The loan allows homeowners to stay in their homes with no repayment requirement until the property is vacated or sold. The program is limited to homeowners 62 years of age and older and is designed for those with limited income.

The HECM program continues to be increasingly popular as more homeowners choose to remain in their homes and draw down on their home equity to pay living expenses. The program provides a valuable resource to individuals traditionally underserved by the mortgage market. HECM loans continue to be a growing product. Since its inception, FHA has endorsed 454,745 HECM loans. The number of reverse mortgages per year insured by FHA has increased over the past seven years, from 12,996 cases in fiscal year 2002 to 111,661 in fiscal year 2008. The Housing and Economic Recovery Act of 2008 contains a provision that moves HECM from the General Insurance Fund to the Mutual Mortgage Insurance Fund.

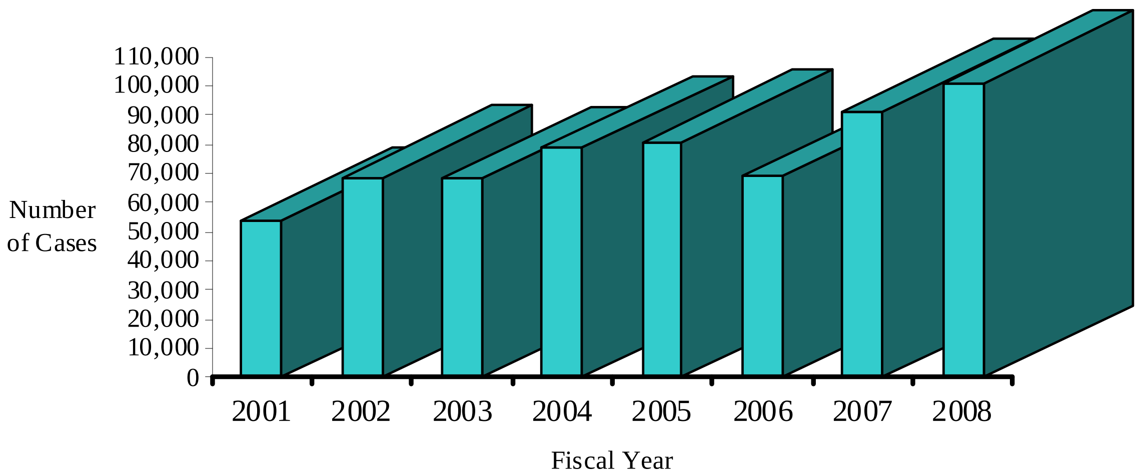


Fiscal Year 2008 Accomplishments

During fiscal year 2008, FHA was highly successful in assisting many Americans to achieve or sustain the goal of homeownership. FHA assisted:

- *First-Time Homebuyers.* In fiscal year 2008, 77.9 percent of FHA-insured purchased loans included first-time homebuyers. FHA provided 492,369 homebuyers with the ability to purchase their first home during the fiscal year.
- *Minority First-Time Homebuyers.* In fiscal year 2008, 31.2 percent of first-time homebuyers who obtained FHA-insured mortgages were minorities.
- *Borrowers Experiencing Financial Difficulties.* One of FHA's most important goals is to assist homeowners facing financial difficulties to remain in their homes through increased use of loss mitigation tools. The use of these tools increased over the past eight years from 53,732 cases in fiscal year 2001 to 101,167 in fiscal year 2008.

Use of Loss Mitigation Tools



Management Initiatives

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

- *FHASecure Program.* This temporary FHA program provides refinancing opportunities to homeowners for various types of Adjustable Rate Mortgages (ARMs). *FHASecure* is designed to increase liquidity in the mortgage market and help individuals who have good credit, but who have not made all of their payments on time because of rising mortgage payments due to ARMs that have "reset". On April 9, 2008, *FHASecure* was expanded after the Administration's announcement of additional mortgage assistance for sub-prime borrowers who are at risk of foreclosure. Homeowners who can no longer afford their mortgages and missed up to three monthly mortgage payments over the past 12 months become eligible for *FHASecure*. As an alternative to foreclosure, eligible borrowers can refinance with FHA and lenders can voluntarily write down the outstanding sub-prime mortgage principal balance. Since September 2007, *FHASecure* has contributed to the housing market by providing $62 billion of insurance-in-force. The program has already helped 368,718 homeowners avoid foreclosure. It is expected to assist a total of 500,000 families by December 31, 2008 with more borrowers being eligible for the expanded program.

- *Predatory Lending Prevention.* FHA continues to help prevent millions of families from becoming victims of predatory lending practices. These efforts include denying FHA insurance for mortgages on homes that have been "flipped" at inflated prices and deploying special monitors to pursue unscrupulous appraisers and lenders. Additional efforts to combat predatory lending focus on print media advertising, publication of informational brochures, and other consumer outreach.

- *Good Neighbor.* HUD's Good Neighbor initiative allows police officers, firefighters, emergency first responders and school teachers to purchase HUD homes at significant discounts. The purpose of the Good Neighbor initiative is to strengthen distressed urban communities and to provide homeownership opportunities for public service professionals. This program is a catalyst in promoting the sale and rehabilitation of vacant HUD properties in targeted neighborhoods.

- *Credit Watch Termination.* FHA's Credit Watch Termination program identifies poorly performing mortgage lenders. FHA may temporarily suspend the authority to originate mortgage loans to the poorest performing mortgage lenders' branch office(s). The program also warns marginally performing lenders to improve their performance if they wish to maintain their status as approved FHA lenders and continue to participate in FHA insurance programs.

- *TOTAL Scorecard.* FHA's Technology Open to Approved Lenders (TOTAL) Scorecard evaluates mortgage applications and credit information in an objective and consistent manner to assess the creditworthiness of FHA borrowers. The scorecard uses a methodology statistically proven to predict the likelihood of borrower default and FHA claims. FHA developed the automated tool to identify potential homebuyers not currently served by the conventional market due to real or perceived risk. When TOTAL returns an "Accept" decision, underwriting requirements are reduced and borrowers can save hundreds of dollars in mortgage origination fees. When TOTAL returns a "Refer" decision, the lender must manually underwrite the loan to ensure that it meets minimum credit-quality requirements. In fiscal year 2008, TOTAL scored 1.37 million applications for loans with FHA case numbers compared to 425,282 requests in fiscal year 2007.

- *Lender Insurance (LI).* "Lender Insurance", an initiative started in fiscal year 2006, allows high-performing mortgagees to endorse FHA loans without a pre-endorsement review conducted by FHA. The FHA Connection system, a web based tool through which approved lenders conduct business with FHA, performs an automated verification process to check the data for accuracy and completeness and electronically generates a mortgage insurance certificate to serve as evidence that the loan was endorsed. LI eliminates the need for mortgagees to submit case binders as a pre-condition for obtaining FHA's mortgage insurance endorsement and therefore eliminates the need for binder re-submissions to satisfy Notices of Return (NOR). A minimum five percent of all insured loans originated by HUD-approved lenders are selected for Post-Endorsement Technical Review (PETR).

LI provides lenders with prompt acceptance or denial of the endorsement package providing tremendous savings in cost, time and resources for all of the parties involved and has been widely praised by the industry. The LI program covers approximately 70.6 percent of FHA insured mortgages for fiscal year 2008.

- *Accelerated Claims and Asset Disposition (ACD) Demonstration Program.* In 2002, FHA introduced the ACD Demonstration program under Section 601 of the VA, HUD, and Independent Agencies Appropriations Act for fiscal year 1999. The primary goal of this program is to sell defaulted single-family assets at the highest recovery to the Government, while also supporting homeownership retention and providing an alternate acquisition and disposition tool. The Demonstration to date has assisted over 57 percent of homeowners in retaining their homes.

  Under this program, the Asset Sales Office has sold previously insured FHA notes through four competitive sealed-bid auctions in which qualified bidders participated to acquire a majority equity interest in the public/private joint ventures. These joint ventures, in which HUD maintains minority ownership, are responsible for servicing, managing, and disposing of the defaulted single family mortgage loans. Since program inception, a total of 22,480 loans with balances of approximately $2.27 billion have been settled that resulted in receipts of approximately $1.1 billion from the auction sales. In addition, HUD received distributions of approximately $671 million of income from the joint ventures for its minority interest. The resulting net recovery is 78.3 percent of Unpaid Principal Balance (UPB) or 74.5 percent of claim cost. The Department projects an additional recovery of $23 million from the final disposition of the remaining assets in the joint venture. Out of the four joint ventures, two were closed in fiscal year 2007 and one in first quarter of fiscal year 2008. The remaining joint venture is scheduled to close during fiscal year 2009. There was no sale in fiscal year 2008, however, Department is preparing for another ACD sale initiative, scheduled for fiscal year 2009.

- *Post Endorsement Technical Review Process (PETR).* A minimum five percent of all insured loans originated by HUD-approved lenders are selected for PETR. The selection process is derived from a defined risk-based algorithm. Based on continued evaluation of previous PETR findings and results, FHA has further refined the specific ratings and codes that are used for the loans being reviewed. The system has four rating categories: Conforming, Deficient, Unacceptable, or Mitigated. The improved ratings and codes clearly identify which loans pose too great a risk to FHA and which loans contain errors or other deficiencies. The revised system more accurately reflects the risk level associated with recently insured mortgages; while at the same time significantly reduces the number of loans with unacceptable ratings.

- *FHA Modernization.* FHA modernization efforts, which include completed administrative and legislative changes, have streamlined the insurance process and received praise and acceptance by mortgage professionals. Furthermore, the legislation makes FHA products more attractive to mortgagees and consumers alike. Changes in the legislation include more favorable loan terms with higher loan limits, extended repayment time, and flexible down payment options.

- *Other Single Family Improvements.* FHA continues to focus its efforts to improve all stages of the single family mortgage insurance process. These additional efforts include the following:

  - Continue System Re-engineering and Integration

    Single Family Housing continued its comprehensive systems re-engineering and integration efforts in 2008. Such efforts assist FHA to comply with federal legislation, address audit weaknesses, improve overall monitoring and oversight, and adhere to HUD's Enterprise Architecture Framework. The modernization and integration of Single Family's systems will simplify systems administration, reduce total cost of ownership and maintenance, provide flexible and adaptable business processes and functionality to continually meet and comply with industry standards, thus improving consumers and stakeholders support and program oversight.

  - Improve Overall Risk Management

    FHA has augmented its efforts to provide a safe alternative to sub-prime loans and assist homeowners in staying in their homes. The expanded *FHASecure* program and new Hope for Homeowners program may bring borrowers with higher risk profiles under FHA insurance. FHA's improved risk management, premium structure and credit modeling will ensure that FHA remains financially sound.

    FHA intensified actions during fiscal year 2008 to improve its overall risk management. FHA used monitoring tools such as a Risk-Based Targeting Model (RBTM) and Appraiser Watch to better monitor program performance and improve oversight of Management & Marketing (M&M) contractors and appraisers. In addition, FHA revised its delinquency rate reporting standards and took corrective actions against problem lenders, underwriters and appraisers.

    The Risk-Based Targeting Model (RBTM) for Real Estate Owned (REO) properties assists FHA in assessing the single family asset portfolio and the contractors' performance. RBTM establishes benchmarking at both the macro and micro levels to determine which Homeownership Center (HOC), contractor, area or property demonstrates anomalous behavior and needs to receive specific and detailed attention. RBTM prioritizes which risk conditions need immediate follow-up and increases the effectiveness of ongoing monitoring and forecasting functions. The model also captures property file review findings, tracks the success of corrective actions that have been implemented, and provides consistent, statistically-based review results.

    FHA's Appraiser Watch system relies on statistical analysis to identify and automatically select appraisers who may contribute to poor loan performance based on certain risk factors, such as association with high mortgage default rates compared to other appraisers. Using this method, FHA removed 45 appraisers from the FHA roster during fiscal year 2008, compared to 60 appraisers removed during fiscal year 2007.

- Combat Fraud and Identity Theft

  FHA expanded the FHA Connection capability to validate Social Security Numbers (SSN) through other Government Agencies. This expansion provides lenders with the ability to verify data immediately upon entry of borrower's name, SSN and Date of Birth (DOB) into FHA Connection. However, if the first level of verification suggests a need for further direct verification with the Social Security Administration, the lender will receive a response the following day.

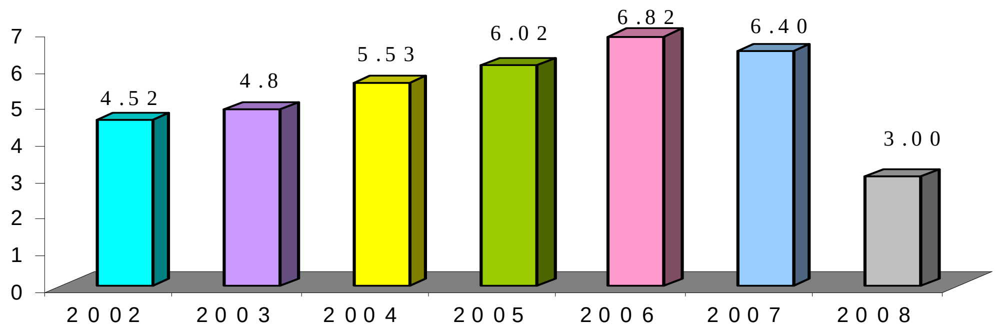
- Stabilize Distressed Communities

  The Asset Control Area (ACA) Program is designed to help stabilize distressed communities and overcome blight through expanded homeownership for low-income families. Foreclosed single-family homes in designated revitalization areas are sold by FHA to local governments and experienced nonprofits at a discount under the program. Participating entities are required to rehabilitate the homes and resell them to low-income home buyers. This year, HUD renewed its ACA agreement with the City of Ogden, UT, St. Ambrose Housing Aid Center, Inc., MD, the City of Rochester, NY and Restored Homes Housing Development Fund Corporation, a partner of New York's Housing Preservation Department (HPD) and currently has 13 operating ACA participants. During fiscal year 2008, ACA participants sold 190 HUD properties to income eligible homeowners and acquired 100 new HUD properties that are currently being rehabilitated.

MMI Capital Ratio

The MMI Fund constitutes the majority of FHA's single family business, with 93.7 percent of the total single family IIF dollars. One measure of the fund's financial soundness is the MMI capital ratio, based on the economic value of the MMI Fund to the balance of the MMI Insurance-In-Force. The Cranston-Gonzalez National Affordable Housing Act of 1990 requires an independent actuarial analysis of the economic net worth of the MMI Fund. In addition, the Act mandates that the MMI Fund achieve a capital ratio, a measure of the Fund's economic net worth, of at least 2 percent by the year 2000, which was achieved in 1995 and maintained ever since. In fiscal year 2008, the estimated economic value of the MMI fund decreased significantly with the forecast of expected house price declines due to a declining housing market. Conversely, the total MMI insurance-in-force, increased significantly due to the volume of new endorsements. The combination of these factors resulted in a decrease in the capital ratio from 6.4 percent in fiscal year 2007 to 3.0 percent in fiscal year 2008.

MMI Fund Capital Ratio



Fiscal Year

Directly related to the decrease in the capital ratio, FHA projected a significant increase in its Liability for Loan Guarantees. This projected additional liability is recorded to reflect anticipated future losses as a result of increased claim rates and reduced recovery rates.

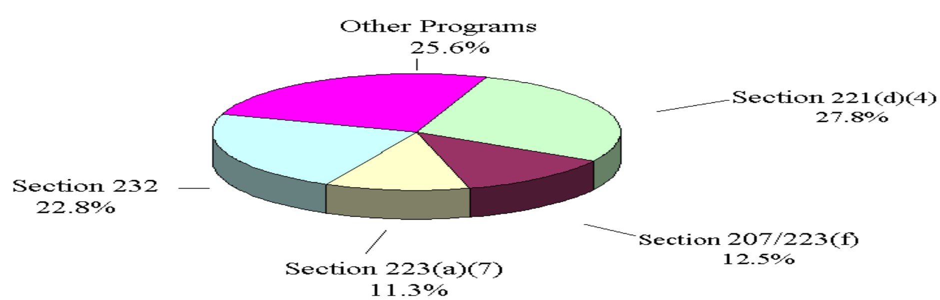
Office of Multifamily Housing

FHA provides financing support for the development of rental housing and healthcare facilities through its Multifamily Mortgage Insurance programs. In fiscal year 2008, FHA initial endorsements include 647 multifamily loans totaling \$3.7 billion. There were 11,931 mortgages in the FHA portfolio with an outstanding principal balance of approximately \$56.7 billion.

Multifamily Housing Programs

FHA's four largest multifamily programs in terms of insurance-in-force dollars are Sections 221(d) (4), 232, 207/223(f), and 223(a) (7) which are discussed below.

Multifamily Insurance-In-Force by Program



Section 221(d) (4)

Section 221(d) (4) has historically been FHA's most popular multifamily program. It provides mortgage insurance for the construction or substantial rehabilitation of multifamily rental properties consisting of five or more units. FHA may insure mortgages for up to 90 percent of a project's estimated replacement cost under this program. In fiscal year 2008, this program makes up 27.8 percent of total Multifamily IIF and insured 78 mortgages valued at \$0.95 billion, covering 12,679 units.

Section 232

The Section 232 Mortgage Insurance for 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. In fiscal year 2008, this program makes up 22.8 percent of total Multifamily IIF and insured 182 mortgages valued at $1.3 billion, covering 21,126 units/beds.

Section 207/223(f)

The Section 207/223(f) program provides mortgage insurance for the refinancing or acquisition of existing multifamily rental properties consisting of five or more units. Under this program, FHA may insure mortgages for up to 85 percent of a project's appraised value, or up to 90 percent of a project's appraised value in cases of refinancing or acquisition of properties formerly financed with Section 202/8 Direct Loans. The program applies to both formerly FHA-insured and conventionally financed properties. In fiscal year 2008, this program makes up 12.5 percent of total Multifamily IIF and insured 237 mortgages valued at $0.89 billion, covering 21,477 units.

Section 223(a) (7)

The Section 223(a) (7) program provides mortgage insurance for the refinancing of existing multifamily rental properties with FHA-insured mortgages. In fiscal year 2008, this program makes up 11.3 percent of total Multifamily IIF and insured 81 mortgages valued at $239.8 million, covering 8,660 units.

The administration of FHA's Multifamily Programs is primarily the responsibility of two offices: Multifamily Housing Development and Asset Management.

Multifamily Housing Development

The Office of Multifamily Housing Development provides direction and oversight for FHA mortgage insurance loan origination. During fiscal year 2008, Multifamily initial endorsements include 647 loans totaling $3.73 billion, and covering 70,914 units/beds in the District of Columbia, Puerto Rico and all states except Alaska and South Dakota. Of these 647 loans, 92.4 percent were processed under basic FHA programs and 7.6 percent were processed by state housing finance agencies and Fannie Mae or Freddie Mac under risk sharing arrangements with HUD. The 598 basic loans processed under basic FHA programs were made by 48 lenders and provided a variety of shelter options, including 317 apartment projects, 88 cooperatives, 67 assisted living/board and care facilities, and 123 nursing homes. Risk Sharing programs created additional shelters, whereby 17 states made 43 HFA risk sharing loans covering 4,137 units/beds. Fannie Mae and Freddie Mac made 6 loans covering 734 units.

While nationwide production fell short of the goal of 750 loans, the 647 loans still represent a significant achievement in the face of a major economic downturn. Special initiatives that made housing units more affordable specifically to low-and moderate-income families produced 263 of the 647 loans and the remaining 384 loans were made for properties located in underserved areas. Section 202 Elderly Housing projects accounted for 166 refinanced loans and 16 loans decoupled Section 236 Interest Reduction Payment (IRP) contracts. In addition, these 647 loans enabled 78 projects in 25 states and the District of Columbia to receive Low Income Housing Tax Credits (LIHTC).

Management Tools for Multifamily Housing Development

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

- *Development Application Processing (DAP) Tracking Module.* Multifamily's DAP system tracks a loan from receipt of the lender's application through processing of commitments, endorsements and completion of construction and repairs for all of FHA's basic, risk sharing and hospital programs. DAP assigns each project a case number and provides analysis reports on lenders, field offices, program mix, and pipeline data. In addition, it feeds data to Real Estate Management System (*i*REMS), the Multifamily Insurance System (F47) and the Comptroller's Credit Subsidy Control (CSC) system that tracks loan obligations and credit subsidy thus ensuring that the same commitment, endorsement and pipeline data are used by all divisions of HUD.

- *Multifamily Accelerated Processing (MAP).* Lenders may choose to use MAP's procedures rather than the traditional processing procedures. HUD staff performs many of the underwriting activities (e.g. appraisals, cost estimates, etc) under traditional processing; whereas under MAP, lenders perform most underwriting activities, collect data, make necessary analysis and submit an underwriting summary and recommendation to HUD. The HUD staff then reviews the submission from MAP lenders and decides whether to insure the loan thus providing better service by reducing processing time and cost to lenders. To become a HUD approved MAP Lender the lender's organizational structure and underwriting procedures must meet Multifamily Development's rigorous standards. Currently, 91 lenders are approved to process loans under MAP.

- *Annual Internal Control Reviews.* As a condition of using accelerated processing, all MAP lenders must perform yearly internal control reviews of at least 10 percent of the MAP loans HUD endorses. The review findings are reported to Multifamily Development's Lender Quality and Monitoring Division (LQMD). If the reviews disclose weaknesses in processing procedures, LQMD works with the lender to improve internal control procedures and ensures that lender's staff receives training on the new procedures.

- *Lender Quality and Monitoring Division (LQMD).* This Division performs annual in-depth reviews of loans processed by MAP lenders. The review team includes HUD staff from all technical disciplines involved in underwriting a loan. In fiscal year 2008, LQMD completed reviews of 21 MAP cases. LQMD focuses on high volume lenders, large loans, and troubled loans in selecting cases for audit.

Multifamily Asset Management

At the end of September 2008, FHA's Multifamily portfolio has 11,931 insured mortgages that covered 1.43 million units, with a total outstanding principal balance of over $56.7 billion. In addition, FHA held 2,894 notes in inventory, with a total outstanding principal balance of $3.2 billion.

Management Initiatives for Multifamily Asset Management

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

- *Note Sales.* To dispose of multifamily assets, HUD can either sell a property through foreclosure or sell the mortgage note. Note sales have historically demonstrated a greater return to the FHA Insurance Fund as compared to foreclosures. FHA conducted two Multifamily and Healthcare Loan Sales in fiscal year 2008 that sold 20 mortgage notes to successful bidders. The total sale proceeds for the two sales combined exceeded $46 million dollars. There are two note sales planed for fiscal year 2009.

- *Lead-based paint.* The Office of Multifamily Housing Programs has continued to assess lead-based paint hazards in HUD assisted multifamily projects in fiscal year 2008. In addition to the assessments, Multifamily Housing has set a goal under the Departmental Management Plan that states "Multifamily Hubs and PCs must receive corrective action plans or certifications from owners/agents documenting that 80 percent of the properties in their jurisdictions, not in compliance as of October 1, 2007, are brought into compliance with the Lead Safe Housing Rule (LSHR)". Multifamily has developed a monitoring and tracking report that allows quarterly review of the owners' compliance with the regulations. Multifamily refers owners who fail to comply with the regulations to HUD's Departmental Enforcement Center for enforcement action. In fiscal year 2008, the lead-based paint compliance rate reached 95 percent.

Management Tools for Multifamily Asset Management

The Office of Multifamily Asset Management uses a number of tools in its oversight of insured and subsidized properties, mortgage notes, and HUD-owned properties.

- *Physical Assessment Subsystem (PASS).* PASS facilitates the completion of physical inspections according to HUD's Uniform Physical Condition Standards (UPCS) protocol. The subsystem schedules the inspections, assigns inspectors and notifies property owners of the inspection date. Inspectors record any deficiencies in the interior, exterior, common areas and building systems of a property using an electronic data collection device. Inspection results are scored by the collection device and uploaded to PASS. PASS technicians review the uploaded inspections for completeness and accuracy and post them on-line for the owners and HUD staff to review. In addition to the overall evaluation of the project's physical condition, HUD tracks the correction or mitigation of Exigent Health and Safety conditions identified in the physical inspection. Owners must certify that they have corrected these conditions within 3 business days of the inspection or they may be subject to administrative action.

Properties scoring below 31 out of a possible scale of 100 are automatically referred to the Departmental Enforcement Center (DEC) for action and properties with scores less than 60 could also be referred at HUD's discretion. HUD re-inspects the referred properties after 60 days for compliance. If the condition remains below standard, HUD takes action to permanently correct the problem and protect the tenants', community and the government's interests. Possible actions include abating or terminating subsidy contracts, recommending sale or physical transfer of the property to new acceptable owners, or foreclosure. As of the end of fiscal year 2008, 91.3 percent of 11,407 properties, consisting of 10,416, insured and under management in the PASS system had scores greater than 60.

- *Financial Assessment Subsystem (FASS*). The FASS subsystem, part of an overall asset management strategy, collects project's annual financial statements information and applies the information to assess a project's financial performance and compliance. FHA uses the FASS to identify financial risks and compliance deficiencies that need loss mitigation or enforcement actions. Financial evaluation indicators employed in the FASS are monitored and refined to better predict which properties may be facing financial difficulties that, if left unaddressed by the owner or HUD, would create a claim against the FHA insurance fund. In addition, the FASS was integrated under the Online Property Integrated Information Suite (OPIIS) with data from other systems to provide better servicing and management priorities for staff in the local field offices.

- *Integrated Real Estate Management System (iREMS). i*REMS is the primary system for HUD staff to review and manage multifamily properties. *i*REMS draws its data from multiple multifamily data systems, including the FASS, the PASS, and the Online Property Integrated Information Suite (OPIIS).

- *Multifamily Default and Delinquency Reporting System (MDDR).* MDDR is a web-enabled system that collects, tracks, and reports FHA-insured mortgage delinquencies, defaults, and elections to assign. MDDR provides the basis for HUD's quarterly report to Congress on multifamily defaults.

- *Online Property Integrated Information Suite (OPIIS).* OPIIS integrates HUD's multifamily data systems including PASS, FASS, MDDR with *i*REMS and external data for property and portfolio analysis. HUD staff use OPIIS to access multiple years of financial statements data and physical inspection results to determine trends in property performance. OPIIS also calculates a property's Integrated Risk Assessment score (IRA) based upon statistical analysis of defaults and delinquencies to predict the likelihood of claims against the insurance fund. The IRA is dynamically updated every time applicable data change and is used to establish workload priorities for HUD staff.

Other Housing Programs

Office of Insured Healthcare Facilities

Section 242

The Section 242 Mortgage Insurance for Hospitals program provides hospitals access to affordable financing for capital projects, including new construction or modernization. Since the program's inception in 1968, FHA has insured 360 hospital mortgages for $13.7 billion. Clients range from small rural hospitals to major medical centers. Hospitals with FHA-insured loans serve as community anchors, providing jobs as well as healthcare services. FHA currently has 81 active hospital loans with principal balance totaling over $6.2 billion. FHA issued insurance commitments totaling $712.6 million for eight hospitals in eight states in fiscal year 2008.

Office of Affordable Housing Preservation

Mark-to-Market Program

FHA's Mark-to-Market (M2M) program seeks to preserve affordable housing inventory by maintaining the long-term physical and financial integrity of such housing and to reduce the Section 8 rental assistance costs and the cost of FHA insurance claims. Under the M2M program, the Office of Affordable Housing Preservation (OAHP) analyzes FHA-insured multifamily properties for which Section 8 rents exceed comparable market rents, and reduces the rents to bring them in line with comparable market rents or levels that preserve financial viability. Sometimes rent reductions can be accomplished and financial viability assured without affecting project debt. More frequently, however, M2M restructures FHA-insured mortgages on eligible multifamily projects. HUD/FHA analyzes properties under M2M and makes appropriate reductions to the mortgages to allow the project debt to be serviced with reduced subsidy payments while remaining financially viable with market rate rent schedules. The M2M process involves either a full or partial payment of claim by FHA on the original mortgage, followed by FHA's commitment of a new mortgage that can be supported at market rents.

During fiscal year 2008, OAHP completed mortgage restructuring on 88 properties covering 8,051 units under the M2M program, with 53 percent resulting in reduced rents and Section 8 savings. Of the 88 properties with mortgage restructuring completed during fiscal year 2008, 47 properties resulted in full debt restructuring, contributing to the long-term preservation of 3,627 units. The restructuring represents an annual Section 8 savings (non-incurrence of cost) of $26.8 million. In addition, 21 properties consisting of 2,380 units charged reduced rents only, representing an annual Section 8 savings (non-incurrence of cost) of over $13.3 million. In total, 47 properties representing over 6,325 units received reduced rents, resulting in annual savings (non-incurrence of cost) of over $13.5 million.

The average savings per debt restructure transaction has shown a downward trend each year since fiscal year 2001. To some extent, this reflects shifts in program guidance as well as shifts in the pipeline. In fiscal year 2002, the program started to emphasize more on "sustainable" underwriting using such guidelines as paying off the existing expense balance at the M2M closing, providing larger allowance for debt service coverage, and giving more attention to the expected future expense levels rather than the historical levels. The M2M staff and Participating Administrative Entities also observe that transactions closed in fiscal year 2003 to fiscal year 2007 had more difficult issues and required more intensive interventions in order to make the transactions viable.

Hurricane Relief Efforts

In September 2008, hurricane Ike made landfall in Texas and caused property damage in areas along or near the Texas shoreline. FHA is providing assistance to the affected homeowners through its existing programs. In addition, HUD continues to focus efforts on providing relief to residents in the Gulf Coast and the Southeast region of the country that were displaced as a result of damages incurred by hurricanes Katrina, Rita and Wilma.

More than 20,488 single family homeowners with FHA-insured loans in areas that were declared eligible for Federal disaster assistance from Hurricanes Katrina, Rita and Wilma were able to retain homeownership through FHA loss mitigation solutions from September 1, 2005 through the end of fiscal year 2008. FHA Mortgage Assistance Initiative provided advance mortgage payment assistance to 782 of those homeowners. Additionally, HUD made permanent replacement housing available by selling properties in its nationwide REO inventory to hurricane evacuees at very special terms including a discount off the sales price. To date, 576 properties have been sold to evacuees. Furthermore, HUD continues to work with the Federal Emergency Management Agency (FEMA) to help enhance FEMA's housing recovery program and has developed general disaster recovery policy and guidance that will apply to any Presidential Declared Disaster.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

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

<u>Office of Single Family Housing Programs</u>

The following sections summarize the Office of Single Family Housing's achievements in meeting its fiscal year 2008 performance goals.

A. Strategic Goal: Increase Homeownership Opportunities

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

  FHA established a national goal of resolving 55 percent of single family mortgage defaults via loss mitigation techniques. In fiscal year 2008, Single Family Housing surpassed this goal, resolving 64.5 percent of claims through loss mitigation techniques, compared to the 65 percent attained in fiscal year 2007.

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

  To help increase the number of families able to secure financing for their first home FHA established a target of 73 percent for its Homeownership Centers (HOC) for single family home purchase mortgage endorsements to first-time homebuyers. In fiscal year 2008, 77.9 percent of FHA-insured single family home purchase mortgages were to first-time homebuyers, compared with the target of 73 percent and the 79.5 percent achieved in fiscal year 2007. This comparable level of home purchase mortgages endorsed to first-time homebuyers for fiscal year 2008 may be attributable to FHA's continued commitment to reaching first-time homebuyers. FHA will continue its efforts to reach potential first-time homebuyers through participation in conferences, seminars and other outreach events.

- *Endorse at least 525,000 FHA single family mortgages nationwide.*

  Although FHA did not establish an output goal in the Annual Performance Plan for the number of single family endorsements nationwide, the agency established an internal field-planning target of 525,000 endorsements. Homeownership Centers can use this target to allocate processing and underwriting workload across the nation to help increase single family homeownership rates. During fiscal year 2008, FHA endorsed 1,200,111 single family mortgages for insurance, exceeding the internal field-planning target of 525,000 endorsements. The increase in the total volume of single family mortgage insurance endorsements from 532,494 in fiscal year 2007 to 1,200,111 in fiscal year 2008 is largely attributable to the collapse of the sub-prime mortgage market. Other contributing factors to the increase in FHA endorsement levels include a rise in the number of mortgage refinance transactions, a continued significant volume of reverse mortgage endorsements, and an overall strong homebuyer acceptance of FHA products.

  In fiscal year 2008, the Department and the Congress put in place several initiatives to deal with the crosscurrents in the mortgage markets and in particular the high rates of foreclosure. These initiatives, including the FHA Modernization Act of 2008 and the HOPE for Homeowners Program, have made FHA mortgage insurance a more prominent portion of the nation's overall mortgage market.

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

  To help increase the number of minority families able to secure financing for their first home, FHA established a target of 33 percent for its Homeownership Centers for single family home purchase mortgage endorsements to minority first-time homebuyers. In fiscal year 2008, FHA-insured 31.2 percent of single family home purchase mortgages to first-time homebuyers who were minority, compared with the target of 33 percent and the 33 percent achieved in fiscal year 2007. There was a 1.8 percent decrease from fiscal year 2007 in the share of home purchase mortgages endorsed to minority first-time homebuyers. Still, FHA continues with its major programmatic efforts in increasing new minority homebuyers while also minimizing attrition of existing minority homeowners during stressful market conditions. FHA will continue to pursue the President's commitment to reaching minorities and increasing the minority homeownership rate through housing counseling outreach programs and print and radio advertising.

- *Sell 45 percent of FHA Real Estate Owned (REO) properties to owner-occupants.*

  In fiscal year 2008, FHA Single Family Housing surpassed the goal of selling 45 percent of REO properties to owner-occupants by achieving a rate of 50.1 percent. FHA sold 23,185 of 46,308 REO properties that it held to owner-occupants.

B. Strategic Goal: Strengthen Communities

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

  FHA established a national goal to ensure that at least 35 percent of single family mortgages endorsed for insurance are in underserved communities, thereby enhancing homeownership opportunities in these neighborhoods. During fiscal year 2008, FHA endorsed 455,523 out of 1,160,956 single family mortgages in underserved communities, representing 39.2 percent.

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

- *Meet congressionally mandated capital reserve targets on the FHA Mutual Mortgage Insurance Fund.*

  FHA's Mutual Mortgage Insurance (MMI) Fund is responsible for all expenses, excluding administrative expenses but including insurance claims incurred under FHA's basic single family mortgage insurance program. The capital ratio is an indicator of the MMI Fund's financial soundness. In fiscal year 2008, FHA achieved a 3.0 percent MMI fund ratio compared to 6.4 percent for fiscal year 2007. The capital ratio is calculated based on the economic value of the fund and insurance-in-force. The estimated economic value of the MMI fund decreased significantly with the forecast of expected house price declines due to a declining housing market. Conversely, the total MMI insurance-in-force, increased significantly due to the volume of new endorsements. The combination of these factors resulted in a decrease in the capital ratio. In the future, this ratio is expected to remain above the mandated 2.0 percent goal.

- *Average at least 50 percent net recovery rate per property sale.*

  FHA established a net recovery rate goal of 50 percent per HUD Real Estate Owned (REO) property sale to reduce insurance claim losses associated with foreclosures. During fiscal year 2008, the average net recovery rate per sale was 53.4 percent. This result exceeds the goal set for this performance indicator in fiscal year 2008.

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

  HUD set a national goal to conduct 300 lender-monitoring reviews of FHA-approved lenders in fiscal year 2008. HUD exceeded that goal by conducting 313 reviews in fiscal year 2008.

<u>Office of Multifamily Housing Programs</u>

The following sections summarize the Office of Multifamily Housing's achievements in meeting its fiscal year 2008 performance goals.

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

- *Endorse 750 Multifamily Initial Loans.*

  Multifamily initial endorsements for fiscal year 2008 totaled 647. The goal of 750 initial endorsements was not met because of heavy refinancing activity in fiscal year 2005 and 2006, which reduced the number of loans available for refinancing in the current fiscal year. In addition, the tightening of credit and higher interest rates in fiscal year 2008 contributed to the decrease in multifamily financing and endorsements.

B. Strategic Goal: Improve Management Accountability for Assisted Housing

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

  Multifamily Housing continues to improve the financial condition of properties by assuring that all property owners submit Annual Financial Statements (AFS) to the Real Estate Assessment Center and HUD field offices for review. Multifamily Housing exceeded the goal by ensuring that 100 percent of the properties in the multifamily inventory exhibit no compliance flags or have their findings closed in fiscal year 2008.

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

  HUD-held loans are placed under a workout plan when delinquent. Delinquent loans that do not have a workout plan are recommended for foreclosure, put in the mortgage sale, or referred to the Departmental Enforcement Center for further action. In fiscal year 2008, 80 percent of the HUD-held loans that are 90 or more days delinquent were brought under control.

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

- *Maintain the share of multifamily properties in underserved areas insured by FHA at 33 percent of initial endorsements.*

FHA set a goal of endorsing at least 33 percent of initial endorsements of multifamily properties in underserved areas in fiscal year 2008. FHA exceeded the goal as of the end of the year and endorsed 384 multifamily properties serving underserved communities, equaling 59 percent of its initial endorsements.

2008 Schedule of Performance Goals and Actual Results

Strategic Goals and Performance Objectives	*Goals*	*Actual Results*	*Goal Met (Yes/No)*
Office of Single Family Housing Programs			
A. Increase Homeownership Opportunities			
Resolve claims on FHA-insured mortgages through loss mitigation	55%	64.5%	Yes
Endorse mortgages to first-time homebuyers	73%	77.9%	Yes
Endorse mortgages nationwide (in thousands)	525	1,200	Yes
Endorse mortgages to first-time minority home buyers	33%	31.2%	No
Sell REO Properties to owner-occupants	45%	50.1%	Yes
B. Strengthen Communities			
Endorse FHA-insured mortgages in underserved communities	35%	39.2%	Yes
C. Embrace High Standards of Ethics, Management and Accountability			
Meet congressional mandated reserve target of 2%	2%	3%	Yes
Achieve property sale recovery rate	50%	53.4%	Yes
Perform FHA-approved lenders monitor reviews	300	313	Yes
Office of Multifamily Housing Programs			
A. Enhance the Availability of Affordable Rental Housing			
Complete Initial Endorsements	750	647	No
B. Improve Management Accountability for Assisted Housing			
Ensure properties have no compliance flags or have their finding closed	98%	100%	Yes
Maintain control over/reduce delinquency of HUD-held loans	75%	80%	Yes
C. Help Communities More Readily Access Revitalization Resources to Become More Livable			
Maintain Initial endorsements in underserved areas	33%	59%	Yes

FINANCIAL STATEMENTS

Credit Reform Accounting

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

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

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

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

Budgetary Resources

FHA finances its operations primarily through appropriations, borrowings from the U.S. Treasury, spending authority from offsetting collections, and prior year unobligated balances. During fiscal year 2008, FHA received appropriations of $627 million, borrowings of $943 million, spending authority from offsetting collections of $15,729 million, and recoveries of prior year obligations of $91 million. Additionally, FHA's budgetary resources were increased by $26,920 million of unobligated balances carried forward from fiscal year 2007 and reduced by $1,025 million for repayment of borrowings, the return of the unobligated GI/SRI liquidating account balances to Treasury, the return of cancelled program funds, and non expenditure transfers for working capital fund expenses.

For fiscal year 2008, $77 million in appropriations were received for MMI/CMHI contract expenses. FHA transferred $25 million to the working capital fund and obligated $48 million for contract expenses in fiscal year 2008. The GI/SRI program received appropriations for subsidy and contract expenses totaling $101 million in fiscal year 2008. FHA transferred $16 million to the working capital fund and obligated $62 million for contract expenses in fiscal year 2008.

During the year, FHA used its borrowing authority to obtain approximately $943 million from the U.S. Treasury and the public. These funds were used to pay for loan guarantee claims and for negative credit subsidy.

Spending authority of $13,458 million and $2,271 million was received from offsetting collections in the MMI and GI/SRI funds, respectively. These offsetting collections include collections of premiums, fees, sales proceeds of credit program assets and credit subsidy transferred between different FHA accounts.

These funds provided FHA the resources to cover the fiscal year 2008 obligations totaling $15,590 million. These obligations included: payments on defaulted guaranteed loans; the cost of acquiring, maintaining and disposing of foreclosed properties; the transfers of credit subsidy re-estimates; and maintaining MMI reserves (capital ratios) as required by the National Affordable Housing Act of 1990.

Assets and Liabilities

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

As of September 30, 2008 FHA had total assets of $37,681 million, a slight increase from the September 30, 2007 total asset balance of $37,165 million. Total liabilities as of September 30, 2008 were $26,923 million as compared to $16,590 million as of September 30, 2007. The increase in assets is mainly attributable to an increase in loans receivable. The increase in liabilities is primarily attributable to a 162 percent increase in loan guarantee liability.

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

	2005	2006	2007	2008
Assets	$ 37,161	$ 37,293	$ 37,165	$ 37,681
Liabilities	14,006	13,294	16,590	26,923
Net Position	$ 23,155	$ 23,999	$ 20,575	$ 10,758

As of September 30, 2008, FHA assets consisted of: investments in U.S. Treasury securities totaling $19,254 million; a fund balance with U.S. Treasury of $12,590 million; loan receivables and related foreclosed properties, net totaling $5,506 million; other receivables and assets totaling $331 million. FHA liabilities as of September 30, 2008 consisted of: loan guarantee liability totaling $19,486 million; borrowings from the U.S. Treasury of $4,832 million; payables to the public totaling $585 million; debentures issued to claimants totaling $52 million; other liabilities to federal agencies and to the public totaling $1,968 million.

Secretary-Held Mortgage Notes

A note is assigned to the Secretary when FHA pays a claim prior to foreclosure and takes possession of the mortgage note for servicing. Between fiscal years 2007 and 2008, the overall unpaid principal balance of Secretary-held mortgage notes had an increase from $3,863 million to $4,179 million. The number of multifamily notes in inventory decreased 3 percent from 2,990 notes in fiscal year 2007 to 2,894 notes in fiscal year 2008. The number of single-family notes increased by 26 percent from 55,622 notes in fiscal year 2007 to 70,559 notes in fiscal year 2008.

For the Single Family program, mortgage notes in default were assigned, under certain specified conditions, for forbearance relief and servicing By FHA. In 1996, statutory authority was enacted that terminated this program for numerous reasons, including the high costs related to servicing the assigned notes under the program and the low success rate of the forbearance program.

Statutory authority enacted in 1999 allows FHA to take assignments of defaulted single family notes, but not for the purpose of FHA providing forbearance relief. FHA has used this authority to sell assigned notes to private joint venture entity, in which FHA has a partial ownership interest, in order to resolve loan defaults.

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

	2005	2006	2007	2008
Single Family	$ 608	$ 631	$ 698	$ 1,038
Multifamily	3,363	3,265	3,165	3,156
Total	$ 3,971	$ 3,896	$ 3,863	$ 4,194

Secretary - Held Property

FHA acquires single family and multifamily properties through conveyance claims. Secretary-held property increased 17 percent in fiscal year 2008 to $4,482 million from $3,061 million in fiscal year 2007.

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

	2005	2006	2007	2008
Single Family	$ 2,830	$ 2,939	$ 3,060	$ 4,480
Multifamily	5	1	1	2
Total	$ 2,835	$ 2,940	$ 3,061	$ 4,482

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.

In fiscal year 2008, the LLG increased by $ 12,244 million from $7,060 million to $19,304 million. The single family LLG increased from a balance of $7,483 million in fiscal year 2007 to a balance of $19,662 million in fiscal year 2008. The $12,179 million single family LLG increase can be mostly attributed to increased claim rates due to two factors: (1) increased insurance of loans with down payment assistance, and (2) the nationwide decrease in projected house price appreciation, which results in increased claims and lower proceeds from the sale of foreclosed properties.

The multifamily LLG slightly increased from a balance of $(423) million in fiscal year 2007 to a balance of $(358) million in fiscal year 2008. The majority of the $64 million increase can be attributed to an increase in the number of loans eligible for Mark to Market restructuring.

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

	2005	2006	2007	2008
Single Family	$ 1,887	$ 3,028	$ 7,483	$ 19,662
Multifamily	1,480	(44)	(423)	(358)
Total	$ 3,367	$ 2,984	$ 7,060	$ 19,304

Pre-1992 Loan Loss Reserve (LLR)

The liability associated with pre-Credit Reform endorsements is computed by estimating the LLR. FHA maintains loss reserves for the estimated costs of future mortgage insurance claims resulting from defaults that have occurred or are likely to occur among insured single family and multifamily mortgages. 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. The LLR is computed using the present value of anticipated cash outflows, such as claim payments, premiums refunds, property expense for on-hand properties and sales expense for sold properties, less present value of anticipated cash inflows such as premium receipts, proceeds from property sales and principal and interest on Secretary-held notes. Overall, loss reserves decreased by $189 million from $371 million in fiscal year 2007 to $182 million in fiscal year 2008. The majority of the decrease can be attributed to a decrease in the Mark to Market program.

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

	2005	2006	2007	2008
Single Family	$ 57	$ 52	$ 97	$ 21
Multifamily	1,160	446	274	161
Total	$ 1,217	$ 498	$ 371	$ 182

Net Cost/ (Surplus)

FHA's program costs exceeded revenues in fiscal year 2008, thus resulting in a net cost. The most important facet of FHA's cost and revenue activity is the treatment of loan guarantee subsidy cost. Loan guarantee subsidy cost is the estimated long-term cost to FHA of a loan guarantee calculated on a net present value basis, excluding administrative costs. The cost of a loan guarantee is the net present value; at the time the loan is disbursed by the lender, of the estimated cash flows paid by FHA to cover claims, interest subsidies, and other requirements. Payments made to FHA, including origination premiums, penalties, and recoveries are also included in the calculation.

FHA has positive net program costs for 2008. This is due to a $9 billion upward re-estimate in the MMI fund and a $2 billion upward re-estimate in the GI fund.

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

	2005	2006	2007	2008
Program Cost	$ 786	$ (380)	$ 3,890	$ 11,378
Program Revenues	1,854	1,701	1,521	1,471
Net Cost (Surplus)	$ (1,068)	$ (2,081)	$ 2,369	$ 9,907

The $7,538 million increase in the Program Cost between fiscal year 2007 and fiscal year 2008 is comprised primarily of the $6,729 million increase in the loan subsidy expense.

Net Position

FHA's Net Position decreased to $10,758 million in fiscal year 2008, a decrease of 48 percent, due to the $9,684 million decrease in Cumulative Results of Operations and the $133 million decrease in Unexpended Appropriations.

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

	2005	2006	2007	2008
Net Position, Beginning of Year	$ 21,169	$ 23,155	$ 23,999	$ 20,575
Net Change in Cumulative Results of Operations	2,076	859	(3,374)	(9,684)
Increase in Unexpended Appropriations	(90)	(15)	(50)	(133)
Net Position, End of Year	$ 23,155	$ 23,999	$ 20,575	$ 10,758

SYSTEMS, CONTROLS, AND COMPLIANCE

FHA continues to improve financial management through the phased implementation of an integrated financial system to better support FHA's business needs. The FHA Comptroller developed a Blueprint for Financial Management to implement an integrated core financial management system that addressed financial management and system deficiencies previously documented by HUD's Inspector General, FHA and HUD financial statements auditors, OMB examiners and GAO auditors.

The FHA Subsidiary Ledger serves as FHA's core financial system and produces FHA's audited financial statements. The Subsidiary Ledger provides funds controls for all FHA financial operations and supports the FHA Comptroller's cash management and contract accounting functions. The FHA Subsidiary Ledger integrates all of FHA's financial operations through interfaces with the systems that perform underwriting, servicing, and post insurance operations for FHA's insurance programs. Through this integration, FHA has achieved compliance with federal statutory and regulatory requirements for financial systems.

Systems Accomplishments

FHA automated an interface from a new system supporting HECM notes management (A80H) to the FHA Subsidiary Ledger (FHASL), satisfying a fiscal year 2007 audit recommendation.

- FHA will complete development of the transaction processing functions required for Multifamily premium billing and collection and Multifamily claims. This marks a milestone in FHA's plan to replace the legacy F47 and F75 systems.

On-going and Planned Initiatives

- Complete data conversion, testing, training, and operational implementation of Multifamily premium billing and collection and claims functions within the FHASL and prepare to retire the F47 and F75 systems following completion of the fiscal year 2008 financial statement reports;
- Support business process engineering and related development and configuration work to adapt the FHASL to Treasury's Pay.Gov initiative;
- Support business process engineering and related development and configuration work to adapt the FHA Subsidiary Ledger to new processes for HECM financial operations;
- Support business process engineering and related development and configuration work to adapt the FHA Subsidiary Ledger to new FHA Modernization, Hope for Homeowners, and Manufactured Housing insurance programs mandated by the Housing and Economic Recovery Act; and
- Migrate the FHA Subsidiary Ledger to a consolidated financial management hosting environment in accordance with OMB's Financial Management Line of Business initiative, in collaboration with the Office of the Chief Financial Officer.

Fiscal Year 2008 Material Weaknesses

There are no material weaknesses identified for fiscal year 2008. FHA has eliminated the material weaknesses identified in fiscal year 2007.

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

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

In addition, FHA conducted its assessment of the effectiveness of internal control over financial reporting in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, FHA can provide reasonable assurance that its internal control over financial reporting as of June 30, 2008 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Fiscal Year 2008

Annual Assurance Statement on Internal Control over Financial Reporting

The Federal Housing Administration (FHA) management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. FHA conducted its assessment of the effectiveness of the FHA internal control over financial reporting in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, FHA can provide reasonable assurance that internal control over financial reporting as of June 30, 2008 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting
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Brian D.Montgomery
Assistant Secretary for Housing, Federal Housing Commissioner

Improper Payments Information Act of 2002

FHA Accomplishments

In accordance with the Improper Payments Information Act, enacted on November 26, 2002, and the OMB Memorandum M-03-13, dated May 21, 2003 (now subsumed into OMB Circular A-123 as Appendix C), FHA continued to comply with the requirements of the Act and determined which of its active inventory required review this year. Following the procedures that were used in 2005 with fiscal year 2004 data, the dollar amount of each FHA disbursement system's total disbursements were compared to the $40 million threshold. Multifamily's Property Management System (PMS) had been one of the five disbursement systems FHA analyzed annually, but it has fallen well below the threshold, and has been dropped from the list of systems to be considered. In fiscal years 2008 and 2007 the disbursements from the other four systems listed below exceeded the threshold.

- Single Family Insurance Claims System (SFIC)
- Multifamily Claims
- Single Family Distributive Shares and Premium Refunds
- Single Family Acquired Asset Management System (SAMS)

In fiscal year 2008, limited risk assessments were made on the first three of the systems listed above to assure that there were no changes that might contribute to vulnerability to improper payments. This year, we again examined the Single Family Acquired Asset Management System (SAMS) in detail. In addition, FHA's internal control review required by OMB Circular A-123, Appendix A concluded that each of these systems has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse.

Single Family Insurance Claims System (SFIC)

In July of fiscal year 2008, FHA again determined using a limited review that the previous risk assessment is still valid, that neither volume of claims, total dollars disbursed or program essentials have changed since the previous assessment, which showed that Single Family Claims were deemed to be not susceptible to improper payments. Additionally, HUD has modified the systems that track loan origination by adding flags that will trigger a review and/or action. Instructions have been made clearer both for HUD field offices and approved lenders to improve the oversight of the process. With loans that are more carefully underwritten and monitored, there will be fewer high-risk loans and fewer claims against the insurance fund.

To provide management with the confidence that the Single Family Claims system, as well as the process employed for assuring that only the appropriate amounts were paid to lenders submitting claims, were not subject to significant risk of improper payments, FHA initiated a review of the Single Family Claims process. The review incorporated a sample of a review of financial transactions with the results of an in house examination of post claim reviews for fiscal year 2007. The review found that the controls were excellent and that the Single Family Claims process should be categorized as low risk.

Multifamily Claims

In fiscal year 2008, as in fiscal year 2007, the dollar amounts of disbursements in the Multifamily Claims system exceeded the $40 million threshold and warranted a risk assessment. Our limited risk assessment revealed that there were no significant changes to the processes in place to make disbursements, leading us to conclude that the system is still not susceptible to improper payments.

Single Family Premium Refunds and Distributive Shares

In fiscal year 2008, as in fiscal year 2007, the dollar amounts of disbursements in the Single Family Premium Refunds and Distributive Shares system exceeded the $40 million threshold and warranted a risk assessment. Our limited risk assessment revealed that there were no significant changes to the volume of business or the processes in place to make disbursements, leading us to conclude that the system is still not susceptible to improper payments and places this system in the low risk category.

Single Family Acquired Asset Management System (SAMS) Improper Payment Analysis

During July and August of fiscal year 2008, an analysis of a statistically valid sample of SAMS disbursements made in fiscal year 2007 revealed that no errors were present in the sample. Limited transaction reviews were conducted and corroborated the previous finding of no significant risk of improper payments for fiscal years 2006 and 2007.

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PRINCIPAL FINANCIAL STATEMENTS

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FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2008 and 2007
(Dollars in Millions)

	2008	2007
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 12,590	$ 9,559
Investments (Note 4)	19,254	22,481
Other Assets (Note 7)	21	4
Total Intragovernmental	31,865	32,044
Investments (Note 4)	48	121
Accounts Receivable, Net (Note 5)	128	119
Loans Receivable and Related Foreclosed Property, Net (Note 6)	5,506	4,738
Other Assets (Note 7)	134	143
TOTAL ASSETS	**$ 37,681**	**$ 37,165**
LIABILITIES		
Intragovernmental		
Borrowings from U.S. Treasury (Note 9)	$ 4,832	$ 4,573
Other Liabilities (Note 10)	1,530	3,657
Total Intragovernmental	6,362	8,230
Accounts Payable (Note 8)	585	385
Loan Guarantee Liability (Note 6)	19,486	7,431
Debentures Issued to Claimants (Note 9)	52	70
Other Liabilities (Note 10)	438	474
TOTAL LIABILITIES	**26,923**	**16,590**
NET POSITION		
Unexpended Appropriations (Note 16)	411	544
Cumulative Results of Operations	10,347	20,031
TOTAL NET POSITION	**10,758**	**20,575**
TOTAL LIABILITIES AND NET POSITION	**$ 37,681**	**$ 37,165**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION

(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)

CONSOLIDATED STATEMENTS OF NET COST

As of September 30, 2008 and 2007

(Dollars in Millions)

	2008	2007
MMI/CMHI PROGRAM COSTS		
Intragovernmental Gross Costs (Note 12)	$ 175	$ 284
Less: Intragovernmental Earned Revenue (Note 13)	1,320	1,299
Intragovernmental Net Costs	(1,145)	(1,015)
Gross Costs with the Public (Note 12)	9,495	4,700
Less: Earned Revenue from the Public (Note 13)	9	24
Net Costs with the Public	9,486	4,676
NET MMI/CMHI PROGRAM COST (SURPLUS)	**$ 8,341**	**$ 3,661**
GI/SRI PROGRAM COSTS		
Intragovernmental Gross Costs (Note 12)	$ 138	$ 141
Less: Intragovernmental Earned Revenue (Note 13)	73	107
Intragovernmental Net Costs	65	34
Gross Costs with the Public (Note 12)	1,569	(1,235)
Less: Earned Revenue from the Public (Note 13)	68	91
Net Costs with the Public	1,501	(1,326)
NET GI/SRI PROGRAM COST (SURPLUS)	**1,566**	**(1,292)**
NET COST (SURPLUS) OF OPERATIONS	**$ 9,907**	**$ 2,369**

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 CHANGES IN NET POSITION

As of September 30, 2008 and 2007

(Dollars in Millions)

	2008 Cumulative Results of Operations	2008 Unexpended Appropriations	2007 Cumulative Results of Operations	2007 Unexpended Appropriations
BEGINNING BALANCES	**$ 20,031**	**$ 544**	**$ 23,405**	**$ 594**
BUDGETARY FINANCING SOURCES				
Appropriations Received (Note 16)	-	627	-	1,252
Other Adjustments (Note 16)	-	(49)	2	(119)
Appropriations Used (Note 16)	435	(435)	415	(415)
Transfers-Out (Note 15 and Note 16)	(613)	(276)	(1,014)	(768)
OTHER FINANCING SOURCES				
Transfers In/Out (Note 15)	387	-	(445)	-
Imputed Financing (Note 12)	14	-	37	-
TOTAL FINANCING SOURCES	**223**	**(133)**	**(1,005)**	**(50)**
NET (COST) SURPLUS OF OPERATIONS	**(9,907)**	**-**	**(2,369)**	**-**
ENDING BALANCES	**$ 10,347**	**$ 411**	**$ 20,031**	**$ 544**

The accompanying notes are an integral part of these statements.

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

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

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
As of September 30, 2007
(Dollars in Millions)

	2007 Budgetary	2007 Non-Budgetary	2007 Total
BUDGETARY RESOURCES			
Unobligated Balance, brought forward, October 1	$ 22,390	$ 7,032	$ 29,422
Recoveries of prior year unpaid obligations	89	124	213
Budget Authority:			
Appropriations	1,252	2	1,254
Borrowing authority	15	602	617
Spending authority from offsetting collections (gross):			
Earned			
Collected (Note 18)	2,057	9,104	11,161
Change in receivables from Federal sources	56	42	98
Change in unfilled customer order w/o advance	-	(4)	(4)
Nonexpenditure transfers, net (Note 19)	(609)	-	(609)
Permanently not available	(291)	(2,315)	(2,606)
TOTAL BUDGETARY RESOURCES	**$ 24,959**	**$ 14,587**	**$ 39,546**
STATUS OF BUDGETARY RESOURCES			
Obligations incurred, Direct (Note 20)	$ 2,116	$ 10,510	$ 12,626
Unobligated balance-Apportioned	187	993	1,180
Unobligated balance-Not available	22,656	3,084	25,740
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 24,959**	**$ 14,587**	**$ 39,546**
Change in Obligated Balances			
Obligated balance, net:			
Unpaid obligations, brought forward, October 1	$ 980	$ 1,377	$ 2,357
Uncollected customer payments from Federal sources, brought forward, October 1	(207)	(7)	(214)
Total, unpaid obligated balance, brought forward, net	773	1,370	2,143
Obligations incurred (Note 20)	2,116	10,510	12,626
Gross outlays	(2,053)	(10,420)	(12,473)
Recoveries of prior-year unpaid obligations, actual	(89)	(124)	(213)
Change in uncollected customer payments-Federal sources	(56)	(38)	(94)
Total, unpaid obligated balance, net, end of period	691	1,298	1,989
Obligated balance, net, end of period:			
Unpaid obligations	954	1,342	2,296
Uncollected customer payments from Federal sources	(263)	(44)	(307)
Total, unpaid obligated balance, net, end of period	691	1,298	1,989
Net outlays:			
Gross outlays	2,053	10,420	12,473
Offsetting collections (Note 18)	(2,057)	(9,104)	(11,161)
Less: Distributed offsetting receipts	2,759	-	2,759
NET OUTLAYS	**$ (2,763)**	**$ 1,316**	**$ (1,447)**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2008

Note 1. Significant Accounting Policies

Entity and Mission

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

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

FHA categorizes its activities 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 organizes its operations into two overall program types – MMI/CMHI and GI/SRI. These program types are comprised of four major 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. Effective in fiscal year 2009, the HECM program and Single Family programs currently in the GI fund will move to the MMI fund.

The Housing and Economic Recovery Act of 2008

On July 30, 2008 the President signed *the Housing and Economic Recovery Act of 2008*. This legislation requires FHA to modify existing programs and initiated a new program entitled *HOPE for Homeowners (H4H)*. The H4H program will begin on October 1, 2008; however, preparations for this new program began soon after the legislation was signed.

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*. The format of the SBR is based on the SF 133, *Report on Budget Execution and Budgetary Resources*.

Reclassifications

In fiscal year 2008, FHA reclassified certain accounts receivable and accounts payable amounts to different financial statement note line items in Note 5 and Note 8, respectively. These changes in classifications have no effect on previously reported financial statements.

Basis of Consolidation

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

Fund Balance with U.S. Treasury

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

Investments

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

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

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

Multifamily Risk Sharing Debentures [Section 542(c)] is a program available to lenders where the lender shares the risk in a property by issuing debentures for claim amount paid by FHA on defaulted insured loans. If FHA's risk is over 50%, HUD must review and approve the underwriting standards, terms, and conditions of the loan. If the loan defaults FHA pays the lender the initial settlement. On the settlement date the lender issues FHA a debenture for the amount of the settlement at the note rate (determined by the U.S. Treasury) thus sharing the risk in the property.

Credit Reform Accounting

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

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

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

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

Loans Receivable and Related Foreclosed Property, Net

FHA's loans receivable include mortgage notes assigned (MNA), also described as Secretary-held notes, and purchase money mortgages (PMM). Under the requirements of the FCRA, PMM notes are considered to be direct loans while MNA notes are considered to be defaulted guaranteed loans. The PMM loans are generated from the sales on credit of FHA's foreclosed properties to qualified non-profit organizations. The MNA notes are created when FHA pays the lenders for claims on defaulted guaranteed loans and takes assignment of the defaulted loans for direct collections. In addition, Multifamily and Single Family performing notes insured pursuant to Section 221(g)(4) of the National Housing Act may be assigned automatically to FHA at a pre-determined point.

In accordance with the FCRA and SFFAS No. 2, Credit Reform direct loans, defaulted guaranteed loans and related foreclosed property are reported at the net present value of expected cash flows associated with these assets, primarily estimated proceeds less selling and maintenance costs. The difference between the cost of these loans and property and the net present value is called the allowance for subsidy (AFS). Pre-Credit Reform loans receivable and foreclosed property in inventory are recorded at net realizable value, which is based on historical recovery rates net of any selling expenses (see Note 6).

Loan Guarantee Liability

The net potential future losses related to FHA's central business of providing mortgage insurance are reflected in the Loan Guarantee Liability in the consolidated balance sheets. As required by SFFAS No. 2, the Loan Guarantee Liability includes the Credit Reform related Liabilities for Loan Guarantees (LLG) and the pre-Credit Reform Loan Loss Reserve (LLR) (see Note 6).

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

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

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

Use of Estimates

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

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

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

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

General Property, Plant and Equipment

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

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

Unearned Premiums

Unearned premiums are recognized for pre-Credit Reform loan guarantee premiums collected but not yet earned in the liquidating account. Premiums charged by FHA’s MMI fund include up-front and annual risk-based premiums. Up-front risk-based premiums are recorded as unearned revenue upon collection and are recognized as revenue over the period in which losses and insurance costs are expected to occur. Annual risk-based premiums are recognized as revenue on a straight-line basis throughout the year. FHA's other funds charge periodic insurance premiums over the mortgage insurance term. Premiums on annual installment policies are recognized for the liquidating account on a straight-line basis throughout the year. Premiums associated with Credit Reform loan guarantees are included in the calculation of the LLG and are not included in the unearned premium amounts reported in the consolidated balance sheets.

Appropriations

FHA receives annual appropriations for Working Capital and Administrative Contract expenses for its MMI/CMHI, GI/SRI, and H4H program activities. Additionally, FHA receives appropriations for GI/SRI positive subsidy, upward reestimates, and permanent indefinite authority to cover any shortage of resources in the liquidating account. The MMI/CMHI fund obtains appropriations for upward reestimates from the Capital Reserve account.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, requires that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. For purposes of HUD’s consolidated financial statements, HUD identifies each responsibility segment’s share of the program costs or resources provided by other Federal agencies. As a responsibility segment of HUD, FHA’s portion of these costs was $14 million for fiscal year 2008 and $19 million for fiscal year 2007, and was included in FHA’s financial statements as an imputed cost in the Consolidated Statements of Net Cost, and an imputed financing in the Consolidated Statements of Changes in Net Position.

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

Distributive Shares

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

Liabilities Covered by Budgetary Resources

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

Statement of Budgetary Resources

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

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

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

Note 2. Non-entity Assets

Non-entity assets consist of assets that belong to other entities but are included in FHA's consolidated balance sheets. To reflect FHA's net position accurately, these non-entity assets are offset by various liabilities. FHA's non-entity assets as of September 30, 2008 and 2007 are as follows:

(Dollars in Millions)

	2008	2007
Intragovernmental:		
Fund Balance with U.S. Treasury	$ 1,551	$ 2,828
Investments in U.S. Treasury Securities	8	5
Total Intragovernmental	1,559	2,833
Other Assets	103	110
Total Non-entity Assets	1,662	2,943
Total Entity Assets	36,019	34,222
Total Assets	**$ 37,681**	**$ 37,165**

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

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

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

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was comprised of the following as of September 30, 2008 and 2007:

(Dollars in Millions)

		2008		2007
Fund Balances:				
Revolving Funds	$	10,746	$	6,450
Appropriated Funds		308		321
Other Funds		1,536		2,788
Total	**$**	**12,590**	**$**	**9,559**
Status of Fund Balance with U.S. Treasury:				
Unobligated Balance:				
Available	$	2,987	$	1,180
Unavailable		7,144		6,083
Obligated Balance not yet Disbursed		2,459		2,296
Total	**$**	**12,590**	**$**	**9,559**

Revolving Funds

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

Appropriated Funds

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

Other Funds

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

Status of Fund Balance with U.S. Treasury

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

Note 4. Investments

Investment in U.S. Treasury Securities

As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30th. The cost, net amortized premium/discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2008 were as follows:

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

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2007 were as follows:

(Dollars in Millions)	Cost	Amortized (Premium)/ Discount, Net	Investment, Net	Market Value
MMI/CMHI Investments	$ 22,129	$ 85	$ 22,214	$ 22,667
GI/SRI Investments	5	-	5	5
Subtotal	$ 22,134	$ 85	$ 22,219	$ 22,672
MMI/CMHI Accrued Interest	-	-	$ 262	$ 262
Total	**$ 22,134**	**$ 85**	**$ 22,481**	**$ 22,934**

Investments in Private-Sector Entities

The following table presents financial data on FHA's investments in Section 601 and Risk Sharing Debentures as of September 30, 2008 and 2007:

(Dollars in Millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Return of Investment	Redeemed	Ending Balance
601 Program	$ 41	$ -	$ (4)	$ (19)	$ -	$ 18
Risk Sharing Debentures	80	-	-	-	(50)	30
FY 2008 Total	**$ 121**	**$ -**	**$ (4)**	**$ (19)**	**$ (50)**	**$ 48**
601 Program	$ 98	$ -	$ (1)	$ (56)	$ -	$ 41
Risk Sharing Debentures	-	80	-	-	-	80
FY 2007 Total	**$ 98**	**$ 80**	**$ (1)**	**$ (56)**	**$ -**	**$ 121**

The fiscal year for the Section 601 Program investments is from December 1 to November 30 for 2008 and a combination of December 1 to November 30 and January 1 to December 31 for 2007. The condensed, audited financial information is as follows:

(Dollars in Millions)	2008	2007
Total assets, primarily mortgage loans	**$ 107**	**$ 258**
Liabilities	-	2
Partners' capital	107	256
Total liabilities and partners' capital	**$ 107**	**$ 258**
Revenues	7	78
Expenses	(5)	(23)
Net Income	**$ 2**	**$ 55**

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2008 and 2007 are as follows:

	Gross		Allowance		Net	
(Dollars in Millions)	2008	2007	2008	2007	2008	2007
With the Public:						
Receivables Related to Credit Program Assets	$ 55	$ 6	$ (3)	$ (5)	$ 52	$ 1
Premiums Receivable	2	5	-	-	2	5
Generic Debt Receivables	72	113	-	-	72	113
Miscellaneous receivables	2	-	-	-	2	-
Total	**$ 131**	**$ 124**	**$ (3)**	**$ (5)**	**$ 128**	**$ 119**

Receivables Related to Credit Program Assets

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

Premiums Receivable

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

Generic Debt Receivables

These amounts are mainly composed of receivables from various sources the largest of which are Single Family Partial Claims, Single Family Indemnification, 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

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and Loan Guarantee Liability as of September 30, 2008 and 2007 are as follows:

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

For the Loan Guarantee Program at FHA, in both the MMI/CMHI and GI/SRI funds there are Single Family and Multifamily activities. In the MMI/CMHI fund, the Single Family portion is represented by Section 203(b) which is the largest program in terms of Insurance in Force. The Multifamily portion of the MMI/CMHI fund is represented by Section 213 which is one of the smallest programs at FHA. In the GI/SRI fund, the Single Family portion is mostly comprised of Section 234(c) and HECM. Due to the size of the program, HECM is reported on its own line in this footnote and the rest of Single Family in GI/SRI on a separate line. The Multifamily portion of the GI/SRI fund contains numerous programs the largest of which are Section 221(d)(4), Section 207/223(f), Section 223(a)(7), and Section 232.

For the Direct Loan Program at FHA, all activity in the MMI/CMHI fund is Single Family and all activity in the GI/SRI fund is Multifamily.

Direct Loan Program

(Dollars in Millions)

Programs	Loans Receivable, Gross	Interest Receivable	Allowance	Foreclosed Property	Value of Assets Related to Direct Loans
MMI/CMHI - Single Family	$ 1	$ -	$ (4)	$ -	$ (3)
GI/SRI - Multifamily	13	4	(5)	-	12
FY 2008 Total	**$ 14**	**$ 4**	**$ (9)**	**$ -**	**$ 9**
MMI/CMHI - Single Family	$ 2	$ 1	$ (4)	$ -	$ (1)
GI/SRI - Multifamily	15	4	(6)	-	13
FY 2007 Total	**$ 17**	**$ 5**	**$ (10)**	**$ -**	**$ 12**

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

(Dollars in millions)

Programs	FY 2008	FY 2007
MMI/CMHI - Single Family	$ -	$ 3
GI/SRI - Multifamily	-	-
Total	**$ -**	**$ 3**

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

(Dollars in Millions)

Loan Guarantee Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net
FY 2008					
MMI/CMHI					
Single Family - 203(b)	$ 16	$ 3	$ (2)	$ 9	$ 26
Multifamily	-	-	-	-	-
MMI/CMHI Subtotal	**$ 16**	**$ 3**	**$ (2)**	**$ 9**	**$ 26**
GI/SRI					
Multifamily	$ 2,787	$ 179	$ (738)	$ -	$ 2,228
Single Family - HECM *	5	2	-	1	8
Single Family - Other	9	3	(6)	6	12
GI/SRI Subtotal	**$ 2,801**	**$ 184**	**$ (744)**	**$ 7**	**$ 2,248**
FY08 Total	**$ 2,817**	**$ 187**	**$ (746)**	**$ 16**	**$ 2,274**
FY 2007					
MMI/CMHI					
Single Family - 203(b)	$ 10	$ 4	$ (2)	$ 4	$ 16
Multifamily	-	-	-	-	-
MMI/CMHI Subtotal	**$ 10**	**$ 4**	**$ (2)**	**$ 4**	**$ 16**
GI/SRI					
Multifamily	$ 2,963	$ 202	$ (794)	$ -	$ 2,371
Single Family - HECM *	5	2	-	-	7
Single Family - Other	11	4	(8)	5	12
GI/SRI Subtotal	**$ 2,979**	**$ 208**	**$ (802)**	**$ 5**	**$ 2,390**
FY07 Total	**$ 2,989**	**$ 212**	**$ (804)**	**$ 9**	**$ 2,406**

*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)

Loan Guarantee Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net
FY 2008					
MMI/CMHI					
Single Family - 203(b)	$ 403	$ -	$ 4,053	$ (2,219)	$ 2,237
Multifamily	-	-	-	-	-
MMI/CMHI Subtotal	**$ 403**	**$ -**	**$ 4,053**	**$ (2,219)**	**$ 2,237**
GI/SRI					
Multifamily	$ 356	$ -	$ 2	$ (263)	$ 95
Single Family - HECM *	565	277	13	(89)	766
Single Family - Other	39	1	398	(313)	125
GI/SRI Subtotal	**$ 960**	**$ 278**	**$ 413**	**$ (665)**	**$ 986**
FY08 Total	**$ 1,363**	**$ 278**	**$ 4,466**	**$ (2,884)**	**$ 3,223**
FY 2007					
MMI/CMHI					
Single Family - 203(b)	$ 331	$ -	$ 2,710	$ (1,661)	$ 1,380
Multifamily	-	-	-	-	-
MMI/CMHI Subtotal	**$ 331**	**$ -**	**$ 2,710**	**$ (1,661)**	**$ 1,380**
GI/SRI					
Multifamily	$ 187	$ -	$ -	$ (44)	$ 143
Single Family - HECM *	310	188	3	-	501
Single Family - Other	45	(2)	327	(74)	296
GI/SRI Subtotal	**$ 542**	**$ 186**	**$ 330**	**$ (118)**	**$ 940**
FY07 Total	**$ 873**	**$ 186**	**$ 3,040**	**$ (1,779)**	**$ 2,320**

*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
FY 2008				
Guaranteed Loans Outstanding:				
MMI/CMHI				
Single Family - 203(b)	$	479,579	$	447,299
Multifamily		416		353
MMI/CMHI Subtotal	**$**	**479,995**	**$**	**447,652**
GI/SRI				
Single Family		30,346		27,685
Multifamily		62,855		56,384
GI/SRI Subtotal	**$**	**93,201**	**$**	**84,069**
Total	**$**	**573,196**	**$**	**531,721**

Loan Guarantee Programs		Outstanding Principal of Guaranteed Loans, Face Value		Amount of Outstanding Principal Guaranteed
FY 2007				
Guaranteed Loans Outstanding:				
MMI/CMHI				
Single Family - 203(b)	$	351,751	$	321,816
Multifamily		449		336
MMI/CMHI Subtotal	**$**	**352,200**	**$**	**322,152**
GI/SRI				
Single Family		24,164		21,519
Multifamily		62,509		56,289
GI/SRI Subtotal	**$**	**86,673**	**$**	**77,808**
Total	**$**	**438,873**	**$**	**399,960**

New Guaranteed Loans Disbursed:

(Dollars in millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value		Amount of Outstanding Principal Guaranteed	
FY 2008				
New Guaranteed Loans Disbursed:				
MMI/CMHI				
Single Family - 203(b)	$	171,811	$	167,338
Multifamily		14		14
MMI/CMHI Subtotal	**$**	**171,825**	**$**	**167,352**
GI/SRI				
Single Family		9,449		9,204
Multifamily		3,458		3,446
GI/SRI Subtotal	$	12,907	$	12,650
Total	**$**	**184,732**	**$**	**180,002**

FY 2007				
New Guaranteed Loans Disbursed:				
MMI/CMHI				
Single Family - 203(b)	$	56,477	$	56,134
Multifamily		33		33
MMI/CMHI Subtotal	**$**	**56,510**	**$**	**56,167**
GI/SRI				
Single Family		3,409		3,387
Multifamily		3,592		3,584
GI/SRI Subtotal	**$**	**7,001**	**$**	**6,971**
Total	**$**	**63,511**	**$**	**63,138**

HECM (reverse mortgages) are not included in the previous tables due to the unique nature of the program. Currently, FHA has 360,033 active HECM insured loans with a maximum claim amount of $78 billion. As of September 30, 2008, the insurance in force (the outstanding balance of active loans) was $44 billion. The insurance in force includes balances drawn by the mortgagee; interest accrued on the balances drawn, service charges, and mortgage insurance premiums. The maximum claim amount is the dollar ceiling to which the outstanding loan balance can grow before being assigned to FHA.

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

		Cumulative	
Loan Guarantee Programs	**Current Year Endorsements**	**Outstanding Balance**	**Potential Liability**
FY 2008 GI/SRI	$ 24,166	$ 43,741	$ 77,736
FY 2007 GI/SRI	$ 24,567	$ 29,982	$ 56,676

Loan Guarantee Liability, Net:

(Dollars in Millions) **Loan Guarantee Programs**	**Liabilities for Losses on Pre-1992 Guarantees, Estimated Future Default Claims**	**Liabilities for Loan Guarantees for Post-1991 Guarantees (LLG)**	**Total Loan Guarantee Liability**
FY 2008			
MMI/CMHI			
Single Family - 203(b)	$ 20	$ 17,384	$ 17,404
Multifamily	-	(4)	(4)
MMI/CMHI Subtotal	**$ 20**	**$ 17,380**	**$ 17,400**
GI/SRI			
Multifamily	$ 160	$ (354)	$ (194)
Single Family - HECM	-	1,521	1,521
Single Family - Other	2	757	759
GI/SRI Subtotal	**$ 162**	**$ 1,924**	**$ 2,086**
FY 2008 Total	**$ 182**	**$ 19,304**	**$ 19,486**
FY 2007			
MMI/CMHI			
Single Family - 203(b)	$ 89	$ 6,906	$ 6,995
Multifamily	-	(4)	(4)
MMI/CMHI Subtotal	**$ 89**	**$ 6,902**	**$ 6,991**
GI/SRI			
Multifamily	$ 275	$ (419)	$ (144)
Single Family - HECM	(2)	326	324
Single Family - Other	9	251	260
GI/SRI Subtotal	**$ 282**	**$ 158**	**$ 440**
FY 2007 Total	**$ 371**	**$ 7,060**	**$ 7,431**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

Subsidy Expense for New Loan Guarantees		Defaults		Fees and Other Collections		Other		Total
FY 2008								
MMI/CMHI								
Single Family - 203(b)	$	4,545	$	(6,600)	$	1,620	$	(435)
Multifamily		1		(1)		-		-
MMI/CMHI Total	**$**	**4,546**	**$**	**(6,601)**	**$**	**1,620**	**$**	**(435)**
GI/SRI								
Multifamily	$	151	$	(227)	$	-	$	(76)
Single Family - HECM		486		(948)		-		(462)
Single Family - Other		284		(339)		-		(55)
GI/SRI Total	**$**	**921**	**$**	**(1,514)**	**$**	**-**	**$**	**(593)**
FY08 Total	**$**	**5,467**	**$**	**(8,115)**	**$**	**1,620**	**$**	**(1,028)**
FY 2007								
MMI/CMHI								
Single Family - 203(b)	$	1,248	$	(2,124)	$	667	$	(209)
Multifamily		1		(1)		-		-
MMI/CMHI Total	**$**	**1,249**	**$**	**(2,125)**	**$**	**667**	**$**	**(209)**
GI/SRI								
Multifamily	$	177	$	(255)	$	-	$	(78)
Single Family - HECM		491		(1,188)		-		(697)
Single Family - Other		86		(126)		-		(40)
GI/SRI Total	**$**	**754**	**$**	**(1,569)**	**$**	**-**	**$**	**(815)**
FY07 Total	**$**	**2,003**	**$**	**(3,694)**	**$**	**667**	**$**	**(1,024)**

Subsidy Expense for Modifications and Reestimates:

(Dollars in Millions)		Total Modifications		Technical Reestimate
FY 2008				
MMI/CMHI	$	-	$	8,650
GI/SRI		-		1,709
Total	**$**	**-**	**$**	**10,359**
FY 2007				
MMI/CMHI	$	(5)	$	3,940
GI/SRI		-		(310)
Total	**$**	**(5)**	**$**	**3,630**

Total Loan Guarantee Subsidy Expense:

(Dollars in Millions)	2008	2007
MMI/CMHI	$ 8,215	$ 3,726
GI/SRI	1,116	(1,125)
Total	**$ 9,331**	**$ 2,601**

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(Percentage)	Defaults	Fees and Other	Other	Total
Budget Subsidy Rates for FY 2008 Loan Guarantees:				
MMI/CMHI				
Single Family - Section 203(b), Effective 10/01/2007-7/13/2008	2.45	(3.71)	0.95	(0.31)
Single Family - Section 203(b), Effective 7/14/2008-9/30/2008	2.99	(4.07)	0.93	(0.15)
Multifamily	1.96	(3.86)	1.00	(0.90)
GI/SRI				
Multifamily				
Section 221(d)(4)	4.46	(5.29)	-	(0.83)
Section 207/223(f)	1.98	(4.73)	-	(2.75)
Section 223(a)(7)	1.98	(4.73)	-	(2.75)
Section 232	3.73	(5.31)	-	(1.58)
Single Family - HECM	2.00	(3.90)	-	(1.90)
Single Family - Section 234(c)	2.68	(3.56)	-	(0.88)
Budget Subsidy Rates for FY 2007 Loan Guarantees:				
MMI/CMHI				
Single Family - Section 203(b)	2.21	(3.76)	1.18	(0.37)
Multifamily	1.77	(3.93)	0.87	(1.29)
GI/SRI				
Multifamily				
Section 221(d)(4)	4.87	(5.48)	-	(0.61)
Section 207/223(f)	3.15	(4.78)	-	(1.63)
Section 223(a)(7)	3.15	(4.78)	-	(1.63)
Section 232	4.64	(5.55)	-	(0.91)
Single Family - HECM	1.99	(4.81)	-	(2.82)
Single Family - Section 234(c)	2.15	(3.64)	-	(1.49)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in millions)

	2008		2007	
	LLR	**LLG**	**LLR**	**LLG**
Beginning Balance of the Loan Guarantee Liability	**$ 371**	**$ 7,060**	**$ 498**	**$ 2,984**
Add:				
Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	5,467	-	2,003
Fees and Other Collections	-	(8,115)	-	(3,694)
Other Subsidy Costs	-	1,620	-	667
Total of the above subsidy expense components	**-**	**(1,028)**	**-**	**(1,024)**
Adjustments:				
Fees Received	-	5,468	-	3,234
Foreclosed Property and Loans Acquired	-	4,683	-	3,756
Claim Payments to Lenders	-	(8,486)	-	(5,869)
Interest Accumulation on the Liability Balance	-	161	-	(68)
Other	-	(66)	-	(6)
Ending Balance before Reestimates	**371**	**7,792**	**498**	**3,007**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate:				
Subsidy Expense Component	(189)	10,369	(127)	3,571
Interest Expense Component	-	1,141	-	381
Adjustment to credit subsidy reestimates	-	2	-	101
Total Technical/Default Reestimate	**(189)**	**11,512**	**(127)**	**4,053**
Ending Balance of the Loan Guarantee Liability	**$ 182**	**$ 19,304**	**$ 371**	**$ 7,060**

Administrative Expense:

(Dollars in millions)

	2008	2007
MMI/CMHI	$ 228	$ 221
GI/SRI	277	273
Total	**$ 505**	**$ 494**

Other Information on Foreclosed Property:

Additional information on FHA foreclosed property as of September 30, 2008 and 2007 is as follows:

	2008	2007
Number of properties in foreclosure process	67	84
Number of properties held	37,890	27,782
Average holding period for property held	7 months	6 months

Pre-Credit Reform Valuation Methodology

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

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

Credit Reform Valuation Methodology

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

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

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

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

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

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

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

Additional information about loan performance assumptions is provided below:

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

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

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

Reliance on historical performance: FHA relies on the average historical performance of its insured portfolio to forecast future performance of that portfolio. Changes in legislation, subsidy programs, tax treatment and economic factors all influence loan performance. FHA assumes that similar events may occur during the remaining life of existing mortgage guarantees, which can be as long as 40 years for Multifamily programs and affect loan performance accordingly.

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

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

Analysis of Change in the Liability for Loan Guarantees

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

FHA estimated the credit subsidy rates for the 2008 cohort in December 2006. At the time of budget submission, the rates reflected prevailing policy and loan performance assumptions based on the most recent information available at that time. The annual credit subsidy reestimates allow FHA to adjust the LLG and subsidy expense to reflect the most current and accurate credit subsidy rate.

Described below are the programs that comprise the majority of FHA’s fiscal year 2008 business. These descriptions highlight the factors that contributed to changing credit subsidy rates and the credit subsidy reestimates. Overall, FHA’s liability increased from the fiscal year 2007 estimates.

Mutual Mortgage Insurance (MMI) - During fiscal year 2008, FHA continued to experience increased claim rates due to the nationwide decrease in house price appreciation, which resulted in increased claims and lower proceeds from the sale of foreclosed properties. Moreover, due to the shrinkage of capital availability in the conventional mortgage market, FHA has experienced a surge in new endorsements during fiscal year 2008. This caused a significant increase in the volume of insurance-in-force, coupled with the increase in expected claims and lowered sales proceeds, the liability for MMI increased from $6,906 million in fiscal year 2007 to $17,384 million in fiscal year 2008.

GI/SRI Home Equity Conversion Mortgage (HECM) - The HECM volume leveled off during fiscal year 2008 and the HECM liability increased from $326 million in fiscal year 2007 to $1,521 million in fiscal year 2008. The change in liability from fiscal 2007 to fiscal 2008 is primarily due to the drop in house price appreciation projections from Global Insights. The drop in house price appreciation projections results in lower recoveries from future HECM assigned assets which increases the liability.

GI/SRI Section 221(d)(4) - The Section 221(d)(4) program was established to provide mortgage insurance for the construction or substantial rehabilitation of Multifamily rental properties with five or more units. Under this program, HUD may insure up to 90 percent of the total project cost and is prohibited from insuring loans with HUD-subsidized interest rates. The Section 221(d)(4) program is the largest Multifamily program in the GI/SRI fund. The Section 221(d)(4) liability increased by $4 million in FY 2008.

Mark-to-Market - The Mark to Market (MTM) program was established by legislation to assess rents at the time of Section 8 Assistance contract renewal. If rents are above market levels, the project is referred to OAHP. OAHP then evaluates the project for potential financial restructuring to determine if the project could survive given the lower revenues from reduced rents. The pool of loans eligible for MTM restructuring is comprised of active insured loans with Section 8 Assistance contracts, which also meet all eligibility requirements such as financial statements submitted within the last 2 years and assistance contracts expiring within the next 5 years. While new Section 8 assistance contracts are not being offered to any properties, which reduces the number of active insured loans with section 8 contracts, the number of projects that meet MTM eligibility criteria may actually increase from year to year. A loan can fail one or more of the eligibility criteria one year but become eligible the following year. For calculating the liability for loan guarantees in FY 2008, the number of loans that met all eligibility requirements increased. As a result, the MTM liability increased.

GI/SRI Section 234(c) - The Section 234(c) program insures loans for condominium purchases. One of the many purposes of FHA’s mortgage insurance programs is to encourage lenders to make affordable mortgage credit available for non-conventional forms of ownership. Condominium ownership, in which the separate owners of the individual units jointly own the development’s common areas and facilities, is one particularly popular alternative. As in the MMI fund, Section 234(c) continued to experience increased claim rates due to the nationwide decrease in house price appreciation, which resulted in increased claims and lower proceeds from the sale of foreclosed properties. These changes resulted in an increase in the liability from $108 million in fiscal year 2007 to $502 million for fiscal year 2008.

Hurricane Ike - In September 2008, Hurricane Ike made landfall in Texas as a category 2 hurricane. While this hurricane caused property damage in areas along or near the Texas shoreline, the impact on FHA insured mortgages is not significant enough to warrant an adjustment in the liability calculation.

Impact of Changing Economic Conditions

The MMI Fund constitutes the majority of FHA’s single family business, with 93.7 percent of the total single family IIF dollars. One measure of the fund’s financial soundness is the MMI capital ratio, based on the economic value of the MMI Fund to the balance of the MMI Insurance-In-Force. The Cranston-Gonzalez National Affordable Housing Act of 1990 requires an independent actuarial analysis of the economic net worth of the MMI Fund. In addition, the Act mandates that the MMI Fund achieve a capital ratio, a measure of the Fund’s economic net worth, of at least 2 percent by the year 2000, which was achieved in 1995 and maintained ever since. In fiscal year 2008, the estimated economic value of the MMI fund decreased significantly with the forecast of expected house price declines due to a declining housing market. Conversely, the total MMI insurance-in-force, increased significantly due to the volume of new endorsements. The combination of these factors resulted in a decrease in the capital ratio from 6.4 percent in fiscal year 2007 to 3.0 percent in fiscal year 2008.

Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2008 and 2007:

(Dollars in Millions)

		2008		2007
Intragovernmental:				
Advances to HUD for Working Capital Fund Expenses	$	21	$	4
Total	**$**	**21**	**$**	**4**
With the Public:				
Escrow Monies Deposited at Minority-Owned Banks	$	103	$	110
Undistributed Charges		31		33
Total	**$**	**134**	**$**	**143**

Advances to HUD for Working Capital Fund Expenses

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

Escrow Monies Deposited at Minority-Owned Banks

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

Undistributed Charges

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

Note 8. Accounts Payable

Accounts Payable as of September 30, 2008 and 2007 are as follows:

(Dollars in Millions)

		2008		2007
With the Public:				
Claims Payable	$	316	$	152
Premium Refunds and Distributive Shares Payable		174		175
Miscellaneous Payables		95		58
Total	**$**	**585**	**$**	**385**

Claims Payable

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

Premium Refunds and Distributive Shares Payable

Premium refunds payable are refunds of previously collected Single Family premiums that will be returned to the borrowers resulting from prepayment of the insured mortgages. Distributive shares payable represent the amount of excess revenues in the liquidating account of the CMHI fund that is to be distributed to the mortgagors at the discretion of the Secretary of HUD.

Miscellaneous Payables

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

Note 9. Debt

The following tables describe the composition of Debt held by FHA as of September 30, 2008 and 2007:

(Dollars in Millions)	2007			2008	
	Beginning Balance	**Net Borrowing**	**Ending Balance**	**Net Borrowing**	**Ending Balance**
Agency Debt:					
Debentures Issued to Claimants	$ 95	$ (25)	$ 70	$ (18)	$ 52
Other Debt:					
Borrowings from U.S. Treasury	6,258	(1,685)	4,573	259	4,832
Total	**$ 6,353**	**$ (1,710)**	**$ 4,643**	**$ 241**	**$ 4,884**

	2008	**2007**
Classification of Debt:		
Intragovernmental Debt	$ 4,832	$ 4,573
Debt held by the Public	52	70
Total	**$ 4,884**	**$ 4,643**

Debentures Issued to Public

The National Housing Act authorizes FHA, in certain cases, to issue debentures in lieu of cash to settle claims. FHA-issued debentures bear interest at rates established by the U.S. Treasury. Interest rates related to the outstanding debentures ranged from 4.00 percent to 12.875 percent in both fiscal years 2008 and 2007. Lenders may redeem FHA debentures prior to maturity in order to pay mortgage insurance premiums to FHA, or they may be called with the approval of the Secretary of the U.S. Treasury.

The par value of debentures outstanding, not including accrued interest, was September 30 was $51 million in fiscal year 2008 and $69 million in fiscal year 2007. The fair values for fiscal years 2008 and 2007 were $74 and $101 million, respectively.

Borrowings from U.S. Treasury

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

During fiscal year 2008, FHA's U.S. Treasury borrowings carried interest rates ranging from 2.33 percent to 7.34 percent. In fiscal year 2007, the carried interest rates also ranged from 2.33 percent to 7.34 percent. Fiscal year 2008 maturity dates occur from September 2009 – September 2027. 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, 2008 and 2007:

(Dollars in Millions)

2008		Current		Non-Current		Total
Intragovernmental:						
Receipt Account Liability	$	1,530	$	-	$	1,530
Total	**$**	**1,530**	**$**	**-**	**$**	**1,530**
With the Public:						
Trust and Deposit Liabilities	$	152	$	-	$	152
Unearned Premiums		15		13		28
Undistributed Credits		49		-		49
Miscellaneous Liabilities		209		-		209
Total	**$**	**425**	**$**	**13**	**$**	**438**

2007		Current		Non-Current		Total
Intragovernmental:						
Receipt Account Liability	$	3,657	$	-	$	3,657
Total	**$**	**3,657**	**$**	**-**	**$**	**3,657**
With the Public:						
Trust and Deposit Liabilities	$	155	$	-	$	155
Unearned Premiums		24		7		31
Undistributed Credits		48		-		48
Miscellaneous Liabilities		240		-		240
Total	**$**	**467**	**$**	**7**	**$**	**474**

Special Receipt Account Liability

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

Trust and Deposit Liabilities

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

Unearned Premiums

As discussed in Note 1, unearned premiums represent premiums collected for the pre-1992 loan guarantees, but not recognized as revenue because the earning process has not been completed.

Undistributed Credits

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

Miscellaneous Liabilities

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

Note 11. Commitments and Contingencies

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 and claims will not have a material affect on FHA's consolidated financial statements as of September 30, 2008. FHA has not recognized any contingent liability due to the probable, or likely, adverse judgment in these cases. However, there are legal actions where judgment against FHA is considered reasonably possible with an estimated potential loss of $3 million.

Pending Litigation Against FHA

(Dollars in millions)

	2008	**2007**
Expected Outcome	Estimated Loss	Estimated Loss
Probable	-	$11
Reasonably Possible	$3	$3
Remote	-	-

Note 12. Gross Costs

Gross costs incurred by FHA for the fiscal years ended September 30, 2008 and 2007 are as follows:

(Dollars in Millions)	2008		2007	
	MMI/CMHI	GI/SRI	MMI/CMHI	GI/SRI
Intragovernmental:				
Interest Expense	$ 167	$ 127	$ 263	$ 104
Imputed Costs	6	8	8	29
Other Expenses	2	3	13	8
Total	**$ 175**	**$ 138**	**$ 284**	**$ 141**
With the Public:				
Salary and Administrative Expenses	$ 226	$ 274	$ 208	$ 265
Subsidy Expense	8,215	1,116	3,726	(1,125)
Interest Expense	1,108	251	697	(338)
Bad Debt Expense	5	(49)	(20)	11
Loan Loss Reserve Expense	(69)	(123)	48	(143)
Other Expenses	10	100	41	95
Total	**$ 9,495**	**$ 1,569**	**$ 4,700**	**$ (1,235)**

Interest Expense

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

Imputed Costs/Imputed Financing

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

Salary and Administrative Expenses

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

Subsidy Expense

Subsidy expense, positive and negative, consists of credit subsidy expense from new endorsements, modifications, and annual credit subsidy reestimates and the subsidy expense incurred by the Church Arson program. Credit subsidy expense is the estimated long-term cost to the U.S. Government of a direct loan or loan guarantee, calculated on a net present value basis of the estimated future cash flows associated with the direct loan or loan guarantee. Subsidy expense incurred by the Church Arson program is the expense of a HUD program administered by the Office of Community Planning and Development (CPD) even though its cost is funded through a FHA program account.

Bad Debt Expense

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

Loan Loss Reserve Expense

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

Other Expenses

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

Note 13. Earned Revenue

Earned revenues generated by FHA for the fiscal years ended September 30, 2008 and 2007 are as follows:

(Dollars in Millions)	2008		2007	
	MMI/CMHI	**GI/SRI**	**MMI/CMHI**	**GI/SRI**
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 424	$ 73	$ 308	$ 107
Interest Revenue from MMI/CMHI Investments	896	-	991	-
Total	**$ 1,320**	**$ 73**	**$ 1,299**	**$ 107**
With the Public:				
Premium Revenue	$ 10	$ 21	$ 13	$ 38
Interest Revenue	(1)	41	2	53
Other Revenue	-	6	9	-
Total	**$ 9**	**$ 68**	**$ 24**	**$ 91**

Interest Revenue

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

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

Premium Revenue

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

Up-front Premiums

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

The FHA up-front premium rates in fiscal year 2008 were:

	Premium Rate
Single Family	1.50%
Multifamily	0.45 %, 0.50%, 0.57% or 0.80%
HECM	2.00% (Based on Maximum Claim Amount)

Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums receivable. These rates, which are also legislated, vary by mortgage type and program. The FHA periodic premium rate in fiscal year 2008 for Single Family and Multifamily were:

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

For Title I, the maximum insurance premium paid for guaranteed cases endorsed in years 1992 through 2001 is equal to 0.50 percent of the loan amount multiplied by the number of years of the loan term. The annual insurance premium for a Title I Property Improvement loan is 0.50 percent of the loan amount until the maximum insurance charge is paid. The annual insurance premium of a Title I Manufactured Housing loan is calculated in tiers by loan term until the maximum insurance charge is paid. For guaranteed cases endorsed in fiscal years 2007 and 2008, the Title I annual insurance premium is 1.00 percent of the loan amount until maturity.

Other Revenue

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

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

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

Note 15. Transfers

Transfers in/out incurred by FHA for the fiscal years ended September 30, 2008 and 2007 are as follows:

(Dollars in Millions)

2008

Budgetary Financing Sources

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

Other Financing Sources

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

2007

Budgetary Financing Sources

	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (1,014)	$ (159)	$ (1,173)
HUD	-	(609)	(609)
Total	**$ (1,014)**	**$ (768)**	**$ (1,782)**

Other Financing Sources

	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (834)	$ -	$ (834)
HUD	389	-	389
Total	**$ (445)**	**$ -**	**$ (445)**

Transfers Out to U.S. Treasury

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

Transfers In/Out From HUD

In fiscal year 2007, FHA made non-expenditure Transfers Out of appropriated funds to HUD for Salaries and Administrative Expenses (S&E) as well as for Working Capital Fund Expenses. In FY 2008, FHA did not receive an appropriation for S&E; instead the FHA amounts were appropriated directly to HUD. In order to recognize the S&E in FHA's Statement of Net Cost, a Transfer In from HUD was recorded with the recognition of FHA S&E costs. FHA continues to make a non-expenditure Transfer Out to HUD for Working Capital Fund Expenses.

Note 16. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2008 and 2007 are as follows:

(Dollars in Millions)

2008	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 28	$ 8	$ -	$ (21)	$ -	$ 15
Working Capital and Contract Expenses	293	205	(49)	(98)	(41)	310
Reestimates	-	301	-	(301)	-	-
GI/SRI Liquidating	223	113	-	(15)	(235)	86
Total	**$ 544**	**$ 627**	**$ (49)**	**$ (435)**	**$ (276)**	**$ 411**

2007	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 64	$ 9	$ (40)	$ (5)	$ -	$ 28
Working Capital and Contract Expenses	365	721	(79)	(105)	(609)	293
Reestimates	-	109	-	(109)	-	-
GI/SRI Liquidating	165	413	-	(196)	(159)	223
Total	**$ 594**	**$ 1,252**	**$ (119)**	**$ (415)**	**$ (768)**	**$ 544**

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

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

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

Note 17. Budgetary Resources

The SF-133 and the Statement of Budgetary Resources for fiscal year 2007 have been reconciled to the fiscal year 2007 actual amounts included in the Program and Financing Schedules presented in the Budget of the United States Government. There were no significant reconciling items. Information from the fiscal year 2008 Statement of Budgetary Resources will be presented in the fiscal year 2010 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2010 and will be available from the Government Printing Office and online at that time.

Obligated balances for the period ended September 30, 2008 and 2007 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders		FY 2008		FY 2007
MMI/CMHI	$	795	$	662
GI/SRI		526		588
Undelivered Orders Subtotal	**$**	**1,321**	**$**	**1,250**
Accounts Payable				
MMI/CMHI	$	793	$	772
GI/SRI		345		274
Accounts Payable Subtotal	**$**	**1,138**	**$**	**1,046**
Unpaid Obligations Total	**$**	**2,459**	**$**	**2,296**

In fiscal year 2007, FHA made non-expenditure Transfers Out of appropriated funds to HUD for Salaries and Administrative Expenses (S&E) as well as for Working Capital Fund Expenses. In FY 2008, FHA did not receive an appropriation for S&E; instead the FHA amounts were appropriated directly to HUD. In order to recognize the S&E in FHA's Statement of Net cost, a Transfer In from HUD was recorded with the recognition of FHA S&E costs. FHA continues to make a non-expenditure Transfer Out to HUD for Working Capital Fund Expenses.

NOTE 18. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2008 and 2007:

(Dollars in Millions)

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

(Dollars in Millions)

2007	MMI/CMHI	GI/SRI	Total
Collections:			
Premiums	$ 2,148	$ 904	$ 3,052
Notes	39	542	581
Property	3,334	142	3,476
Interest Earned from U.S Treasury	1,264	107	1,371
Subsidy	214	124	338
Reestimates	1,904	109	2,013
Other	101	229	330
Total	**$ 9,004**	**$ 2,157**	**$ 11,161**

Note 19. Budgetary Resources – Non-expenditure Transfers

The following table presents the composition of FHA's non-expenditure transfers through September 30, 2008 and 2007:

(Dollars in Millions)

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

(Dollars in Millions)

2007	MMI/CMHI	GI/SRI	Total
Transfers:			
Salaries, Administrative Expense and Working Capital Expenses	$ (369)	$ (240)	$ (609)
Total	**$ (369)**	**$ (240)**	**$ (609)**

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2008 and 2007:

(Dollars in Millions)

September 30, 2008	**MMI/CMHI**	**GI/SRI**	**H4H**	**Total**
Obligations:				
Claims	$ 6,494	$ 1,146	$ -	$ 7,640
Single Family Property Management Contracts	411	21	-	432
Contract Obligations	47	79	20	146
Subsidy	435	643	-	1,078
Downward Reestimates	5	897	-	902
Upward Reestimates	4,555	301	-	4,856
Interest on Borrowings	167	134	-	301
Other	94	141	-	235
Total	**$ 12,208**	**$ 3,362**	**$ 20**	**$ 15,590**

(Dollars in Millions)

September 30, 2007	**MMI/CMHI**	**GI/SRI**	**H4H**	**Total**
Obligations:				
Claims	$ 5,340	$ 1,003	$ -	$ 6,343
Single Family Property Management Contracts	360	17	-	377
Contract Obligations	40	142	-	182
Subsidy	214	1,134	-	1,348
Downward Reestimates	554	1,746	-	2,300
Upward Reestimates	1,351	109	-	1,460
Interest on Borrowings	263	115	-	378
Other	68	170	-	238
Total	**$ 8,190**	**$ 4,436**	**$ -**	**$ 12,626**

NOTE 21. Reconciliation of Net Cost of Operations to Budget

This note (formerly the Statement of Financing) links the proprietary data to the budgetary data. Most transactions are recorded in both proprietary and budgetary accounts. However, because different accounting bases are used for budgetary and proprietary accounting, some transactions may appear in only one set of accounts. The Reconciliation of Net Cost of Operations to Budget is as follows for the periods ending September 30, 2008 and 2007:

(Dollars in Millions)		**2008**		**2007**
RESOURCES USED TO FINANCE ACTIVITIES				
Obligations Incurred	$	15,590	$	12,626
Spending Authority from Offsetting Collections and Recoveries		(15,820)		(11,468)
Offsetting Receipts		(1,511)		(2,759)
Transfers In / Out		387		(445)
Imputed Financing from Costs Absorbed by Others		14		37
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$**	**(1,340)**	**$**	**(2,009)**
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS				
Undelivered Orders and Adjustments	$	(87)	$	90
Revenue and Other Resources		15,784		12,668
Purchase of Assets		(10,419)		(9,879)
Appropriation for prior year Re-estimate		(4,856)		(1,460)
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	**$**	**422**	**$**	**1,419**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$**	**(918)**	**$**	**(590)**
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	$	11,611	$	4,870
Downward Re-estimate of Credit Subsidy Expense		(99)		(817)
Changes in Loan Loss Reserve Expense		(192)		(127)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables		(44)		(9)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees		(1,047)		(1,032)
Gains or Losses on Sales of Credit Program Assets		101		56
Other		495		18
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$**	**10,825**	**$**	**2,959**
NET COST (SURPLUS) OF OPERATIONS	**$**	**9,907**	**$**	**2,369**

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intragovernmental assets, by federal entity, are as follows for the periods ending September 30, 2008 and 2007:

(Dollars in millions) **Agency**		**Fund Balance with U.S. Treasury**		**Investments in U.S. Treasury Securities**		**Other Assets**
U.S. Treasury	$	12,590	$	19,254	$	-
HUD		-		-		21
2008 Total	**$**	**12,590**	**$**	**19,254**	**$**	**21**
U.S. Treasury	$	9,559	$	22,481	$	-
HUD		-		-		4
2007 Total	**$**	**9,559**	**$**	**22,481**	**$**	**4**

Schedule B: Intragovernmental Liabilities

FHA's Intragovernmental liabilities, by federal entity, are as follows on September 30, 2008 and 2007:

(Dollars in Millions) **Agency**		**Borrowings from U.S. Treasury**		**Other Liabilities**
U.S. Treasury	$	4,832	$	1,530
2008 Total	**$**	**4,832**	**$**	**1,530**
U.S. Treasury	$	4,573	$	3,657
2007 Total	**$**	**4,573**	**$**	**3,657**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program
September 30, 2008 and 2007:

(Dollars in Millions)	MMI/CMHI		GI/SRI		H4H	Total	
	2008	2007	2008	2007	2008	2008	2007
BUDGETARY RESOURCES							
Unobligated Balance Carried Forward							
Beginning of period	$25,499	$26,367	$ 1,421	$ 3,055	$ -	$26,920	$29,422
Recoveries of Prior Year Obligations	49	127	42	86	-	91	213
Budget Authority:							
Appropriations received	77	413	520	841	30	627	1,254
Borrowing Authority	235	2	708	615	-	943	617
Spending Authority from Offsetting Collections:							
Earned							
Collected	13,487	9,004	2,309	2,157	-	15,796	11,161
Receivable from Federal Sources	(29)	63	(38)	35	-	(67)	98
Unfilled Customer Orders	-	-	-	(4)	-	-	(4)
Net Transfers	(25)	(369)	(16)	(240)	-	(41)	(609)
Permanently Not Available	(252)	(1,919)	(732)	(687)	-	(984)	(2,606)
TOTAL BUDGETARY RESOURCES	**$39,041**	**$33,688**	**$ 4,214**	**$ 5,858**	**$ 30**	**$43,285**	**$39,546**
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred	$12,208	$ 8,190	$ 3,362	$ 4,436	$ 20	$15,590	$12,626
Unobligated Balance-Apportioned	2,179	537	798	643	10	2,987	1,180
Unobligated Balance Not Available	24,654	24,961	54	779	-	24,708	25,740
TOTAL STATUS OF BUDGETARY RESOURCES	**$39,041**	**$33,688**	**$ 4,214**	**$ 5,858**	**$ 30**	**$43,285**	**$39,546**
CHANGE IN OBLIGATED BALANCES							
Obligated Balance, Net, Beginning of Period:							
Unpaid Obligations Carried Forward	$ 1,435	$ 1,476	$ 861	$ 881	$ -	$ 2,296	$ 2,357
Receivable from Federal Sources Carried Forward	(263)	(203)	(44)	(11)	-	(307)	(214)
Obligations Incurred	12,208	8,190	3,362	4,436	20	15,590	12,626
Gross Outlays	(12,005)	(8,101)	(3,311)	(4,372)	(20)	(15,336)	(12,473)
Obligated Balance Transfers, Net:							-
Recoveries of Prior Year Obligations	(49)	(127)	(42)	(86)	-	(91)	(213)
Change in Receivable from Federal Sources	29	(63)	38	(31)	-	67	(94)
Obligated Balance, Net, End of Period:						-	-
Unpaid Obligations	1,589	1,435	870	861	-	2,459	2,296
Receivable from Federal Sources	(234)	(263)	(6)	(44)	-	(240)	(307)
Outlays:						-	-
Disbursements	$12,005	$ 8,101	$ 3,311	$ 4,372	$ 20	15,336	12,473
Collections	(13,487)	(9,004)	(2,309)	(2,157)	-	(15,796)	(11,161)
Subtotal	(1,482)	(903)	1,002	2,215	20	(460)	1,312
Less: Offsetting Receipts	-	-	1,511	2,759	-	1,511	2,759
NET OUTLAYS	**$ (1,482)**	**$ (903)**	**$ (509)**	**$ (544)**	**$ 20**	**$ (1,971)**	**$ (1,447)**

Required Supplementary Information

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

(Dollars in Millions)	86 0183	86x4070	86x4587 & 86x4242	86x0236	MMI/CMHI Total
BUDGETARY RESOURCES					
Unobligated Balance Carried Forward					
Beginning of period	$ 47	$ 64	$ 2,993	$ 22,395	$ 25,499
Recoveries of Prior Year Obligations	13	23	13		49
Budget Authority:					
Appropriations received	77	-	-	-	77
Borrowing Authority	-	-	235	-	235
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	13	12,185	1,289	13,487
Receivable from Federal Sources	-	-	-	(29)	(29)
Unfilled Customer Orders	-	-	-	-	-
Net Transfers	4,531	15	-	(4,571)	(25)
Permanently Not Available	(17)	-	(235)	-	(252)
TOTAL BUDGETARY RESOURCES	**$ 4,651**	**$ 115**	**$ 15,191**	**$ 19,084**	**$ 39,041**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 4,603	$ 65	$ 7,540	$ -	$ 12,208
Unobligated Balance-Apportioned	4	50	2,125	-	2,179
Unobligated Balance Not Available	44	-	5,526	19,084	24,654
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 4,651**	**$ 115**	**$ 15,191**	**$ 19,084**	**$ 39,041**
CHANGE IN OBLIGATED BALANCES					
Obligated Balance, Net, Beginning of Period:					
Unpaid Obligations Carried Forward	$ 71	$ 212	$ 1,152	$ -	$ 1,435
Receivable from Federal Sources Carried Forward	-	-	(2)	(261)	(263)
Obligations Incurred	4,603	65	7,540	-	12,208
Gross Outlays	(4,595)	(49)	(7,361)	-	(12,005)
Obligated Balance Transfers, Net:					
Recoveries of Prior Year Obligations	(13)	(23)	(13)	-	(49)
Change in Receivable from Federal Sources	-	-	-	29	29
Obligated Balance, Net, End of Period:					
Unpaid Obligations	66	205	1,318	-	1,589
Receivable from Federal Sources	-	-	(2)	(232)	(234)
Outlays:					
Disbursements	$ 4,595	$ 49	$ 7,361	$ -	$ 12,005
Collections	-	(13)	(12,185)	(1,289)	(13,487)
Subtotal	4,595	36	(4,824)	(1,289)	(1,482)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 4,595**	**$ 36**	**$ (4,824)**	**$ (1,289)**	**$ (1,482)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by Appropriation for the MMI/CMHI Program
September 30, 2007

(Dollars in Millions)	86 0183	86x4070	86x4587 & 86x4242	86x0236	MMI/CMHI Total
BUDGETARY RESOURCES					
Unobligated Balance Carried Forward					
Beginning of period	$ 43	$ 47	$ 4,318	$ 21,959	$ 26,367
Recoveries of Prior Year Obligations	16	26	85	-	127
Budget Authority:					
Appropriations received	413	-	-	-	413
Borrowing Authority	-	-	2	-	2
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	59	7,221	1,724	9,004
Receivable from Federal Sources	-	-	-	63	63
Unfilled Customer Orders	-	-	-	-	-
Net Transfers	981	-	-	(1,350)	(369)
Permanently Not Available	(17)	-	(1,902)	-	(1,919)
TOTAL BUDGETARY RESOURCES	**$ 1,436**	**$ 132**	**$ 9,724**	**$ 22,396**	**$ 33,688**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 1,390	$ 68	$ 6,732	$ -	$ 8,190
Unobligated Balance-Apportioned	4	15	518	-	537
Unobligated Balance Not Available	42	49	2,474	22,396	24,961
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 1,436**	**$ 132**	**$ 9,724**	**$ 22,396**	**$ 33,688**
CHANGE IN OBLIGATED BALANCES					
Obligated Balance, Net, Beginning of Period:					
Unpaid Obligations Carried Forward	$ 82	$ 233	$ 1,161	$ -	$ 1,476
Receivable from Federal Sources Carried Forward	-	(1)	(2)	(200)	(203)
Obligations Incurred	1,390	68	6,732	-	8,190
Gross Outlays	(1,385)	(62)	(6,654)	-	(8,101)
Obligated Balance Transfers, Net:					
Recoveries of Prior Year Obligations	(16)	(26)	(85)	-	(127)
Change in Receivable from Federal Sources	-	-	-	(63)	(63)
Obligated Balance, Net, End of Period:					
Unpaid Obligations	71	212	1,152	-	1,435
Receivable from Federal Sources	-	-	(2)	(261)	(263)
Outlays:					
Disbursements	$ 1,385	62	6,654	-	8,101
Collections	-	(59)	(7,221)	(1,724)	(9,004)
Subtotal	1,385	3	(567)	(1,724)	(903)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 1,385**	**$ 3**	**$ (567)**	**$ (1,724)**	**$ (903)**

Required Supplementary Information

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

(Dollars in Millions)	86 0200	86x4072	86x4077 & 86x4105	GI/SRI Total
BUDGETARY RESOURCES				
Unobligated Balance Carried Forward				
Beginning of period	$ 102	$ 235	$ 1,084	$ 1,421
Recoveries of Prior Year Obligations	9	27	6	42
Budget Authority:				
Appropriations received	407	113	-	520
Borrowing Authority	-	3	705	708
Spending Authority from Offsetting Collections:				
Earned				
Collected	-	334	1,975	2,309
Receivable from Federal Sources	-	4	(42)	(38)
Unfilled Customer Orders	-	-	-	-
Net Transfers	(16)	-	-	(16)
Permanently Not Available	(32)	(244)	(456)	(732)
TOTAL BUDGETARY RESOURCES	**$ 470**	**$ 472**	**$ 3,272**	**$ 4,214**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 383	$ 203	$ 2,776	$ 3,362
Unobligated Balance-Apportioned	33	269	496	798
Unobligated Balance Not Available	54	-	-	54
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 470**	**$ 472**	**$ 3,272**	**$ 4,214**
CHANGE IN OBLIGATED BALANCES				
Obligated Balance, Net, Beginning of Period:				
Unpaid Obligations Carried Forward	$ 100	$ 571	$ 190	$ 861
Receivable from Federal Sources Carried Forward	-	-	(44)	(44)
Obligations Incurred	383	203	2,776	3,362
Gross Outlays	(376)	(253)	(2,682)	(3,311)
Obligated Balance Transfers, Net:				
Recoveries of Prior Year Obligations	(9)	(27)	(6)	(42)
Change in Receivable from Federal Sources	-	(5)	43	38
Obligated Balance, Net, End of Period:				
Unpaid Obligations	98	494	278	870
Receivable from Federal Sources	-	(5)	(1)	(6)
Outlays:				
Disbursements	$ 376	$ 253	$ 2,682	$ 3,311
Collections	-	(334)	(1,975)	(2,309)
Subtotal	376	(81)	707	1,002
Less: Offsetting Receipts	-	-	-	1,511
NET OUTLAYS	**$ 376**	**$ (81)**	**$ 707**	**$ (509)**

Required Supplementary Information

Schedule E: Comparative Combining Budgetary Resources by Appropriation for the GI/SRI Program
September 30, 2007:

(Dollars in Millions)	86 0200	86x4072	86x4077 & 86x4105	GI/SRI Total
BUDGETARY RESOURCES				
Unobligated Balance Carried Forward				
Beginning of period	$ 182	$ 160	$ 2,713	$ 3,055
Recoveries of Prior Year Obligations	11	36	39	86
Budget Authority:				
Appropriations received	426	413	2	841
Borrowing Authority	-	15	600	615
Spending Authority from Offsetting Collections:				
Earned				
Collected	-	274	1,883	2,157
Receivable from Federal Sources	-	(6)	41	35
Unfilled Customer Orders	-	-	(4)	(4)
Net Transfers	(240)	-	-	(240)
Permanently Not Available	(101)	(173)	(413)	(687)
TOTAL BUDGETARY RESOURCES	**$ 278**	**$ 719**	**$ 4,861**	**$ 5,858**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 175	$ 484	$ 3,777	$ 4,436
Unobligated Balance-Apportioned	28	140	475	643
Unobligated Balance Not Available	75	95	609	779
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 278**	**$ 719**	**$ 4,861**	**$ 5,858**
CHANGE IN OBLIGATED BALANCES				
Obligated Balance, Net, Beginning of Period:				
Unpaid Obligations Carried Forward	$ 102	$ 564	$ 215	$ 881
Receivable from Federal Sources Carried Forward	-	(6)	(5)	(11)
Obligations Incurred	175	484	3,777	4,436
Gross Outlays	(165)	(442)	(3,765)	(4,372)
Obligated Balance Transfers, Net:				
Recoveries of Prior Year Obligations	(11)	(36)	(39)	(86)
Change in Receivable from Federal Sources	-	6	(37)	(31)
Obligated Balance, Net, End of Period:				
Unpaid Obligations	100	571	190	861
Receivable from Federal Sources	-	-	(44)	(44)
Outlays:				
Disbursements	$ 165	442	3,765	4,372
Collections	-	(274)	(1,883)	(2,157)
Subtotal	165	168	1,882	2,215
Less: Offsetting Receipts	-	-	-	2,759
NET OUTLAYS	**$ 165**	**$ 168**	**$ 1,882**	**$ (544)**

Required Supplementary Information

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

(Dollars in Millions)

		86x0343		H4H Total
BUDGETARY RESOURCES				
Unobligated Balance Carried Forward				
Beginning of period	$	-	$	-
Recoveries of Prior Year Obligations		-		-
Budget Authority:				
Appropriations received		30		30
Borrowing Authority		-		-
Spending Authority from Offsetting Collections:				
Earned				
Collected		-		-
Receivable from Federal Sources		-		-
Unfilled Customer Orders		-		-
Net Transfers		-		-
Permanently Not Available		-		-
TOTAL BUDGETARY RESOURCES	**$**	**30**	**$**	**30**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$	20	$	20
Unobligated Balance-Apportioned		10		10
Unobligated Balance Not Available		-		-
TOTAL STATUS OF BUDGETARY RESOURCES	**$**	**30**	**$**	**30**
CHANGE IN OBLIGATED BALANCES				
Obligated Balance, Net, Beginning of Period:				
Unpaid Obligations Carried Forward	$	-	$	-
Receivable from Federal Sources Carried Forward		-		-
Obligations Incurred		20		20
Gross Outlays		(20)		(20)
Obligated Balance Transfers, Net:				
Recoveries of Prior Year Obligations		-		-
Change in Receivable from Federal Sources		-		-
Obligated Balance, Net, End of Period:				
Unpaid Obligations		-		-
Receivable from Federal Sources		-		-
Outlays:				
Disbursements		20	$	20
Collections		-		-
Subtotal		20		20
Less: Offsetting Receipts		-		-
NET OUTLAYS	**$**	**20**	**$**	**20**

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OIG
REPORT

This report is a condensed version of a more detailed report issued separately on November 7, 2008 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2008 and 2007" (2009-FO-0002). The report is available at HUD, OIG's Internet site at http://www.hud.gov/offices/oig/reports/files/ig09F0002.pdf

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audit report

Issue Date
November 7, 2008
Audit Case Number
2009-FO-0002

TO: Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing Commissioner, H

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

SUBJECT: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2008 and 2007

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of Urbach Kahn and Werlin LLP (UKW) to audit the fiscal year 2008 and 2007 financial statements of the Federal Housing Administration (FHA). The contract required that the audit be performed according to generally accepted government auditing standards (GAGAS).

UKW is responsible for the attached auditor's report dated October 30, 2008 and the conclusions expressed in the report. Accordingly, we do not express an opinion on FHA's financial statements or conclusions on FHA's internal controls or compliance with laws, regulations and government-wide policies. Within 30 days of this report, UKW expects to issue a separate letter to management dated October 30, 2008 regarding other matters that came to its attention during the audit.

This report includes both the Independent Auditor's Report and FHA's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include, as required supplementary information (RSI), a section devoted to Management's Discussion and Analysis (MD&A). The MD&A is not included with this report. FHA plans to separately publish an annual report for fiscal year 2008 that conforms to FASAB standards.

The report contains one significant deficiency in FHA's internal controls and two reportable instances of noncompliance with laws and regulations. The report contains six new recommendations. As part of the audit resolution process, we will record six new recommendation(s) in the Department's Audit Resolution and Corrective Action Tracking System (ARCATS). We will also endeavor to work with FHA to reach a mutually acceptable management decision prior to the mandated deadline. The proposed management decision and corrective action plan will be reviewed and evaluated by UKW with concurrence from the OIG.

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

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INDEPENDENT AUDITOR'S REPORT

Inspector General
United States Department of Housing and Urban Development

Commissioner
Federal Housing Administration

We have audited the accompanying consolidated balance sheets of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2008 and 2007, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources (Principal Financial Statements) for the years then ended.

Summary

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

Our consideration of internal control over financial reporting resulted in the following matter being identified as a significant deficiency:

- FHA needs to continue its efforts to modernize and enhance its information systems

We found two reportable instances of noncompliance with laws and regulations.

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

Opinion on the Principal Financial Statements

In our opinion, the Principal Financial Statements referred to above present fairly, in all material respects, the financial position of FHA as of September 30, 2008 and 2007, and its net cost, changes in net position, and combined budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's Mutual Mortgage Insurance Fund maintain a capital ratio of at least 2.0 percent, which is determined based on a statutorily-defined formula relating net assets (or economic value) as a percentage of insurance-in-force. As reported by management in Note 6 to the Principal Financial Statements, an independent actuarial study found that the capital ratio has dropped from 6.4 percent in fiscal year 2007 to 3.0 percent at the end of fiscal year 2008. This study used independent macroeconomic forecast data as of June 2008 as well as certain management assumptions to estimate the economic value of endorsements for each of the next seven years. Based on these assumptions, the study projects the capital ratio will decline slightly through fiscal year 2011, but remain slightly above 2.0 percent, and begin to increase through fiscal year 2015. These projections are profoundly sensitive to macroeconomic data forecasts and several alternative projections using more pessimistic assumptions, including higher loss rates of foreclosed properties and the continued use of seller-assisted down payment loans, show the capital ratio dropping below 2.0 percent in future years. The dramatic deterioration in the macroeconomic environment during the third quarter of 2008 may result in this study overstating the projected capital ratio of the fund.

Consideration of Internal Control

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

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

FHA needs to continue to modernize and enhance its information systems

FHA continues to make progress improving its overall financial system control environment despite limited systems resources. Efforts to implement newly legislated HUD and FHA programs have increased the demand on these resources. This may further reduce FHA's ability to address various system initiatives and control deficiencies affecting the reliability of FHA's financial information. We recommend FHA management work with the HUD Secretary and the Chief Information Officer to conduct a risk assessment of the various systems initiatives in connection with the Office of the Chief

Information Officer Strategic Plan and ensure HUD information technology resources are appropriately allocated to address the Department's and FHA's highest system priorities.

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

Compliance with Laws and Regulations

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

Due to deficiencies in the interface with the Generic Debt subsystem, the FHA's core financial management system does not maintain accurate trial balance account information at the cohort level for the financing accounts. Accordingly, FHA may not be able to accurately calculate the reestimated cost "for a group of direct loans or loan guarantees for a given credit program made in a fiscal year" in accordance with the requirements of Statement of Federal Financial Accounting Standard No 2, *Accounting for Direct Loans and Loan Guarantees* and the Federal Credit Reform Act of 1990. These balances are adjusted manually at the end of the year.

The HUD Office of the Chief Financial Officer (OCFO) is responsible for investigating and reporting on violations of the Anti-Deficiency Act. The OCFO determined an Anti-Deficiency Act violation occurred associated with the commitment limitation for FHA's General Insurance/Special Risk Fund programs for fiscal year 2003, but has not formally reported this matter to the President and Congress of the United States and the Government Accountability Office (GAO) as required by OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, Section 435 and 31 U.S.C. 1351 and 1517(b). Other potential violations are still under review by the OCFO. No final legal determination regarding these other potential compliance matters has been made.

INDEPENDENT AUDITOR'S REPORT, CONTINUED

Supplementary Information

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

Management Responsibilities

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

Objectives, Scope and Methodology

Our responsibility is to express an opinion on FHA's Principal Financial Statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Financial Statements are free of material misstatement.

An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

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

- Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Transactions are executed in accordance with (1) laws governing the use of budget authority, (2) other laws and regulations that could have a direct and material effect on the financial statements, and (3) any other laws, regulations, and government-wide policies identified by OMB audit guidance.

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

We are also responsible for testing compliance with selected provisions of laws, regulations and government-wide policies that have a direct and material effect on the financial statements. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended September 30, 2008. Compliance with FFMIA will be reported on by the HUD Office of Inspector General (OIG) in connection with their audit of the consolidated financial statements of HUD.

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

FHA Comments and Our Evaluation

FHA management generally concurred with our findings and recommendations. The full text of FHA management's response is included in Appendix B. We did not perform audit procedures on FHA management's written response and accordingly, we express no opinion on it. Our assessment of FHA management's response is included in Appendix C. The current status of prior year findings and recommendations is included in Appendix D.

We also noted other less significant matters involving FHA's internal control and its operation, which we have reported to the management of FHA in a separate letter, dated October 30, 2008.

INDEPENDENT AUDITOR'S REPORT, CONTINUED

Distribution

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

Urbach Kahn & Werlin LLP

Arlington, Virginia
October 30, 2008

Appendix A
Significant Deficiency

In our report dated October 30, 2008, we described the results of our audits of the consolidated balance sheets of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2008 and 2007, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources (Principal Financial Statements) for the years then ended. The objective of our audits was to express an opinion on these financial statements. In connection with our audits, we also considered FHA's internal control over financial reporting and tested FHA's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements. The following presents additional detail on the internal control matters discussed in that report.

1. FHA needs to continue to enhance and modernize its information systems

FHA continues to make progress improving its overall financial system control environment despite limited systems resources. During fiscal year (FY) 2008, we noted several key improvements to FHA's overall systems general control environment, including (a) reductions in the number of system security vulnerabilities, (b) progress in implementing a new user access management system, (c) a new automated interface between FHA's reverse mortgage notes management system and the core financial management system, and (d) improved security controls at the single family property management contractors.

These improvements were implemented with FHA's historically limited resources for IT systems maintenance and development. Our audit and several audits by the Office of Inspector General (OIG) continue to identify systems control deficiencies that need to be addressed. However, recent efforts to implement newly legislated FHA programs have increased the demand on these limited resources. Although FHA received new funding in FY2008 for these new programs, management focus on these new initiatives may further reduce FHA's capacity to simultaneously address other system modernization initiatives and control deficiencies thereby affecting the reliability and completeness of FHA's financial information.

FHA manages its program operations through a complex set of Multifamily and Single Family business systems that provide data to the core financial management system (FHA Subsidiary Ledger or FHASL) through automated interfaces. After the implementation of FHASL in 2003, FHA's Enterprise Architecture Plan anticipated than many of these business systems would be replaced by components of FHASL. Several of these system replacements have been delayed due to resource constraints. FHA currently maintains four Multifamily and 11 Single Family systems that are administered separately from FHASL.

Appendix A
Significant Deficiency, Continued

Multifamily Systems

Two of these business systems to be replaced are FHA's two primary Multifamily insurance systems. The new systems were scheduled to be operational on October 1, 2008, but as of the date of this report they were still going through user acceptance testing. The implementation date was revised to November 11, 2008. Preliminary test results indicated anomalies in the transaction processing and missing system functionality. The FHA Comptroller has indicated that these anomalies have been corrected. Because these systems are being developed as modules of FHASL, FHA will conduct a re-accreditation of FHASL in November 2008. Funding for the systems implementation contract expires on December 31, 2008.

Single Family Systems

In an audit conducted by the OIG, other system general control weaknesses were noted as follows:

- Only 3 of 24 HUD employees or contractors with access to the Single Family Claims system had complete and proper background investigations.
- Two users of the Single Family Claims system had unauthorized access rights to read, write and update records.
- Five contract developers had update access to Single Family Claims production data files.
- FHA neither had adequate controls over, nor reviews of, audit logs for the Single Family Claims system.
- FHA did not develop or implement adequate security controls over information transmitted between FHA and its numerous lenders and other business partners.
- FHA failed to adequately assess its compliance with mandatory system security controls.
- FHA did not properly ensure annual security reviews were completed by HUD employees.

Detailed findings and specific recommendations can be found in a separate OIG audit report.[1]

HECM Systems

As noted in our prior year Independent Auditor's Report, the FHA continues to use a manual business process for handling applications for claim benefits for the FHA's Home Equity Conversion Mortgage (HECM) program. FHA has conducted an accounting risk assessment to identify short and long term deficiencies in this process, but will continue to rely on significant review and reconciliation procedures as compensating controls until a replacement system solution can be procured and implemented.

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[1] Audit Report No. 2008-DP-0004 Review of Selected FHA Major Applications' Information Security Controls

An independent examination, conducted in accordance with AICPA Statement on Auditing Standards (SAS) No. 70, *Audits of Service Organizations*, Type I, *Control Design*, of the HECM notes servicing system identified over thirty specific system control deficiencies, including:

- Lack of formal approval for critical system security documents
- Weaknesses with system access policies and physical access control monitoring
- Inadequate system baseline documentation
- Lack of formal authorization procedures for system software changes
- Segregation of duties weaknesses
- Deficiencies in the Continuity of Operations Plan

Management has planned to conduct a SAS No. 70 Type II examination, which will test the operation of the controls over the HECM notes servicing system during FY2009.

Other Systems

We also found that due to deficiencies in the Generic Debt subsystem interface, FHA is unable to maintain reliable cohort level data for the financing accounts within its (FHASL) general ledger system as required by the Credit Reform Act of 1990.

In addition to the efforts to address these deficiencies, the FHA's Systems Division is currently responsible for a number of other major IT related projects, including:

- Implementing systems to handle the newly legislated Hope for Homeowners program for risk-sharing of single family loans insured that became effective October 1, 2008.
- Procurement and implementation of a new integrated insured reverse mortgage loan and notes servicing system.
- Implementing the new Real Estate Owned property management system at the various Single Family Marketing and Management (M&M) contractor sites. This system will be interfaced with the SAMS legacy application system.

Managing such critical system initiatives simultaneously and without sufficient funding or staff resources may increase the risk of system or processing errors in the agency's financial data, or increase the risk of unauthorized access into critical or sensitive agency systems. Such errors or unauthorized access could lead to misstatements in financial reporting or misappropriation of FHA assets.

Recommendations

We recommend:

1a. The FHA Commissioner, Assistant Secretary for Housing, coordinate with the HUD Secretary and the HUD CIO to conduct a risk assessment of the various systems initiatives and required corrective actions in connection with the OCIO Strategic Plan and document how HUD's/FHA's IT resources will be appropriately allocated in fiscal year 2009 to address the Department's and FHA's highest system priorities. (New)

Appendix A
Significant Deficiency, Continued

1b. The FHA Comptroller document the revised Multifamily business processes, identify and assess key internal controls and perform tests of those controls commensurate with the inherent risk for a new system in conjunction with the agency's OMB Circular No. A-123 Management Control Program and ensure the system's compliance with OMB Circular No. A-130, *Management of Federal Information Resources*. (New)

1c. The FHA Comptroller develop an automated process for HECM claims and establish an automated interface with FHASL and ensure such interfaces are included in the overall system functional requirements document. (Repeat)

1d. The FHA Comptroller should ensure the identified deficiencies in the controls over the HECM notes servicing system are corrected before proceeding with the Type II review. (New)

1e. The FHA Comptroller should ensure the control testing of the HECM notes system to be performed under AICPA SAS No. 70, Type II is expanded to test for compliance with systems requirements unique to the federal government. (New)

1f. The FHA Comptroller should ensure that any HECM system replacement is initiated in accordance with HUD system development life cycle guidelines and established program timelines. (New)

1g. The FHA Comptroller should work with OCIO to correct the Generic Debt system interfaces to ensure FHASL properly balances the financing accounts at the cohort level. (New)

Appendix B
Management's Response

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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

November 6, 2008

MEMORANDUM FOR: Urbach Kahn & Werlin LLP

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

SUBJECT: Response to UKW's Fiscal Year 2008 FHA Audit Report

I am pleased to present Federal Housing Administration (FHA) management's responses to your audit report on the fiscal year 2008 FHA financial statements.

General Comments

FHA is pleased that UKW recognized the considerable progress and efforts made in the last year by eliminating both fiscal year 2007 material weaknesses. Additionally, FHA will continue to address the financial information system concerns raised in the significant deficiency identified this year.

Compliance with Laws and Regulations

FHA strongly disagrees with the conclusion that the Generic Debt system interface does not comply with the Statement of Federal Financial Accounting Standard No. 2 (SFFAS No. 2), *Accounting for Direct Loans and Loan Guarantees* and the Credit Reform Act of 1990. Neither the SFFAS No. 2 nor the Credit Reform Act requires that transactions be recorded at the cohort level. FHA maintains cohort level trial balances and reports to Treasury and OMB at the cohort level. Over 99 percent of FHA's $9 billion in collection transactions are recorded at the cohort level and FHA makes an annual cohort adjustment for a relatively small amount of transactions processed through the Generic Debt Servicing System.

Report on Internal Controls – Significant Deficiency

1. FHA needs to continue to enhance and modernize its financial information systems.

FHA concurs with this finding and recommendations.

www.hud.gov espanol.hud.gov

Appendix B
Management's Response, Continued

FHA understands there are increased risks with managing critical systems and new program initiatives with limited funding and staff resources. HUD's Chief Financial Officer (CFO) has worked with Congress on reprogramming resources for these new initiatives as well as Congress providing a funding mechanism for HOPE for Homeowners. In addition, FHA is performing risk analyses to prioritize these initiatives and projects.

FHA is on track to integrate two multifamily systems in to the FHASL. FHA understands there are risks involved with replacing systems and will ensure proper functionality as well as re-accreditation will occur.

FHA recognizes the need for improved systems for the HECM program. FHA is in the process of procuring a HECM business service provider to improve processes and controls within the HECM program. In addition, the HECM Notes service provider is addressing the concerns identified from the SAS 70 Type I review. A SAS 70 Type II review will be conducted in FY 2009.

FHA will continue to assess and improve its systems. These efforts will include: updating existing systems to process transactions for the new Hope for Homeowners program; procurement of an integrated HECM service provider; implementation of a new Real Estate Owned property management system; enhancements to the Generic Debt system to improve cohort level accounting.

Regarding the recommendations, FHA will work with the Inspector General and financial statement auditors to address the recommendations included in this report.

Appendix C
UKW's Assessment of Management's Response

UKW has obtained and reviewed FHA management's response to the findings and recommendations made in connection with our audit of FHA's 2008 Principal Financial Statements, which is included as Appendix B. We did not perform audit procedures on FHA's written response to the significant deficiency and accordingly, we express no opinion on it. Our assessment of management's responses is discussed below.

Assessment of management's response to significant deficiency No. 1:

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

Assessment of management's response to noncompliance with laws and regulations:

We concur that FHA's core financial management system is properly designed to account for credit reform transactions at the cohort level and that the transactions derived from the Generic Debt subsystem are generally not material to the financial statements as a whole. However, qualitative, rather than quantitative, factors are considered when assessing reportable matters regarding an agency's compliance with laws and regulations. We believe SFFAS No. 2 and OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, which represent government-wide policies designed to properly and effectively implement the requirements of the Credit Reform Act of 1990, explicitly outline the requirements for the use of cohorts to account for financing account transactions. Federal system guidelines are designed to ensure that agencies comply with accounting standards "at the transaction level".

This system deficiency affects the ability of FHA to perform reconciliations to ensure that all of its other accounting transactions are being recorded to the proper cohorts and resulting reestimates may not accurately present the interest costs or technical reestimate costs arising from changes in the program's performance for a given cohort. Accordingly, we believe we have properly classified this as reportable noncompliance.

Appendix D
Status of Prior Year Findings and Recommendations

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

Prior Finding/Recommendation	*Type*	*Fiscal Year 2008 Status*
1. We recommend the FHA Comptroller:		
a. Coordinate with the Acting Deputy Assistant Secretary for Single Family Housing to compile and document a comprehensive program risk assessment of the HECM program based on anticipated program volume, and activity.	2007 Material Weakness	Resolved.
b. Coordinate with HUD's Acting Chief Information Officer and the Acting Deputy Assistant Secretary for Single Family Housing to establish a comprehensive system functional requirements document in accordance with HUD guidance for the new HECM system based on anticipated future volumes of transactions.	2007 Material Weakness	Not yet completed. FHA has developed a solicitation Statement of Work but no Functional Requirements Document.
c. Coordinate with HUD's Acting Chief Information Officer to complete a full assessment of the Privacy Act requirements for the HECM notes database and its contractor.	2007 Material Weakness	Resolved.
d. Complete a full assessment of the effectiveness of the existing controls (including an Independent Type II review of the service provider under AICPA Statement on Auditing Standards No. 70, Service Organizations) over the notes database given the sensitivity of the data and the anticipated growth in reported assigned note balances and transactions.	2007 Material Weakness	Partially resolved. Management was able to complete a Type I SAS 70 review and plans to complete a Type II review in FY2009. See 2008 Significant Deficiency.
e. Develop and implement automated system interfaces between the current HECM claims and notes systems and FHASL, if the new system(s) cannot be implemented timely.	2007 Material Weakness	Partially resolved. A system interface between the HECM notes system and FHASL implemented in 2008. See 2008 Significant Deficiency.

Appendix D
Status of Prior Year Findings and Recommendations, Cont'd

Prior Finding/Recommendation	*Type*	*Fiscal Year 2008 Status*
2. We recommend the Deputy Assistant Secretary for Finance and Budget request the Director of the Office of Evaluation to:		
a. Enhance its documentation on how specific assignment and termination rates are calculated and how macroeconomic projections are incorporated	2007 Material Weakness	Resolved.
b. Document the results of the current pricing and termination model reviews and their effect on the methodology for calculating future cash flow reestimates	2007 Material Weakness	Resolved.
c. Document any impact on the FY2007 HECM liability reestimate as a result of changes in the methodologies for calculating future cash flow estimates	2007 Material Weakness	Resolved.
d. Document FHA's conclusion on how recent HUD studies on HECM experience can be used to improve the calculation of the model's calculated assumptions	2007 Material Weakness	Resolved.
e. Establish new validation review procedures to compare the actual premium collections and post-assignment terminations to the balances in the model	2007 Material Weakness	Resolved.
f. Document the use OMB approved CSC2 calculator in the model	2007 Material Weakness	Resolved.
g. Ensure the propriety of the discounting algorithm used in next year's model	2007 Material Weakness	Resolved.
h. Reevaluate the assumption for calculating note recoveries to better reflect the "crossover risk" in the recovery cash flows	2007 Material Weakness	Resolved.

Appendix D
Status of Prior Year Findings and Recommendations, Cont'd

Prior Finding/Recommendation	***Type***	***Fiscal Year 2008 Status***
2. We recommend the Deputy Assistant Secretary for Finance and Budget request the Director of the Office of Evaluation to:		
i. Incorporate the use of disbursements into the calculation of the credit subsidy rate	2007 Material Weakness	Resolved.
j. Incorporate sensitivity analysis variables directly within the cash flow model and document management's assessment of the results of the sensitivity analysis.	2007 Material Weakness	Resolved.
k. Develop a more formal process for documenting management's conclusions regarding required model modifications as a result of the annual validation process.	2007 Material Weakness	Resolved.

November 2008
HUD - 2015 - FHA