



**Government National Mortgage Association  
Fiscal Years 2012 and 2011  
Financial Statements Audit**



Issue Date: November 7, 2012

Audit Report Number: 2013-FO-0001

TO: Theodore Tozer, President, Government National Mortgage Association, T

FROM: Thom as R. McEnanly, Director, Financial Audit Division, GAF

SUBJECT: Audit of the Government National Mortgage Association's (Ginnie Mae) Financial Statements for Fiscal Years 2012 and 2011

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of CliftonLarsonAllen LLP (CLA) to audit the fiscal years 2012 and 2011 financial statements of the Government National Mortgage Association (Ginnie Mae). The contract required that the audit be performed according to Generally Accepted Government Auditing Standards (U.S. GAGAS). Ginnie Mae's fiscal year 2011 financial statements were audited by Clifton Gunderson<sup>1</sup>; whose report dated November 7, 2011 expressed an unqualified opinion on those financial statements.

In connection with the contract, we reviewed CLA's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with U.S. GAGAS, was neither intended to enable us to express an opinion nor do we express an opinion on GNMA's financial statements, internal controls or conclusions on compliance with laws and regulations. CLA is responsible for the attached auditor's report dated November 7, 2012 and the conclusions expressed in the report. Our review disclosed no instances where CLA did not comply, in all material respects, with U.S. GAGAS.

This report includes both the Independent Auditors' Report and Ginnie Mae's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information (RSI) a section devoted to Management's Discussion and Analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. Ginnie Mae plans to separately publish a Report to Congress for fiscal year 2012 that conforms to FASAB standards.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision,

---

<sup>1</sup> In early 2012, Clifton Gunderson LLP merged with another firm and became CliftonLarsonAllen LLP.

please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

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

Within 60 days of this report, CLA expects to issue a separate letter to management dated November 7, 2012 regarding other matters that came to its attention during the audit.

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

---

## TABLE OF CONTENTS

|   |    |
|---|----|
| OIG Transmittal Memorandum.....   | 1  |
| Independent Auditor's Report.....   | 4  |
| Appendix A: Management's Response.....  | 9  |
| Appendix B: Status of Prior Year Recommendations.....                                   | 10 |
| Financial Statements.....   | 11 |
| Balance Sheets.....   | 12 |
| Statement of Revenues and Expenses and Changes in Investment of U.S.<br>Government..... | 13 |
| Statement of Cash Flows.....  | 14 |
| Notes to the Financial Statements.....  | 15 |



CliftonLarsonAllen LLP

[www.cliftonlarsonallen.com](http://www.cliftonlarsonallen.com)

## INDEPENDENT AUDITOR'S REPORT

Inspector General  
United States Department of Housing and Urban Development

President  
Government National Mortgage Association

We have audited the accompanying balance sheets of the Government National Mortgage Association (Ginnie Mae), a wholly-owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2012 and 2011, and the related statements of revenues and expenses and changes in investment of U.S. Government, and cash flows ("financial statements") for the years then ended. The objective of our audit was to express an opinion on the fairness of these financial statements. In connection with our audit, we also considered the internal control over financial reporting and considered Ginnie Mae's compliance with laws and regulations. In our audit, we found:

- The financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America (U.S.);
- No material weaknesses in internal control over financial reporting (including safeguarding of assets) and compliance with laws and regulations; and
- No instances of reportable noncompliance with selected provisions of laws and regulations tested or other matters.

The following sections and Exhibits discuss in more detail: (1) these conclusions, (2) our conclusions on Management's Discussion and Analysis (MD&A), and other accompanying information, (3) our responsibility for the audit, (4) management's responsibility for the financial statements, (5) Ginnie Mae's response, and (6) the current status of prior year findings and recommendations.

### Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ginnie Mae as of September 30, 2012 and 2011, and the results of its operations; changes in investment of U.S. Government; and its cash flows for the years then ended in conformity with accounting principles generally accepted in the U.S.

---

## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

As discussed in Note H regarding the MBS Loss Liability, Ginnie Mae has not completed the final certification and recertification of approximately 20,000 loans following the default of a major issuer in August 2009 and which were required to be recertified within one year based on Ginnie Mae guidelines. Ginnie Mae has implemented a corrective action plan to complete the final certification, which is ongoing. In FY2012, a separate task group, under the direction of the HUD Office of General Counsel, has identified a group of loans that could suggest a high risk of loss to Ginnie Mae. Ginnie Mae has adjusted its MBS Loss Liability and Allowance for Loss against Mortgages Held for Investment for the additional potential risk of loss from these loans.

As discussed in Note K, Commitments and Contingencies, Ginnie Mae defaulted an issuer with a portfolio of \$42 billion of Ginnie Mae-insured Mortgage Backed Securities following the issuer's bankruptcy in 2012. Ginnie Mae has elected to not cancel the servicer's rights to service the insured portfolio, pending the successful sale of the portfolio to a third party. As of the date of this report, a buyer had been selected but the sale had not been approved by the bankruptcy court nor has the sale closed. In the event the sale is not completed, Ginnie Mae has executed an agreement with the defaulted issuer to continue to service the underlying mortgages and securities on behalf of Ginnie Mae. Ginnie Mae believes the likelihood of the sale not being consummated is remote, and accordingly, has made no adjustment to the accompanying financial statements to reflect any effect on their financial position that might be incurred if a sale of the portfolio is unsuccessful.

### Report on Internal Control

In planning and performing our audit, we considered Ginnie Mae's internal control over financial reporting and compliance (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Ginnie Mae's internal control. Accordingly, we do not express an opinion on the effectiveness of Ginnie Mae's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of Ginnie Mae's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

---

## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

We noted certain matters that we reported to Ginnie Mae management in a separate letter dated October 31, 2012.

### Report on Compliance

In connection with our audit, we performed tests of Ginnie Mae's compliance with certain provisions of laws and regulations. The results of our tests disclosed no instances of noncompliance that are required to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States or OMB Bulletin No. 07-04 *Audit Requirements for Federal Financial Statements*, as amended (OMB Bulletin 07-04).

However, the objective of our audit was not to provide an opinion on compliance with laws and regulations. Accordingly, we do not express such an opinion.

### Status of Prior Year's Control Deficiencies

We have reviewed the status of Ginnie Mae's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditor's Report, dated November 2, 2011. The status of the prior year findings and recommendations is presented in Exhibit A.

### Other Information

Accounting principles generally accepted in the U.S. require that Ginnie Mae's Management Discussion and Analysis (MD&A) found in Section IV be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the OMB. We have applied certain limited procedures to the MD&A in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The information in Sections I through IV (pages 2-35) is presented for purposes of additional analyses and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

### Management's Responsibility for the Financial Statements

Ginnie Mae management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the U.S., (2) designing, implementing, and

## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

maintaining internal control to provide reasonable assurance that the broad control objectives of the Federal Manager's Financial Integrity Act (FMFIA) are met, (3) ensuring that Ginnie Mae's financial management systems substantially comply with Federal requirements, and (4) complying with other applicable laws and regulations.

### Auditor's Responsibility

We are responsible for conducting our audit in accordance with auditing standards generally accepted in the U.S.; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin 07-04. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the U.S. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB Bulletin 07-04 requires testing, and (3) performing limited procedures with respect to certain other information appearing in the Annual Report.

In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessed the appropriateness of the accounting policies used and the reasonableness of significant estimates made by management; (3) evaluated the overall presentation of the financial statements; (4) obtained an understanding of Ginnie Mae and its operations, including its internal control related to financial reporting (including safeguarding of assets) and compliance with laws and regulations (including execution of transactions in accordance with budget authority); (5) evaluated the effectiveness of the design of internal control; (6) tested the operating effectiveness of relevant internal controls over financial reporting and compliance; (7) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA; and (8) tested compliance with selected provisions of certain laws and regulations. The procedures selected depend on the auditors' judgment, including our assessment of risks of material misstatement of the financial statements, whether due to fraud or error. We believe we obtained sufficient and appropriate audit evidence on which to base our conclusions.

We did not evaluate 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. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls



---

**INDEPENDENT AUDITOR'S REPORT (CONTINUED)**

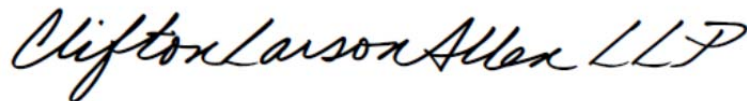
may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to Ginnie Mae. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB Bulletin 07-04 that we deemed applicable to Ginnie Mae's financial statements for the fiscal year ended September 30, 2012. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

**Agency Comments and our Evaluation**

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

This report is intended solely for the information and use of Ginnie Mae's management, the HUD Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.



Arlington, Virginia  
October 31, 2012

## Ginnie Mae Management's Response Appendix A



November 6, 2012

Roger Von Elm  
CliftonLarsonAllen LLP  
4250 North Fairfax Drive  
Suite 1020  
Arlington, VA 22203

Dear Mr. Von Elm:

Thank you for the opportunity to review and comment on CliftonLarsonAllen's (CLA) draft Independent Auditor's Report on Ginnie Mae's financial statement for Fiscal Year (FY) 2012.

We appreciate CLA's acknowledgement that: i) Ginnie Mae's financial statements, in all material respects, the financial position of Ginnie Mae as of September 30, 2012 and 2011, and the results of our operations; ii) changes in investing of U.S. Government; and iii) our cash flows for the years then ended are in conformity with accounting principles generally accepted in the United States of America. Additionally, we appreciate CLA's acknowledgement that for FY 2012, the audit disclosed no material weaknesses in internal controls over financial reporting (including safeguarding of assets), and no instance of noncompliance with laws and regulations.

We enjoyed working with CLA and appreciate the time spent by CLA staff to understand our business and operations. Again, thank you for the opportunity to comment on the draft report.

Sincerely,

A handwritten signature in cursive script that reads "Mary K. Kinney".

Mary K. Kinney  
Executive Vice President

**Ginnie Mae  
Status of Prior Year Recommendations  
Appendix B**

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

| Prior Year Finding   | Prior Year Recommendations   | Current Year Status                                |
|--|--|--|
| 1. Need to Improve Compliance Control to Ensure the Safety, Completeness and Validity of Collateral Loan Files   | 1a. We recommended that Ginnie Mae's Acting Vice President for MBS hold the master sub-servicer accountable for delays by requiring an acceptable written timeline for final review/certification of the loan documentation/pools  | 1a. Partially resolved - management letter comment |
| 2. Strengthen Internal Control over Risk-Based Issuer and Document Custodian Reviews to Improve the Effectiveness of Counterparty Monitoring and Oversight | 2a. Ginnie Mae's Acting Vice President for MBS should increase its oversight and monitoring of field reviews performed on issuers and document custodians to ensure the reviews meet management's objectives and are adequately and completely performed and properly documented.<br>2b. Ginnie Mae Executive Vice President should allocate resource within MBS and Risk Management Division to accelerate the update to the Issuer and Document Custodian Risk Based Review Procedures Manual within the second fiscal quarter of 2012 if possible, so that the new updated reviews are performed in second half of 2012 to eliminate this deficiency. | 2a. Resolved<br><br>2b. Resolved                   |

**GINNIE MAE  
FISCAL YEAR 2012  
FINANCIAL  
STATEMENTS**

## Ginnie Mae Fiscal Year 2012 Financial Statements

| Balance Sheets  |                      |                      |
|---|----------------------|----------------------|
| As of September 30  | 2012                 | 2011                 |
| <i>(Dollars in thousands)</i>                                     |                      |                      |
| <b>Assets:</b>  |                      |                      |
| Funds with U.S. Treasury  | \$ 7,075,500         | \$ 7,210,300         |
| U.S. Government securities  | 2,113,600            | 2,126,800            |
| Accrued interest on U.S. Government securities                    | 10,300               | 11,800               |
| Accrued fees and other receivables, net                           | 66,300               | 62,500               |
| Fixed assets--software, net of accumulated amortization           | 40,100               | 31,100               |
| Mortgage loans held for investment                                | 6,866,500            | 6,350,300            |
| Less: Allowance for mortgage loans held for investment            | (177,400)            |                      |
| Mortgage loans held for investment, net                           | 6,689,100            | 6,350,300            |
| Accrued interest on mortgage loans held for investment            | 88,600               | 83,400               |
| Advances against defaulted mortgage-backed security pools         | 1,092,800            | 873,700              |
| Less: Allowance for uncollectible advances                        | (174,000)            | (220,500)            |
| Advances against defaulted mortgage-backed security pools, net    | 918,800              | 653,200              |
| Short sale claims receivables                                     | 36,800               | 38,600               |
| Less: Allowance for uncollectible short sale claims receivables   | (15,700)             | (6,300)              |
| Short sale claims receivables, net                                | 21,100               | 32,300               |
| Properties held for sale  | 15,500               | 7,400                |
| Less: Allowance for losses on properties held for sale            | (3,900)              | (4,000)              |
| Properties held for sale, net                                     | 11,600               | 3,400                |
| Mortgage servicing rights   | 60,700               | 110,900              |
| Guaranty asset  | 6,633,900            | 2,175,100            |
| <b>Total Assets</b>   | <b>\$ 23,729,600</b> | <b>\$ 18,851,100</b> |
| <b>Liabilities and Investment of U.S. Government:</b>             |                      |                      |
| <b>Liabilities:</b>   |                      |                      |
| Liability for loss on mortgage-backed securities program guaranty | 357,400              | 395,800              |
| Deferred revenue  | 134,400              | 117,400              |
| Deferred liabilities and deposits                                 | (2,700)              | 35,700               |
| Accounts payable and accrued liabilities                          | 235,200              | 365,300              |
| Guaranty liability  | 6,633,900            | 2,175,100            |
| <b>Total Liabilities</b>  | <b>\$ 7,358,200</b>  | <b>\$ 3,089,300</b>  |
| <b>Commitments and Contingencies</b>                              |                      |                      |
| Investment of U.S. Government                                     | 16,371,400           | 15,761,800           |
| <b>Total Liabilities and Investment of U.S. Government</b>        | <b>\$ 23,729,600</b> | <b>\$ 18,851,100</b> |

See the accompanying notes to the financial statements.

| Statements of Revenues and Expenses and Changes in Investment of U.S. Government |                      |                      |
|--|----------------------|----------------------|
| For the Years Ended September 30   | 2012                 | 2011                 |
| <i>(Dollars in thousands)</i>  |                      |                      |
| <b>Revenues:</b>   |                      |                      |
| Mortgage-backed securities guaranty fees   | \$ 779,400           | \$ 686,200           |
| Interest income - mortgage loans held for investment                             | 279,800              | 42,300               |
| Interest income - US Government securities                                       | 81,500               | 208,100              |
| Commitment fees  | 79,100               | 74,000               |
| Multiclass fees  | 25,000               | 52,500               |
| Other mortgage-backed securities program income                                  | 1,800                | 1,500                |
| <b>Total Revenues</b>  | <b>\$ 1,246,600</b>  | <b>\$ 1,064,600</b>  |
| <b>Expenses:</b>   |                      |                      |
| Mortgage-backed securities program expenses                                      | (62,900)             | (72,800)             |
| Administrative expenses  | (14,100)             | (11,000)             |
| Fixed asset amortization   | (9,000)              | (9,900)              |
| <b>Total Expenses</b>  | <b>\$ (86,000)</b>   | <b>\$ (93,700)</b>   |
| Recapture (Provision) for loss on properties held for sale                       | (9,200)              | 2,900                |
| Recapture (Provision) for loss mortgage loans held for investment                | (158,100)            | -                    |
| Recapture (Provision) for loss on mortgage-backed securities liability           | (264,500)            | 407,000              |
| Recapture (Provision) for loss on short sale claims and other receivables        | (16,900)             | (6,800)              |
| Recapture (Provision) for loss on uncollectible advances                         | 17,100               | (8,500)              |
| <b>Total Recapture (Provision)</b>   | <b>\$ (431,600)</b>  | <b>\$ 394,600</b>    |
| Gain on disposition of investment  | 12,500               | 24,000               |
| Gain on acquisition mortgage servicing rights                                    |                      |                      |
| Less: Loss on credit impairment of mortgage loans HFI, net                       | (81,700)             | (178,700)            |
| Less: Loss on mortgage servicing rights  | (50,200)             | (26,800)             |
| <b>Total Other Gains / (Losses)</b>  | <b>\$ (119,400)</b>  | <b>\$ (181,500)</b>  |
| <b>Excess of Revenues over Expenses</b>  | <b>609,600</b>       | <b>1,184,000</b>     |
| <b>Investment of U.S. Government at Beginning of Year</b>                        | <b>15,761,800</b>    | <b>14,577,800</b>    |
| Returned to U.S. Treasury  | -                    | -                    |
| <b>Investment of U.S. Government at End of Year</b>                              | <b>\$ 16,371,400</b> | <b>\$ 15,761,800</b> |

See the accompanying notes to the financial statements.

| <b>Statements of Cash Flows</b>   |                     |                     |
|---|---------------------|---------------------|
| <b>For the Years Ended September 30</b>   | <b>2012</b>         | <b>2011</b>         |
| <i>(Dollars in thousands)</i>   |                     |                     |
| <b>Cash Flow from Operating Activities</b>  |                     |                     |
| <b>Net Excess of Revenues over Expenses</b>   | <b>\$ 609,600</b>   | <b>\$ 1,184,000</b> |
| <b>Adjustments to reconcile Net Excess of Revenues Over Expenses to Net Cash from Operating Activities:</b> |                     |                     |
| Amortization  | 9,000               | 9,900               |
| Decrease / increase in accrued interest on U.S. Government securities                                       | 1,500               | 8,600               |
| Increase / decrease in accrued interest on mortgage loans held for investment                               | (5,200)             | 97,900              |
| Increase / decrease in advances against defaulted MBS pools, net  | (265,600)           | 188,900             |
| Decrease / increase in mortgage servicing rights  | 50,200              | 26,800              |
| Increase / decrease in deferred revenue   | 17,000              | 3,500               |
| Decrease / increase in deferred liabilities and deposits  | (38,400)            | 34,500              |
| Decrease in accounts payable and accrued liabilities  | (130,100)           | 103,600             |
| Increase / decrease in accrued fees and other receivables   | (3,800)             | (7,600)             |
| Decrease / increase in short sale claims receivables, net   | 11,200              | (32,300)            |
| Increase / decrease in properties held for sale, net  | (8,200)             | 38,900              |
| Decrease / increase in liability for loss on MBS program guaranty   | (38,400)            | (609,100)           |
| <b>Net Cash from Operating Activities</b>   | <b>\$ 208,800</b>   | <b>\$ 1,047,600</b> |
| <b>Cash Flow from Investing Activities</b>  |                     |                     |
| Increase / decrease in mortgage loans held for investment, net  | (338,800)           | (1,907,000)         |
| Sale / purchase of U.S. Government securities, net  | 13,200              | 1,424,400           |
| Purchase / sale of software   | (18,000)            | (5,200)             |
| <b>Net Cash (used for) from Investing Activities</b>  | <b>\$ (343,600)</b> | <b>\$ (487,800)</b> |
| <b>Cash Flow from Financing Activities</b>  |                     |                     |
| Financing activities  | -                   | -                   |
| <b>Net Cash from Financing Activities</b>   | <b>\$ -</b>         | <b>\$ -</b>         |
| Net increase (decrease) in cash & cash equivalents  | (134,800)           | 559,800             |
| Cash & cash equivalents - beginning of period   | 7,210,300           | 6,650,500           |
| Cash & cash equivalents - end of period   | <b>\$ 7,075,500</b> | <b>\$ 7,210,300</b> |

| <b>Supplemental Schedule of Non-Cash Activities</b>                                       |             |              |
|---|-------------|--------------|
| <b>For the Years Ended September 30</b>   | <b>2012</b> | <b>2011</b>  |
| <i>(Dollars in thousands)</i>   |             |              |
| Transfer of Advances against Defaulted MBS pools to<br>Mortgage Loans Held for Investment | \$ 705,007  | \$ 2,175,500 |
| Transfer from Mortgage Loans Held for Investment to<br>Properties Held for Sale           | \$ 25,500   | \$ 148,900   |

See the accompanying notes to the financial statements.

## Notes to the Financial Statements

### September 30, 2012 and 2011

#### **Note A: Organization and Summary of Significant Accounting Policies**

The Government National Mortgage Association (Ginnie Mae) was created in 1968, through an amendment of Title III of the National Housing Act as a government corporation within the Department of Housing and Urban Development (HUD). The Mortgage-Backed Securities (MBS) program is Ginnie Mae's primary ongoing activity. Its purpose is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential mortgage loans. Through the program, Ginnie Mae guarantees the timely payment of principal and interest on securities backed by pools of mortgages issued by private institutions. This guaranty is backed by the *full faith and credit of the U.S. Government*. Ginnie Mae requires that the mortgages be insured or guaranteed by the Federal Housing Administration (FHA), the U.S. Department of Agriculture (USDA), the Department of Veterans Affairs (VA), or the HUD Office of Public and Indian Housing (PIH). These MBS are not assets of Ginnie Mae, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying Balance Sheets.

To ensure that adequate capital continues to flow, Ginnie Mae offers reliable solutions that meet the needs of a broad constituent base and provide sufficient flexibility to respond to market changes. At the core of its business model and its product offering menu is the simple pass-through security, which comes in the form of two product structures—Ginnie Mae I MBS and Ginnie Mae II MBS. Each Ginnie Mae product structure has specific characteristics regarding pool types, note rates, collateral, payment dates, and geographical locations.

The underlying source of loans for the Ginnie Mae I MBS and Ginnie Mae II MBS comes from Ginnie Mae's following four main programs, which serve a variety of loan financing needs and different issuer origination capabilities:

- **Single Family Program** – The majority of Ginnie Mae securities are backed by single family mortgages predominantly originated through FHA and VA loan insurance programs.
- **Multifamily Program** – Ginnie Mae insures securities backed by FHA and USDA purchase and refinance loans for the purchase, construction, and renovation of apartment buildings, hospitals, nursing homes, and assisted living facilities.
- **HMBS Program** – Ginnie Mae's Home Equity Conversion Mortgage (HECM) securities program provides capital and liquidity for FHA-insured reverse mortgages. HECM loans are insured separately from regular single family mortgages due to their unique cash flow and fee structure. HECM loans can be pooled in to HECM Mortgage Backed Securities (HMBS) within the Ginnie Mae II MBS program.



- **Manufactured Housing Program** – Ginnie Mae’s Manufactured Housing program allows the issuance of pools of loans insured by FHA’s Title I Manufactured Home Loan Program.

**Basis of Presentation:** The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

**Funds with U.S. Treasury :** All of Ginnie Mae’s receipts and disbursements are processed by the U.S. Treasury, which in effect maintains Ginnie Mae’s bank accounts. For purposes of the Statements of Cash Flow, Funds with U.S. Treasury are considered cash.

**U.S. Government Securities:** U.S. Government Securities are classified as held for investment as Ginnie Mae has both the ability and the intent to hold until maturity, and are carried at amortized cost. Interest income on such securities is presented on the Statements of Revenues and Expenses and Changes in Investment of U.S. Government (Statements of Revenues and Expenses). Discounts and premiums are amortized, on a level yield basis, over the life of the related security.

**Fixed Assets :** Ginnie Mae’s fixed assets represent systems (software) that are used to accomplish its mission. Ginnie Mae capitalizes significant software development project costs based on guidance in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 350-40 *Intangibles—Goodwill and Other – Internal-Use Software* (ASC 350-40). Ginnie Mae capitalizes costs equal to or exceeding \$100,000 and amortizes the amount over a three- to five-year period beginning with the project’s completion on a straight-line basis.

**Mortgage Loans Held for Investment (HFI):** When a Ginnie Mae issuer defaults, Ginnie Mae is required to step into the role of the issuer and make the timely pass-through payments to investors, and subsequently, acquires the servicing rights and obligations of the issuer’s entire Ginnie Mae guaranteed, pooled loan portfolio of the defaulted issuer. Ginnie Mae utilizes contractors known as Master Servicers (MSS) to perform servicing responsibilities related to defaulted issuers. There are currently two MSSs for Single Family and one MSS for Manufactured Housing defaulted issuers. These MSSs currently service 100% of all non-pooled loans.

As the servicer, Ginnie Mae assesses loans to determine whether the loan should be purchased out of the pool. Ginnie Mae will purchase mortgage loans out of the pool when:

- a. Mortgage loans are uninsured by the FHA, USDA, VA or PIH
- b. Mortgage loans were previously insured but insurance is currently denied (collectively with (a.), referred to as uninsured mortgage loans)
- c. Mortgage loans are insured but are delinquent for more than 90 and 120 days based on management discretion for manufactured housing and single family loans, respectively.

Ginnie Mae assesses the collectability of mortgage loans bought out of the pools of defaulted portfolios. During FY 2012, the majority of mortgage loans were bought out due to borrower delinquency of more than 120 days. Ginnie Mae evaluates the collectability of all loans and considers a loan as credit impaired at acquisition when there is evidence of credit deterioration subsequent to the loan's origination and it is probable, at acquisition, that Ginnie Mae will be unable to collect all contractually required payments receivable. Ginnie Mae considers guarantees and insurance from FHA, USDA, VA and PIH in determining whether it is probable that Ginnie Mae will collect all amounts due according to the contractual terms.

For FHA insured loans, Ginnie Mae expects to collect the full amount of the unpaid principal balance and debenture rate interest (for months allowed in the insuring agency's timeline), when the insurer reimburses Ginnie Mae subsequent to filing a claim. As a result, these loans are accounted for under ASC Subtopic 310-20, Receivables – *Nonrefundable Fees and Other Costs*. In accordance with ASC 310-20-30-5, these loans are recorded at the unpaid principal balance which is the amount Ginnie Mae pays to repurchase these loans. Accordingly, Ginnie Mae recognizes interest income on these loans on an accrual basis at the debenture rate for the number of months allowed under the insuring agency's timeline. After the allowed timeline, Ginnie Mae considers these loans to be non-performing as the collection of interest is no longer reasonably assured, and places these loans on nonaccrual status.

Ginnie Mae separately assesses the collectability of mortgage loans bought out of the defaulted portfolios that are uninsured and loans that are non-FHA insured for which Ginnie Mae only receives a portion of the outstanding principal balance. If the principal and interest payments are not fully guaranteed from the insurer (i.e., there is a lack of insurance), or loans are delinquent at acquisition, it is probable that Ginnie Mae will be unable to collect all contractually required payments receivable. Accordingly, these loans are considered to be credit impaired and are accounted for under ASC Subtopic 310-30, Receivables – *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. At the time of acquisition, these loans are recorded at the lower of their acquisition cost or present value of expected amounts to be received. As non-performing loans, these loans are placed on nonaccrual status.

Ginnie Mae has the ability and the intent to hold these acquired loans for the foreseeable future or until maturity according to policy; therefore, Ginnie Mae classifies the mortgage loans as held for investment (HFI). The mortgage loans HFI are reported net of allowance for loan losses. Mortgage loans HFI also include mortgages loans that are undergoing the foreclosure process and loans which management identified to be sold as a short sale. Upon completion of the foreclosure process, when Ginnie Mae acquires the title of the underlying properties, these properties are either conveyed to the insuring agency (or are in the process of being conveyed) for claim and are reported as advances against defaulted MBS pools, or are classified as properties held for sale. Upon completion of the short sale, when the underlying property is sold, the remaining balances for claim are reported to short sales claims receivable.

Ginnie Mae performs periodic and systematic reviews of its loan portfolios to identify credit risks and assess the overall collectability of the portfolios. The allowance for loss on mortgage loans HFI represents management's estimate of probable credit losses inherent in Ginnie Mae's

mortgage loan portfolio. The allowance for loss on mortgage loans HFI is netted against the balance of mortgage loans HFI, representing the net realizable value of these loans.

**Accrued Interest Mortgage Loans Held for Investment:** Ginnie Mae records accrued interest on mortgage loans HFI for interest which Ginnie Mae determines that the ultimate collectability is probable. For FHA insured loans, Ginnie Mae recognizes interest income on an accrual basis at the debenture rate for the number of months allowed under the insuring agency's timeline. After the allowed timeline, Ginnie Mae considers these loans to be non-performing as the collection of interest is not reasonably assured, and places these loans on nonaccrual status. Ginnie Mae has assessed the collectability of non-FHA and uninsured loans and determined that these loans are non-performing and hence, are placed on nonaccrual status. Ginnie Mae recognizes interest income for loans on nonaccrual status when cash is received.

**Advances Against Defaulted MBS Pools:** Advances against defaulted MBS pools represent payments made to fulfill Ginnie Mae's guaranty of timely principal and interest payments to MBS security holders. Such advances are reported net of an allowance for uncollectible advances to the extent management believes they will not be recovered. Principal and interest receivable for foreclosed properties that have been conveyed to the insuring agency or are in the process of being conveyed to the insuring agency are reported in the advance category while Ginnie Mae is awaiting payment of the receivable. These claims are reported net of allowance. The allowance for uncollectible advances is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA, and PIH. Other factors considered in the estimate include market analysis and appraised value of the loans.

**Short Sales Claims Receivable:** As an alternative to foreclosure, a property may be sold for its appraised value even if the sale results in a short sale where the proceeds are not sufficient to pay off the mortgage. Ginnie Mae's MSSs analyze mortgage loans HFI for factors such as delinquency, appraised value of the loan, and market in locale of the loan to identify loans that may be short sale eligible. These transactions are analyzed and approved by Ginnie Mae's MBS program office.

For FHA insured loans, for which the underlying property was sold in a short sale, the insurer typically pays Ginnie Mae the difference between the proceeds received from the sale and the total contractual amount of the mortgage loan and interest at the debenture rate. Hence, Ginnie Mae does not incur any losses as a result of the short sale. Ginnie Mae records a short sale claims receivable while it awaits repayment of this amount from the insurer. For short sale claims receivable for which Ginnie Mae believes that collection is not probable, Ginnie Mae records an allowance for short sale claims receivable. The allowance for short sale claims receivable is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA, and PIH. The aggregate of the short sale receivable and the allowance for short sale receivable is the amount that Ginnie Mae determines to be collectible.

**Properties Held for Sale:** Properties held for sale represent assets that Ginnie Mae has received the title of the underlying collateral (e.g. completely foreclosed upon and repossessed) and intends to sell the collateral. For instances in which Ginnie Mae does not convey the property to the insuring agency, Ginnie Mae holds the title until the property is sold. As the properties are

available for immediate sale in their current condition and are actively marketed for sale, they are reported as Properties Held for Sale on the Balance Sheets in accordance with ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*. Properties held for sale are initially recorded on the Balance Sheets at fair value less its estimated cost to sell. The fair value less estimated cost to sell on the date of foreclosure is deemed to be the carrying value of the foreclosed asset. Subsequent to initial measurement, the Properties held for sale are reported at the lower of the carrying amount or fair value less estimated cost to sell.

**Mortgage Servicing Rights:** Mortgage Servicing Rights (MSR) represent Ginnie Mae's right and obligation to service mortgage loans in mortgage backed securities obtained from defaulted issuers. Ginnie Mae contracts with multiple MSSs to provide the servicing of its mortgage loans. The servicing functions typically performed by Ginnie Mae's MSSs include: collecting and remitting loan payments, responding to borrower inquiries, accounting for principal and interest, holding custodial funds for payment of property taxes and insurance premiums, counseling delinquent mortgagors, supervising foreclosures and property dispositions, and generally administering the loans. Ginnie Mae receives a weighted average servicing fee annually on the remaining outstanding principal balances of the loans. These servicing fees are included in and collected from the monthly payments made by the borrowers. Ginnie Mae pays a servicing expense to the MSSs in consideration for servicing the loans.

Ginnie Mae records a servicing asset or liability each time it takes over a defaulted issuer's Ginnie Mae-guaranteed portfolio. The balance of the MSR represents the present value of the estimated compensation for mortgage servicing activities that exceeds the fair market cost for such servicing activities. Ginnie Mae considers its fair market cost to be the amount of compensation that would be required by a substitute MSS should one be required. Market information is used to determine the fair market cost for these services.

Ginnie Mae has elected the fair value option for the MSRs to better reflect the potential net realizable or market value that could be ultimately realized from the disposition of the MSR asset or the settlement of a future MSR liability. Upon acquisition, Ginnie Mae measures its MSRs at fair value and subsequently re-measures the assets or liabilities with changes in the fair value recorded in the Statements of Revenues and Expenses.

**Fair Value:** Ginnie Mae measures the fair value of its financial instruments in accordance with FASB ASC Topic 820, *Fair Value Measurement* (ASC 820) that requires an entity to base fair value on exit price and maximize the use of observable inputs and minimize the use of unobservable inputs to determine the exit price. Accounting guidance defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Ginnie Mae categorizes its financial instruments, based on the priority of inputs to the valuation technique, into a three-level hierarchy, as described below.

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and

liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. Government securities that are highly liquid and are actively traded in over-the-counter markets.

- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include securities with quoted prices that are traded less frequently than exchange-traded instruments that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

**Liability for Loss on MBS Program Guaranty :** Liability for loss on MBS program guaranty (MBS loss liability) represents management's estimate of future losses to be incurred as a result of the guaranty provided on MBS portfolios when information indicates a loss is probable and the amount of loss can be reasonably estimated.

The MBS loss liability is established to the extent management believes losses due to issuer defaults are probable and estimable and servicing income and FHA, USDA, VA, and PIH insurance proceeds do not fully cover Ginnie Mae servicing and loan acquisition related costs. The MBS Loss Liability is a liability account on the Balance Sheet. Ginnie Mae recognizes the loss by recording a charge to the provision for loss on MBS program guaranty on the Statements of Revenue and Expenses. Ginnie Mae records charge-offs as a reduction to the MBS loss liability account when losses are confirmed and records recoveries as a credit to the MBS loss liability account. Accordingly, the MBS loss liability is increased by provisions recorded as an expense in the Statements of Revenues and Expenses and reduced by charge-offs, net of recoveries. Among other losses and recoveries, miscellaneous expenses related to foreclosure are not capitalized on the Balance Sheet and are charged off against the MBS loss liability and recoveries of these expenses through the claims process are shown as recoveries against the MBS loss liability.

**Financial Guarantees :** Ginnie Mae, as guarantor, follows the guidance in ASC Topic 460, *Guarantees* (ASC 460), for its accounting for, and disclosure of, the issuance of certain types of guarantees. ASC 460 requires that upon issuance of a guaranty, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guaranty. The issuance of a guaranty under the MBS program obligates Ginnie Mae to stand ready to perform over the term of the guaranty in the event that the specified triggering events or conditions occur.

At inception of the guaranty, Ginnie Mae recognizes a liability for the guaranty it provides on MBSs issued by third-party issuers. Generally, a guaranty liability is initially measured at fair value. However, Ginnie Mae applies the practical expedient in ASC 460, which allows the guaranty liability to be recognized at inception based on the premium received or receivable by the guarantor, provided the guaranty is issued in a standalone arm's length transaction with an unrelated party.

Ginnie Mae provides the guaranty of principal and interest payments to MBS holders in the event of issuer default and, in exchange, receives guaranty fees from the issuers. Ginnie Mae receives guaranty fees from the issuers on the unpaid principal balance of the outstanding MBSs in the non-defaulted issuer portfolio. These fees are paid on a monthly basis over the period that the guaranty is provided. As Ginnie Mae does not receive guaranty fees at inception of the guaranty, Ginnie Mae determines the initial measurement of the guaranty liability based on the expected present value cash flows to be received for the guaranty fee. Subsequently, the guaranty liability is measured by a systematic and rational amortization method.

Additionally, as the guaranty is issued in a standalone transaction for a premium, Ginnie Mae records a guaranty asset for the guaranty fees as the offsetting entry for the guaranty liability. The guaranty asset is calculated based on the present value of the expected future cash flows from the guaranty fees based on the unpaid principal balance of the outstanding MBSs in the non-defaulted issuer portfolio. Thus, there is no impact due to the guaranty liability and asset on the net financial position of Ginnie Mae.

In FY 2012, the model for the valuation of Ginnie Mae's guaranty-fee asset and ASC 460 liability was updated to utilize FHA's actuarially reviewed prepayment and default econometric model to predict loan behavior and more accurately capture the probability that loans will remain in Ginnie Mae pools.

**Recognition of Revenues and Expenses :** Ginnie Mae receives monthly guaranty fees for each MBS mortgage pool, based on a percentage of the pool's outstanding balance. Fees received for Ginnie Mae's guaranty of MBS are recognized as earned. Ginnie Mae receives commitment fees as issuers request commitment authority, and recognizes the commitment fees as income as issuers use their commitment authority, with the balance deferred until earned or expired, whichever occurs first. Fees from expired commitment authority are not returned to issuers. Additionally, Ginnie Mae receives one-time upfront fees related to the issuance of multiclass products. These multiclass fees are recognized as revenue over the service period in proportion to the costs expected to be incurred.

Ginnie Mae's expenses are classified into three groups: MBS program expenses, administrative expenses, and fixed asset amortization. The main components of the MBS program expense line item are multiclass expenses, MBS information systems and compliance expenses, and transfer agent expenses.

**Statements of Cash Flows:** Ginnie Mae prepares the Statements of Cash Flows on an indirect basis. For purposes of the Statements of Cash Flows, Funds with U.S. Treasury are considered cash. Ginnie Mae classifies cash flows from operations related to its programs and overall

business operations (i.e., accrued interest, deferred revenue and liabilities, accounts payable, and MBS loss liability) as operating activities. Ginnie Mae classifies cash flows from securities that Ginnie Mae intends to hold for investment (i.e., U.S. Government securities and mortgage loans HFI) and capital expenditures and proceeds from sale of software as investing activities. Ginnie Mae classifies cash flows from any non-federal transactions necessary to finance or fund the operations of the agency as financing activities; of which there are none. Management determines the cash flow classification at the date of purchase of a loan, whether it intends to sell (operating activity) or hold the loan for the foreseeable future (investing activity).

**Use of Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ginnie Mae has made significant estimates in a variety of areas including, but not limited to, valuation of certain financial instruments and assets (e.g., MSRs, properties held for sale, and fixed assets - software), and liabilities (e.g., accruals for payments of contracts and miscellaneous expenses related to maintaining mortgage assets, and litigation-related obligations), including establishing the MBS loss liability. While Ginnie Mae believes its estimates and assumptions are reasonable based on historical experience and other factors, actual results could differ from those estimates.

**Adoption of New Accounting Standard:** Ginnie Mae adopted the new accounting standard, FASB Accounting Standards Update (ASU) 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which was effective for annual reporting periods ending on or after December 15, 2011 for information that Ginnie Mae has available. The adoption of ASU 2010-20 did not affect the financial statement results as it only amended and enhanced the disclosure requirements about the credit quality of financing receivables and the allowance for credit losses.

#### Note B: U.S. Government Securities

The amortized cost and fair values as of September 30, 2012, were as follows:

| <i>(Dollars in thousands)</i>              | Amortized Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value          |
|--|---------------------|------------------------------|-------------------------------|---------------------|
| U.S. Treasury Overnight Certificates       | \$ 509,600          | \$ -                         | \$ -                          | \$ 509,600          |
| U.S. Treasury Notes                        | 996,300             | 29,600                       | -                             | 1,025,900           |
| U.S. Treasury Inflation-Indexed Securities | 607,700             | 40,600                       | -                             | 648,300             |
| <b>Total</b>                               | <b>\$ 2,113,600</b> | <b>\$ 70,200</b>             | <b>\$ -</b>                   | <b>\$ 2,183,800</b> |

The amortized cost and fair values as of September 30, 2011, were as follows:

| <i>(Dollars in thousands)</i>              | Amortized Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value          |
|--|---------------------|------------------------------|-------------------------------|---------------------|
| U.S. Treasury Overnight Certificates       | \$ -                | \$ -                         | \$ -                          | \$ -                |
| U.S. Treasury Notes                        | 994,100             | 44,400                       | -                             | 1,038,500           |
| U.S. Treasury Inflation-Indexed Securities | 1,132,700           | 56,300                       | -                             | 1,189,000           |
| <b>Total</b>                               | <b>\$ 2,126,800</b> | <b>\$ 100,700</b>            | <b>\$ -</b>                   | <b>\$ 2,227,500</b> |

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2012, by contractual maturity date, were as follows:

| <i>(Dollars in thousands)</i>          | Amortized Cost      | Fair Value          | Weighted<br>Average<br>Interest Rate |
|--|---------------------|---------------------|--------------------------------------|
| Due within one year                    | \$ 509,600          | \$ 509,600          | 0.05%                                |
| Due after one year through five years  | 1,604,000           | 1,674,200           | -0.49%                               |
| Due after five years through ten years | -                   | -                   | -                                    |
| <b>Total</b>                           | <b>\$ 2,113,600</b> | <b>\$ 2,183,800</b> | <b>-0.36%</b>                        |

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2011, by contractual maturity date, were as follows:

| <i>(Dollars in thousands)</i>          | Amortized Cost      | Fair Value          | Weighted<br>Average<br>Interest Rate |
|--|---------------------|---------------------|--------------------------------------|
| Due within one year                    | \$ -                | \$ -                |                                      |
| Due after one year through five years  | 2,126,800           | 2,227,500           | 0.16%                                |
| Due after five years through ten years | -                   | -                   |                                      |
| <b>Total</b>                           | <b>\$ 2,126,800</b> | <b>\$ 2,227,500</b> | <b>0.16%</b>                         |

The U.S. Government securities portfolio is held in special market-based U.S. Treasury securities that are bought and sold at composite prices received from the Federal Reserve Bank of New York. These securities are maintained in book-entry form at the Bureau of Public Debt and include overnight certificates, U.S. Treasury notes, and U.S. Treasury inflation-indexed securities (reflecting inflation compensation). The coupon rates of Ginnie Mae's holdings, with a maturity of greater than one year, as of September 30, 2012, range from 1.88 percent to 2.00 percent. As of September 30, 2011, they ranged from 0.63 percent to 2.00 percent.

Although sales of investments are rare, Ginnie Mae liquidated one of its U.S. Government securities within one year of maturity. The par value of the security sold was \$520.6 million and the realized gain on the sale was \$12.5 million. These funds were used to repurchase mortgage loans held for investment from defaulted issuer MBS pools. See note on mortgage loans HFI regarding loan repurchases.



**Note C: Mortgage Loans Held for Investment, Net**

Mortgage loans HFI, net as of September 30, 2012 and 2011 were as follows:

| <i>(Dollars in thousands)</i>              | September 30        |                     |
|--|---------------------|---------------------|
|  | 2012                | 2011                |
| Single Family Mortgages                    | \$ 6,866,500        | \$ 6,350,300        |
| Single Family Mortgages Allowance for Loss | (177,400)           | -                   |
| <b>Single Family Mortgages HFI, net</b>    | <b>\$ 6,689,100</b> | <b>\$ 6,350,300</b> |

| <i>(Dollars in thousands)</i>                     | September 30 |             |
|---|--------------|-------------|
|   | 2012         | 2011        |
| Manufactured Housing Mortgages                    | \$ -         | \$ -        |
| Manufactured Housing Mortgages Allowance for Loss | -            | -           |
| <b>Manufactured Housing Mortgages HFI, net</b>    | <b>\$ -</b>  | <b>\$ -</b> |

| <i>(Dollars in thousands)</i>               | September 30        |                     |
|---|---------------------|---------------------|
|   | 2012                | 2011                |
| Total Mortgage Loans HFI                    | \$ 6,866,500        | \$ 6,350,300        |
| Total Mortgage Loans HFI Allowance for Loss | (177,400)           | -                   |
| <b>Total Mortgage Loans HFI, net</b>        | <b>\$ 6,689,100</b> | <b>\$ 6,350,300</b> |

During FY 2012, Ginnie Mae purchased \$705.0 million in mortgage loans out of pools, primarily in the single family defaulted portfolio and categorized these mortgage loans as HFI. Ginnie Mae utilizes the non-pooled valuation and allowance methodology to evaluate mortgage loans HFI on an individual basis. Items evaluated to determine impairment include insurance status and probable recovery amount based on experience and industry studies. As of September 30, 2012, there are no multifamily mortgage loans HFI. Manufactured housing mortgage loans HFI have a Remaining Principal Balance (RPB) of \$1.0 million and have been written down to \$0; as these are delinquent past 90 days and considered credit impaired, these are placed on a nonaccrual status.

Ginnie Mae analyzes its risk structure based on a loan's insurance coverage. Loans, which are insured by the FHA, have the least credit risk and are classified as Credit Risk Level 1 because Ginnie Mae expects to receive full recovery of principal in the event of a loan default. Loans, which are classified as a Credit Risk Level 2, are insured by other agencies (i.e., VA, USDA, etc.). These loans are more risky than Credit Level 1 loans because Ginnie Mae expects to receive partial recovery of principal. All loans without insurance coverage are classified as a Credit Risk Level 3. These loans are high risk because they have a lower probability for recovery than insured loans.

As discussed in Note A, Ginnie Mae records accrued interest on mortgage loans HFI for interest which Ginnie Mae determines that the ultimate collectability is probable. For FHA insured loans, Ginnie Mae recognizes interest income on an accrual basis at the debenture rate for the number of months allowed under the insuring agency's timeline. After the allowed timeline,

Ginnie Mae considers these loans to be non-performing as the collection of interest is not reasonably assured, and places these loans on nonaccrual status. Thus, it is important to note that FHA insured mortgage loans HFI that are greater than 90 days delinquent continue to accrue interest during the time line for which the insurer will reimburse Ginnie Mae. Ginnie Mae has assessed the collectability of non-FHA and uninsured loans; these loans are non-performing and hence, are placed on nonaccrual status at the time of purchase. In fiscal years 2012 and 2011, Ginnie Mae recorded \$279.8 and \$42.3 million, respectively, in interest income on mortgage loans HFI.

#### **Note D: Advances Against Defaulted MBS Pools, Net**

The advances against defaulted MBS pools balance is \$918.8 million in FY 2012 and \$653.2 million in FY 2011. This account represents pass-through payments to MBS investors on pooled loans, loans in post foreclosure which have not been submitted to an insuring agency for claim, and insurance claims filed with insuring agencies but not paid. Of the total net advances of \$918.8 million, \$59.7 million represents pass-through payments to MBS investors on pooled loans, \$852.6 million of the balance is loans in post foreclosure which have not been submitted to an insuring agency for claim, and \$6.5 million represents insurance claims filed with insuring agencies but not paid. The comparative information is displayed in the table below.

| <i>(Dollars in thousands)</i>                    | September 30      |                   |
|--|-------------------|-------------------|
|  | 2012              | 2011              |
| Post Foreclosure/Preclaim                        | \$ 852,600        | \$ 583,400        |
| Advances   | \$ 59,700         | \$ 67,700         |
| Insurance claims filed                           | \$ 6,500          | \$ 2,100          |
| <b>Advances against defaulted MBS pools, net</b> | <b>\$ 918,800</b> | <b>\$ 653,200</b> |

#### **Note E: Properties Held for Sale, Net**

Properties held for sale represent assets that Ginnie Mae has received the title of the underlying collateral (e.g., completely foreclosed upon and repossessed) and intends to sell the collateral. Properties held for sale, net consists of the foreclosed and repossessed property received in full satisfaction of a loan, net of a valuation allowance for declines in the fair value of foreclosed properties less estimated costs to sell. The properties are appraised by independent entities on a regular basis. During FY 2012, \$25.5 million of loans were repurchased out of pools and transferred from other asset categories, and categorized as properties held for sale. The properties held for sale balance is composed primarily of single family collateral. Balances and activity for these acquired properties were as follows:

| <i>(Dollars in thousands)</i>            | September 30     |                 |
|--|------------------|-----------------|
|  | 2012             | 2011            |
| Balance of properties, beginning of year | \$ 7,400         | \$ 49,200       |
| Additions                                | 25,500           | 148,900         |
| Dispositions and Losses                  | (17,400)         | (190,700)       |
| Balance of properties, end of year       | \$ 15,500        | \$ 7,400        |
| Valuation Allowance                      | (3,900)          | (4,000)         |
| <b>Properties held for sale, net</b>     | <b>\$ 11,600</b> | <b>\$ 3,400</b> |

### Note F: Mortgage Servicing Rights

The following table presents activity for residential first mortgage MSR:

| <i>(Dollars in thousands)</i>      | September 30     |
|------------------------------------|------------------|
|                                    | 2012             |
| Balance, October 1, 2011           | \$ 110,900       |
| Additions                          | -                |
| Changes in Fair Value              | (50,200)         |
| <b>Balance, September 30, 2012</b> | <b>\$ 60,700</b> |

| <i>(Dollars in thousands)</i>      | September 30      |
|------------------------------------|-------------------|
|                                    | 2011              |
| Balance, October 1, 2010           | \$ 137,700        |
| Additions                          | -                 |
| Changes in Fair Value              | (26,800)          |
| <b>Balance, September 30, 2011</b> | <b>\$ 110,900</b> |

Ginnie Mae uses a valuation model that calculates the present value of estimated future net servicing income to determine the fair value of MSR, which factors in prepayment risk. This approach consists of projecting servicing cash flows under multiple interest rate scenarios and discounting these cash flows using risk-adjusted discount rates. The decrease in MSR value is directly attributed to changes in fair value during the fiscal year.

The key economic assumptions used in valuations of MSR include weighted-average lives and prepayment rates of the MSR. The discount rate is used to discount expected cash flows in order to derive the fair value of the MSR. The discount rate assumptions reflect the market's required rate of return adjusted for the relative risk of the asset type. Discount rate assumptions are derived from a range of observed discount rate assumptions in the industry to which a risk premium is added in order to account for current credit conditions. These variables can, and generally do, change from period to period as market conditions and projected interest rates change, and could have an adverse impact on the value of the MSR and could result in a corresponding reduction in servicing income.

Key economic assumptions used in determining the fair value of the Ginnie Mae's MSR are as follows:

| <i>(Dollars in thousands)</i>                | September 30 |            |
|--|--------------|------------|
|  | 2012         | 2011       |
| Valuation at period end:                     |              |            |
| Fair value (thousands)                       | \$ 60,700    | \$ 110,900 |
| Weighted- average life (years)               | 2.43         | 3.97       |
| Prepayment rates assumptions:                |              |            |
| Rate assumption                              | 32.89%       | 20.62%     |
| Impact on fair value of a 10% adverse change | (4,420)      | (6,245)    |
| Impact on fair value of a 20% adverse change | (8,339)      | (11,875)   |
| Discount rate assumptions:                   |              |            |
| Rate assumption                              | 12.52%       | 12.50%     |
| Impact on fair value of a 10% adverse change | (1,398)      | (3,740)    |
| Impact on fair value of a 20% adverse change | (2,735)      | (7,251)    |

These sensitivities are hypothetical and should be considered with caution. Changes in fair value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another (e.g., increased market interest rates may result in lower prepayments and increased credit losses) that could magnify or counteract the sensitivities. Further, these sensitivities show only the change in the asset balances and do not show any expected change in the fair value of the instruments used to manage the interest rates and prepayment risks associated with these assets. The primary risk of Ginnie Mae's MSRs is interest rate risk and the resulting impact on prepayments. A significant decline in interest rates could lead to higher than expected prepayments that could reduce the value of the MSRs.

Ginnie Mae collected \$ 57.0 million and \$73.0 million in mortgage servicing fees for the years ended September 30, 2012 and 2011, respectively. This amount is recorded as a recovery in the MBS loss liability.

### **Note G: Fair Value Measurements**

This note discusses the recurring and non-recurring changes in fair value measurement as well as the fair value of financial instruments. The following sections provide detailed information.

#### Recurring Changes in Fair Value

The following table presents for each of these fair value measurement hierarchy levels, Ginnie Mae's assets that are measured at fair value on a recurring basis subsequent to initial recognition, including financial instruments for which Ginnie Mae has elected the fair value option:

| <i>(Dollars in thousands)</i> | September 30, 2012 |         |           |           |
|-------------------------------|--------------------|---------|-----------|-----------|
|                               | Level 1            | Level 2 | Level 3   | Total     |
| Assets                        |                    |         |           |           |
| Mortgage Servicing Rights     | -                  | -       | 60,700    | 60,700    |
| Total Assets at Fair Value    | \$ -               | \$ -    | \$ 60,700 | \$ 60,700 |

| <i>(Dollars in thousands)</i> | September 30, 2011 |         |            |            |
|-------------------------------|--------------------|---------|------------|------------|
|                               | Level 1            | Level 2 | Level 3    | Total      |
| Assets                        |                    |         |            |            |
| Mortgage Servicing Rights     | -                  | -       | 110,900    | 110,900    |
| Total Assets at Fair Value    | \$ -               | \$ -    | \$ 110,900 | \$ 110,900 |

Total assets measured at fair value on a recurring basis and classified as Level 3 were \$60.7 million or less than 1% of Total Assets, and \$110.9 million or less than 1% of Total Assets, on the Balance Sheets as of September 30, 2012 and 2011, respectively.

The following table presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended September 30, 2012 and 2011:

| <i>(Dollars in thousands)</i>                                       | MSRs              |
|---|-------------------|
| Assets:   |                   |
| <b>October 1, 2011</b>  | \$ 110,900        |
| Net realized losses included in Excess of Revenue over Expenses (1) | (50,200)          |
| <b>September 30, 2012</b>   | <b>\$ 60,700</b>  |
| Unrealized gains(losses) still held                                 | -                 |
| Assets:   |                   |
| <b>October 1, 2010</b>  | \$ 137,700        |
| Net realized losses included in Excess of Revenue over Expenses (1) | (26,800)          |
| <b>September 30, 2011</b>   | <b>\$ 110,900</b> |
| Unrealized gains(losses) still held                                 | -                 |

(1) Net realized/ unrealized gains (losses) included in Excess of Revenue over Expenses represent the periodic fair value changes of the MSR

The table below summarizes gains and losses due to changes in fair value, including both realized and unrealized gains and losses, recorded in excess of revenue over expenses for the fiscal year ended 2012 and 2011 for Level 3 assets:

|  |             | Total Gains and Losses on MSR |                  |
|--|-------------|-------------------------------|------------------|
|  |             | 2012                          | 2011             |
| <i>(Dollars in thousands)</i>  |             |                               |                  |
| Classification of gains and losses (realized/unrealized) included in Excess of Revenue over Expenses for the period: |             |                               |                  |
|  | Loss on MSR | 50,200                        | 26,800           |
| <b>Total</b>   |             | <b>\$ 50,200</b>              | <b>\$ 26,800</b> |

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis, as well as the basis for classifying these assets and liabilities as Level 1, Level 2 or Level 3. The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument:

*Mortgage Servicing Rights* – Ginnie Mae elected the fair value option for its MSRs and they are recorded on the Balance Sheets at fair value on a recurring basis. Ginnie Mae measures the fair value of MSRs based on the present value of expected cash flows of the underlying mortgage assets using management's best estimates of certain key assumptions, which include prepayment speeds, forward yield curves, adequate compensation, and discount rates commensurate with the risks involved. Changes in anticipated prepayment speeds, in particular, result in fluctuations in the estimated fair values of the servicing rights. If actual prepayment experience differs from the anticipated rates used in the model, this may result in a material change in the fair value. MSRs are classified within Level 3 of the valuation hierarchy because significant inputs are unobservable.

#### Nonrecurring Changes in Fair Value

The following tables display assets measured on the Balance Sheets at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (e.g., when Ginnie Mae evaluates for impairment), and the gains or losses recognized for these assets and liabilities for the years ended September 30, 2012 and 2011, as a result of fair value measurements:

| <b>September 30, 2012</b>     |                |                |                |                     |
|-------------------------------|----------------|----------------|----------------|---------------------|
| <i>(Dollars in thousands)</i> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total Losses</b> |
| <b>Assets:</b>                |                |                |                |                     |
| Properties held for sale      |                |                | \$ 11,600      | -                   |

| <b>September 30, 2011</b>     |                |                |                |                     |
|-------------------------------|----------------|----------------|----------------|---------------------|
| <i>(Dollars in thousands)</i> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total Losses</b> |
| <b>Assets:</b>                |                |                |                |                     |
| Properties held for sale      |                |                | \$ 3,400       | -                   |

The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument. The same valuation methodologies are used to estimate the fair value of financial instruments not carried at fair value but disclosed as part of the fair value of financial instruments:

*Properties Held for Sale, net* – Properties held for sale, net represents foreclosed property received in full satisfaction of a loan, which Ginnie Mae intends to sell, net of a valuation allowance. Properties held for sale is initially recorded on the Balance Sheets at its fair value less its estimated cost to sell. Subsequent to initial measurement, the properties held for sale are reported at the lower of the carrying amount or fair value less estimated cost to sell. The fair value estimate is based on relevant current and historical factors available at the time of valuation. Acquired property is classified within Level 3 of the valuation hierarchy because significant inputs are unobservable.

#### Fair Value of Financial Instruments

The following table displays the carrying value and estimated fair value of Ginnie Mae's financial instruments as of September 30, 2012 and 2011. The fair value of financial instruments disclosed in the table includes commitments to guaranty MBS, which are off-balance sheet financial instruments as described in Note I. The fair values of these commitments are presented as "unrecognized MBS commitment."

| <i>(Dollars in thousands)</i>              | September 30, 2012 |              | September 30, 2011 |              |
|--|--------------------|--------------|--------------------|--------------|
|  | Carrying Value     | Fair Value   | Carrying Value     | Fair Value   |
| <u>Financial Assets:</u>                   |                    |              |                    |              |
| Funds with U.S. Treasury                   | \$ 7,075,500       | \$ 7,075,500 | \$ 7,210,300       | \$ 7,210,300 |
| U.S. Government securities                 | \$ 2,113,600       | \$ 2,183,800 | \$ 2,126,800       | \$ 2,227,500 |
| Mortgages held for investment, net         | \$ 6,689,100       | \$ 6,689,100 | \$ 6,350,300       | \$ 6,350,300 |
| Advances against defaulted MBS Pools, net  | \$ 918,800         | \$ 918,800   | \$ 653,200         | \$ 653,200   |
| Short sales claims receivable, net         | \$ 21,100          | \$ 21,100    | \$ 32,300          | \$ 32,300    |
| Properties held for sale, net              | \$ 11,600          | \$ 11,600    | \$ 3,400           | \$ 3,400     |
| Mortgage servicing rights                  | \$ 60,700          | \$ 60,700    | \$ 110,900         | \$ 110,900   |
| Guaranty asset                             | \$ 6,633,900       | \$ 6,633,900 | \$ 2,175,100       | \$ 2,175,100 |
| <u>Financial Liabilities:</u>              |                    |              |                    |              |
| Guaranty liability                         | \$ 6,633,900       | \$ 6,633,900 | \$ 2,175,100       | \$ 2,175,100 |
| <u>Unrecognized financial instruments:</u> |                    |              |                    |              |
| Unrecognized MBS commitments               | \$ 601,700         | \$ 601,700   | \$ 213,900         | \$ 213,900   |

Ginnie Mae's standing as a federal government corporation whose guaranty carries the full faith and credit of the U.S. Government makes it difficult to determine what the fair value of its financial instruments would be in the private market. Therefore, the fair values presented in the table above do not purport to present the net realizable, liquidation, or market value as a whole. Furthermore, amounts Ginnie Mae ultimately realizes from the disposition of assets or settlement of liabilities may vary significantly from the fair values presented.

The valuation techniques for the line items disclosed in the above table, including funds with U.S. Treasury, advances against defaulted MBS pools, and short sales claims receivable have a carrying amount which approximates fair value due to the short-term nature and low credit risk inherent in them. These line items are discussed in Note A and other applicable disclosures contained in the Notes to the Financial Statements. Mortgage loans HFI are reported net of allowance for loan losses. The disclosures related to mortgage loans HFI are discussed in Notes A and C. The following are valuation techniques for items not subject to the fair value hierarchy either because they are not measured at fair value other than for the purpose of the above table or because they are only measured at fair value at inception:

*U.S. Government Securities* – Ginnie Mae recognizes the fair value as the carrying value for the line items in the table except for U.S. Government Securities which is based on Treasury values as of September 30.

*Guaranty Asset and Liability* – Ginnie Mae uses the practical expedient to determine the guaranty asset and liability based on the present value of the expected future cash flows from the guaranty fees based on the unpaid principal balance of the outstanding MBSs in the non-defaulted issuer portfolio which results from new issuances of MBSs, scheduled run-offs of



MBSs, prepayments and defaults. Subsequently, the guaranty asset and liability is measured by a systematic and rational amortization method.

In FY 2012, the model was updated to rely heavily on FHA's actuarially reviewed prepayment and default economic model to predict loan behavior and more accurately captures the probability that loans will remain in Ginnie Mae pools.

*Unrecognized MBS Commitment* – During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guaranty MBS. The commitment ends when the securities are issued or the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for the outstanding balance of MBS commitments. Outstanding MBS commitments as of September 30, 2012 and September 30, 2011 were \$115.7 billion and \$102.6 billion, respectively. If the outstanding MBS commitments were utilized in FY 2012, Ginnie Mae's corresponding guaranty liability, its obligation to stand ready to perform on these securities, would be approximately \$601.7 million as of September 30, 2012 and \$213.9 million as of September 30, 2011. These are shown as unrecognized MBS commitments.

#### **Note H: Allowances for Losses and MBS Loss Liability**

Ginnie Mae establishes allowances for losses and a MBS loss liability on an annual basis. The main components of the total estimated credit losses are discussed below.

Ginnie Mae records actual losses on its financing receivables, which may be for all or part of a particular advance, mortgage loan, properties held for sale or claims receivable as a charge/deduction (debit) against the allowance. The related asset balance is charged off (credited) in the period in which the principal and/or interest portion are deemed uncollectible. Ginnie Mae deems the loans to be uncollectible and records a charge-off when Ginnie Mae has ceased all collection efforts of receiving payment or collateral for the outstanding debt.

#### Allowance for Uncollectible Advances

Under its MBS guaranty, Ginnie Mae makes payments (advances) to fulfill its guaranty of timely principal and interest payments to investors for pooled mortgage loans when an issuer defaults. Ginnie Mae establishes an allowance for uncollectible advances and records a corresponding provision for loss from uncollectible advances to reflect the estimates of losses when Ginnie Mae deems a portion of the advances recorded are uncollectible. Principal and interest receivable for foreclosed properties that have been conveyed or are in the process of being conveyed to the insuring agency are also reported in Advances and reported net of allowance. The allowance for uncollectible advances is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA, and PIH. Other factors include market analysis and appraised value of the loans.

#### Allowance for Loss on Mortgage Loans HFI

Ginnie Mae establishes an allowance for loss on mortgage loans HFI for the estimated uncollectible portion of the principal balance of the loan. This means evaluating whether all of the contractual payments will be collected as scheduled according to the contractual terms. Additionally, Ginnie Mae incorporates the probable recovery amount from mortgage insurance

(e.g., FHA, USDA, VA, or PIH) based on established insurance rates. To make this evaluation, Ginnie Mae reviews the delinquency of mortgage loans, industry benchmarks, as well as the established rates of insurance recoveries from insurers.

#### Allowance for Loss Short Sales Claims Receivable

As an alternative to foreclosure, borrowers may sell the property for its appraised value even if such a sale results in a short sale where the proceeds are not sufficient to pay off the mortgage. For FHA insured loans where the underlying property was sold in a short sale, the insurer typically pays Ginnie Mae the differences between the proceeds received from the sale and the total contractual amount of the mortgage loan and interest at the debenture rate. Ginnie Mae records a short sale claims receivable while it awaits repayment of this amount from the insurer. For non-FHA insured loans for which Ginnie Mae receives less than the difference as described, and allowance for short sale claim receivable is recorded for the portion of the balance estimated to be uncollectible. The allowance for short sales claims receivable is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA, and PIH. The aggregate of the short sales receivable and the allowance for short sales receivable is the amount that Ginnie Mae determines to be collectible.

#### MBS Loss Liability

Ginnie Mae establishes a MBS loss liability through a provision charged to operations when, in management's judgment, losses associated with existing defaulted issuers or new issuer defaults are probable and estimable. In estimating losses, management utilizes a statistically-based model that evaluates numerous factors, including, but not limited to, general and regional economic conditions, mortgage characteristics, and actual and expected future default and loan loss experience. Ginnie Mae also analyzes the ability of the borrowers to pay as well as the recovery amount from mortgage insurance when estimating valuations of the mortgage-related assets and liabilities. Ginnie Mae's MBS loss liability is made up of three components:

- A. Liability for currently defaulted issuers' pooled loans - loss contingency that arises from the guaranty obligation that Ginnie Mae has to the MBS holders subsequent to issuer default. Ginnie Mae is obligated to make timely principal and interest payments to investors subsequent to issuer default even if Ginnie Mae is unable to collect payments for the underlying loans from the homeowners or insuring agencies. Accordingly, Ginnie Mae records a loss liability contingency that arises from the net present value of cash outflows being in excess of cash inflows as related to the defaulted issuer pooled loans.
- B. Liability for currently defaulted issuers' non-pooled loans - loss contingency related to any non-recoverable foreclosure costs that arise from the mortgage loans HFI and properties held for sale. Ginnie Mae records the net present value for the estimated non-recoverable costs that arise as part of the guaranty fulfillment for the MBS program.
- C. Liability for probable issuer defaults - loss contingency that arises from the guaranty obligation that Ginnie Mae has to the MBS holders as a result of a probable issuer default. The issuers have the obligation to make timely principal and interest payments to investors, however, in the event whereby the issuer defaults, Ginnie Mae steps in and continues to make the contractual payments to investors. Ginnie Mae estimates the

amount of liability by determining the net present value of cash outflows and inflows for issuers that are determined to be probable defaults. For the issuers who are identified as probable defaults, Ginnie Mae records a contingent liability for the estimated amount of the cash flows in the loss liability.

Management also considers uncertainties related to estimates in the loss liability setting process. When losses are confirmed and realized on the defaulted issuers' portfolios, Ginnie Mae records the amounts as charged-off (debit) to the loss liability. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios which are recorded as a recovery (credit) to the loss liability. As Ginnie Mae's defaulted issuer portfolio changes, original estimates are compared with actual results over time and the loss liability's adequacy is assessed and adjusted as necessary. Typically, Ginnie Mae performs this assessment of the overall model on an annual basis.

In August 2009, Ginnie Mae defaulted a large issuer and assumed responsibility for its portfolio of 30,174 loans which is managed by a MSS. Ginnie Mae was required to certify the loans by August 2010 in accordance with its policies. However, Ginnie Mae subsequently discovered that the portfolio contained numerous documentation deficiencies.

To resolve the deficiencies, the MSS, on behalf of Ginnie Mae, engaged a third contractor specifically to remediate the documentation deficiencies during FY 2012. Ginnie Mae also worked with the U.S. Department of Housing and Urban Development (HUD) Office of General Counsel (OGC) to assess which types of document deficiencies are likely to present a high risk of loss to HUD, either through lack of insurance coverage or collateral deficiencies.

Based on the remediation process, Ginnie Mae reported approximately 20,000 loans from this issuer with a remaining principal balance of approximately \$2.8 billion, had custodial documentation deficiencies preventing certification. Of these 20,000 loans, approximately 731 loans were identified by the OGC as having deficiencies that may lead to an increased risk of loss to Ginnie Mae. The remaining principal balance associated with the 731 loans is approximately \$103 million. As a result of the risk related to the 731 loans, Ginnie Mae recorded an additional Provision for MBS Loss Liability and corresponding provision of approximately \$7.8 million which is included in the table below. Ginnie Mae also recorded an additional Allowance for mortgage loans held for investment and corresponding provision of approximately \$40.6 million.

Changes in the MBS loss liability for the years ended September 30, 2012, and 2011 were as follows:

| <i>(Dollars in thousands)</i> | Single Family     | Multifamily      | Manufactured Housing | Total               |
|-------------------------------|-------------------|------------------|----------------------|---------------------|
| <b>MBS Loss Liability</b>     |                   |                  |                      |                     |
| <b>September 30, 2010</b>     | <b>\$ 886,100</b> | <b>\$ 61,300</b> | <b>\$ 57,500</b>     | <b>\$ 1,004,900</b> |
| Provision for losses          | (287,400)         | (61,300)         | (58,300)             | (407,000)           |
| Charge-offs                   | (296,200)         | -                | (1,300)              | (297,500)           |
| Recoveries                    | 91,700            | -                | 3,700                | 95,400              |
| <b>MBS Loss Liability</b>     |                   |                  |                      |                     |
| <b>September 30, 2011</b>     | <b>\$ 394,200</b> | <b>\$ -</b>      | <b>\$ 1,600</b>      | <b>\$ 395,800</b>   |
| Provision for losses          | 266,500           | 300              | (2,300)              | 264,500             |
| Charge-offs                   | (446,200)         | (200)            | (1,000)              | (447,400)           |
| Recoveries                    | 142,000           | -                | 2,500                | 144,500             |
| <b>MBS Loss Liability</b>     |                   |                  |                      |                     |
| <b>September 30, 2012</b>     | <b>\$ 356,500</b> | <b>\$ 100</b>    | <b>\$ 800</b>        | <b>\$ 357,400</b>   |

Management believes that its MBS loss liability is adequate to cover probable and estimable losses on the MBS program guaranty. Ginnie Mae incurs losses when FHA, USDA, VA, and PIH insurance and guaranty proceeds do not cover losses that result from issuer defaults or in the event loans are uninsured and proceeds do not cover losses from default.

During FY 2012, Ginnie Mae defaulted on one single family issuer and one multifamily issuer without extinguishment. There is no financial impact because the defaults are without extinguishment. Additionally, Ginnie Mae defaulted one single family issuer in FY 2012 which was previously accounted for and included in the MBS Loss Liability as a recognized subsequent event in the FY 2011 financial statements. Ginnie Mae believes that the MBS loss liability is adequate to cover probable and estimable guaranty related losses.

#### **Note I: Financial Guarantees and Financial Instruments with Off-Balance Sheet Risk**

Ginnie Mae guarantees the timely payment of principal and interest to MBS investors in the event of issuer default and, in exchange, receives guaranty fees from the issuers. The guarantees are assessed annually. The guaranty fee is calculated based on the unpaid principal balance of outstanding MBS in the non-defaulted issuer portfolio and is Ginnie Mae's compensation for taking on the risk of providing the guaranty. The MBS securities are backed by pools of insured or guaranteed FHA, USDA, VA, or PIH mortgage loans. Ginnie Mae recognizes a guaranty asset upon issuance of a guaranty and also recognizes a non-contingent guaranty liability for its obligation to stand ready to perform on these guarantees. The guaranty liability recognized on the Balance Sheets is \$6,633.9 million and \$2,175.1 million as of September 30, 2012 and 2011, respectively. In addition to the guaranty liability, Ginnie Mae recognizes a MBS loss liability, which is contingent liability for estimable and probable losses in relation to these guarantees (i.e., MBS Loss Liability).

For those guarantees recognized on the Balance Sheets, Ginnie Mae's maximum potential exposure under these guarantees is primarily comprised of the amount of MBS securities

outstanding. On September 30, 2012, the amount of securities outstanding, which is guaranteed by Ginnie Mae, was \$ 1.3 trillion, including \$4.1 billion of Ginnie Mae-guaranteed bonds. However, Ginnie Mae's potential loss is considerably less because of the financial strength of its issuers. Additionally, in the event of default, the underlying mortgages serve as primary collateral, and FHA, USDA, VA, and PIH insurance or guaranty indemnifies Ginnie Mae for most losses. The Ginnie Mae guaranteed security is a pass-through security whereby mortgage principal and interest payments, except for servicing and guaranty fees, are passed through to the security holders monthly. Mortgage prepayments are also passed through to security holders. As a result of the security's structure, Ginnie Mae bears no interest rate or liquidity risk. Ginnie Mae's exposure to credit loss is contingent on the nonperformance of Ginnie Mae issuers. Other than those issuers considered in the MBS loss liability, Ginnie Mae does not anticipate nonperformance by its other counterparties.

Ginnie Mae is also subject to credit risk for its outstanding commitments to guarantee MBS which are not reflected in its Balance Sheets in the normal course of operations. During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guarantee MBS. The commitment ends when the securities are issued or the commitment period expires. Ginnie Mae's risk related to guarantee commitments is much less than for the commitment amount authorized, due in part to Ginnie Mae's ability to limit commitment authority granted to individual MBS issuers.

Outstanding MBS and commitments were as follows:

| <i>(Dollars in billions)</i> | September 30 |            |
|------------------------------|--------------|------------|
|                              | 2012         | 2011       |
| Outstanding MBS              | \$ 1,341.4   | \$ 1,221.7 |
| Outstanding MBS Commitments  | \$ 115.7     | \$ 102.6   |

The Ginnie Mae MBS serves as the underlying collateral for multiclass products, such as Real Estate Mortgage Investment Conduits (REMICs), Callable Trusts, Platitudes, and Stripped Mortgage-Backed Securities (SMBS), for which Ginnie Mae also guarantees the timely payment of principal and interest. These structured transactions allow the private sector to combine and restructure cash flows from Ginnie Mae MBS into securities that meet unique investor requirements for yield, maturity, and call-option features.

In FY 2012, Ginnie Mae issued a total of \$106.7 billion in its multiclass securities program. The estimated outstanding balance of multiclass securities included in the outstanding MBS balance as of September 30, 2012, was \$522.5 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

#### **Note J: Concentrations of Credit Risk**

Concentrations of credit risk exist when a significant number of counterparties (for example, issuers and borrowers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally,

Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers. It is important to note that many of Ginnie Mae's largest performing issuers are regulated institutions and as such are subjected to regulation and reviews by other government entities in addition to monitoring by Ginnie Mae.

Concentrations of credit risk are as noted below, as of September 30, 2012:

|                              | Single Family     |                             | Multifamily       |                             | Manufactured Housing |                             | Home Equity Conversion (HECM/HMBS) |                             |
|------------------------------|-------------------|-----------------------------|-------------------|-----------------------------|----------------------|-----------------------------|------------------------------------|-----------------------------|
|                              | Number of Issuers | Remaining Principal Balance | Number of Issuers | Remaining Principal Balance | Number of Issuers    | Remaining Principal Balance | Number of Issuers                  | Remaining Principal Balance |
| <i>(Dollars in billions)</i> |                   |                             |                   |                             |                      |                             |                                    |                             |
| Largest performing issuers   | 25                | \$ 1,135.3                  | 19                | \$ 58.5                     | 1                    | \$ 0.3                      | 11                                 | \$ 36.9                     |
| Other performing issuers     | 169               | \$ 92.2                     | 37                | \$ 9.0                      | 2                    | \$ -                        | 0                                  | \$ -                        |
| Defaulted issuers            | 22                | \$ 11.2                     | 0                 | \$ -                        | 3                    | \$ -                        | 0                                  | \$ -                        |

Issuers are permitted only to pool insured or guaranteed loans (from FHA, USDA, VA or PIH). The insuring and guarantying entities have strict underwriting standards and criteria for quality of collateral. In the event of issuer default, Ginnie Mae assumes the rights and obligations of the issuer and becomes the owner of the MSR asset, which typically is a sale-able asset. In addition, in the event of borrower delinquency in excess of 90 days, Ginnie Mae has the right to repurchase the loan out of the pool and can obtain access to the underlying collateral or insurance claim by pursuing foreclosure.

As of September 30, 2012, Ginnie Mae's single family and manufactured housing pooled defaulted portfolio had remaining principal balances of \$11.2 billion and \$651 thousand, respectively.

#### **Note K: Commitments and Contingencies**

As of September 30, 2012, and as of this report, Ginnie Mae's Office of General Counsel has identified one pending or threatened action or unasserted claim or assessment in which Ginnie Mae's exposure is \$ 1.0 million, individually, or in the aggregate for similar matters. Additionally, Ginnie Mae's Office of General Counsel has determined that there are no pending or threatened actions or unasserted claims or assessments in which Ginnie Mae's potential loss exceeds \$3.0 million in the aggregate for cases not listed individually or as part of similar cases that could be material to the financial statements. In the opinion of Ginnie Mae's management and Office of General Counsel the likelihood of an unfavorable outcome is remote in the case. It is the opinion of Ginnie Mae that the disposition or ultimate resolution of the case will not have a material adverse effect on the financial position of Ginnie Mae. Ginnie Mae's management recognizes the uncertainties that could occur in regard to potential defaulted issuers and other indirect guarantees (i.e., large issuer portfolio default, lack of proper insurance coverage of defaulted loans, etc.).

During FY 2012, Ginnie Mae defaulted one single family issuer with a portfolio of \$41.1 billion without extinguishment. The issuer was approximately 3.0% of the Ginnie Mae portfolio. The default occurred as the result of the issuer's bankruptcy. Ginnie Mae expects the bankruptcy sale and transfer of portfolio servicing to another issuer to occur during FY 2013. Additionally, Ginnie Mae currently has an Interim Service Agreement in place to mitigate any potential risk if the bankruptcy sale and servicing transfer does not occur as expected. Ginnie Mae has not disclosed a dollar amount related to a corresponding asset or liability associated with the default because the likelihood of a loss is not probable.

#### **Note L: Related Parties**

Ginnie Mae is subject to controls established by government corporation control laws (31 U.S.C. Chapter 91) and management controls by the Secretary of HUD and the Director of the Office of Management and Budget (OMB). These controls could affect Ginnie Mae's financial position or operating results in a manner that differs from those that might have been obtained if Ginnie Mae were autonomous.

Ginnie Mae was authorized to use \$19.5 million during FY 2012 for personnel (payroll) and non-personnel (travel, training) costs only. During FY 2012, Ginnie Mae incurred \$14.1 million, net, for Salaries and Expenses. Ginnie Mae has no liability for future payments to employees under the CSRS or FERS retirement systems. Ginnie Mae does not account for the assets of CSRS or FERS nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM) and are allocated to HUD. OPM also accounts for the health and life insurance programs for federal employees and retirees and funds the non-employee portion of these programs' costs.

Cash receipts, disbursements, and investment activities are processed by the U.S. Treasury. Funds with U.S. Treasury represent cash and are treated as such for the Statements of Cash Flow. Ginnie Mae has authority to borrow from the U.S. Treasury to finance operations in lieu of appropriations, if necessary.

Additionally, Ginnie Mae has an intra-entity relationship with the FHA, which is part of HUD. Of the total mortgage loans HFI, net, approximately \$6.2 billion and \$5.9 billion loans were insured by FHA as of September 30, 2012 and 2011, respectively. In addition, Ginnie Mae submits and receives claim proceeds for FHA-insured loans that have been through the foreclosure and short sale process. The breakdown of FHA claims pending payment or pre-submission to FHA is below:

| <i>(Dollars in thousands)</i> | September 30      |                   |
|-------------------------------|-------------------|-------------------|
|                               | 2012              | 2011              |
| Post Foreclosure/Preclaim     | \$ 829,500        | \$ 568,300        |
| Short Sales Claims Receivable | \$ 14,900         | \$ 25,600         |
| Insurance claims filed        | \$ 6,500          | \$ 2,100          |
| <b>Total FHA Claims, net</b>  | <b>\$ 850,900</b> | <b>\$ 596,000</b> |

**Note M: Credit Reform**

The Federal Credit Reform Act of 1990, which became effective on October 1, 1991, was enacted to more accurately measure the cost of federal credit programs and to place the cost of these credit programs on a basis equivalent with other federal spending. Credit reform focuses on credit programs that operate at a loss by providing for appropriated funding, within budgetary limitations, to subsidize the loss element of the credit program. Negative subsidies, calculated for credit programs operating at a profit, normally result in the return of funds to the U.S. Treasury. OMB specifies the methodology an agency is to follow in accounting for the cash flows of its credit programs.

Ginnie Mae's credit activities have historically operated at a profit. Ginnie Mae has not incurred borrowings or received appropriations to finance its credit operations. As of September 30, 2012, the U.S. Government has an investment of \$16.4 billion in Ginnie Mae. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management and HUD's general counsel, Ginnie Mae is not subject to the Federal Credit Reform Act.

**Note N: Subsequent Event**

Ginnie Mae management has evaluated potential subsequent events through October 31, 2012, the date through which the financial statements were made available to be issued. Based on the evaluation, Ginnie Mae management identified one subsequent event. On September 28, 2012, Ginnie Mae approved a Transfer of Servicing Agreement between two issuers. The transfer is scheduled to occur on November 1, 2012. Ginnie Mae identified the issuer, who transferred their servicing rights to the other Ginnie Mae approved issuer in this transaction, as a probable risk of default during the MBS Loss Liability analysis. However, as a result of the Transfer of Servicing Agreement, Ginnie Mae no longer assesses the risk of default as probable. Accordingly, no liability related to this issuer has been included in the MBS loss liability calculation. Any estimate of this liability would be insignificant.