

Comprehensive Mortgage Audit

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In the Matter Of

**IN RE:
JAVIER PENA and
SANDRA PENA
Debtors**

CASE NO. 03-45813-H4-13
CHAPTER 13

By Order of the Court

THE HONORABLE JEFF BOHM

Order Granting Motion To Set Aside Notice Of Termination Of The Automatic Stay
March 8, 2007
Docket No. 68

July 9, 2007

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DISCLAIMER

The opinions expressed herein do not constitute legal advice or conclusions but fall out logically from facts as they became known through the author's forensic analysis of the evidence. The author understands that the Court is the trier of fact and the arbiter of the law. This report is intended for the sole purpose of illuminating the facts so that the Court is better equipped to apply the law in this matter.

QUALIFICATIONS

My name is Marie Therese McDonnell. I am a Mortgage Fraud and Forensic Analyst located in Orleans, Massachusetts. I have twenty years experience in this emerging field and have, since 1991, specialized in auditing residential and commercial mortgage finance transactions on behalf of consumers and the attorneys who represent them.

The core of my practice involves crisis and foreclosure intervention, problem resolution, and mediation on behalf of consumers who are experiencing difficulties with their mortgage lenders and servicers. I rely upon the objective data produced incident to auditing these transactions as the basis for negotiating fair-minded solutions that avert litigation, preserve homeownership, and protect the bond holders who have an equal but opposite interest at stake.

A significant portion of my practice consists of providing litigation support services to attorneys who represent clients that have been negatively impacted by lender abuses in the origination and servicing of these complex transactions. My background and methodologies are more particularly described in the Professional Profile attached hereto. (See Exhibit A. - Professional Profile)

The information in this report is accurate, true and correct to the best of my personal knowledge given the documentary evidence provided to me for review as of this writing.

Methodologies

Over the past sixteen years, I have developed, extensively tested, and reliably employed a proprietary set of auditing tools and protocols that enable me to track with precision a lender's loan servicing system and determine with particularity whether a problem is the result of borrower failure, lender malfeasance, or whether it is technology and policy related.

My process begins by assembling documentation from borrowers, lenders, closing agents, loan servicers, and interested third parties so that I have a well rounded view of the entire history. I then integrate the data into a Microsoft Excel spreadsheet and map out each transaction by date in all contractual, fiduciary and collection accounts.

This mapping modality enables me to detect and quantify a lender's failure to disclose properly the material disclosures required under state and federal truth in lending laws; expose hidden devices that result in the gleaning of unearned interest; see how and when a loan servicer breaches its fiduciary duty in the handling of escrow and suspense accounts; uncover equity skimming schemes; and discover nefarious unfair and deceptive acts and practices as these are defined by the Federal Trade Commission.

I am also able to reconstruct lost or suppressed data through a variety of forensic accounting techniques, detect unconscionable loan terms, identify predatory lending schemes, cite violations of state and federal consumer protection statutes, and uncover fraud.

Reliability & Validity

My analysis here is based on loan documents that were generated by the originating lender, Summit Mortgage Corporation (“Summit”), and loan servicing histories maintained by Washington Mutual Bank, N.A. (“Washington Mutual”) and Wells Fargo Home Mortgage (“Wells Fargo”) in the regular course of business. In addition, I have incorporated proof of payment records supplied by Javier and Sandra Pena (“the Penas”), and have reviewed pertinent pleadings and evidence found in the Court’s docket. I also examined, cross-referenced, and proved-out the Trustee’s disbursement ledger for this claim, and independently verified tax payments made to the Harris County Tax Office as these were available online.

CASE HISTORY

On January 22, 1996, the Penas consummated the subject mortgage transaction with Summit in order to purchase 10318 Pimlico Court, Houston, Texas as their primary residence. Mr. Pena is solely obligated on the Note but both he and Mrs. Pena executed the Deed of Trust. The loan was made pursuant to Section 203(b) of the National Housing Act and is insured by the Federal Housing Administration.

The Penas’ Note provides for a principal advance of \$45,436.00 in exchange for 360 monthly payments of \$349.36 which amortizes the loan to a zero balance over thirty years at a fixed interest rate of eight and one half percent (8.50%). It also provides for a late charge amounting to four percent (4.0000%) of the total monthly payment consisting of principal, interest, and escrow items as required under the Security Instrument.

Section 203(b) loans place restrictions on lenders and loan servicers in the event of default to forego acceleration and foreclosure until they have complied with regulations of the Secretary of the Department of Housing and Urban Development. Paragraph 6(B) of the Penas’ Note and paragraph 9(a) & (d) of the Deed of Trust contain these limitations.

Immediately after the closing on January 22, 1996, Summit assigned the Penas’ mortgage obligation to Fleet Mortgage Corp. (“Fleet”). Due to a merger/acquisition, Washington Mutual assumed servicing the Penas’ loan on or about December 31, 1997. From January 1, 1998 through November 31, 2006, Washington Mutual serviced the subject loan which was complicated by two

bankruptcy filings and an Order Conditioning Automatic Stay issued on March 22, 2005. Thereafter, from December 1, 2006 to the present, Wells Fargo assumed servicing the Penas' loan.

COURT ORDER OF MARCH 8, 2007

During the past year, a dispute arose over the question of whether the Penas had defaulted on their monthly payment obligations pursuant to the March 22, 2005 Order. Washington Mutual sought relief from the automatic stay and filed Certificates of Default on July 11, 2006 and January 10, 2007. The Penas argued that they had made timely payments and that they could prove their case. A hearing was held on February 27, 2007 pursuant to which the Court found in favor of the Penas and, among other sanctions, ordered that Washington Mutual and/or Wells Fargo pay for an independent accounting to clear up a number of outstanding questions. Specifically, the Court ordered:

The accounting shall determine at the very least, the following non-exclusive list of issues:

- a) Explain how late charges and other charges are calculated and applied;
- b) Conduct an escrow analysis;
- c) Determine if the Penas are current with their mortgage post-petition and if not, explain exactly which payments have been missed; and
- d) Determine how payments from the chapter 13 trustee have been applied.

The following narrative and the attached exhibits will answer all of the Court's specific questions and beyond that, will address a number of serious issues that deserve further consideration.

FORENSIC ANALYSIS OF THE EVIDENCE PRESENTED

I have prepared a comprehensive translation of the loan servicing history from inception on January 22, 1996 through June 27, 2007. This accounting matches to the penny every single transaction recorded in the loan servicing histories maintained by Fleet, Washington Mutual and Wells Fargo ("the Servicers"). (*See* Exhibit B. - Mortgage Map #1)

Exhibit "B" should be referred to frequently as the reader looks for validation in the record of my findings below. I begin this report by describing five distinct phases in the servicing of the Penas' loan spanning some eleven and a half years. Under the topic "Bankruptcy Compliant Servicing," I explain how the subject loan should be set up to conform to the "fresh start" provisions of the Bankruptcy Code. Following that, I address the Court's specific questions. Finally, I discuss the

contractual and statutory options that FHA home loan borrowers like the Penas have under the National Housing Act that afford relief even while in bankruptcy.

PHASE I: 1/22/1996 TO 4/10/2001

Washington Mutual's Prepetition Servicing

The transaction histories supplied covering the period from consummation of the loan on January 22, 1996 through April 10, 2001 show that under Fleet's management, the Penas' monthly mortgage payments were timely made except for a 30-day delinquency that ran from February 1997 through August 1997. Washington Mutual took over servicing the Penas' loan on or about December 31, 1997 and their records show that all payments were made within the permissible grace period through and including April 10, 2001. Thus, the prepetition history is unremarkable.

PHASE II: 4/11/2001 TO 11/2/2003

First Bankruptcy

When Javier and Sandra Pena first filed for bankruptcy on April 11, 2001, their mortgage was current. Moreover, it appears that their mortgage payments were timely made, or considerably early, up until February 1, 2002. At that point in time, Washington Mutual virtually doubled the amount due for "escrow items" from \$205.89 to \$413.73.

Further investigation is required to ascertain precisely what happened here but it appears to be related to a 218% spike in homeowners insurance from \$887.00 to \$1,934.00 which was charged against the Penas' escrow account on January 1, 2002. Washington Mutual claims, and Mr. Pena has confirmed, that homeowners insurance rates soared that year due to fears of "black mold" from extensive flooding in the region. On June 4, 2002, Washington Mutual again disbursed funds in the amount of \$751.47 for force placed insurance after allegedly receiving notice from Allstate Insurance Company that the Penas' coverage had lapsed. This must have been a mistake after all because Washington Mutual redeposited those funds on August 12, 2002 when it reportedly learned that the Penas' policy had been reinstated.

I find Washington Mutual's explanation inconsistent and recommend that the Penas request a history of their insurance coverage and policy premiums spanning the life of their homeownership. One thing is obvious from looking at the transaction histories and that is the corresponding increase in the Penas' monthly payment obligation from \$555.25 to \$763.09 was so chilling that it caused them to default on their loan.

The Real Estate Settlement Procedures Act governs the handling of funds escrowed for payment of items necessary to protect the mortgaged property and the Mortgagee's lien position. When an account is current but an Annual Escrow Analysis reveals that a shortage will result in excess of one month's escrow account payment, the Servicer may either ignore the situation or require the borrower to repay the shortage in equal monthly payments over at least a 12-month period. [See 24 CFR § 3500.17(f)(3)(i). Escrow Accounts.]

In this instance, a shortage of \$1,047.00 may have arisen which, when spread over twelve months, would increase the Penas' monthly payment obligation by \$87.25 and not \$207.84 as imposed by Washington Mutual. The consequences to the Penas of this breach of servicing duties was fatal in that it threw them hopelessly into default and foreclosure which forced the Penas to file a second bankruptcy one week after being discharged from their first bankruptcy.

PHASE III: 11/3/2003 TO 3/21/2005

Second Bankruptcy

Javier and Sandra Pena filed their second bankruptcy on November 3, 2003 to prevent foreclosure of their home at 10318 Pimlico Court, Houston, Texas. Washington Mutual submitted a Proof of Claim on December 8, 2003 asserting that as of November 4, 2003, the Penas were 13 installments behind and due for the months of November 1, 2002 through November 1, 2003.

Accordingly, Washington Mutual claimed 13 payments of \$621.47 each were due for a total of \$8,079.11; plus late charges of \$620.26; property inspection fees of \$87.00; foreclosure attorney fees and costs of \$1,481.17; and bankruptcy attorney fees and costs of \$1,235.00. The total claim amounted to \$11,502.54. (See Exhibit C. - Proof of Claim)

In contrast, Washington Mutual's transaction history shows that as of November 3, 2003 the Penas were 19 months in arrears and were due for the months of May 1, 2002 through November 1, 2003. A total of \$3,789.18 was held in the Penas' "suspense account" as a result of payments tendered that had not been disbursed to the appropriate sub-accounts. My analysis of Washington Mutual's Proof of Claim also shows that legal fees and costs were overstated by \$226.19 when compared to their transaction history. (See Exhibit D. - Analysis of Proof of Claim)

Approximately two weeks after the Penas had filed for bankruptcy, Washington Mutual debited the Penas' suspense account for the entire \$3,789.18 and credited those funds to cover six installments due for May 1, 2002 thorough October 1, 2002. Thus, Washington Mutual portrayed the account status as of November 18th not November 4th in its Proof of Claim. (See Exhibit B. – Mortgage Map #1, p. 5)

Although one might argue that Washington Mutual's post-petition alterations are mathematically equivalent to reducing the 19-month prepetition arrearages by funds on deposit in the suspense account, handling the Penas' loan in this manner is improper for reasons more particularly described below under the topic "Bankruptcy Compliant Servicing."

Essentially, Washington Mutual failed to recalibrate the loan balance to bring the Penas' account current as of the petition date and continued to service their loan in a perpetual state of default. Moreover, Washington Mutual failed to open the Trustee's suspense account with a debit for prepetition arrearages of \$11,502.54 as claimed, which makes it extremely difficult to determine whether the Servicers have applied the Trustee's payments against prepetition or postpetition obligations.

The transaction histories for this period show that the Penas were correctly making postpetition payments in the amount of \$572.05 as required by an Escrow Account Statement that Washington Mutual issued to them on November 13, 2003, ten days after the Penas had filed for bankruptcy. (See Exhibit E. - Escrow Account Statement)

Notwithstanding its own computer-generated instructions, Washington Mutual placed the Penas' first postpetition payment, due for the December 1, 2003 installment, in their suspense account thus causing them to fall one month behind in their postpetition mortgage obligations. (See Exhibit B. – Mortgage Map #1, p. 5)

Thereafter, Washington Mutual subsidized the Penas' monthly payments due for January 1, 2004 through April 1, 2004 by drawing \$49.42 from suspense which was added to the escrow portion of the installment effectively raising the required monthly payment from \$572.05 to \$621.47. The Penas were, no doubt, unaware that this was happening.

On April 23, 2004, Washington Mutual drained the Penas' suspense account by transferring the remainder of their first postpetition payment to settle \$347.37 in prepetition late charges.

Washington Mutual repeated the above scenario on July 14, 2004 by depositing another of the Pena's monthly payments into suspense and subsidizing the next eight installments, five of which occurred after the Court issued its Order of March 22, 2005 conditioning the automatic stay.

Hence, Washington Mutual improperly serviced the Penas' loan during this entire period of time. Late charges of \$366.08 were imposed as well as miscellaneous foreclosure fees, bankruptcy fees, and costs totaling \$2,072.43.

PHASE IV: 3/22/2005 TO 11/30/2006

Court Order Conditioning Automatic Stay

For reasons unknown to this analyst, the Penas fell behind in making some of their postpetition payments and on March 22, 2005, the Court issued an Order Conditioning Automatic Stay (“Order”) that allowed arrearages of \$4,326.46 to be incorporated into the Penas’ Plan; Washington Mutual was given leave to amend its Proof of Claim accordingly. The Order also instructed the Penas to resume making timely postpetition payments in the amount of \$572.05 beginning April 1, 2005 and monthly thereafter. As of this writing, the Penas’ plan has not been modified, nor has Washington Mutual amended its Proof of Claim. Despite the administrative lag in perfecting the paperwork, all parties have otherwise complied with the Court’s Order.

I do not have all of the Penas’ canceled checks for this critical period of time, but among those I do have, I discovered that two payments were not credited in Washington Mutual’s transaction history. The first of these, check number 2478, was issued on June 2, 2006 in the amount of \$572.05; the second, check number 2518, was issued on November 6, 2006 in the amount of \$632.68. (See Exhibit B. – Mortgage Map #1, p. 7)

In reading through the documentation provided to me by Washington Mutual I discovered a collection letter dated June 30, 2006 which explains what happened to check number 2478. The letter reads:

Dear Mortgagor(s):

The enclosed check number 2478 in the amount of \$572.05 and dated 06/02/06 is being returned to you for the following reason(s):

- Amount not sufficient to reinstate loan

Please send your payment with the loan number clearly referenced to:

Washington Mutual Bank
Default Cash Operations
11200 W. parkland Ave
Milwaukee, WI 53224

If you have any questions or concerns, please call our Customer Service Representatives toll free at 1-866-926-8937.

Sincerely,

Default Cash Operations
Washington Mutual Bank

(See Exhibit F. - FDCPA Letter, 6/30/06)

Subsequently, on July 11, 2006, Washington Mutual filed a Certificate of Default alleging that the Debtors had defaulted on this Court's Order of March 22, 2005 conditioning the automatic stay by failing to make or show proof of payments. The Certificate referred to a Default Letter of June 26, 2006 which is not in evidence.

My audit of Washington Mutual's transaction histories shows that the Penas had missed making the payment due on March 1, 2006 but payments were recorded and applied for April and May. Washington Mutual's collection notes do not indicate that any letters were sent or phone calls initiated to inquire as to whether there was a problem. Instead, Washington Mutual took the draconian step of returning the Penas' June payment on June 30, 2006; filed the Certificate of Default on July 11, 2006; and instituted foreclosure on July 12, 2006. (See Exhibit G. - Collection Log, 7/12/06)

The Penas' second, check number 2518, was issued on November 6, 2006 in the amount of \$632.68 and appears to have been lost in the shuffle when Washington Mutual transferred the Penas' loan to Wells Fargo. This "lost" check no doubt triggered the initiation of Washington Mutual's second Certificate of Default which was filed on January 10, 2007.

The Penas should examine their bank statements to see if check number 2518 cleared their account. I also recommend that they research their records to see if they might have issued a mortgage payment in March 2006 as this "skip" is inconsistent with their payment history since the March 22, 2005 Order.

PHASE V: 12/1/2006 TO 6/27/2007

Servicing Transferred to Wells Fargo

Wells Fargo continued to service the Penas' loan in lock step with Washington Mutual, that is to say, in a perpetual state of default because it failed to recalibrate the loan according to the Bankruptcy Rules and to properly establish the Trustee's suspense account.

The Penas have been making timely payments to Wells Fargo during this period, the first three of which were in the amount of \$632.68 which exceeded the scheduled payment of \$572.05 by \$60.63. On December 14, 2006, Wells Fargo placed the \$60.63 overage in the Penas' escrow account; on January 15, 2007 and February 14, 2007, Wells Fargo placed the overage in the Penas' suspense account.

Wells Fargo hit a snafu when, on March 14, 2007, the Penas sent in a payment of \$572.05 instead of \$632.68. Wells Fargo placed that payment in the Penas' suspense account and then credited the payment on March 20, 2007. On April 3, 2007 Wells Fargo appears to have advanced \$333.14

from the Penas' negative escrow account and credited those funds to principal and interest. To make up the shortfall, Wells Fargo debited the Trustee's suspense account by \$16.22. This transaction is highly unusual. (See Exhibit B. – Mortgage Map #1, p. 8)

On April 3, 2007, Wells Fargo fouled up the Penas' account by crediting a lump sum payment of \$4,767.00 which apparently, was somebody else's money. The erroneous postings were reversed on April 19, 2007, but in the meantime, the Penas sent in payments of \$572.05 on April 13, May 17 and June 15, 2007 that Wells Fargo placed into their suspense account. Two of those payments were credited on June 27, 2007; but the third payment appears to be missing. (See Exhibit B. – Mortgage Map #1, p. 8)

BANKRUPTCY COMPLIANT SERVICING

Two seminal decisions have been handed down recently by bankruptcy court justices who believed that it was vital to the integrity of the system that mortgage servicing companies conform their accounting practices to the Bankruptcy Code. The first of these important cases was decided by the Honorable Joel B. Rosenthal, United States Bankruptcy Judge, District of Massachusetts in the matter of *Jacalyn S. Nosek v. Ameriquest Mortgage Company*, A.P. No. 04-04517. Judge Rosenthal opined:

Ameriquest next argued that “because Ameriquest cannot use its computer system to track bankruptcy payments and because no software exists to track such payments, Ameriquest must account for payments from Chapter 13 Debtors manually.” *See Ameriquest's Reply Brief, p. 16.* Ameriquest offers this as an apparent excuse as to why Nosek's payment history was inaccurate. The Court is unpersuaded. Even if Ameriquest must manually account for these payments (though the Court is not convinced that a computer system could not be developed with the appropriate investment of time and money), Ameriquest is not excused from doing it right, even if it is an administrative burden. It is not sufficient that Ameriquest only internally accounted Nosek with having made the payments and internally considered her current. This must be reflected on Ameriquest's external payment history, which is shared with the debtor and the outside world and which is usually necessary for a refinancing, something a lender of Ameriquest's experience should recognize. In sum, Ameriquest is simply unable or unwilling to conform its accounting practices to what is required under the Bankruptcy Code, something this Court can encourage by assessing punitive damages under Section 105(a).

(See Exhibit H. - Rosenthal Memorandum on Remand)

The second case I have studied with particular care is *In re Jones*, No. 03-16518, Section A (Bankr.E.D.La. 4/13/2007) (Bankr.E.D.La., 2007). In Judge Elizabeth Magner's Memorandum Opinion she offers specific guidance and instructions as to how prepetition arrearages are to be sat-

ified under the auspices of the Chapter 13 Trustee. With regard to postpetition debt, Judge Magner explained:

As for the postpetition debt, the confirmation of a plan recalibrates the amounts owed by Debtor as of the petition date. Because the prepetition arrearage is paid by the Trustee under the plan, Debtor's account gets a fresh start, free of all past due sums. [FN26] Thus, going forward, Debtor's balance should only reflect the principal amount due under the Wells Fargo Note as of the petition date, and all other charges, fees, or negative escrow balances should be zero.

In this Court's experience, few, if any, lenders make the adjustments necessary to properly account for a reorganized debt repayment plan. As a result, it is common to see late charges, fees, and other expenses assessed to a debtor's loan as a result of postpetition accounting mistakes made by lenders. If the lender does not recalibrate the loan to reflect the terms of the plan, more likely than not, it will miscalculate the amounts due by a debtor. It appears to this Court that lenders refuse to make these adjustments because few debtors challenge their accounting and even less pay out their entire loan before discharge. There are also a sizeable number of debtors that default on their plans or the direct postpetition payments on their loans, resulting in the lifting of the automatic stay and a return to foreclosure. Thus, many lenders appear to take a "wait and see" attitude rather than provide the type of individualized administration that a reorganized debt requires.

Such was the case with Wells Fargo. Rather than recalibrate the loan as current on the petition date, Wells Fargo continued to carry the past due amounts contained in its proof of claim in Debtor's loan balance. Wells Fargo applied any amounts received, regardless of source or intended application, to pre and postpetition charges, interest and noninterest bearing debt. This resulted in such a tangled mess that neither Debtor, who is a certified public accountant, nor Wells Fargo's own representative could fully understand or explain the accounting offered. [FN27]

(See Exhibit I. - Magner Memorandum Opinion)

Before I could answer this Court's questions, I first had to translate the Penas' entire loan servicing history into a format that would allow me to analyze the data precisely as it was booked into the Servicers' accounting systems. This proved to be a monumental task as there are literally thousands of transactions that occurred over the life of this eleven and a half year old loan, each one of which had to be independently calculated, cross referenced, and verified. The result was the creation of Mortgage Map #1.

Next, I had to create a second version, Mortgage Map #2, wherein I followed Judge Magner's instructions on how to set up a bankruptcy compliant model. Mortgage Maps #1 and #2 are identical up until November 3, 2003 when the Penas filed their second bankruptcy petition. At that point Mortgage Map #2 departs from the actual servicing history in that I recalibrated the Penas'

loan to bring it current, zeroed out all contractual and fiduciary accounts, and setup plan-approved arrearages in the Trustee's suspense account. I also zeroed out inappropriate transactions to maintain the integrity of the account. (See Exhibit J. - Mortgage Map #2 – Bankruptcy Compliant Servicing)

Once accomplished, I found there are so many analogies between the Jones case and the Penas' case, that I constructed a "Similarities and Differences" schema to aid the Court in seeing some of the parallels. (See Exhibit K. - Mortgage Servicing Abuses In Bankruptcy)

Briefly, the following transgressions can be verified by comparing Mortgage Map #1 with Mortgage Map #2:

1. The Servicers failed to recalibrate the loan to bring it current as of the bankruptcy petition date of November 3, 2003;
2. The Servicers failed to zero out escrow, late charge, corporate & foreclosure account balances to effect a fresh start;
3. The Servicers placed postpetition payments in a suspense account thereby manufacturing or deepening a default;
4. The Servicers kept the Principal balance artificially high by failing to credit payments that were placed in a suspense account and then stripped;
5. The Servicers applied postpetition payments to prepetition arrearages;
6. The Servicers imposed undisclosed legal fees post-petition but pre-confirmation;
7. The Servicers failed to notify debtor it was adding postpetition fees and costs;

ANSWERS TO THE COURT'S SPECIFIC QUESTIONS

Late Charges

Paragraph 6(A) of the Pena's FHA guaranteed Fixed Rate Mortgage Note addresses "Late Charges For Overdue Payments" and provides that for payments received after the fifteenth day past the due date, a late charge of four percent (4.0000%) of the "total monthly payment" may be imposed. Unlike most conventional loans, the total monthly payment in FHA cases includes both the installment due under the Note for principal and interest as well as for escrow items required pursuant to the Security Instrument.

I analyzed the late charges imposed on the subject loan and found that there were deviations between the escrow items "disclosed" in various Escrow Account Statements and the escrow items actually charged and collected which, in turn, affected late charges. Since the Servicers' computer

automatically generates late charges based on the scheduled monthly payments, I can tell that Washington Mutual overcharged the Penas for escrow items from, at the very least, September 16, 2002 through December 13, 2003 during which time they were in bankruptcy. (See Exhibit L - Late Charge Analysis)

Immediately following the Penas' first bankruptcy filing, Washington Mutual wrongfully imposed late charges totaling \$199.89 for the first nine payments due on April 1, 2001 through February 1, 2002 which were timely made. On April 23, 2004, Washington Mutual wrongfully diverted \$374.37 from one of the Penas' postpetition mortgage payments to settle prepetition late charges.

Escrow Analysis

Mortgage Map #1 illustrates how the Penas' loan was actually serviced with respect to the escrow account. Mortgage Map #2 shows how the Penas' escrow account should have been maintained had the Servicers followed the bankruptcy rules. The difference is stark. In the first instance, Wells Fargo is currently reporting a negative escrow balance of \$3,896.32 whereas, if the Servicers had complied with the bankruptcy rules, the Penas would be both current and "in the black" with respect to their escrow account as of June 27, 2007. (See Exhibits B. & J.)

Other than my concern over whether or not the insurance payment of \$1,934.00 made on January 1, 2002 and the \$333.14 debited on April 3, 2007 which was applied to a monthly installment were proper, I believe that all other disbursements from the Penas' escrow account are valid.

Status of Account on June 27, 2007

As of June 27, 2007, Wells Fargo's loan history indicates that the Penas' outstanding principal balance is \$40,033.92 and that they are contractually due for 17 monthly payments dating from February 1, 2006 through June 1, 2007. Past due arrearages for principal and interest total \$5,939.12; past due arrearages for escrow items total \$3,785.73. In addition, Wells Fargo is reporting a negative escrow advance balance of \$3,896.32 which means that even if past due escrow items were brought up to date, there would still be a negative balance of \$110.59. Late charges of \$243.67 are outstanding along with \$440.00 in recoverable costs. There should be \$293.98 in the Trustee's suspense account according to my tracking of deposits and disbursements contained the Servicers' loan histories. (See Exhibit B. – Mortgage Map #1, p. 8-9)

In contrast, I find that when the Penas' loan is recalibrated as of November 3, 2003, the date of their second bankruptcy petition, and the Court's Order of March 22, 2005 is treated as fully implemented, the Penas should be current and in good standing as of June 27, 2007. Their outstanding

principal balance should be \$38,849.88; their escrow balance should be \$0.00; their escrow advance balance should be \$0.00; Court approved late charges should be incorporated into their modified plan as should legal fees and costs; in addition, the Penas should have \$68.47 in their suspense account. The Trustee's suspense account should reflect an outstanding balance due of \$9,290.07 which remains after Trustee payments of \$6,541.93 are applied against arrearages totaling \$15,832.00. Finally, the status of the Penas' loan may be further offset if certain missing checks were negotiated by the Servicers. (See Exhibit J. – Mortgage Map #2, p. 8)

For the Court's convenience, I have summarized the "Status of the Pena Loan as of 6/27/07" in a side-by-side comparison attached hereto as Exhibit "M." (See Exhibit M. - Status of the Pena Loan)

Trustee Payments

One of the most troubling aspects of how the Penas' loan has been serviced throughout the course of their bankruptcy involves the Trustee's suspense account. To aide the Court on this topic, I constructed two exhibits that compare the way Washington Mutual and Wells Fargo should be handling the Trustee's payments versus the way they were/are handling them.

Exhibit "N." is a very simple accounting of how Washington Mutual should have booked the Penas' prepetition arrearages of \$11,505.54, and postpetition arrearages of \$4,326.46 i.e., these are both "receivables" quantified in my illustration as negative items. Each Trustee payment tendered is a positive item that reduces the obligation *pro tanto* until the plan is fully funded and the arrearages are extinguished. (See Exhibit N. - Bankruptcy Compliant Trustee Account)

In contrast, Exhibit "O." illustrates how the Servicers have allocated the Trustee's payments and shows that of the \$6,541.93 paid to date \$3,032.42 has been applied to postpetition payments in derogation of the Bankruptcy Code and the Penas' confirmed plan. The danger in handling the accounting this way, as Judge Magner admonished, is that the "in and out" transactions cloak what is really going on and make it extremely difficult for anyone to detect whether the Servicer is diverting Trustee payments to non-approved items. (See Exhibit O. - Application of Trustee Payments)

LOSS MITIGATION RELIEF PURSUANT TO 24 CFR 203.355

Summit Mortgage Corporation made this loan pursuant to Section 203(b) of the National Housing Act, which promotes affordable home ownership opportunities to low and moderate-income persons such as the Penas by providing mortgage insurance that mitigates the risk for investors who ultimately provide the funding. Congress understood when it passed the National Housing

Act that homeowners in this category were especially susceptible to life's vicissitudes and provided relief for those who fell upon hard times.¹

Section 203(b) loans place restrictions on lenders and loan servicers in the event of default to forego acceleration and foreclosure until they have complied with regulations of the Secretary of the Department of Housing and Urban Development. Paragraph 6(B) of Mr. Pena's Fixed Rate Note and paragraph 9(a) & (d) of his Deed of Trust contain these limitations.

HUD Mortgagee Letter 00-05 clarifies HUD's policies and states in part: "Though lenders have great latitude in selecting the loss mitigation strategy appropriate for each borrower, it is critical to understand that **PARTICIPATION IN THE LOSS MITIGATION PROGRAM IS NOT OPTIONAL.**" HUD is serious about enforcing these provisions of the National Housing Act and may impose treble damages on Servicers who fail to offer relief to homeowners desiring to avert foreclosure. (See Exhibit P. - HUD Mortgagee Letter 00-05)

Part of my review in this matter involved reading through various collection letters and logs maintained by Washington Mutual. I did not see anything in those documents that indicated Washington Mutual inquired about the cause of the Penas' delinquency or offered loss mitigation relief pursuant to 24 CFR 203.355. On the contrary, Washington Mutual renewed its attempts to foreclose upon the Penas at every opportunity, hampered only by the automatic stay imposed by Section 362 of the Bankruptcy Code.

Washington Mutual's collection log states that loss mitigation efforts were started on January 28, 2003, when Mr. Pena faxed a financial statement that was part of a workout package he had requested. The log goes on to say that the workout was approved on February 5, 2003 and the loan was reinstated. Mortgage Map #1, page 4, shows that the Penas sent \$1,500.00 on February 27, 2003 and resumed making regular mortgage payments of \$763.09 which Washington Mutual posted on March 21, April 3, and April 30, 2003. All of these funds were placed in the Penas' suspense account and were not credited towards the mortgage obligation. The collection log shows that Mr. Pena called Washington Mutual repeatedly between June and September 2003 to ask for an update

¹ **12 USCS § 1715u. Authority to assist mortgagors in default.**

(a) **Loss mitigation.** Upon default of any mortgage insured under this title, mortgagees shall engage in loss mitigation actions for the purpose of providing an alternative to foreclosure (including but not limited to actions such as special forbearance, loss modification, and deeds in lieu of foreclosure, but not including assignment of mortgages to the Secretary under section 204(a)(1)(A) [12 USCS § 1710(a)(1)(A)]) as provided in regulations by the Secretary.

on his workout plan. He was bandied about and unable to cut through Washington Mutual's chain of command until September 4, 2003 when the log indicates "WORKOUT FAILED, RESTART FCL."

In my opinion, Washington Mutual's collection log indicates that Mr. Pena was diligent in his efforts to communicate with Washington Mutual, in particular, during the months leading up to the filing of his second bankruptcy. There appears to have been a breakdown in communication at Washington Mutual that made it impossible for Mr. Pena to get the information he needed. To understand the Penas' mounting frustration in dealing with Washington Mutual, one need only read the collection log between January 28, 2003 and November 3, 2003 when the exasperated couple were left with no alternative but to file for bankruptcy – one week after they had been discharged from their first bankruptcy – in order to save their home from foreclosure. (*See* Exhibit Q. - Collection Log, 11/9/01 to 11/10/03)

I had an opportunity to speak to Mr. Pena briefly about what led to his extended period of delinquency and learned that he was involved in two serious motor vehicle accidents in 2001 and 2002 that put him out of work for a sustained period of time. In the first instance, a non-licensed, uninsured driver ran a stop sign on his way to an "AA" meeting. Mr. Pena hit him head-on totaling both vehicles which caused the toolbox in the trunk of his car to fly into the front seat injuring his spine and sandwiching him between the two crash points. The second accident occurred on June 23, 2002 when Mr. Pena was rear-ended while stopped at a traffic light. Mr. Pena's injuries were so debilitating he was out of work and in therapy for many months. Due to lack of adequate insurance, Mr. Pena was unable to afford back surgery, estimated to cost over \$150,000.00, which would have restored him to health. No longer able perform his duties, Mr. Pena had to settle for a lower-paying job.

These circumstances are precisely what the Loss Mitigation provisions of the National Housing Act attempt to address. Washington Mutual had discretion to help the Penas stabilize their homeownership by offering one or more loss mitigation tools that would permanently lighten their load. Rather than force the Penas to file a second bankruptcy, for example, Washington Mutual could have offered a "Partial Claim," which would have enabled the Penas to cure their default by making one monthly payment and deferring all remaining arrearages to the end of their loan under a non-interest bearing Note secured by a second mortgage.²

² **PARTIAL CLAIM:** "Under the partial claim option, a lender will advance funds on behalf of a borrower in an amount necessary to reinstate a delinquent loan (not to exceed the equivalent of 12 months PITI). The borrower, upon acceptance of the advance, will execute a promissory note and subordinate mortgage payable to HUD. Currently, these promissory or "partial claim" notes carry no interest and are not due and payable until the borrower either pays off the first mortgage or no longer owns the property." (*See* Mortgagee Letter 00-05, p. 24)

Wells Fargo has this same opportunity and could, if it had the will, repackage some or all of the Penas' outstanding arrearages of \$9,290.07 as a partial claim thus reducing, not increasing, plan payments. In addition, this Court could find that the Servicers involved here may not be entitled, under the Penas' mortgage contract and Regulations of the Secretary, to recover collection costs and legal fees if it were to find they willfully failed to offer HUD-mandated loss mitigation relief.

RESERVATION OF RIGHTS

I am aware that additional research is necessary to resolve several outstanding questions. Accordingly, the opinions given here may change or further develop as more information becomes available. I am happy to answer any questions or be of further assistance as the Court requests.

Respectfully submitted,



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