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Facing huge debts, investors ponder next steps

By: CHRIS BAGLEY - Staff Writer

As lenders begin to seize houses that were purchased in an unusual series of transactions two years ago, investors are attempting to arrange complicated sales and several are beginning to struggle with difficult decisions on whether to file for bankruptcy.

Nurses and other middle-class investors bought more than 100 Murrieta-area houses in 2004 and 2005 through Stonewood Consulting Inc., a Murrieta mortgage brokerage that the California Department of Real Estate is now seeking to bar from the industry. The first of those houses fell into the foreclosure process last fall, and the owners began filing lawsuits in January. Stonewood clients often paid far more for their houses than did buyers of comparable houses nearby and, according to numerous neighbors and real estate agents who followed the purchases, \$50,000 to \$120,000 more than the original asking prices ---- a pattern that raised eyebrows in the slackening market.

Many of the clients bought multiple houses, typically financing each with an 80 percent mortgage and a second, 20 percent mortgage,



Rialto residents Anna and Mark Richter, with daughter Grace, 1, in front of their Murrieta investment home that is in foreclosure. Anna Richter and another plaintiff are suing several Murrieta men in federal court, alleging that the men facilitated mortgage loans and credit-card debt as part of a vast fraud.

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according to a local real estate database. Several are now saddled with more than \$3 million in debt, according to their court filings.

At the time the investors bought the houses, prices in surrounding neighborhoods were still rising, a fact that buyers said led them to conclude they were making solid investments. But market prices leveled off without catching up to the investors' loan balances, leaving them "upside down," in real estate parlance.

Short sales

In recent weeks, the investors and their real estate agents have begun to negotiate with their mortgage lenders, hoping to avoid foreclosure, even as some lenders begin to seize the properties.

Most are attempting to sell properties for less than the balance of the mortgages. Known as "short sales," such transactions can allow an owner to crawl out from under an upside-down mortgage. They don't cause the foreclosure-sized black mark on a credit rating, either, but they can carry a tax penalty because sellers are required to report the difference as income.

Short sales also require the consent of the original lenders, and buyers don't always have the patience to wait through the months of negotiations that this can require. Nor do the lenders, necessarily.

Vicky Reiss, the Temecula resident who filed the first lawsuit Jan. 5, bought five houses through Stonewood, according to a local real estate database. She still owed more than \$600,000 on her house on East View Way in Murrieta's Copper Canyon area. A seller offered about \$500,000, she said, but the lender didn't bite. It seized the house earlier this month.

"One down, four to go," Reiss said, ruefully.

Reiss' real estate agent, on the other hand, said she's optimistic that she'll be able to win over several of the lenders. The agent said she has received offers on five of the 23 properties owned by former Stonewood clients.

The challenge, agents said, is to show the lender that it wouldn't be able to sell the house for significantly more after seizing it and that the seller would never otherwise be able to repay the remaining balance of the loan. Lenders also consider that federal rules require them to set aside more cash in reserve accounts as they record more foreclosures, agents said.

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Foreclosures

But short sales aren't always an attractive option. Several plaintiffs in the lawsuits allege that they refinanced their primary residences to fund investments arranged by Stonewood chief executive Hendrix Montecastro, La Cresta resident James Duncan and Murrieta-area resident Maurice McLeod. These plaintiffs say they now find themselves struggling with monthly mortgage payments as much as double what they were paying before.

"That's where I live," said Temecula resident Mercy Ferido, who is watching her three investment properties slide into foreclosure. "I took another job just to keep up with my payments."

Ferido said she has also made an appointment with a bankruptcy attorney, a move being contemplated by several people who say they invested through Stonewood or related companies.

Rising numbers of foreclosure properties coming onto local real estate markets threaten to weigh on home prices at a time when they've slipped from record highs.

As of June 4, nearly 1,050 lender-owned properties were listed for sale in Riverside County, up from less than a half-dozen in June 2006, according to ZipRealty, an Emeryville, Calif.-based real estate brokerage. Such properties account for about 3.5 percent of the properties for sale in the area, according to the company's data.

More than 30 of the clients have signed onto the six lawsuits against Montecastro, Duncan, McLeod and several of their business partners. The plaintiffs and the Department of Real Estate allege that Montecastro arranged for inflated appraisals and pocketed millions of dollars from excess mortgage payouts.

'Unclean hands'

In many cases, the plaintiffs allege, they were pressured to sign incomplete loan applications that were later completed with false information about their incomes and the reasons they were buying the houses.

The three men promised that part of the surplus payouts from the mortgages would be used to help cover initial mortgage payments, with most being rolled into high-yield, low-risk investments, according to plaintiffs. The houses began to fall into foreclosure when the payments suddenly ceased last summer, the lawsuits allege.

Stonewood's attorney acknowledged that many of the clients paid more for the houses than buyers of surrounding properties, but said the prices ---- and the resulting mortgages ---- were supported by third-party appraisals, including several arranged by the lending institutions.

Allegations that Montecastro helped divert the extra cash toward any sort of investments are "just plain untrue," Riverside attorney Scott Grossman said.

In a June 7 court filing, Grossman argued that Stonewood and Montecastro shouldn't be responsible for investors with "unclean hands" who knowingly signed false or incomplete documents. Montecastro never made payments on the clients' mortgages and never promised

to do so, Riverside attorney Scott Grossman said.

"It is hard for me to understand how someone could intend to defraud another person and make one to two years' worth of payments as part of their plan," Grossman said. "The plaintiffs won't produce any evidence that Stonewood ever made any payments on their behalf."

In the meantime, many of the aggrieved clients have become vocal in calling attention to their plight, creating a Web site earlier this year and rallying along Winchester Road near The Promenade shopping center last month. The group plans a second rally Monday, in front of a Riverside courthouse, to demand criminal charges in the matter.

Representatives of the Riverside County district attorney's office have recently confirmed an ongoing investigation but declined to comment further on its status.

District Attorney Rod Pacheco repeated that position earlier this month, adding "In a robbery case you get a report that's three pages long, and you can read it in five minutes. You get a case like this, and there are dozens of boxes of evidence."

New chapter

The lawsuits, which are pending in state and federal courts, allege that the defendants convinced several hundred clients to borrow tens of thousands of dollars each on credit cards that the men arranged for them. A spreadsheet filed as evidence in one of the suits lists 423 "core clients" and "golden clients" with most living in Riverside County and large numbers of others in Contra Costa County, Phoenix and Tucson. Several live as far away as Minnesota and Puerto Rico.

Jon and Angie Jackson, who moved to Lubbock, Texas, from the Phoenix area in 2006, filed last month for Chapter 7 bankruptcy, which would temporarily protect them from creditors while also liquidating most of their assets above a certain threshold. The couple owe about \$2.2 million, including a second mortgage on their home near Tucson, full mortgages on two houses in Temecula and mortgages on their house outside of Lubbock, Jon Jackson said. The lender seized the Lubbock house earlier this year, prompting the couple to begin renting a house in town, he said.

Their bankruptcy filing lists 28 creditors, ranging from credit-card companies to Wal-Mart.

With his wife liquidating her business and starting school for a nursing degree, Jackson said he and his wife decided lawsuits would be too expensive and time-consuming, and would delay the rest of their lives.

"It would just complicate the bankruptcy," he said by phone. "In some ways, this is a fresh start for us."

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There are good investors and there are bad investors wrote on Jun 17, 2007 6:24 AM:

" Sounds like the (bad) investors did not do their homework and got caught in the hype of increasing real estate values. Had they had experience with real estate they would have realized the predicament they were getting into rather than just believing sales reps who are focused on closing a deal rather than watching out for the investors investment. Tax payers should not have to bail out these investors and they should not be allowed to declare bankruptcy. "

hmmmm wrote on Jun 17, 2007 7:20 AM:

" shame all this mess has one driving factor= greed. "

Cry me a river wrote on Jun 17, 2007 7:43 AM:

" If it sounds too good to be true then guess what. What bothers me is that after all the stupidity and greed transactions that drove up prices in the market 3 years ago, Stonewood's only reward was fees and commissions? All this risk and so little reward for the effort? Nope "pocketed millions of dollars from excess mortgage payouts" and now what surprises me is they hung around after the scheme broke down. "

Greed Greed Greed wrote on Jun 17, 2007 9:17 AM:

" enough said "

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