

STATE OF WASHINGTON  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
SECURITIES DIVISION

IN THE MATTER OF DETERMINING ) Order Number S-09-038-09-SC01  
Whether there has been a violation of the )  
Securities Act of Washington by: ) STATEMENT OF CHARGES AND NOTICE  
) OF INTENT TO ENTER AN ORDER TO  
Michael R. Mastro, doing business as Mastro ) CEASE AND DESIST, TO REVOKE  
Properties, and their agents, ) EXEMPTIONS, AND TO IMPOSE A FINE  
)  
)  
Respondents )

THE STATE OF WASHINGTON TO: Michael Robert Mastro

**STATEMENT OF CHARGES**

Please take notice that the Securities Administrator of the State of Washington has reason to believe that Respondents, Michael R. Mastro, doing business as Mastro Properties, has violated the Securities Act of Washington and that his violations justify the entry of an order from the Securities Administrator under RCW 21.20.390 to cease and desist from such violations, under RCW 21.20.325 to revoke exemptions, and under RCW 21.20.395 to impose a fine. The Securities Administrator finds as follows:

**TENTATIVE FINDINGS OF FACT**

Respondents and Their Business Activities

1. Michael R. Mastro (“Mastro”) is a King County, Washington resident. He has a college degree in business and economics and was a commercial banker for more than twenty years. Sometime around 1965, Mastro left commercial banking and began working as a real estate lender and developer. Mastro has been self-employed in the real estate development business for more than forty years.

1           2. Mastro Properties was a trade name and a sole proprietorship that was 100% owned  
2 by Mastro and was operated by Mastro and under Mastro's direction for more than thirty  
3 years. During 2009, Mastro Properties' primary place of business was located at 510 Rainier  
4 Avenue South in Seattle, Washington. During 2009, Mastro Properties had several  
5 employees, including Mastro's son, Michael K. Mastro, who was in charge of real estate  
6 development, and Thomas Kenyon, the company's Chief Financial Officer.

8           3. Mastro, doing business as Mastro Properties, owned and developed residential, multi-  
9 family, and commercial real estate. Mastro's development projects included residential  
10 subdivisions, apartment or condominium complexes, warehouses, and office buildings.  
11 Mastro, doing business as Mastro Properties, also made real estate secured loans to borrowers  
12 who could put up real property for collateral. The borrowers included other real property  
13 developers, car dealers, a former Mastro employee, and two attorneys who were trying to  
14 purchase defaulted home mortgages. The loans were originated and were approved by Mastro,  
15 using his own lending criteria. The loans were evidenced by promissory notes and were  
16 secured by deeds of trust that were granted to Mastro and were recorded against the real  
17 property that was to secure the loan. If the borrowers were unable to make their loan  
18 payments, Mastro would foreclose on the real property that secured the loan.

21           Raising Business Operating Capital By Selling Personal Promissory Notes to Investors

22           4. For more than twenty years, Mastro has raised funds to use as working capital for his  
23 own business, Mastro Properties, by offering and selling personal promissory notes to  
24 investors. The investor funds were deposited in a single bank account and were pooled  
25 together, along with other business operating funds. The investors had no control over the use

1 of their funds. The investors relied upon Mastro to operate his real estate lending and  
2 development business and to generate a return on their investments. Mastro testified before  
3 the Securities Division that the proceeds from the sale of the promissory notes were always  
4 used for business purposes.  
5

6 “Friends and Family” Investments

7 5. When offering and selling the promissory note investments, Mastro claimed that he  
8 was selling the investments to “friends and family.” When Mastro issued his 2007 and 2008  
9 annual financial statements, Mastro captioned the amount of the total outstanding promissory  
10 note balance as “Friends and Family” Investments. When he sent a September 30, 2008 letter  
11 to the note holders, Mastro addressed the letter to “Dear Friends and Family Investor.” When  
12 he sent an August 21, 2009 letter to the note holders, Mastro again addressed the letter to  
13 “Dear Friends and Family investor.” However, the Securities Act of Washington contains no  
14 specific exemption for securities sales to “friends and family,” but requires that securities must  
15 be registered, unless there is an available exemption, which there does not appear to be in this  
16 case.  
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19 6. Mastro testified that when he began selling promissory notes, he sold the notes only to  
20 his family members. He testified that approximately ten million dollars of worth outstanding  
21 Mastro promissory notes are held by his family members. Mastro testified that later he began  
22 selling promissory notes to his friends. However, many of the investors never met Mastro or  
23 had any direct connection with him. Instead, they were introduced to the Mastro promissory  
24 note investment through a word-of-mouth referral from other Mastro investors. Most of the  
25 investors were not in the business of making loans and they did not have any significant real

1 estate experience. Most of the note purchasers considered their Mastro promissory notes to be  
2 investments.

3 Offering of Promissory Note Investments

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5 7. Investors generally purchased the Mastro promissory note investments because of the  
6 higher than market rates of interest that were offered for the investment, the purported safety  
7 of the investment, and the perceived immediate liquidity that came with holding a demand  
8 promissory note. From the records that Mastro has provided to the Securities Division, it  
9 appears that Mastro has offered and sold more than \$100 million worth of outstanding  
10 promissory note investments to more than 175 investors.  
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12 8. When offering and selling promissory note investments, Mastro required a minimum  
13 note purchase of \$50,000. The notes were payable upon demand, with no fixed due date.  
14 Mastro was the maker of the notes, which were generally standard form promissory notes.  
15 Mastro instructed some investors to make their investment checks payable to Mastro  
16 Properties. Mastro or his employees would send the investors a promissory note and would  
17 generally attach an "Exhibit A," that listed investments, interest accumulated, withdrawals,  
18 deposits, and the balance of the investment account. Mastro or his employees also sent  
19 quarterly account statements to the investors. The statements listed the dollar amount of  
20 investments, the amount of withdrawals, and the amount of interest earned. Mastro testified  
21 that there was never any advertising to solicit note sales. He testified that no commissions  
22 were ever paid for the sale of notes. He testified that for about the first five years, the  
23 promissory notes were secured by deeds of trust against real property. He testified that  
24 afterwards the promissory note investments were secured only if the investor asked for  
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1 collateral. Mastro testified that approximately \$15 million of the outstanding promissory notes  
2 are secured.

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4 9. Over the past five years, it appears that Mastro has offered and sold promissory notes  
5 totaling more than \$35 million to approximately 88 investors. During 2004, it appears that  
6 Mastro offered and sold more than four million dollars worth of promissory notes to more than  
7 fifteen investors. During 2005, it appears that Mastro offered and sold more than six million  
8 dollars worth of notes to more than fifteen investors. During 2006, it appears that Mastro  
9 offered and sold more than nine million dollars worth of notes to more than twenty investors.  
10 During 2007, it appears that Mastro offered and sold more than two million dollars worth of  
11 notes to more than fifteen investors. During 2008, it appears that Mastro sold almost fifteen  
12 million dollars worth of notes to more than twenty investors. During 2009, it appears that  
13 Mastro sold more than one million dollars worth of notes to three investors. Mastro testified  
14 that he stopped selling promissory notes in February 2009, after he was initially contacted by  
15 the Securities Division regarding the offer and sale of the promissory notes.  
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18 Investments Were Inappropriately Sold to Some Non-accredited Investors

19 10. For several investors, who each had a net worth of less than one million dollars and  
20 an annual income of less than \$200,000, the Mastro note investments represented 75% or more  
21 of their total savings. The investors were retired and they needed the income from their  
22 investments to support their retirement. The investors did not have any significant business,  
23 real estate, or investment experience, nor did they have access to financial and other  
24 information regarding the Mastro promissory note investments. When offering and selling the  
25 investments, Mastro did not ask the investors questions to determine whether the investments

1 were suitable in light of the investors' risk tolerance, financial situation, financial needs, and  
2 investment objectives. Mastro did not require the investors to obtain expert and  
3 independent financial advice before making their investments. Some of the investors were  
4 also led to believe, in part because there were no written risk disclosures, that there were no  
5 risks associated with the promissory note investments.  
6

#### 7 Interest on the Promissory Note Investments

8 11. The Mastro promissory notes carried higher than market rates of interest. The notes  
9 were generally subject to interest rate adjustments by Mastro every six months, but interest  
10 rate adjustments were seldom made. However, over time, the interest rates declined.  
11 Originally, the notes paid 12% annual interest. During 2007 and 2008, investors who  
12 purchased promissory notes with a principal balance between \$50,000 and \$100,000 generally  
13 received 8% annual interest and investors who purchased promissory notes with a principal  
14 balance of more than \$100,000 generally received 9% annual interest. Some of the investors  
15 received monthly interest payments. Other investors elected to accrue the interest that was  
16 due, by adding the accumulated interest to the outstanding principal balance. Mastro also  
17 testified that some of his family members received 12% annual interest payments from the  
18 time that the notes were issued, which was probably fifteen years ago, until August 2009,  
19 when Mastro stopped making interest payments on all of the outstanding promissory notes.  
20 Those family members had inherited promissory notes of \$25,000 each from Mastro's father.  
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#### 24 Purported Security for the Promissory Note Investments

25 12. When offering and selling promissory note investments, Mastro, who is now 84  
years old, caused some investors to believe that their notes would be secured by life insurance

1 policies for which Mastro was the insured. Mastro represented to some investors that their  
2 investments would be secured by the real properties that were being purchased and developed  
3 by Mastro and Mastro Properties. Mastro also represented to investors who purchased  
4 promissory note investments prior to 2005 that their investments would be secured by deeds of  
5 trust against real property or by UCC-1 filings against personal property owned by LLCs that  
6 were formed by Mastro to develop specific properties.  
7

8 Misrepresentations or Omissions and Background Information

9 13. When offering and selling the promissory note investments, Mastro caused some  
10 investors to believe that their investments would be secured by life insurance policies that had  
11 Mastro as the insured. Mastro failed to disclose to investors that the life insurance policies  
12 were not assigned to the investors and that the policies did not name the investors as  
13 beneficiaries, so the investors had no protected security interest in the life insurance policies.  
14 Mastro failed to disclose to investors that the beneficial value of the life insurance policies did  
15 not fully cover the total amount of the outstanding promissory notes and that Mastro had sold  
16 or had taken out loans against some of the policies. Mastro also failed to disclose to investors  
17 that even if the investors had been named as beneficiaries for the life insurance policies, the  
18 policies might not adequately protect their investments, because the policy proceeds would not  
19 become subject to creditor claims until after the insured's death and because Mastro might  
20 have an unusually long life expectancy, given that Mastro's father lived to be 103 years old.  
21

22 14. When offering and selling promissory note investments, Mastro represented to some  
23 investors that their promissory note investments were secured by real property deeds of trust  
24 or by UCC-1 filings against personal property owned by LLCs that were formed by Mastro to  
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1 develop specific real properties. Mastro failed to disclose to investors that most of the  
2 investors did not have any real property deeds of trust to secure their promissory note  
3 investments. Mastro apparently formed separate LLCs, which he controlled, to hold title to  
4 some individual real properties or assets associated with specific real estate development  
5 projects. It appears that Mastro assigned UCC-1 interests in some of those LLCs to investors,  
6 but he failed to disclose that he might not maintain UCC-1 filings to secure the investments.  
7 Mastro testified that over time he made several UCC-1 filings in favor of the investors, with  
8 the earliest filing being made about twenty years ago. He testified that the last UCC-1 filing  
9 was made in May 2008. From a review of UCC filings, it appears that during February 2009,  
10 Mastro's son, Michael K. Mastro, subordinated the security interests of the investors to a  
11 security interest of Pacific Continental Bank. Apparently, Mastro owes the bank  
12 approximately \$15 million.  
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15 Inadequate Investment Offering Information

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17 15. When offering and selling promissory note investments, Mastro generally did not  
18 give the investors any written offering materials, except sometimes a sample copy of a Mastro  
19 promissory note. Mastro did not disclose any specific use of investor proceeds. He did not  
20 give the investors a personal financial statement and he often did not show the investors and  
21 generally did not give the investors a business financial statement for Mastro Properties. He  
22 did not give the investors any audited financial statements. When one of the investors asked  
23 for a prospectus before investing, the investor recalled that Mastro told the investor that “we  
24 don't do that here.”  
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Undisclosed Investment Risks

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2           16. When offering and selling promissory note investments, Mastro failed to disclose to  
3 investors some significant risks pertaining to their investments. Mastro failed to disclose that  
4 the value of the promissory note investments was heavily dependent upon real property market  
5 values and that a general market decline might seriously impair Mastro's ability to repay the  
6 investments. Mastro failed to disclose that a change in commercial lending guidelines could  
7 result in the unavailability of capital through commercial lenders, which could mean that  
8 Mastro Properties might not be able to continue doing business as a going concern. Mastro  
9 failed to disclose that he and his company might be unable to sell real properties or to raise  
10 other sources of capital and that the inability to obtain adequate capital could create a liquidity  
11 crisis. Mastro failed to disclose that the inability to service debt could impair Mastro's and his  
12 company's ability to continue doing business as a going concern. Mastro failed to disclose  
13 that a promissory note investor might be subject to a risk of loss of their entire investment due  
14 to superior collateral claims by other creditors, including commercial lenders that advanced  
15 funds to Mastro to conduct business or to develop specific properties. In some cases, Mastro  
16 failed to disclose that the promissory note investors might be considered unsecured creditors in  
17 a bankruptcy proceeding. Mastro failed to disclose that investors should be able to withstand  
18 the loss of their entire investment. Mastro failed to disclose that the promissory note  
19 investments should only be purchased by investors who are capable, either by themselves or  
20 with the assistance of an independent financial adviser, of evaluating the merits and risks of  
21 the investment.  
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1 Undisclosed Financial Problems

2 17. During at least 2008 and 2009, when offering and selling promissory note  
3 investments, Mastro failed to disclose adverse information about his financial condition.  
4 Mastro testified that for many years Mastro Properties maintained cash balances of  
5 approximately \$10,000,000. However, the Mastro Properties 2008 financial statement shows  
6 that as of December 31, 2008, the company's cash balance was only \$2,478,897. During 2008  
7 and 2009, several of the investors asked Mastro to redeem the full amount of their  
8 investments, but Mastro was either unable or unwilling to repay the investors in full. At the  
9 end of 2008, one investor asked Mastro to redeem an investment totaling about \$79,000, but  
10 Mastro did not fully honor the repayment request, although he did pay \$25,000 to the investor  
11 about three weeks after the request was made. Mastro testified that he stopped making  
12 payments on all of his outstanding bank loans by at least April 2009 and court filings show  
13 that at least one monthly bank payment stopped in February 2009. Mastro testified that  
14 Mastro Properties generated before-tax profits of \$31 million for 2006 and \$1.7 million for  
15 2007 and a before-tax loss of \$6.4 million for 2008. Despite these problems, on September  
16 30, 2008, Mastro sent an upbeat letter to his "Friends and Family" investors. In the letter,  
17 Mastro told promissory note investors that "our organization is strong and healthy, in no small  
18 part because of the relationships we value so greatly with lenders including you, our friends  
19 and family. I hope this report eased any concerns you may have."  
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24 Mastro Bankruptcy Proceedings

25 18. On July 10, 2009, three banks, Columbia Bank, First Sound Bank, and Venture  
Bank, filed an involuntary chapter 7 bankruptcy petition against Mastro. Initially, Mastro

1 challenged the basis for the filing of the petition. However, in August 2009, Mastro consented  
2 to the bankruptcy petition. Among other things, Mastro has submitted bankruptcy filings  
3 listing his assets and liabilities, along with his creditors' names and the dollar amounts of the  
4 debts that are owed to his secured and his unsecured creditors. Mastro's bankruptcy filings list  
5 total assets of approximately \$250 million and total liabilities of more than \$550 million.  
6

#### 7 Reported Deficiencies in Real Property Values

8 19. As part of the bankruptcy proceedings, Mastro filed "Schedule A," a list of his real  
9 property, the current value of the property, and the amount of any outstanding claims against  
10 the property. Schedule A showed that the total current value of the real property was  
11 \$271,327,900 and the amount of the secured claims against the real property was  
12 \$354,199,797, leaving a deficiency of \$82,871,897. Some of the greater discrepancies were  
13 for Emerald Ridge, 635 single family lots, that had a current value of \$15,000,000 and secured  
14 claims of \$30,616,970; Eagle Point, 209 single family lots, with a current value of \$5,000,000  
15 and secured claims of \$13,033,125; the Quadrant Building on Lake Union, an office building,  
16 with a \$20,000,000 current value and secured claims of \$27,220,868; and Sammamish Ridge,  
17 land with a current value of \$10,000,000 and secured claims of \$19,655,984.  
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#### 20 Undisclosed Declines in Real Property Values

21 20. It appears that at least during 2008 and 2009, when offering and selling promissory  
22 note investments, Mastro failed to disclose to investors that there were significant declines in  
23 the market value of his real property holdings. Along with his September 30, 2008 letter to  
24 investors, Mastro sent a September 22, 2008 list of potential sales for specific properties. The  
25 list appears to show that the properties had a total net equity value of \$67,000,000. However,

1 Mastro testified that only two of the listed properties were actually sold. Apparently, those  
2 two sales generated net cash totaling approximately \$7,500,000.

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4 Securities Registration Status

5 21. Mastro and Mastro Properties are not currently registered to sell their securities in the  
6 state of Washington and they have not previously been so registered, nor have they filed a  
7 claim of exemption from registration.

8 22. Mastro is not currently registered as a securities broker-dealer or a securities  
9 salesperson in the state of Washington and he has not previously been so registered.

10 Based upon the Tentative Findings of Fact, the following Conclusions of Law are made:  
11

12 **CONCLUSIONS OF LAW**

13 **I.**

14 The offer or sale of the promissory note investments described above constitutes the offer  
15 or sale of a security, as defined in RCW 21.20.005(10) and (12), whether in the form of a note,  
16 an evidence of indebtedness, or an investment contract.  
17

18 **II.**

19 The offer or sale of said securities is in violation of RCW 21.20.140 because no  
20 registration for such offer or sale is on file with the Securities Administrator.  
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22 **III.**

23 Michael R. Mastro, doing business as Mastro Properties, has violated RCW 21.20.040 by  
24 offering or selling said securities while not registered as a securities broker-dealer or a  
25 securities salesperson in the state of Washington.

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IV.

The offer or sale of said securities was made in violation of RCW 21.20.010 because, as set forth above in the Tentative Findings of Fact, Mastro made untrue statements of material fact and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading .

**CONTINUING INVESTIGATION**

The Securities Division is continuing to investigate and will be reviewing further documents and taking further testimony to determine whether there might have been any additional violations of the Securities Act, in connection with the offer and sale of the Mastro promissory note investments, by Mastro or by his agents.

**NOTICE OF INTENT TO ORDER THE RESPONDENT TO CEASE AND DESIST**

Based on the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order, pursuant to RCW 21.20.390(1), that Michael R. Mastro, and his agents, employees, and representatives, each shall cease and desist from any violation of RCW 21.20.010, RCW 21.20.040, and RCW 21.20.140.

**NOTICE OF INTENT TO REVOKE EXEMPTIONS**

Based on the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order, pursuant to RCW 21.20.325, that any exemptions under RCW 21.20.320(1), RCW 21.20.320(9), RCW 21.20.320(11), and RCW 21.20.320(17) shall be permanently revoked as to Michael R. Mastro.

1 **NOTICE OF INTENT TO IMPOSE A FINE**

2 Based on the above Tentative Findings of Fact and Conclusions of Law, the Securities  
3 Administrator intends to order, pursuant to RCW 21.20.395, that Michael R. Mastro shall be  
4 liable for and shall pay a fine of \$100,000. Payment of the fine is to be deferred until the  
5 Mastro promissory note investors have been repaid in full.  
6

7 **AUTHORITY AND PROCEDURE**

8 This Statement of Charges is entered pursuant to the provisions of chapter 21.20 RCW  
9 and is subject to the provisions of chapter 34.05 RCW. The Respondent, Michael R. Mastro,  
10 may make a written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO  
11 DEFEND AND OPPORTUNITY FOR HEARING accompanying this order.  
12

13 If the Respondent, Michael R. Mastro, does not make a timely hearing request, the  
14 Securities Administrator intends to adopt the above Tentative Findings of Fact and  
15 Conclusions of Law as final, to enter a permanent order to cease and desist against the  
16 Respondent, to enter a permanent order against the Respondent to revoke the securities  
17 exemptions set forth in RCW 21.20320(1), RCW 21.20.320(9), RCW 21.20.320(11), and  
18 RCW 21.20.320(17), and to impose the fine on the Respondent.  
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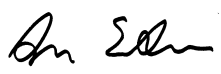
21 Dated and Entered this 1st day of October, 2009

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24 MICHAEL E. STEVENSON  
25 Securities Administrator

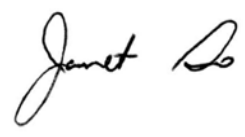
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