ABERDEEN TOWNSHIP, N.J.—The government's civil-fraud allegation against Goldman Sachs Group Inc. centers on a deal the firm crafted so that hedge-fund king John Paulson could bet on a collapse in U.S. housing prices.

It was a dizzyingly complex transaction, involving 90 bonds and a 65-page deal sheet. But it all boiled down to whether people like Stella Onyeukwu, Gheorghe Bledea and Jack Booket could pay their mortgages.

They couldn't, and Mr. Paulson made $1 billion as a result.

Mr. Booket, a 44-year-old heating and air-conditioning repairman, owed $300,000 on his three-bedroom home in Aberdeen Township. His house was one of thousands that wound up in a pool of mortgages that were referenced in the so-called collateralized debt obligation, or CDO, which Goldman created for Mr. Paulson. The hedge-fund manager invested heavily in a form of insurance that could yield huge gains if the borrowers grew unable to pay.

In 2006, Mr. Booket got hit by a car while riding a motorcycle from a late-night party, was unable to find much work and couldn't pay the bank. In October 2008, he lost the house to foreclosure and plans to move out by next week. He says he bears no grudge against Mr. Paulson and Goldman.

"The man came up with a scheme to get rich, and he did it," says Mr. Booket, who had refinanced his mortgage just months before the accident. "So more power to him."

More than half of the 500,000 mortgages from 48 states contained in the Goldman deal—known as Abacus 2007-AC1—are now in default or foreclosed.

Mr. Paulson didn't have any direct involvement in the mortgages contained in the Goldman deal under scrutiny by the Securities and Exchange Commission. And the bets that Mr. Paulson placed on Abacus didn't affect whether or not homeowners defaulted. Rather, he used Wall Street to help structure hugely lucrative side bets that homeowners such as Mr. Booket couldn't make their monthly mortgage payments.

One loser in the deal, German bank IKB Deutsche Industriebank AG, saw most of its $150 million Abacus investment evaporate. It had believed that borrowers broadly could afford the loans. The bank says it is cooperating with the SEC's inquiry.

"There's no question we made money in these transactions," said a Paulson spokesman in a statement.
"However, all our dealings were through arms-length transactions with experienced counterparties who had opposing views based on all available information at the time. We were straightforward in our dislike of these securities but the vast majority of people in the market thought we were dead wrong and openly and aggressively purchased the securities we were selling."

Some of the people whose mortgages underpinned Mr. Paulson's wager were themselves taking a gamble—that U.S. housing prices would continue to march upward, making it possible for them to eventually pay off loans they couldn't afford.

The Wall Street Journal identified homeowners in the Abacus portfolio by taking the 90 bonds listed in a February 2007 Abacus pitchbook and matching them with court records, foreclosure listings, title records and loan servicing reports. The bonds contained nearly 500,000 mortgage loans.

One mortgage in the Abacus pool was held by Ms. Onyeukwu, a 43-year-old nursing-home assistant in Pittsburg, Calif. Ms. Onyeukwu already was under financial strain in 2006, when she applied to Fremont Investment & Loan for a new mortgage on her two-story, six-bedroom house in a subdivision called Highlands Ranch. With pre-tax income of about $9,000 a month from a child-care business, she says she was having a hard time making the $5,000 monthly payments on her existing $688,000 mortgage, which carried an initial interest rate of 9.05%.

Nonetheless, she took out an even bigger loan from Fremont, which lent her $786,250 at an initial interest rate of 7.55%—but that would begin to float as high as 13.55% two years later. She says the monthly payment on the new loan came to a bit more than $5,000.

She defaulted in early 2008 and was evicted from the house in early 2009.

Fremont didn’t respond to requests for comment.

In early 2007, Paulson was identifying different bonds from across the country that it wanted to place bets against. Paolo Pellegrini, Mr. Paulson’s right-hand man, began working with Goldman trader Fabrice Tourre to choose bonds for the Abacus portfolio, say people familiar with the deal.

Abacus was a "synthetic" CDO, meaning that it didn’t contain any actual bonds. Rather, it allowed Paulson’s firm to buy insurance on bonds it didn’t own. If the bonds performed well, Paulson would make a steady stream of small payments—much like insurance premiums. If they performed poorly, Paulson would receive potentially large payouts.

According to the SEC complaint, Mr. Paulson especially wanted to find risky subprime adjustable-rate mortgages that had been given to borrowers with low credit scores who lived in California, Arizona, Florida, and Nevada—states with big spikes in home prices that he reckoned would crash.

Mr. Pellegrini and a colleague had purchased an enormous database capable of tracking the characteristics of more than six million mortgages in various parts of the country. They spent long hours scouring it all, according to people familiar with the matter.

The home mortgage of Gheorghe Bledea was among those that wound up in the Abacus portfolio.

In May of 2006, a broker had approached Mr. Bledea, a Romanian immigrant, to pitch him a deal on a loan to refinance the existing mortgage on his Folsom, Calif., home.

Mr. Bledea, who is suing his lender in Superior Court of California in Sacramento on allegations that he was defrauded, wanted a 30-year fixed-rate loan, according to his complaint. His broker told him the only one available was an adjustable-rate mortgage carrying an 8% interest rate, according his court filing.
Mr. Bledea, who says he has limited English-speaking skills, was told that he’d be able to exit the risky loan in six months and refinance into yet another one carrying a lower 1% rate. Mr. Bledea agreed to take out the $531,000 loan on July 21, 2006.

The new loan never materialized. Within months, Mr. Bledea and his family were struggling under the weight of a $5,800 monthly note, says his son, Joe Bledea.

"We were putting ourselves in a lot of debt," Joe Bledea says. By spring of 2009, the loan was in default. The elder Mr. Bledea is now appealing to the court to avoid eviction from his ranch-style house, says family attorney Will Ramey.

The loan, underwritten by Washington Mutual, itself had moved through the U.S. mortgage machine. It was put into a debt pool, or residential-mortgage backed security, with the arcane name of Long Beach Mortgage Loan Trust 2006-8.

A spokesman for J.P. Morgan Chase & Co., which acquired WaMu in September of 2008, said the bank was unable to comment on the loan.

By mid-October of 2007, just seven months after Abacus was formed, 83% of the bonds in its portfolio had been downgraded. By then, sheriff departments across the U.S. were seizing homes and putting them up for sale at public auction as souring Abacus-related loans metastasized.

In Dayton, Ohio, a two-story home that served as collateral for Abacus now stands empty. The house was purchased for $75,000 in 2006 by a borrower who used a subprime loan from a California-based mortgage bank. That $67,500 loan was placed into a pool called Structured Asset Investment Loan Trust 2006-4, which underpinned Abacus.

After the borrower defaulted, the trust acquired the home through foreclosure in October 2007 and resold it to an investor in April 2008 for $7,500, a tenth of the price paid two years before.

Neighbor Lonnie Ross, sitting on the porch Tuesday morning while enjoying a cigarette, says most homes on the block are vacant or occupied by squatters.

Inside the unoccupied house, which is missing its front door knob, hardwood floors are strewn with old bills. A fake Christmas tree is still decorated with candy canes. Instant pudding and other discarded food litters the kitchen. Dirty dishes are soaking in a sink.

A few blocks away, a homemade sign reads: "This community is dead already. We need leadership to rebuild this community. Too many run down houses need to be torn down."

But not all homes have gone south.

In a wealthy Denver neighborhood, neighbors are thrilled that Joel Champagne rescued a house on East Alameda Circle, where a previous mortgage was contained in the Abacus deal via a pool called First Franklin Mortgage Loan Trust 2006-FF9.

Mr. Champagne bought the home last year for $370,000. The prior owner, according to title records, had paid $1.2 million, borrowing the entire amount from First Franklin. The owner had started on a renovation and then vanished, says Mr. Champagne and neighbors, leaving the home with no plumbing, wiring or roof shingles.

Today, hyacinths are starting to peep through the flower beds.

"I'm very fortunate. We capitalized on the market and we were very fortunate to be in a position to do that," says the 45-year- old. "I don't know enough details to say if I'm upset with Goldman Sachs or
whoever. The problem's bigger than that. Everyone made a lot of mistakes back then."

—Stephanie Simon, James R. Hagerty, Serena Ng, Cari Tuna contributed to this article.