

**TMG**

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

1

UNITED STATES OF AMERICA

v.

DAVID C. PAUL  
DIANE F. FLANNERY

CRIMINAL NO. 08cr178-1, 2

DATE FILED: **FILED MAR 27 2008**

**FILED**

MAR 27 2008

MICHAEL E. KUNZ, Clerk  
By  Dep. Clerk

VIOLATIONS:  
18 U.S.C. § 1341 (mail fraud - 2 counts)  
18 U.S.C. § 2 (aiding and abetting)

INDICTMENT

COUNT ONE

THE GRAND JURY CHARGES THAT:

The Defendants

At all times material to this indictment:

1. Defendant DAVID C. PAUL, through various real estate investment companies, including CLASSIC HOMES, INC., D.C.P. INVESTMENT PROPERTIES LLC, DIKOR CORPORATION, and VISION BUILDERS GROUP, INC., bought, rehabilitated, rented, and sold houses in the Reading, Pennsylvania area.

2. Defendant DIANE F. FLANNERY worked as a mortgage broker/loan officer for SOURCE MORTGAGE COMPANY.

### **The FHA Program**

3. The Department of Housing and Urban Development (“HUD”) was a department of the United States government that administered the Single Family Mortgage Insurance Program to encourage private lenders to provide mortgage loans to home buyers.

4. The Federal Housing Administration (“FHA”) was the agency within HUD that administered HUD’s mortgage insurance program. For this reason, the loans in the program are often referred to as “FHA-insured loans.”

5. Under HUD’s insurance program, FHA insured home mortgages that private lenders provided to borrowers, thereby protecting the lenders from any loss in the event that the borrower defaulted on the loan.

6. By this means, HUD shifted the financial risk of issuing its insured mortgages from the lender to the taxpayers.

7. HUD had rules, regulations, and guidelines governing the minimum requirements in the documentation of every mortgage loan transaction that was to be FHA-insured.

8. The accuracy and truthfulness of the information contained in the documentation underlying an FHA-insured mortgage loan transaction was vital. Such information was used in the underwriting process, a process that assessed the risk that the loan will go into foreclosure. Both the lenders and HUD relied on that information in determining whether a loan was to be FHA-insured. Included among the information that the lender and HUD relied on were the borrower’s income, employment, and credit histories; the amount of the borrower’s own money used to purchase the house; and any money provided to the borrower by a

third party to assist him or her in purchasing the house. Should such information be inaccurate or untruthful, then the underwriting process was undermined. Any assessment of the risk of the loan's going into foreclosure would be based on false and inaccurate information. Such an assessment would deny FHA the opportunity to protect taxpayer funds by an accurate evaluation of the mortgage application.

9. The information described above was collected in a number of documents. Those documents were included in file folders sometimes called "direct endorsement binders." These file folders – and the original documents therein – were provided by mail to HUD in the process of a lender's obtaining FHA insurance for a mortgage loan.

10. Among the documents contained in "direct endorsement binders" would be so-called "gift letters." Gift letters are form documents used in those instances in which a borrower receives a gift of money from a third party to assist him or her in purchasing the house. Among other things, gift letters typically identify the donor, the relationship of the donor to the borrower, and the amount of the gift.

11. Evaluating the information contained on gift letters is an important part of the process by which HUD or its agents determine whether a borrower qualifies for an FHA-insured loan. FHA regulations require that a borrower invest a minimum amount of his or her own money in the purchase of the house. If a borrower has difficulty obtaining the required minimum investment, he or she can get help – a gift – from a specified set of individuals or institutions. These individuals or institutions include a relative, an employer, or a qualified charity. A borrower may not get such help from the seller of the house (or any other interested party).

12. The reasons underlying the minimum investment requirement and underlying the limits on who may be a gift donor derive in part from HUD's experience concerning the likelihood of a borrower's repaying the mortgage. It has been HUD's experience – experience confirmed in the mortgage lending industry generally – that a borrower who invests his or her own money in a house has a strong incentive to repay the mortgage; the borrower does not want to lose that investment by defaulting on the loan and losing the house. It has also been HUD's experience – again confirmed by the mortgage lending industry generally – that a borrower who receives a gift from a close relation (e.g., a family member or an employer) has a similar, though less strong, incentive to repay the mortgage; the borrower does not want to lose that relation's money by defaulting on the loan and losing the house. There are no similar incentives when a seller (or other interested party) provides assistance to a borrower.

13. The information on a gift letter, then, is important information in evaluating the risk that a borrower will fail to repay the mortgage. It is information on which HUD or its agents rely.

#### **The Scheme**

14. From in or about April 2002, to in or about July 2003, defendants

**DAVID C. PAUL, and  
DIANE F. FLANNERY**

devised and intended to devise, and aided and abetted the devising of, a scheme to defraud the United States, in particular, to defraud HUD into providing FHA insurance on certain mortgage loans, and to obtain money and property by means of false and fraudulent pretenses, representations and promises.

## MANNER AND MEANS

15. It was part of the scheme that the defendants falsified gift letters thereby misleading HUD and its agents into providing FHA-insured mortgage loans to borrowers who used the loans to purchase houses from defendant DAVID C. PAUL or his companies.

It was further part of the scheme that:

16. Defendant DAVID C. PAUL or his companies sold many of the houses he purchased in Reading.

17. At times, defendant DAVID C. PAUL'S prospective customers failed to qualify for FHA-insured mortgage loans to finance the purchase of the houses. One reasons for that failure was the inability of these customers to obtain their own money to invest in the houses they wished to purchase.

18. In such circumstances, defendant DAVID C. PAUL provided the necessary money. Knowing that it was against HUD rules for him – as the seller (or as an interested party) – to do so, he falsified documents to make it appear that the money was coming from a qualified individual. (As part of the real estate transactions, the money returned to defendant PAUL.)

19. In several instances, defendant DAVID C. PAUL prepared or directed others to prepare false gift letters that made it appear that one of his employees, J.C. or J.S., was providing money to the borrower. J.C. or J.S. appeared on the gift letter as a donor. The gift letter falsely stated that J.C. or J.S. was a relative of the borrower.

20. Defendant DAVID C. PAUL knew that the false gift letters became part of the documentation used to apply for FHA-insured loans.

21. Acting as a mortgage broker/loan officer, defendant DIANE F. FLANNERY gathered together the documentation to support the borrowers' applications for FHA-insured mortgage loans. Among the documentation she gathered were these false gift letters. Defendant FLANNERY was aware that these gift letters were false. It was her job, in part, to make initial, professional assessments as to whether borrowers could qualify for FHA-insured loans. She then passed the application documentation (including the false gift letters) to lenders, which, in turn passed that information to HUD.

22. Both defendant DAVID C. PAUL and defendant DIANE F. FLANNERY knew that mortgage lenders and HUD relied on the information in these false gift letters in determining whether to approve FHA-insurance for the borrowers.

23. Both defendant DAVID C. PAUL and defendant DIANE F. FLANNERY knew that the false gift letters made it appear that borrowers were qualified for FHA-insured loans when, in fact, these borrowers did not actually satisfy HUD requirements. They therefore knew that, if HUD were aware of the truth, HUD would not approve these borrowers for FHA-insured loans.

24. Both defendant DAVID C. PAUL and defendant DIANE F. FLANNERY knew that the mortgage lenders mailed documentation to HUD during the ordinary course of processing applications for FHA-insured mortgages.

25. Defendant DAVID C. PAUL and defendant DIANE F. FLANNERY used false gift letters to obtain FHA-insured loans for borrowers to allow those borrowers to purchase houses at 515 S. 15 ½ Street and 1515 Mulberry Street, both in Reading, Pennsylvania. The

FHA-insured loans used to purchase those houses fell into foreclosure causing HUD to incur losses. A third loan is in default. The losses to HUD total approximately \$60,000.

26. On or about June 30, 2003, in Reading, in the Eastern District of Pennsylvania, and elsewhere, defendants

**DAVID C. PAUL, and  
DIANE F. FLANNERY,**

for the purpose of executing the scheme described above, and attempting to do so, and aiding and abetting its execution, knowingly caused to be delivered to HUD by commercial interstate carrier according to the directions thereon the direct endorsement binder for the mortgage loan associated with 515 S. 15 ½ Street, Reading, Pennsylvania.

All in violation of Title 18, United States Code, Sections 1341 and 2.

**COUNT TWO**

**THE GRAND JURY FURTHER CHARGES THAT:**

1. Paragraphs 1 and 3 through 13 of Count One are incorporated here.

**The Scheme**

2. From in or about April 2002, to in or about July 2003, defendant

**DAVID C. PAUL**

devised and intended to devise, and aided and abetted the devising of, a scheme to defraud the United States, in particular, to defraud HUD into providing FHA insurance on certain mortgage loans, and to obtain money and property by means of false and fraudulent pretenses, representations and promises.

**MANNER AND MEANS**

3. It was part of the scheme that the defendant falsified gift letters thereby misleading HUD and its agents into providing FHA-insured mortgage loans to borrowers who used the loans to purchase houses from defendant DAVID C. PAUL or his companies.

It was further part of the scheme that:

4. Paragraphs 16 through 18 of Count One are incorporated here.
5. In several instances, defendant DAVID C. PAUL prepared or directed others to prepare false gift letters that made it appear that a relative of the borrower was providing money to the borrower. In fact, PAUL gave the money to the relative who, in turn, gave it to the borrower.
6. Defendant DAVID C. PAUL knew that the false gift letters became part of the documentation used to apply for FHA-insured loans.

7. Defendant DAVID C. PAUL knew that mortgage lenders and HUD would rely on the information in these false gift letters in determining whether to approve FHA-insurance for the borrowers.

8. Defendant DAVID C. PAUL knew that the false gift letters made it appear that borrowers were qualified for FHA-insured loans when, in fact, these borrowers did not actually satisfy HUD requirements. He therefore knew that, if HUD were aware of the truth, HUD would not approve these borrowers for FHA-insured loans.

9. Defendant DAVID C. PAUL knew that the mortgage lenders mailed documentation to HUD during the ordinary course of processing applications for FHA-insured mortgages.

10. Defendant DAVID C. PAUL used false gift letters to obtain FHA-insured loans for borrowers to allow those borrowers to purchase houses at 521 S. 15 ½ Street, 1152 Mulberry Street, 539 Perry Street, and 300 S. 16<sup>th</sup> Street, all in Reading, Pennsylvania. The FHA-insured loans used to purchase those houses fell into foreclosure causing HUD to incur losses. The losses to HUD total approximately \$140,000.

11. Defendant DAVID C. PAUL also used false gift letters to obtain FHA-insured loans for borrowers to allow those borrowers to purchase houses at 1525 Cotton Street, 1244 Douglas Street, 1346 Greenwich Street, and 919 Perry Street, all in Reading, Pennsylvania.

12. On or about April 2, 2003, in Reading, in the Eastern District of Pennsylvania, and elsewhere, defendant

**DAVID C. PAUL**

for the purpose of executing the scheme described above, and attempting to do so, and aiding and abetting its execution, knowingly caused to be delivered to HUD by commercial interstate carrier according to the directions thereon the direct endorsement binder for the mortgage loan associated with 521 S. 15 ½ Street, Reading, Pennsylvania.

All in violation of Title 18, United States Code, Sections 1341 and 2.

**A TRUE BILL:**

  
**GRAND JURY FOREPERSON**

  
**PATRICK L. MEEHAN**  
**UNITED STATES ATTORNEY**