



3. Between 1996 and December 2009, when Connolly Properties filed for Chapter 11 bankruptcy protection, Connolly raised more than \$50 million from over 200 investors through the offer and sale of “shares” in at least 25 separate investment vehicles (“Investment Vehicles”). Connolly formed the Investment Vehicles, each of which was used for a separate offering of securities to investors and each of which purportedly employed the proceeds of the offering to acquire and manage one or more specified residential rental apartment buildings in New Jersey or Pennsylvania. Connolly drafted an “offering prospectus” for each Investment Vehicle. In each prospectus, Connolly represented that investors would receive “shares” constituting an ownership interest in the property or properties identified in the prospectus for that particular Investment Vehicle.

4. Starting at least in 2006 and continuing through 2009 (the “Relevant Period”), Connolly fraudulently induced investors to purchase interests in certain Investment Vehicles by (i) making repeated material misrepresentations to them concerning the use and segregation of investor funds within each Investment Vehicle; and (ii) concealing from investors the poor performance of prior Investment Vehicles and Connolly’s prior misuse of investor funds.

5. In prospectuses, for example, Connolly represented that funds invested in a particular Investment Vehicle would be used solely with respect to the specific property or properties for which Connolly formed that Investment Vehicle. On numerous occasions, however, Connolly used funds invested in one Investment Vehicle to purchase real estate that was the subject of a different Investment Vehicle. As a general matter, Connolly did not segregate investors’ money. Instead, he commingled it with funds related to other Investment Vehicles in a number of business bank accounts that he alone controlled. In addition, Connolly misused the improperly commingled investor money in numerous ways, including: (i) paying

purported monthly “cash flow” dividends to investors in older Investment Vehicles with funds paid by investors in newer Investment Vehicles (the classic hallmark of a Ponzi scheme); (ii) refinancing properties and using the cash proceeds for unauthorized purposes; and (iii) improperly paying himself with investor funds.

6. The scheme ultimately collapsed in 2009 when new investor funds dried up and rental income was insufficient to support payment on the mortgages. The properties owned by the Investment Vehicles were forced into foreclosure, wiping out the equity of the investors.

7. In addition, Connolly failed to register his offerings of shares in the Investment Vehicles he formed during the Relevant Period, and his offerings did not qualify for any valid exemption from the registration requirements of the federal securities laws.

#### **VIOLATIONS OF THE FEDERAL SECURITIES LAWS**

8. By virtue of the foregoing conduct and as alleged further herein, Connolly, directly or indirectly, has engaged in transactions, acts, practices, and courses of business that violated Sections 5(a), 5(c), and 17(a)(1), (2), and (3) of the Securities Act of 1933 (“Securities Act”) [15 U.S.C. §§ 77e(a), 77e(c), and 77q(a)(1), (2), and (3)] and Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. § 78j(b)] and Rules 10b-5(a), (b), and (c) [17 C.F.R. § 240.10b-5(a), (b), and (c)].

9. Unless Connolly is permanently restrained and enjoined, he will again engage in the transactions, acts, practices, and courses of business set forth in this Complaint and in transactions, acts, practices, and courses of business of similar type and object.

#### **JURISDICTION AND VENUE**

10. The Commission brings this action pursuant to Section 20 of the Securities Act [15 U.S.C. § 77t] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)]. The Commission

seeks a final judgment (a) permanently restraining and enjoining Connolly from engaging in the transactions, acts, practices, and courses of business alleged herein; (b) ordering Connolly to disgorge all ill-gotten gains with prejudgment interest thereon; (c) ordering Connolly to pay civil money penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)]; and (d) ordering such equitable and other relief as the Court deems just, appropriate or necessary for the benefit of investors [15 U.S.C. § 78u(d)(5)].

11. This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa]. Connolly, directly or indirectly, has made use of the means or instrumentalities of interstate commerce, or of the mails, in connection with the transactions, acts, practices and courses of businesses alleged herein.

12. Venue lies in the District of New Jersey pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa]. Certain of the transactions, acts, practices, and courses of business alleged herein occurred in the District of New Jersey. Specifically, Connolly engaged in the misconduct alleged herein while residing and transacting business in this District, and also maintained Connolly Properties' principal place of business in this District.

#### **DEFENDANT**

13. **Connolly**, age 50, resides in Watchung, New Jersey. At all relevant times, he was the President of Connolly Properties, a New Jersey corporation headquartered in Plainfield, New Jersey, over which he exercised complete control. Connolly and his wife each owned 50 percent of Connolly Properties. Connolly Properties filed for bankruptcy protection under Chapter 11 of

the United States Bankruptcy Code on December 22, 2009, and on September 16, 2010, the case was converted to one under Chapter 7.

**Connolly Fraudulently Solicited Investors to Buy “Shares” in Investment Vehicles**

14. From 1996 through 2009, Connolly formed a series of at least 25 Investment Vehicles for which he solicited investors, and he obtained more than \$50 million from over 200 investors in those vehicles. Beginning at least in 2006, and continuing through 2009, Connolly, directly and through Connolly Properties, made material misrepresentations and omissions, and engaged in other fraudulent conduct, in soliciting investors to buy shares in the Investment Vehicles.

15. Connolly represented to investors that each Investment Vehicle had been formed solely for the purpose of purchasing one or more specified apartment buildings in New Jersey or Pennsylvania and that investors’ money would be used solely for the purpose of making and servicing such real estate purchases. Connolly solicited investors by offering them ownership interests or “shares” in a particular Investment Vehicle in exchange for their cash investments, and some investors received certificates purportedly evidencing the number of shares they owned. The interests or shares in the Investment Vehicles that Connolly sold to investors are securities within the meaning of Section 2(a)(1) of the Securities Act [15 U.S.C. § 77(b)(1)] and Section 3(a)(10) of the Exchange Act [15 U.S.C. § 78c(a)(10)].

16. Depending on the particular Investment Vehicle’s specified real estate property or properties, investors could invest as little as \$15,000 to acquire a share in one of the Investment Vehicles.

17. The investors in the Investment Vehicles were primarily individuals (who resided throughout the United States) and small family trusts. Some of the individual investors were

retired and/or invested their IRA savings in the Investment Vehicles, and at least one investor took out home equity loans to finance the purchase of his shares. The Investment Vehicles appeared to be attractive investments because they purportedly paid dividends of 12%, 15%, or higher, while purportedly safeguarding the investors' principal investments.

18. Connolly located prospective investors through various means. A number of the investors were Connolly's friends and family. Other investors were referred to Connolly by the network of existing investors.

19. The Investment Vehicles included purported trusts, limited liability companies, and limited partnerships. Regardless of corporate form, each of the Investment Vehicles either directly owned the relevant real property or indirectly owned it (through a corresponding limited liability company or limited partnership holding company). Connolly, through Connolly Properties, managed each property.

#### **Material Misrepresentations and Omissions in the Offering Documents**

20. Connolly drafted and provided to potential investors an "offering prospectus" for each of the Investment Vehicles. Each prospectus, on its cover page, stated prominently: "Prepared by David M. Connolly Managing Partner." The prospectuses contained a number of material misrepresentations and omissions, concerning, among other things, the Investment Vehicles' use of investor funds, the vehicle's projected investment returns, the performance of prior Investment Vehicles offered by Connolly, the source of funds for dividend payments to investors, the amount of mortgage financing for the real estate held by the Investment Vehicles, and the vacancy rates of the apartment buildings being purchased by the Investment Vehicles.

##### **A. Commingling and Misuse of Investor Funds**

21. The offering prospectus for each Investment Vehicle falsely stated that the funds

invested in that Investment Vehicle would be used solely for purposes related to the real property described in the offering prospectus for that particular Investment Vehicle. In fact, Connolly repeatedly used investor funds raised for one Investment Vehicle (i) to finance, or pay expenses of, the real property held by other Investment Vehicles; (ii) to make purported “cash flow” dividend distributions to investors in other Investment Vehicles; and (iii) to enrich himself.

22. Connolly commingled investor funds and otherwise did not use them as promised in the offering prospectuses for the Investment Vehicles. Instead, Connolly repeatedly engaged in the fraudulent practice of using funds raised for one Investment Vehicle to pay for acquisitions for, and obligations of, another Investment Vehicle.

23. For example, the offering prospectus for the “Livingston Trust” Investment Vehicle (dated December 2006) represented that the vehicle was formed to acquire two buildings, one called “The Livingston,” at 1411 West Hamilton Street, Allentown, Pennsylvania, and the other called “Julian Court,” at 1521 West Union Avenue, Allentown, Pennsylvania. The prospectus alternately referred to those buildings as “the property” and “the subject property.” The offering prospectus describes 1411 West Hamilton Street as “a six story, 1920s style apartment building containing 36 units,” and 1521 West Union Avenue as a “four story apartment building containing 20 units.” The prospectus included photographs of both buildings. The prospectus also stated that there would be “thirty eight (38) shares, thirty four (34) of which may be purchased for \$50,000 [and] [e]ach share represents 2.6315% interest in the subject property.” Regarding “Use of Capital Contributions,” the offering prospectus further represented that \$1,700,000 in investor funds would be raised in the offering and that, of that amount, \$1,050,000 would be used as a down payment on the purchase of the property (30% of the \$3,500,000 purchase price of the property) and approximately \$346,882 would be applied to

closing costs, with the remaining \$303,118 “Balance Held as Contingency Reserve.”

24. The purchase of the Livingston Trust’s subject property closed on June 26, 2007, but not with the funds actually raised for the Livingston Trust. By January 11, 2007, Connolly already had spent the funds raised for the Livingston Trust to close the purchase of an entirely different property—the purported subject of the Executive Arms Trust, an earlier Investment Vehicle. But as described above, according to the Livingston Trust prospectus, funds invested in that Investment Vehicle were to be used to purchase the subject property of the Livingston Trust, not the subject property of the Executive Arms Trust or any other Investment Vehicle.

25. Likewise, the funds to purchase the subject property of the Executive Arms Trust were to come from investments in the Executive Arms Trust, not from some other Investment Vehicle. The prospectus for the Executive Arms Trust (dated August 2006) stated that the Executive Arms Trust purportedly was formed to purchase a 27-unit apartment building at 315 West 8th Street in Plainfield, New Jersey. Connolly instead used the funds raised in the Executive Arms Trust offering for other purposes, such that by January 11, 2007—the date the subject property of the Executive Arms Trust closed—Connolly had depleted virtually all funds invested in the Executive Arms Trust. Connolly closed on the subject property for the Executive Arms Trust by using investor funds that had been raised in the separate offering for the Livingston Trust (in contravention of the representations made in offering materials of both the Livingston Trust and the Executive Arms Trust).

26. Subsequently, because Connolly had misused the investor funds that he had raised in the Livingston Trust offering, Connolly furthered his fraudulent scheme by using funds raised in yet another subsequent offering of a separate Investment Vehicle (purportedly for the purchase of different property) to acquire property for the Livingston Trust. Connolly continued this chain

of misrepresentation and misappropriation such that, for each Investment Vehicle offering thereafter, the acquisition of every property by Connolly's Investment Vehicles was accomplished by using funds raised in subsequent offerings of separate Investment Vehicles. From at least late 2006, Connolly therefore knew, or at least recklessly disregarded, that the representations in the Investment Vehicle offering materials described in paragraph 23 above regarding the use of investor funds were materially false and/or misleading.

**B. Projected Investment Returns and Prior Investment Performance**

27. The offering prospectuses for each of the Investment Vehicles also misrepresented the Investment Vehicles' investment returns. The prospectuses stated that investment returns would be generated in two ways: (1) from the anticipated appreciation of the value of the subject property; and (2) from purported "cash-flow" distributions (monthly dividend payments), to be paid from the rental incomes of the subject real properties, less their operating expenses and debt service. Each offering prospectus set forth the projected cash-flow dividends (12% to 15% or higher annually, depending on the Investment Vehicle) that the subject property purportedly would support, based on the low vacancy rates anticipated (3% – 5%) and projected payments of the mortgage and operating expenses. The offering prospectuses stated that these "cash-flow" dividend distributions would be made on a monthly basis. Connolly personally prepared the projected cash-flow analyses for each offering prospectus, and he did so without consulting an accountant.

28. Connolly's presentation of projected investment returns in the offering prospectuses and other materials were materially false and misleading. Beginning in at least 2006 and continuing through at least April 2009, Connolly paid investors consistent monthly dividend distributions in amounts that far exceeded the actual cash flow from the rental income

generated by the subject properties. To cover that shortfall, Connolly engaged in an ongoing chain of fraudulent transactions, in which he continually made monthly dividend payments to investors in one Investment Vehicle by misappropriating funds from other Investment Vehicles.

29. For example, in the offering prospectus for the Grand Court Villas Trust Investment Vehicle (dated April 2008), Connolly projected a monthly dividend of 11.6% (annualized). Rather than pay a monthly dividend based on the actual cash flow from rent obtained from the Grand Court Villas property, Connolly instead consistently paid the Grand Court Villas Trust investors monthly dividend payments of exactly \$500 per share (constituting exactly a 12% annual investment return). In fact, the Grand Court Villas Trust Investment Vehicle did not produce those investment returns, and Connolly misappropriated funds from other Investment Vehicles to make those Grand Court Villas monthly dividend payments.

30. Connolly's repeated and continuous practice of misappropriating funds from one Investment Vehicle to pay monthly dividends with respect to other Investment Vehicles demonstrates that, throughout the Relevant Period, Connolly knew or at least recklessly disregarded that the Investment Vehicle prospectuses' representations during that time period—regarding their projected monthly dividends and the source of those dividends—were materially false and/or misleading.

31. Connolly made further material misrepresentations in the offering prospectuses by knowingly misstating the investment returns of prior offerings. For example, in the offering prospectus for the Grand Court Villas Trust Investment Vehicle, Connolly listed 27 previous Investment Vehicles offered to investors and the purported rate of return for each of them. The purported rates of return listed were never less than 12%, and were as high as 30% in some cases. These listed percentages were materially false and misleading because, although Connolly

consistently paid dividends in those amounts to investors in the respective Investment Vehicles, those dividend payments were not supported, and Connolly knew that they were not supported, by the actual cash flow from each of the subject properties. Rather, Connolly paid those dividends out of an undifferentiated pool of the commingled funds of the various Investment Vehicles.

### **C. Connolly's Entitlement to Compensation**

32. The offering prospectuses for the Investment Vehicles also contained false and misleading statements concerning Connolly's compensation. The offering prospectuses represented that Connolly's compensation would consist of a fixed number of shares in the Investment Vehicles (on which he, like other investors, would receive monthly dividends). The number of shares Connolly received varied from vehicle to vehicle but generally amounted to an ownership stake in the individual Investment Vehicles of approximately 6% to 12%. For example, the Grand Court Villas Trust offering prospectus stated that it would issue 44 shares, 41 of which could be purchased by investors (for \$50,000 each), and 3 of which Connolly would retain "as compensation for locating the property, forming the investment group, handling all aspects of the transaction and managing the property on an on-going basis." The prospectus specifically represented: "There is no other management fee paid." This representation was materially false and misleading because, both before and after the issuance of the Grand Court Villas Trust prospectus, Connolly routinely misappropriated investor funds for personal use, in excess of the dividends to which he purportedly was entitled. Between 2007 and 2010, Connolly wrote checks to "cash" in excess of \$2.5 million and made payments to himself of over \$2 million from the Connolly Properties bank accounts (in which he had deposited investor funds). These payments vastly exceeded the dividends to which Connolly was supposedly entitled given

his ownership stake. Moreover, even after Connolly stopped making dividend payments to investors in April 2009, he continued to pay himself dividends throughout most of the remainder of 2009. At around this time, he also started to pay himself a \$250,000 “salary” out of funds raised in offerings of Investment Vehicles.

33. By continually paying himself funds from proceeds of the Investment Vehicle offerings that greatly exceeded his appropriate share of purported dividends, Connolly knew, or at least recklessly disregarded, that the representations he made in the Investment Vehicle prospectuses during the Relevant Period concerning his compensation were materially false and/or misleading.

#### **D. Vacancy Rates**

34. In certain of the Investment Vehicle offering prospectuses, Connolly also misrepresented the purported estimates of the vacancy rates of apartments in the subject properties. The offering prospectuses generally contained estimated vacancy rates of 3% to 5%. However, the actual vacancy rates of certain of the subject properties at the time of the offering were materially higher than those estimates. For example, the offering prospectus for the Grand Court Villas Trust Investment Vehicle contained an estimated 3% vacancy rate. The actual vacancy rate at the time of that offering, however, was approximately 20%.

#### **Additional Fraudulent Conduct**

35. During the Relevant Period, Connolly furthered his fraudulent scheme by making additional material misrepresentations and omissions to existing investors to conceal his misconduct and to fraudulently induce a significant number of existing investors to invest in additional Connolly-created Investment Vehicles. Connolly’s misrepresentations provided existing investors false assurances that (i) Connolly was properly segregating their invested

funds and using them for the purposes stated in the offering prospectuses; and (ii) their investments were successful.

#### **A. Money Market Interest Earned**

36. Connolly made material misrepresentations in letters he signed and typically sent to investors (on behalf of Connolly properties) confirming receipt of their investment. In those letters, Connolly falsely represented that (i) he would open a money market account in the name of the Investment Vehicle to allow investors to earn interest on their invested funds pending the Investment Vehicles' use of those funds to purchase real estate; and (ii) investors were to receive a check constituting their proportional share of accrued interest from the date of their investment to the real estate purchase closing date. In fact, Connolly never opened, or deposited the invested funds into, any money market or interest-bearing accounts.

37. For example, the Grand Court Villas Trust investor letter, which was typical of other such investor letters, stated:

This is to confirm our receipt of your check #[Number] in the amount of \$50,000.00 for the purchase of one (1) share in the limited partnership being formed for the purchase of the above referenced property [Grand Court Villas/Trenton, NJ]. . . . Once [company formation] has been established, we will open a Money Market Account in the company's name and shift the bulk of the funds to that account. This will allow interest to be earned during the three months or so it will take to close on this transaction. Your proportionate share of the interest will be forwarded to you after closing.

38. After closing on the apartment buildings for a particular Investment Vehicle, Connolly typically sent the investors in that Investment Vehicle another letter informing them that the property had closed and enclosing a check purportedly constituting accrued interest on their share of the funds in the money market account. The Grand Court Villas Trust post-closing letter was typical of those letters and stated:

We are pleased to inform you that the closing on the purchase of the above referenced property [Grand Court Villas/Trenton, NJ] took place on Wednesday, July 23, 2008, with property ownership effective today. Enclosed please find a check for the proportionate share of interest your money earned in the money market account in which it was deposited and held from the time of receipt until the final closing date.

39. Connolly's statements in the investor letters discussed in paragraphs 37-38 above were false and misleading because Connolly never deposited the investors' money into money market accounts. Therefore, the so-called money market "interest" payments that Connolly sent investors were not interest payments at all. Rather, the money for those payments either came from later investors or was simply investors' own principal disguised as "interest" payments. During the Relevant Period, by repeatedly making these same misrepresentations to investors in successive Investment Vehicle offerings, while never opening any type of interest-earning account, Connolly knew, or at least recklessly disregarded, that the statements he made concerning the opening of money market accounts and subsequent interest payments were false and/or misleading.

#### **B. Refinancings**

40. Connolly also perpetuated his ongoing fraudulent scheme by refinancing mortgages on properties owned by certain Investment Vehicles and using the refinancing proceeds for improper purposes, such as to acquire new real estate properties on behalf of other Investment Vehicles. The improper use of investor money was concealed from investors, who neither approved nor were timely informed of the new acquisitions. Connolly also failed to disclose to investors in new Investment Vehicles that their equity might be reduced below the amounts stated in the prospectuses through refinancing or that the funds obtained in a refinancing might be used for any other purpose, including funding the acquisitions of other properties by other Investment Vehicles.

41. One such refinancing was the purchase of Carteret Arms, a 16-story apartment building at 333 West State Street in Trenton, NJ, by the Carteret Arms Trust Investment Vehicle. The Investment Vehicle purchased Carteret Arms with cash Connolly obtained by refinancing a different property, Fulton Towers, which was owned by the Fulton Towers Trust Investment Vehicle. In October 2007, Connolly refinanced Fulton Towers (which had been purchased in December 2004). On October 30, 2007, using cash from the Fulton Towers refinancing, Connolly closed on the purchase of Carteret Arms. Connolly did not disclose to the investors in the Fulton Towers Trust that he was refinancing Fulton Towers or the manner in which he was using the funds from that refinancing. Investors did not learn of either the Fulton Towers refinancing or the Carteret Arms purchase until on or about October 26, 2009, after both Fulton Towers and Carteret Arms had filed for bankruptcy. Because Carteret Arms was purchased using funds from the Fulton Towers Trust, the Fulton Towers investors should have received any income generated by Carteret Arms. But Connolly, having misappropriated these funds from Fulton Towers investors, never made any distributions to Fulton Towers investors out of the income that Carteret Arms may have generated.

### **C. Financing**

42. With respect to certain of the Investment Vehicles, Connolly also made material misrepresentations and/or omissions concerning the amount of financing that a particular Investment Vehicle would obtain to acquire the subject property. For example, the Watchung Gardens Trust Investment Vehicle offering prospectus (dated January 2007), stated that the down payment for the subject real property would be 25% of its \$7.5 million purchase price (or \$1.875 million) and that the Investment Vehicle would obtain a mortgage for the remaining 75% (\$5.625 million). The prospectus also stated that all investors would receive a “complete set of

all documents,” including “closing documents, partnership agreement and a certificate of ownership.” In subsequent letters to investors, Connolly stated “after closing, I will send you a complete package of all relevant documents for your own records . . . .” Consistent with these representations, on May 18, 2007, Connolly obtained a primary mortgage in the amount of \$5.625 million. However, contrary to the representations in the prospectus, Connolly also obtained on the same day a second mortgage of \$605,000. Also contrary to the prospectus and Connolly’s letter to investors, in June 2007, in the packet of documents that Connolly sent to investors for their records, Connolly included the first mortgage but not the second.

#### **D. Dividends**

43. Connolly’s misappropriations from the Investment Vehicles (described above) caused the vehicles to have cash-flow problems, which were exacerbated by adverse real estate market conditions starting in late 2007. Nevertheless, Connolly refused to institute necessary dividend reductions for investors in older Investment Vehicles and, instead, continued his fraudulent scheme to mislead investors and to secure future investments.

44. For example, in early 2008, when Connolly Properties’ recently-hired CFO started to review cash flow, the CFO told Connolly that the rental income generated by the properties was insufficient to support both the mortgage payments for those properties and the dividend distributions to investors at the levels provided (generally 12% or 15%). Connolly refused to reduce the dividend distributions, however, and told the CFO that investors would not want to invest more money in the future unless they received at least a 12% return. Connolly continued to solicit investors for new Investment Vehicles while misrepresenting to them the purported dividend distributions that the investments’ projected cash-flow would support.

45. Beginning in November 2008, as the Investment Vehicles were running out of

cash from rental incomes, and new investor money stopped coming in, the Investment Vehicles began missing their promised investor dividend payments. The Investment Vehicles initially missed dividend distributions to investors in November 2008 and again in March and April 2009, although they made up these distributions shortly thereafter. In communications with investors, Connolly falsely blamed purported bank processing errors for the missed dividend payments. In fact, as Connolly knew or recklessly disregarded at the time, the Investment Vehicles missed their purported dividend payments because they lacked sufficient funds to pay them. The last dividend payments made to investors in any of the Investment Vehicles were the April 2009 dividends, which were not actually paid until May and/or June 2009. In any event, as alleged above, the purported dividend payments did not represent actual cash-flow from the subject properties.

#### **E. Security of the Investments**

46. Beginning in February 2009, the Investment Vehicles started missing multiple mortgage payments on their properties. Those missed mortgage payments put the properties at risk of foreclosure and/or other penalties. Connolly not only failed to disclose to investors the existence of those missed mortgage payments, but he made affirmative misrepresentations to them regarding this subject. For example, in a June 6, 2009, e-mail message responding to a concerned investor, Connolly wrote:

I appreciate your concerns as expressed in this email and I hope to address them here in order to put your mind at least somewhat at ease. While we have experienced a downturn in collections and leasing overall in the last couple of months, we remain current with our mortgage payments and our investors are not at risk of losing their investments.

47. Connolly knew at the time that he sent this e-mail message that his assertions were false. At the time, the mortgage payments had not been made with respect to the subject

properties of a number of the Investment Vehicles, including at least one of the Investment Vehicles in which the investor who wrote the e-mail message had invested. Connolly also knowingly, or at least recklessly, misrepresented that the investors were not at risk of losing their investments.

48. In a June 26, 2009, e-mail message to this same investor, Connolly further falsely stated that funds were segregated and not commingled with investor money in other Investment Vehicles. Connolly wrote:

You are correct that each property (or in some cases portfolio of properties) is held by a single purpose entity. We do account for the monthly/annual revenues, expenses and investor distributions individually by property. They are not pooled together.

49. This statement was false, and Connolly knew it was false. As previously described, Connolly for years had been commingling the funds related to the different properties and Investment Vehicles. This statement compounded the misrepresentations that Connolly had made in the various offering documents for the Investment Vehicles in the Relevant Period.

#### **The Marshall Woods and Hampshire Court Offerings**

50. Connolly's solicitation of investors for the Marshall Woods and Hampshire Court Investment Vehicles is another example of Connolly's intentional material misrepresentations and omissions and other conduct that defrauded investors. In 2008, Connolly identified Marshall Woods, a 305-unit apartment complex in Norristown, Pennsylvania, as a potential investment. Connolly drafted an offering prospectus for Marshall Woods LP (dated May 2008) and, over the summer and fall of 2008, raised approximately \$8 million from investors in the offering. In or around the same time period, Connolly separately raised approximately \$1.3 million from investors in an offering by the Hampshire Court, LLC, Investment Vehicle (offering prospectus dated November 2008). Marshall Woods and Hampshire Court both failed to close on their

subject properties. Nevertheless, by the end of 2008, Connolly had spent or otherwise misused nearly all of the \$9.3 million of investor money that he had raised in the Marshall Woods and Hampshire Court offerings.

51. At the end of January 2009, Connolly began making purported cash-flow dividend payments to investors in the Marshall Woods offering, despite the fact that he had not closed on the property and, therefore, had no rental income from that property to support such payments. When questioned about the purported dividend payments by at least one investor, Connolly falsely told him that the dividend payments came from a “slush fund” he had created for the investment. In fact, Connolly never created such a “slush fund.” Rather, the purported dividend payments came from the general pool of commingled funds that included funds of other Investment Vehicles.

52. In April 2009, Connolly informed the Marshall Woods investors that he would use their invested funds to purchase a different property, Newport Village, a 182-apartment complex in Eastern Pennsylvania. Connolly prepared and sent investors a new offering prospectus for the Newport Village, LP, Investment Vehicle (dated April 2009), but he did not offer investors the opportunity to opt out of the replacement investment. Connolly also failed to close on this new property.

53. In the spring and summer of 2009, several investors in the Marshall Woods and the Hampshire Court offerings requested that Connolly return their invested money. Although Connolly returned funds to a select few investors, he was unable to return most investors’ money because he had misappropriated it and used it for improper purposes.

54. In August 2009, to conceal his misappropriation of investor money, Connolly engaged in an additional fraud involving an undisclosed self-dealing transaction. Connolly

falsely told investors that he was using their funds to purchase yet another investment property, called Hillside Valley (which was new construction, rather than an existing apartment building). In a letter to investors dated August 4, 2009, describing the investment, and in an offering prospectus for the Hillside Valley Investment Trust, Connolly knowingly, or at least recklessly, made numerous material misrepresentations and omissions.

55. The Hillside Valley property was a business venture that Connolly had earlier undertaken with a business partner, in which they each held 50% ownership interests. In 2007, Connolly had purchased the land for approximately \$1 million, using money that Connolly had misappropriated from one of the other Investment Vehicles. On July 27, 2009, Connolly increased his ownership interest in the Hillside Valley project to 88% and then transferred a 78% interest in the project to the investors in Marshall Woods/Newport Village and Hampshire Court Investment Vehicles.

56. Connolly misrepresented and misled investors about the use of investor funds and his ownership interest in the Hillside Valley project. For example, in his August 4, 2009, letter to investors, Connolly falsely wrote: "In the last few days I have recovered the escrow and deposit monies on the above deals [Marshall Woods, Newport Village, Hampshire Court, and West Seventh Street Associates] and seized an opportunity on behalf of the investors in all projects." Connolly further falsely stated that he owned a small minority interest (10%) in Hillside Valley, that he was able to obtain this investment "prior to the sale to an outside buyer," and that he promised to reimburse any investor who did not want to proceed with the investment. These statements were materially false and misleading. As Connolly knew or recklessly disregarded, he did not "recover" any "escrow or deposit funds," as he already had used that money for other purposes. Connolly also failed to disclose to investors that he had transferred

his personal interest in Hillside Valley to them and that, in fact, he was unable to reimburse most investors. The offering prospectus that Connolly drafted and sent to investors repeated, and/or did not correct, the material misrepresentations and omissions that Connolly made in his August 4 letter.

### **Connolly's Scheme Collapsed**

57. In 2009, Connolly's scheme unraveled as new investor funds dried up and rental income was insufficient to support even payment on the mortgages. In June and July 2009, several banks initiated foreclosure proceedings against the Investment Vehicles (and/or related holding companies) that owned the properties for which mortgage payments had been missed. Ultimately, all or nearly all of the Investment Vehicles defaulted on the mortgage loans for their respective subject properties.

58. Beginning in August and September 2009, bankruptcy proceedings were initiated for all or nearly all of those Investment Vehicles and/or related holding companies, wiping out the equity of the investors. Connolly Properties itself filed for bankruptcy on December 22, 2009.

### **Connolly Failed to Register the Offerings and to Provide Required Financial Information**

59. Connolly failed to register any of the offerings of shares in the Investment Vehicles that he formed during the Relevant Period, and those offerings did not qualify for any valid exemption from the registration requirements of the federal securities laws. As a result, investors were unlawfully deprived of the disclosures mandated by law for publicly issued securities. Notably, Connolly did not provide investors with audited financial statements for the Investment Vehicles, and no such audited financials were ever prepared. For most of the Relevant Period, Connolly also did not provide to investors unaudited financial statements.

Moreover, those financial statements that Connolly did provide were materially false and misleading because, among other things, they did not disclose Connolly's commingling and misuse of investor funds described in paragraphs 21-26 above.

**FIRST CLAIM**  
**Violations of Sections 5(a) and 5(c) of the Securities Act**

60. Paragraphs 1 through 59 are re-alleged and incorporated by reference as if fully set forth herein.

61. Connolly, directly or indirectly, has made use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer and sell securities through the use or medium of a prospectus or otherwise when no registration statement has been filed or was in effect as to such securities.

62. By reason of the foregoing, Connolly, directly or indirectly, violated, and unless enjoined will again violate, Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

**SECOND CLAIM**  
**Violations of Sections 17(a)(1), (2), and (3) of the Securities Act**

63. Paragraphs 1 through 62 are re-alleged and incorporated by reference as if fully set forth herein.

64. Connolly, directly or indirectly, by the use of means or instruments of transportation or communication in interstate commerce or by use of the mails, in the offer or sale of securities of the Investment Vehicles, has: (a) employed devices, schemes or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading; and/or (c) engaged in transactions,

practices, or courses of business which operated or would operate as a fraud or deceit upon the purchaser.

65. The misrepresentations and omissions described in paragraphs 4-5, 14-15, 17, 20-54, 56 and 59 were material, and Connolly knew or recklessly disregarded that the misrepresentations and omissions were false and misleading.

66. By reason of the foregoing, Connolly violated, and unless enjoined will again violate, Sections 17(a)(1), (2), and (3) of the Securities Act [15 U.S.C. §§ 77q(a)(1), (2), and (3)].

### **THIRD CLAIM**

#### **Violations of Section 10(b) of the Exchange Act and Rules 10b-5(a), (b), and (c)**

67. Paragraphs 1 through 66 are re-alleged and incorporated by reference as if fully set forth herein.

68. Connolly, directly or indirectly, by use of means or instrumentalities of interstate commerce, or of the mails, or of the facilities of a national securities exchange, in connection with the purchase or sale of securities of the Investment Vehicles, knowingly or recklessly: (a) employed devices, schemes or artifices to defraud; (b) made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and/or (c) engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon other persons.

69. The misrepresentations and omissions described in paragraphs 4-5, 14-15, 17, 20-54, 56 and 59 were material, and Connolly knew or recklessly disregarded that the misrepresentations and omissions were false and misleading.

70. By reason of the foregoing, Connolly violated, and unless enjoined will again

violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rules 10b-5(a), (b), and (c) [17 C.F.R. § 240.10b-5(a), (b), and (c)] thereunder.

### **PRAYER FOR RELIEF**

**WHEREFORE**, the Commission respectfully requests that this Court issue a Final Judgment:

#### **I.**

Permanently enjoining and restraining Connolly and his agents, servants, employees, attorneys, and all persons in active concert or participation with him who receive actual notice of the injunction by personal service or otherwise, and each of them, from directly or indirectly violating Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)], Sections 17(a)(1), (2), and (3) of the Securities Act [15 U.S.C. § 77q(a)(1), (2), and (3)], and Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rules 10b-5(a), (b), and (c) [17 C.F.R. § 240.10b-5(a), (b), and (c)] thereunder.

#### **II.**

Ordering Connolly to disgorge all ill-gotten gains received directly or indirectly as a result of the violative conduct alleged in this Complaint, and to pay prejudgment interest thereon.

#### **III.**

Ordering Connolly to pay civil money penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

IV.

Granting such other and further relief as the Court deems just and proper.

Dated: New York, NY  
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