BANKING ON SOMETHING NEW: THE EB-5 ALTERNATIVE TO TRADITIONAL BANK FINANCING

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INTRODUCTION

Since our last review of the state of the EB-5 Program last winter, EB-5 Regional Centers remain a hot topic in property development spheres as traditional sources of capital continue to disappear. The program is steadily proving to be a "win-win" for developers looking for a viable alternative to traditional modes of financing. The Program is undergoing significant modernization and procedural streamlining that is capturing the attention of many. Through EB-5, (short for the fifth preference employment based category for immigrant investors), developers are able to fund projects with foreign investment capital. Congress created the program—known as the EB-5 Regional Center Pilot Program—in 1992 to attract foreign entrepreneurs who would invest substantial sums in the United States and stimulate the economy through job creation. The program allows foreign investors and their immediate family to receive conditional green cards upon the investment of one million dollars (or $500,000 into a "targeted employment area") into a U.S. project that creates at least 10 full-time jobs. The program has attracted more than a billion of dollars in capital investments and has helped create tens of thousands of jobs across the country.[1]

THE GOOD AND THE BAD OF EB-5

The cost of financing through EB-5 is much less than traditional funding. Developers have found great measures of success by organizing EB-5 Regional Centers to fund their projects. But not all regional centers are created equal. There are certainly horror stories of failed projects, but when looking into the causes for failure, it was really no surprise. Some failed projects allowed impermissible returns of investment contrary to the immigration laws. Others attempted to skirt requirements that the investor's capital investment truly be at full risk of loss. Others still failed to create a "new commercial enterprise" within the meaning of EB-5 law, a vital prerequisite to receiving investors' funds.

Some projects currently waiting to break ground, however, have success written all over them. So what is the difference between a regional center that works and one that doesn't? In addition to adhering to EB-5 law, a sound EB-5 investment presents a business plan and overall business concept that makes sense and demonstrates that it will have a good market and investor demand. Successful projects have included a variety of single and mixed-use commercial projects. Passive investments in real estate and residential development are not conducive to funding through the EB-5 Program. The successful project will demonstrate its ability to create at least ten full time jobs per investor within the two-year limit. The successful project will also

[1] According to USCIS estimates, as of June 30, 2011, the EB-5 Program has resulted in more than $1.5 billion in capital investments and created at least 34,000 jobs.

have a capital structure demonstrating a balanced mix of developer equity and EB-5 monies. The project should present a viable exit strategy that provides a reasonable means for the foreign investor to receive a return on the investment. Vitally, the successful project will have an experienced management and development team guided by experienced EB-5 immigration counsel.

REGIONAL CENTERS AND THE KEYS TO SUCCESS

The EB-5 Regional Center Pilot Program advances economic growth and job creation by encouraging foreign investors to invest funds in an economic unit known as a "regional center." A regional center has no prescribed form. Most are LLCs. To form a regional center, a promoter presents a proposal to the United States Citizenship and Immigration Services (USCIS). If the USCIS finds that the plan will benefit the proposed geographic area and shows potential for providing significant employment, the entity will be designated a Regional Center. But what exactly is a regional center? Regional centers are the mechanism that allows the developer to pool immigrant investors' resources to have a larger positive impact on the economy. This designation allows the entity to propose development projects for foreign nationals who seek to immigrate to the United States through investments in projects within the center's geographic boundaries. In order to become a USCIS-approved regional center, the organizers seeking the regional center designation from USCIS must submit a proposal showing:

1. How the regional center plans to achieve the required economic growth within its regional area;
2. That the regional center's business plan is a viable business model grounded in reasonable and credible estimates;
3. How jobs will be created directly or indirectly in accordance with the regional center's business plan; and
4. The amount and source of capital committed to the project and the promotional efforts made and planned for the project.

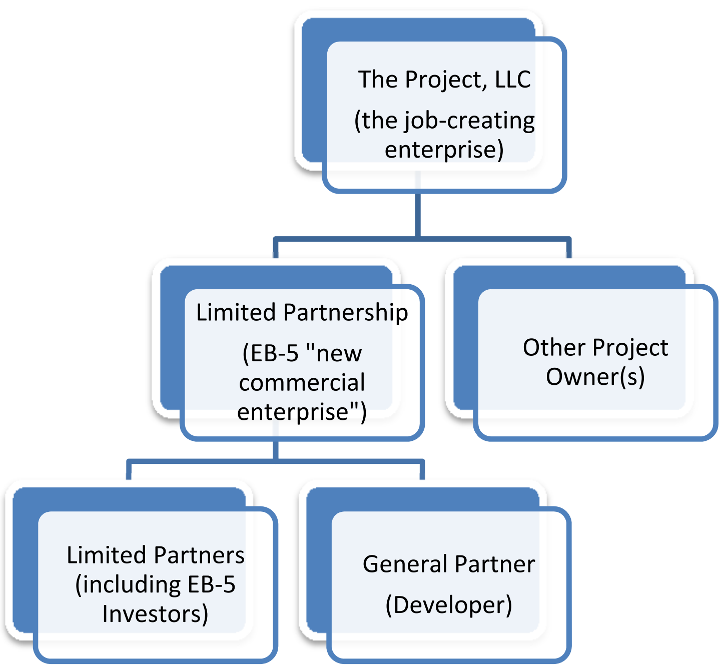
The regional center proposal materials must also be submitted with business plans and an economic analysis for a project that is either (1) "shovel-ready" or (2) a feasible project that is not quite shovel ready (an "exemplar"). Materials submitted to USCIS for a shovel-ready project must also include the actual capital investment structure and because the offered investment constitutes a securities offering, the actual offering documents.

THE REGIONAL CENTER INVESTMENT STRUCTURE

There are a variety of ways to structure a Regional Center. In a typical structure, investors are offered the opportunity to purchase a Limited Partnership interest in the new commercial enterprise within the Regional Center. As a Limited Partner, the investor receives all the rights and obligations entitled under the Uniform Limited Partnership Act of the particular state where the investment is made and takes an equity interest in an actual business. The exit strategy for this project is initiated when the majority of partners elect to dissolve the partnership. In the other typical structure, the investor purchases a Limited Partnership interest, which in turn makes a loan to finance the job-creating project. The exit plan under the loan model begins when the loan reaches maturity, usually about five years.

Without a Limited Partnership arrangement, it would be difficult, if not impossible, for a group of EB-5 investors to participate in large EB-5 projects. Without the presence and participation of a General Partner and the structures imposed by a Limited Partnership, nothing would get accomplished. This, therefore, is the common practice in commercial settings. Rights of Limited Partners are, in fact, limited, and the EB-5 law specifically acknowledges the validity of such arrangements. If a foreign investor's objective is to direct and control his or her own majority share in a new commercial enterprise, that investor is better off steering away from the Regional Center Program and pursue another avenue to obtaining green card status.

Sample EB-5 Project Ownership Structure with Limited Partnership Arrangement



Finally, in terms of structuring EB-5 investments, it is important to note that in its current form, the EB-5 program does not allow for indirect investment through an investment company that relies on the crediting of jobs in businesses that are not wholly owned by the new commercial enterprise. This is due to the fact that job creation can only be credited through the creation or preservation of jobs that are directly within the commercial enterprise in which the EB-5 Investor made his or her investment. Accordingly, such "true" diversification of funds is beyond the EB-5's scope.

THE INVESTOR'S PERSPECTIVE

The foreign investor will carefully evaluate approved regional centers and projects, and invest through the regional center that will best allow him to meet his requirements under the EB-5 law. To meet his obligations under the law, the EB-5 investor must show that he:

1. Has created a "new commercial enterprise." Investing into a project within a USCIS-approved regional center as a limited partner satisfies this requirement.
2. Has made a capital investment of $1 million (or $500,000 into a "TEA") that is at risk of total loss, fully committed for two years, and shown to be from a lawful source.
3. Will create 10 full time jobs with the investment capital within 2 years of making the investment.

If the investor's application meets these requirements and is approved, the investor is granted conditional permanent resident status for two years while the investor's investment goes to work. After this period, the investor may petition to become an unconditional lawful permanent resident of the United States.

HOW REGIONAL CENTERS COUNT JOBS CREATED BY THE PROJECT

The Developer wants successful finance of the project, and the foreign investor wants a sound investment that creates enough jobs to remove the conditions on his green card. The most important feature of the Regional Center Pilot Program is that foreign investors in regional centers are credited with jobs created directly *or* indirectly as a result of their investment. Direct jobs are those employees actually employed by the project, such as the so-called "W-2 employees." Indirect jobs are the jobs created in other businesses in the greater community as a result of the investment. Indirect jobs are counted using a "reasonable" economic methodology that shows a correlation between the investment and the indirect jobs.

An experienced EB-5 economist calculates the indirect job-count. Although several indirect job-counting methodologies exist, economists will typically utilize a methodology known as "RIMS II." RIMS II is a transparent and cost-effective way to estimate the economic impacts of the developer's project in a regional economy, including the number of indirect jobs that will be created, which, as we've discussed, is the all-important category for EB-5. Using RIMS II, one way that that indirect job creation can be estimated is based on the amount of gross revenue earned by the project. Thus, if the project's actual revenue is the same or greater than the estimated revenues in the approved business plan and economic analysis, then the number of indirect jobs predicted will be deemed to have been created.

Another common question is whether construction jobs can be counted for EB-5 purposes. The answer is that indirect jobs resulting from construction activity can always be counted. Thus, similar to the revenue model, if the amount of hard construction expenditures matches the estimates in the approved business plan and economic analysis, then the estimated jobs number will be deemed created. These jobs are calculated by the amount of construction costs. Direct construction jobs count for EB-5 purposes as long as the position will last *continuously* for at least two years.

REDUCING THE INVESTMENT THRESHOLD: THE TARGETED EMPLOYMENT AREA

The lower the threshold investment is, the greater the number of investors that can be attracted to a project becomes, and the greater the ease of raising the necessary capital. Most Regional Center investors in fact do take advantage of the lowered $500,000 investment threshold for targeted employment areas (either through a debt or equity arrangement discussed above) by investing into a "job-creating" business that is located in a targeted employment area ("TEA") within the approved geographic boundaries of a Regional Center.

A TEA is an area which is either a high unemployment area or a rural area. A high unemployment area is an area with an unemployment rate that is at least 150% of the national average. A rural area is any area outside a metropolitan statistical area (as designated by the Office of Management and Budget) or outside the boundary of any city or town having a population of 20,000 or more according to the decennial census. The new commercial enterprise must be "principally doing business" in a targeted employment area. If the new commercial enterprise lends capital to other job-creating businesses, it must only lend money to businesses located within TEAs. Direct expenditures of capital by the new commercial enterprise should be principally within a TEA.

A BRIGHT FUTURE – USCIS MAKES THE PROGRAM EASIER TO UTILIZE

EB-5 Regional Centers are becoming the magnet for inward investment that Congress intended them to be. Recognizing the program's massive potential for even greater investment and job-creation, USCIS Director Alejandro Mayorkas has become significantly involved with the streamlining of EB-5. On May 19, 2011 USCIS rolled out a proposal indicating that they intend to streamline the process for organizers of regional centers and for foreign investors by accelerating their respective application processes—the agency anticipates that the current processing time of approximately four (or more) months for the developer's and investors' respective applications can be reduced to as little as 15 days for shovel-ready projects.

Other initiatives within the proposal include opening direct lines of communication between the applicants and USCIS, and providing applicants with the opportunity for an interview before a USCIS panel of experts to resolve outstanding issues in an application. After reviewing stakeholder feedback on the proposal, USCIS is developing a phased plan to roll out these enhancements and is poised to begin implementing the first of these enhancements before year's end. Such positive developments are leading the way to a modernized program that will efficiently serve the dual roles as an accessible, inexpensive source of funding for developers' projects and as a job creation engine benefiting the entire United States.

SUMMARY/CONCLUSION

The EB-5 Regional Center Pilot Program is a win-win for developers and foreign investors alike. Besides the Program's utility as a low-cost means of finance in times where bank financing is often unavailable, it is the fastest way for the foreign investor to obtain a green card and U.S. citizenship, as there is no waiting list or quota backlogs that exist in other visa programs. The EB-5 law sets aside 10,000 visas each year for foreign investors who invest one million dollars into a U.S. business. The new enterprise must benefit the United States economy and create at least ten full-time jobs. The investor must invest one million dollars into the business, or, one-half million dollars is sufficient under the law if the investment is in a "targeted employment" area. A targeted employment area which is either rural or has experienced unemployment of at least 150 percent of the national average rate. We are likely to see the continued expansion of the EB-5 Regional Center Pilot Program as developers realize the financial benefits of foreign capital over bank financing. Furthermore, foreign investors benefit from the program as a path to the green card, and citizens enjoy the creation of much needed jobs.

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