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Client Alert

The EB-5 Program

Background

In 1992, Congress enacted the Immigrant Investor Pilot Program, commonly known as the "EB-5 Program," to stimulate the U.S. economy through job creation in distressed and rural areas and capital investment in U.S. businesses by foreign investors ("Investors"). In exchange for investing in businesses that create jobs in the U.S., these Investors and their families can become permanent residents of the U.S. The EB-5 Program is administered by the United States Citizenship and Immigration Services (the "USCIS").

While the EB-5 Program has been around for over 20 years, it only recently has become an important source of equity and debt capital for new construction. It was after the recession, when securing loans from traditional lenders became difficult, that developers began using the Program with greater frequency to raise money for their projects. Indeed, the EB-5 Program has been implemented by developers in the New York real estate market. In fiscal year 2013, the most recent year for which numbers are available, investments in the EB-5 Program in New York State (mostly New York City) totaled \$379 million or 19% of the total investments in the Program nationwide (second only to California, which makes up 22%).

How the EB-5 Program Works

There are currently two ways for a foreigner to become an Investor and obtain an EB-5 visa: either by (a) making a direct investment in a new or existing commercial enterprise that creates or preserves jobs; or (b) investing capital through a "Regional Center," that is a government-approved firm that actively manages Investor funds and the immigration approval process. Regardless of which option an Investor chooses, his or her investment must be for not less than \$1,000,000 unless the commercial enterprise in which he invests is located in a Targeted Employment Area (a "TEA"), [1] in which case, the minimum investment amount drops to \$500,000. In return for this investment, the Investor including the Investor's family [2] (as defined) receives a "green card" on an expedited basis, authorizing him or her to live in the United States as a permanent resident.

Generally, an Investor is not required to actively manage the business, but is required to play an "active role" in the business. This requirement typically is satisfied by becoming a limited partner in a limited partnership or a member in a limited liability company that conducts the job-creating enterprise.

In addition to being located in a TEA, the project must create 10 new jobs per Investor and either must be a newly developed project or an existing project where the equity value has suffered a decline of more than

20 % of the net worth of the project prior to the loss. The Investor must be at risk with respect to the investment and generally the investment must be for a 5-year period. For the most part, Investors do not make these investments to achieve a meaningful return on their investments--typically, they earn less than 1% of their investments--but rather, they invest to procure a "green card" on an expedited basis. Developers are eager to access the EB-5 Program because it is cheaper than many other financing sources.

For all practical purposes, there are few \$1 million minimum deals (non-TEAs). An Investor just as easily can invest only \$500,000 (in a TEA) and receive the same benefits with fewer dollars at risk. The determination of TEA status is made on the state level. Most states create a TEA to induce investments that will create jobs. They do this by merging a census tract that does not qualify as a TEA with other contiguous census tracts, so the average of the merged census tracts exceeds 150% of the NUA. For example, in New York City, by merging contiguous census tracts, Pacific Park Brooklyn, which is on the border of wealthy brownstone Brooklyn neighborhoods, relied on high unemployment figures from areas of Crown Heights and Bedford-Stuyvesant in order to be eligible under the EB-5 Program.

An EB-5 investment must be at risk; it cannot have guaranteed repayments or returns. Today, there is a tendency to move to investments with perceived lower risk; and therefore, Investors are investing in lower-risk debt. Because of the requirement to create 10 new "permanent, full-time" jobs for every \$500,000 invested in a TEA, EB-5 investments are unlikely to be invested in multi-family or single family projects as they are not labor intensive. Lately, EB-5 investments have been made primarily in real estate first mortgages or mezzanine loans in full service hotels and senior housing facilities that provide services.

Often, money is raised by a Regional Center^[3] or by EB-5 syndicators who enter into agreements to "rent" the Regional Center. The syndicators raise the money by paying a fee to the Regional Center, and indemnifying the Regional Center against certain risks. The Regional Center or syndicator agrees to proceed with the project generally with a term sheet accepted by the developer. The Regional Center or syndicator then secures a study from a labor economist who, based upon on criteria established by the USCIS, determines the number of direct and indirect jobs that will be created. The reason almost all EB-5 investments are made through Regional Centers is that if the investments are made through a Regional Center, then in addition to direct jobs, induced or indirect jobs also are included, as measured by econometric models approved by USCIS. On the other hand, if investments are made directly into a project rather than through a Regional Center, only direct jobs "count."

Case Study

This is an example of a project in which our Firm is acting as counsel to the developer on a project located in Ft. Lauderdale, FL, that will use EB-5 mezzanine financing. It will have 127 units of assisted and memory care and will cost approximately \$25 million. According to the labor economist study, 286 direct and indirect jobs will be created. (For EB-5 purposes, job count is rounded down to the nearest 10, so 286 jobs becomes 280 jobs.) This level of job creation will support an investment of \$14,000,000 (280 jobs divided by 10 per Investor equals 28 Investors multiplied by \$500,000). ($280/10 = 28$; $28 \times \$500,000 = \$14,000,000$). EB-5 syndicators often raise less than the total amount that could be supported to allow for a margin of error in the job count when the investment is recalculated by USCIS after two years. In this example, the EB-5 syndicator felt comfortable raising \$12 million. The developer itself invested \$2.75 million (most syndicators doing mezzanine investing want a cushion of 10-15% equity behind them). Here, the syndicator will have 19.64% equity behind it. In this EB-5 Project, approximately \$10.25 million of senior debt will have to be raised.

The Approval Process

The process for getting approval for an EB-5 Project is arduous, currently taking nine months or more. The initial approval is a "qualified" approval that has a two year duration. At the end of the two years, it is reevaluated by the USCIS to insure that the project has generated the jobs indicated in the initial job study. One of the principal factors making the approval process difficult is that it generally takes the syndicator over nine months to secure the investment and get the USCIS to qualify the Investor. As a result, developers are required to secure the property in which the investment will be made with no assurance that the syndicator will succeed in raising the money. Many syndicators have the ability to release the money before final

approval from the USCIS and some have arranged bridge financing based upon the equity before it has been approved by the USCIS.

Conclusion

The EB-5 Program is an effective, less costly method of securing financing for qualifying projects. The competition for funding is increasing. Because of the complexity of the regulations pertaining to EB-5 investments, persons seeking such financing should make certain to work with an experienced, successful syndicator or Regional Center, as well as counsel having knowledge and experience with the laws and regulations governing these investments.

If you have any questions relating to EB-5 investments or the EB-5 Program in general, please contact Michael Zukerman, any of the undersigned, or your regular Warsaw Burstein attorney.

[1] A TEA is defined by the USCIS as a rural area or an area with more than 150% of the National Unemployment Average (the "NUA"). The NUA presently is approximately 5.7%, so to qualify as a TEA, the area must have an unemployment rate of approximately 8.5%.

[2] Under the EB-5 Program, the family of an Investor, including any dependent under age 21, can apply for a green card, and each family member is counted towards the quota of visas.

[3] A Regional Center is defined as any economic unit, public or private, engaged in the promotion of economic growth, improved regional productivity, job creation and increased domestic capital investment.

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