Outlook: The new rules for developers raising inexpensive capital with EB-5 financing for hotel, hotel condo and mixed-use development projects

08 December 2015

Click here for the latest articles on EB-5 Financing.

Editor's note: The EB-5 program has been renewed! The article below describes the changes to the EB-5 Immigrant Investor Visa program that were ALMOST enacted in December 2015. At the eleventh hour, Congress completely shelved all the proposals discussed below, and instead decided to continue the program, without any change, through September 15, 2016.

Hotel Lawyer preview of the new EB-5 financing rules.

Although minor tweaks and adjustments continue to be made to legislation in the final hours before Congress votes, it looks like we have a pretty good idea of what the new rules will be for EB-5 financing. Top takeaways for developers are:

- The EB-5 regional center program will be extended for 5 years
- Developers will be able to raise 60% more EB-5 capital on the same number of jobs
- Minimum investment will be raised to $800,000 (not expected to deter investors)
- TEAs will be forced into a “modified California model” of not more than 12 contiguous tracts
- NOW is a good time to get started on EB-5 financing before the New Year rush
- There will be much greater scrutiny and compliance required of those in the capital raising process, and there may be a trickle-down effect on developers (unless they want to form and use their own regional center)

Read on for more details.

What is all the talk about EB-5 and the new legislation?

EB-5 is a program administered by the United States Citizenship and Immigration Service (USCIS). It is sometimes referred to as the “EB-5 Program” or the “Immigrant Investor Program.” It was created by Congress in 1990 to stimulate the US economy through job creation and capital investment by foreign investors. In essence, it offers foreign aliens a fast track to obtain a US green card, provided they invest a minimum amount of capital which creates at least 10 new jobs for US citizens per alien investor. The program offers a maximum of 10,000 visas per year which represents less than 1% of the total annual immigration to the United States.

Although the program was authorized almost 25 years ago, the EB-5 program was not a serious source of capital until 2010 and 2011, when the economy slowly recovered from the Great Recession and developers found a shortage of traditional bank loans for new development. Since then, use of the program has exploded. It is being used by major institutional players for significant development projects and reached its cap of 10,000 visas before the end of the fiscal year in each of the last two fiscal years, prompting many to hope that Congress would authorize more visas for the program, or accomplish a similar result by counting only the visas granted to each investor (and not those of the investor’s
spouse or children).

JMBM and its Global Hospitality Group® were “early adoptors” in helping developer-clients tap into the EB-5 program to raise capital for new construction projects — particularly for hotels, resorts and mixed use projects. As the Regional Center element of the program approached its “sunset” by expiration of its Congressional authorization, we have actively participated with the IIUSA in the dialog with Congress on revising and extending the EB-5 program.

Subject to final tweaks, it now appears that the final format for the EB-5 legislation has been set, and it is expected to be adopted on December 11, 2015 as part of the omnibus appropriations bill.

It is always perilous to “assume” or predict anything about legislation until the final votes have been counted, but as of now, most knowledgeable industry experts and political commentators believe we know what the final outcome will be. Subject to those changes, this article provides a preview of the practical impact that the new rules for EB-5 will have on development projects.

If you want to know more about EB-5, please click here to see a number of articles that cover the basics of EB-5 and also discuss many of the more advanced issues. If you want the detailed section-by-section analysis of the new law and all the minutia about immigration and security processing, please look to immigration publications.

This article is focused on the practical aspects of the new rules for EB-5 for serious developers of hotels and other commercial real estate projects.

A preview of what every developer should know about major changes in the rules for raising capital with EB-5.

The following preview of practical consequences of the new legislation is based upon our personal experience over the years, discussions with other industry experts, and participation in the long process that has led up to this point in the re-authorization of the EB-5 program. We have carefully reviewed what is widely believed to be the “final draft” of the legislation.

Obviously, this preview assumes that the draft of the law we have analyzed will be enacted as part of the omnibus appropriations on December 11, 2015 or thereabouts. Before you take any action regarding these preliminary thoughts, you should confirm with us or other knowledgeable industry experts that the legislation has been enacted as envisioned, and that nothing has altered this preliminary assessment.

With that “fine print” out of the way, here are our picks for the “top 6” practical implications of the new EB-5 legislation for real estate developers:

1. The critical Regional Center program is extended through September 30, 2020. This five year extension is great news for the EB-5 program and developers.

2. The minimum investment threshold for alien investors has been raised from $500,000 to $800,000. The non-TEA investment remains at $1 million. Our sources do not expect the new $800,000 minimum investment to have any significant impact on investor interest, and they believe that the reduced “delta” between the new
minimum investment of $800,000 and the continued non-TEA investment of $1 million, will reduce the importance of a project being in a TEA. In other words, they think that with this reduced spread, more investors will be willing to pay $1 million. In any event, this change means that even with the minimum investment of $800,000, a developer will be able to raise 60% more money with the same number of investors. For example, old rules that prevailed until late 2015, 10 investors would be required to put up a minimum of $5 million assuming their project was in a TEA. Under the new rules effective December 2015, the minimum investment for these 10 investors would be $8 million. This is a very significant advantage.

3. **The number of visas allocated for the EB-5 program remains 10,000 visas per fiscal year.** The visas granted to the investor, the investor's spouse and children all count against this 10,000 visa limit. The average number of visas per investor is approximately 2.5. While the hoped-for increase in visas was not made, a developer can now raise at least 60% more capital for each project using the minimum EB-5 investment (now $800,000 instead of $500,000). And if the $1 million investments become more popular (because of the much smaller delta between the $800,000 minimum and $1 million standard), then the increased capital raise will be even more significant.

4. **The standards for determining a TEA (Targeted Employment Area) have essentially adopted a modified California model** (with up to 12 contiguous census tracts) to determine what qualifies as a TEA. However, ultimate authority rests with the USCIS to accept or reject a TEA designation. Only projects located in a TEA can qualify for the lowest $800,000 investment, and a 20% priority of the visas under the program is allocated for TEA projects and for government infrastructure projects.

5. **Effective dates for provisions of the EB-5 program vary** and may be critical to significant business decisions in each deal. Importantly, the new $800,000 minimum investment (available only in TEAs and for government infrastructure projects) will be effective immediately upon adoption/effectiveness of the legislation. Essentially, this will mean that if an investor has already made his $500,000 investment in a project, he will not be required to increase that investment. Similarly, any investor making a new investment after the effective date must invest at least the new $800,000 minimum. This will mean that projects currently in the process of being sold will need a “sticker amendment” stating that the minimum investment has been increased from $500,000 to $800,000. There is still some last-minute talk about a “phase-in” of the new $800,000 minimum investment requirement over a 90 day period or some other relatively short period of time.

6. **There is a new direct investment requirement for each project** — the direct jobs must be at least 10% of the total job creation, and indirect jobs cannot exceed 90% of the total jobs. One of the critical areas we counsel clients about is structuring their offering to optimize the amount of capital they can raise, and making the most advantageous presentation of this situation to the lender and the investors. We do not believe this new requirement would have limited or adversely affected any of the deals we have worked on to date or the models our team use. But is it a new item for compliance on the new checklist. **Other implications may be important too!**

Importance of particular legislative changes will vary depending upon your specific role and goals. But after our “top 6” considerations above, we think industry stakeholders will also find the balance of our baker’s dozen to be important:

7. **Tenant occupancy.** The new legislation contains an express provision authorizing the USCIS to include in the jobs count those jobs estimated to be created by prospective tenants occupying commercial real estate, provided the jobs are not existing jobs that are relocated. We are presently evaluating whether this provision will change the status quo on the USCIS’ position for development of shopping centers and office buildings.

8. **More reasons NOT to form your own regional center.** Becoming a regional center and maintaining regional center status will be more costly, time-consuming, involved in extensive due diligence, restrictive and exposed to liability. Although we do assist select clients in establishing regional centers, we generally believe that the typical developer should NOT establish his own regional center. This is a different business and is extensively regulated. It
is now even more extensively regulated. The typical developer goes to an investment bank when it wants to have an IPO. It does not set up its own investment bank. Similarly, the typical developer should go to an existing lender/regional center rather than set up its own. If you want to take the plunge, prepare yourself for extensive governmental examinations, inspections, and reporting. Many players with regional centers may decide to leave the field and outsource the EB-5 financing.

9. **Prohibition on certain foreign government involvement.** Government control over foreign involvement in the regional center program will increase. The public, EB-5 program critics, and Congress have all been very concerned about inappropriate use of the EB-5 program by criminals, foreign government instrumentalities, and others. Although we have never seen any indication of such improper use of the program, many provisions of the new law are dedicated to preventing abuse. There is a flat prohibition on any person owning a regional center unless that person is a national of the United States or admitted for permanent residence. There is a flat prohibition on foreign government entities providing capital to or being directly or indirectly involved with the ownership or administration of a regional center, a new commercial enterprise or the job-creating entity. There are many such provisions, they are complex, and they are intertwined. It remains to be seen what impact all of this new, potentially burdensome regulation will have upon Chinese (and other foreign) construction companies and related entities. Many of the largest Chinese construction companies are government owned, as are their banks. And it is unknown how the interrelationship of these entities will trigger difficult government regulation, investigations, reports and enforcement actions.

10. **Certifications and filings.** Many new certifications of compliance and additional information (including fingerprints or other biometrics for the FBI) will be required by the USCIS for criminal record and other background checks of existing regional centers, new commercial enterprises, job creating entities and persons associated with such entities.

11. **SEC has jurisdiction.** EB-5 offerings are now made expressly subject to the jurisdiction of the SEC. While we have always advised our clients to comply with the full disclosure requirements of the US securities laws, even when relying upon Regulation S for foreign offerings, the SEC now clearly has jurisdiction over all EB-5 securities offerings. This express grant of jurisdiction to the SEC does not change or eliminate the exemption from the registration requirement (but only the registration requirement) under section 5 of the Securities Act of 1933 provided by regulation S. But the Regulation S exemption does not affect other registration and anti-fraud provisions applicable to issuers, affiliates, broker-dealers, and others associated with an offering.

12. **Annual fee for regional centers.** Regional centers will now have to pay a new annual fee. Initially, the fee will be $25,000 per year per regional center, but may be reduced to $10,000 per year if the regional center has 20 or fewer total investments for the prior fiscal year. As of a recent date, the USCIS listed 761 regional centers in the US. We have seen no studies on this subject, but we would not be surprised if we were told that 5% or 10% of the regional centers have raised more than 90% of all the EB-5 capital to date. Many of the dormant or speculative regional centers will struggle for survival or put themselves up for sale to recover their investment before they have to pay at least $10,000 per year to maintain their “charter.” This may create an interesting opportunity for the first time in many years to buy a regional center for a “bargain” price.

13. **More government reports and oversight.** There will be extensive government reports and overights. Regional centers and those related to them must file compliance reports on a quarterly and annual basis. Reports must also be filed by the GAO, the Inspector General of the Intelligence Community, the Inspector General of Homeland Security and the FBI. These reports must cover a number of issues including vulnerabilities of the program that could undermine national security, result in a use to export sensitive technology, facilitate government espionage, succor foreign government agents or facilitate terrorist activity.
The bottom line is great news for developers who want to use the EB-5 program to raise capital for new development projects.

Editor’s note: The article above describes the changes to the EB-5 Immigrant Investor Visa program that were ALMOST enacted in December 2015. At the eleventh hour, Congress completely shelved all the proposals discussed above, and instead decided to continue the program, without any change, through September 15, 2016.

For the current status of the EB-5 financing program, see “EB-5 Immigrant Visa program extension signed into law — without any changes. EB-5 financing continues for new development projects.”

Why you want to start raising your EB-5 capital NOW . . .

With the EB-5 program extended for another year (through September 30, 2016) without a single change in the rules, we are advising our developer clients to proceed with all due haste in pursuing their EB-5 financing. On this timing issue, our thinking is very simple:

There has been something of a hiatus or gap in EB-5 financings as developers and lenders waited to see if Congress would change the law on essential details that affect how (or even whether) a project can be structured for EB-5 — matters such as the minimum investment, how or whether one could qualify as a TEA, how the minimum new jobs requirement would be calculated, and other important business and legal details.

Finally, as the program has been renewed now without a single change, lenders and foreign investors are now rushing to fill the pipeline again. And it is much more desirable to be at the front of the line, rather than at the back of the line.

JMBM’s team has closed more than $1.5 billion of EB-5 financing and sourced more than half of that for our clients. Please give us a call if you would like to see if we can help you.

Other articles on EB-5 Financing

To access our rich library of articles on EB-5 financing, go to www.HotelLawyer.com, scroll down the right-hand side under LEARN MORE ABOUT and click on “EB-5 Financing.” For your convenience, here are a few popular EB-5 articles that may be of interest:

- EB-5 funding for new development: JMBM has closed more than $1.5 billion of EB-5 financing.
- EB-5 extended without change: President Donald Trump signs bill
- What’s happening with EB-5 financing for new development projects? Is it still available?
- JMBM’s “preferred” EB-5 construction financing program for top developers and projects.
- FAQs about EB-5 project financing for new hotel development
Hotel development & EB-5 financing: Why you don’t want to form your own regional center

Financing hotel development today: The 5 questions every hotel developer is asking about EB-5 financing

This is Jim Butler, author of www.HotelLawBlog.com and hotel lawyer. We represent hotel owners, developers and investors. We have helped our clients find business and legal solutions for more than $87 billion of hotel transactions, involving more than 3,900 hotels. As of January 31, 2017, we have closed more than $1.5 billion of EB-5 financing for our clients' projects, and sourced most of that. I invite you to contact me to explore how our experience and resources might help you accomplish your goals. 310.201-3526 or jbutler@jmbm.com