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December 17, 2014

EB-5: A Creative Financing Option for U.S. Developers and Businesses

Maria del Carmen Ramos, Partner
slk-law.com | mramos@slk-law.com | 813.227.2252

In recent years, as raising capital has become more difficult for developers and the waiting time for green cards has increased for immigrants from certain countries, the popularity of the EB-5 Regional Center Program (also known as the Investor Pilot Program) has skyrocketed. On the one hand, that is great news for developers and investors alike. On the other hand, the parties have to be careful to make sure the prospective investment in the developer's project is structured in a way that complies with the Pilot Program's requirements and makes it enticing to foreign investors.

<u>What is the EB-5 Pilot Program</u>?

Created two years after the original EB-5 Immigrant Investor Program ("Investor Program"), the Pilot Program was designed to attract foreign investment and stimulate the U.S. economy. Under both the Investor and Pilot programs, foreign investors who make a significant investment in a new, reorganized, or restructured business that creates ten jobs for qualified workers can qualify for a green card. If the initial EB-5 visa petition is approved, the foreign investor is granted conditional permanent residence for two years, after which the foreign investor can seek to have the conditions removed —and, therefore, become a legal permanent resident—provided the investor has made the required capital investment and that the investment actually created the requisite jobs.

Although the requirements for the Investor Program and Pilot Program are largely the same, the Pilot Program offers three distinct advantages over the Investor Program. First, the required investment is significantly less under the Pilot Program. A foreign investor need only put $500,000 at risk in a regional center in a Targeted Employment Area ("TEA") to qualify for an EB-5 visa. Under the Investor Program, the foreign investor must put $1 million at risk. Second, the ten jobs that must be created before the investor can become a legal permanent resident under the Pilot Program can be "direct" or "indirect" jobs—a lower standard than under the Investor Program. The Investor Program only counts "direct" jobs. Third, investors are permitted to make a passive investment and are not required to show that they are actively involved in the management of the enterprise. For these reasons, most foreign investors prefer investing in a regional center under the Pilot Program.

How Should the EB-5 Investment be Structured?

A foreign investor is entitled to a green card only if the investor puts the minimum-required investment ($1 million under the Investor Program or $500,000 under the Pilot Program) "at risk." Capital is "at risk" only where there is a chance for a loss or a gain. If an investor is guaranteed a return on any portion of his or her investment, then that portion of the investment is not considered "at risk" under the Pilot Program. So it is important that the developer structures the investment in a way that puts the investor's capital "at risk." Developers traditionally structure the EB-5 capital investment in one of two ways: as a loan or as equity.

Under the loan model, two enterprises are created: a "new commercial enterprise" ("NCE") and a "job creating enterprise" ("JCE"). Foreign investors make a capital investment in the NCE. The NCE, in turn, loans the JCE capital raised from the foreign investors, which the JCE uses to create the requisite jobs. The JCE repays the NCE typically at 5-8% interest. Once the JCE repays the loan from the NCE, the NCE can be liquidated.

Under the equity model, the foreign investor is given either true or preferred equity in the JCE in exchange for his or her capital investment. The JCE can issue the equity directly to the foreign investor or it may issue it to an NCE. Most investors and developers prefer the preferred equity model since investors are generally not interested in maximizing their rate of return (they are more concerned with obtaining a green card) and developers would prefer to share their upside with investors.

Choosing between the loan and equity model, of course, is complicated and involves any number of considerations that should be explored with competent counsel. But here are some things a developer should take into consideration when deciding how to structure the EB-5 investment and the composition of the "capital stack" (i.e., the total sum of capital investment in the project):

- Will the developer be putting its own capital at risk? Not surprisingly, most prospective investors want to see that the developer has enough confidence in a project to put its own capital at risk. And prospective EB-5 investors would generally prefer to see the developer's equity be at greater risk than theirs.
- How much EB-5 capital will be invested in the project? That decision needs to be made taking into account the number of jobs the project is expected to create. Remember that the capital from each foreign investor must create 10 jobs. So if the project is expected to create 100 jobs, then theoretically the project could support 10 EB-5 investors, which means $5 million could be raised under the pilot program (10 investors at $500,000 each). But what happens if the developer raises $5 million from 10 EB-5 investors but the project only creates 90 jobs. In that case, one EB-5 investor will be ineligible for a green card. Because of this inherent risk, most foreign investors insist on a 20% "buffer," meaning that if a project is expected to create 100 jobs, a developer only seek a maximum of eight EB-5 investors.

- How much non-EB-5 capital will be invested in the project? If the developer proposes that EB-5 capital will have a first-priority lien on the project, then most investors would prefer that the EB-5 capital make up no more than 70% of the capital investment. If the EB-5 capital will occupy a "mezzanine" position in the "capital stack" (i.e., if it will be subordinate to senior debt but senior to the developer's equity), then most foreign investors would prefer to see the developer contribute 10-20% of the total capital investment.

- If there is a senior lender, will accepting the EB-5 capital investment in the form of debt impact the loan terms from the senior lender? Many senior lenders prefer that there not be subordinate debt. To discourage the use of subordinate debt, senior lenders will prohibit it outright or offer less favorable terms if it is permitted.

- How long will the term of any loan be? It is important that an investor's capital be at risk during the entire visa process. An investor can typically expect to receive his or her green card within five years (assuming the project meets all of the EB-5 visa requirements). So the loans are typically structured with a 5-year terms to ensure the investor's capital is sufficiently at risk.

Because there is a multitude of factors and considerations when deciding how to structure an EB-5 investment project, developers and businesses should seek the advice of competent corporate and immigration counsel sooner rather than later.

Shumaker, Loop & Kendrick, LLP provides an array of comprehensive legal services. For more information, please contact María del Carmen Ramos at 813.227.2252 or mramos@slk-law.com.