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Promoting Economic Development Through Foreign Direct Investment

By Rod Crider, CEcD, CCE

THE PROS AND CONS OF BECOMING AND RUNNING AN EB-5 REGIONAL CENTER

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DEVELOPMENT THROUGH FOREIGN DIRECT INVESTMENT

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As communities look to provide creative financing tools to spur economic growth, more are considering use of the Immigrant Investor Program, also known as "EB-5," which allows foreigners to gain permanent residency in the United States by making an investment in a project which creates American jobs.

This novel approach to bringing more foreign capital into local economies is gaining in popularity both because developers are struggling to get traditional sources of funding for their projects and, the EB-5 visa seems to be catching on with people in foreign countries with money to invest.

As communities look to provide creative financing tools to spur economic growth, more are considering use of the Immigrant Investor Program, also known as "EB-5," which allows foreigners to gain permanent residency in the United States by making an investment in a project which creates American jobs.

The program has been successful in supporting new investment in communities as well. It is estimated that since 2005, over $4.7 billion in foreign capital has been invested in the U.S. and those investments have created over 95,000 American jobs. In 2013, it is estimated that foreign investment through the EB-5 program will exceed $2 billion.

EB-5 OVERVIEW

The U.S. Citizenship and Immigration Services (USCIS) administers the Employment-Based Immigration: Fifth Preference (EB-5) program which was created by Congress in 1990 to stimulate the U.S. economy through job creation and capital investment by foreign investors. The law provides for 10,000 green cards to be made available each year in this preference. The current annual usage is about 6,000 cards and is growing.

There are two types of EB-5 cases: Individual and Regional Centers. Both require that the investor make an investment that creates or preserves at least 10 jobs for U.S. workers, excluding the investor and their immediate family.

Under a pilot immigration program first enacted in 1992 and regularly reauthorized since, a certain number of EB-5 visas are set aside for investors in Regional Centers designated by USCIS. Under this pilot program, foreign nationals may invest in a pre-approved regional center, or "economic unit, public or private, which is involved with the promotion of economic growth, including increased export sales, improved regional productivity, job creation, or increased domestic capital investment."

The EB-5 requirements for an investor under the pilot program are essentially the same as in the individual EB-5 investor program, except that investments made through regional centers can take advantage of a more expansive concept of job creation including both "indirect" and "direct" jobs.

The Regional Center program is the mechanism by which communities, economic development or-

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ganizations, chambers of commerce, and private organizations are using the EB-5 program to promote economic development.

REGIONAL CENTERS

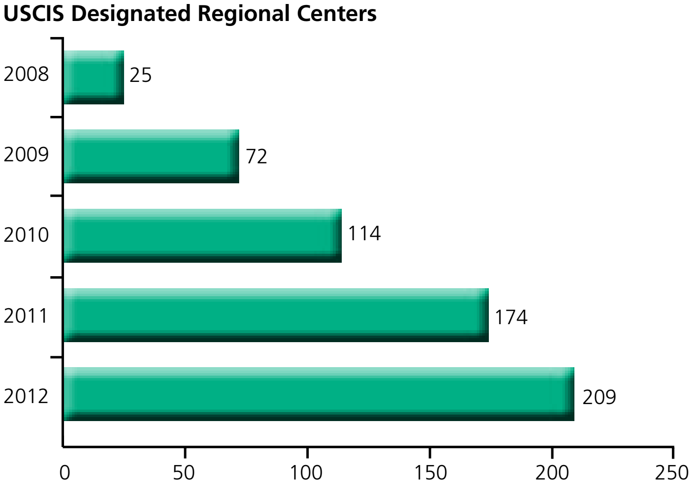
A "Regional Center" is defined as any economic entity, public or private, which is involved with the promotion of economic growth, improved regional productivity, job creation, and increased domestic capital investment. The organizers of a regional center seeking the "Regional Center" designation from USCIS must submit a proposal, supported by economically or statistically valid forecasting tools, showing:

- How the regional center plans to focus on a geographical region within the United States. The proposal must explain how the regional center will promote economic growth in that region.
- How, in verifiable detail, jobs will be created directly or indirectly through capital investments made in accordance with the regional center's business plan.
- The amount and source of capital committed to the regional center and the promotional efforts made and planned for the business project.
- How the regional center will have a positive impact on the regional or national economy.

Regional centers may have a for-profit purpose or be organized to promote economic development. In 2007, there were just 11 regional centers nationwide. Since 2008, the number of regional centers has grown by an astounding 836 percent to total more than 200 at the end of 2012 with dozens more under review. The states with the highest numbers of regional centers were California (71), Florida (22), and Washington (11). A list of regional centers can be found at www.uscis.gov/eb-5centers. (Figure 1)

FIGURE 1 – GROWTH IN EB-5 REGIONAL CENTERS

USCIS Designated Regional Centers



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As of May 31, 2012, the processing time for approving Regional Centers was nine months. The USCIS has recently taken a more conservative approach to approving additional Regional Center applications because of fraud suspicions and defects in job-creation estimates by developers.

If a regional center designated for participation in the EB-5 pilot program no longer serves the purpose of promoting economic growth, improved regional productivity, job creation, and increased domestic capital investment, USCIS can terminate the Regional Center designation.

ISSUES IN APPLYING TO BE A REGIONAL CENTER

Organizers of a Regional Center have a few options to consider. The first is whether to use a loan or equity model. In most cases, the investors become limited partners in a limited partnership. The limited partnership may invest in and acquire an ownership interest in the development projects. This is the equity model. In the debt model, the limited partnership provides a low interest term loan (often five years) to the developer.

The regional center designation request may either include hypothetical projects or actual projects. A regional center may be created for one project or multiple projects over time. It is possible for each individual project to be pre-approved prior to investors investing in the project through a process called an exemplar I-526 petition.

Another issue is whether to have public or private sponsors. There are some advantages to both approaches and a hybrid model may be best. The predominant number of Regional Centers are organized by private concerns and many feel this is the most successful approach. Generally, public sponsored Regional Centers have an economic development or public purpose and the backing of a public entity may provide credibility and a stronger sense of security to the potential investor.

The cost of establishing a Regional Center can be prohibitive. Including the legal fees, application fees, econometric analysis and expenses, the cost of forming an RC can easily exceed $150,000.

If a Regional Center wants to add a project which has a new industry code, or add a geographic area not previously approved for the Regional Center by the USCIS, an amendment must be filed with the USCIS. There is an application fee associated with an amendment and the current estimated time for an amendment approval is eight months.

Regional Centers are not awarded exclusive rights to operate in a designated geographic area and in many cases, multiple centers may be established. There are Regional Centers that cover entire states, some are regional and yet others are project specific, i.e. a former military base.

While there are many advantages to establishing a Regional Center, it is important that an economic development organization consider the potential disadvantages that include:

- Regional Center certification can take a great deal of time with no guarantee of being approved. Nine months has been the average approval time and it can take even longer. Because of the rapid growth and problems with a few Regional Centers, applications for new centers have come under increased scrutiny. In late 2012, the USCIS reported that 60 percent of the I-924 Regional Center applications and amendments processed in Q1-Q3 2012 were denied.
- Regional Center certification requires a significant expense to hire an economist, develop a business plan, legal fees, and other expenses. Costs can easily range between $150,000 and $250,000.
- Earning status as a Regional Center does not guarantee approval of a particular Regional Center project.
- Regional Centers are growing in number and so the competition for foreign investment has become fierce. The USCIS currently lists 349 Regional Centers in the U.S. Many Regional Centers have attracted no investors. The older, more established centers have more resources for marketing and a proven track record of getting immigrant approvals.
- Without a targeted employment area (TEA) designation, it will be difficult to obtain foreign investors. A TEA qualifies for a $500,000 investment as opposed to a required investment of $1 million in areas outside of a TEA. Why would an investor choose a higher threshold when the same benefit can be achieved by directing their dollars to a Regional Center with TEA qualified projects?
- Regional Centers have significant administrative and filing requirements that must be met. These regulations are complex and often require the assistance of a highly compensated legal expert with expertise in EB-5 matters. With the recent growth of the EB-5 program, the USCIS has faced more and more questions about key ambiguities in its EB-5 regulations. Dealing with ever-changing USCIS interpretations and delays is another issue that approved Regional Centers must confront.

There are also risks for the developer who uses a Regional Center to finance their project. If, for instance, a hotel developer would like to include EB-5 funding in their capital stack, they have a lot to consider when evaluating a potential Regional Center partner. H. Ronald Klasko is managing partner of Philadelphia-based Klasko, Rulon, Stock & Seltzer, LLP and chair of the EB-5 Committee of the American Immigration Lawyers Association. Klasko cites the following considerations for project developers:

- If the regional center is a profit-making enterprise, some of the developer's profit may be siphoned off to the regional center operators.
- The developer needs to do serious due diligence with respect to the regional center. If the regional center operators are less than scrupulous, or provide less than complete information, the developer may be affiliating with a regional center with which, in retrospect, it wishes it had not been in association.
- The developer is ceding some control of its project to the regional center operator.
- The developer assumes the risk that the regional center operator may become de-certified.
- The regional center may need to amend its certification with USCIS in order to incorporate the new project, thus entailing delay.

REGIONAL CENTER INVESTMENTS

Once a Regional Center is established, it can then seek foreign investments. An investor seeking an EB-5 green card through the program must make a qualifying investment of $1 million. This qualifying investment can be reduced to $500,000 if the project is located in a targeted employment area (TEA) or a rural area.

A **targeted employment area** is an area that, at the time of investment, is a rural area or an area experiencing unemployment of at least 150 percent of the national average rate.

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.

Because of the intense competition for foreign investment capital, a project that is not contained within a targeted employment area is considered non-competitive. Since the investor can place their investment in any Regional Center in the U.S., most will choose to invest the

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lower amount required because it will provide them with the same green card benefits.

Before an investor can participate in a Regional Center's EB-5 investment program, each investor must independently petition USCIS for an EB-5 visa by filing Form I-526, Immigrant Petition by Alien Entrepreneur. The USCIS solely determines whether the investor qualifies for the EB-5 visa. USCIS' diligence includes a full background check, including detailed review of the sources of the investor's funds (to confirm its lawful origin), family history, and other representations of the head of the household and his/her immediate family member(s) under the age of 21.

Additionally, each investment must create 10 new jobs. The EB-5 Regional Center Program does not require that the foreign investor's enterprise itself directly employ 10 U.S. workers. Instead, it is enough if 10 or more jobs will be created directly or indirectly as a result of the investment.

The timing of required job creation numbers presents another issue. The USCIS limits regional center job creation to the job creation that exists 2.5 years from the filing of the I-526. This is an arbitrary rule, as there is no time limit for a regional center investment to create employment.

It is difficult for larger projects to comply with this timeline. In the case of a hotel for instance, there is the time and expense of required permitting, which can last from 12 to 18 months. It is not unusual to spend over $1 million to undergo required studies (soils, seismic, environmental impact, structural. etc.), develop a set of building plans, and go through land use and design reviews. Most Regional Centers need EB-5 capital to even begin this process. Once the permitting and review process is completed, the actual construction can take 18 months. Finally, a new hotel does not reach a stabilization stage for three years. Thus, the total time frame for a hotel project from start to stabilization is six years, not the 2.5 years the USCIS imposes. The timeline for stabilizing commercial property or redeveloping older buildings is similar.

The USCIS now interprets that direct and indirect construction jobs that are created by the petitioner's investment and that are expected to last at least two years may now count as permanent jobs. The USCIS has determined that the key to their eligibility is whether the position lasts for two years, not whether the same person works in that position the entire time. The positions must be filled by an employee, not an independent contractor and the USCIS forbids investors from combining multiple part-time positions to create one full time position.

As the program has grown, securities fraud has become more prevalent, and federal authorities have increased their oversight.

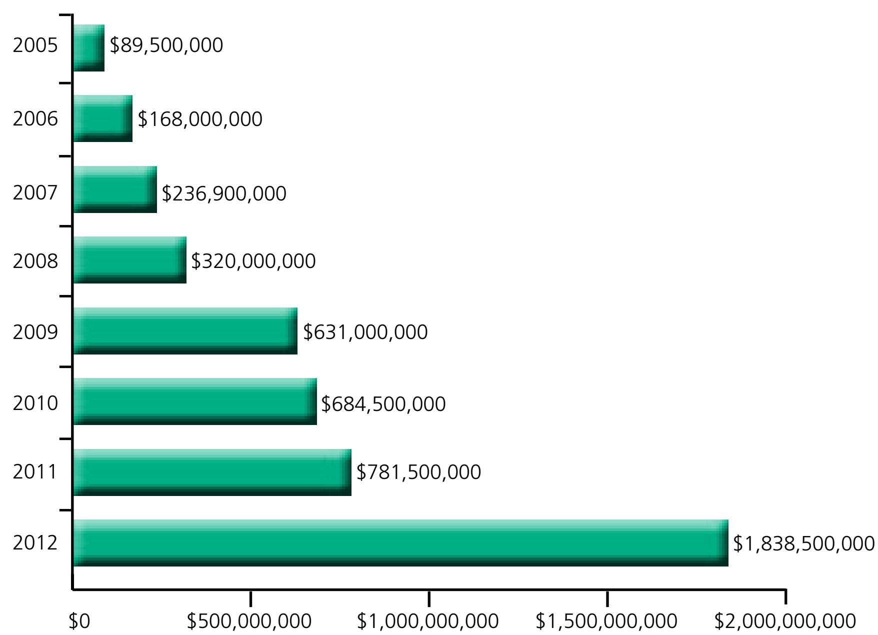
The Wall Street Journal reported that in early 2013, the SEC filed a lawsuit against an EB-5 project in Chicago federal court, alleging that the promoters of a hotel-and-convention-center plan had fraudulently sold more than $145 million in securities and collected $11 million in administrative fees from more than 250 Chinese investors. The SEC alleged that some of the funds had been misappropriated and nothing had been built.

In Louisiana 31 investors, mostly from China, filed a federal lawsuit alleging that the project they had invested $15.5 million in was idle and consisted only of an undeveloped property across the Mississippi River from New Orleans. The project developers are seeking to dismiss the suit partly on the grounds that immigration authorities thwarted the project by rejecting the project's job-creation estimates.

In San Bruno, CA, three Chinese investors allege that they lost $3 million when an EB-5 developer disappeared after he faked a heart attack in a karaoke bar and his associates concocted a story about his death. In January, the court awarded investors a default judgment because the developers never appeared.

Despite these increasing instances of fraud, the use of EB-5 capital is expanding and has grown from about $400 million in 2007 to over $1.8 billion nationally in 2012 (Figure 2).

FIGURE 2 – EB-5 FOREIGN DIRECT INVESTMENT CAPITAL FORMATION 2005-2012



Source: U.S. Department of State

SECURING INVESTORS

The investment offering itself is subject to U.S. securities laws, enforced by state securities regulators and the U.S. Securities & Exchange Commission (SEC).

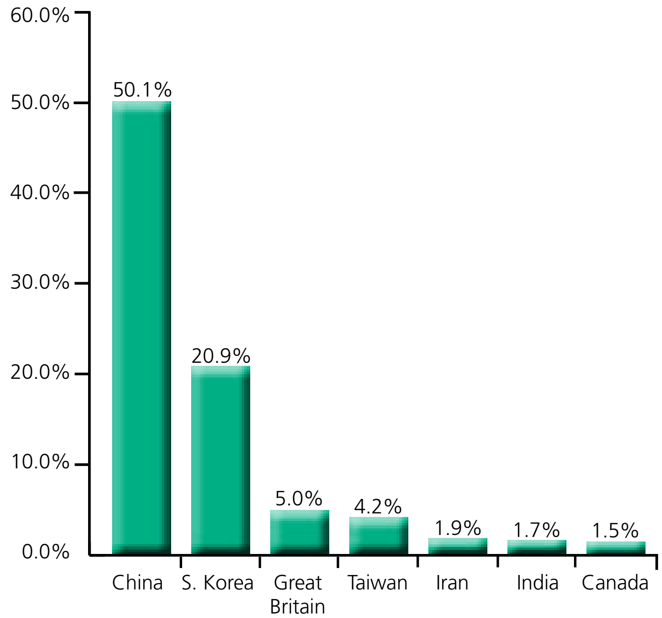
The benefits to the foreign investor of using the EB-5 program to secure a green card include:

- It provides a direct route to a green card.

- It does not require day-to-day business management of the project being funded.
- Permanent residency in the United States is granted to the investor, their partner, and any children under 21 years of age.
- The investor can live, work, and retire anywhere in the United States.
- The investor becomes a U.S. citizen after 5 years of being a green card holder.
- There are no quota backlogs - There are many delays and backlogs for employment and family based green card categories, but there is no backlog for the EB-5 Visa Investor category.
- The investor does not require a sponsor - Foreign investors use their own personal funds and do not require sponsorship from either an employer or a family member.

Investors in the EB-5 program come from a large number of countries. Between 2006 and 2012, there were 14,708 investors in the EB-5 program originating from more than 100 countries. China and South Korea have been the largest providers of EB-5 capital over this time period (Figure 3).

FIGURE 3 – TOP COUNTRIES OF ORIGIN FOR EB-5 INVESTORS 2006-12



Source: U.S. Department of State

REGIONAL CENTER EXAMPLES

The Northeast Ohio Regional Center (NORC) was formed by the Wayne Economic Development Council and the City of Wooster Growth Corporation, covering a 16-county region that includes the cities of Cleveland, Akron, Canton, and Youngstown. It received Regional Center approval in June, 2009.

Communities within this 16-county region of Northeast Ohio can establish eligible investment projects in the following areas:

- Bio-science: Agribusiness, biotechnology, technology transfer from universities, hospital-related technology development, medical development and innovation;
- Energy: Alternative energy sources, energy conservation and pollution reduction;
- Information technology: Process improvements and advanced manufacturing techniques; and
- Revitalization, including commercial and other property development.

The application process took over a year, at an estimated cost of $250,000. It was originally intended to be a single-purpose Regional Center to meet financing needs for a new facility at the recently established BioHio Research Park.

During its early stages, the NORC struggled to educate the development community on the benefits of the EB-5 program; to identify which experts to use; and to capitalize the operation to the level needed to make the program more successful. Some of the post approval issues it has experienced are related to compliance, operations, and marketing.

The program is being marketed through local and regional economic development groups, through Jobs Ohio international business development managers, and through immigration attorneys. The group is also working closely with the Association to Invest In the USA (IIUSA), a trade association of Regional Centers and others interested in foreign investors.

The Vermont EB-5 Regional Center is the only USCIS Designated Regional Center in the United States owned, controlled, and supervised directly by a state government. As the only state run, statewide EB-5 regional center, Vermont offers unique advantages. It can provide the oversight and infrastructure required by USCIS, allowing businesses located in Vermont to access the EB-5 program without added cost or administrative burden.

Vermont's Regional Center was created in 1998 and is managed and operated by the Vermont Agency of Commerce and Community Development. Since 1998, more than $250 million has been invested in Vermont by EB-5 investors in companies such as Jay Peak Resort, Sugarbush Resort, Country Home Products, and Seldon Technologies. Businesses that are approved for an EB-5 project under the Vermont EB-5 Regional Center benefit from the added credibility that a state run EB-5 regional center provides.

The way that Vermont has structured its Regional Center is considered a big reason for its success. EB-5 investors often look for as much safety as possible in their at-risk investment. As one of the first EB-5 Regional Centers in the country, Vermont has a good understanding of the EB-5 program, offers the credibility of a government entity, and can demonstrate a significant track record to tout to investors.

A hybrid approach is used by some economic development organizations, chambers of commerce, and governmental entities. The City of Dallas, Texas, was interested in offering the EB-5 program and researched the Regional Center marketplace for two full years before launching the City of Dallas Regional Center (CDRC) in 2009.

The City of Dallas owns the Regional Center but has contracted with an outside party to manage the CDRC. Civitas Capital Management, LLC, is a professional, independent investment manager. Civitas performs rigorous institutional-quality financial analysis of each project, screening investments to ensure they meet job creation requirements and preserve investors' capital.

Civitas does not sponsor its own projects so the CDRC is able to choose projects based solely on their ability to provide what is important to EB-5 investors. The City of Dallas often co-invests directly in CDRC projects through tax abatements, grants, and other programs. By being strategically and contractually bound together, the CDRC and Civitas can offer a high degree of security to potential investors.

The CDRC, which operates exclusively within the city limits of Dallas, has made EB-5 investments in a range of industries, including assisted living, call centers, restaurants, and multifamily apartments. Most recently, the CDRC had raised $169.5 million, creating nearly 5,000 jobs in Dallas; funding all or part of eight development projects; and enabling 339 immigrant investors and their families to receive EB-5 visas.

While an investment must be considered to be "at risk," the main issues of consideration for the investor will include the safety offered by the project. Investors will want to know that the project will be completed and that it will generate the required number of jobs. Like most investors, they will seek investments that offer higher levels of security.

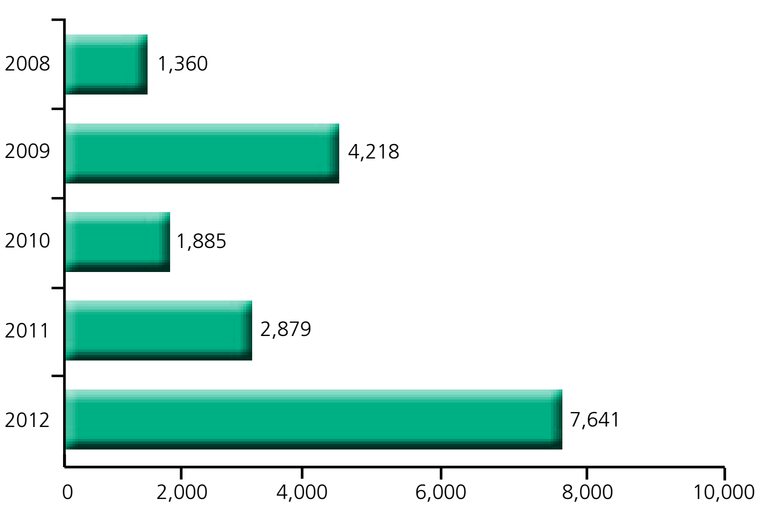
Investors are primarily motivated by receiving a green card; however, they also are generally looking for a return of their capital within a five-year time frame that includes interest of one to two percent. At a minimum, the investor must feel confident their principal is safe.

As with the regular EB-5 program, qualified investors investing through a Regional Center first receive a conditional green card valid for two years. At the end of that time, the investor files another application with USCIS showing that their money was "at risk" during the two-year period and that the jobs have been created. Once those applications have been approved, the investor and his immediate family become permanent green card holders and can later apply to become U.S. citizens. For investors, the whole EB-5 process takes approximately 3-5 years or longer depending upon the timeliness, quality, and validity of the project

The Regional Center designation does not mean that the Regional Center's capital investment projects are backed or guaranteed by the government. Further, there are no guarantees that an investor may ultimately be granted unconditional permanent resident status through an EB-5 investment. For example, if it is determined that the investor's money is not truly at risk or that insufficient jobs were created through the investment, then the investor's petition may be denied.

In the past, projects have failed and investors have lost their money. What's more, foreigners who've been allowed into the country through the program on a conditional green card face deportation if a project they invested in fails to meet the job-creation requirement after two years. Investors should exercise due diligence when making an EB-5 investment.

FIGURE 4 – NUMBER OF EB-5 VISAS ISSUED



Source: U.S. Department of State

As Regional Center popularity has grown, the competition for investors has increased. Regional Center representatives looking to drum up investors for their projects are frequent visitors to foreign lands. And, a virtual cottage industry has sprung up among marketing agents overseas who promote the centers while selling U.S. residency to the wealthy.

The number of EB-5 visas issued through the program is increasing each year (Figure 4). As the volume of applications has increased, both the Regional Center operators and the USCIS have become more adept at establishing clear policies and guidelines that lead to a successful investment.

SECURITIES LAW: CENTERS & FINDERS

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It is important to point out that any U.S. person or firm associated with the purchase or sale of a U.S. security must be registered to receive success-based compensation. Payments made to non-registered persons may result in the offering losing its exempt status. It is common practice in the EB-5 program for Regional Centers and developers to pay non-registered "finders" compensation for bringing investors & capital into their projects. So far, there have been no sanctions or enforcement by federal and state agencies; however, there are investigations underway by Federal Bureau of Investigation, Department of Justice, Securities & Exchange Commission, and state regulators into issuer and promoter fundraising activity both in the U.S. and abroad.

Also, there has been virtually no litigation by investors facing removal due to failure of the project to create sufficient jobs to remove conditions or return capital. This will change as USCIS scrutinizes project results more closely and developers fail to exit with sufficient value to repay investors their capital contribution. Investors may invoke their rights to relief should there be violations of the offering, fraud, material misrepresentation or omissions by the issuer or their agents, whether or not they were registered.

Regional Centers and their members could be responsible for repayment of investment, fines, and penalties for failing to adequately audit and supervise the roles of the fundraisers and consultants they have contracted to raise capital for their development projects. This is a lucrative field for litigators because of the size of the capital raised and the lack of regulation & oversight.

CONCLUSION

The EB-5 Regional Center program provides significant benefits to the U.S. and many foreign nationals. Communities and economic development agencies can use the tool to provide these heretofore unavailable sources of capital to spur economic growth. Localities receive much needed capital to spur economic growth while the foreign national gains eligibility for permanent residency status.

Those considering establishing an EB-5 Regional Center as an impetus for economic development should understand that the process is expensive and that they will be entering an environment that contains inherent risks, a high degree of complexity, and a great deal of ambiguity and delays from the regulating authorities.

In addition to the entry costs ranging from $150,000 to $250,000, an EDO should budget for operating expenses to cover marketing, legal fees, staffing, and other costs. It could take as long as 12 to 24 months before the Regional Center begins to generate sustaining revenue.

The staff for the Regional Center will need to be highly skilled professionals with an aptitude for complex legal issues, a marketing mindset, sales skills, and financial savvy. A separate governing organization will need to be established to carry out the legal and fiduciary duties of the organization and directors selected with a skill set and network that can support the Regional Center staff. Because of the complexity of the program, the new Regional Center will have to rely on a bevy of outside service providers, including those that can provide the requisite legal, accounting, marketing, sales, and economic forecasting knowledge.

Another inherent risk is a political one. The political climate surrounding immigration issues is a volatile one, and Congress has had to reauthorize the program every two years. It has suffered to overcome the unfounded criticisms that the program is simply a way to "sell" green cards.

Additionally, increasing instances of fraud are hurting the credibility of the program and causing investors to be more cautious. As a result, the USCIS is scrutinizing Regional Center applications more heavily and the job claims that go along with them. Likewise, foreign nationals can be much more selective about where to place their investments. They will seek those that offer greater safety and a higher return.

Finally, as more communities and for-profit enterprises apply for Regional Center status, the competition for the limited number of investors has become more intense. It takes significant resources, established networks, and much time to cultivate the relationships that will result in a foreign investment. Likewise, the community needs to be able to identify quality projects eligible to use EB-5 financing in order to draw investors' attention.

Despite these obstacles, there are still many advantages to receiving an EB-5 Regional Center designation. By providing an attractive way for a business project to raise low interest debt, communities can attract new development projects that spur economic growth.

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