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The Brewing Storm of EB-5 Defaults

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Today's Agenda

- Overview of EB-5 Immigrant Investor Program
- Current landscape for EB-5 loan defaults
- Projected trends in EB-5 loan defaults
- Red flags that an EB-5 loan may not perform
- Business/workout challenges unique to EB-5 loans
- Immigration concerns with potential EB-5 workout solutions
- Potential regulatory and legislative changes to EB-5 program



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EB-5 Immigrant Investor Program

Program Background:

- EB-5 stands for Employment Based 5th category.
- Created in 1990 to stimulate the U.S. economy through job creation and capital investment by foreign investors.
- An original goal was to stimulate rural and economically disadvantaged areas by offering a lower minimum investment for those areas.
- For projects in rural or high-unemployment areas, the minimum investment is currently \$500,000. In other areas, \$1 million is currently required. Current regulatory proposals would increase these numbers to \$1.35 million and \$1.8 million, respectively.
- Qualifying foreign investors are eligible to apply for permanent US residence (i.e., a Green Card) if they: (i) make the necessary investment in a new US commercial enterprise; and (ii) demonstrate that 10 or more new jobs are created for US workers either directly or indirectly (RC program only) by the new commercial enterprise.



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EB-5 Immigrant Investor Program

Program Background:

- The EB-5 Regional Center Program which allows for indirect job creation will expire on April 28, 2017.
- There have been several proposed legislation along with proposed USCIS regulatory changes to the EB-5 Program. Most proposals seek to increase the minimum investment amount and change how a TEA (Targeted Employment Area) is designated. The comments period for the proposed USCIS regulations will run through April 11, 2017.

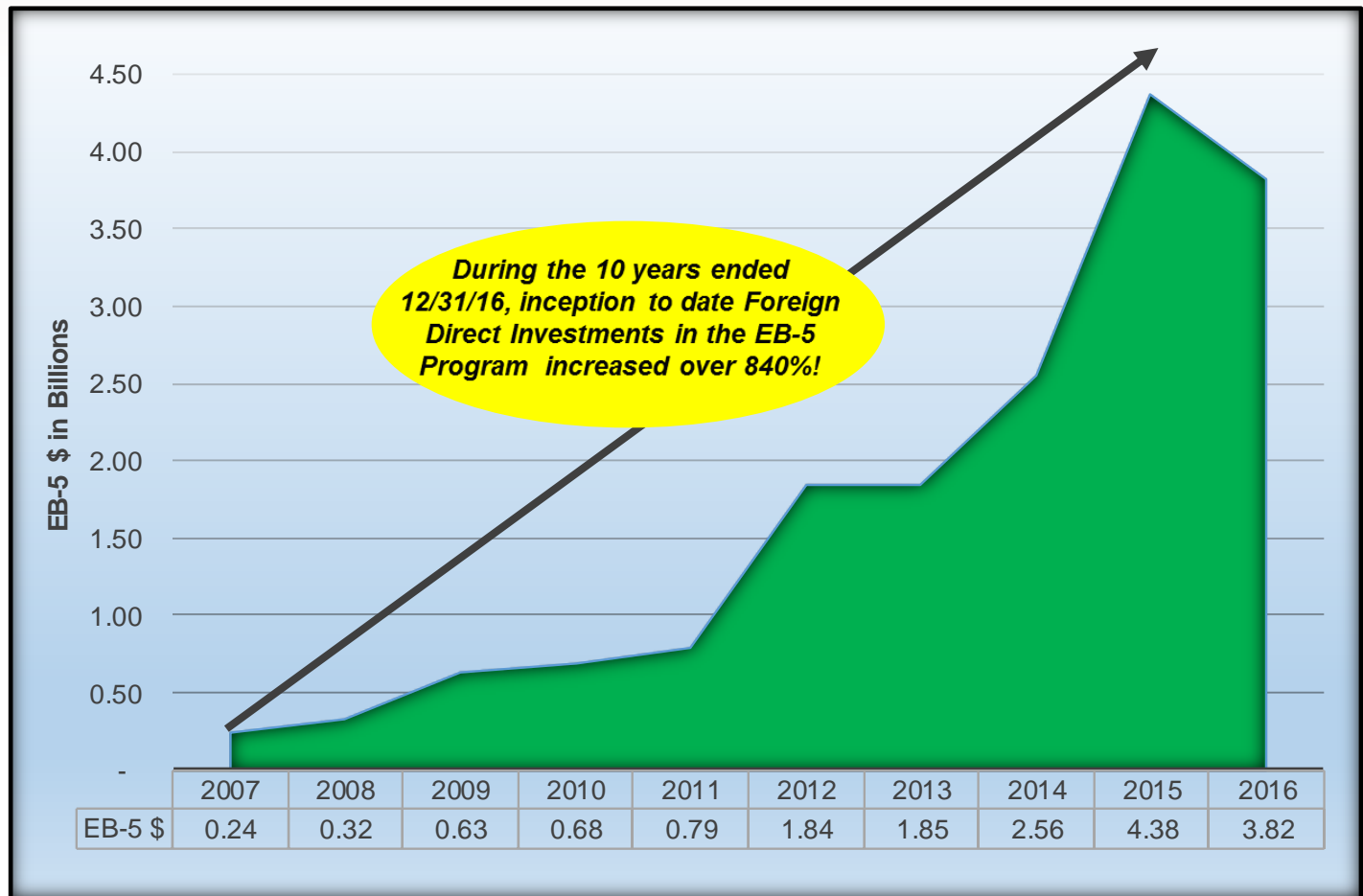


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EB-5 Foreign Direct Investment since Fiscal Year 2007





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How Real Estate Developers Leverage the EB-5 Program

- In recent years, developers have embraced the EB-5 Program, tapping foreign investors, especially Chinese investors, to help finance their projects at a cost substantially below the market cost of “equity” capital.
- The foreign investors have shown a preference for flashy real-estate projects, often built on “spec” versus rural manufacturing plants, nursing homes or hotels.
- Despite the fact that one of the original goals was to stimulate rural and economically disadvantaged areas, defined as TEA, a high volume of projects that have raised EB-5 financing are now located in central urban neighborhoods (more than 20 are currently in New York City).
- Individual states currently designate TEAs and developers have been successful at leveraging the wide discretion the states have in drawing census tract boundaries to bring lower investment amounts to central and urban districts.



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Fraud Relating to EB-5 Investments

As the EB-5 Program has increased in popularity, so has SEC investigation of fraudulent schemes and misappropriation of investor funds – Between January, 2013 and January, 2015, **the SEC received over 100 tips, complaints and referrals relating to possible securities fraud violations in the EB-5 Program.**

Below are some recent EB-5 fraud cases filed by the SEC in which the underlying business involved either commercial or residential real estate projects:

SCAM

February, 2013 – Chicago Convention Center ≈ \$156 Million raised

SCAM

October, 2013 – Marco and Bebe Ramirez ≈ \$5 Million raised

SCAM

August, 2015 – Path America ≈ \$136 Million raised

SCAM

November, 2015 – Zhong ≈ \$8.5 Million raised

SCAM

November, 2015 – Suncor ≈ \$20 Million raised

SCAM

April, 2016 – Jay Peak ≈ \$400 Million raised

“Rampant fraud and abuse within the EB-5 Regional Center program prevents the program from serving its original purpose, which was to create jobs and direct capital to underserved areas starved for investment. As I have said before, the program needs to be reformed or it needs to end.”

Senator Patrick Leahy (D-VT)

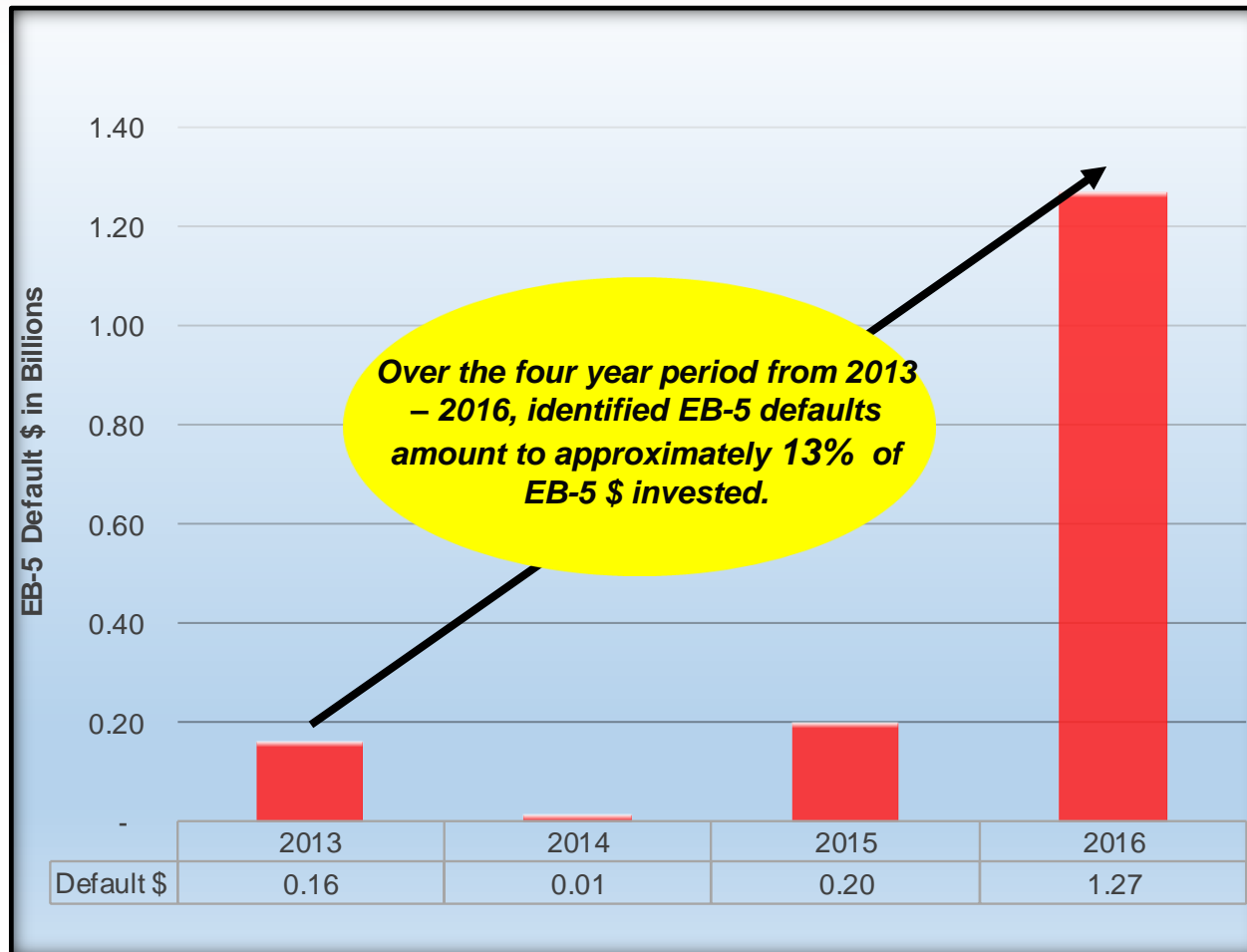


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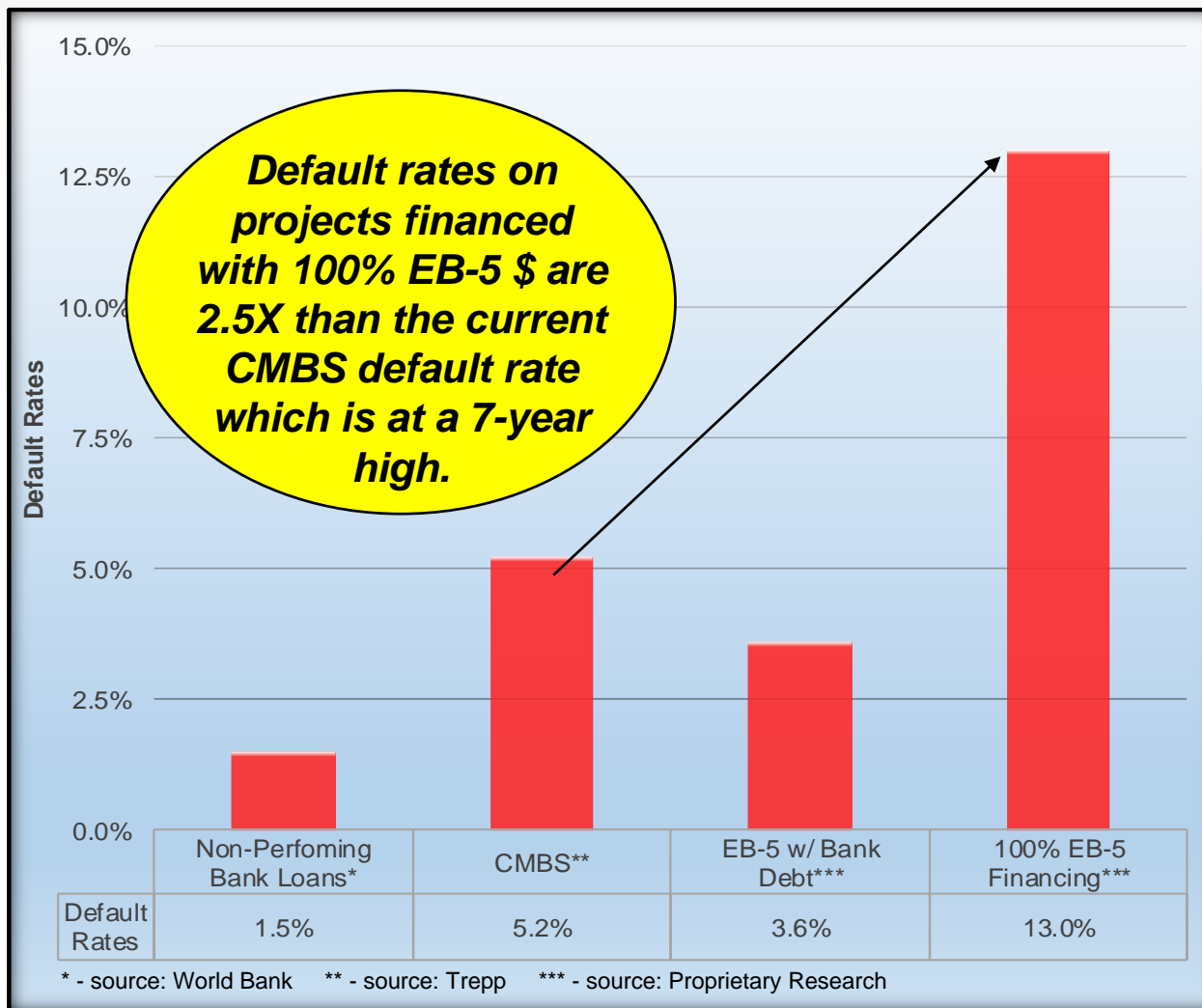
Known Defaults of EB-5 Foreign Direct Investments since 2013





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Causes of Exaggerated Default Rate

- Poor Underwriting – Some EB-5 investors have less concern for underwriting because their primary concern is to obtain a visa, not an economic benefit from the investment.
- Fraud – EB-5 loans are ripe for fraud. Target investors are foreigners and may not be sophisticated business people. Non-economic motivations play a factor here too.
- General market forces
- Many luxury residential developments are funded by EB-5 debt. There is currently an overabundance of supply, leading to potential defaults.
- Construction boom is unsustainable.



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Red Flags for Troubled EB-5 Loans

- Failure of the EB-5 project developer to deliver regular reports to the EB-5 investment fund manager of the status of the financing, construction and/or operation of the project
- Failure of the EB-5 project developer to obtain all necessary financing to commence or complete the project
- Failure to make payments on an EB-5 loan or equity investment, or on any other financing obtained by the EB-5 project
- Failure to deliver required financial and other reports to EB-5 lender and/or EB-5 investors
- Receipt of notice of default from the senior lender to the EB-5 project.
- Receipt of information that the EB-5 project is not paying its contractors.
- Commencement of litigation against the EB-5 project or developer.
- Delay in commencement of EB-5 project
- Halt in construction of EB-5 project
- Failure of the EB-5 project to meet the dates specified in the project construction schedule



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Challenges Unique to EB-5 Loan Defaults and Workouts

- Non-economic motivations: While EB-5 investors no doubt would like to recover their investment plus a return, the primary motivation of most EB-5 investors is to obtain immigration status.
 - Important to structure workout in a manner that preserves immigration status of EB-5 investors.
 - Other stakeholders are more concerned with maximizing their recoveries, which can result in potentially divergent reorganization strategies and challenging negotiation dynamics.
 - Challenge is to keep EB-5 investors “in the deal” despite potentially being out of the money.



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Challenges Unique to EB-5 Loan Defaults and Workouts

- Challenging to raise new money to complete the project. In the absence of new capital, many troubled EB-5 projects will fail, thus dooming both the success of the reorganization and the immigration status of the EB-5 investors.
 - Difficult to raise new capital from EB-5 investors.
 - Individual EB-5 investors may not have the wherewithal to provide additional capital.
 - Coordination, communication and free-rider issues.
 - Third party financing is also more difficult.
 - Any provider of new capital will want to “prime” EB-5 investment. Infusion of this priming capital may conflict with EB-5 investors’ need to preserve immigration benefits.
 - Provider of new capital may wish to change character of project, which also jeopardizes immigration status of EB-5 investors.

Challenges Unique to EB-5 Loan Defaults and Workouts

- Communication and organization issues:
 - EB-5 lender formation documents do not always contemplate flexibility in distressed situations (as would more traditional financing documents).
 - Investors are spread throughout foreign countries, often China, and may not speak English.
 - Unlike with syndicated bank debt or a more traditional note issuance, there is no agent or trustee that can speak for the underlying EB-5 investors in a centralized way.
 - Difficult to obtain consents and approvals to any contemplated reorganization transactions.



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Challenges Unique to EB-5 Loan Defaults and Workouts

- Where there is also traditional bank financing in the capital structure, intercreditor agreements can be extremely restrictive. EB-5 lender can be largely sidelined in the event of a default.
- Priority on jobs and liens may be bifurcated, which adds complexity since a junior creditor could be senior on job creation.
- Receivers often appointed, which can complicate matters.
 - Not clear where receiver's duties lie – maximize value or retain immigration status?
 - Often lack of organization on part of EB-5 investors in interactions with receivers.
- Uncertainty with new administration and lack of precedents with regard to how the USCIS will view the restructured project (i.e., how it differs from project that was originally approved).



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Immigration Concerns – Defaults/Material Changes

EB-5 project failures have major consequences for individual investors no matter where in EB-5 process they occur.

Project selection is very important. We advise our clients to seek financial experts and professionals to analyze the project's offering documents prior to subscription.

The 3 main steps in the EB-5 process are:

1. File I-526 (includes prospective investment project, job creation document, and source of funds report);
2. File 2-year conditional green card application; and
3. File I-829 to remove conditions to obtain full validity 10-year green card.



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Immigration Concerns – Defaults/Material Changes

- What if the project defaults/fails when the I-526 has been filed? Or when the conditional green card application has been filed?
- A project default/failure is typically considered to be a material change to the project's business plan and private placement memorandum.
- If there has been a **material change**, Immigration Services will require the investor to refile an I-526 petition.
- Concerns from refiling the I-526 petition include:
 - Loss of capital investment;
 - Loss of administrative fees;
 - Loss of priority date if need to refile I-526;
 - Additional fees for refiling.



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Immigration Concerns – Defaults/Material Changes

- What if the project defaults before the I-829 is filed?
- Immigration Services has stated that it will be more flexible if there are changes to the business plan and PPM at the I-829 stage. However, there is no specific guidance and petitions are reviewed on a case-by-case basis.
- **Job creation and material change** are still important issues at the I-829 stage.
- A project default is likely to be a material change that will not withstand USCIS scrutiny at the I-829 stage.



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Immigration Concerns Removal of Conditions

In order to remove the conditions necessary for a successful I-829 petition, the following 4 criteria must be met:

1. Required funds placed “at risk” throughout investor’s residence in the U.S.;
2. Required capital was made available to the business for creating the jobs;
3. “At risk” investment was “sustained throughout” the investor’s residence in the U.S.;
4. Investor created (or maintained) or can be expected to create 10 jobs for U.S. workers within a reasonable period of time.

A change that affects any criteria above will be an issue.



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Immigration Concerns Removal of Conditions

If a project defaults/fails while the investor has a conditional green card, and is unable to show the creation of 10 jobs for U.S. workers, the investor will likely have to **refile** an I-526 petition (i.e., start over and go to the back of the line).

Concerns include:

- Loss of capital investment;
- Loss of administrative fee;
- Loss of priority date;
- Needs to quickly refile an I-526 petition prior to expiry of the conditional green card;
- May accrue unlawful presence if I-526 not timely filed;
- May need to depart the U.S.;
- Could be a major timing issue for Chinese nationals with visa backlogs; and
- Additional fees for refiling the I-526 petition.



Proposed USCIS Changes to the EB-5 Program

Capital Contribution

- USCIS proposes to increase minimum investment amount from \$500,000 to \$1.35 Million in TEA area and from \$1 Million to \$1.8 Million in Non-TEA area.

TEA Designation

- USCIS proposes to eliminate state designation of high unemployment areas. Rule out configurations that rely on large numbers of census tracts indirectly linked to the actual project by several degrees of separation. TEA proposals:
 - Add cities and towns with a pop. of 20,000 or more to the types of areas that can be designated as high unemployment areas.
 - Census tract or contiguous census tracts where NCE is located where weighted average of unemployment for the tracts is at least 150% of national average.
 - Include any or all adjacent tracts where NCE is located if weighted average of unemployment is at least 150% of national average.

Retention of Priority Dates

- EB-5 petitioners would be able to retain their priority dates due to circumstances out of their control or for other reasons. This includes RC termination or a material change in a business plan.



Proposed “Staff Draft” Legislative Changes to the EB-5 Program

Projects and TEA

- Special categories broken down into infrastructure, manufacturing, and TEAs.
- DHS TEA designation is made at the time of the investment or at the time the application is filed and valid for 2-year period.
- TEA area is (1) priority urban investment, (2) rural area or (3) closed military base.
- Priority urban investment area – area consisting of census tract or group of contiguous tracts each within an MSA and show at least 2 of the 3 criteria:
 - At least 150% of national average unemployment rate
 - Poverty rate at least 30%
 - Median family income is 60% or less of the statewide median family income or MSA median family income, whichever is greater
- Rural area – area outside of any city/town with 20,000+ population AND is (1) outside an MSA or (2) in an outlying county of MSA or (3) within a census tract larger than 100 miles with a population density of less than 100 people per square mile.
- Closed Military Base – an area within the boundaries of any military installation closed in the past 25 years
- Visa Set-Asides: 7.5% reserved for investors who invest in rural and priority urban areas in 2018. 15% reserved for investors who invest in rural and priority urban areas in 2019 and after.

Proposed “Staff Draft” Legislative Changes to the EB-5 Program

Capital Contributions

- Gradual yearly increases to the capital investment amount:
- 2017: \$650,000 for TEA + gov./manu. projects and \$700,000 for all others
- 2018: \$750,000 for TEA + gov./manu. Projects and \$850,000 for all others
- 2019: \$800,000 for TEA + gov./manu. Projects and \$1 Million for all others

RC Troubles and Issues

- If DHS terminates or bars an RC, NCE, or JCE, investors in affected projects remain authorized to remain in the U.S. unless investor was knowing participant. Affected investors have 180 days to invest in a new EB-5 project; otherwise they will lose their status. Investors who make a second investment can file I-829 two years later.
- If there is enforcement action, investor can retain original priority date.

Allows for concurrent I-526 and AOS applications if eligible. This is beneficial for Chinese nationals with a long visa backlog.



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Presenter – Chad Ellsworth



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Chad joined Fragomen as an Associate in 2002 from Tulane Law School cum laude. While at Tulane, he served as Associate Executive Editor for The Tulane Journal of International and Comparative Law.

His practice focuses on the representation of individual and business clients on a wide variety of corporate immigration and related employment matters.

Chad has advised human resource personnel, managers, executives and professionals and multinational corporations on a variety of global immigration matters with an emphasis on the establishment and/or improvement of immigration compliant global mobility programs including jurisdictions with less formalized immigration processes and procedures.

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Presenter – Daniel Besikof



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Daniel Besikof, a partner at Loeb & Loeb LLP, has more than a dozen years of experience advising debtors, financial institutions, indenture trustees, creditors' committees, equity holders, landlords, estate fiduciaries, asset purchasers and other stakeholders in all phases of restructuring and bankruptcy. Dan also has substantial experience defending significant fraudulent transfer actions and other bankruptcy avoidance litigation. Dan currently is representing, or has recently represented, debtors or significant stakeholders in a variety of bankruptcy cases, including, among others, C&J Energy, Ultra Petroleum, Bernard L. Madoff Investment Securities, Cengage Learning, Horsehead Holdings, Colt Defense, Xfire Holding, Hooters Casino, and Linens 'n Things.



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Presenter – Lance Jurich



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Lance Jurich, a partner in Loeb & Loeb's Bankruptcy, Restructuring and Creditors' Rights Practice Group in its Los Angeles office, serves as a trusted advisor to many clients. He is a commercial litigator who specializes in business bankruptcies, restructurings and the enforcement of creditors' rights. Mr. Jurich has broad experience representing financial institutions and handles complex matters for these clients. Mr. Jurich's depth of experience includes bankruptcy and creditors' rights, real estate disputes, Ponzi scheme litigation, and bankruptcy appellate litigation.

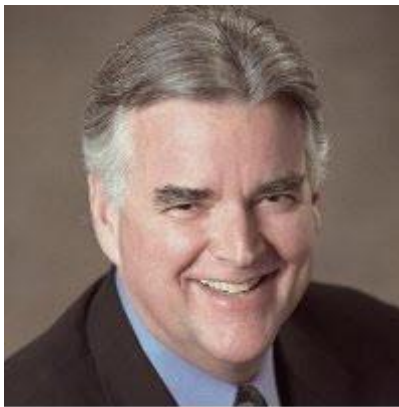


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Presenter – Jeffrey E. Brandlin



Jeffrey E. Brandlin
President & Founder
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Jeff founded Brandlin & Associates in 1980 to provide clients with tangible, timely and action-oriented insight. During his 40 year career, Jeff has pursued numerous financial frauds, accounting malpractices and trust fund embezzlements including recent work done on behalf of the SEC under enforcement actions pertaining to the EB-5 Program.

Jeff and his team have restructured and rehabilitated more than \$10 billion of real estate projects. Jeff and his team have also provided thorough financial due diligence in support of hundreds of successful transactions for equity and debt capital providers. Jeff is a frequent speaker to industry organizations and law firms on the topics of fraud, forensic accounting and financial statement analysis. He earned his Bachelor of Science degree in Accounting and has been licensed to practice accountancy in California since April 1976.

Jeff is a Certified Insolvency and Restructuring Advisor (CIRA), a Certified Merger & Acquisition Advisor (CM&AA) and is Certified in Financial Forensics (CFF) by the American Institute of Certified Public Accountants and currently serves as both the Secretary and Treasurer of the National Association of Federal Equity Receivers (NAFER).



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Presenter – Mark Elletson



Mark Elletson

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Mark has actively participated in the last three real estate corrections dating back to the late 80's and as such, leverages 30+ years of experience originating loans, acquiring distressed assets and managing debt workouts in the real estate industry (both in the USA and in Europe). During just the last cycle from 2008-2012, Mark helped build a development platform to house and rehabilitate over \$5B in assets for his clients, including; single family home developments, time share operators, assisted living centers, commercial office buildings and a variety of retail and hospitality assets.

Mark is a frequent speaker to industry organizations and law firms on the topics of rescuing and rehabilitating real estate assets, acquiring distressed assets and identifying potential fraud and misappropriation of trust fund money. Mark has lived and worked in the United States, Europe and Australia . He graduated from Fairfield University in 1987 with a Bachelor's Degree in Finance and earned his MBA with distinction, from Columbia University in 1995.



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Subject Matter Advisor – Danielle Bennett



Danielle is LexisNexis' Subject Matter Advisor for Banking, Finance and Restructuring. She is a licensed attorney with nearly ten years of experience in finance and restructuring matters. At LexisNexis, she counsels clients on research processes and work flow efficiency, and has conducted numerous Continuing Legal Education seminars.

Danielle Bennett

Subject Matter Advisor

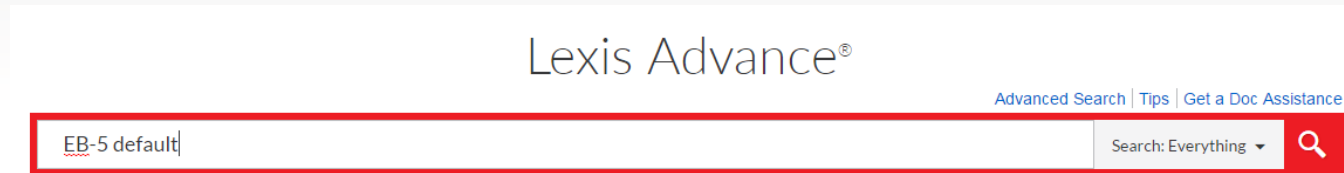
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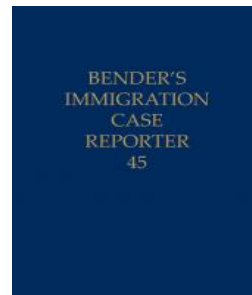
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Critical Resources to help you stay current



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