

Loan Agreement Best Practices



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The overwhelming majority of projects using funds from foreign immigrants investing in the Employment Based

Fifth Preference Immigrant Visa Program (“EB-5 Program”) use a loan model structure (the “Loan Model”). As depicted in the chart below, under the Loan Model, the EB-5 investor funds that are pooled into the new commercial enterprise (“NCE”) are in turn loaned to a borrower, usually on a secured basis. The borrower will be the job creating entity (“JCE”) or, in the case of a mezzanine-type structure, an affiliate of the JCE, which will usually be a JCE holding company that will borrow the funds and in turn contribute (or loan) them to the JCE for the financing of all or a portion of the development costs of the EB-5 project.

Despite the popularity of the Loan Model, NCE project principals sometimes neglect to pay sufficient attention to the EB-5 loan documents or fail to apply best loan practices to the administration of the EB-5 loan. Because critical rights of the EB-5 lender are at stake in the Loan Model, this article aims to guide NCE project principals on how to best ensure that the EB-5 loan documents adequately protect EB-5 investor funds.

LOAN TERMS

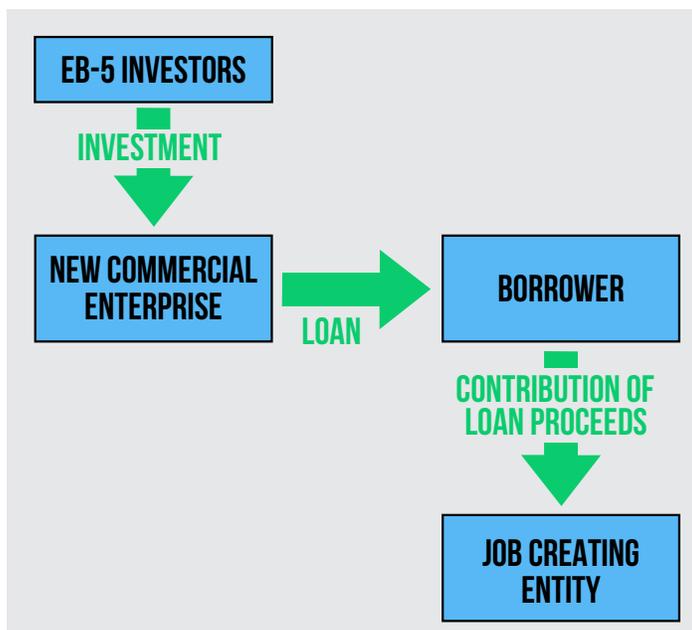
The EB-5 loan agreements should, of course, include standard loan provisions. These would typically include loan term, maturity date, interest rate, repayment terms, representations and warranties, conditions precedent to any loan advance, affirmative and negative covenants, terms of collateral, clear descriptions of events of default (and notice of such events, as well as cure periods) and remedies, among other standard loan provisions. Without question, the EB-5 lender should make every effort to ensure that all loan provisions meet the requirements of the EB-5 Program. As such, having properly drafted loan documentation in place is a fundamental requirement.

Even if strong and compliant EB-5 loan documents are in effect, the EB-5 lender must properly administer the EB-5 loan. The goal of proper loan administration should be to effectively implement the provisions of the EB-5 loan documents. Proper administration should also reinforce lending best practices. Of course, properly drafted EB-5 loan documents should embody the critical elements of lending best practices. If that is the case,

effective administration of properly drafted loan documents will ensure the implementation of lending best practices. Importantly, then, lending best practices begins with the EB-5 lender’s proper focus on the negotiation and drafting of proper and compliant loan documents.

IMPORTANCE OF CONDITIONS PRECEDENT

Logically, until the EB-5 lender makes EB-5 loan advances, there exists little risk. As such, special attention should be paid to the conditions precedent contained in the EB-5 loan documents dealing with the making of EB-5 loan advances, which must be well-considered and



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tailored to fit the type of (and coinciding risks attendant to) the EB-5 project. Such conditions precedent could include, among many others, the EB-5 lender's satisfaction with (i) its due diligence review of the EB-5 project; (ii) the existence and verification of funding of all other financing indicated in the development or other budget for the EB-5 project; (iii) the adequacy and condition of the collateral that secures the EB-5 loan, including the proper recordation or perfection of any security interest in such collateral; (iv) any required appraisal, valuation and/or feasibility or market study; (v) any corporate or personal guaranty to be made by a JCE affiliate; (vi) lien and judgment searches; (vii) the background of the JCE principals; (viii) environmental or other necessary or applicable reports; and (viii) escrow release conditions (if any) having been met.

Of the conditions precedent noted above, some are more critical than others and demand special attention. One of such conditions precedent relates to the JCE having secured and received the other required funding sources forming part of the capital stack for the EB-5 project, as noted above. Simple reason would dictate that the EB-5 lender should not make any EB-5 loan advances until it has confirmed that any required project equity infusions (such as developer equity) and/or senior or construction loan proceeds have been funded. The importance of this condition precedent cannot be overemphasized. Violating this condition precedent would clearly defy lending best practices because it would expose the EB-5 capital to unreasonable increased risk. If the EB-5 project has not secured the necessary equity and/or debt financing, there can be no assurance that all of the funds necessary to complete the project will be ultimately available. Under such a circumstance, the EB-5 lender may have inappropriately exposed the EB-5 investor funds to the risk of project failure and EB-5 loan default.

IMPORTANCE OF AFFIRMATIVE AND NEGATIVE COVENANTS

The inclusion of appropriate affirmative and negative covenants in the EB-5 loan documents may also be used to better ensure EB-5 Program compliance. Affirmative covenants should require the JCE to undertake the project solely within the targeted employment area and in accordance with the project's business plan. Compliance with such an affirmative covenant would ensure necessary job creation requirements. Affirmative covenants may also require the borrower and/or the JCE to: (i) maintain specified net worth, debt service and/

or collateral coverage ratios; (ii) follow specific procedures to keep the EB-5 lender informed of any material changes, adverse developments and/or changes in management or ownership; (iii) provide periodic financial statements and reports and audits or reviews of the financial statements by qualified unaffiliated professionals; and (iv) provide financial statements and certain information regarding changes in the borrower's and/or the JCE's ownership or its business, among other covenants. Similarly, EB-5 investor funds that have been subsequently loaned to the borrower may be better protected through negative covenants, which, among other things, may restrict the borrower from incurring further debt, selling all or a portion of its property, entering into certain agreements or taking other actions that may adversely affect the EB-5 project.

The inclusion of all necessary or appropriate negative and affirmative covenants in the EB-5 loan documents should help better protect the EB-5 lender because a breach of either an affirmative or negative covenant would likely constitute an event of default. Enforcing the EB-5 loan agreement in such a case may permit the NCE to accelerate the loan, enforce its security interest and seek payment from guarantors, among other remedies.

SECURING THE LOAN

The adequacy and sufficiency of the collateral securing the EB-5 loan is another important consideration. To secure the EB-5 loan, the borrower may provide the NCE with a security interest in all or part of its real and/or personal property. In connection with the security interest, the parties should enter into, as applicable, a mortgage (or deed of trust) and/or a pledge and/or security agreement tailored specifically for the EB-5 loan. As explained above, affirmative covenants may be used to ensure ownership by the JCE and/or the borrower of the real and/or personal property that is the subject of the security interest and uncover any issues with title to such property, including any claims third parties may have against the property.

Even if the loan agreement and accompanying security documents are well-drafted, EB-5 investors will not be protected if the collateral is not properly perfected. As such, there must be follow-through to perfect the security interest in accordance with applicable state laws to the letter. This is because virtually any failure to properly perfect a security interest may result in the EB-5 lender losing priority to other creditors. The NCE may then be left without an

adequate remedy in the event of a default by the borrower.

INTERCREDITOR ISSUES

Assuming that the security interest granted by the borrower to secure the loan is adequately perfected, the existence of intercreditor and/or subordination agreements with the borrower's senior lenders may also adversely affect the NCE's ability to exercise its remedies under the EB-5 loan documents. For example, a senior lender may require that the intercreditor agreement include a standstill, which exposes the NCE to the risk that it will not be able to foreclose on the collateral. Senior lenders may insist on such standstill provisions because, among other reasons, senior lenders do not want the EB-5 lender to take any action that might impair the senior lender's collateral or expose it to claims or litigation. Additionally, in the case where the collateral is in the form of a pledge, senior lenders resist having persons that they have not underwritten or qualified wind up as the manager or owners of the borrower upon the EB-5 lender's foreclosure of the pledge. Consequently, senior lenders often restrict who may serve as a substitute owners of the JCE and require that only those who have the requisite experience, knowledge and financial assets be permitted to act as substitute managers or owners of the JCE.

Thus, the borrower should carefully negotiate any intercreditor or subordination agreements with the NCE lender in mind to safeguard the NCE's ability to exercise its remedies under the EB-5 loan documents and the JCE's retention of the flexibility it needs to undertake the project in accordance with the business plan. And once intercreditor and/or subordination agreements are in place, the EB-5 loan documents should be prepared in a manner to not run afoul of such agreements.

SUMMARY OF BEST PRACTICES

The best practices for EB-5 loan documents can be summarized as follows: making sure the loan documents (1) include not just standard loan terms but that such terms are compliant with EB-5 Program requirements and best loan practices; (2) have adequate collateral that is perfected; and (3) take into account any intercreditor issues. Ultimately, because of the central role that EB-5 loan documents play in protecting EB-5 investor funds, it is advisable for EB-5 project principals to seek the assistance of knowledgeable and experienced professionals in the preparation and review of loan documents. ■