

# Combating Construction Fraud To Protect EB-5 Investors:

## The Need for Proper, Industry-Wide Construction Integrity Monitoring



**RUSSELL SCARCELLA**  
DIRECTOR, EXIGER



**CHRISTOPHER PRATHER,**  
MANAGING DIRECTOR AT EXIGER

In April 2016, the SEC cast a shadow over the EB-5 industry when it announced one of the largest fraud cases in the program's history. The Commission charged Jay Peak, a Vermont-based ski resort, with fraud and froze its assets based on the misuse of more than \$200 million of the \$350 million solicited from foreign investors under the EB-5 program. Of the \$200 million, \$50 million was spent on personal expenses—including the purchase of a luxury

condominium. Notably, aside from the charges brought by the Commission against the owner and CEO of the ski resort, a Jay Peak investor is suing the State of Vermont for its negligent oversight of the EB-5 program.

The effect of fraud within the EB-5 program can be far reaching. The Jay Peak scandal decimated the dreams of more than 700 foreign investors, kept hundreds of American jobs from being created under the EB-5 program, and sent contractors into bankruptcy. As a result, reputations within the EB-5 industry were crushed. Indeed, in the wake of Jay Peak, the reputation of Vermont's EB-5 industry was so damaged that state officials considered ending Vermont's involvement with the program.

Jay Peak, unfortunately, was not an isolated instance of fraud, with EB-5 construction fraud continuing to make headlines across the United States and abroad. Among the scandals that have plagued the industry are those involving the Chicago Convention Center, Path America, and the Florida Gateway Regional Center. Often, these scandals involved the misdirection and misappropriation of funds, abandoned projects, substitution of materials, wage and hour violations, and the failure to meet required benchmarks.

Unsurprisingly, these public scandals have resulted in foreign investors and the agents who represent them becoming wary of EB-5 projects. With growing wait times for access to the United States faced by Mainland Chinese investors, foreign investors are concerned about anything that might cause greater delays in the EB-5

process. Eager to minimize that risk, investors may be more responsive to regional center operators and developers who offer transparency into their projects.

Nevertheless, many regional center operators currently undertake limited efforts to demonstrate their transparency and trustworthiness to overseas agents and their investor clients. Specifically, many industry stakeholders have historically held themselves out as conducting background checks and providing construction monitoring with respect to the projects they market, while providing only a low-level employment background screen or an on-site camera allowing investors to view the construction site remotely. However, a robust diligence process requires thorough and proper background checks of regional center operators, developers, and contractors. Additionally, because the investors' capital and dreams are at risk long past the initial due diligence process, a structured method for ongoing monitoring and project oversight is essential.

Moreover, it appears that some agents accept at face value claims by regional center operators and developers that they provide sufficient diligence and construction oversight, without further inquiry. As noted by Roy Carrasquillo, a partner in Cozen O'Connor's EB-5 practice group, although the immigration aspect of the EB-5 program is subject to extensive monitoring, "the construction and development aspect of the system has lacked sufficient scrutiny thus far." Without sufficient oversight, Carrasquillo believes that the door is left open for the developer to "use funds inappropriately."<sup>1</sup> Despite the availability of proper, robust, and reasonably cost-effective solutions, the measures

1 <https://www.constructiondive.com/news/development-boon-or-fraud-risk-inside-the-controversial-eb-5-immigrant-inv/433852/>

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currently proffered by many regional center operators and developers are inadequate to ensure project integrity.

So what can be done to provide greater transparency and integrity? With pending legislation that will eventually force operators and developers into action, regional center operators and developers should respond proactively by including greater integrity measures in their projects. Doing so will effectively set these operators and developers apart from their competitors by demonstrating a genuine desire to protect their integrity and ensure transparency. An increasingly popular option in accomplishing this among both public and private sector entities is the use of construction integrity monitors, engaged by state and local developers for more than 20 years with great success.<sup>2</sup>

Integrity monitors are engaged to detect and prevent fraud, waste, and other unethical behaviors in the first instance—often before they become public or cause reputational damage. Thus, integrity monitors can help send a valuable message to foreign investors and agents: that the regional center operators and developers care to maintain their integrity, and are not merely concerned with meeting the minimum regulatory requirements to maintain operations. Beyond these benefits, an integrity monitor can save hundreds of thousands of dollars through fraud prevention as well as in litigation fees resulting from alleged fraudulent activity.

Importantly, integrity monitors are third-parties, known for their skills and integrity, who are completely independent of the projects, developers, and regional centers. As EB-5 veterans know, all too often, the developer, NCE, and regional center are

affiliated—or, worse yet, one and the same. As observed by Ronald R. Fieldstone, a Partner with Saul Ewing Arnstein & Lehr LLP, nearly all EB-5 fraud cases involved a funds user who was also responsible for monitoring fund disbursement. Fieldstone believes that “[t]here must be independence in the process whereby a competent party unaffiliated with the developer/JCE is monitoring the process to insure integrity, in much the same manner as an institutional lender would oversee a construction loan.” He noted that the majority of regional centers and general partners or managers of the NCE simply lack the expertise to provide this oversight. Because of this, he encourages they seek the help of independent third parties who have experience with such oversight and can mitigate the risk of fraud.

The EB-5 industry needs trusted, independent, third-party professionals to provide true integrity diligence. Such diligence includes incorporating proper techniques and tested measures in background due diligence and construction integrity monitoring that go beyond a mere superficial review. Accordingly, a construction monitor must review the project details, focus on contractual and legal compliance, and work to detect waste, or even fraud.

As a best practice, a properly designed construction integrity monitorship should include the following four aspects of integrity oversight:

- (1) a preliminary contract document review that includes examining the construction contract plans, checking the reasonableness of the project schedule and budget, and flagging areas of risk;
- (2) scheduled monthly on-site reviews of the actual construction and the

current financial status of the project to prevent typical frauds and keep investors aware of project status, as well as a thorough review of Draw Requests to analyze overall billing and supporting documentation;

- (3) unscheduled monthly site inspections to deter fraudulent activities on the job site and include oversight of a variety of construction issues that are susceptible and historically tied to fraud; and
- (4) quarterly construction progress reports that summarize all monitoring tasks performed during that quarter in addition to any recommendations for improvement or identified weaknesses.

Ultimately, enhanced integrity measures, such as in-depth background investigations and proper, independent construction integrity monitoring, will serve all EB-5 stakeholders. Such integrity measures may better protect investors against fraud and deceptive construction practices that can delay or destroy their immigration dreams, while agents, regional centers, and developers may also benefit by better safeguarding their reputations. Regional centers and developers will also enjoy greater protection against financial and reputational risk, while also allowing for a distinct marketing advantage.

Considering the cost-benefit balance, regional centers and developers should consider employing deeper integrity measures, including monitors in the right instance. Providing this level of transparency to investors and agents would allow the EB-5 industry, as a whole, to develop a stronger reputation for proactive self-regulation, enhanced integrity, and greater transparency to investors. Now is the time to embrace these practices. ▶

<sup>2</sup> See, for example, the description of the New York City Integrity Monitor, run by the City Department of Investigation, at <https://www1.nyc.gov/site/doi/about/integrity-monitor-program.page>