

CROWDFUNDING IN EB-5: Securing Funding From the Immigrant Investor Crowd



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Crowdfunding persists as one of the hottest topics of the business investor financing and securities worlds, since its introduction via the JOBS Act (“Jump-start Our Business Startups”) passed by Congress and signed into law by President Obama in 2012.*¹ Crowdfunding has revolutionized raising investor funding for small- and medium-sized businesses in every industry, from real estate development to manufacturing, agriculture to technology, energy to movies. Its use in EB-5 continues steady growth, offering the chance to expand marketability in a significantly constrained industry while potentially reducing sky-high fees.

What is “crowdfunding”? Simply, raising funding from a crowd. Initially, the idea was to raise small amounts per investor from a large number (a crowd) of investors. In order to reach large numbers of possible investors, the new technology of the internet is used (along with print, radio, and television) to publicly advertise an offered investment to complete strangers located

¹ As used here, “crowdfunding” relates to investment or equity crowdfunding, as opposed to charity, gift, or reward crowdfunding of the classic Kickstarter or Indiegogo variety that does not involve investing for an ownership stake.

locally, regionally, nationwide, and/or across the globe – and not only investors with whom the issuer or its brokers were already introduced. In addition to strangers, a business can reach out to its existing stable of social media connections, through Facebook, LinkedIn, Yelp, etc. And finally, funding could be accepted not only from accredited (wealthy) investors, but in many cases from less wealthy “unaccredited” or non-accredited investors (the pool or “crowd” of which dwarfs in sheer numbers the comparatively limited crowd of accredited investors).

The JOBS Act is actually a set of six acts, each with its own specifics and implementing regulations recently promulgated by the Securities and Exchange Commission (“SEC”), and all of them intended to make easier the funding of businesses, especially smaller ones. The three JOBS acts most relevant to business crowdfunding (including EB-5) all share the new permission to use broad public advertising (especially the internet) to raise money from investors without full formal registration, an outreach strategy previously denied businesses

since the securities laws were first adopted over 80 years ago. Further, two of those three avenues allow pursuit of the huge new class of unaccredited investors that effectively has not previously been allowed to invest.

Briefly (and generally), the three key JOBS Act crowdfunding laws are the following:

- Title III, “Regulation Crowdfunding” (“Reg CF”), which allows both accredited and unaccredited investors to participate, for businesses seeking up to \$1,070,000 maximum per year;
- Title IV, “Regulation A+”, the “Mini-IPO” (“Initial Public Offering”), allowing raises of up to either \$20 Million or \$50 Million every 12 months from both unaccredited and accredited investors following SEC “qualification” of an issuer’s proposed offering materials submitted, refined, and ultimately approved by SEC prior to commencement of the raise; and
- Title II, which added new “Rule 506(c)” to the long-standing Regulation D exemption, a new rule for offerings with no maximum that now allows public advertising, but only permits investment by accredited investors whose status as such is affirmatively verified.

How do these relate to the EB-5 industry?

Regulation CF. Practically, the Reg CF \$1 Million ceiling is too low to be availed for the standard EB-5 regional center indirect project, almost all seeking funds in excess of that cap.

This does not necessarily mean end of story for all EB-5. A small project seeking one or two \$500,000 investors that it hasn’t already identified, could use this avenue to find them, through the public advertising allowed by Regulation CF (again, primarily via the internet). Since CF investors need not be accredited, low net income or a net worth no greater than, say, the investment amount may still permit the investment (assuming satisfaction of a 5-10% net worth/income

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requirement or a ceiling, calculated for each investor). Launch time is fast, costs (including filing a Form C) are moderate, and Reg CF preempts state blue sky securities compliance, so for the right small EB-5 project, there is a definite opportunity. Flip side: there are ongoing business and financial reporting issues as well as portal participation complexities.

Practice Pointer: Involvement of experienced securities counsel to guide analysis whether Reg CF truly affords a cost-effective avenue for the particular small EB-5 project is essential.

Regulation D Rule 506(c) is the JOBS Act crowdfunding regulation already being increasingly utilized in EB-5. It uses the standard, tried-and-true Reg D exemption and rules, but with a major twist: instead of prohibiting public advertising as in “old Reg D” (now referred to as “Rule 506(b)”), using new Rule 506(c) expressly permits general solicitation of prospective investors. However, two significant additional requirements are mandated: while anyone (accredited or not) may be solicited, sales may only be made to investors who are in fact accredited; also, prior to accepting a subscription the issuer must take affirmative “reasonable steps to verify” accredited status (the old written questionnaire where investors “self-certify” they are accredited will explicitly not suffice).

These are the only new wrinkles (positive and negative) to Reg D required by the new Rule 506(c). Otherwise, Reg D operates as always. Total raise ceiling remains unlimited (except as impacted by other securities laws, such as the Investment Company Act of 1940), time to launch is very fast (relatively), transaction costs are low, SEC filing is light (Form D), no ongoing audits or financial reporting is required (though advisable), state qualification is preempted, and other than accredited status the only investor requirements are effectively those imposed by the EB-5 Program itself (the investment minimum whether TEA or not, and perhaps sometime soon, rural or other set-asides, etc.).

Practice Pointer: Unlike non-EB-5 Projects, which rarely use the Regulation S “foreign offering” exemption, most EB-5 offerings are structured to claim both the Reg D and Reg S exemptions simultaneously. If one exemption is lost, the other can function as a “fall-back” to maintain the exempted status of an EB-5 raise and avoid the dire consequences of conducting

a non-exempt, unregistered offering. In a crowdfunded EB-5 offering, since both Reg S and Reg D Rule 506(c) allow public advertising, continuing to harmonize concurrent reliance on the two exemptions seems easy. However, the Reg S exemption not only limits investors to “non-US persons,” but while it contains no apparent limit on advertising, does preclude “conditioning the US market,” understood to include public advertising inside the United States. Since 506(c) allows public advertising, while Reg S allows advertising but only outside the USA, harmonizing the two requires complying with the more restrictive requirements. That means conducting targeted media advertising strictly overseas and limiting web content from access by US-based users (usually identifiable by US-based addresses).

Why bother? General advertising over the internet (especially) permits crowdfunding issuers to reach out to prospective investors without having to go through intermediaries such as brokers who require heavy fees as the price for their introductions to captive investors. It also permits issuers seeking large numbers of investors to reach large crowds of potential investors, and to target those who might be self-segregated by their expressed interest in certain types of investments: say, real estate versus movies, or EB-5 versus non-immigrant investing. Finally, social media over the internet enables businesses to create stables of fans, customers, users, business connections, admirers, and the like, many of whom might welcome an opportunity to invest financially in the business to which they are already socially connected, and thus form a readily-available and entirely independent (of middlemen) crowd of potential funders.

Practice Pointer: Some EB-5 issuers elect to use 506(c) even though they have no intention of pursuing investors directly on their own, and are willing to pay the placement fees associated



with foreign brokers soliciting investors as usual. These issuers elect 506(c) compliance as an “insurance policy,” in case inadvertent public advertising or general solicitation should occur in connection with their offering that would violate “old Reg D” (Rule 506(b))—because issuers who have not conducted timely accredited investor verification would be unable to retroactively claim reliance on 506(c) as a default or fall-back position (verification prior to subscription being an affirmative obligation to claiming the 506(c) exemption).

Given Reg D’s unlimited offering size, and absence of formalities whether up-front or ongoing, EB-5 issuers are primarily using crowdfunding targeting immigrant investors through Rule 506(c). Just a small sampling of some of the crowdfunded EB-5 offerings on which our firm has worked include:

- A New York-based restaurant chain that has successfully obtained direct EB-5 investment for financing a number of its locations, typically with one or two investors per restaurant contributing toward a total budget of \$1.5 million for each location, using 506(c) to reach investors through an internet crowdfunding platform established by an EB-5-experienced investment advisory firm.

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- A California Bay Area regional center that has crowdfunded three of its EB-5 investment opportunities, all multi-family residential and mixed-use projects raising from \$7 Million to well over \$50 Million, through a global 506(c) offering, or alternatively via Regulation S combined with California’s “Blue Sky” (state securities) exemption afforded by that state’s Corporations Code Section 25102(f).
- A Texas regional center raising over \$100 Million for a mixed use development combining Rule 506(c) with a fall-back reliance on Regulation S (via a distinct companion offering) for investors unable or unwilling to verify accredited investor status as required by 506(c).

Regulation A+ offerings are called “Mini-IPOs” not only because the offering ceilings are significant (up to \$20 or \$50 Million in every 12-month period), but also because they require SEC pre-qualification of written offering and marketing materials through a back-and-forth process that can take weeks to complete. Such a time-consuming process,

involving possibly rewriting offering materials until the agency is satisfied, can certainly result in longer timeframes and markedly higher cost, both up-front and ongoing. Periodic business and financial filing requirements are more burdensome, and there may be state compliance or else ongoing reporting obligations. On the other hand, the end result is a set of materials bearing the potentially great marketing advantage of having been vetted by SEC and therefore considered more credible and complete. An issuer who plans in advance may find the time delay needed to secure SEC qualification could be made to accommodate its EB-5 calendar, so the additional expense and delay could be well worth it where timing permits.

Practice Pointer: Since unlike Reg D, Reg A+ investors may be accredited or unaccredited, it appears potential EB-5 investors with \$500,000 to invest but not \$1 Million of net worth or otherwise sufficient income to meet accredited status could participate, however there are investor limits (10% net income or net worth for unaccredited) that complicate this. Consequently, a typical EB-5 project crowdfunding its raise using Reg A+ would need to carefully examine the particulars of those unaccredited investors it targets—or else accept accredited only, currently the typical practice in the EB-5 industry. This likely

explains why my firm is only now seeing serious interest by EB-5 issuers in the benefits of using the Reg A+ crowdfunding avenue, while clients have been doing EB-5 via 506(c) for quite some time and on a strongly increasing trajectory.

Conclusion. Crowdfunding presents additional avenues for an increasing number of EB-5 issuers to reach many more investors, shorten offering timetables, and greatly reduce marketing expenses. Those avenues include complexities as well as advantages, so they present further trade-offs requiring a careful weighing of the balance of pluses versus minuses. For those issuers whose potential benefits exceed the drawbacks, crowdfunding can contribute to facilitating a more successful (faster and less costly) EB-5 offering and thus a more successful EB-5 project, without requiring huge additional investment in education, professional fees, or interaction with governmental personnel. This is no doubt the reason why increasing numbers of EB-5 issuers are including crowdfunding approaches in their project offerings. Issuers in the planning and structuring phases are strongly advised to consult with experienced securities crowdfunding counsel to thoroughly investigate whether those advantages can be realized on their own raises, as they have by an increasing crowd of their EB-5 industry colleagues. ▀

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