EB-5 Bridge Financing: A Study of Market-Driven Applications & Definitions

DAVID HIRSON, ESQ.
MANAGING PARTNER, DAVID HIRSON & PARTNERS, LLP

NIMA KORPIVAARA, ESQ.
PARTNER, DAVID HIRSON & PARTNERS, LLP

PHUONG LE, ESQ.
PARTNER, DAVID HIRSON & PARTNERS, LLP

In this article we explore the evolution of bridge financing in EB-5 projects and the role the United States and Citizenship and Immigration Services ("USCIS") has played in defining the acceptable parameters and uses for the EB-5 industry. We will trace the USCIS' position since it officially stated in its May 30, 2013 EB-5 Policy Memorandum that projects could use bridge financing and still be credited with job creation. From there we present a modified definition along with an analytical framework to bridge the understanding between policy and application, so we can explore the current parameters of what USCIS considers acceptable bridge financing for the purposes of job creation[1].

A MODIFIED DEFINITION & ANALYTICAL FRAMEWORK:

While the general definition of bridge financing is largely unchanged since the May 30, 2013 EB-5 policy memorandum,[2] here's a modified definition that may be a useful way of understanding USCIS' intent/adjudication:

> *Generally, the JCE can use EB-5 funds to repay the JCE's short-term or temporary funding that is necessary for completion of a project. This is true regardless of when the JCE contemplated the need for bridge financing at the beginning of project development. While not clearly defined, absent any other compelling factors, USCIS has referenced 1-2 years as an acceptable "short-term" to be approximately 1-2 years.*

As we will further explore below, while bridge financing was adopted by USCIS as a pragmatic solution to allow projects to overcome unexpected delays and obstacles, the general definition provided by USCIS is best analyzed in conjunction with how the EB-5 market

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1 For simplicity's sake, below, we use the term Job Creating Entity ("JCE") to refer to the entity that is ultimately responsible for receiving/using the EB-5 funds for project development and job creation. It may be the developer, an affiliate of the developer, or the Special Purpose Entity formed to build/own a particular project. However, this distinction is critical because it will ultimately decide whether a project's temporary or short-term financing will be eligible for replacement with EB-5 funds.

2 The current definition can be found at USCIS Policy Manual, Volume 6, Part G – Investors, Chapter 2(D)(1) -- "Eligibility Requirements" – Section D.1. "Bridge Financing" (August 23, 2017) (available at https://www.uscis.gov/policymanual/HTML/PolicyManual-Volume6-PartG-Chapter2.html#S-D).

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applies adjudication standards to real life situations.

A. WHAT IS THE "NEXUS" TO THE PROJECT

As a preliminary matter, perhaps most importantly for bridge financing to be acceptable, the "short-term" financing that is being repaid with EB-5 funds must have been spent on expenditures related or necessary to the project for the EB-5 investors to receive credit for job creation. In other words, complete this sentence. "But-for this funding, the project could not have been completed because_____________." Two factors to consider are: (1) where the supposed bridge financing fits into the project's overall capital stack; and (2) when was it necessary.

On one end of the spectrum, a short-term loan to pay for construction costs in advance of the EB-5 loan closing is uncontroversial. On the other hand, USCIS and the Immigrant Investor Program Office ("IPO") has specifically rejected (including during the recent November 2017 EB-5 Stakeholders Teleconference in New York) the use of EB-5 funds to buyout developer/owner equity when it appears that it was not contemplated as a short-term contribution or to pay down permanent financing. This makes sense if we look at it from an economic policy standpoint. The first situation has a direct nexus to the project's development and thus creates economic benefits to the surrounding community. The second situation provides no economic benefit or jobs to the community because of a lack of project-related nexus and EB-5 is being used to facilitate a paper transfer of wealth or to refinance and help lower the cost of capital for a project.

Any understanding of bridge financing will thus depend on the facts or circumstances and the underlying terms, which should always be explained by the JCE.

While USCIS has stated that there is no specific memorialization needed to qualify bridge financing, as a best practice it is advisable that the bridge financing be disclosed to both USCIS and the EB-5 investors whenever possible. If bridge financing was contemplated before the EB-5 offering went to market, the business plan and offering documents should include descriptions and disclosures of the funding being replaced. If the bridge financing occurred after the project went to market, at a minimum the JCE should provide the bridge financing documents to both the NCE and EB-5 investors and a statement explaining the circumstances and need for the short-term financing and the project-related nexus.

B. EB-5 FUNDS MAY ONLY BE USED (1) BY THE JCE (2) TO REPAY THE JCE'S BRIDGE FINANCING

It is critical to understand that even if it is a necessary project cost, EB-5 funds can only be used by the JCE to repay the JCE's bridge financing.

The two key questions to keep in mind are: (1) Which entity is repaying bridge financing? (2) Which entity is legally obligated to repay the bridge funds? While seemingly straightforward, this is an issue that can easily be overlooked that brings devastating consequences.

Recently we conducted a peer review of a project with affiliated entities. A parent company (not the JCE), takes out $3 million from a revolving line of credit to help purchase land necessary for completion of the project. But-for the land, another buyer would purchase the land. EB-5 funds are then used to repay the $3 million line of credit. Is this acceptable?

- Potentially risky, because the bridge financing belongs to the parent company instead of the JCE. This is a common pitfall in projects with affiliated entities. Here, it is likely that this would be categorized as both short-term financing and necessary to the project. However, it could be denied because the bridge financing that is being repaid is not the JCE's—it is the parent company. Note it would be acceptable if the JCE first sought a short-term loan from the parent company to purchase the land and then the JCE repaid with EB-5 funds

In another similar situation, the parent company took out a bridge loan on behalf of the JCE, who then uses it for project-related hard construction costs. The NCE raises EB-5 funds and then pays off the bridge loan. Is this ok?

- No. While the bridge loan may have otherwise qualified for repayment with EB-5 funds, the case would be denied if the NCE paid off the bridge loan directly. For EB-5 investments to qualify as fully at-risk, all EB-5 capital contributions raised by the NCE must be made fully available to the JCE before it can be used on the project. Here, it would have been acceptable if the NCE had simply issued the entire amount of the EB-5 loan to the JCE before the JCE repaid the bridge loan.

The above distinctions must be understood because both scenarios could easily have been avoided with simple planning.

C. WHAT IS "SHORT-TERM" OR "TEMPORARY" FINANCING?

Aside from a project-related nexus, pay careful attention to the underlying terms of the bridge facility being repaid. To paraphrase an adage, if it looks, smells, and acts like a permanent loan, then it will likely get adjudicated (and denied) like one as well absent a compelling credible explanation. Substance—not labels—matter.

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The simple reality is that there is no such thing as a standard short-term or temporary financing arrangement. Thus, it is critical to analyze and explain the underlying substance and nature of the short-term financing arrangement. For example, during the recent November 2017 EB-5 Stakeholders Teleconference mentioned above, it was remarked that there are multiple exotic flavors of short-term financing in the world of real estate development. Sometimes bridge financing terms run for 3 years or longer. This may be true, but then the analysis cannot end there. It is necessary for a project to explain the need and context.

Consider this scenario: A project costs $120 million and acquires $20 million in debt that is set to mature in 5 years. The project is set to be completed within 5 years. Could this qualify as "short-term" financing eligible for repayment of EB-5 funds?

The answer is "perhaps" depending on the underlying terms; the difference can be like night and day:

- On one hand, if the $20 million loan was acquired from an institutional lender at standard market rates, then this probably would be rejected as an attempted refinancing of long-term debt with EB-5 funds.
- On the other hand, it would be much different if the JCE raised $20 million by issuing preferred shares in itself, and the underlying terms include economic incentives or restrictions to accelerate repayment of the preferred equity, such as punitive escalator clauses that double the preferred return unless the JCE buys out the preferred shareholders within two years.

As illustrated above, the answer is fact-dependent and not always straightforward. This is compounded by the fact that in the world of finance, you can find an endless menu of creative options for whatever your heart desires.

Other factors that may trigger scrutiny because they resemble permanent financing (and thus need careful explanation) are loans that comprise a large amount of the capital stack and maturity dates that are over two years or coincide with project completion. Thus, when a JCE anticipates USCIS may question whether the bridge financing's terms qualify as temporary, it may be advisable to provide an explanation of why it qualifies as "temporary" to preempt a Request For Evidence or Denial. Another option, if possible, is to include provisions in the documents memorializing the bridge financing that state that the funds have been issued in contemplation of repayment by EB-5 funds.

D. EB-5 FUNDS CAN BE USED TO REPAY SHORT-TERM EQUITY? SO I CAN BUY MYSELF OUT RIGHT? (NOT SO FAST)

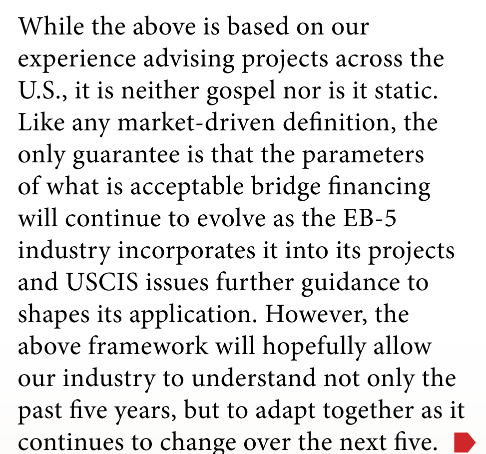
One final area that causes confusion is what constitutes acceptable "short-term equity" for replacement with EB-5 funds. While USCIS has yet to issue clear guidance on this issue, when a developer or project asks whether their equity may qualify as "short-term," we typically advise them to proceed with caution because it will likely invite increased scrutiny from both USCIS and the EB-5 investors.

A specific situation that would be an acceptable example of "short-term equity" is when the developer is the JCE and raises funds to purchase land by issuing preferred equity in itself. Say the preferred shares include restrictions that block any development of the project before they are retired and also include a put option that kicks in after X years that doubles the preferred return. While the JCE was able to purchase the land, it is clear from the underlying terms that they have every economic incentive to retire the preferred shares as soon as possible.[3]

On the other hand, say a JCE that provides $20 million in land for project development and later claims it was short-term equity to be replaced with EB-5 funds may run into problems with both USCIS and the EB-5 market. Absent a compelling or credible explanation, in most scenarios USCIS would likely reject this as a creatively disguised early cash out of the JCE's own equity. Moreover, at a minimum, it should be disclosed in the EB-5 and offering documents that the JCE intends to replace their short-term equity with EB-5 funds. If there is no other equity in the project, this could be self-defeating for marketing purposes and completely turn away agents or investors.

While it requires a fact-based analysis based on the project, practically speaking, absent a compelling or credible reason, in most instances if the JCE is attempting to replace short-term equity it will likely be difficult unless it is the equity of other shareholders in the JCE, rather than the JCE itself (e.g., project owner or developer), unless it can be established that the equity was contemplated as short-term or temporary.

CLOSING THOUGHTS



While the above is based on our experience advising projects across the U.S., it is neither gospel nor is it static. Like any market-driven definition, the only guarantee is that the parameters of what is acceptable bridge financing will continue to evolve as the EB-5 industry incorporates it into its projects and USCIS issues further guidance to shapes its application. However, the above framework will hopefully allow our industry to understand not only the past five years, but to adapt together as it continues to change over the next five.

3 Preferred equity comes in many flavors and can easily be the subject of its own article. However, for another real-life (albeit non-EB-5 example) of preferred equity that would likely qualify under this criteria, see Vornado's stake in Jared Kushner's 666 Fifth Avenue: https://therealdeal.com/2017/09/20/behind-kushners-record-deal-for-666-fifth-an-unusual-appraisal/