Hiring Professional Money Managers to Lower and Diversify Project Risk Should be a Must for Investors

ABTEEN VAZIRI
MANAGING DIRECTOR, BREVET CAPITAL MANAGEMENT, IIUSA DIRECTOR

The effect of fraud within the EB-5 progOne of the first questions that EB-5 investors are coached into asking regional center operators is whether the project operator has any I-526 approvals, I-829 approvals, or any project paybacks. These lines of questioning are somewhat unfair, and their answers are potentially misleading given that many newer regional centers have not been around long enough to have reached the point of I-829 approvals, and hence project paybacks. For most EB-5 investors, the most important criteria in evaluating an EB-5 investment is approval of their I-526 petition and ultimately securing conditional and permanent residency for themselves and their families. The second criteria is the likelihood of receiving a return of their capital. While investors seek out and hire the top immigration attorneys and select projects with a past history of I-526 and I-829 approval in order to maximize the likelihood of securing the first objective, the majority of investors seek little to no outside counsel in evaluating the second. Selecting a project with an exemplar petition approval record and hiring a competent attorney only decreases the risk of not attaining the first criteria, but does nothing for the second criteria. Why are investors not hiring professional money managers to manage their EB-5 real estate investors? Why is there not enough emphasis on this point by the industry? Securing ***both*** permanent residency and a return of investors' funds should be the goal for all EB-5 investors. In addition to evaluating project performance and hiring top immigration attorneys, investors should be as focused on hiring professional money managers to oversee investment strategy in order to achieve the best results from EB-5 investment.

Today there are more than 1,100 regional centers, and less than 10% of them existed even 5-7 years ago. Given that the EB-5 project cycle can often take 8 years or more, the vast majority of them have not had enough time in the business to have completed an entire cycle. One look at the statistics posted by the United States Citizenship and Immigration Services (USCIS) for fiscal year 2017 shows that roughly 89% of all the I-526 applications and close to 80% of all I-829 applications adjudicated in that year were approved. Those percentages are fairly good. And while many agents in China and elsewhere focus on these approval ratings as if they are some sort of stamp of approval on a project's viability, the truth is that the USCIS is not approving EB-5 projects based on their viability as projects or the ability of the projects to pay back investors. At the I-526 stage the USCIS is looking at the projects to evaluate if they meet the very broad statutory requirements for approval of the immigrant petition. These criteria essentially focus on job creation, TEA designation, and other technicalities such as a comprehensive *t* business plan, and the investor's source of funds for the investment. At the I-829 stage the USCIS is verifying that the project dollars were spent, and the project created the required number of jobs.

Approval of the I-526 and I-829 criteria may give investors the false sense of security that the USCIS is evaluating the viability of these projects, but that could not be further from the truth. Investors hire the top attorneys in the business to ensure that they meet these I-526 technicalities, and in some cases, investors evaluate many law firms to choose only the best—ones that boast 100% approval rates and over 1,000 I-526 and I-829 approvals under their belt. Neither the USCIS nor the immigration attorneys, however are required or qualified to evaluate the investment itself. Therefore while investors, and placement agents do quite a bit of homework on selecting the right attorneys and projects that have been exemplar approved, they are performing virtually no research on what projects are most likely be able to pay them back their investment. An 89% and an 80% approval rate of the immigrant petitions is a good result, but it gives zero insight into the investors' ability to get their principal investment back at the end of the EB-5 process.

Much of this is the result of lack of underwriting ability by EB-5 regional center operators and immigration attorneys not being properly equipped in giving advice in real estate and finance. Other reasons are the complexity of real estate capital structures in the United States and development procedures in other countries being completely different.

In fact, while the rate of immigrant petition approvals may be relatively high, the rate at which investors are securing a return of their investment appears to be disturbingly low. Although there are not exact figures as to the total amount of dollars that have been invested through the EB-5 program since its inception in 1993, a few unverified reports indicate that the total amount is between $27 billion and $30 billion over the last 25 years. It is true that some of the EB-5 funds that have been raised are not yet due for a payback, but relatively speaking there have been very few projects that have returned investors' funds. Some projects are years overdue on payment deadlines according to their loan documents. Those projects that have paid back investors, which have been few and far between, have been sure to widely advertise this feat. One regional center that has been around for over 30 years boasts

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having paid back 23 projects' investors totaling over $860 million. While there are no public databases with published data on this topic, and the USCIS does not publish repayment statistics, assuming that $10 billion out of the $27-30 billion of the EB-5 project funds raised are not due for repayment yet, one can estimate with a fair amount of certainty that the total amount of repaid funds is under $1 billion. This would imply that the amount of funds invested in projects that have been paid back is in the 5% range. This data clearly shows that the biggest risk for EB-5 investors is therefore not the regional centers' ability to get them their green cards, but the regional center's ability to repay the investment. Even the reputable regional center with 23 paybacks discussed above currently has reports that one of their projects with a few hundred investors already invested may ultimately never break ground. As the famous securities law disclosures from most broker dealer e-mails state: "past performance is not an indication of future results." Why are EB-5 investors and agents so obsessed with past performance when the securities regulators are telling investors that past performance should not be relied on?

The answer is a bit complicated. Part of the reason is because EB-5 regional centers and fundraisers have traditionally been real estate developers and marketing specialists, and not sophisticated financial institutions like the investment banks on Wall Street that manage assets for high net worth clients. The risk to investors of not receiving their capital back is a result of various factors which include: numerous project failures in the form of Ponzi schemes, outright frauds, projects that have been underwritten poorly or have been in non-traditional assets classes that banks do not lend to (which makes them very difficult to refinance), and other shortcomings that have become favorite topics for headline financial news over the past few years. For EB-5 investors, to lose their EB-5 investment does not just have financial consequences. It can lead to immigration consequences as well. This is why fiduciary duties to EB-5 investors should be adhered to with a much greater degree, and "[n]ot honesty alone, but the punctilio of an honor the most sensitive" should be the standard of conduct for these project operator fiduciaries.[1] However, the lack of expertise that can be provided by professional financial managers exacerbates these risks.

The other potential answer is that the portfolio model of investment has been more difficult to get approved by the USCIS for reasons that I will explain, and that has deterred others from adopting this model. From an investment viewpoint, single project failure should be all the reason more why investors should look at diversifying in an EB-5 portfolio fund. Historically however, there have been numerous attempts at projects in a portfolio model that have been denied, and relatively few that have actually been approved. More recently, however, this trend may be shifting as more portfolio models have been receiving approvals. The USCIS does not allow the pooling of jobs but does allow the pooling of assets in an EB-5 portfolio fund, and this has been the differentiating factor between the portfolio models that have been approved by the USCIS and the ones that have been rejected. Now that the USCIS has approved portfolio models, this could be the future of the industry, reversing the trend of such low percentages of estimated returns of investor capital.

Diversifying is the best way to lower project risk, as we have seen that even project operators with perfect project success rates and project payback rates can have a blowup. One example of a portfolio fund model is an EB-5 fund based out of Florida that was the first successful fund in getting approval from the USCIS. The way they got approved was by pooling investors' funds together in order to diversify investors' risks, but requiring investors to pick one project for job creation purposes. What that means is that, for the purposes of meeting the investors' job creation requirements in the immigration context, I-526 petition and I-829 petition success are still reliant on the completion of one project, but the investors' return on their investment and capital at risk can be diversified across a pool of investments.

Under portfolio theory, the less correlation that investments in a portfolio have to each other the less variance that the portfolio will have. What this means is that a portfolio of all technology stocks or all energy stocks will theoretically have a higher variance than one that has less correlation by having stocks from different industry sectors. This can also be mimicked in an EB-5 portfolio fund. Such EB-5 portfolio funds theoretically can help minimize investors' variance by the number of investments in the portfolio. They may also lower the variance by having different asset classes in the portfolio and assets in different geographic locations across the United States. The less homogenous the projects, the less variance that the portfolio will have according to *Modern Portfolio Theory*. Asset classes such as hotels, apartments, condos, office buildings, and retail outlets all perform differently in different parts of the real estate cycle. Also, different regions in the United States can be affected differently by regional downturns or natural disasters. Imagine having a portfolio of EB-5 projects that are all located in Puerto Rico or New Orleans where all such projects could be affected by a single tropical storm or hurricane or any other geographic event. Having a well-balanced portfolio of EB-5 projects that lowers investors variance by the number of investments, asset classes, and geographies can conceptually lower an EB-5 investor's variance, and hence investment risk. The way money managers have reduced, and diversified investment risk has always been by diversifying and lowering the investment variance.

Implementing a successful Portfolio Model in the context of EB-5 investment is a highly complex strategy with the potential to yield key financial returns at the end of the EB-5 project cycle. This is why more emphasis should be placed by investors on hiring professional money managers for their EB-5 investments. In the EB-5 marketplace where almost all projects get approved for job creation by the USCIS, regardless of their safety or viability, the industry's focus has been on good attorneys, exemplar approvals and hence green card approvals, instead of return of their capital. Although getting green card approval is very important, it should be just as important for the industry to focus on taking steps to make sure EB-5 investors can receive their investment back. Where the industry has 89% initial green card application approvals but less than a 5% payback rate, one can see that emphasis is lacking in one of the two important investment criteria by the investors. The industry has always focused on trusting the top immigration attorneys for the first category, but the industry has never focused on trusting the top money managers for the latter category. We hope that more of the industry begin focusing on the last point. By giving more trust to professional attorneys **and** professional money managers, there should be no reason why both categories cannot achieve a greater than a 90% success rate.

1 Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928)