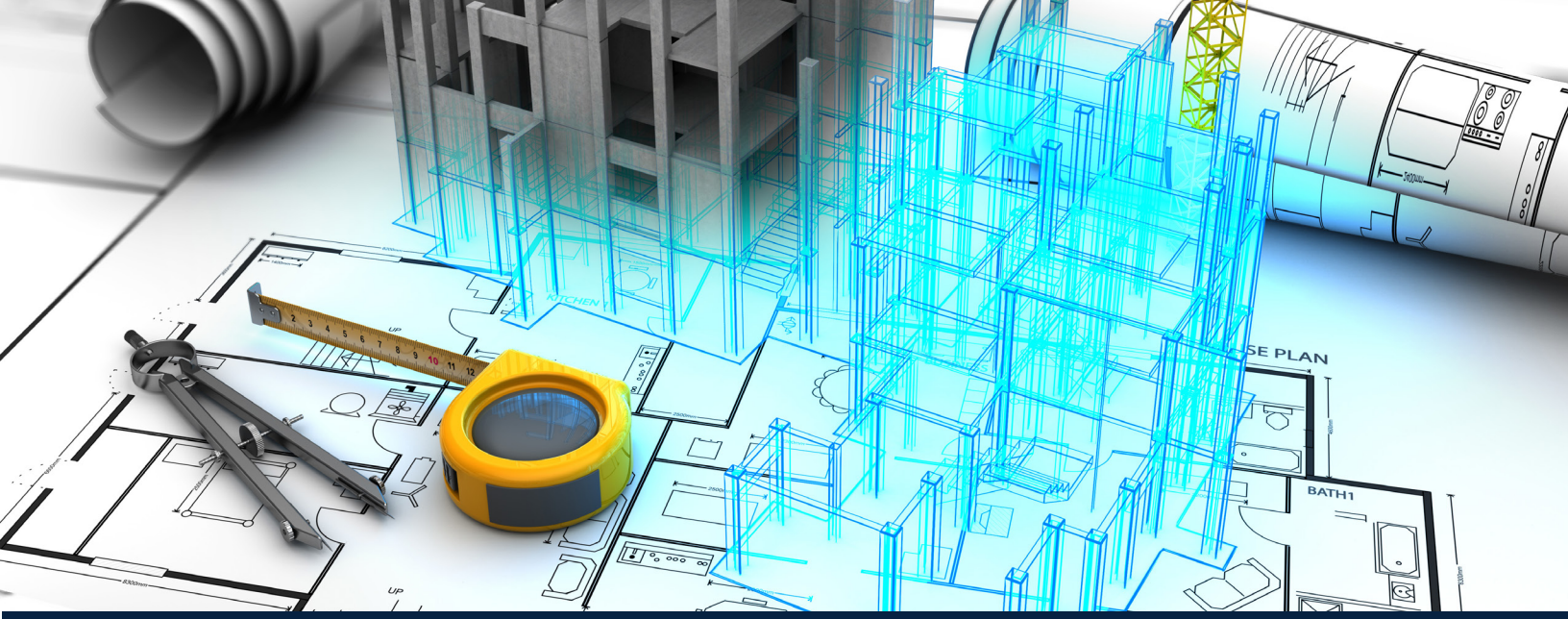

EB-5 Investor Trends:

Shifts from Large Real Estate Projects

MONA SHAH, ESQ.
PARTNER, MONA SHAH & ASSOCIATES GLOBAL

CHRISTINA DILBONE, ESQ.
ATTORNEY, MONA SHAH & ASSOCIATES GLOBAL

Introduction

The dominance of large real estate projects in EB-5 investment financing began as a result of the 2008 Great Recession in the United States. The years 2008 and 2009 were historically catastrophic years for real estate development in general, and for hotel development in particular. Obtaining financing from conventional lenders became increasingly difficult, construction loans notably being the first victims. On January 16, 2009, USCIS released a policy memorandum that would facilitate the infusion of EB-5 funding into the real estate industry through the counting of indirect and induced jobs created through construction. The result was to provide alternative financing for real estate developers that could be structured as short-term, low-interest, and sometimes unsecured or membership interest only secured, loans. During this period, EB-5 investors came to the rescue of many troubled hotel and real estate developments. Following the recovery of the market, real estate developers continued to seek low-interest EB-5 financing, most often used in place of mezzanine capital, saving themselves millions of dollars. The collateral value of a tangible asset ensured that EB-5 investors would continue preferring real estate projects over alternate industries, with hotels, condominiums and hospitality leading the way.

Fast forward twelve years, though real estate projects continue to dominate the EB-5

Continued On Page 24

Continued From Page 23

industry, there has been a divergence that may be explained by a variety of factors, including the increase in the minimum investment amount, a swing in the cultural origins of investors and a global pandemic that wrought havoc to the hospitality industry. These factors have led to a noticeable increase in the shift towards more entrepreneurial projects in non-real estate industries and may continue to do so as we enter yet another era of EB-5.

Factor One: Sufficient Startup Capital

Prior to the 2019 EB-5 Modernization Regulations, the minimum capital investment of $500,000, encouraged investors to file with a pooled regional center project rather than their own entrepreneurial project, which likely would require additional investment to achieve viability. The initial investment in a new operating business is often the venture's "startup capital," which is used to pay for the required expenses to start the new EB-5 business, including paying for initial hires, obtaining office space, permits, licenses, inventory, research and market testing, product manufacturing, marketing, or any other expense. Depending on the project, these costs can be quite substantial and $500,000 is often insufficient to support the initial stages of the business, requiring an additional injection of capital that may be unavailable to the average EB-5 investor. Thus, even for entrepreneurs, investing into a pooled development project made financial and practical sense at the $500,000 investment level. However, with the introduction of the EB-5 Modernization Regulations, a single investment of $900,000 could be enough startup capital to launch a credible operating business venture, allowing entrepreneurial investors to pursue their own, or their family's or friend's, new operating business with their EB-5 investment.

Factor Two: Economic Turmoil- The Effect of the COVID-19 Pandemic

The EB-5 Modernization Regulations went into effect on November 21, 2019 and the EB-5 industry was still reeling from its impact when, a short four months later, the full brunt of the COVID-19 pandemic hit the United States. During this initial onslaught, the constant newsfeed of bankruptcies and closures within the hospitality industry undermined confidence in the viability and longevity of some hospitality projects. Investors, nervous of losing their investment from larger, pooled real estate development projects in the hospitality sector, began favoring smaller raises or projects with friends and family. In addition, some investors began showing an interest in moving away from traditional development projects in the real estate industry to more countercyclical, or defensive, industries.

Countercyclical industries exhibit positive financial performance in direct contradiction to negative economic trends. Such industries can include the food and beverage industry, information technology industry, health and senior services industries and the transportation industry. Recent projects within these industries have provided diversification to the EB-5 industry, introducing alternative projects that provide investors with a wider array of options when choosing an industry within to invest.

Industries with high revenues have attracted EB-5 investors in recent years, such as the technology sector. The IT industry is forecast to experience consistent growth over the next five years. Due to the high market capitalization of the top 5 companies in the S&P 500, IT is the largest single segment of the market, eclipsing all others (including the financial sector and the industrials sector). In fact, the top five companies in the S&P 500 (Apple, Amazon, Microsoft, Facebook and Google parent Alphabet) are all part of the tech sector, accounting for 18% of the total market capitalization of the S&P 500 in Q1 2020.[1] Though start-up technology ventures are more complex, investors largely expect steady streams of growth fueled by innovative new products, services, and features developed by companies in the tech sector.

Another example is the U.S. pharmaceutical industry, which accounts for 3.2% of U.S. GDP and supporting over 4 million direct and indirect jobs.[2] EB-5 projects within this industry look to attract investors through their potential for revenue growth. For example, spending on prescription medicines in the United States has been forecasted to reach USD 1,562.15 billion by 2026, with an expected growth of 8.9%.[3] More than 2,300 novel products in later stage development, including more than 600 drugs for cancer, if they prove effective and are approved for use, may be able to command very high prices in the global market.[4] As per Evaluate Pharma research, the global prescription drugs market in 2024 is expected to reach USD $1.18 trillion.[5]

Another example of a popular non-real estate project is transportation and, in particular, trucking:

Freight trucking is the backbone of the nation's supply system, carrying 85%

1 https://www.morganstanley.com.au/ideas/other-type-income-inequality
2 The Economic Impact of The U.S. Biopharmaceutical Industry: 2017 National and State Estimates. TEConomy Partners. December 2019. https://www.phrma.org/-/media/Project/PhRMA/PhRMA-Org/PhRMA-Org/PDF/D-F/Economic-Impact-US-Biopharmaceutical-Industry-December-2019.pdf
3 Prescription Drugs Market Size, Share & Industry Analysis. Fortune Business Insights. May 2020. https://www.fortunebusinessinsights.com/enquiry/request-sample-pdf/prescription-drugs-market-102709
4 QuintilesIMS Institute Study: U.S. Drug Spending Growth Of 4.8 Percent In 2016. BioSpace. May 05, 2017. https://www.biospace.com/article/releases/quintilesims-institute-study-u-s-drug-spending-growth-of-4-8-percent-in-2016-/
5 World Preview 2019, Outlook to 2024. EvaluatePharma. June 2019. https://info.evaluate.com/rs/607-YGS-364/images/EvaluatePharma_World_Preview_2019.pdf
World Preview 2019, Outlook to 2024. EvaluatePharma. June 2019. https://info.evaluate.com/rs/607-YGS-364/images/EvaluatePharma_World_Preview_2019.pdf

Continued On Page 25

Continued From Page 24

of domestic cargo by value and 70% by weight.[6] Trucking is responsible for most overland freight movement and comprises a USD $791.7 billion industry in the United States (as of 2019).[7] Data also shows that nearly 6% of all full-time jobs in the United States are in the trucking industry.[8] This number has grown exponentially even in the past few years, with the number of employees in the trucking industry in the United States estimated at 7.95 million people in 2019.[9]

"Despite a challenging year, the data contained in American Trucking Trends shows the industry was in good shape entering the global pandemic," said the American Trucking Association's Chief Economist Bob Costello.[10] Though almost every industry in the country has experienced disruption due to the Coronavirus, the trucking industry is expecting a quick rebound in the coming months. A recent Morgan Stanley Research survey of 400 transportation and logistics executives indicates that though supply chains reached their peak disruption over the summer, the transportation industry is expected to have a "V-shaped" recovery in which the rebound trajectory is sharp and quick.[11] This is expected even in the face of a U- or L-shaped recovery in the overall economy of the U.S.

Factor Three: Investor Entrepreneurism and Experience

The increase in entrepreneurial projects may also be explained by the change in the cultural origin of EB-5 investors. In 2015, the majority of EB-5 investors came from Mainland China and tended to be younger in age with a desire for passive investments. By 2019, the country of origin shifted from East Asia to include: India (#2), Brazil (#5), Mexico (#9) and South Africa (#10). According to global market research, these countries have some of the highest rates of entrepreneurial spirit within a cultural context, with South Africa ranked second in the world, followed closely by Mexico (#5), India (#7) and Brazil (#11). Data provided by Ipsos Global Advisor. Entrepreneurialism: The Emergence of Social Entrepreneurialism to Compete with Business Entrepreneurialism. The strong entrepreneurial spirit fostered in these cultures may also contribute to the increase in entrepreneurial EB-5 projects across a wide range of industries outside of real estate.

EB-5 investors habitually represent the top echelon of their countries, with a strong record of investment and capital markets experience. These investors are frequently self-made and have funded their own diverse and often intelligently structured ventures in different industry sectors, not necessarily high-end real estate. This factor has garnered interest in EB-5 projects from more diverse industries, thus allowing investment into projects the Investor understands, or can even own-and-operate. Warren Buffett has discussed the concept of a "circle of competence," which he posits consists of businesses and industries with which the investor is familiar and thoroughly understands. He encourages investors to largely stay within their circle, where they have an advantage in analyzing the performance of a prospective business, pinpointing its strengths and weaknesses and evaluating the competitive climate of the industry.[12] The investor's knowledge is even more valuable if they pursue their own entrepreneurial project, which they can guide and operate using their knowledge and expertise.

A Real Estate component in Alternative Industries

Unlike other residential visas, the US EB-5 Investment Visa is a job creation program. Non- real estate projects focused on operating businesses such as technology, pharmaceuticals or transportation, would derive their job creation from operations and expenditures, using top line revenues from the pro forma income statement and the appropriate multipliers. In comparison, construction project jobs are calculated by the amount spent on construction multiplied by a final demand multiplier. This is far easier to understand and calculate than operational jobs. In addition, over the years, USCIS have become familiar with real estate idiosyncrasies, lessening the chance of a Request for Evidence. Therefore, it is common to add a real estate component to an alternative industry project to bolster the job creation.

Conclusion

It is likely that, even with the increasing popularity of smaller EB-5 investment projects among prospective EB-5 investors, real estate projects will continue to dominate. As stated above, even within alternative industries, a real-estate component gives investors a level of job creation security. Regardless of the industry, there are many factors that play a role in the success or failure of a project. The volatility of the real estate market during the COVID-19 pandemic has shown that unconventional industries can provide viable alternative investment opportunities. EB-5 investors are continuing to become savvier, turning to countercyclical industries often within their circle of competence, to pursue investments that they understand rather than trusting developers exclusively.

6 1997 Commodity Flow Survey, U.S. Census.
7 https://www.statista.com/topics/4912/trucking-industry-in-the-us/#:~:text=Trucking%20is%20responsible%20for%20most,less%20than%20the%20industry%20requires.
8 https://markets.businessinsider.com/news/stocks/trucking-industry-facts-us-truckers-2019-5-1028248577#
U.S. Trade Representative's Office Report (2019).
9 https://www.rtsinc.com/articles/why-trucking-still-america-s-number-one-job
10 https://www.trucking.org/news-insights/trucking-moved-1184-billion-tons-freight-2019
11 https://www.joc.com/trucking-logistics/truckload-freight/after-april-crash-us-trucking-industry-awaits-peak-disruption_20200414.html
12 https://buffett.cnbc.com/video/2014/05/03/afternoon-session---2014-berkshire-hathaway-annual-meeting.html?&start=1675&end=1966