EB-5 DIRECT: An Alternative Approach to EB-5 Financing for Regional Centers

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While EB-5 Regional Center Program participants hold their breath awaiting reauthorization of the "indirect program," some pro-active regional center principals aren't sitting on their heels waiting. Instead, they are turning to the original EB-5 Immigrant Investor Program, the "direct program," regardless of if and when reauthorization occurs.

These regional center principals still have all the contacts, connections, experience, and education accumulated from years of success in the Regional Center Program and are leveraging all those assets in order to keep working. The Direct Program is viewed as limited by a lower job creation ceiling counting only "payroll-provable" jobs, compared to the high ceilings allowed by econometric-modelled indirect job creation under the Regional Center Program. To be sure, with significantly fewer "count-able" jobs, direct projects can accommodate fewer investors and thus produce smaller raises. But modest-sized projects with raises of up to a dozen or two dozen investors can be enough to enable projects with total budgets in the $10-30 Million range (including EB-5) to be green-lit, in particular those that will generate large numbers of direct jobs such as manufacturing, services, restaurants, health care, education, even tech.

To make it work, of course, requires careful planning and meticulous execution, in particular with regard to the job creation obligation, as there is less margin for error than that often afforded by indirect job calculation. But then, success in EB-5 has always required careful planning and follow-through, even for indirect projects with larger capital stacks, larger EB-5 raises, and highly complex structures. So, what's different? How does Direct EB-5 compare to Indirect Regional Center EB-5? What must be done differently than the old familiar RC projects?

"Doing Direct" utilizes all the prior education, experience, practices, strategies, and people involved in "doing Indirect" – except where it doesn't. Most of what Regional Center principals have done before with Indirect remains relevant to Direct. There's no need to abandon all past practices or learn an entirely new approach—just a modified one. The following are some highlights of the primary differences for the seemingly novel Direct EB-5 scenario, from the areas of immigration and jobs, securities/corporate compliance, business plan writing, and examples of how economists can contribute validation to Direct job counting.

Immigration/jobs

Under the direct program, when making an investment in a "New Commercial Enterprise," (also known as the "NCE)," an EB-5 investor can only satisfy the EB-5 job creation requirements through the employment of qualified workers who are compensated as employees on the NCE's payroll. This means that the NCE must create or preserve[1] 10 full-time jobs (each position being a minimum of 35 hours per week) for qualifying U.S. workers, for each EB-5 investor invested in the NCE, within two years and six months after adjudication of each investor's I-526 petition. The EB-5 investor must show that the NCE directly created these full-time positions for qualifying employees, which are U.S. citizens, lawful permanent residents, and other certain

1 In order to count jobs that are preserved, the business must be "troubled", which is defined by USCIS as one that has been in existence for at least two years and has incurred a net loss during the 12- or 24-month period before the date of filing. As such, this route for the EB-5 direct model entails additional requirements and associated evidentiary due diligence.

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qualifying immigrants. The EB-5 investor and his or her immediate family members do not count towards the tally of new jobs for EB-5 purposes. Jobs created outside of the NCE are also not counted. And existing jobs – even in the case where the NCE acquires an existing business – do not count, except in the case of a troubled business.

For direct jobs created as a result of the EB-5 investor's investment, evidence to prove job creation may include, but is not limited to, payroll records, relevant tax documents, and Employment Eligibility Verification (Form I-9) showing employment by the NCE. E-Verify, which is a web-based system that allows employers to confirm the eligibility of their employees to work in the United States, is an excellent way to document the EB-5 job creation requirements under the direct program.

The 10 full-time jobs created by the NCE as a result of EB-5 investment also need to be considered as permanent jobs. According to the United States Citizenship and Immigration Services (USCIS) Policy Manual, "[d]irect jobs that are intermittent, temporary, seasonal, or transient in nature do not qualify as permanent full-time jobs … jobs that are expected to last for at least 2 years generally are not considered intermittent, temporary, seasonal, or transient in nature."

Same as the Regional Center Program, the EB-5 investor must file his or her I-829 petition with USCIS within 90 days prior to the 2-year anniversary of being issued conditional permanent resident status, and one of the most significant components of the I-829 is demonstrating that the job creation requirements were met. Job creation within the direct program typically means that the business must generate sufficient revenue to continue operating and hire employees. However, an important clarification about receiving credit for job creation is that the USCIS Policy Manual makes it clear that USCIS does not require that the jobs still be in existence at the time of adjudicating the I-829 petition, so long as the job creation requirements were otherwise already fulfilled. This clarification is important to keep in mind for certain EB-5 investors subject to long backlogs due to the EB-5 visa cap, who will be filing their I-829 petitions many years after the 10 full-time jobs were already created.

On a note related to EB-5 visa backlogs, an EB-5 investor must also maintain his or her qualifying investment "at risk" for up to two years from the date of being granted conditional permanent resident status, otherwise known as the Sustainment Period for the EB-5 investor's investment in the NCE. If an investor has not completed his or her Sustainment Period before receiving his or her investment funds back from the NCE, USCIS is likely to determine that the EB-5 investment is no longer at risk or sustaining the job creating investment, and will deny that investor's I-829 petition. However, the concept of redeployment may serve as a solution towards maintaining the at-risk investment through the EB-5 investor's Sustainment Period if the NCE receives a return of its EB-5 capital from a sale of its project assets, rather than a sale of the NCE's equity interests, and then redeploys the cash proceeds from the sale of assets into another at-risk project in order to enable the EB-5 investor to complete his or her Sustainment Period. New jobs do not need to be created through the redeployment of EB-5 funds if a sufficient number of qualifying jobs were already created by the original business, especially if those jobs will be maintained by the new operator of the business.

Securities/corporate

From a corporate point of view, the most significant difference between Direct and Indirect is the deal structure. In most cases Indirect uses a two-entity structure with (1) a funding entity (the NCE) deploying aggregate EB-5 capital into (2) a separate business entity (the "Job Creating Entity" or "JCE") which spends the EB-5 financing and creates the jobs credited back to the NCE. By contrast, the Direct structure involves only a single entity, the NCE, that serves as both the investment vehicle for the EB-5 investors and as the job creating entity (JCE) spending the funding and creating its own jobs for its "in-house" investors. The Direct entity is referred to below as the combined "NCE+JCE."

The Direct structure reflects the original EB-5 Program job creation requirement that only jobs directly on the NCE's payroll count toward the minimum, unlike the Indirect structure, which also counts indirect and induced jobs. In the latter, jobs are deemed created by calculating the employment-enhancing economic impact of a project's expenditures and operating revenue. This literal "jobs-multiplier" effect permitted larger EB-5 raises as more jobs allowed more investors bringing in more money. Further, the two-entity structure that is common under the Regional Center Program is considered indirect from a corporate law perspective, since the EB-5 investors become equity owners not of the actual Job Creating Entity, but instead in the separate NCE; while the NCE does loan or invest the aggregate EB-5 funds its investors provide to it to the JCE, the JCE has no EB-5 investors itself.

The issue of "where the investors are located" (that is, are they holders of the equity of the NCE or the JCE) makes a significant difference due to the rights that accrue to investors. All equity owners of U.S. entities have significant "shareholder" rights (whether LLC members, limited partners, or preferred shareholders) under state corporate laws to participate in the management, receive timely and accurate information, and inspect the books, records, and accounts of the entity into which they invest, and the managers of their investment entity owe them significant and broadly un-waivable fiduciary duties of good faith, fair dealing, loyalty, and the like. While rights may be affected by contract (primarily the investment entity's governing agreement, whether an LLC operating agreement or limited partnership agreement), many of those required by statute are broadly un-waivable and afford "shareholders" significant protection—and pose significant issues for the investment entity. "Shareholder" litigation brought to enforce these rights can restrict or freeze an entity's freedom of action, second-guess or substitute decision-making, or even force management's replacement by new management recruited by shareholders, even before reaching a final conclusion. These difficulties can be magnified by competing blocs of shareholders with conflicting

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objectives.

From a developer/owner JCE's perspective, having the EB-5 investors investing in a separate NCE is highly advantageous: all these issues are not the JCE's. In an Indirect scenario, the JCE itself has no EB-5 investors to recruit, manage, report to, or worry about all the technicalities of immigration compliance and satisfying all of the EB-5 Program's many particular requirements. Additionally, all of the risks attending to "shareholder" rights and fiduciary duties attach to the entity in which the "shareholders" are invested—the separate NCE. In an Indirect context, these are issues for the NCE's principals (often also the sponsoring regional center's principals). By contrast, in a Direct structure, these issues are the NCE+JCE's issues, because it functions both as the NCE and JCE combined.

Likely the primary risk issue for the developer in the Direct, single-entity scenario involves the "location" of the developer's assets: the land, improvements, and/or operating business typically owned by the JCE. With Direct investors "inside" the developer's entity, even though they are co-owners of the entity and not of its individual assets, the investors have much greater access to the assets and much greater ability to impact them, not only through potential control but also ultimate liquidation. The "firewall" protection afforded by the two-entity Indirect structure with the investors' co-ownership of the NCE whose only connection to the JCE and its assets is either an attenuated preferred equity interest or a likely unsecured lender interest, disappears in the Direct single-entity structure with the investors directly co-owning the asset-owning NCE+JCE.

Many developers balk at this enhanced risk profile, and it is likely the primary reason other than limited raise size for potential recipients of EB-5 capital declining participation in the Direct Program historically. However, as demand for capital continues and alternate sources and providers become more stressed due to rising inflation and flat economic performance, this risk profile is proving more tolerable to developers and other potential NCE+JCE businesses, especially for those already experienced with accommodating non-EB-5 private equity. Careful NCE+JCEs can utilize wholly-owned subsidiary entities to hold assets or employ workers, allowing for some diffusion of "inside the house" concerns assuming scrupulous alter ego avoidance. Lawfully minimizing "shareholder" risk and avoiding alter ego complications are standard, legitimate corporate risk management strategies, and presuming legitimate motives, they cannot be assumed to be predicates to fraudulent intent. Accurate and complete disclosure in the NCE+JCE's Private Placement Memorandum as compelled by securities law compliance requirements, and thereafter doing what was promised to be done (and not done) following the EB-5 raise, should go far not only to ease the concerns of potential investors and protect actual "shareholders," but also to afford protection to the NCE+JCE's principals as well.

As for the securities laws, an additional issue exists for the Direct single-entity scenario: the broker-dealer prohibition of unregistered salespeople selling investments. In the Indirect scenario, the NCE is the issuer of securities to the EB-5 investors, and its principals contract with foreign emigration brokers and agents overseas who source the investors. To the extent the NCE is involved in sourcing investors, it is usually viewed as technically not brokering, defined as a person selling an investment opportunity "for the account of others." Classically, Indirect NCEs are operated by principals with deep experience in EB-5, often also active in operating the Regional Centers necessary for Indirect projects. By contrast, in the Direct scenario, investors purchase an investment opportunity of the combined NCE+JCE, not a stand-alone NCE, and the Direct NCE+JCE business owner/developer is typically inexperienced with the EB-5 Program, certainly with sourcing of immigrant investors. Experienced Indirect NCE and Regional Center principals who engage in sourcing EB-5 investors for Direct NCE+JCEs would appear to be selling an investment opportunity for the account of another. Doing so "outside" the NCE+JCE raises brokering issues. Whether an "Issuer Exemption" or other avenue may exist allowing for the lawful participation of experienced Indirect principals "inside" the NCE+JCE without running afoul of the broker issue is a complicated fact-based inquiry on an individual project by project basis for which consultation with securities counsel in advance of a Direct EB-5 offering is strongly advised. For this survey, suffice to say avenues may well exist if carefully planned for in advance.

Modeling Job Creation in a Direct EB-5 Business Plan

Of course, economic models are the best method for predicting job creation in Indirect/Regional Center projects because they account for indirect and induced job creation as well as direct job creation from construction and operations. Further, the economic model can be used at both the I-526 stage and the I-829 stage: a project uses estimated project costs and a pro forma to project job creation in the former and actual project costs and operating statements to prove job creation in the latter.

Obviously the approach is different for Direct EB-5 projects. While an economic model may be an approved methodology for projecting job creation of a new enterprise at the I-526 stage, USCIS requires employment documentation (i.e., W-2 forms and other payroll records for employees) to prove job creation at the I-829 stage.

While economic reports do include direct operations jobs in the overall results, the results are derived from methodologies and multipliers, and can skew higher than the on-the-ground hiring and staffing decisions of management teams and executives. This is one of many reasons the business plan is typically the primary documentation for projecting new job creation in a Direct EB-5 project. The business plan's purpose is to show that – due to the nature and the size of the business – the minimum number of jobs will be created. To accomplish this, a Direct EB-5 business plan should include a five-year forecast for job creation, showing the yearly positions hired, average salary per position, and associated payroll costs. But it's not enough to simply assert that the jobs will be created; the business plan needs to present data and evidence that the job projections are reasonable and realistic relative to the business model, industry, and

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market. A business plan writer will typically start with staffing input from the project developer/owner, and provide an analysis, using national and industry data, to ensure that the projected job creation aligns with industry standards, relative to the size and projections of the business. The plan should also include a comprehensive market analysis or feasibility study, ideally by a third-party industry organization, to provide justification that the size and job projections of the business are realistic relative to standard employment parameters in the market. This level of detail and analysis gives the business plan credibility and is fundamental to making the plan Matter of Ho compliant, which is a requirement of business plans under the Direct program just as it is under the Regional Center Program.

Examples of Economist Contribution to Validate Job Creation

Although a job creation study is not required for Direct EB-5 projects, it could easily be argued that including one in an I-526 petition could corroborate the direct job creation estimate of the developer contained in the business plan. As most Direct EB-5 project I-526 packages do not include economic job creation reports, it is unclear how well and/or close to the developer's plan the economic models estimate direct job creation. Therefore, we thought it would be interesting to examine a couple of actual Direct EB-5 projects to see how closely the economic model comes to the staffing forecast contain in the project proforma income statement and business plan. The economic model used in this analysis is the IMPLAN (Impacts for PLANning) model V3.1 and associated 2019 model year data.

The first example studied was a full-service sushi restaurant in the Atlanta, GA area, and the geographic area used for the IMPLAN model was the Atlanta Metropolitan Statistical Area (MSA). The proforma from the developer forecast total restaurant gross revenues at $1,365,100 in 2019 with a corresponding total direct job count of 18 W-2 employees ranging from the Manager down to the Servers. Running the total revenue figure of $1.37 million in the IMPLAN model for year 2019 resulted in the results below. As one can see, the IMPLAN model forecasts the direct job count as 18 jobs, the same as the developer, so the model forecast is quite accurate in this case. The added benefit of having full economic model results are the other data generated by the analysis for the project in its local region. Although the direct job count is the only job creation estimate that is pertinent for a Direct EB-5 application, the full results from the model concerning the other standard variables produced by the model are fully applicable. In other words, the project will generate $1.35 million in Labor or Household Income, $2.27 million in Value Added or the change in Gross Domestic Product (GDP), and $4.16 million of total spending or Output.

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	18	$368,957	$612,395	$1,393,646
Indirect Effect	5	$280,101	$478,751	$897,057
Induced Effect	12	$703,103	$1,176,503	$1,869,291
Total Effect	35	1	$2,267,648	$4,159,995

The second example examined was a hotel in the Phoenix, AZ area with corresponding geographic area of the Phoenix, AZ MSA. The proforma from the developer forecasts total gross hotel room revenues in 2023 at $2,925,688 with a corresponding total direct job count of 22 full time W-2 employees ranging from General Manager down to Housekeepers. Running the total revenue figure of $2.93 million in the IMPLAN model for year 2023 resulted in the following full set of results. The direct jobs estimate from the IMPLAN model is 24 jobs compared to 22 projected by the developer, so the IMPLAN forecast is a bit high for this project. As with the previous example, we see the full estimate of Labor Income is $3.10 million, and the change in GDP is $5.37 million, while the change in total spending (Output) is $8.72 million.

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	24	$984,216	$1,875,340	$2,849,629
Indirect Effect	6	$354,365	$557,629	$1,060,378
Induced Effect	31	$1,765,581	$2,935,223	$4,806,103
Total Effect	61	$3,104,162	$5,368,192	$8,716,110

While an economic job creation study is not required for a Direct I-526 petition, it can provide useful corroboration of the developer's job estimates and estimates of other measures of economic impact obtained from the total impacts from the project, including the change in Labor Income and changes in GDP.

Conclusion

Direct EB-5 is do-able. It has its notable differences, including immigration, corporate/securities, and business plan development, and still benefits from support from economists even absent the controlling econometric modelling of the Indirect avenue. The most significant differences are touched upon above. (There are more, to be sure.) But Direct involves variations on The Theme, rather than an entirely different game with completely novel rules and concepts. For principals already experienced in the EB-5 Program's rules and approaches, especially those with expertise in the suspended Regional Center Program, it's an issue of learning those differences, rather than going back to school spending years earning a degree in an alien field. Doing so allows participation in an additional area of real investment activity, albeit of more modest size, as long as the original investment minimums and state approved Targeted Employment Area rules remain resurrected.