

**Structuring and Function of EB-5 Limited Partnership or
Limited Liability Company for EB-5 Securities Offerings**

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A. STRUCTURE OF EB-5 ENTITY

1. There is no significant difference in whether a limited liability company or limited partnership is selected as the entity of choice for the EB-5 Lender (the “NCE”). The advantage of using a limited liability company is the fact that a general partner entity does not need to be formed for the purpose of managing a limited partnership. An existing entity can serve as a manager and the limited liability company does not directly impose personal liability on the manager compared to the personal liability of a general partner in a limited partnership structure.
2. Jurisdictional Choices. Usually the jurisdiction is either the state in which the project is being undertaken or the state of Delaware. Delaware is very popular since it has the most commonly used jurisdiction in the United States and has many protections for the benefit of management, including the ability to have a waiver of fiduciary duties subject to certain limitations. Furthermore, Delaware is a fairly simple jurisdiction for incorporation and has no effective income tax since all of the income would be earned outside of the state. To the extent that an entity is formed in a particular state, there may be an issue whether the interest would be subject to taxation and that should be considered in the process.
3. Selection of Manager or General Partner. Independence has become key as well as project oversight. Therefore, it is important that projects have a competent manager/financial advisor to oversee the entire loan process. This is becoming more mainstream and we are seeing several projects where the developer owns a regional center, appoints a co-manager or a financial manager that is independent to oversee the loan process, especially if a default occurs.
4. Loan Versus Equity Model Use Of Preferred Equity
 - (a) Certainty and transparency of loan model – market preference
 - (b) Absolute payment obligation for developer to pay loan – possibly greater risk
 - (c) Financing issues with senior lender
 - (d) Developer equity model and advantages of preferred equity. Ability to actually share in net profits in addition to preferred return
 - (e) Preferred return as substitute for interest on loan, except different legal obligations and subordinate to all creditor claims
 - (f) Rule of RC in equity model – management rights
 - (g) 1940 Investment Act considerations – Loan vs. Equity Model

B. MATERIALITY AND OTHER STRUCTURE ISSUES

1. U.S. Citizenship and Immigration Services issued a policy memorandum draft on August 10, 2015, “Guidance on the Job Creation Requirement and Sustainment of the Investment for EB-5 Adjudication of Form I-526 and Form I-829.” In relation to the policy draft, various issues concerning job creation, I-526 and I-829 adjudications, at risk issues including redeploy[ment of funds and other related matters are discussed below
2. Pursuant to the draft policy memorandum and contained in footnote 11, there is a citing to the Supreme Court case of *Kungys v. United States* involving the definition of “materiality” in the context of denaturalization. That reference in the policy memo was relevant from the point of view that, with respect to materiality in connection with a specific transaction and business plan, it is apparent that the standards utilized by the Supreme Court in the *Kungys* case may be applicable. The key in that case was a Supreme Court determination that a misrepresentation or concealment by a naturalized citizen was material if it was more likely than not to have produced an erroneous result as a result of the misrepresentation. The Supreme Court held that in the particular case, the date and place of birth that was not correctly stated was not material in affecting the ultimate outcome of a decision to naturalize the applicant, and therefore, the Supreme Court ruled on behalf of the immigrant.
3. Another significant factor involved remaining at risk and what that means. It was noted by the chief economist that having a sinking fund in and of itself should be permissible, providing the investor has no direct access to those funds and that the sinking fund is consistent with a bond sinking fund for bond offerings.
4. One of the most important takeaways at the stakeholders meeting was the concept of “redeployment.” It was acknowledged that a loan could be repaid before 829 adjudications have been finalized for all investors, and that the NCE would then have the obligation to redeploy the loan proceeds in a manner that maintains the “at risk” requirement. There were several questions raised from attendees and parties calling in about what it means to be at risk. USCIS indicated that it would take into account suggestions made by those parties wishing to provide comments by September 8 in order to make a final policy decision. In connection, suggestions were made that money funds, marketable securities and the like should qualify, and USCIS said it would take under advisement all suggestions in trying to come up with a policy memorandum. It would appear to me that investments in money funds would probably not work since they are not risky enough. Marketable securities may or may not comply. Another possibility would be to invest in a real estate investment trust (REIT), which arguably is a replacement of a real estate investment in a real estate fund, so that as 829 are adjudicated, the shares could be liquidated and used to repay the investor that receives 829 final adjudication.

5. *Matter of Izumi & Redemption.* An alien may not enter into a redemption agreement with the NCE at any time prior to the end of the two-year period of conditional residence. “For the alien’s money truly to be at risk, the alien cannot enter into a partnership knowing that he already has a willing buyer in a certain number of years, nor can he be assured that he will receive a certain price.”

C. REGIONAL CENTER ENGAGEMENT

Role of Regional Center

A regional center that sponsors an EB-5 offering which enables the sponsor company to utilize not only direct jobs, but indirect and induced jobs, plays a key role in the EB-5 program and it is extremely important to clarify the role of the regional center in a particular transaction. Generally, a regional center can play the following three roles in any EB-5 transaction, among others:

1. Sponsoring the Project. At a bare minimum, the regional center must sponsor the Project and take responsibility for ensuring that the offering and procedures related thereto at least meet the minimum guidelines required under the EB-5 program as part of the minimum due diligence responsibilities of the regional center. In connection therewith, the regional center is paid compensation for services rendered, which should be adequately disclosed in the offering documents.
2. Serving as Manager/General Partner of New Commercial Enterprise. In many cases, the regional center (especially where it is not affiliated with the developer/project company), may serve as the manager/general partner of the new commercial enterprise (“NCE”) formed to undertake the EB-5 offering. In connection with that role, it is important to specifically articulate the role of the regional center and/or its affiliate in managing the entity, including, but not limited to, various reporting requirements, oversight of the EB-5 program with respect to immigration matters and, most importantly, the administration of the operation of the NCE (including, but not limited to, assisting in all aspects related to the due diligence and enforcement of the loan provisions that normally apply with respect to a regional center EB-5 project). In connection therewith, it is important to disclose exactly how the regional center and/or its affiliate intends to undertake its due diligence and administrative responsibilities and whether or not third-party professionals will be engaged to provide certain of those functions. By way of example, in connection with a typical real estate-related EB-5 program involving significant construction activities, it is common for the manager/general partner to engage a qualified disbursement agent, title company or financial institution to administer the loan disbursement in order to protect the EB-5 loan.

A good practice would be to interpose an entity between the LP/NCE and the regional center to be the GP/Manager and thereby minimize the liability of the regional center in the event that the project/joint commercial enterprise fails and the partners, members or any other creditors of the NCE decide to make a claim

against the GP/Manager for failing to protect the NCE, that the GP/Manager improperly administered the NCE.

3. Assisting with Marketing. In addition to sponsoring the project and serving as a manager of the NCE, the regional center can also assist in the marketing of the EB-5 offering process. In assisting in marketing activities, the regional center has a further responsibility to ensure that its marketing activities are in compliance with U.S. securities laws and, in all cases, should ensure that the EB-5 offering otherwise complies with U.S. securities laws. In particular, the offer and sale of securities to investors under the EB-5 offering will need to fall within the permitted exemptions from registration under Regulation S and/or Regulation D of the Securities Act of 1933 (the “**1933 Act**”) and otherwise not violate the registration requirements related to broker-dealer registration under the Securities Exchange Act of 1934, investment adviser registration under the Investment Adviser’s Act of 1940 or investment company registration under the Investment Company Act of 1940.

It is important to disclose exactly what roles the regional center is playing in an EB-5 Project and any affiliations the regional center has with other parties involved with the EB-5 Project. In certain situations, the developer may be affiliated with the regional center and the NCE and serve as the manager/general partner of the NCE. In such case, there is an inherent conflict of interest concerning how a lender entity having the borrower-affiliate as its manager/general partner can properly administer a loan to itself. We have suggested in such cases that at least an independent co-manager be appointed that would assume the responsibilities of administering the loan program. As a fallback position, another structure would be for the affiliated manager/general partner to appoint an independent/third party to at least administer the loan, even if such party is not a co-manager/general partner of the NCE. Appropriate disclosures need to be undertaken to reflect all of these affiliated relationships between the various parties to a transaction in order to articulate more clearly how investors are being protected in all oversight matters related to the program.

D. ESCROW

Escrow is becoming a much more significant factor in EB-5 offerings given the heightened caution of the United States financial institutions in undertaking EB-5 projects. The key components in many transactions involve the following:

1. Establishment of escrow agreement that addresses all necessary terms and conditions with respect to the release of funds from escrow.
2. Separation of capital contribution amount and administrative fee amount. In many situations, the administrative fee is not paid to the escrow agent but is paid directly to the manager or marketing agents since those funds are disbursed immediately.

3. Many escrow agents require a certain minimum subscription amount before releasing any funds prior to I-526 approval. There are two methods to be utilized:
 - (a) A holdback concept where the entire holdback amount is utilized to refund any denied investor.
 - (b) The holdback amount only applies to the individual investor and that amount is applied only to either a refund or contribute to the company that investor's funds depending upon whether the I-526 Petition is approved or denied.
4. Developer guarantee of refund. It is common in the industry that if an I-526 Petition is denied for any reason, then the developer guarantees the refund of the capital contribution amount to the extent funded by agreeing in the loan agreement to refund the NCE the loan amount advance with respect to that investor, with the NCE agreeing upon receipt of funding to refund the investor the capital contribution amount.
5. As a separate matter, the refund of the administration fee is an open issue and depends upon the marketing arrangements to be negotiated with agents. In some cases, the entire administrative fee is forfeited if the investor is at fault in the EB-5 process as opposed to the project. Sometimes a portion of the administrative fee is forfeited and the balance is returned to the investor. It seems that in the minority of situations the entire administrative fee is refunded no matter what the cause of the denial. There are also special provisions involving withdrawal of application or failure to process the application as well.
6. Engagement of special financial service agencies that help to administer the EB-5 Program and serve as subscriber administrator under the escrow agreement in order to overview the entire escrow process as well as tracking the investment and the distribution of funds for each applicable investor.

E. COLLATERAL, CAPITAL STACK AND OTHER FINANCIAL ISSUES

1. Sources of Funds
 - (a) Developer Equity
 - (b) Senior Debt and/or Capital
 - (c) Other funding – tax credits, government grants and subordinate financing
2. Percentage of developer equity in capital stack – 20% to 25% as market standards
3. Form of Collateral
 - (a) Mortgage

- (b) Mezzanine Pledge
 - (c) Collateral assignment of ancillary agreements – general contractor’s agreement, architect’s agreement, franchise agreement (if applicable)
4. Prepayment, Defeasance and Other Financing Issues
- (a) Prepayment penalty – optional
 - (b) Senior debt – terms and conditions and EB-5 funding requirements
 - (c) Uniqueness of condominium projects and potential for payment of senior debt first with excess funds available to pay NCE loan prior to maturity.
 - (d) Redeployment concept and reinvestment of funds prior to maturity
 - (e) Substitution of collateral – provide for in loan agreement
 - (f) Intercreditor agreement – possibility of standstill on NCE loan with inability to execute on collateral until senior loan paid.
5. SPECIFIC LOAN TERMS
- (a) Term
 - (b) Extension rights
 - (c) Prepayment rights
 - (d) Sinking fund
 - (e) Other guarantees – bad buy, guaranty of completion, refund guaranteeing for denied investors
6. Loan Versus Equity Model Use Of Preferred Equity
- (a) Certainty and transparency of loan model – market preference
 - (b) Absolute payment obligation for developer to pay loan – possibly greater risk
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 - (d) Developer Equity Model and advantages of preferred equity. Ability to actually share in net liabilities in addition to preferred return
 - (e) Preferred return as substitute for interest on loan, except different legal obligations and subordinate to all creditor claims

(f) 1940 Investment Act considerations – Loan vs. Equity Model

F. MARKETABILITY FEATURES OF EB-5 PROJECT

1. Developer equity – need for 20% to 25% equity
2. Developer background and experience, especially in similar type projects
3. Viability of project – supporting appraisal, marketing study or feasibility study
4. Job creation certainty – job cushion amount and nature of EB-5 job creation. Construction jobs tend to be the safest although need to satisfy two year requirement
5. Credibility of professional team undertaking EB-5 project documentation
6. Size, scalability, certainty of funding if all EB-5 capital not raised. Determine other sources of funding to complete project. This has become a critical issue with senior lenders. Furthermore, the NCE needs to ensure that the entire capital stack is in place in order to be assured that the project will be completed.

SCHEDULE 1

AVAILABILITY OF DUE DILIGENCE MATERIALS

1. Feasibility Study
2. Appraisal
3. Market Reports
4. Loan Documents/Equity Agreements
5. Detailed projections, pro-forma financial statements, sources and uses, capital stack
6. Business plan, etc.
7. Cushion for job creation – Economist Report
8. Project Organization Chart
9. Lease Agreement, Land Use Agreement
10. Term sheet with Developer, background on Developer
11. Agreements with General Contractor/Construction Company, Operators, background on each
12. Permits, site plan, architectural renderings
13. Arrangements with Municipalities for financing
14. Signed Loan Term Sheet