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"Why the EB-5 Industry Seeks to Make the TEA Incentive Meaningless Again and Continues to Keep EB-5 Investors in the Dark"

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November 12, 2019

Why the EB-5 Industry Seeks to Make the TEA Incentive Meaningless Again and Continues to Keep EB-5 Investors in the Dark

By Gary Friedland and Jeanne Calderon[1]

Introduction:

In an ironic role reversal, the same powerful segment of the EB-5 industry that has repeatedly over the past five years blocked bipartisan EB-5 reform legislation is now promoting the passage of a bill hailed by this group as "EB-5 Modernization".[2] In reality the bill, introduced in Congress on November 5, 2019 by Senators Graham, Cornyn and Rounds (the "Graham/Cornyn Bill or the "Bill"), is aimed to preserve the status quo which incentivizes immigrants seeking the EB-5 visa to invest their capital in projects by the largest developers in the most affluent urban areas of the country, contrary to the original intent of the law.[3] The obvious purpose of this Bill is to nullify the regulation recently finalized by USCIS that would remedy the abuse that has enabled these developers to dominate this visa program that provides them with an inexpensive source of capital.[4] Rather than EB-5 Modernization, this Bill represents a return to the past.

We assume and hope that the Graham/Cornyn Bill will not progress in Congress. Even though the EB-5 Program is not on the radar of most members of Congress, it is an immigration program nevertheless, and the leading Democrats have consistently taken the position that DACA relief is essential before they will entertain comprehensive immigration reform, or any immigration reform. Moreover, Congressional polarization imperils any legislation today.

Nevertheless, in the unlikely event that either the Bill moves from the Senate Judiciary Committee chaired by Senator Graham to consideration by the full Senate or the leaders choose to incorporate some EB-5 matters as part of the continuing resolution pending before Congress[5], we express our vehement opposition to this Bill. It would accomplish very little besides preserving the status quo.

Although the Bill is flawed in numerous ways, we focus on two of its most fundamental failures. First, it effectively eliminates the Targeted Employment Area ("TEA") incentive – very effectively and purposely.[6] Second, it purports to impose desperately needed integrity measures, yet it omits account transparency and fund administration, the only integrity measures included in previous bipartisan reform bills introduced by Senators Grassley and Leahy squarely aimed to address the pervasive fraud plaguing the EB-5 Program in recent years.

TEA Incentive and Abuse:

The TEA incentive is a special limited exception established by Congress in 1990 to incentivize immigrants seeking to qualify for an EB-5 visa to invest their capital in projects located in rural areas and economically distressed inner cities (TEA locations). The incentive is accomplished by granting a discount to the minimum amount that immigrants must invest in a TEA location to qualify. As a result, these areas will be revitalized by the injection of capital that could not be obtained from conventional sources and thereby new jobs will be created.

However, the TEA incentive has become meaningless in recent years based on the tortured application of an outdated USCIS regulation that enables virtually every project

location in the US, even the most affluent areas, such as Beverly Hills, to qualify as a TEA location, and thus all immigrants seeking an EB-5 visa can invest at the discounted level. [7]

On June 21, 2019, after numerous failed attempts at a legislative solution by Congressional reformers, USCIS released final "TEA" regulations that restored the "TEA" incentive to enable it to operate as Congress originally intended. The TEA regulations have a delayed effective date of November 21, 2019.[8]

Predictably, the Graham/Cornyn Bill would negate the TEA regulations and restore the same broken system sought to be remedied by the regulations. The Bill simply parrots the position that the leaders of the EB-5 industry have championed for the past five years.[9]

Under current law, the limited exception is available for immigrants who invest in a project located in a TEA by investing only $500,000, rather than the standard amount of $1,000,000 required for all other locations. The $500,000 differential is known as the "TEA discount".[10] However, due to the TEA abuse described above, the TEA discount, designed as the exception, has become the rule.

As a result, the TEA incentive operates in the opposite manner originally intended by Congress. The lion's share of the EB-5 capital investment flows to luxury projects by the largest real estate developers in the most affluent urban areas of the US that immigrant investors typically prefer for a variety of reasons.[11] Most of these projects would have been built and the jobs created without the injection of EB-5 capital. Thus, TEA abuse stifles job creation rather than promotes it by depriving the underserved areas of needed capital, and thus the potential for new job creation.

As recognized by Congressional leaders at the time of the enactment of the EB-5 law, it is common sense that the greater the TEA discount, the greater the encouragement to the immigrant to invest in a project located in a TEA.[12] Yet the Graham/Cornyn Bill reduces the TEA discount from $500,000 under the current law to $100,000. Not only does it provide a meaningless incentive, the proposed investment levels strongly favor non-TEA locations by raising the statutory minimum of $1,000,000 by a mere $100,000 representing a 10% increase. In sharp contrast, the TEA minimum represents a 100% increase from $500,000 to $1,000,000.

If the Bill were to become law, it would represent another example of the steady deterioration of the TEA incentive. The following chart illustrates this trend by comparing the minimum investment levels and TEA discount under the current law before the regulations are scheduled to take effect; the real world discount of $0 because all locations qualify; the final regulations that would remedy TEA abuse; and the Graham/Cornyn Bill that would restore the abuse.

Summary Comparison: Minimum Investment Amount and TEA Spread for Projects in Non-TEA vs. TEA Locations				
	Law Unchanged Since 1990 Enactment	**Current Market: All Project Locations Qualify as a TEA**	**Final Regulations Issued 6/21/2019, Effective 11/21/2019**	**Senators Graham/Cornyn Bill Introduced 11/5/19**
Non-TEA (standard) Investment	**$1,000,000**	**$500,000**	**$1,800,000**	**$1,100,000**
TEA Investment	**$500,000**	**$500,000**	**$900,000**	**$1,000,000**
TEA Discount	**$500,000**	**0**	**$900,000**	**$100,000**
TEA Discount as Percentage of Non-TEA Investment Amount	**50%**	**0%**	**50%**	**9%**

We believe that the Bill's $100,000 differential, representing a discount of less than 10%, would be insufficient to motivate many investors to choose to invest in a project in either rural Iowa or in downtown Detroit, rather than in a large project in the most affluent areas of New York City, especially those offered by the well-known, well-capitalized megadevelopers that dominate the Program today. Keep in mind the EB-5 investment is typically structured as a loan that will presumably be repaid soon after the visa process reaches a certain stage, and not as a purchase. Thus, under the Graham/Cornyn Bill, TEA status would still be merely a label and not provide the meaningful incentive for immigrants to invest in these undercapitalized areas.

We emphasize that establishing a significant TEA differential is an essential ingredient to creating a meaningful TEA incentive to stimulate investment in the desired locations.[13] However, presumably an effective incentive could be established at minimum investment levels lower than those set by the TEA regulations, so long as the increases are proportional as under current law and under the final TEA regulations.

We are sensitive to the concerns expressed by industry that the dramatic increase in investment amounts set by the TEA regulations might hinder the EB-5 capital raising market, at least in the short term. A sufficient differential could be achieved at lower investment levels. For example, the standard investment amount might be raised by only 25% to $1,250,000 ($550,000 less than the regulations), and the TEA investment amount might be raised by the same percentage from $500,000 to $625,000. This would seem to be a sufficient differential to make a meaningful TEA incentive.

The Bill purports to narrow the geographic location of census tracts that may qualify as a TEA location by incorporating the Opportunity Zone definition. At first blush, this might seem appropriate as an alternative to the TEA regulations' approach to avoid TEA gerrymandering that has been at the root of TEA abuse. However, on reflection, the Opportunity Zone definition would not be meaningful and might be inappropriate.

First, although limiting the geographic location is essential to an effective TEA incentive, the narrow TEA discount makes the incentive meaningless irrespective of the scope of the locations that are eligible because it will not influence many immigrants' investment decision, as described above. Furthermore, the Opportunity Zone definition has several flaws that might make it an unsuitable standard for TEA status, including: (1) by definition, 75% of the "low income communities" are not selected for Opportunity Zone designation; (2) many of these ineligible areas are more deserving than the contiguous tracts that qualify even those the contiguous tracts do not meet the economic threshold applicable to low income communities; and (3) the census tract data (based on the American Community Survey 5 year average of 2011 to 2015) is outdated and allows areas that have been gentrified and not in need of unconventional capital to qualify. [14]

Account Transparency and Fund Administration:

We can understand the motivation for the large developers and regional centers to oppose TEA reform: it is in their self-interest to perpetuate a system that tilts the EB-5 capital raising playing field towards their projects. However, we are perplexed that the Bill omits a simple provision designed to prevent the fraud that has pervaded the EB-5 Program in recent years. The EB-5 reform bill recently introduced by Senators Grassley and Leahy once again contains account transparency and fund administration provisions designed to afford these protections.[15] The Grassley/Leahy reform bill would (1) deter principals of the Regional Center and related entities from misappropriating EB-5 investor funds; (2) promote early detection by USCIS, investors and third-party inspectors of any unlawful diversion; and (3) enhance prompt government enforcement, discovery and recovery of the misappropriated funds.[16] We are not surprised by this glaring omission in the Graham/Cornyn Bill because the draft "reform" bill proposed by Senator Cornyn in 2017 omitted the account transparency provision added by Senators Grassley and Leahy in a previous reform bill.[17]

Perhaps the Bill's proponents simply seek to continue keeping the immigrant investors in the dark, unaware of the location of their invested funds and whether the funds have reached the project which serves as the basis for their visa qualification. A review of the EB-5 misappropriation cases demonstrates that an account transparency and funds administration provision would be an effective tool to combat EB-5 fraud by imposing controls on the flow of

EB-5 investor funds from the moment they are received by the regional center (or the EB-5 investment vehicle) through the time the funds are incorporated into the project.[18]

The lack of transparency that permeates the Program makes it extremely difficult to ascertain the level of fraud that actually exists. Several factors contribute to the opaqueness: minimal disclosure required by the EB-5 law; the late stage in the visa process that USCIS scrutinizes the flow of immigrant investors' funds; lax enforcement by USCIS until recently; the secrecy surrounding the substantial financial savings to developers and lucrative fees earned by regional centers and migration agents; the extreme vulnerability of EB-5 investors to fraud; the unwillingness of many members of industry to self-police; the absence of government mandated internal controls; and the lack of any watchdog.

Surge of Investment Activity Sparked by TEA Regulations:

The EB-5 Regional Center Program is temporary, requiring periodic Congressional reauthorization to continue. Until 2015, the Program routinely was reauthorized every 3 to 5 years without any legislative changes. However, since 2015 when the first EB-5 reform bill was introduced and subsequently blocked by industry, the Program has survived based on series of short-term extensions. Congressional reformers have opposed a long-term extension until fundamental changes are made to the Program.

A surge of EB-5 investor activity has occurred as the sunset date approached or as rumors spread about the regulations becoming finalized or a reform bill being passed. Investors sought to invest at the lower $500,000 level irrespective of the project location.

The release of the final TEA regulations on June 21st created a tidal wave of investment activity as immigrants rushed to invest before the November 21, 2019 effective date. The timing was perfect for the many projects seeking EB-5 funding because immigrant investor interest had sharply declined largely due to the long visa waiting lines faced by investors from mainland China. In recent years Chinese nationals had represented as much as 85% of the immigrants relying on the EB-5 visa as their path to a green card.

The timing of the introduction of the Graham/Cornyn Bill suggests that the industry might have intentionally delayed introduction of this Bill so it would not interfere with the capital raise prompted by the surge. Thus, the approaching effective date of this regulation would serve the purpose of creating a sense of immigrant investor urgency, yet allow an opportunity for a bill to be passed before the regulation took effect so immigrants who invest could still qualify by investing in projects located in the most affluent areas at essentially the same investment level as projects located in economically distressed areas.

Conclusion:

We had assumed that if the regulations were finalized, this would prompt industry to instruct its Congressional proponents to finally negotiate in good faith towards true EB-5 reform legislation.[19] We were obviously naïve as this bill reiterates the same industry positions with no compromise to address the fundamental flaws of the Program. Moreover, the bill would provide stability for a temporary program – a 6 year extended reauthorization period - without requiring any improvements.

We hope that this bill was introduced to serve as a negotiating tool to lead to real compromise legislation that will incorporate a meaningful TEA incentive and account transparency, as well as address other important measures. It will be interesting to observe whether the powerful EB-5 lobby will be as successful at pushing self-interested, senseless changes to the EB-5 law incorporated in the Graham/Cornyn Bill as it has been at blocking sensible reform that would promote true job creation and impose the most important integrity provision - fraud protection.

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[2] https://iiusa.org/blog/iiusa-eb-5-advocacy-alert-long-term-eb-5-reauthorization-bill-introduced-senate/; https://www.natlawreview.com/article/comprehensive-eb-5-modernization-legislation-introduced-us-senate; https://iiusa.org/blog/wp-content/uploads/2019/05/FINAL-EB-5-Reform-Principles-Letter-05-17-19.pdf

[3] https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Fix%20the%20Broken%20Program%204.5.2018.pdf

[4] https://www.federalregister.gov/documents/2019/07/24/2019-15000/eb-5-immigrant-investor-program-modernization

[5] https://www.congress.gov/bill/116th-congress/house-bill/4378

[6] For a discussion of the history of the TEA incentive, see pages 3 to 12 of https://www.judiciary.senate.gov/imo/media/doc/04-13-16%20Friedland%20Testimony.pdf

[77] See pages 8-10 of https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Prescription%20for%20Reform%20-%20Legislation%20or%20Regulation%206.19.2017%20draft.pdf

[8] https://www.federalregister.gov/documents/2019/07/24/2019-15000/eb-5-immigrant-investor-program-modernization

[9] See for example: https://iiusa.org/blog/wp-content/uploads/2019/05/FINAL-EB-5-Reform-Principles-Letter-05-17-19.pdf

[10] This discount is very meaningful to immigrant investors who always seek to invest the minimum amount because the rate of return on their EB-5 investment is minimal. See

[11] https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Prescription%20for%20Reform%20-%20Legislation%20or%20Regulation%206.19.2017%20draft.pdf

[12] See Senator Simon's statements in https://www.judiciary.senate.gov/imo/media/doc/04-13-16%20Friedland%20Testimony.pdf

[13] The other essential ingredient is limiting qualification to a narrow geographic location. Otherwise, the incentive is diluted. The absence of either of these two ingredients renders the TEA incentive ineffective. See page 11 of https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Prescription%20for%20Reform%20-%20Legislation%20or%20Regulation%206.19.2017%20draft.pdf

[14] See https://www.bisnow.com/national/news/opportunity-zones/senate-bill-disqualify-opportunity-zones-misuse-101701?utm_source=outbound_pub_90&utm_campaign=outbound_issue_33625&utm_content=outbound_link_9&utm_medium=email; https://www.bisnow.com/national/news/opportunity-zones/senate-bill-disqualify-opportunity-zones-misuse-101701?utm_source=outbound_pub_90&utm_campaign=outbound_issue_33625&utm_content=outbound_link_9&utm_medium=email

[15] https://www.grassley.senate.gov/sites/default/files/documents/116.S.2540%20EB-5%20Reform%20and%20Integrity%20Act.pdf

[16] See https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%202.0%20%20Can%20Account%20Transparency%20Save%20the%20Program.pdf

[17] See page 16 and 17 of https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Fix%20the%20Broken%20Program%204.5.2018.pdf

[18] See https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%202.0%20%20Can%20Account%20Transparency%20Save%20the%20Program.pdf; https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%202.0%20%20Can%20Account%20Transparency%20Save%20the%20Program.pdf

[19] See https://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Prescription%20for%20Reform%20-%20Legislation%20or%20Regulation%206.19.2017%20draft.pdf