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**“EB-5 Prescription for Reform:  
Legislation or Regulation?”**

**By**

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**June 19, 2017**

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## I Introduction

This might seem counterintuitive to those who follow the EB-5 visa program reform efforts: the publicity surrounding the Kushner Company (“Kushner”) controversy is likely to play a major role in saving the EB-5 visa program (sometimes the “Program” or the “EB-5 Program”).<sup>2</sup> Certainly, Kushner’s EB-5 fundraising activities in mainland China raise serious legal and ethical issues.<sup>3</sup> But more importantly, from the Program’s perspective, a spotlight has been cast on TEA<sup>4</sup> abuse - how the special incentive intended by Congress to promote business development in areas that are unable to attract conventional capital is not working; it is being abused to attract most EB-5 immigrant investor capital to those projects that need it the least and were never intended to benefit from this incentive.

EB-5 capital flows primarily to the largest real estate projects in affluent areas and is diverted from the areas that need it the most, rural and economically distressed urban areas.<sup>5</sup> In fact, Kushner’s Jersey City projects represent merely routine examples of TEA abuse; the classic, most egregious examples include real estate development projects located in the most affluent urban areas in the country, such as in Beverly Hills and along Billionaires’ Row in New York City.<sup>6</sup> Notably, the states that benefit the most from TEA abuse are New York and California, states that did not support President Trump in the 2016 election. The states that stand to benefit the most from TEA reform – those with vast rural areas and that lack major affluent urban areas – represent his base of support.

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<sup>2</sup> See footnotes in <https://www.leahy.senate.gov/imo/media/doc/LeahyConyerLofgren.pdf>.

<sup>3</sup> See <https://www.leahy.senate.gov/press/leahy-conyers-lofgren-send-letter-to-kushner-companies-asking-about-eb-5-visas-and-conflicts-of-interest>; also see <https://www.grassley.senate.gov/news/news-releases/grassley-pushes-quick-executive-actions-curb-eb-5-visa-abuse>.

<sup>4</sup> TEA is the abbreviation for a “Targeted Employment Area.” TEA status is significant for two reasons. First, it determines which project locations qualify for the special incentive by which immigrants may invest only \$500,000, rather than \$1,000,000. Immigrant investors prefer to minimize their EB-5 investment amount because they earn only a minimal return on their EB-5 investment. Secondly, TEA investors qualify for priority status for 3,000 of the 10,000 EB-5 visas permitted to be issued under the annual quota. As discussed in this paper, neither incentive works under the current system. See INA §203(b)(5).

<sup>5</sup> See <https://www.judiciary.senate.gov/imo/media/doc/04-13-16%20Friedland%20Testimony.pdf>. (“Friedland’s Congressional Testimony”); <http://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20TEA%20Reform%204.24.2016.pdf> (“Reflections on Senate Judiciary Committee Hearing”).

<sup>6</sup> See <http://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Capital%20Project%20Database%20-%20Revised%20and%20Expanded.pdf> (“Supplemental EB-5 Project Database – March 2016”).

June 2017 marks the second anniversary of the introduction of comprehensive EB-5 reform legislation by Senators Grassley (R-IA) and Leahy (D-VT).<sup>7</sup> Anyone familiar with the Program knows that while TEA reform is the most controversial aspect of the Reform Bill, many other critical issues are addressed. The recent flurry of news articles focusing on the Kushner controversy overshadows the other problems plaguing the Program, especially the disturbing trend of lawsuits alleging misappropriation of EB-5 investor funds and other securities fraud violations by certain regional centers and developers.<sup>8</sup>

At the urging of the Congressional reformers who were frustrated by the logjam in Congress, the United States Citizenship and Immigration Services (“USCIS”) released proposed regulations (sometimes the “Proposed Regulations”) that would remedy the TEA abuse, but in a manner that the industry believes will make it even more difficult to attract EB-5 investors than under the provisions of the Reform Bill.<sup>9</sup> Unfortunately, USCIS issued the Proposed Regulations on January 13, 2017, only one week prior to the inauguration of President Trump.

This paper supplements our paper entitled “EB-5 2.0 Proposed Regulations: A Missed Opportunity, Next Steps for Reform” (referred to herein as “Missed Opportunity”), released in February 2017.<sup>10</sup> In Missed Opportunity, we incorrectly assumed that the Trump Administration would immediately block these Proposed Regulations.<sup>11</sup> However, the Administration has permitted the regulations to proceed through the public comment process. As explained in this paper, we now expect that the regulations will become final, perhaps as early as this summer, although the Trump Administration still retains the power to prevent this.

EB-5 stakeholders, including regional centers and developers, recognize that Congress will require comprehensive reform in exchange for a long-term extension of this temporary program that was created in the early 1990’s. However, a few

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<sup>7</sup> The Senate reform bill was introduced as S. 1501 and followed by four informal discussion drafts. H.R. 5992, the House companion bill was introduced in the House by Representatives Goodlatte (R-VA) and Conyers (R-MI) in September 2016. An informal staff draft of H.R. 5992 dated December 2, 2016 was circulated. An informal Senate legislative counsel draft dated April 15, 2017 was circulated. S. 1501 and H.R. 5992 are companion bills and contain many similar provisions. The December 2016 House staff draft and the April 2017 Senate legislative counsel draft contain similar provisions. For ease of reading, we refer to these drafts as the pending “Reform Bill” even though these are merely informal drafts. We realize that this is technically incorrect, but sufficient for purposes of this paper.

<sup>8</sup> <http://www.ilw.com/articles/2016,1006-friedland.pdf>. (“Account Transparency”).

<sup>9</sup> <https://www.federalregister.gov/documents/2017/01/13/2017-00447/eb-5-immigrant-investor-program-modernization>. (the “Proposed Regulations”). Technically, the Proposed Regulations were released by the U.S. Department of Homeland Security (“DHS”). USCIS is an agency that is part of DHS.

<sup>10</sup> <http://www.stern.nyu.edu/sites/default/files/assets/documents/EB-5%20Proposed%20Regulations-A%20Missed%20Opportunity%2C%20Next%20Steps%20Rev%202.14.2017%20.pdf> (“Missed Opportunity”).

<sup>11</sup> Id.

key members of industry who seek to maintain the status quo have continued to block the reform efforts.<sup>12</sup> For them delay is a strategy. Their apparent goal is to raise as much EB-5 capital as possible, at exceptionally low interest rates, under the current distorted system that overwhelmingly favors their projects.<sup>13</sup>

Now that it appears increasingly likely that the Proposed Regulations will become final regulations, possibly as soon as this summer, the status quo proponents appear to be willing to negotiate towards broad-based reform. However, they propose to negotiate based on a draft bill circulated for discussion purposes by Senator Cornyn (R-TX), the majority whip.<sup>14</sup> Reportedly, the real estate industry - especially regional centers and developers based in Gateway cities whose projects would not qualify as a TEA under the Proposed Regulations or Reform Bill - is uniting with the status quo proponents to rally support behind the Cornyn proposal. This should come as no surprise because the proposal does not reflect true reform, especially in the case of reform of TEA abuse, as discussed in this paper. The issue is whether these “reforms” will be accepted by the Congressional reformers, particularly as the negotiating leverage shifts to the reformers if and when the Proposed Regulations become final.

The alternative paths to reform – the Proposed Regulations, the Reform Bill and the Cornyn bill – would effectively eliminate TEA gerrymandering, the heart of TEA abuse under the current system. However, this alone does not automatically make the TEA incentive meaningful to spur investment in the targeted rural and urban areas. The proposals, to varying degrees, narrow the spread between the minimum investment amounts required for a project located in a TEA versus a project not so located (“TEA spread” or “TEA discount”). If the TEA discount is not sufficiently wide to incentivize investment in the areas intended to be benefitted, TEA status would become merely a label and not provide the meaningful incentive for immigrants to invest in these undercapitalized areas. Thus, one form of TEA

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<sup>12</sup> <https://www.wsj.com/articles/new-york-developer-lobbies-against-changes-to-immigrant-investor-program-1484058703>.

<sup>13</sup> For example, the Related Companies recently announced the launching of a third tranche of EB-5 capital for its Hudson Yards project in New York City. <https://therealdeal.com/2017/06/09/related-oxford-want-to-raise-another-380m-in-eb-5-funds-for-hudson-yards/>. This project location will qualify as a TEA under existing gerrymandering rules, but would not so qualify under the Proposed Regulations, Reform Bill or Cornyn proposal. This would bring the total capital raised by Related, if fully funded, to more than \$1.5 Billion for the Hudson Yards project. Collectively, this would absorb almost an entire year of the EB-5 visa quota. (Note that most EB-5 capital investments are deployed to the project as a loan to the developer-Job Creating Entity at a cost of capital to the developer that is significantly lower than other capital sources.)

<sup>14</sup> The bill has not been formally introduced in the Senate. See <http://www.indoamerican-news.com/huge-change-planned-to-eb-5-investment-visa-program/>; <http://www.breitbart.com/texas/2017/05/11/texas-senators-proposal-expand-scandal-plagued-eb-5-visa-program/>.

abuse would be eliminated, but another form of TEA abuse would thereby be created.

This paper focuses principally on TEA reform and the alternative paths to achieve reform. To illustrate the major differences in the minimum investment amounts and the spread as a TEA incentive, here is a table summarizing the key provisions under the existing EB-5 law, the Reform Bills, the Cornyn draft bill and the Proposed Regulations.

	Summary Comparison Minimum Investment Amount and TEA Spread					
	Existing Statute (Unchanged since enactment in 1990) <sup>15</sup>	Current Market: All Projects Qualify as a TEA	S.1501 (introduced June 2015); H.R. 5992 (introduced Sept. 2016)	Most recent Staff drafts of S. 1501 and H.R. 5992	Senator Cornyn draft bill April 2017 (not introduced)	USCIS Proposed Regulations January 13, 2017
Non-TEA (standard)	1,000,000	500,000	1,200,000	1,000,000	925,000	1,800,000
TEA	500,000	500,000	800,000	800,000	800,000	1,350,000
<b>TEA Spread</b>	<b>500,000</b>	<b>0</b>	<b>400,000</b>	<b>200,000</b>	<b>125,000</b>	<b>450,000</b>

Thus, the Cornyn draft bill proposes the narrowest spread of any of the alternative paths to reform. This proposal can be viewed as an incentive only by comparison to the current distorted system in which there is no incentive because virtually all projects qualify at the \$500,000 TEA minimum investment level due to gerrymandering.

This paper analyzes the reasons we believe the Proposed Regulations are likely to be finalized substantially in the form proposed, and will promptly lead to sorely needed broad-based legislative reform, not limited to TEA reform - that is, unless a comprehensive reform bill is passed by Congress before the Proposed Regulations are finalized.

This paper also supplements our paper entitled “EB-5 2.0: Can Account Transparency Save the Program?” (October 2016) about the most important integrity measure added by the Reform Bill introduced in September 2016 – account transparency and independent third-party fund administration.<sup>16</sup>

Finally, this paper discusses a lawsuit recently filed by Chinese investors against one of the largest regional centers in the country and the first regional

<sup>15</sup> Technically, the statute provides that the TEA amount must be no less than one-half of the standard amount. In 1991, regulations set the minimum investment amount for investments in projects located in a TEA. 8 C.F.R. §204.6(f).

<sup>16</sup> Account Transparency. Supra at footnote 8.

center to be designated by USCIS in New York City.<sup>17</sup> If the investors' allegations are proven to be true, this case might lead to broader integrity reforms and an expansion of the scope of due diligence that immigrant investors will routinely require to be performed throughout the EB-5 investment process.

## II EB-5 Reform - Brief Background

In 1990 when the EB-5 law took effect as part of the Immigration Act of 1990, Congress could not foresee that a program designed to attract foreigners to invest capital in any type of U.S. business that creates jobs would evolve into one whose primary use is providing a mainstream capital source for real estate development projects. In fact, investments in very few real estate projects could even qualify for EB-5 purposes until 2009 when USCIS liberalized its interpretation of jobs to include construction-activity jobs, the principal type of jobs created by real estate projects.<sup>18</sup>

Furthermore, in 1990 the EB-5 program was limited to direct investments that promote entrepreneurship by immigrants to create jobs. In 1992, after the EB-5 direct program quickly failed to generate significant interest, Congress enacted the Regional Center Program, a temporary program to be reauthorized on a periodic basis.<sup>19</sup> Even though this Program was very different in nature from the direct program, Congress did not tailor the basic statutory framework to reflect the fundamental differences between the direct investment and the new regional center investment programs.<sup>20</sup> As the September 30, 2015 reauthorization date neared, Senators Grassley and Leahy seized the opportunity to reform the EB-5 Program by introducing a broad-based reform bill, S. 1501, in June 2015.

The proposed reforms under that bill and the subsequent House companion bill (H.R. 5992) were aimed to address a myriad of issues, some of which (but not

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<sup>17</sup> <http://www.nycrc.com/press/93/new-york-city-regional-center-reaches--3-000th-permanent-residency-milestone.html>

<sup>18</sup> Memorandum from Donald Neufeld, Acting Associate Director, Domestic Operations entitled "Adjudication of EB-5 Regional Center Proposals and Affiliated Form I-526 and form I-829 Petitions; Adjudicator's Field Manual (AFM) Update to Chapters 22.4 and 25.2 (AD09-38)" dated December 11, 2009 and Memorandum from Neufeld entitled "EB-5 Alien Entrepreneurs – Job Creation and Full Time Positions" dated June 17, 2009. Also see the discussion of the USCIS's policy change in <http://www.stern.nyu.edu/sites/default/files/assets/documents/EB5%20paper%20final%205.24.2015.pdf> ("Roadmap").

<sup>19</sup> The Regional Center Program provides the overwhelming majority of the capital raised from immigrants seeking to qualify for the EB-5 visas.

<sup>20</sup> Section 610 of Public Law 102-395 (October 6, 1992) created the Immigrant Investment Program, also known as the Regional Center Program.

all) more commonly arise in the context of real estate development projects. These issues include: the lack of any standards or qualifications for a regional center;<sup>21</sup> the obvious conflict of interest raised where there is an overlap in ownership or control between the regional center, new commercial enterprise and/or the project developer-job creating entity; the easy opportunity for fraudulent misappropriation of the investors' funds created by deployment into the project by a series of construction advances rather than in a lump sum; the creation of construction activity jobs of limited duration, rather than the creation of long-term jobs in other sectors (such as manufacturing); the common use of EB-5 capital as gap financing, providing only a small percentage of the total project capital costs with total costs often exceeding \$1 Billion, yet the EB-5 capital is credited with 100% of the jobs; and capital flow concentration towards large projects in affluent urban areas built by major real estate developers that inappropriately qualify for the TEA incentive by the use of gerrymandering.

### III TEA Abuse

#### A. TEA status has been rendered meaningless

The current EB-5 law incentivizes an immigrant to invest in a U.S. project that creates jobs in exchange for an EB-5 visa. The EB-5 investor's sole reason for making the investment is to secure an EB-5 visa, unlike a conventional investor who invests in a project to maximize his economic return. Thus, the EB-5 investor accepts a minimal rate of return on his investment. Accordingly, he seeks to minimize the amount of his investment in a qualifying project. If the immigrant invests in a project location that qualifies as a TEA – a rural area or certain economically distressed urban areas - he is entitled to a special incentive that allows him to invest only \$500,000, rather than the standard \$1,000,000.<sup>22</sup>

The immigrant seeks to secure the visa as quickly as possible. Investors prefer to invest in projects that are most likely to be completed without interruption because generally the jobs must be created before the unconditional visa will be issued. This favors a developer that has a track record of successfully completed projects, is well capitalized and is able to resolve financial and other problems that may arise during the construction process. In addition, the investor's relatives who have settled in the US may be more likely to recommend projects located in Gateway cities built by major developers whose name they recognize.

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<sup>21</sup> The regional center typically sponsors the project and serves as the intermediary between the immigrant investors and the developer-job creating entity.

<sup>22</sup> 8 C.F.R. §204.6(f).



Thus, large projects in affluent urban areas built by brand-name developers have an obvious advantage. As discussed below, many of these projects would have been fully funded and built, and the jobs would have been created, without any EB-5 capital.<sup>23</sup>

It is well documented that due to TEA gerrymandering practiced by the individual states, virtually all project locations currently qualify as a TEA, contrary to Congress' original intent. Thus, all investors in those projects can invest \$500,000, rather than \$1,000,00, to qualify for the EB-5 visa. Consequently, under the law, the TEA discount is \$500,000, but in the "real world" there is no discount.<sup>24</sup>

Thus, TEA status has been rendered meaningless because there is no incentive to invest in the project areas that Congress originally intended to benefit. Given a choice between investing the same amount of money offering the same minimal investment return in projects located in the most affluent parts of Manhattan (New York City) versus Manhattan, Kansas or rural Idaho or downtown Detroit, the investors select the project in New York City because they perceive it is most likely to result in the visa approval in the shortest period of time. Also, the project is likely to be started and completed on time resulting in the creation of jobs and the issuance of the EB-5 visa.

In 1990, Congress recognized that immigrant investors would prefer to invest the minimum amount in projects located in affluent areas. That is why the TEA discount was established as the incentive. Otherwise, EB-5 capital will flow to the most affluent areas. However, TEA gerrymandering designed by the individual states circumvented, and continues to circumvent, the Congressional will.<sup>25</sup>

Under the current system of gerrymandering, the TEA incentive operates in the opposite manner originally intended by Congress. Since every project location qualifies as a TEA, it is nearly impossible for projects in rural or economically distressed urban areas to compete for the valuable EB-5 capital – the very reason Congress established the incentive in 1990.

It must be emphasized that the inexpensive EB-5 capital is available to all developers, whether or not their project is located in a TEA.<sup>26</sup> TEA status

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<sup>23</sup> See

<http://www.stern.nyu.edu/sites/default/files/assets/documents/Reflections%20on%20the%20Judiciary%20Committee%20Hearings%202.29.2016.pdf>. ("Reflections on House Judiciary Committee Hearing").

<sup>24</sup> See Reflections on Senate Judiciary Committee Hearing. Supra at footnote 5.

<sup>25</sup> See Reflections on Senate Judiciary Committee Hearing. Supra at footnote 5.

<sup>26</sup> The government offers the "EB-5 subsidy" to all projects that create jobs in the U.S. by offering a visa to an immigrant in exchange for investing in these projects. The visa incentivizes the immigrant to accept a lower rate of return on his investment because his goal is to secure the visa.

determines which projects should qualify for the special TEA incentive designed to attract immigrants to invest in project locations that need the capital and would otherwise have difficulty in obtaining such capital.

B. Many projects that artificially qualify for TEA status would be built even without the injection of EB-5 capital

Furthermore, the increasingly common use of bridge financing to fund a project before the EB-5 capital is deployed to the project illustrates that many EB-5 projects would be built without the EB-capital.<sup>27</sup> Immigrant investors seek to minimize the construction and other risks posed by development projects. Bridge financing eliminates the risk that the project commencement will be delayed as this type of financing enables the project to get a jump start, rather than wait until the EB-5 capital becomes available to fund the project.<sup>28</sup> Developers intend to replace this expensive bridge financing with the inexpensive EB-5 capital that will receive the credit for the job creation, even if the jobs were created by the bridge financing rather than the EB-5 capital.<sup>29</sup> However, when the bridge lender funds its loan, there is no certainty that the EB-5 capital raise will be successful. Thus, it would be difficult for a developer to argue that the EB-5 financing is critical to project commencement or completion if the project is commenced with bridge financing that will be replaced only if and when the EB-5 capital is raised and becomes available.

Similarly, a developer would be hard pressed to argue that it acquired a property in today's market in reliance on EB-5 capital, and particularly in reliance on the TEA incentive, to fund the development project. The EB-5 capital market is very competitive with more projects seeking capital from a limited number of immigrant investors. This competition gives rise to uncertainty of a successful EB-5 capital raise coupled with the program's current uncertain status. As one major NYC developer aptly stated: "raising [EB-5] funds is not a requirement for our [EB-5] project to move forward in a timely manner, we view it as an accretive component to the overall capital."<sup>30</sup> In other words, in many cases EB-5 merely enhances the developer's profit and return on investment, and does not determine the project's fate. In addition, many capital providers are available to the project developer to fund gap financing, such as private equity debt funds, foreign lenders

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<sup>27</sup> See Reflections on House Judiciary Committee. Supra at footnote 23. USCIS Policy Memorandum dated May 30, 2013.

<sup>28</sup> See <http://eb5arnstein.com/eb-5-marketplace-measurement-china-and-beyond/>

<sup>29</sup> See USCIS Policy Memorandum dated May 30, 2013.

<sup>30</sup> <https://commercialobserver.com/2015/10/kuafu-seeks-nearly-50m-in-eb-5-money-for-east-86th-street-project/>

and unrelated developers, although they command a much higher cost of capital than EB-5 capital.

#### IV Keys to a Meaningful TEA Incentive

The two essential ingredients to a meaningful TEA incentive are (1) a narrowly defined area that limits the number of projects that may qualify for the TEA discount, and (2) a sufficiently wide TEA spread between the minimum amount required for a TEA project location and other locations.

TEA abuse is the lack of a meaningful tool to incentivize the immigrant to invest in projects areas that Congress seeks to benefit – rural and economically distressed urban areas. Under the current system, gerrymandering by the individual states is the heart of the TEA abuse. Gerrymandering results in virtually all projects qualifying as a TEA. Thus, there is no incentive for the immigrant to invest in a rural or economically distressed urban area project, given that he can qualify for the EB-5 visa by investing in projects in the most affluent areas. Eliminating gerrymandering solves the “narrow area” prong of making TEA meaningful but does not automatically solve the problem. If the TEA spread is not sufficiently wide, then the TEA incentive would still not be meaningful. Investors will still be attracted to the affluent areas and be less inclined to invest in the areas intended to be benefitted.

#### V TEA Abuse Due to Gerrymandering Results in Unintended Consequences

As described below, TEA abuse creates unintended winners and losers, contrary to the original intent of the TEA incentive.

##### A. Project Level: EB-5 capital flows to affluent areas, depriving undercapitalized areas of EB-5 capital and jobs

The most obvious unintended consequence is that TEA abuse further incentivizes the lion’s share of the EB-5 capital to flow to the most affluent urban areas (rather than to the targeted areas intended to benefit). Thus, the TEA discount works exactly in the opposite manner that Congress originally intended – it benefits those areas and projects least in need of an incentive. Compounding this, most of that capital flows to large projects in affluent urban areas by brand-name developers that in many cases would have been funded and built without EB-5 capital and thus, the jobs would have been created in any event. This is not only contrary to the TEA incentive, but also contrary to the overall purpose of the

Program which is to promote the investment of foreign capital to create jobs that would not otherwise be created.

As a result, the concentration of capital to the affluent areas deprives EB-5 capital from flowing to projects in the areas intended to benefit from this capital. Jobs are lost in the project areas that cannot otherwise attract capital. Without the injection of EB-5 capital, the projects are deprived of the opportunity to be built, and thus create jobs that would not otherwise be created.

B. Immigrant level: Immigrants invest at a 50% discount even if the project is located in an affluent area

Another obvious consequence is that virtually all immigrant investors qualify for the visa and a path to U.S. citizenship by investing only 50% of the amount set by Congress in 1990 because even projects located in the most affluent areas qualify as a TEA. The 50% minimum investment level was reserved for TEA projects. Most immigrants invest in EB-5 projects that would not qualify as a TEA if a strict definition were applied based on the statute, such as the definition set forth in the Proposed Regulations or the Reform Bill. Thus, these investors are not providing the risk capital to the areas that were originally intended to benefit by, and are most deserving of, the TEA status, yet the immigrants are securing the valuable visa by investing only one half of the amount, rather than the full amount mandated by the statute. The discount is even steeper when one takes into account that the investment amount has never been raised despite the statutory authority granted to DHS.<sup>31</sup> Moreover, some Congressional reformers complain that even at \$1,000,000 the visa is being offered too cheaply by the U.S. government.<sup>32</sup>

Furthermore, this abuse of the TEA discount contributes to the long visa waiting lines and slow processing times by USCIS that have provoked countless complaints by industry and immigrants. The visa waiting line is almost doubled because investors are inappropriately allowed to qualify by investing \$500,000 rather than \$1,000,000. If instead these immigrants were required to invest \$1,000,000 for projects that are not located in a bona fide TEA, then fewer visa applications (I-526 petitions) would be filed and processed to raise the same amount of capital. An ancillary benefit is that investment at the \$1,000,000 level would raise substantially more capital from the same number of investors.

In any event, EB-5 investors in the aggregate have saved billions of dollars by virtue of their investments qualifying for the TEA discount due to gerrymandering applied by the individual states to projects that would not have qualified if the

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<sup>31</sup> Statute originally granted the authority to the U.S. Attorney General.

<sup>32</sup> See, for example, statements by Representatives Goodlatte (R-VA) and Lofgren (D-CA) at the House Judiciary Committee Hearing held on February 11, 2016.

statutory standards were appropriately applied to a single census tract. Arguably, TEA abuse by gerrymandering allows EB-5 investors to save at least \$1 Billion in just one year.<sup>33</sup>

## VI Proposed Regulations

### A. Summary

The Proposed Regulations would impose higher minimum investment amounts and widen the TEA spread compared to the Reform Bill.<sup>34</sup> Similar to the Reform Bill, it would effectively eliminate gerrymandering.<sup>35</sup>

The proposed TEA discount is \$450,000, with a TEA minimum investment amount of \$1,350,000 and \$1,800,000 for all other project locations. The regulations propose to raise the minimum investment amounts to keep pace with inflation - the amounts have never been adjusted since they were established in the early 1990's.<sup>36</sup> The TEA spread proposed by the regulations is \$50,000 less than the amount set under the current law, but represents an effective increase of \$450,000 more than the real world spread.

For ease of comparison, set forth again is a table summarizing the minimum investment amount and TEA discount under the existing law, the Reform Bills, the Cornyn draft bill and the Proposed Regulations.

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<sup>33</sup> GAO has estimated that 99% of the immigrants who filed I-526 petitions in the fourth quarter of fiscal year 2015 invested in a TEA. GAO also estimated that 90% of those petitioners who elected to invest in a high unemployment TEA (i.e., not including rural areas), based the TEA on gerrymandering of more than one census tract. <https://www.gao.gov/products/GAO-17-487T>. Approximately 3,000 to 3,500 investors qualify for the annual visa quota of 10,000, with the balance of the visas issued to the investors' family members. Even if only 80% of the immigrants invested in gerrymandered TEA projects and only 3,000 investors qualify for the visa, the savings would exceed \$1 Billion for a single year (80% gerrymandered TEA projects x 3,000 investors x \$500,000 TEA savings exceeds \$1 Billion.) It must be emphasized that the annual quota does not limit the number of immigrants who may make an EB-5 investment in a particular year. The quota limits how many visas may be issued. Thus, the number of immigrants who make an EB-5 investment in a particular year may exceed the annual quota.

<sup>34</sup> The regulations address other technical issues. However, the TEA issues are the most significant and the focus of this paper's concern. <https://www.federalregister.gov/documents/2017/01/13/2017-00447/eb-5-immigrant-investor-program-modernization>.

<sup>35</sup> We prefer the Reform Bill's definition which generally limits the TEA to the census tract in which the project is located. The Proposed Regulations allow any census tract contiguous to the project's census tract.

<sup>36</sup> The 1990 statute sets the standard minimum investment amount at \$1,000,000 and, in 1991, the regulations set the TEA minimum investment amount at \$500,000.

Summary Comparison Minimum Investment Amount and TEA Spread						
	Existing Statute (Unchanged since enactment in 1990) <sup>37</sup>	Current Market: All Projects Qualify as a TEA	S.1501 (introduced June 2015); H.R. 5992 (introduced Sept. 2016)	Most recent Staff drafts of S. 1501 and H.R. 5992	Senator Cornyn draft bill April 2017 (not introduced)	USCIS Proposed Regulations January 13, 2017
Non-TEA (standard)	1,000,000	500,000	1,200,000	1,000,000	925,000	1,800,000
TEA	500,000	500,000	800,000	800,000	800,000	1,350,000
<b>TEA Spread</b>	<b>500,000</b>	<b>0</b>	<b>400,000</b>	<b>200,000</b>	<b>125,000</b>	<b>450,000</b>

B. Public comments to Proposed Regulations

290 public comments were submitted to USCIS in response to the Proposed Regulations. Most of these letters were submitted by current or potential immigrant investors, regional centers and other stakeholders including trade groups and professional associations.<sup>38</sup>

These comments did not advance any new ideas or arguments. Instead, they largely reflected a repeat of the same arguments advanced by these stakeholders that have opposed the TEA measures in the Reform Bill for the past two years. These arguments were already anticipated and taken into account by USCIS in its well-reasoned analysis set forth in the Proposed Regulations. Thus, these comments are unlikely to persuade USCIS to reevaluate or alter the substance of the Proposed Regulations.

1. Comments by immigrant investors

Immigrant investors obviously seek to minimize the required investment amount given that their sole purpose for making the investment is to secure a visa, and thus typically accept a rate of return on their investment of one-half of one percent (1/2%) or less per year.

Some of the investors, presumably those from mainland China who face retrogression,<sup>39</sup> complained about the long visa waiting lines and advocated an

<sup>37</sup> Technically, the statute provides that the TEA amount must be no less than one-half of the standard amount. In 1991, regulations set the minimum investment amount for investments in projects located in a TEA. 8 C.F.R. §204.6(f).

<sup>38</sup> This discussion is not intended as an exhaustive list or analysis of the public comments. For an excellent in-depth summary that categorizes and analyzes the comments, see Suzanne Lazicki’s recent blog post at: <https://blog.lucidtext.com/2017/05/20/new-eb-5-regulations-comments-discussion/#comments>. Although we share many of Ms. Lazicki’s views, we do not agree with all of her observations.

<sup>39</sup> For a discussion of Chinese retrogression, see [https://iiusa.org/blog/wp-content/uploads/2016/01/Delays-for-Todays-Chinese-Investor-and-Implications\\_IUSA.pdf](https://iiusa.org/blog/wp-content/uploads/2016/01/Delays-for-Todays-Chinese-Investor-and-Implications_IUSA.pdf).

increase in the annual EB-5 visa quota. The Proposed Regulations do not address this issue because only Congress has the authority to increase the quota.

We assume USCIS will accord less weight to the investors' comments, particularly given their self-interest in keeping the required investment amount as low as possible. It is easy for the immigrants to boldly assert that they would invest in other countries' programs if the minimum investment amounts were raised, with recognition that their assertions cannot be verified.

## 2. Comments by regional centers, developers and other stakeholders

Regional centers and developers obviously seek to keep minimum investment levels as low as possible to maximize the pool of potential investors for their projects. Most of these comments objected to the increase in the minimum investment amounts. These stakeholders expressed concern that immigrants would not be able to afford a major increase, and that such an increase would prompt them to pursue visas from other countries with lower required investment amounts.

These comments do not take into account that the minimum investment amount has effectively declined because it has never been adjusted, even to keep pace with inflation, since the law's enactment over 25 years ago. They also provide no evidence or studies to demonstrate the average net worth of immigrant investors, their ability to afford an EB-5 investment or the impact of increased investment amounts on investors.

We acknowledge the difficulty in developing an accurate, unbiased study to predict whether increased minimum investment amounts would influence or affect the willingness of the wealthy immigrants who qualify to invest in the United States to obtain a visa. Undoubtedly, it is easy to find immigrants and migration agents to make the self-interested assertion that the increased amount would dissuade them from investing.<sup>40</sup> In addition, the comments ignore the preference of many immigrants to obtain the U.S. visa for advantages that other countries cannot offer.

Not surprisingly, the comments on the TEA spread were split. The regional centers in Gateway cities seek to minimize the spread. The regional centers in rural area and smaller cities with few affluent areas support a wider spread.

A comment letter jointly submitted by the leading industry groups and a professional association appears to have been submitted as a delay tactic. The letter requested that the Proposed Regulations be withdrawn and folded into a related proposed rulemaking that was released by USCIS to seek public comment

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<sup>40</sup> Obviously, if the minimum investment amounts were raised, fewer immigrants would be able to afford the increased amounts.

on other important EB-5 issues before the Proposed Regulations be promulgated. They also requested that the comment period be extended until June 10, 2017 rather than the April 11, 2017 deadline.<sup>41</sup> USCIS did not grant their request to withdraw the regulations or to extend the comment period.

These stakeholders included the three groups that have played the most active role in blocking the Reform Bills, especially the TEA reform measures – namely, the EB-5 Investment Coalition, the U.S. Chamber of Commerce and the Real Estate Roundtable. The TEA issue is the pivotal issue – if it is resolved, bridging the differences on the other issues should be relatively easy. The stakeholders obviously realized that if the Proposed Regulations that are aimed at TEA reform were to become final, industry would face a dilemma because the regulations would be even more effective than the Reform Bill to curb TEA abuse due to the wider TEA spread. In addition, the Proposed Regulations would impose significantly higher minimum investment amounts that would reduce the pool of EB-5 investors.

### 3. Comments by Congressional Reformers

In our view, the most convincing comment letter was submitted jointly on behalf of the leading Congressional reformers who have sponsored the Reform Bills in the Senate and House of Representatives.<sup>42</sup> Predictably, this letter expressed strong support for the Proposed Regulations. The letter thoroughly examined the legislative history of the TEA incentive and the manner in which the Program has strayed from its original intent.

#### C. Our proposed alternative approach

Our public comment letter suggested a simple alternative, that we previously suggested in Missed Opportunity.<sup>43</sup> Our approach seeks to make the TEA incentive meaningful under the current statutory scheme. It recognizes that the key to the current TEA abuse is gerrymandering and takes into account the two essential ingredients: a narrowly defined TEA area and a wide TEA spread.

This is how our alternative would work: revoke the existing regulation that grants the authority to the individual states to designate a project location as a TEA. Based on the existing statute, the authority would be vested in USCIS (as it would

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<sup>41</sup> The comments were submitted on behalf of the EB-5 Investment Coalition, the U.S. Chamber of Commerce, the Real Estate Roundtable, the American Immigration Lawyers Association, IIUSA and the Rural Alliance.

<https://www.regulations.gov/document?D=USCIS-2016-0006-0031>.

<sup>42</sup> <https://www.regulations.gov/document?D=USCIS-2016-0006-0252>. These champions of EB-5 reform are Senators Grassley and Leahy, and Representatives Goodlatte and Conyers.

<sup>43</sup> <https://www.regulations.gov/document?D=USCIS-2016-0006-0254>. Also see Missed Opportunity. Supra at footnote 10.



no longer be delegated to the individual states). USCIS could then clarify that TEA status is based on a single census tract– the tract where the project is located. This would eliminate gerrymandering. Consequently, most project locations would not qualify as a TEA.

Under the existing statute, the \$1,000,000 investment level would apply to most investments, and the \$500,000 TEA minimum amount would be limited to investments in projects located in rural areas and high unemployment areas. Even though this is essentially the same structure as the current statute, the elimination of gerrymandering would allow the \$500,000 discount to incentivize investment in the undercapitalized areas, as originally intended by Congress.

The proposed investment amount of \$1,000,000 for standard investments (i.e., projects not located in a TEA) under this alternative would be the same as under the Reform Bill. However, the TEA minimum investment amount would be only \$500,000 (the same as current law), rather than increased to \$800,000 as proposed under the Reform Bill. Due to the wider TEA spread, this alternative would provide a greater incentive for immigrants to invest in the targeted areas.

Even though the investment levels under our alternative approach are substantially lower than those in the Proposed Regulations and lower than in the Reform Bill, we realize industry might not embrace our alternative. However, it would be difficult for industry to challenge this proposal because it is identical to the statutory TEA structure that was established by Congress more than 25 years ago, but never implemented as a result of the TEA gerrymandering practiced by the individual states. This would finally allow the TEA incentive to work in the manner that Congress originally intended.

This simple alternative to make TEA status meaningful would shift the leverage to the Congressional reformers. We are confident that if this alternative were incorporated in the final regulations, it would prompt industry to negotiate in good faith towards a broad-based legislative Reform Bill that would include TEA reform measures similar to those proposed in the most recent version of the Reform Bill. If legislative reform did not result, we would expect industry to favor this alternative rather than the Proposed Regulations because the minimum investment amounts are lower, even though the TEA spread is slightly higher.

#### [D. Next steps](#)

Although we believe USCIS will decide to finalize the Proposed Regulations on the same terms as proposed, the adoption of these regulations must comply with the prescribed administrative procedure.

As discussed above, the public comments did not reveal any objections that would persuade USCIS to change its position. Furthermore, essentially the same career officials and employees who prepared and reviewed the Proposed Regulations continue to serve in their positions. President Trump nominated Francis Cessna as USCIS Director. Mr. Cessna, based on his experience while working with Senator Grassley's office, is likely to support the regulations, although at his recent confirmation hearing the issue did not arise.<sup>44</sup> We assume DHS Secretary Kelly will likely defer to these officials due to his lack of experience with the EB-5 Program prior to his recent appointment.

There is no timetable for the balance of the administrative process. The 30-day minimum period from the end of the comment period has expired. However, there is no deadline by which USCIS must make a decision about the Proposed Regulations. If it decides to finalize the regulations, it must update the impact analysis and submit this to the Office of Management and Budget (OMB). OMB and the President then have the opportunity to weigh in.<sup>45</sup>

1. Trump Administration's alternatives and considerations

Assuming USCIS decides to proceed to finalize the Proposed Regulations, the Trump Administration would be presented with three basic alternatives: (1) block the regulations; (2) modify the regulations; or (3) allow the regulations to become final.

President Trump has not yet publicly stated his opinion on the EB-5 Program or its reform. In *Missed Opportunity*, we inaccurately predicted that he would likely oppose EB-5 reform based on the claim that it would inhibit job creation. We assumed that if the Trump Administration were to oppose the Proposed Regulations, presumably it would rely on similar arguments to those advanced by industry: EB-5 capital creates jobs and the Proposed Regulations will adversely impact the ability of U.S. businesses to create jobs by raising the minimum investment amounts. However, on reflection, we believe other factors will likely play a key role in the Administration's ultimate position on the regulations.

First, the President's base of support resides in rural districts, the area that is intended to benefit the most from TEA reform. TEA reform efforts pit big city urban areas with large affluent centers against rural and small city urban areas with only small pockets of affluent areas.

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<sup>44</sup> <https://www.bna.com/trump-nominating-francis-n57982086523/>.

<sup>45</sup> [https://www.federalregister.gov/uploads/2011/01/the\\_rulemaking\\_process.pdf](https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf).

Second, the Kushner controversy has intensified public and media attention to the EB-5 Program. Thus, it is less likely that the Trump Administration would seek to make the Proposed Regulations a political issue.

The American Idea hotel chain, a chain that reportedly will be branded with a name trademarked by the Trump Organization, may be able to access EB-5 financing as a capital source for the development of the hotels, assuming they need capital and will create new jobs.<sup>46</sup> We do not believe that the Trump Organization's involvement with this hotel chain will influence the President's action regarding EB-5, but it is noteworthy in the context of this discussion. The chain will likely include several hotel locations that qualify as a TEA under the restrictive definition contained in the various alternatives.<sup>47</sup> More importantly, this type of project, with the support and involvement of a company owned by the President or his family, is likely to be particularly attractive to EB-5 investors, whether or not the project location qualifies as a TEA.

Of course, the Trump Administration's course of action is unpredictable. Several factors contribute to this unpredictability: (1) the Program is known as a job creation program; (2) the Program is part of the controversial immigration program; (3) the many real estate developers who have a long-standing relationship with the President and utilize EB-5 capital in their development projects located in affluent areas; and (4) the Administration's policy aim to reduce regulations.

The Trump Administration's infrastructure plan (announced in early June 2017) introduces a new wrinkle. The plan proposes a substantial allocation of funds for rural projects.<sup>48</sup> This might indicate that the Administration will favor TEA reform that restores the incentive for rural areas. On the other hand, this proposal might be offered, in part, as an alternative to provide relief to rural areas that will have a greater impact than TEA reform and to prepare the path for opposition to TEA reform. Or the President's rural component of the infrastructure plan might be completely unrelated to EB-5 reform.

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<sup>46</sup> <https://mobile.nytimes.com/2017/06/05/business/trump-organization-american-idea-hotel-chain.html> .

Reportedly many of the hotels to be included in the chain already exist. Thus, they may have only a limited opportunity to be eligible for EB-5 capital based on the limited number of new jobs that may be created.

<sup>47</sup> <https://mobile.nytimes.com/2017/06/05/business/trump-organization-american-idea-hotel-chain.html>.

According to the article, the hotels will be located in small towns throughout the United States. Apparently, the Trump Organization will not obtain an ownership interest in the chain or any of the hotels. Instead, it will license the American Idea name to the hotel owners in exchange for royalties and other payments.

<sup>48</sup> <https://www.whitehouse.gov/blog/2017/06/08/president-trumps-plan-rebuild-americas-infrastructure>.

Nevertheless, we believe it is likely that USCIS will prepare final regulations consistent with the Proposed Regulations, and that the Trump Administration will not seek to block or modify them.

E. Job Creation is a weak justification for maintaining the status quo

We submit that while the capital provided by the EB-5 Program creates jobs, the number of jobs created is fewer than the numbers suggested by some in industry. Thus, job creation is not a powerful justification for maintaining the status quo.

More importantly, the job creation impact is more complicated than we suggested in Missed Opportunity.<sup>49</sup> A more detailed discussion is warranted. If the Trump Administration were to seek to block the final regulations, it would most likely rely upon the job creation impact as the justification.

1. Allocation of 100% of jobs to EB-5 investors by USCIS overstates economic impact of EB-5 capital upon job creation

At the outset of this discussion, we emphasize that we are not suggesting that USCIS change its job credit methodology and allocate less than 100% of the jobs created by a project to the EB-5 investors. However, the USCIS methodology of allocating the job credit should not be cited as evidence of the economic impact that EB-5 capital has upon the jobs created by a project.

The maximum amount of EB-5 capital that can fund a particular project (i.e., the size of the capital raise) is directly tied to the number of jobs likely to be created by the project. Some stakeholders suggest that all of the jobs generated by an EB-5 project are created by the EB-5 capital.<sup>50</sup> However, closer examination reveals that this vastly overstates the true economic impact of EB-5 capital upon job creation.

In support of their assertion, stakeholders rely upon (1) the USCIS regulations that credit 100% of the jobs to EB-5 investors even though EB-5 capital typically provides only 10% to 30% of the total project capital; and (2) the Department of Commerce Study released in January 2017. We will first discuss the credit methodology under the regulations, and then discuss the Department of Commerce Study. Certainly, real estate development projects that utilize some EB-5 capital in the capital stack create jobs, similar to the way that any real estate development project creates jobs.

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<sup>49</sup> Missed Opportunity. Supra at footnote 10.

<sup>50</sup> See, for example, page 2 of 54 of <https://www.regulations.gov/document?D=USCIS-2016-0006-0257>. Comment submitted by Robert Maple on behalf of the EB-5 Investment Coalition. This comment is addressed in the next section regarding the Department of Commerce Study.

The real question from a strictly economic perspective is how many jobs are created by the use of EB-5 capital. For purposes of this discussion we focus on real estate development projects because the bulk of the EB-5 capital is deployed as an investment (typically a mezzanine loan) to a real estate project.

In most cases, USCIS credits EB-5 capital for job creation purposes with more jobs than the EB-5 capital actually creates. It is credited with 100% of the jobs, even though the EB-5 capital typically provides only 10% to 30% of the total project costs.<sup>51</sup>

The statute merely provides that 10 new jobs must be created per EB-5 investor. It does not address how the jobs are to be counted, or how they should be allocated amongst the investors, including immigrant investors compared to other capital providers. The plain meaning of the statute would seem to support the interpretation that the jobs should be allocated to the EB-5 investors proportionately to the share of the total capital represented by the EB-5 capital.<sup>52</sup>

However, in 1991, USCIS adopted regulations that took an expansive view, allowing 100% of the jobs to be credited to the EB-5 investors.<sup>53</sup> Several reasons may account for USCIS's adoption of this position and allowing it to continue. First, in 1991, the Program was only a direct program, not a Regional Center program. Jobs under the direct program are based on creation of direct jobs (actual employees employed by the recipient of the EB-5 capital), while the Regional Center program allows economic impact models that count direct, indirect and induced jobs resulting in the "creation" of significantly more jobs. Secondly, as has been well documented, the Program remained underutilized until the Financial Crisis of 2008-2009. Thirdly, EB-5 capital represented a much larger share of the total capital stack until recently, so the 100% credit was not as disproportionate by comparison to the actual EB-5 capital deployed to the project. When the regulations were adopted, mezzanine ("gap") financing was not a popular financing tool, and did not become a popular investment structure for EB-5 projects until after the Financial Crisis, particularly since 2012.

Not as well publicized is that in 2009, USCIS adopted two policies that represented a shift in its position. It allowed construction-activity jobs to count, and allowed large projects (those lasting at least 2 years) to count even more jobs. These construction-activity jobs, which tend to be of relatively short duration, serve

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<sup>51</sup> See Reflections on Senate Judiciary Committee Hearing. *Supra* at footnote 5.

<sup>52</sup> INA §203(b)(5)(A).

<sup>53</sup> 8 C.F.R. §204.6(g)(2), 56 FR 60910, published November 29, 1991.

as the bulk of the jobs created for most real estate development projects in today's market.<sup>54</sup>

These policy changes resulted in EB-5 capital becoming more readily available to a wide range of real estate development projects. Simply stated, under some of the economic models, construction-activity jobs are deemed created by spending money on construction. A multiplier factor is applied to total construction expenditures to arrive at the total number of jobs created. The multiplier factor varies depending on a number of inputs, including the project's geographic location. A lower factor applies to projects located in rural areas.

The advantage available to real estate projects (especially those located in affluent urban areas) is magnified by the type of project financing used for these projects. At the House Judiciary Committee Hearing in February 2016,<sup>55</sup> Chairman Goodlatte pointed out the egregious case where EB-5 capital represented only 18% of the total project costs, yet it was credited with 100% of the jobs. However, this small percentage of EB-5 capital represents the norm for large real estate projects.

Multiple sources of capital fund these projects. EB-5 capital typically funds only 10% to 30% of the total project costs. It fills the gap between the amount funded by the bank construction loan (typically 50 to 65% of the total project costs) and by the developer and other equity capital (typically 10% to 20% of the total project costs). Thus, no jobs are allocated to the sources that provide the bulk of the capital – the bank construction loan and developer equity capital.

USCIS presumably has allowed the 100% allocation to continue because if it applied an alternative allocation - such as proportionate to the share of total capital provided - the amount of EB-5 capital that could be raised would not be meaningful for the particular project. Thus, the use of EB-5 capital would be dramatically reduced – at least for real estate projects where the capital provides gap financing.

A strictly economic methodology would credit the EB-5 capital with only a proportionate share of the jobs, based on the relative capital that it represents. A greater percentage would be justified only if it could be demonstrated that the project would not proceed to be funded and built, and hence the jobs created,

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<sup>54</sup> Memorandum from Donald Neufeld, Acting Associate Director, Domestic Operations entitled "Adjudication of EB-5 Regional Center Proposals and Affiliated Form I-526 and form I-829 Petitions; Adjudicator's Field Manual (AFM) Update to Chapters 22.4 and 25.2 (AD09-38)" dated December 11, 2009, and Memorandum from Neufeld entitled "EB-5 Alien Entrepreneurs – Job Creation and Full Time Positions" dated June 17, 2009. Also see the discussion in

<http://www.stern.nyu.edu/sites/default/files/assets/documents/EB5%20paper%20final%2005.24.2015.pdf>.

<sup>55</sup> <https://judiciary.house.gov/hearing/is-the-investor-visa-program-an-underperforming-asset/>

without the infusion of EB-5 capital. Given that in many real estate projects EB-5 capital represents only a small slice of the capital stack and other sources of conventional financing (such as construction mezzanine financing and preferred equity) are relatively plentiful, this might be a challenge for most projects to demonstrate. Furthermore, the 100% credit is especially inappropriate where the EB-5 capital is brought into the project to replace more expensive capital *after* (emphasis added) the project is fully funded and all of the jobs have been created by those other capital sources. This has become increasingly common since USCIS announced its liberal bridge financing rules in the May 30, 2013 Policy Memorandum.<sup>56</sup>

2. Department of Commerce Study does not support claims of job creation

The Department of Commerce Study that was released in January 2017 (the “Commerce Study”)<sup>57</sup> has been cited to support the industry’s claim that EB-5 capital creates all of the jobs created by the projects in which EB-5 capital is utilized.<sup>58</sup> However, this claim distorts the Study’s findings.<sup>59</sup>

The Commerce Study’s main finding is that for the two years studied (fiscal years 2012 and 2013) more jobs were expected to be created by the EB-5 projects than required under the EB-5 rules to support the investment (10 jobs per EB-5 investor.)<sup>60</sup> That finding is not surprising. This result is merely consistent with the practical requirement that the market of EB-5 investors demands that the project have a “job” cushion so that the visa is issued even if some of the jobs are not recognized by USCIS or are not created.<sup>61</sup>

Furthermore, two key assumptions stated in the Study must be highlighted. First, the Study repeatedly emphasizes that it relies solely on the job creation data and estimates set forth in the economic impact assessments prepared by the economic consulting firms hired by the regional centers.<sup>62</sup> Secondly, the Study allocates 100% of the jobs created by the project to the EB-5 investors *because* (emphasis added) the USCIS regulations do.<sup>63</sup> The Study does not determine that

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<sup>56</sup> See the earlier discussion in Section IIIB of this paper.

<sup>57</sup> [http://www.esa.doc.gov/sites/default/files/estimating-the-investment-and-job-creation-impact-of-the-eb-5-program\\_0.pdf](http://www.esa.doc.gov/sites/default/files/estimating-the-investment-and-job-creation-impact-of-the-eb-5-program_0.pdf). (the “Commerce Study”).

<sup>58</sup> See page 2 of 54 of <https://www.regulations.gov/document?D=USCIS-2016-0006-0257>. Comment submitted by Robert Maple on behalf of the EB-5 Investment Coalition.

<sup>59</sup> It is noted that the regional center section of the Commerce Study was limited to 134 regional center projects that were active in fiscal years 2012 and 2013.

<sup>60</sup> Commerce Study at page 11 and 12. Supra at footnote 57.

<sup>61</sup> See the discussion of job cushion in Roadmap. Supra at footnote 18.

<sup>62</sup> See for example pages 7 and 8 of the Commerce Study. Supra at footnote 57.

<sup>63</sup> Commerce Study at page 11 and 12. Supra at footnote 57.

this is an accurate measure. Instead, it points out that this allocation methodology is a “contentious issue”.<sup>64</sup> Further, the Study does not establish any causal link between the use of EB-5 capital and jobs created by the project.<sup>65</sup>

## VII Final Regulations Likely to Result in Broad-Based Legislative Reform

### A. Broad-based reform includes integrity reform

If and when the Proposed Regulations become final and effective, we expect this would merely be the first step towards comprehensive EB-5 reform. To date, the status quo proponents have been able to resist legislative reform efforts through the lead of prominent Senators who are members of the Senate Judiciary Committee.<sup>66</sup> However, the leverage dramatically shifts to the Congressional reformers once the regulations become effective.

Obviously, industry - particularly large regional centers and real estate developers in Gateway cities - would seek to avoid the application of the TEA rules under the Proposed Regulations and prefer the provisions under the Reform Bill that include a narrower TEA spread and lower minimum investment amounts. Undoubtedly, the Congressional reformers would require that the TEA reforms be incorporated in a comprehensive reform bill, presumably in the form of the Reform Bill.

Although TEA reform is the most controversial topic, it is certainly not the only topic that the Reform Bill addresses. Two broad categories of reform are addressed in the Reform Bill: (1) economic issues (most notably, TEA reform) and (2) integrity issues.

Unlike the economic issues, there is a consensus that integrity measures are needed. However, as explained in the discussion of the Cornyn draft bill below, there is no consensus on the shape that these measures should take.<sup>67</sup>

Some of the integrity measures include: oversight by USCIS and SEC of regional centers, new commercial enterprises (“NCE”) and job creating entities (“JCE”); imposition of qualifications and standards on regional centers; full

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<sup>64</sup> Footnote 21 on page 12 off the Commerce Study. Supra at footnote 57.

<sup>65</sup> More importantly, the Commerce Department study does not address the issue of whether there is a causal link between EB-5 capital and job creation – a point raised numerous times by GAO in its report dated August 2015. <http://www.gao.gov/assets/680/671940.pdf>. See, for example, pages 40 to 44 thereof.

<sup>66</sup> <https://www.wsj.com/articles/new-york-developer-lobbies-against-changes-to-immigrant-investor-program-1484058703>.

<sup>67</sup> Compare the EB-5 Integrity Act of 2015 introduced by Senator Flake in 2016, <https://www.congress.gov/bill/114th-congress/senate-bill/2415>, with H.R. 5992 (or its discussion draft dated December 2016 or the Senate Legislative Counsel draft dated April 15, 2017).



disclosure of conflicts of interest; and account transparency and fund administration.

#### B. Account transparency and fund administration – needed now more than ever

In our Account Transparency paper, we applauded Congressional reformers for their bold addition of the most important integrity measure - the account transparency provisions.<sup>68</sup> These measures were proposed in response to a series of recent cases involving the misappropriation of EB-5 investors' funds by operators of certain regional centers and developers.<sup>69</sup> The account transparency provisions are aimed to control the flow of investor funds from initial receipt of the funds by the regional center in escrow through the deployment of the funds to the project. We believe this is the best method to prevent immigrants' funds from being illegally diverted to personal and other uses by the operator of the regional center or related entities. This will deter misappropriation, promote early detection of any diversions, and enhance recovery of misappropriated funds.

Initially, the misappropriation of EB-5 investor funds was dismissed by some in industry as an isolated event limited to projects in rural areas. However, within a matter of months of the first major misappropriation case, the SEC brought a series of enforcement actions alleging illegal misappropriation of funds by bad operators of regional center affiliates located throughout the United States.<sup>70</sup>

This disturbing trend continues. In the past few months, the SEC has brought several more enforcement actions against other unscrupulous EB-5 operators. These well-publicized cases expose the creative, bold and brazen actions taken by these operators.<sup>71</sup> Many of these cases highlight the pressing need for independent fund administration and account transparency measures. The misappropriations have typically continued for several years before they are detected by the governmental authorities or before an action is filed.

While we assume that most regional centers do not engage in this type of egregious conduct, we believe that it is extremely likely that a dramatic increase in SEC enforcement actions involving the misappropriation of immigrant investor funds will surface as investors in more projects reach the I-829 stage. It is not until this late point in the visa process that USCIS scrutinizes the actual flow of funds from the investor to the project and beyond.

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<sup>68</sup> Account Transparency. Supra at footnote 8.

<sup>69</sup> These cases are described in Account Transparency. Supra at footnote 8.

<sup>70</sup> Id.

<sup>71</sup> See, for example, <https://www.sec.gov/litigation/litreleases/2016/lr23712.htm>; and <https://www.sec.gov/litigation/litreleases/2017/lr23721.htm>; also see <https://therealdeal.com/la/2017/04/10/your-only-opportunity-to-get-rich-in-america-inside-las-deceptively-simple-50m-eb-5-scam/>

The account transparency provisions contained in the Reform Bills in tandem with greater USCIS and SEC oversight would serve as a serious deterrent to future abuses and materially assist discovery of current abuses and the prompt recovery of misappropriated funds. To be most effective, the protections should become effective upon enactment and apply to all regional centers and affiliates, including projects already in the EB-5 visa process.

The December 2016 draft of the House Reform Bill slightly altered the approach to impose an independent third-party fund administrator to monitor the flow of funds. We support this change.

The account transparency and fund administrator provisions recognize the unique setting of the EB-5 investment. Not only is the typical investor unsophisticated, particularly with respect to real estate development projects in this country, but generally the investor lives overseas and his capital investment is required by EB-5 rules to be committed for a long term (typically at least 5 years) with little expectation of profit. Thus, the EB-5 investor is focused less on investment activity than a traditional investor who monitors the periodic financial returns on his investment and has the ability to more readily exit the investment. Hedge fund investors provide the sharpest contrast because the sophisticated institutional investors insist upon an independent third-party fund administrator.<sup>72</sup>

The immigration and securities bar seems to generally support the account transparency and fund administration provisions. For example, a leading EB-5 securities lawyer suggests in a recent article that a bank serve as the independent administrator - at all critical stages – starting with the deposit of the EB-5 funds in escrow followed by release to the NCE and through deployment into the project.<sup>73</sup>

It should be noted that a United States Supreme Court decision released on June 5, 2017 illustrates the critical importance of early detection of misappropriation of funds to enable the SEC to promptly file a complaint to preserve the legal right to recover the EB-5 investors funds.<sup>74</sup>

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<sup>72</sup> See Account Transparency. Supra at footnote 8.

<sup>73</sup> [https://nesfinancial.com/wp-content/uploads/2017/05/Ebook\\_DIGITAL\\_McKeeCurylo\\_NES.pdf](https://nesfinancial.com/wp-content/uploads/2017/05/Ebook_DIGITAL_McKeeCurylo_NES.pdf), Mariza McKee and Kamille Curylo; also see [https://iiusa.org/blog/wp-content/uploads/2017/05/RCBJ-2017-Q1\\_p35-36.pdf](https://iiusa.org/blog/wp-content/uploads/2017/05/RCBJ-2017-Q1_p35-36.pdf), Mariza McKee and Kurt Reuss.

<sup>74</sup> [https://www.supremecourt.gov/opinions/16pdf/16-529\\_i426.pdf](https://www.supremecourt.gov/opinions/16pdf/16-529_i426.pdf). *Kokesh v. SEC*, No. 16-529 (June 5, 2017).

## VIII Lawsuit Recently Filed Against One of the Largest Regional Centers, the New York City Regional Center

A group of Chinese investors recently filed a complaint against one of the largest and most successful regional centers in the country, the New York City Regional Center (NYCRC).<sup>75</sup> If their allegations are proven to be true, this case suggests that the Reform Bill should impose additional controls. The NYCRC was the first regional center to be designated in New York City and the first New York City regional center to return capital to its EB-5 investors.<sup>76</sup>

The regional center and NCE in the NYCRC case were not related to the developer-JCE, unlike most of the SEC enforcement actions brought to date.<sup>77</sup> In 2016, the project developer defaulted on the EB-5 loan, as well as its rent payments under the ground lease.<sup>78</sup> The complaint details numerous instances of outrageous conduct by the regional center, particularly with respect to its lack of oversight of the EB-5 loan administration and the many instances in which it failed to protect the investors. The investors' legal claims include fraud, gross negligence and breach of fiduciary duty. Given that the case is pending and the defendants have been granted an extension to answer or otherwise respond to the complaint, it is not appropriate to describe the allegations in detail.

However, if a regional center as large, experienced and well capitalized as the NYCRC, in fact, mismanaged the investors' funds and committed other serious violations as alleged, one might question how pervasive these type of abuses might be throughout the industry.

Additional controls should be mandated by legislation or regulation. For example, perhaps the rules in the Reform Bill that apply only to a JCE that is affiliated with a regional center or NCE should be expanded to apply to all JCEs, whether or not they are affiliated.<sup>79</sup> This case, and the recent Kushner controversy,

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<sup>75</sup> Chen Dongwu et al. v. New York City Regional Center et al., Sup Ct, NY County, May 5, 2017, Index No. 652024/2017.

<sup>76</sup> <http://nycrc.com/press/91/new-york-city-regional-center-reaches-1-000th-i-829-petition-approval-milestone.html>

<sup>77</sup> Note that the case was brought in state court and does not allege any securities law violations. In addition, note that the SEC has not commenced an enforcement action.

<sup>78</sup> <https://therealdeal.com/2016/11/17/dermot-execs-threatened-with-foreclosure-on-battery-maritime-building/>;  
<https://therealdeal.com/2016/09/29/eb-5-regional-center-slaps-dermot-with-lawsuit-over-battery-maritime-loans/>

<sup>79</sup> See the definition of an Affiliated Job Creating Entity in H.R. 5992.

suggests that the integrity rules should not be limited to only those JCEs that are affiliated with a regional center or NCE. If the integrity rules are so limited, some potential abuses might escape coverage.

Moreover, the alleged mismanagement and negligence in the NYCRC case might heighten the sensitivity of investors and migration agents as to the appropriate scope of due diligence that they should perform prior to making an EB-5 investment, as well as subsequent to investing in a project. Further, Congress might consider whether the integrity section of the Reform Bill should be expanded to address the types of issues raised by this case. Alternatively, Congress might leave this to USCIS to address in future regulations.

## IX Cornyn Bill: Alternative to Proposed Regulations and Reform

In light of recent events – the impending release of final TEA regulations and the spotlight cast on the Program by the Kushner Company fundraiser in China – it is hard to reconcile the draft EB-5 reform bill recently circulated by Senator Cornyn (R-TX). It is noted that this draft has not yet been formally introduced in the Senate as a bill.

At first glance, we viewed this proposal as simply an effort to delay meaningful reform and maintain the status quo by ignoring important reform issues and proposing compromises that we assume would be unacceptable to the Congressional reformers. However, a recent news article reports that the real estate industry is rallying to support this proposal.<sup>80</sup> We only briefly discuss the TEA aspects of the Cornyn proposal in this section.

Even though it appears that the Proposed Regulations will soon become final with a significantly wider spread than the Reform Bill, the Cornyn draft bill proposes a TEA spread of only \$125,000, based on a minimum investment of \$925,000 for all project locations except \$800,000 for projects in a TEA location.<sup>81</sup> Although it is not surprising that the real estate industry is rallying to support this proposal that contains such favorable provisions, it would be surprising if industry believes the proposal has a realistic chance of being accepted by the Congressional reformers. The TEA discount and the minimum investment amounts are less than any of the

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<sup>80</sup> <https://therealdeal.com/miami/2017/06/12/real-estate-experts-rally-behind-proposed-eb-5-legislation-increasing-number-of-qualified-investors/>; also see <http://www.indoamerican-news.com/huge-change-planned-to-eb-5-investment-visa-program/>.

<sup>81</sup> <http://www.indoamerican-news.com/huge-change-planned-to-eb-5-investment-visa-program/> by Charles Foster points out that this represents a major increase from Senator's original proposal of a \$50,000 TEA spread.

alternative paths to reform. Thus, we assume this is an opening offer to seek a compromise before the final regulations take effect.

Moreover, the current EB-5 law and pending Reform Bill provide a dual incentive. In addition to the TEA discount, the law and Reform Bill each creates a visa priority for investors in a TEA project. However, the current law's visa priority is ineffective for the same reason that the TEA discount is ineffective – virtually all projects qualify. The most recent version of Reform Bill creates a visa priority for TEA project investors that is likely to be meaningful. The Cornyn proposal also includes a visa priority, but one that would be less effective than the Reform Bill.

More importantly, the Cornyn proposal would severely diminish the importance of visa priority by effectively tripling the EB-5 annual quota.<sup>82</sup> To date, the Congressional reformers have consistently rejected industry's repeated requests for an increase in the annual EB-5 quota, insisting that EB-5 reform would not include an increase in the quota; instead, this would be addressed only as part of comprehensive immigration reform. Thus, if the Congressional reformers were willing to reconsider and increase the quota, one would anticipate that the industry would be willing to be more flexible on other reform issues.

Furthermore, if a TEA proposal effectively eliminates, or substantially reduces the importance of, the visa priority as an incentive, and instead relies primarily, if not exclusively, on the TEA discount, certainly a wider spread would be justified. Assuming Congress were willing to increase the quota and also reduce the non-TEA minimum investment amount to \$925,000 (\$75,000 less than the amount set more than 25 years ago), then it should consider leaving the TEA minimum investment amount at \$500,000. This would result in a wider spread that would have a greater chance of incentivizing investment in TEA projects.

The Cornyn proposal also represents the clearest example of the lack of agreement on integrity provisions. It eliminates the account transparency and fund administration provision aimed at addressing the disturbing and growing trend of misappropriation of the investor funds that threatens the core of the Program.

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<sup>82</sup> The proposal would change the EB-5 quota rules so that family members (investor's spouse and unmarried children under age 21) would not count towards the annual EB-5 visa quota. Thus, the annual quota would be 10,000 investors, rather than the 3,000 to 3,500 investors. Each of the family members would still be eligible for an EB-5 visa. Based on the historical average of roughly 3 visas per investor, the Cornyn proposal would permit approximately 30,000 EB-5 visas per year rather than the current 10,000 annual quota.

## X Conclusion

We favor broad-based legislative reform. We believe TEA reform by regulation provides the best path to legislative reform because, in the absence of regulations, some in industry are likely to continue to resist legislative reform. Even if USCIS were to issue additional regulations to address other reform issues besides the TEA incentive, it has much less flexibility than Congress because it is constrained by the existing statute and cannot be as innovative as Congress in formulating new rules. Furthermore, reform by regulations are more susceptible to change in the future by a new administration, as opposed to more durable legislative reform by statute.

In light of the impending final regulations expected to be released by UCIS as soon as this summer, one would expect that industry would be engaged in vigorous negotiations towards a reform bill along the lines of the Reform Bill proposed by the Congressional reformers.

Perhaps large regional centers and developers are correct that even with an incentive immigrants will prefer to invest in megaprojects. Thus, a delicate balance must be met to achieve the precise level of a TEA discount that will incentivize at least some immigrants to invest in under-capitalized areas and to sustain an immigration program that provides benefits to the national economy.

Large, well-capitalized, experienced developers in affluent urban areas take advantage of a playing field tilted heavily in their favor. Congressional reformers believe these developers will always attract EB-5 investors because many investors will be willing to invest a premium to maximize the chance that their visas will be obtained and in the shortest period of time. The reformers simply seek to tilt the playing field slightly back towards the disadvantaged areas. Ending TEA abuse by implementing an effective TEA incentive will finally provide the opportunity to test whether the incentive will work as Congress originally intended.

We reiterate our hope that the EB-5 industry will seek to negotiate towards reform now and avoid the application of the final regulations. Otherwise, it takes the risk that after the Proposed Regulations become law, the reformers may be unwilling to agree to reform on the same terms as set forth in the most recent Reform Bill drafts.

Legislative reform would bring stability to the Program with a long-term extension. The choice seems obvious. To be clear, we believe the EB-5 Program should be retained, but the rules should be changed.

