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Reflections on the Judiciary Committee Hearings on EB-5
Reform

Part I: Possible TEA Reform by USCIS

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Introduction – Hearings and Proposed Legislation

We participated at the House Judiciary Committee’s Hearing - “Is the Investor Visa Program an Underperforming Asset” - that was held on February 11, 2016 (the “House Hearing”). As participants, we are encouraged that the members of the House Judiciary Committee and the Senate Judiciary Committee at its hearing on EB-5 reform held on February 2, 2016 (the “Senate Hearing”) displayed resolve to pass meaningful reform of the EB-5 Program.² The Hearings reflect a step forward, despite the temporary setback that occurred in December 2015 when Congress unconditionally extended the EB-5 Regional Center program until September 30, 2016.³

The EB-5 Integrity bills introduced in the Senate (in December 2015) and in the House (in February 2016) address many of the integrity, compliance and transparency issues plaguing the EB-5 program.⁴ Although there seems to be a consensus in the House and Senate Judiciary Committees on most of the points in the respective bills, the likelihood of passage of an integrity bill during this legislative session is far from certain given that this is a Presidential election year. The threat of the Regional Center Program’s sunset in September 2016 might be the strongest reason to believe that an integrity bill will pass.

These Integrity bills intentionally avoid the most controversial issues – the Targeted Employment Area (“TEA”) definition, minimum investment amounts, job count methodology and visa reserves – apparently in an effort to increase the likelihood of passage of at least some EB-5 reforms for which a consensus does exist. However, as each week passes without the introduction of a bill that addresses the TEA issues, the likelihood of real TEA reform being passed by Congress during this session greatly diminishes.

¹ Professor Jeanne Calderon was one of the four witness who testified at the House Judiciary Committee Hearing on EB-5 reform. Professor Calderon and Scholar-in-Residence Gary Friedland jointly prepared the written testimony she submitted in advance of the House Hearing (our “Written Testimony”). Our Written Testimony and a video of the Hearing is available at:

http://judiciary.house.gov/?a=Files.Serve&File_id=BBA55A44-310A-4E9F-AC0D-EBE605CC5EEE
<http://judiciary.house.gov/index.cfm/hearings?ID=22D22033-1110-4DAD-BE27-7F65CC159384>

² The title of the Senate Hearing was “The Failures and Future of the EB-5 Regional Center Program: Can It be Fixed.”

³ No action was taken on S. 1501 co-sponsored by Senators Grassley and Leahy. Four discussion drafts based on S. 1501 circulated among a select few in November and December 2015 (the “Discussion Drafts”).

⁴ S.2415 was introduced by Senators Flake, Schumer and Cronyn on December 23, 2015. H.R. 4530, introduced on February 11, 2016 by Representatives Amodei and Polis, mirrors S. 2415. However, these bills do not incorporate some of the ethics, integrity and compliances provisions contained in S. 1501, and add others. S. 2415 is available at: <https://www.congress.gov/bill/114th-congress/senate-bill/2415/text>; and H.R. 4350 is available at <https://www.congress.gov/bill/114th-congress/house-bill/4530/text>.

Series of Articles

This is the first in a series of articles we intend to release on the most significant issues to be addressed by EB-5 reform legislation or alternatively, in the absence of legislative action, EB-5 reform by USCIS rulemaking. We view our role as academics to generate serious discussion and debate.⁵ This initial article focuses on TEA reform by USCIS because this is the most time-sensitive issue. Chief Colucci of the Immigrant Investor Protection Office of USCIS testified at both Hearings that USCIS is formulating changes to the method by which TEAs are designated, rather than waiting for reform legislation to be passed by Congress.⁶

TEA Reform by USCIS

At both Hearings, Committee members addressed most of the key issues relating to TEA reform, such as gerrymandering, narrowing or eliminating the state's role in the TEA designation process, increasing the minimum investment amount for TEA and non-TEA project locations, prioritizing visa reserves and counting jobs. Recognizing that Congressional action might not be imminent, key members of both Committees – Senators Grassley and Leahy, and Representatives Goodlatte, Conyers, Issa, Lofgren and Jackson -- pressed Chief Colucci to take action to reform the TEA designation process. He responded that USCIS plans to propose potential regulatory action that would make the TEA designations more consistent.

Although it was entirely appropriate in 1991 for INS, USCIS's predecessor, to delegate TEA designation authority to the individual states when the immigration agency lacked the expertise and experience to evaluate these economic-based applications, virtually every member at the House Hearing, as well as Senators Grassley and Leahy at the Senate Hearing, acknowledged that the continued delegation of this authority to the individual states without uniform guidelines results in the gerrymandering of census tracts.⁷ The combined census tracts often include remote tracts that bear no relationship to the economic condition of the census tract in which the project is located.

Furthermore, the current operation of the TEA system is contrary to the original legislative intent. The statute established a two-tier investment level, intending that most immigrants would invest at the \$1,000,000 level, with a discount at \$500,000 reserved for a limited number of locations that Congress believed needed added incentive to attract the immigrants' capital. Yet, it operates in fact as a single level system where the exception has become the rule, with the

⁵ At the House Hearing, several House Committee members expressed a desire to have open dialogue with the public on key EB-5 reform issues. (House Hearing discussion by Representatives Lofgren and Issa). This would be a welcome change from the limited discussions surrounding consideration of S. 1501 last year. See, for example, Jeanne Calderon and Gary Friedland. *What TEA Projects Might Look Like under EB-5 2.0: Alternatives Illustrated with Maps and Data*. (Last revised February 6, 2016) New York University Stern Center for Real Estate Finance Research. We refer to this paper as the "EB-5 2.0 paper". Available at: <http://www.stern.nyu.edu/sites/default/files/assets/documents/What%20TEA%20Projects%20Might%20Look%20Like%20Under%20EB5%202.0%20Alternatives%20with%20Maps%20and%20Data%202%206%2016.pdf>; and <http://www.klaskolaw.com/eb-5-investor-visas/eb-5-legislation-retrospective-and-prospective>.

⁶ We will prepare a separate paper on TEA reform by legislative action, including a review of the "original intent" of the TEA provisions based on the statutory language and the legislative history. See the discussion in pages 3 to 5 of our Written Testimony.

⁷ See the discussion of gerrymandering at pages 8 to 10 of our Written Testimony.

result that almost all immigrants invest at the discounted \$500,000 level irrespective of project location.⁸

Unlike Congress, which has broad power to amend the statutory definition of a TEA, USCIS is restricted by the statutory language. The statute clearly defines the high unemployment standard.⁹ However, Congress left to the agency the definition of the “area” against which the high unemployment standard is measured. This provides USCIS with greater latitude in formulating the standard than if the statute contained a definition or more guidance as to what was intended. Presumably, the main focus of the regulations will be to formulate the procedure by which the “area” against which the high unemployment standard in the statute is to be measured, rather than rely upon the inconsistent methodology currently employed by the various states. The only significance of TEA status is to determine whether the immigrants must invest at \$500,000 or \$1,000,000.¹⁰

USCIS has two alternatives. USCIS could formulate uniform and objective TEA standards to be consistently applied by the various states. In addition, presumably USCIS would assume and exercise the powers of oversight, review and audit of state action.¹¹ Alternatively, USCIS could revoke the authority delegated to the states, and assume full responsibility for administering the TEA designation process from its national office in Washington, D.C.

At the House Hearing, Chief Colucci explained that USCIS did not act to reform the process during 2015 on the assumption that S. 1501 or similar legislation would be enacted. S. 1501 would have revoked the individual states’ role in the designation process, and would have vested all authority in USCIS.

We agree with the approach described in S. 1501. Unless the revised TEA standards are clear, objective and easily applied, some state agencies that administer the TEA designation process might be tempted to stretch the rules to facilitate economic development within the state, particularly given that in many states the agency charged with TEA designation authority is the same agency that promotes economic development. USCIS is more independent and less likely to be influenced by these factors. Reportedly, the states have developed efficient procedures over the years to quickly process TEA requests. USCIS is currently facing record backlogs in processing petitions. However, if the TEA designation rules are objective and simple, USCIS should be able to streamline the process after a transition period. At the House Hearing, Chief Colucci testified that staffing of the Immigrant Investor Protection Office (“IPO”) will be dramatically increased this year. The rulemaking process will provide IPO with ample time to gear up for this. Finally, the cost to administer and process at the national office level might not

⁸ See remarks of Senator Paul Simon in the Conference Committee Report cited at page 5 of our Written Testimony.

⁹ INA §203(b)(5)(B)(ii) simply defines the TEA, in other than rural areas, as “an area which has experienced high unemployment of at least 150% of the national average rate.”

¹⁰ The TEA designation also affects an immigrant’s eligibility for a visa reserve. Not less than 3,000 visas are reserved for immigrants who invest in a new commercial enterprise which will create employment in a TEA. INA §203(b)(5)(B)(i). However, this reserve is not significant because virtually all immigrants invest in TEA projects.

¹¹ Presumably, the individual states would be required to provide periodic reports to USCIS, including a report as to the number of applications or requests filed and the action taken by the state, as well as on a project basis the number of tracts that were aggregated for each project location.

be substantially higher than the cost of overseeing and coordinating designations being made by the various states.

California approach to TEA Designation – Maximum of 12 Tracts

Based on the positive discussion at the House Hearing, it would not be surprising if USCIS formulates TEA standards tied to the California methodology that allows a maximum of 12 census tracts to be aggregated.¹²

Several House members, who represent districts in California, spoke favorably of the California model as applied to projects in their own districts.¹³ However, we believe it would be a mistake for USCIS to rush to apply the California approach or any other approach. As Professor Calderon mentioned at the House Hearing, the California approach represents an improvement over the approach followed by most states. Limiting a TEA to 12 tracts is more appropriate than the virtually unlimited aggregation that is currently permitted by some states.¹⁴ However, we have been unable to quickly determine why the State of California determined 12 was the appropriate limitation. More importantly, we are not aware of any evidence that, if this methodology were implemented nationwide, especially in Gateway cities, it would result in a meaningful reduction in the number of project locations qualifying as a TEA.

USCIS Should Test its Proposed New TEA Definition to Determine it is Likely to Result in Meaningful Change

Once USCIS determines the approach it intends to follow, it should test whether that approach is likely to be effective to significantly reduce the number of project locations that qualify as a TEA. This would be similar to the approach we followed in our recent EB-5 2.0 paper.

After we reviewed and analyzed the three urban area TEA definitions considered in the December 2015 Discussion Drafts, we realized that a mere reading of the proposed statutory language would not provide a reasonable basis for determining whether each alternative would be significantly more restrictive than the TEA methodology permitted under the current system. Since NYC is the epicenter of the debate, we decided to measure the potential impact that each alternative would have upon NYC projects. Some of the results were surprising. For example, two of the project locations that the Wall Street Journal cited as illustrations of inappropriate gerrymandering would continue to qualify under some of the TEA alternatives. This would not have been evident by merely reading the language in the Discussion Drafts.¹⁵

USCIS should apply its proposed TEA approach to existing or completed large-scale real estate projects in major urban areas that have utilized EB-5 capital as part of the capital stack. These types of projects represent a very significant percentage of the EB-5 capital raised

¹² <http://business.ca.gov/International/EB5Program.aspx>

¹³ See remarks by House Judiciary Committee members Issa, Lofgren, and Chu at the House Hearing.

¹⁴ See the gerrymandering in the Laredo, Texas project that Chairman Goodlatte highlighted in his introductory remarks at the House Hearing. Contrast this with the final sentence of the October 24, 2011 letter to USCIS from then Governor Rick Perry designating the local authorities in Texas that are authorized to certify high unemployment area TEAs. http://www.impactdatasource.com/Download_Files/Texas%20TEA%20Designations.pdf

¹⁵ Of course, this anecdotal evidence does not demonstrate that the proposed definitions were or were not appropriate.

nationwide, and thus include a substantial number of the immigrant investors participating in the Program. Like all other EB-5 project locations, virtually all of these large-scale real estate project locations qualify as TEAs under the rules applied by the various states. Most of these projects rely on the unemployment rate experienced by remote tracts to enable the project tract to qualify as a TEA.

As a starting point, we suggest that USCIS consider reviewing the 25 large-scale real estate projects in major urban areas that were the subject of the database contained in our comprehensive overview of the use of EB-5 capital in real estate development projects.¹⁶ We have supplemented this database to include several more recent projects and are continuing to update this. Presumably, USCIS has a database of all projects that includes as a variable the maximum amount of EB-5 capital to be raised for each project.

The TEA designation letters, including a list of relevant census tracts and maps, submitted by the various regional centers as part of their exemplar applications or filed by the immigrant investors as part of their I-526 petitions should be in USCIS' possession. If the support documentation is lacking, presumably this information is readily available to USCIS from the individual states.

USCIS can quickly review each file to determine whether the project location qualified as a TEA based on the aggregation of 12 or fewer tracts, or a greater number of tracts.¹⁷ If a high percentage of these project locations or other project locations tested by USCIS qualified as a TEA by combining 12 or fewer tracts, then this would suggest that a different approach should be considered. Otherwise, the proposal would be ineffective to remedy the perceived abuse because it would apply different rules but yield the same results.

Should the TEA be Expanded to Include the Areas where Workers Arguably Reside

Supporters of the 12 tract approach believe that the TEA definition should be expanded to encompass the geographic area within which workers from high unemployment areas commute to the project tract, even if the project is located in an affluent area. The largest development projects that generate the most EB-5 capital are generally located in "luxury" areas. However, even if this commuter pattern approach were followed, the economic model upon which most job estimates are calculated does not indicate how many workers, if any, commute from residences in high unemployment areas. Moreover, we believe that it is likely that if the TEA boundaries were expanded to incorporate these remote tracts, most existing TEA locations would continue to qualify, thereby perpetuating the current single investment level system.

Furthermore, it is noted that many of the large-scale projects would be built, and hence the jobs would be created, whether or not EB-5 capital was available. For example, the developer of a \$340 million

¹⁶ Although we were able to collect substantial data about these projects from sources other than state or Federal government agencies, we were not able to easily obtain information about the combination of census tracts that formed the TEA or the number of tracts for most of these projects. We believe that most of these projects were not single census tract TEAs, although the San Francisco Shipyard project is probably one of the few exceptions. San Francisco. Jeanne Calderon and Gary Friedland. *A Roadmap to the Use of EB-5 Capital: An Alternative Financing Tool for Commercial Real Estate Projects*. (May 22, 2015). New York University Stern Center for Real Estate Finance Research. Available at:

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

¹⁷ For purposes of this testing, to keep this simple and to apply the same factor, USCIS should rely upon the same applicable unemployment rates that were used in the applications or petitions relating to these projects.

luxury condominium TEA project on the Upper East Side of Manhattan that will bring in \$49.5 million of EB-5 capital explained in a recent interview that “it is most prudent to plan for a development project using EB-5 funding as a substitute to the higher cost of capital already within a project capitalization.” He continued that “raising funds is not a requirement for our 86th Street project to move forward in a timely manner, we view it as an accretive component to the overall capital.” One-third of the conventional capital will be funded by equity and the balance will be financed by a traditional construction loan, to be refinanced by a “conventional loan at moderate leverage to round out the development.”¹⁸

The ability of these large-scale projects to attract funding without the infusion of EB-5 capital raises two separate but related points. The first point relates to job creation. The fundamental issue is whether the 10 jobs per investor requirement should be deemed to be satisfied given that the project would have been built and the jobs created without EB-5 capital. Crediting 100% of the project's jobs to EB-5 capital in these cases exacerbates the matter. Further compounding this, in most of the large-scale projects, EB-5 capital represents less than 25% of the total capital stack.

The second point relates to TEA eligibility. In the case of those projects which could proceed without any EB-5 capital investment, the locations should not qualify for the special incentive that Congress intended to be reserved for "TEA" locations, especially for projects in locations that are not otherwise able to attract capital. This would echo the sentiments expressed by Senators Simon and Boschwitz.¹⁹

Other Changes to be Incorporated in USCIS' Revised TEA Definition

Whether or not USCIS bases its new approach on the California model, USCIS might consider other factors, including:

1. If testing of a sufficiently large sample of large-scale real estate projects reveals that most of these projects qualified by aggregating 12 or fewer tracts, USCIS should consider a different standard. A different approach would require that all bordering tracts be included before the boundaries are expanded beyond the bordering tracts.²⁰ The Special Incentive Zone (“SIZ”) urban area TEA definition proposed in the December 12, 2015 Discussion Draft allowed up to 12 tracts, but required that all bordering tracts be included in the potential TEA.²¹ We referred to this in our EB-5 2.0 paper as “Cluster and Extend.” The maximum 12 census tract aggregation (gerrymandering) employed by the California model and followed in the December 12, 2015 Discussion Draft allows the applicant (regional center or developer), for purposes of measuring the high unemployment standard, to extend the boundary in any direction that results in the high unemployment standard to be met, even if all of the other tracts bordering the project have low unemployment levels and are

¹⁸ <https://commercialobserver.com/2015/10/kuafu-seeks-nearly-50m-in-eb-5-money-for-east-86th-street-project/>. Also see the last paragraph of the following article about a \$350M EB-5 capital raise for a Miami project: <http://www.globest.com/sites/globest/2016/01/25/taking-the-mystery-out-of-eb-5-regional-centers/>. Also see the statements by the developer of this Washington, D.C. hotel project that would have been built without EB-5 capital. <http://www.washingtoncitypaper.com/articles/46035/green-construction/>

¹⁹ See the Senators’ remarks quoted on pages 3 to 5 of our Written Testimony.

²⁰ We referred to this in our EB-5 2.0 paper as “Cluster and Extend.”

²¹ The December 12th Discussion Draft required that the TEA include “each census tract..bordering” the project tract, while the first Discussion Draft in December (December 2nd or 4th) required that the TEA must include “each census tract contiguous” to the project tract. We assume that in either case this would include any tract with a point or segment in common with the project tract. However, this should be clarified.

excluded by the applicant from the combined area.²² We believe the “Cluster and Extend” approach is more representative of the area surrounding the project site, and appropriately focuses on the location where the EB-5 capital is invested consistent with the legislative history.²³

2. Exclude tracts that encompass parks and water bodies as proposed in the December 12, 2015 Discussion Draft definition of SIZ.²⁴
3. Consistent with the Discussion Drafts, build in flexibility that will allow public infrastructure projects, manufacturing and closed military bases to qualify irrespective of location and the project tract’s unemployment status. Public infrastructure projects are particularly appropriate given that in recent years real estate development projects receive the dominant share of EB-5 capital deployment, which contributes to the increased burden on our nation’s crumbling infrastructure.²⁵ However, it must be determined whether the scope of USCIS’s regulatory powers would permit this expanded interpretation.
4. Consider whether the unemployment rate of a county or city as a whole that, on a cumulative basis, meets the standard should enable every tract in that area to qualify as a TEA. However, even if the county or city as a whole experiences a high unemployment rate, perhaps tracts with a median income exceeding the area median income by a certain percentage (for example, 120% of the AMI) should be excluded to avoid the inclusion of “affluent area” tracts.
5. Consider the appropriate unemployment dataset. For example, consider whether the “Handbook Method” (census tract disaggregation) should be the only acceptable method for determining the applicable unemployment rate. Some states permit the use of ACS only, that sometimes make it easier for locations to qualify.²⁶

Related Change to Minimum Investment Amount

Chief Colucci also indicated that USCIS is considering raising the minimum investment amounts.²⁷ Raising the investment amount for non-TEA projects is virtually meaningless unless USCIS first establishes a meaningful TEA definition that results in many project locations failing to qualify as a TEA. Otherwise, the EB-5 program will continue to operate at a single level, where all project locations qualify as a TEA.

²² We referred to this limited form of census tract aggregation in our EB-5 2.0 paper as “Modified Gerrymandering”.

²³ The other approach that was considered in the Discussion Drafts was the Priority Urban Investment Area definition. We referred to this in our EB-5 2.0 paper as the “Good Neighbor” approach. However, two of the three alternative tests considered under that definition were based on standards other than the area’s unemployment rate. Even though these two tests take the unemployment level into account, USCIS may lack the authority to vary the unemployment standard specified in the statute.

²⁴ We discussed the rationale for this in our EB-5 2.0 paper at pages 19 and 25.

²⁵ A liberal interpretation issued by USCIS in 2009 greatly expanded the types of real estate development projects that could utilize EB-5 capital.

²⁶ See discussion of data at pages 33 to 37 of our EB-5 2.0 paper.

²⁷ See 8 CFR §204.6(f).

Any increase in the minimum investment amount for TEA and non-TEA locations should be made in tandem with the revision of the TEA definition. If and when the revised TEA definition becomes effective, the current minimum investment amounts of \$500,000 and \$1,000,000 would become effective, unlike the spread in today's market that is merely theoretical. The \$500,000 spread might be greater than that which USCIS determines is appropriate. We will include a discussion of the minimum investment amounts in an upcoming article.

Time Frame for USCIS Action

Chief Colucci indicated at the House Hearing that USCIS intends to act through rulemaking, rather than issuing a Policy Memo or other interpretation (that has been the route that USCIS has utilized in recent years). Rulemaking will require compliance with the Administrative Procedures Act, including a notice and comment period.

TEA reform by legislative action would be the preferred route. In contrast to administrative action, Congressional action can change the TEA standards (including introducing new standards, such as poverty rate and AMI), incentivize project types irrespective of location and the area's unemployment level and consider the inability of an area to otherwise attract conventional financing. Thus, more meaningful change cannot be made until and unless Congress takes action and passes real reform legislation. It remains to be seen whether USCIS will take action and implement meaningful change in the interim.