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What To Do If You Suspect Your **EB-5** Project Is In Trouble

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Managers and Investors in EB-5 Investment Funds should regularly monitor their investments in EB-5 Projects and be ready to take protective actions if their EB-5 Projects show signs of trouble.

It is vitally important for managers and investors in EB-5 investment funds^[1] to stay informed of the status of their EB-5 projects^[2], because EB-5 investors must demonstrate that the projects in which they invested were completed and, in some cases, that those projects are operating in accordance with projections, in order to qualify for approval of their I-829 petitions to remove conditions to their residence. If the manager or EB-5 investors in an EB-5 investment fund discover signs that their EB-5 project may be experiencing financial distress or other difficulties that could prevent the project from being completed or operated in accordance with the original business plan for the project, the manager, the investors or their representatives need to evaluate whether there are any actions that could be taken to save the project, so that the EB-5 investors will ultimately qualify for approval of their I-829 petitions. The manager or investors are in a far better position to take protective actions before the problems with their EB-5 project result in litigation, foreclosure, or SEC enforcement action, although it is still possible to take protective actions after one of these events occurs. This article is the first of a series of articles that will describe how managers or investors can monitor their EB-5 projects to discover potential problems before they become a crisis, and the protective actions that may be taken to protect EB-5 investors if their EB-5 projects are in trouble.

Both managers and investors in EB-5 investment funds should continuously monitor and evaluate the progress of their EB-5 projects, and collect documentation of transfers of EB-5 funds, payments of project expenditures, and other financial records that will be required as part of the I-829 petitions. An unwillingness to provide such documentation, which is mostly generated in the normal course of busi-

ness, can be a red flag indicating that something is wrong. The manager of each EB-5 investment fund is the primary party responsible for monitoring the EB-5 fund's investment in the EB-5 project. However, in cases in which the manager is affiliated with the EB-5 project developer, or the manager is not fulfilling its obligation to properly supervise and monitor the EB-5 project, the EB-5 investors should have their own independent representatives monitor the EB-5 project and evaluate if and when protective actions are necessary to protect the E-5 investors. The manager of an EB-5 investment fund, or third party service provider where the manager is affiliated with the developer, should provide regular reports (preferably on a quarterly basis) to the EB-5 investors in the fund regarding the status of construction and financing of the project, payments made to the EB-5 investment fund and whether or not the EB-5 project is in compliance with the terms of the investment made by the EB-5 investment fund in the project. EB-5 investors should insist that the manager of their EB-5 investment fund make these periodic reports if the manager is not already doing so. If EB-5 investors do not receive these reports, they should engage an independent representative to meet with the manager, review the EB-5 project and advise the EB-5 investors directly regarding the status of the project and any problems that are discovered as a result of the review. In the paragraphs below, we provide further information regarding how that may be done.

Managers and investors in EB-5 investment funds should be aware of the warning signs that their EB-5 project may be in trouble.

Listed below are some of the warning signs that an EB-5 project may be in trouble:

- Failure of the EB-5 project developer to deliver regular reports to the EB-5 investment fund manager of the status of the financing, construction and/or operation of the project

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- Failure of the EB-5 project developer to provide documentation of expenditures and the use of EB-5 funds on a regular basis
- Failure of the EB-5 project developer to obtain all necessary financing to commence or complete the project
- Failure to make payments on an EB-5 loan or equity investment, or on any other financing obtained by the EB-5 project
- Failure to deliver required financial and other reports to EB-5 lender and/or EB-5 investors
- Receipt of notice of default from the senior lender to the EB-5 project
- Receipt of information that the EB-5 project is not paying its contractors
- Receipt of notice that litigation has been filed against the EB-5 project or developer
- Evidence that the EB-5 project has not commenced or has ceased construction
- Failure of the EB-5 project to meet the dates specified in the project construction schedule

The fact that one or more of these events has occurred may not necessarily indicate that the EB-5 project is in trouble, but it is an indication that there may be a problem, and that further investigation should be done to determine if there is a problem.

The manager of the EB-5 investment fund should hire an experienced construction monitor and/or accountant when it suspects the EB-5 project is in trouble to conduct a thorough review of the status of the EB-5 project.

An experienced construction monitor and/or accountant will take the following steps to evaluate the status of the EB-5 project:

- Interview the developer, architect and engineer for the EB-5 project
- Obtain copies of the EB-5 project entity financial statements
- Visit the office where the EB-5 project related books and records are maintained, and review the books and records, including general ledger, invoices and other financial records of the EB-5 project
- Review all cash transfers of the EB-5 project entities above a specified dollar amount to determine if improper payments are being made
- Conduct a site visit to assess construction activity and compare it to the project construction schedule and project construction reports
- Conduct a public records search to determine all liens filed against the EB-5 project property
- Review zoning approvals and building permits for the EB-5 project
- Assess the market valuation of the EB-5 project with local real estate brokers

Depending upon the results of that evaluation, the construction monitor and/or accountant will present a report to the manager regarding the status of the EB-5 project and any problems that have been discovered. The construction monitor and/or accountant will also be able to assist the manager in determining the severity of the problem and evaluating potential solutions to the problem. The manager and its consultants should review the options available for completing the project and determining which of those options should be pursued. In a future article, we will discuss options for saving an EB-5 project in trouble and how those options may be pursued.

If EB-5 investors are concerned that the manager of their EB-5 investment fund is not performing its obligations, the EB-5 investors or their agents should hire their own experienced construction monitor and/or accountant to act as the representative of the EB-5 investors and report directly to the EB-5 investors.

EB-5 investors have rights as limited partners or members of an EB-5 investment fund to review the books and records of the EB-5 investment fund and to require that the manager of the fund fulfill its duties to monitor the EB-5 project and protect the interests of the EB-5 investment fund and the EB-5 investors. EB-5 investors may exercise these rights either individually or as a group. EB-5 investors who are concerned that the manager of their EB-5 investment fund is not fulfilling its duties should engage an attorney to act as representative of one or more of the EB-5 investors to review the books and records of the EB-5 investment fund itself and the EB-5 project entities, and to meet with the manager of the EB-5 investment fund regarding the steps that should be taken so that the necessary monitoring and reporting is done. The attorney for the EB-5 investors will undertake the following review and analysis of the protective actions that may be taken on behalf of the EB-5 investors:

- Review the partnership agreement or operating agreement of the EB-5 investment fund to determine the specific rights of the EB-5 investors to take actions under the terms of the partnership agreement or operating agreement
- Review the communications, construction reports and financial statements that have been received by the EB-5 investors
- Review the books and records maintained by the manager of the EB-5 investment fund, including notices, reports and financial statements received by the manager from the EB-5 project entity or developer
- Review the financial statements of the EB-5 investment fund
- Review the project financing documents between the EB-5 investment fund and the EB-5 project entity (loan agreement, pledges, guaranties, intercreditor agreements, etc.) to determine the rights of the EB-5 investment fund
- Interview the manager of the EB-5 investment fund and the EB-5 project developer
- Review the adequacy of the documentation necessary to meet annual USCIS reporting requirements and the I-829 requirements
- Evaluate the status of the EB-5 project to determine additional steps necessary to be taken to protect the EB-5 investors (both with respect to their visa petitions and their financial investment) and their investment in the EB-5 project

The evaluation steps listed above should take two to four weeks, but may take additional time if the manager does not cooperate. If the manager of the EB-5 investment fund does not cooperate, then the attorney may recommend that legal action be filed by the EB-5 investors to obtain a court order for the manager to turn over the necessary books and records to the attorney for the EB-5 investors. Upon completing the review, the attorney should prepare a report of the findings of the review and distribute it to the EB-5 investors in the fund. The report should include an analysis of the actions recommended by the attorney to protect the interests of the EB-5 investors. These recommendations could include implementation of new reporting requirements by the manager of the EB-5 investment fund or by the EB-5 project entity, or requiring the manager to hire an independent

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construction monitor or loan servicer, or seeking further court orders if necessary for the protection of the EB-5 investors. If the attorney discovers problems with the EB-5 project itself, the report would include an evaluation of the problems and discussion of the options available to the EB-5 investors to save the EB-5 project.

The manager or investors in an EB-5 investment fund should implement a systematic plan for continuous monitoring and reporting on the status of the EB-5 project.

Every EB-5 investment fund should have a regular process in place for monitoring its investment in the EB-5 project. This is often referred to as EB-5 compliance, but can also be thought of as on-going due diligence. These processes are similar to those that would be used by any other private lender or institutional investor in a construction project or business, with the additional focus on job creation in addition to the financial health of the EB-5 project. The following are some of the key components for monitoring an EB-5 project that every EB-5 investment fund should have in place:

- Document all money into the EB-5 investment fund escrow account, all money disbursed out of escrow to the EB-5 investment fund, and all money disbursed to the job creating entity for use in financing the EB-5 project, to demonstrate an unbroken chain in the path of funds from the EB-5 investor to the job creating entity
- Conduct regular inspections of the project and review disbursement requests, and if appropriate hire a construction monitor to make the inspections and/or an independent loan servicer to receive reports and payments made by the EB-5 project entity to the EB-5 investment fund
- Require requests for disbursement of EB-5 proceeds with detailed use of proceeds of each advance, including contractor invoices, architect or engineer certification, lien releases, and other documents (i.e., a draw package or payment application)
- Require regular construction reports and financial statements from the EB-5 project developer
- Require that the senior lender provide copies of notices to the NCE concurrently with delivery to the developer
- Regularly communicate with the EB-5 project developer to find out as early as possible if problems are developing and if possible work with the developer to help resolve issues before they become a crisis

If an SEC enforcement action is filed against a manager of an EB-5 investment fund, EB-5 investors should engage their own legal counsel to participate as interested parties in the action.

The SEC is aware of the issues facing EB-5 investors whose EB-5 investment funds have become the subject of fraud enforcement actions, and will work with legal counsel for EB-5 investors to assist them if possible to save the EB-5 project so that the EB-5 investors will retain their eligibility for permanent visas. However, the SEC does not represent the investors, and has limited tools at its disposal to help investors. The legal and financial representatives of the EB-5 investors can assist them in the following actions:

- Communicate with the SEC, receiver (if appointed by the Court) and USCIS regarding EB-5 investors' desire to analyze viability of completing the EB-5 project
- Hire (or coordinate with the receiver to hire) an experienced construction monitor/accountant to conduct the investigation described above and determine if the EB-5 project can be completed

- Determine what additional capital sources would be required to complete the EB-5 project and assist in the transactions required to bring in those capital sources
- Determine what changes in the business plan would be required to accept the additional capital and work with the USCIS to preserve the eligibility of the EB-5 investors in the project under the new capital structure

In a future article, we will provide further information regarding the process of an SEC enforcement action and the steps that can be taken to assist EB-5 investors during that process.

Conclusion: Managers and EB-5 investors can and must take appropriate steps to monitor their EB-5 investment in order to discover any problems that arise and if possible participate in the resolution of those problems so that the EB-5 investors will retain eligibility for their permanent visas and if possible receive a return of their capital. Managers should implement a process for regular monitoring of the EB-5 project status and reporting of any problems that develop. Managers should provide regular reports to EB-5 investors so that the investors know that their investment is being properly monitored. If managers do not fulfill their obligations, EB-5 investors should hire their own representatives to take the steps necessary to investigate the status of the EB-5 project and to implement a better monitoring process in the future. If necessary, the manager or EB-5 investors need to be prepared to evaluate options to save their EB-5 project if it experiences financial or other problems.


About the Authors:

Daniel B. Lundy is a Partner and a member of the EB-5 practice of Klasko Immigration Law Partners, LLC. Mr. Lundy leads the Regional Center/Developer and EB-5 Compliance practice areas, and represents developers and others who seek to use foreign investment funds under the EB-5 program to fund their projects, either through the formation of a Regional Center or by joining with an existing Regional Center. Mr. Lundy works with various securities lawyers, economists, business plan writers and other professionals in the preparation and filing of Regional Center designation and Regional Center amendment applications. Mr. Lundy is experienced in reviewing Regional Center and project business plans, economic reports, securities offering documents, and corporate documents for compliance with the EB-5 program requirements, and in consulting and advising clients on the specific immigration requirements of the EB-5 program. Mr. Lundy has experience working with court appointed receivers in EB-5 matters involving SEC actions, and helping investors and regional centers with troubled projects. Mr. Lundy has also successfully represented numerous immigrant investors in their EB-5 petitions and applications. Mr. Lundy is also experienced in litigating immigration cases in Federal Court. For the last two years, he has been named as one of the top 25 immigration lawyers in the country by *EB5 Investors* magazine.

Catherine D. Holmes is Chair of the JMBM Investment Capital Law Group, and she has practiced law at JMBM for over 35 years. She has also worked as a senior member of the JMBM Global Hospitality Group and JMBM Chinese Investment Group. Within the Investment Capital Law Group, she helps real estate developers and business owners, brokers, investment advisers and investment managers raise and manage investment capital from U.S. and non-U.S. investors. In the last five years, she has represented over 100 real estate developers obtain financing through the EB-5 immigrant investor visa program

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for the development of hotels, multi-family and mixed use developments throughout the U.S. She has also acted as lead counsel on numerous hotel and mixed-use developments and transactions in the U.S., Europe, China, South America and Asia Pacific regions, as well as hotel management and franchise agreements and public-private hotel developments. She has also represented private investment fund managers, registered securities broker-dealers and investment advisers on securities offerings, business transactions and regulatory compliance issues. For the last two years, she has been named as one of the top 25 securities lawyers in the country by *EB5 Investors* magazine.

Jeffrey E. Brandlin, CPA, CIRA, CFF founded Brandlin & Associates in 1980 to provide clients with tangible, timely and action-oriented insight. During his 40 year career, Jeff has pursued numerous financial frauds, accounting malpractices and trust fund embezzlements including recent work done on behalf of the SEC under enforcement actions pertaining to the EB-5 Program. Jeff and his team have restructured and rehabilitated more than \$10 billion of real estate projects. Jeff and his team have also provided thorough financial due diligence in support of hundreds of successful transactions for equity and debt capital providers. Jeff is a frequent speaker to industry organizations and law firms on the topics of fraud, forensic accounting and financial statement analysis. He earned his Bachelor of Science degree in Accounting and has been licensed to practice accountancy in California since April 1976. Jeff is a Certified Insolvency and Restructuring Advisor (CIRA), a Certified Merger & Acquisition Advisor (CM&AA) and is Certified in Financial Forensics (CFF) by the American Institute of Certified Public Accountants and currently serves as both the Secretary and Treasurer of the National Association of Federal Equity Receivers (NAFER). 

ENDNOTES

- ¹ We refer to “EB-5 investment funds” as the “new commercial enterprise” in which EB-5 investors make their investment. An EB-5 investment fund may be either a limited partnership or a limited liability company. The authors refer to the “managers” of EB-5 investment funds as the parties designated as the general partner of the limited partnership or the manager of the limited liability company.
- ² The authors refer to “EB-5 projects” as the project to be completed and/or operated by the “job creating entity” in which the EB-5 investment funds make their investment.