



AMERICAN  
BANKRUPTCY  
INSTITUTE

## 2019 Bankruptcy Battleground West

### **EB-5 Program Company Restructurings**

**Lance N. Jurich, Moderator**

*Loeb & Loeb LLP; Los Angeles*

**Prof. Gary Friedland**

*New York University Leonard N. Stern School of Business; New York*

**Andrew Kingston**

*Kingston Petersen; Seattle*

**Alan N. Tantleff**

*FTI Consulting, Inc.; New York*

# **2019 Bankruptcy Battleground West**

## ***"EB-5 Bankruptcy Restructuring Issues"***

**March 28, 2019**

**Presented By:**

**Lance Jurich (Moderator)**

**Gary Friedland**

**Andrew Kingston**

**Alan Tantleff**

**EB-5 Bankruptcy Restructuring Issues**  
(Summary Prepared by Lance N. Jurich)

Program Background:

- EB-5 stands for 5th Category of Employment Based Visas.
- Created in 1990 to stimulate the U.S. economy through job creation and capital investment by foreign investors.
- An original goal was to stimulate rural and economically disadvantaged areas by offering a lower minimum investment for those areas.
- Qualifying foreign investors are eligible to apply for permanent US residence (*i.e.*, a Green Card) if they: (i) make the necessary investment in a new US commercial enterprise; and (ii) demonstrate that 10 or more new jobs are created for US workers either directly or indirectly (RC program only) by the new commercial enterprise.
- There have been several proposed legislative reforms since 2015, along with proposed USCIS regulatory changes to the EB-5 Program. Most proposals seek to increase the minimum investment amount, improve RC program accountability and change how a TEA (Targeted Employment Area) is designated.

**How Real Estate Developers Leverage the EB-5 Program**

- In recent years, developers have embraced the EB-5 Program, tapping foreign investors, especially Chinese investors, to help finance their projects at a cost substantially below the market cost of conventional capital and “equity” sources.
- The foreign investors have shown a preference for large real-estate projects often in the most affluent areas of Gateway cities, versus manufacturing in rural or projects in economically-distressed urban areas.
- Despite the fact that one of the original goals was to stimulate rural and economically disadvantaged areas, defined as “TEA”, a disproportionate amount of capital from projects EB-5 investors has been attracted to affluent urban neighborhoods.
- Individual states currently designate TEAs and developers have been successful at leveraging the wide discretion the states have in drawing census tract boundaries to bring lower investment amounts to central and urban districts.

### **Causes of Exaggerated Default Rate**

- Poor Underwriting – Some EB-5 investors have less concern for underwriting because their primary concern is to obtain a visa, not an economic benefit from the investment.
- Fraud – EB-5 loans are ripe for fraud. Target investors are foreigners and may not be sophisticated business people. Non-economic motivations play a factor here too.
- General market forces
  - Many luxury residential developments are funded by EB-5 debt. There is currently an overabundance of supply, leading to potential defaults.
  - Construction boom is unsustainable.

### **Red Flags for Troubled EB-5 Loans**

- 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
- 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.
- Commencement of litigation against the EB-5 project or developer.
- Delay in commencement of EB-5 project
- Halt in construction of EB-5 project
- Failure of the EB-5 project to meet the dates specified in the project construction schedule

### Challenges Unique to EB-5 Loan Defaults and Workouts

- Non-economic motivations: While EB-5 investors no doubt would like to recover their investment plus a return, the primary motivation of most EB-5 investors is to obtain immigration status.
  - Important to structure workout in a manner that preserves immigration status of EB-5 investors.
  - Other stakeholders are more concerned with maximizing their recoveries, which can result in potentially divergent reorganization strategies and challenging negotiation dynamics.
  - Challenge is to keep EB-5 investors “in the deal” despite potentially being out of the money.
- Challenging to raise new money to complete the project. In the absence of new capital, many troubled EB-5 projects will fail, thus dooming both the success of the reorganization and the immigration status of the EB-5 investors.
  - Difficult to raise new capital from EB-5 investors.
  - Individual EB-5 investors may not have the wherewithal to provide additional capital.
  - Coordination, communication and free-rider issues.
- Third party financing is also more difficult.
  - Any provider of new capital will want to “prime” EB-5 investment. Infusion of this priming capital may conflict with EB-5 investors’ need to preserve immigration benefits.
  - Provider of new capital may wish to change character of project, which also jeopardizes immigration status of EB-5 investors.
- Communication and organization issues:
  - EB-5 lender formation documents do not always contemplate flexibility in distressed situations (as would more traditional financing documents).
  - Investors are spread throughout foreign countries, often China, and may not speak English.

- Unlike with syndicated bank debt or a more traditional note issuance, there is no agent or trustee that can speak for the underlying EB-5 investors in a centralized way.
- Difficult to obtain consents and approvals to any contemplated reorganization transactions.
- Amount and quality of EB-5 lender communications with its investors varies widely, and investors are more likely to grow frustrated when communication is limited.
- Where there is also traditional bank financing in the capital structure, intercreditor agreements can be extremely restrictive. EB-5 lender can be largely sidelined in the event of a default.
- Priority on jobs and liens may be bifurcated, which adds complexity since a junior creditor could be senior on job creation.
- Receivers often appointed, which can complicate matters.
  - Not clear where receiver's duties lie – maximize value or retain immigration status?
  - Often lack of organization on part of EB-5 investors in interactions with receivers.
- Uncertainty with new administration and lack of precedents with regard to how the USCIS will view the restructured project (i.e., how it differs from project that was originally approved).

### **Immigration Concerns Removal of Conditions**

In order to remove the conditions necessary for a successful I-829 petition, the following 4 criteria must be met:

1. Required funds placed “at risk” throughout investor’s residence in the U.S.;
2. Required capital was made available to the business for creating the jobs;
3. “At risk” investment was “sustained throughout” the investor’s period of conditional permanent residence in the U.S.; and
4. Investor created (or maintained) or can be expected to create 10 jobs for U.S. workers within a reasonable period of time.

A change that affects any criteria above will be an issue. USCIS's position continues to evolve.

### **Immigration Concerns Removal of Conditions**

If a project defaults/fails while the investor has a conditional green card, and is unable to show the creation of 10 jobs for U.S. workers, the investor will likely have to refile an I-526 petition (i.e., start over and go to the back of the line).

Concerns include:

- Loss of capital investment;
- Loss of administrative fee;
- Loss of priority date;
- Needs to quickly refile an I-526 petition prior to expiration of the conditional green card;
- May accrue unlawful presence if I-526 not timely filed;
- May need to depart the U.S.;
- Could be a major timing issue for Chinese nationals with visa backlogs; and
- Additional fees for refiling the I-526 petition.

**The Intersection of EB-5 Capital with  
Bankruptcy or Receivership**

Gary Friedland, Scholar-in-Residence, NYU Stern School of Business  
*1.20.2019*

**I. EB-5 Basics<sup>1</sup>**

1. What is EB-5?
  - a. A visa category for immigrants
    - i. One of the quickest paths to permanent lawful residency and green card
    - ii. Much longer time frame in recent years, especially for Chinese investors
  - b. A source of capital for developers
    - i. Inexpensive, flexible and patient
    - ii. Typically structured as construction mezzanine debt; however, can be debt or equity, even unsecured debt
2. What are requirements to obtain EB-5 visa
  - a. Invest \$500K (or \$1M) as equity
  - b. Project creates 10 jobs per investor
  - c. Investment at risk and sustained throughout immigration process
3. What is an EB-5 project
  - a. Project must create jobs in the US per EB-5 requirements
  - b. Real estate development projects most common
    - i. Construction jobs count as jobs
4. Examples of EB-5 projects on West Coast – Century Park Plaza (\$450M of EB-5 capital, 900 EB-5 immigrant investors), Beverly Hills Wilshire, and Lennar’s Shipyards project in San Francisco
5. Who are the participants in EB-5
  - a. Regional Center (RC), EB-5 investment fund (NCE), project owning entity (JCE), immigrant investors, and migration agents
6. How is EB-5 investment structured
  - a. Typically, mezz loan to fund construction (gap financing)
  - b. Typical capital stack – 10% to 30% of Total Project Costs
7. Why is EB-5 capital an attractive capital source
  - i. Terms favorable to developer, RC and migration agent

---

<sup>1</sup> For a more detailed discussion of EB-5 matters, see EB-5 Research Papers by Gary Friedland and Professor Jeanne Calderon of NYU Stern School of Business, <http://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/center-real-estate-finance-research/research/eb-5-research>. Also, an outline “EB-5 Basics for Bankruptcy Practitioners” is available upon request.



- ii. Cheap source of construction and development capital for developer
    - costs 5+% less per annum than conventional construction mezz
    - 1. Note: many migration agents earn commissions of 10%+
    - 2. Regional centers earn hefty fees
  - iii. Investors accept minimal rate of return on their investment because they are motivated to invest to secure the visa
8. Role of intercreditor agreement between senior (institutional) construction lender and EB-5 fund as mezz lender
- a. EB-5 fund's (and immigrant investors') rights severely limited – more limited than rights of conventional mezz lenders
  - b. In case of senior default, rights often limited to cure the senior or buy the senior
  - c. Until recently, most EB-5 investors didn't understand risk posed to mezz lender
  - d. Strong real estate market since the financial crisis, especially since 2012, has coincided with EB-5 visa as popular route to visa

## **II. How and when does EB-5 capital intersect with bankruptcy and/or receivership**

- 1. Arises in two contexts
  - a. Receivership ancillary to SEC filing of civil enforcement action alleging fraud
    - i. Fraud by RC, EB-5 fund, developers and their principals
    - ii. SEC seeks appointment of (equity) receiver to take control of the property, maintain the property, and recover the misappropriated assets
  - b. Bankruptcy
    - i. 4 cases/proceedings filed in 2018 and at least one other threatened
    - ii. See accompanying outline: "Comparative Summary of Recent Bankruptcy Court Cases in Which EB-5 Investors Have a Claim or Potential Claim."
    - iii. Chapter 11 filed by developer as debtor or by lender or unsecured creditors
      - 1. EB-5 investors' role in the proceedings
    - iv. Most cases arise after mortgage default and commencement of foreclosure action to impose automatic stay to stop mortgage foreclosure or sale of property

## **III. Receivership ancillary to SEC enforcement actions<sup>2</sup>**

---

<sup>2</sup> For a more detailed discussion of securities law aspects of EB-5 capital, as well as SEC enforcement actions and private rights of action, see [EB-5 Securities: New Developments &](#)

1. Since 2013, SEC has aggressively pursued fraud by EB-5 regional centers, EB- 5 investment funds, as well as developers and principals
  - c. EB-5 investment constitutes a security for purposes of securities laws
2. EB-5 investors are particularly vulnerable to fraud
  - d. Investors typically live overseas, and are not sophisticated or experienced in US real estate investments
    - i. Many immigrants foolishly rely on migration agent who are richly compensated by the regional center and/or developer
  - e. Often, no one independently monitors flow of funds or progress of construction
    - i. No government required periodic reports to investors and no required web access for investors
  - f. EB-5 is a long-term investment with an expectation of minimal return to the immigrant investors
  - g. No oversight by USCIS and no tracking of flow of funds until years after the investment made
  - h. Investors who suspect fraud are not inclined to report to USCIS (or SEC) because it might jeopardize their visa application
  - i. Investors reluctant to file private right of action against EB-5 bad actors because it might jeopardize visa application and it is difficult to coordinate with numerous other EB-5 investors
  - j. It is not uncommon for the EB-5 lender and developer-borrower to be owned and controlled by the same individual, ripe with conflicts of interest
  - k. No qualification requirements imposed on RC or its management
3. SEC has filed 16 civil enforcement actions alleging fraud since 2013 (through November 2018)
  - l. Virtually all cases involve misappropriation of funds or Ponzi schemes
  - m. Investor funds typically required to be held in escrow, often prematurely released and diverted before funds reach the project – instead, used to purchase luxury autos, boats and real estate for personal benefit of the bad actors and/or diverted overseas
    - a. Most cases involve RC, EB-5 fund and developer under common ownership and control
5. SEC seeks appointment of receiver rather than pursue bankruptcy in fraud cases
  - a. Enforcement actions typically involve multiple defendants, including related entities and individuals. These can be consolidated in one action in the same court.

---

Updated NYU Stern Database 2018 Edition (10/21/18) and Understanding EB-5 Securities - NYU Stern Database of SEC EB-5 Securities Enforcement Actions (Draft 12/9/2017).

- b. The receiver is vested with the authority to commence litigation in the court against any potential defendant irrespective of its location.
  - c. Broad, flexible, equitable powers are granted to the receiver by the court, including flexible distribution plans compared to the statutory rules of a bankruptcy court.
  - d. Relatively cost efficient compared to bringing separate actions in various courts in different jurisdictions against the several bad actors. Consider, for example, separate bankruptcy actions.
6. Receivers have acknowledged complexity posed by administration of project with EB-5 investors
- a. Balancing act
    - i. Not simply collecting and liquidating assets
    - ii. As a fiduciary, receiver continues operation of project to meet immigration goals of EB-5 investors
      - 1. Create jobs necessary to support the EB-5 investors' immigration petition
      - 2. Don't distribute recovered assets to EB-5 investors if it will jeopardize EB-5 visa petitions
      - 3. Maintain the immigrants' investment at risk and sustained
      - 4. Avoid termination of regional center
7. SEC Remedies
- a. Injunction and appointment of receiver
  - b. Principal monetary remedy available to SEC in its enforcement actions is disgorgement of the ill-gotten gains by the bad actors
  - c. Disgorgement seeks to recover the money made by the bad actors as a result of the fraud. It is not entitled to restitution (recovery of the entire amount invested by the EB-5 investors). The purpose is to prevent the bad actor from profiting (being unjustly enriched) from his illegal acts, not to reimburse those who have been injured by his conduct.
  - d. Proceeds are typically distributed to those injured by the fraud (for example, the EB-5 investors).
8. US Department of Justice can bring parallel criminal action
- a. Against individual bad actors
  - b. Sanctions can include imprisonment and restitution
9. Broad receiver powers
- a. For ex., in Jay Peak receivership, Raymond James Financial, the brokerage firm, settled with the receiver for \$150M. (Alleged that RJ aided and abetted Ponzi scheme, allowing EB-5 investor funds to be used for margin loans to the managers of the EB-5 fund.)

- i. Note: The attorneys who served as counsel for the class action collected \$25M in fees
- 10. SEC enforcement outcomes
  - a. Most cases settle. See, for example:
    - i. Jay Peak
    - ii. Path America – Seattle area projects
  - b. Some involve major recovery of misappropriated funds
    - i. Jay Peak: in addition to the \$150M settlement with Raymond James, the bad actor paid more than \$80M in settlement of SEC enforcement action
  - c. Even if a judgment in favor of SEC is rendered, the award might not be collectible. See, for example, Proton case.
- 11. Roles of lawyers and bankruptcy practitioners/professionals
- 12. Impact of 2017 US Supreme Court decision in SEC v Kokesch
  - a. Imposed 5-year statute of limitations – disgorgement is a “penalty”
  - b. As a result, hundreds of millions of funds not recovered per recent Congressional testimony by SEC Chairman and Commissioners
- 13. Impact of SEC budget and staff reductions
- 14. Impact of SEC Whistleblower Program

#### **IV. Bankruptcy**

See accompanying outline: “Comparative Summary of Recent Bankruptcy Court Cases in Which EB-5 Investors Have a Claim or Potential Claim.”

#### **V. Alternative Methods to Restructure**

- 1. It is generally easier to restructure with the cooperation of the EB-5 investors
  - a. EB-5 investors’ cooperation often depends on the status of their immigration/visa petitions
    - i. If investors have already obtained their unconditional visa and permanent green card versus
    - ii. If investors have achieved conditional residency and the jobs have been created versus
    - iii. If investors have received their I-526 petitions but have not received conditional visa or temporary green card and/or jobs have not been created
- 2. Alternative methods to restructure an EB-5 project include:
  - a. Convert EB-5 debt to equity and defer the payment to the EB-5 investors
  - b. Senior forecloses on the conventional senior and wipes out the EB-5 mezz debt – obviously this would be without the cooperation of the EB-5 purchasers

- c. Buy the EB-5 investors' equity interest in the EB-5 lender at a discounted price – that is, less than the \$500,000 investment.
  - i. EB-5 investors might be willing, particularly if they have already obtained their unconditional visa and permanent green card
- d. Replace the regional center owner-operator and manager of the EB-5 lender
  - ii. Based on Path America, this might preserve the visa status of the EB-5 investors
- e. Sell the property

## **VI. The Current State of the EB-5 Market**

- a. State of flux: Chinese immigrants were the dominant group seeking EB-5 visas until 2018. However, EB-5 projects are no longer attracting Chinese immigrants due to long visa waiting lines – 14+ years - based on per country limitations that currently affect the Chinese investors.
- b. RC and developers attempt to fill the void by seeking investors from other countries – particularly, India, Vietnam, So. Korea, and Brazil.
- c. Many of those Chinese who have already invested are seeking to rescind – see the recent action brought by immigrant investor against CMB re Century Park Plaza (900 investors)
- d. Expect many projects to fail or be restructured as they are unable to fill the gap between developer equity and institutional construction loan
  - i. More mortgage foreclosures likely to occur as projects partially under construction lack funds to be completed
  - ii. More EB-5 fraud likely to be revealed as projects reach stage where USCIS tracks the flow of funds and discovers the fraud
  - iii. Developers will be forced to pursue more expensive sources of capital to fill the gap to be supplied by EB-5 capital
  - iv. Developers will be forced to sell their projects at a discount or bring in JV partners
  - v. Investors from other countries are not as inclined as the Chinese to invest in large real estate projects that historically have sought and obtained EB-5 capital to serve as a major capital source
- e. Those projects located in an Opportunity Zones census tract are likely to pursue Opportunity Fund investors as an alternative capital source, based on the community development tool introduced by the Tax Cuts and Jobs Act of 2017

**Comparative Summary of Recent Bankruptcy Court Cases  
In Which EB-5 Investors Have a Claim or Potential Claim <sup>3</sup>**

Gary Friedland, Scholar-in-Residence, NYU Stern School of Business  
1.21.2019

The presence of capital supplied by immigrant investors seeking an EB-5 visa (“EB-5 investors”) in the capital stack of a project (an “EB-5 project”) may impact how a debtor and/or creditor proceeds with a bankruptcy action. The EB-5 investors’ goals and motives for making the investment are different than those of a conventional investor. The immigrant does not seek to make a profit or maximize returns; instead, the primary goals are to qualify for permanent residence in the United States and to receive back his or her capital investment as soon as possible after the immigration process is complete.

The sale of the EB-5 project, including a foreclosure sale, might jeopardize the investors’ immigration status as explained below. Even though the bankruptcy statutory scheme does not specifically address EB-5 capital, the presence of EB-5 investors is likely to complicate the bankruptcy process. Thus, debtor’s and creditors’ counsel must be sensitive to the rules that apply to EB-5 investors in EB-5 projects. (See item 8 of this outline, as well as the “EB-5 Basics for Bankruptcy Practitioners” outline available upon request.)

Below is a comparative review of 4 bankruptcy cases filed in 2018 which involve EB-5 projects, as well as one project where a Chapter 11 petition was averted after the proposed sale of the EB-5 project was restructured to accommodate the immigration concerns of the EB-5 investors.

Note that the use of the EB-5 visa as a path to permanent residency was dominated for years by immigrants from mainland China. Over the past year, the Chinese market for EB-5 visas has dramatically declined, and the void has not been fully replaced. It is anticipated that many projects that expected to rely on inexpensive EB-5 capital as gap financing will be unable to find replacement capital, including projects which began construction with partial funding. Some of these projects might consider bankruptcy protection.

Another outline accompanies this outline: “The Intersection of EB-5 Capital with Bankruptcy or Receivership.” Also, an outline on “EB-5 Basics for Bankruptcy Practitioners” is available upon request.

1. Debtor and project:
  - a. In re 550 Seabreeze Development, LLC (“Seabreeze”): resort hotel in Ft. Lauderdale, FL
  - b. In re 160 Royal Palm, LLC (“Palm House Hotel”): hotel in Palm Beach, FL

---

<sup>3</sup> For a more detailed discussion of EB-5 matters, including securities law aspects, see EB-5 Research Papers by Gary Friedland and Professor Jeanne Calderon of NYU Stern School of Business, <http://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/center-real-estate-finance-research/research/eb-5-research>.

- c. In re Aurora Memory Care, LLC (“AMC”): health care facility in Illinois
- d. In re Lucky Dragon Hotel & Casino (sometimes “Lucky Dragon”): casino in Las Vegas (billed as the first Las Vegas casino designed specifically for Asian customers, and the first ground-up casino construction in Las Vegas since the Great Recession)
  - i. The real estate is owned by Lucky Dragon, LP.
- e. The SLS Las Vegas Hotel & Casino: casino in Las Vegas (renovation of preexisting Sahara Hotel & Casino)
  - i. Note: SLS is included in the database, even though the bankruptcy petition filing was threatened to be filed but was not actually filed.
- 2. Bankruptcy Court, index number and filing date:
  - a. In re 550 Seabreeze Development, LLC (“Seabreeze”), Ch. 11 Case No. 18-12193-RBR (S.D. Fla. Feb. 26, 2018)
  - b. In re 160 Royal Palm (“Palm House Hotel”), Ch. 11 Case NO. 18-19441-EPK (S.D. Fla. Aug. 2, 2018)
  - c. In re Aurora Memory Care, LLC (“AMC”), Ch. 11 Case No. 18-11289 (N.D. Ill. Apr. 18, 2018)
  - d. In re Lucky Dragon Hotel & Casino, LLC (“Lucky Dragon”), Ch. 11 Case No. 18-10792-MKN (D. Nev. Feb. 16, 2018)
  - e. SLS: Not applicable. No bankruptcy filed.
- 3. Chapter 7 or 11 (the chapter under which the bankruptcy petition was filed):
  - a. In each of the cases, a Chapter 11 petition was filed.
  - b. In AMC, the court converted the chapter 11 filed by trade creditors to a chapter 7 at the request of the secured creditor – the senior mortgage lender (a bank). Further discussed below.
- 4. Who filed and what event triggered or motivated the filing:
  - a. Seabreeze: Debtor, to delay pending foreclosure of senior mortgage
  - b. Palm House Hotel: Debtor, to delay pending foreclosure of senior mortgage
  - c. AMC: Unsecured trade creditor(s) to delay pending foreclosure of senior mortgage
  - d. Lucky Dragon: Debtor, to delay pending foreclosure of senior mortgage
  - e. SLS Las Vegas: Debtor threatened to file to facilitate sale of hotel-casino and restructuring of debt obligations
- 5. Senior debt amount and other debt (approximate amounts), *excluding* EB-5 investment:
  - a. The total of the senior debt and the “other” debt amounts compared to the FMV, stalking horse bid or actual sales price, as the case may be, indicates whether a sale or foreclosure of the debtor’s property is or was likely to result in proceeds available to repay all or some of the EB-5 debt or equity.
  - b. Seabreeze:

- i. Senior: \$39.6M. Bancorp Bank.
      - 1. Original loan amount was \$21.6M. Bank agreed to lend additional funds, conditioned on Debtor raising \$15M of EB-5 capital. Debtor raised \$30M of EB-5 capital and bank increased the construction loan funding.
    - ii. Other: \$11.0M
  - c. PHH:
    - i. Senior: \$27.5M original, \$32M as of Ch. 11 filing. Private lender.
    - ii. Other: ~\$40M
  - d. In AMC:
    - i. Senior: \$6.5M original, \$8.4M as of Ch. 11 filing. West Suburban Bank.
      - 1. \$6.5M bank loan made in 2015 was secured by a first mortgage against the property as well as a pledge of the equity in the parent company.
    - ii. Other: \$1.2M
  - e. Lucky Dragon:
    - i. Senior: \$45M. Snow Covered Capital, LLC, a private lender.
  - f. SLS:
    - i. Senior: \$185M original. Mesa West, a private portfolio lender
6. EB-5 debt or equity, and amount:
- a. EB-5 capital is pooled in a special purpose entity (an “EB-5 fund”), generally a limited liability company or limited partnership. The pooled EB-5 capital can be deployed by the EB-5 fund as debt or equity. However, typically it is deployed to the project as debt, sometimes senior debt but more often as mezzanine or subordinated debt.
  - b. In 4 of the cases, the EB-5 investment was deployed either as mezzanine or subordinated debt
    - i. In Lucky Dragon, the EB-5 capital was deployed as equity - a limited partnership interest in the limited partnership that owned the casino.
    - ii. EB-5 investors accept the same or similar cost of capital rates whether the debt is structured as senior debt or mezz debt. The EB-5 investors prefer debt rather than equity because they seek a fixed maturity date and perceive this as an easy exit strategy based on sale or refinance of the property. Although EB-5 investors prefer the relative safety of senior debt, when available, they are also willing to provide subordinate financing (debt or equity) to EB-5 projects in which due diligence has been conducted by a reputable institutional lender.



- iii. EB-5 has become popular during the period after the financial crisis, a period during which real estate values have generally increased. Many EB-5 investors do not understand the risk posed by mezz debt and limited remedies available to them due to the Intercreditor Agreement with the senior lender (discussed below).
  - iv. Note that the borrower under the mezz loan is not the owner of the property. The borrower is a parent company that wholly owns the equity interests in the subsidiary which directly owns the property. The debtor in each of the 4 bankruptcy cases is the subsidiary, not the borrower under the mezz loan.
  - v. Furthermore, the loan proceeds are repaid by the borrower to the EB-5 fund (the EB-5 lender), not directly to the EB-5 investors. To comply with the EB-5 program requirement that funds remain “at-risk,” funds may not be returned to an EB-5 investor until the second anniversary of the date on which the EB-5 investor obtained conditional permanent residency, provided the EB-5 project has also created the required minimum number of jobs.
- c. EB-5 investment amounts:
- i. Seabreeze: \$ 30M
  - ii. PHH: \$ 44M
  - iii. AMC: \$ 12M
  - iv. Lucky Dragon: \$ 89.5M
    - 1. As indicated above, EB-5 capital was deployed as equity
  - v. SLS: \$398M
    - 1. 2nd lien: \$199M. SLS Tranche 1 Lender, LLC, an EB-5 fund comprising 398 EB-5 investors (“Tranche 1”)
    - 2. 3rd lien: \$200M. SLS Lender, LLC, an EB-5 fund comprising 400 EB-5 investors (“Tranche 2”)
7. FMV, Stalking Horse Bid, or Sales Price, and net proceeds available to repay the EB-5 fund:
- a. If a stalking horse bid has been made, that is indicated. If the property was sold, the sale price is indicated.
  - b. Seabreeze: In August 2018, an affiliate of Magna Hospitality acquired the property for \$39.1M, the amount of its stalking horse bid made in July.
    - i. No bidders appeared at the 363 sale. After satisfaction of the senior mortgage and other expenses, no surplus proceeds were available to the EB-5 fund.
  - c. Palm House Hotel: An entity controlled by The Related Companies (the developers of Hudson Yards in NYC) bid \$32M as the stalking horse bidder.

- i. The 363 sale was scheduled to occur in November 2018 but was postponed twice, most recently to January 28, 2019.
  - ii. The Bankruptcy Court is scheduled to hear in January 2019 the mortgage lender's claim that it is entitled to submit a credit bid at the auction. The US Trustee has taken the position that the lender is not entitled to a credit bid because of the suspicious circumstances surrounding the loan.
  - iii. Presumably the auction will occur before our panel discussion in March 2019.
  - iv. The amount of the other debt, even without considering the senior debt, exceeds the amount of the bid. Thus, it is highly unlikely that any surplus will exist for application to the EB-5 fund mezz debt.
- d. AMC:
  - i. Debtor provided to the Bankruptcy Court several estimates of the FMV of its sole asset, the facility, ranging from \$10M to \$16M.
  - ii. The bankruptcy has focused on the bank lender's petition to have the bankruptcy court either (a) dismiss the Chapter 11 (and thus allow the pending foreclosure to proceed to auction) or (b) convert the case to a Ch. 7. No sale of the property has been contemplated.
- e. Lucky Dragon: The bankruptcy sale was scheduled to occur in September 2018 and postponed to October 2018. No stalking horse bid was made. At October 30, 2018 auction, the lender acquired the property when none of the 30 bidders appearing at the auction were willing to bid \$35M. Thus, no proceeds were available to repay any of the EB-5 mezz debt.
- f. SLS Las Vegas: In 2017, Stockbridge Capital, the owner of the hotel/casino entity, agreed to sell to the Meruelo Group in a transaction which closed in 2018 after the Nevada Gaming Commission approved the transfer of ownership (and the sale was restructured to address the immigration concerns of the EB-5 investors.) Meruelo continued the operations of SLS Las Vegas.
  - i. The purchase price was \$195M, comprising a \$75M paydown of accrued interest and principal under the Mesa West senior debt and the personal guaranty of Alex Meruelo of the remaining Mesa West senior debt at the agreed value of \$140M.
  - ii. The Tranche 1 and Tranche 2 loans were restructured to cap accrued interest and provide that loan repayments will be made from future profits of the hotel-casino, if any, and Meruelo Group committed to continue the borrower's efforts to support each EB-5 investor's immigration process.

- iii. Beginning in March 2022, Meruelo Group and Tranche 1 each have the right to liquidate the Tranche 1 loan for an amount equal to 14% of the then-current enterprise value of the hotel-casino, less any loan payments previously made. Meruelo Group and Tranche 2 each have a similar right to liquidate the Tranche 2 loan for an amount equal to 6% of the then-current enterprise value of the hotel-casino, less any loan payments previously made.
- iv. The Tranche 1 and Tranche 2 deeds of trust were retained to secure the borrower's and Meruelo Group's obligations.
- v. This structure – a sale of the equity, rather than a sale of the property – serves two benefits for the EB-5 investors:
  - 1. It minimized the risk that USCIS would characterize this as a “material change” in the approved business plan. A sale of the property could be viewed as a material change, in which case, the investors' visa petitions would be denied and the investors would have to make a new investment and file new petitions.
  - 2. The EB-5 investors' interests would continue to be “sustained” and “at risk”, as required by USCIS until at least the requisite number of jobs were created. The sale of the hotel would have potentially resulted in the EB-5 investors' recovery of a part of their investment capital in violation of USCSI requirements.
  - 3. The continued operations would enable the project to create the additional jobs necessary to support the visa approvals.

8. EB-5 Visa Status as of Filing Date:

a. Background:

- i. The interests of the senior mortgage lender, the developer and the EB-5 investors are likely to be different. The senior mortgage lender seeks to maximize the value of the collateral and to gain control of the asset as soon as possible. The developer seeks to maximize the value of the property. The EB-5 investor's main goal is to obtain a visa, and thus, to make sure that a sale or foreclosure does not jeopardize the status of his or her immigration process.
- ii. The sale of the property, including a foreclosure sale might jeopardize the EB-5 investors' visa status. Below is a simplified discussion.
- iii. For example, a sale or foreclosure of the project might constitute a “material change” of the business plan approved by USCIS. As such, USCIS would no longer defer to any prior EB-5 project

approvals and may deny EB-5 investor petitions on the grounds that the EB-5 project has materially changed.

- iv. Also, if the sale or foreclosure results in the return of any EB-5 capital to the EB-5 fund or to an EB-5 investor prior to the second anniversary of the EB-5 investor's receipt of conditional permanent residence or prior to creation of the required minimum number of jobs, the EB-5 investor will no longer be able to show that his or her remained "at risk" for the required period of time or created the required number of jobs.
  - v. The immigration visa process is complete after an EB-5 investor has received USCIS approval of his or her I-829 petition to remove conditions attached to his or her green card. Although a sale of the property at that point might affect the recovery of their EB-5 capital investment, it would not affect their visa and immigration status.
  - vi. USCIS's policy on "material change," job creation and how long the investment must be sustained has varied over the years, and is subject to change.
- b. Seabreeze:
- i. All of the EB-5 investors have received conditional visa approval and temporary green cards. Each has filed an I-829 petition seeking an unconditional visa. However, the requisite number of jobs has not yet been completed to support the applications.
- c. Palm House Hotel:
- i. USCIS denied the I-526 petitions of all of the investors (except possibly one) because they could not demonstrate that the jobs were likely to be created.
  - ii. The bulk of the funds were misappropriated and virtually no construction occurred. In 2016, the investors filed a private lawsuit alleging fraud, among other claims, against the regional center, EB-5 investment fund and the developer.
- d. Lucky Dragon Casino: The investors have received I-526 approvals. However, insufficient jobs have been created to support the visas, even though the hotel construction was completed in 2016. The acquisition of the property by the foreclosing lender and the closing of the operations are likely to adversely affect the visa immigration status of the investors.
- e. SLS Las Vegas: Bankruptcy action was not filed. Most EB-5 investors in Tranche 2 have obtained approval of their I-829 petitions. Although a handful of EB-5 investors in Tranche 1 have obtained approval of their I-829 petitions, many EB-5 investors have not yet obtained their conditional green cards. The hotel-casino project has created a sufficient number of

jobs to enable all 398 EB-5 investors to obtain approval of their I-829 petitions.

9. Job creation, types of jobs to be created and construction status:

a. Background:

- i. A minimum of 10 jobs must be created for each investor, which typically translates into 20 jobs per \$1M of EB-5 capital raised (assuming the project is located in a “TEA”).
- ii. If the EB-5 project is sponsored by a USCIS-approved regional center, the required jobs may be direct, indirect or induced. USCIS counts construction activity jobs and operational jobs, among others.
- iii. In most cases, EB-5 projects are ground-up development projects. Typically, these projects generate sufficient jobs to support all the visas based on construction activity jobs. The number of jobs created is based on the use of an economic-impact model in which construction spending is the key input variable.
  1. EB-5 ground-up development projects often create more than a sufficient number of jobs to support the EB-5 visas, especially if the EB-5 capital represents no more than 30% of the total project costs, as is usually the case. All of the jobs deemed to be created by the project are allocated to the EB-5 investors even though the EB-5 capital may represent as little as 1% of the total capital.
  2. By the time the project is completed, and sometimes sooner (because of a job cushion built into most projects), the requisite number of jobs are created. Thus, typically, construction activity jobs (rather than operational jobs) are the type of jobs created in an EB-5 project.
- iv. Typically, a renovation/rehabilitation of an existing building does not generate sufficient jobs to support the EB-5 visa because it involves less construction spending.
  1. In renovation projects, the EB-5 visas typically rely, at least in part, on jobs from actual operations after the project construction is completed.
- v. Also see discussion in EB-5 Basics outline.

- b. SLS Las Vegas, a renovation of the pre-existing Sahara Hotel, apparently relied, at least in part, on operation jobs to support the EB-5 visas.
- c. Even though Lucky Dragon was ground up construction (the first on the Las Vegas Strip since 2010), apparently the construction did not create sufficient construction activity jobs to support the visas. The bulk of the

project costs were funded by EB-5 capital and thus, the other sources of capital did not support sufficient construction jobs.

- d. And even though Seabreeze (the Las Olas Resort) was ground up construction, the visas were partially dependent on the creation of operation jobs. Since the construction was not yet completed, none of the jobs from operations had been created as of the date of the filing of the bankruptcy petition.
- e. Palm House Hotel did not create sufficient construction activity jobs to support the investors' visas because the bulk of the EB-5 capital was misappropriated and not utilized for the construction of the hotel.

10. Intercreditor Agreement (ICA):

- a. Background:
  - i. EB-5 capital deployed by the EB-5 fund is often structured as mezzanine debt.
    - 1. This results in greater savings for the developer-borrower compared to conventional mezzanine debt. The EB-5 investors are willing to accept similar low interest rates for mezzanine debt as for senior debt despite the greater risk posed by mezzanine debt.
    - 2. The ICA for EB-5 mezz debt is generally more restrictive than conventional mezz. Most EB-5 lenders/investment funds are less experienced at owning and operating a project than conventional mezz lenders. In the case of a senior default, the EB-5 mezz lender's rights are often limited to paying off the senior or curing the default. The typical ICA won't allow the EB-5 fund to step into the shoes of the defaulting developer mezz borrower.
- b. The court filings in these cases did not refer to an ICA between the senior lender and mezz lender.
- c. Also see discussion in EB-5 Basics outline.

11. Relationship between Debtor (developer-borrower) and the regional center/EB-5 investment fund:

- a. Some developers form their own regional center (an "in-house RC") rather than enter into a contract with a third-party regional center ("third-party RC") to sponsor the EB-5 project before USCIS.
  - i. This saves the developer the fees that would be imposed by the regional center. The in-house RC arrangement exposes the EB-5 investors to additional risk because the same individuals would own and/or control the RC and the EB-5 fund, on the one hand, and the developer-borrower, on the other hand. Obviously, this arrangement

poses conflicts of interest, especially if an independent fund administrator is not retained. In the in-house RC structure, the developer essentially negotiates the terms of the EB-5 loan with itself.

- ii. Some regional centers, whether in-house RCs or third-party RCs, also create EB-5 funds and participate in the raising of EB-5 capital. The SEC considers capital raising to be an unlawful regional center activity, unless the regional center is also a licensed and registered securities broker-dealer.
  - iii. Also see discussion in EB-5 Basics outline.
  - b. In AMC and Lucky Dragon, in-house RCs were involved – that is, the entities (RC, EB-5 fund and developer) were under common ownership or control by the same individuals.
    - i. Seabreeze: It is unclear whether the Debtor (developer – Ken Bernstein and others) was related to American Life Investment RC (Roger Bernstein – principal owner)
    - ii. In Palm House Hotel, it is unclear whether the entities were controlled by the same individuals [South Atlantic Regional Center and Robert Matthews (Palm House Hotel LLC)]
  - c. AMC: Chicagoland Regional Center and AMC were controlled by Seyed Kameli, an immigration lawyer
  - d. Lucky Dragon: Lucky Dragon and Las Vegas Economic Impact Regional Center (LVEIRC) were controlled and/or owned by Andrew Fonfa.
  - e. In SLS Las Vegas, the developer (Stockbridge) and the RC (American Dream Fund) were unrelated.
12. Single Asset Real Estate (SARE): All of the projects involve SARE, except AMC.
13. Status of the Chapter proceeding:
- a. Seabreeze:
    - i. Property was sold in a 363 sale for \$39.1M to the stalking horse.
    - ii. Prior to the sale, EB-5 investors filed an action in the Bankruptcy Court alleging fraud and civil conspiracy by the bank and the developer. Prior to the investment made by the EB-5 investors, Bank provided a letter to developer that in the case of an uncured default, each EB-5 investor would be entitled to a unit in the condo hotel. The loan documents omitted this. The EB-5 fund as mezz lender also failed to record the UCC-1 for the pledge as security for the debt.
  - b. Palm House Hotel:
    - i. 363 sale scheduled for November 2018 was postponed to January 2019.

- ii. The US Trustee refuses to allow the private senior lender to credit bid. The lender is challenging this. In any case, it is highly unlikely that any surplus proceeds will be remaining to repay the EB-5 mezz loan.
  - c. AMC: In September 2018, the court converted the Chapter 11 to a Chapter 7.
    - i. The bank had sought a conversion or dismissal, but preferred the dismissal so it could quickly proceed to complete the foreclosure sale.
    - ii. The Debtor had been trying to obtain post-petition financing in an amount to pay off the bank and for the court to allow debtor to continue operations of the health care facility.
    - iii. However, debtor had not filed operation report, and had not submitted a plan. It had obtained only a letter of intent from a potential lender with funding based on numerous contingencies, and was unable to demonstrate that the value of the facilities was sufficient to support the necessary loan amount.
    - iv. The court converted the case to a Chapter 7. Apparently, Debtor is still seeking to refinance the bank debt to structure a plan of reorganization (or to cause a dismissal of the bankruptcy).
  - d. Lucky Dragon: The bankruptcy sale was originally scheduled to occur on September 10, 2018. At the October 30, 2018 auction, the property was acquired by the lender by credit bid. The property opened in November 2016 and closed less than two years later.
  - e. SLS Las Vegas: A bankruptcy filing was averted. The borrower's obligations under the Mesa West senior loan and the two EB-5 subordinated loans were restructured, and the sale of the borrower to Meruelo Group was completed without adversely affecting EB-5 investor immigration petitions.
14. Resolution and Notes/Comments:
- a. Seabreeze:
    - i. The 363 sale of property occurred, with no proceeds available to pay the EB-5 investment fund.
    - ii. The EB-5 investors (all Chinese) have filed a legal action against the bank and the developers (who were also the managers of the EB-5 investment fund and related to the regional center). EB-5 investors claim they were induced to invest by the bank's agreement in a letter that in the case of a default, each investor would be entitled to a unit in the hotel. Neither the bank nor the developers disclosed that the collateral was subject to several contingencies including a default



only after the building was completed. Also, the EB-5 investment fund owned and operated by the developer neglected to record the fund's pledge of the security interest in the equity collateral.

- b. Palm House Hotel:
    - i. Still pending. See Status section above.
    - ii. Several other lawsuits are pending including:
      - 1. SEC enforcement action alleging fraud.<sup>4</sup>
      - 2. DOJ criminal action against the RC owner-operator and the developer.
      - 3. Private legal action filed by the EB-5 investors.
      - 4. Bankruptcy filed by the developer.
  - c. AMC: Still pending.
    - i. The Bankruptcy Court ordered the Trustee in the converted Chapter 7 to determine whether a surplus beyond the senior debt is likely to exist in the case of the sale of the Estate's assets, and thus be available for distribution to unsecured creditors. If no equity exists beyond the bank debt, the court indicated that the bankruptcy should be dismissed, in which case the foreclosure sale would proceed. Presumably, the Debtor is continuing to try to refinance the property to pay off the creditors and cause a plan of reorganization to be approved (or a dismissal of the bankruptcy).
  - d. Lucky Dragon Casino: The property was acquired at auction by the lender by credit bid. The operations of the casino/hotel were closed on or before October 2018.
  - e. SLS Las Vegas: See Status section above.
15. Receiver appointed before the bankruptcy petition was filed:
- a. In each of Seabreeze, PHC, Lucky Dragon and AMC, a mortgage foreclosure action was pending before the bankruptcy petition was filed. The lender petitioned the state court for the appointment of a receiver.
    - i. The lender seeks a receiver to collect the rent and to manage the property during the foreclosure process.
  - b. In Seabreeze, the foreclosure commenced in January 2018.
    - i. The bank lender moved to appoint a receiver.

---

<sup>4</sup> For a more detail discussion of securities law aspects of EB-5 capital, as well as SEC enforcement actions and private rights of action, see [EB-5 Securities: New Developments & Updated NYU Stern Database 2018 Edition \(10/21/18\)](#) and [Understanding EB-5 Securities - NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(Draft 12/9/2017\)](#)

- ii. The EB-5 investors moved to intervene to request that the receiver should have relevant EB-5 project experience who will take into account the interests of the EB-5 Investors
    - iii. On the eve of the hearing on the bank's motion to appoint a receiver, Debtor filed the Ch. 11 petition. Thus, a receiver was not appointed.
  - c. In Palm House Hotel, the foreclosure commenced in 2014.
    - i. At the request of the senior lender, the state court appointed a receiver.
    - ii. The foreclosure has been tied up in litigation, and did not proceed to sale before the pending bankruptcy action was filed.
  - d. In AMC, the foreclosure commenced in 2016.
    - i. At the request of the lender, the state court appointed a receiver.
16. Private right of action filed by EB-5 investors:
- a. In two of the cases – Palm House Hotel and Lucky Dragon - the EB-5 investors filed a lawsuit against the Debtor and others before the bankruptcy petition was filed.
  - b. In Seabreeze, the EB-5 investors filed an action against the Debtor, bank lender and others as part of the bankruptcy case. The cases focus on fraud and related matters, rather than a payment default under the EB-5 financing.
    - i. Seabreeze: Filed against senior lender (bank) and the developer
      - 1. 21 of the 60 investors filed a challenge to the bank's proof of claim and a complaint in the bankruptcy court proceeding seeking equitable subordination of the senior lender's claim. This claim was apparently denied.
  - c. Palm House Hotel: Filed in 2016 (2 years before bankruptcy petition) against the RC, EB-5 fund, the developer and others.
    - i. Since then, the SEC has filed an enforcement action alleging fraud by the RC, EB-5 fund and the developer.
    - ii. DOJ has filed a criminal action against the developer and is likely to amend to add the RC owner-operator.
    - iii. The developer has filed a personal bankruptcy petition.
  - d. AMC: None filed. However, see below re SEC enforcement action
  - e. Lucky Dragon: Filed
  - f. SLS: In November 2017, 60 EB-5 investors filed suit against various parties, including Stockbridge, the borrower, Tranche 1 and Tranche 2. The lawsuit alleged that EB-5 funds did not invest their capital in the EB-5 project, and that the project did not generate the required number of jobs. The investors are seeking unspecified damages for fraud and breach of fiduciary obligations. In March 2018, the court referred the matter to JAMS arbitration.

17. SEC Enforcement Action:

- a. Background:
  - i. Every federal district court that has decided the issue has determined that the immigrant investors' investment in an EB-5 fund constitutes a security for purposes of the federal securities laws. The courts have applied the Howey test as enunciated by the US Supreme Court in 1946. Regional centers and other defendants have unsuccessfully argued that the securities laws do not apply because the motive for the investor making the investment is immigration, rather than to make a profit.
- b. Palm House Hotel and AMC are the subject of pending SEC civil enforcement actions alleging fraud. The other cases are not the subject of SEC actions.
  - i. Palm House Hotel and related parties – regional center, EB-5 investment fund, the owner-operator of the regional center and EB-5 investment fund, and the developer are named as defendants.
    - 1. On August 2, 2018, the day after the SEC filed the enforcement action, the Debtor filed a chapter 11 petition.
    - 2. Related litigation:
      - a. In November 2017, the developer (Robert Matthews) filed personal Chapter 11 bankruptcy petition.
      - b. The SEC filed a proof of claim in the Matthews personal bankruptcy even though the SEC enforcement action was then only in the investigation phase.
      - c. In March 2018, DOJ filed a criminal action against the developer Robert Mathews seeking restitution. Based on the SEC enforcement action, it is likely that DOJ will file a criminal action against the RC and EB-5 investment fund owner/operator.
  - ii. AMC is a relief defendant in the SEC enforcement action alleging fraud relating to several health care facilities owned and operated by an immigration attorney, Kameli, who also owns the regional center that sponsored the projects.
    - 1. The enforcement action was filed in April 2017.
    - 2. As a relief defendant, AMC was not accused of wrongdoing. It was joined to have it disgorge monies received as a result of the wrongdoing by the named defendants.
- c. Note that when the SEC files a civil enforcement action alleging fraud, it routinely seeks the appointment of an equity receiver.

- i. The receiver's typical duties include seeking the recovery of the misappropriated funds and operation of the property.
- ii. See the EB-5 Basics outline for a discussion of why the SEC pursues a receivership rather than bankruptcy in connection with SEC enforcement actions alleging fraud.