

Feasibility of EB-5 Financing for a SOLAS-Certificated Ferry Vessel

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Introduction

Legislative Background

Sec. 307 (2) of ESSB 5988 passed by the 2015 Legislature directed the Washington State Department of Transportation (WSDOT) to analyze the feasibility of using EB-5 financing to acquire a new ferry vessel:

Within existing resources, the department must evaluate the feasibility of utilizing the federal EB-5 immigrant investor program for financing the construction of a safety of life at sea (SOLAS) certificated vessel for the Anacortes-Sidney ferry route. The department must establish a group that includes, but is not limited to, the department of commerce and entities or individuals experienced with vessel engineering and EB-5 financing for assistance in evaluating the applicability of the EB-5 immigrant investor program. The department must deliver a report containing the results of the evaluation to the transportation committees of the legislature and the office of financial management by December 1, 2015.

This report is in response to that direction.

Summary of Findings

The feasibility of using the federal EB-5 immigrant investor program to finance a new state ferry was investigated by a group that included Washington State Ferries (WSF) Finance and Administration; WSF Vessel Engineering; WSDOT Financial Planning; the Washington State Department of Commerce; and the Office of the State Treasurer (OST). The conclusion is that it is neither feasible nor advantageous for the state to acquire a safety of life at sea (SOLAS) certificated vessel by means of EB-5 financing because:

- To get the lowest possible cost of funds, the state typically uses a combination of cash and bond proceeds to pay for the design and construction of ferries and other transportation projects. As another source of borrowed money, the EB-5 program will not achieve a lower cost of funds compared with the low debt service costs the state gets in the tax exempt bond market.
- Nationally, the EB-5 program has most often been used to finance projects that generate an income stream that is used to pay back EB-5 investors, such as hotels, housing, and retail facilities. EB-5 financing for a ferry would not create any income so investors would need to be repaid from state funds – not unlike how the state pays off its other debts.
- Pursuant to state law, the State Financing Committee (the Treasurer, Governor and Lieutenant Governor) oversees legislatively authorized borrowing and financing done by the state. Competitive auction-based bond sales and occasionally negotiated sales are used to get the lowest possible cost of funds for the state. Competitive sales offer the greatest transparency throughout the process. In both cases, the state sells bonds to underwriters who sell to investors of all types. The state does not sell bonds directly to investors (such as EB-5 investors) through noncompetitive

private placements because this method would not get the lowest cost of funds for the state, offer limited transparency and would be viewed quite negatively by the bond market.

- While EB-5 investors bought bonds that were sold to pay for part of the 520 bridge project, they did so by competing with all other investors when they sought to buy from the underwriter to whom the state sold its bonds. All investors who purchase bonds (including EB-5 investors) must meet certain criteria established by federal regulatory agencies.
- Beyond buying bonds or entering into a financing agreement with the state, federal law also makes it possible for EB-5 investors to contribute capital and participate by taking an active management role in a business such as a shipyard. However, based on conversations, there is very little chance that a Washington-based shipyard large enough to build Washington State Ferries would turn over partial control of its business and operations as required by the EB-5 program.

Background on the EB-5 Visa Program

Under the federal EB-5 immigrant investor program, foreign nationals can apply for a visa and ultimately permanent residency by making a certain level of investment in a commercial enterprise in the U.S. in a way that expects to create or preserve 10 permanent full-time jobs for qualified U.S. workers. The program is called “EB-5” because it is the fifth preference employment-based visa that participants can get (among four other employment-based preferences (EB-1 to EB-4) that foreign nationals can use based on other qualifying factors). Obtaining a visa is a first step toward permanent residence and U.S. citizenship.

Congress first created the EB-5 program in 1990 to stimulate the U.S. economy by attracting capital investment by foreign nationals into businesses or projects to areas where it would be difficult to draw domestic investment. In 1992, Congress created a temporary pilot program to give eligible foreign nationals a way to become lawful permanent residents. This Immigrant Investor Pilot Program, also known as the Regional Center Program, sets aside 10,000 EB-5 visas for participants who invest in commercial enterprises associated with regional centers approved by the United States Citizenship and Immigration Service (USCIS). As of October 5, 2015, USCIS had approved 735 regional centers.

There are two models for EB-5 investments: direct investment in a business, or a contribution of capital to a Regional Center that in turn makes the investment. The differences in these two approaches are shown in Figure 1.

Figure 1

	Direct Investment	Regional Center
Type of investment	Must be in the form of equity; loans are not permitted.	Loans and equity are permitted.
Risk	Risk of business failure. Risk that project does not produce the required number of jobs.	Essentially no risk of bond repayment if investment is in highly rated municipal bonds. Risk of improper conduct by regional center. Risk that funds are not used for the agreed-upon project. Risk that project does not produce the required number of jobs.
Management role	Investor must have an active role.	Regional Center decides on the project or business; no need for active role in management by the investor.
Cost of process	Uncertain. Investor must pay costs of immigration attorneys, securities attorneys, economists, and business plan development consultants.	Regional Centers charge a fee for services. By bundling investors together into one financing, economies of scale may make the establishment of an eligible project less costly.
How jobs are counted	Only direct jobs are counted; no induced or indirect jobs.	Direct, induced, and indirect jobs may be counted.
Reporting responsibility	Investor.	Regional Center.

Immigrant investors are often primarily motivated by obtaining access to a visa. In addition, no job offer or employer sponsorship is needed. There is also location flexibility, business and investment type flexibility, and no residency requirement. Applicants must document that funds are from a lawful source, document the path of the funds, and be otherwise eligible to apply to immigrate.

Investments must be tied to proposals to promote economic growth in enterprises that create or preserve at least 10 jobs for U.S. workers. The required minimum investment is \$1 million, reduced to \$500,000 if the investment is in a Targeted Employment Area (a high unemployment (150 percent or more of national average) or rural area (not in a Metropolitan Statistical Area or a town of more than 20,000)). Regional Center operators often find ways to carve out employment zones that qualify as Targeted Employment Areas to reduce the minimum investment to \$500,000.

Investments through Regional Centers are made either by purchasing securities through private placements or by purchasing bonds. A private placement (a non-public offering) consists of securities sold through a

private offering to a small number of qualified investors. EB-5 private placements are subject to federal and state securities laws and regulations. If the investment is made through a Regional Center, loans also qualify as investments.

EB-5 investments must be in a “new commercial enterprise” defined in federal law as an enterprise established after November 29, 1990, or established on or before November 29, 1990, that is purchased and the existing business is restructured or reorganized in such a way that a new commercial enterprise results, or expanded through the investment so that a 40 percent increase in the net worth or number of employees occurs. Unless the investment is made through a Regional Center, the EB-5 investor must be engaged in the management of the commercial enterprise, not a passive investor. The investor may be a member of the board of directors, a corporate officer, or a limited partner.

When an EB-5 investment is not made through a Regional Center, the entire amount of the immigrant investor’s capital must be placed at risk for the purpose of generating a return. If the investor is guaranteed the return of a portion of the investment or is guaranteed a rate of return on a portion of the investment, the entire investment is considered “not at risk.” A contribution of capital in exchange for a note, bond, convertible debt, obligation, or any other debt arrangement between the foreign investor and the new commercial enterprise does not constitute a contribution of capital, i.e. loans are not considered capital contributions.

To date, EB-5 funding has been used mainly for real estate investments. Some developers have set up their own Regional Centers for the purpose of soliciting EB-5 investments. So far only two states, Vermont and Michigan, have established their own Regional Centers.

Previous Public Transactions

The 520 Bridge Corridor Project is the only State of Washington financing that we are aware of in which EB-5 investors have participated. In this transaction, EB-5 investors purchased a portion of one series of general obligation bonds (“triple pledge” bonds) used to finance the project. The state did not seek out or conduct an EB-5 financing for this project. Rather, an EB-5 program set up by a Regional Center bought state bonds from the underwriter to whom the state sold its bonds.

It is our understanding that prospective orders from EB-5 investors were turned away by an underwriter in a second sale of bonds for the SR520 Corridor Project. The Regional Center subsequently brought suit against the state asserting that the state failed to sell bonds to them and/or interfered with the underwriter. The state is now defending itself against these allegations.

Other public entities that have used EB-5 financing include:

City of Miami: The City of Miami created its own Regional Center to help finance affordable housing. Its first development was a luxury project, the 83-story Panorama Tower.

University of Miami: The developer of the \$107 million University of Miami Life Science and Technology Park was developed using EB-5 funding for \$20 million of the project.

Los Angeles: The Los Angeles Economic Development Corporation set up an EB-5 Regional Center in partnership with a private entity. The Regional Center was used to obtain financing for \$35 million for a new office building for Molina Healthcare, a publically traded company. The financing provided part of the cost for a new office building to accommodate Molina’s employment growth that occurred as a result of the Affordable Care Act.

Cincinnati: The Port of Greater Cincinnati Development Authority recently announced creation of its own Regional Center. The EB-5 program is being set up in partnership with a private equity fund. They plan to invest in a mixed-use development and a downtown hotel.

Vermont: The Vermont EB-5 Regional Center is state-owned and operated by Vermont’s Agency of Commerce and Community Development. The center is working with several Vermont EB-5 projects.

Michigan: The State of Michigan EB-5 Regional Center was approved by USCIS in March 2014. No transactions have occurred using this Regional Center.

Other examples: There are other examples in which a creature of a municipality, such as an economic development authority or similar corporation, has established a Regional Center. The Regional Center is established for the purpose of facilitating development of projects that would otherwise have difficulty obtaining bank loans or garnering investor interest.

State Debt Management Policy

An EB-5 financing or a private placement with EB-5 investors creates debt. For the state, this is usually accomplished by borrowing in public securities markets – typically with long-term fixed rate bonds. With the exception of the annual “retail sale” which gives priority to Washington residents, the state does not give special treatment or preference to any bond investors.

The vast majority of bond sales overseen by the State Finance Committee and conducted by the Treasurer are done by competitive bid. In these cases, underwriters compete through an auction for the chance to buy the state’s bonds. The bonds are awarded to the underwriter who offers the highest price, or lowest cost of funds. Underwriters are required to make a bona fide public offering of the securities to investors. This process is public and regulated by federal agencies.

In certain limited circumstances, the state uses a highly competitive version of a negotiated sale process to achieve the lowest possible cost of funds. Again, similar to the competitive sale process, in a negotiated sale, the state sells its bonds to an underwriter through a bond purchase and sale agreement after which the underwriter offers the bonds to investors.

The Debt Issuance Policy of the State Finance Committee addressed methods of sale in Section V:

V. ISSUANCE POLICIES

In accordance with the finance committee’s responsibility to establish the method and manner of sale of state debt, all state debt will be issued subject to the following policies.

Methods of Sale

Presumption of Competitive Sale

Unless otherwise necessary to minimize the costs and risks of state borrowing, all fixed rate state debt will require approval by the finance committee by two written resolutions. The first, "authorizing", resolution will provide for the issuance and sale of the debt, set forth the terms and conditions of the sale, and direct the state treasurer to make the necessary preparations for receiving competitive bids.

State debt issued by sealed competitive bid will be sold to the bidder proposing the lowest true interest cost to the state, provided the bid conforms to the official notice of sale issued in accordance with the authorizing resolution. The second, "performance", resolution will accept the winning bid and direct the state treasurer to take whatever actions are necessary to complete the issuance and delivery of the duly authorized debt. "

In the event that a negotiated sale is used, the policy notes "Documentation supporting the authorizing resolution will be provided to the finance committee and will include the goals and limitations of the proposed sale, as well as an explanation of the reasons why a negotiated sale is justified." (*"Conditions of Negotiated Sale"*)

A private placement EB-5 financing transaction would differ sharply from the state's long history of using public bond sales and would need separate approval from the State Finance Committee. Private placement financing is most commonly used by governments that are unable to effectively borrow in the regular market place due to limited market access, weaker credit ratings or uncertain litigation challenges. Alternatively, private placements may be used by small or infrequent borrowers.

SOLAS Vessel Cost

A SOLAS vessel built from the keel up would cost approximately \$130 million, which would require at least 260 investors to contribute \$500,000 each - assuming a Regional Center could carve out an area meeting the high unemployment criterion. This size would appear possible based on past EB-5 transactions.

The investors would also have to pay a one-time fee to the regional center of \$35,000 to \$50,000 or higher to cover the Regional Center's fees to the United States Citizenship and Immigration Services (USCIS), immigration attorneys, securities attorneys, economists, business plan development consultants, and commissions for immigration brokers for finding investors.

EB-5 Reform and Reauthorization

Over the last year, five bills seeking to reform the EB-5 program have been introduced in both the House and the Senate, all proposing different measures for reform and improvement. Additionally, concerns with the program were identified in an August 2015 report from the Government Accountability Office (GAO), *Immigrant Investor Program: Additional Actions Needed to Better Assess Fraud Risks and Report Economic Benefits*. The report found that unique fraud risks in the program include the possibility that invested funds

were obtained illegally, findings of various investment-related schemes to defraud investors, the ongoing development of new schemes, and USCIS's limited capacity to access data and address fraud risks in the program.

The Securities and Exchange Commission (SEC) has also filed civil securities fraud lawsuits against a number of EB-5 program participants. And, there are additional concerns from some members of Congress about the function of Regional Centers and the methodology for designating Targeted Employment Areas.

However, in mid-December 2015 the House and Senate reached an agreement on a federal fiscal year 2016 omnibus appropriations bill that extended the EB-5 program until September 30, 2016. This "clean extension" means the program will not change, including issues such as minimum investment amounts, definitions for Targeted Employment Areas, or other reforms.

In light of the current state of the program, as well as the factors identified above in the "Summary of Findings," the EB-5 immigrant investor program would not appear to be an advantageous alternative to current WSF capital financing.

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