EB-5 Investments and "Troubled Businesses":
Sources of Mutual Opportunities?

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Under the Immigrant Investor Program, also known as the "EB-5 Program," foreign investors who make qualifying investments in U.S. companies are eligible to receive EB-5 visas, 10,000 of which are allotted by the federal government annually.[1] An EB-5 visa entitles the investor to conditional permanent United States residency and, ultimately, the opportunity for unconditional U.S. permanent residency, which itself ultimately gives rise to eligibility for U.S. citizenship. Historically, newly formed businesses in the real estate and hospitality sectors have been popular investment vehicles for investors under the EB-5 Program. This is because one of the qualifications for an investment under the EB-5 Program is that the investment must lead to the creation of jobs for U.S. workers, and new businesses that require construction of buildings followed by retail or service jobs generally tend to create the requisite number of jobs. In our experience, foreign investors have been generally less likely to seek out existing operating businesses for investment under the EB-5 Program and, similarly, existing operating businesses have been generally less likely to seek capital from foreign investors under the EB-5 Program. As discussed below, however, investments under the EB-5 Program in certain types of "troubled" existing operating companies may offer advantages both to foreign investors and to the companies themselves.

The EB-5 Program was created by Congress in 1990 to stimulate the U.S. economy by encouraging the flow of capital into the U.S. from foreign investors and promoting employment of workers in the U.S. The EB-5 Program, administered by U.S. Citizenship and Immigration Services (USCIS) under the Department of Homeland Security, provides for an annual allotment of 10,000 EB-5 visas to be made available to aliens seeking to enter the U.S. for the purpose of investing in a new commercial enterprise.[2] Several requirements must be met for an investment to qualify under the EB-5 Program, including the amount of the investment, the number and type of jobs created by the investment and the type of business in which the investment is made.

The first major qualification that must be met for an investment to qualify under the EB-5 Program is that the investment must be at least US $1,000,000, unless the investment is made in a "targeted employment area," or TEA, in which case the minimum investment must be at least US $500,000.[3] A TEA is an area which, at the time of investment, is a rural area or an area which has experienced unemployment of at least 150% of the national average rate.[4]

The second major qualification that must be met for an investment to qualify under the EB-5 Program is that the investment must create full-time employment for at least ten U.S. citizens, permanent residents or other immigrants legally allowed to work in the U.S. (not including the investor's family members). Full-time employment is defined as a position that requires at least 35 hours of service per week.[5] Under the Pilot Program created by Congress shortly after introduction of the EB-5 Program, investments made in enterprises located within a "regional center" will meet the ten jobs requirement if the investment will create ten qualifying jobs directly or indirectly through revenues generated from the investment.[6] A regional center is any economic unit, public or private, which is involved with the promotion of economic growth, including increased export sales, improved regional productivity, job creation and increased domestic capital investment.[7] Regional centers must submit proposals and be approved by USCIS before they can participate in the Pilot Program.[8]

The third major qualification that must be met for an investment to qualify under the EB-5 Program is that the investment must be made in a type of business that is eligible under the EB-5 Program. There are 3 types of businesses in which an investment may be made:

(1) The creation of an original (i.e., new) business;
(2) The purchase of an existing business and simultaneous or subsequent restructuring or reorganization such that a new commercial enterprise results; or
(3) The expansion of an existing business through the investment of the required amount ($1,000,000 or $500,000 if in a TEA), so that a "substantial change" in the net worth or number of employees results from the investment of capital. Substantial change means a 40% increase in either the net worth or the number of employees, so that the new net worth or number of employees amounts to at least 140% of the pre-expansion net worth or number of employees. Establishment of a new commercial enterprise in this manner does not exempt the petitioner from the required amount of capital investment and the creation of full-time employment for ten qualifying employees. In the case of a capital investment in a "troubled business," however, the investment need not create 10 new full-time jobs, but rather must allow the "troubled business" to maintain its number of existing employees at the pre-investment level for a period of at least two years.[9]

A "troubled business" is a business that has been in existence for at least two years, has incurred a net loss for accounting purposes during the previous 12 or 24-month period, and the loss for such period is at least equal to 20% of the troubled business' net worth prior to such loss. For purposes of determining whether or not the troubled business has been in existence for two years, successors in interest to the troubled business will be deemed to have been in existence for the same period of time as the business they succeeded.[10]

Each such investor seeking an EB-5 visa must file with USCIS a petition on Form I-526.[11] The petition must be accompanied by documentation evidencing that each investment qualification has been met, including documentation evidencing the amount of the investment and the number of jobs created/preserved and describing the business in which the investment is being made.

From the beginning, most investments made under the EB-5 Program have been in new businesses. There are a number of reasons for this, such as new businesses having no operating history and are a blank slate on which financial and business projections can be made. Investors also typically don't want to invest in a "troubled business," the very description of which gives rise to negative connotations. In addition, USCIS more frequently reviews, and more frequently approves, petitions for new businesses which may make it appear to foreign investors that such businesses are a safer and more stable method of obtaining an EB-5 visa. I-526 petitions are thoroughly scrutinized and foreign investors seem not to want to draw unnecessary attention by basing their applications on investment opportunities that may be perceived to be outside of what is more customary.

Nevertheless, the fact that troubled businesses are not a typical or customary EB-5 investment vehicle need not necessarily be a reason for investors to shy away from them. With the help of experienced legal counsel, good investment advice, proper due diligence and careful attention to all I-526 documentation needed to qualify the investment, investments made in troubled businesses otherwise meeting regulatory requirements may and should be approved by USCIS. In addition to the fact that investments in troubled businesses do not require the creation of ten new jobs to qualify under the EB-5 Program, troubled businesses may offer certain other advantages that benefit both the investor and the existing business.

From the outset, one of the reasons to consider investing in a troubled business is simply that many different types of businesses can fall within the meaning of the term "troubled business." For example, a "troubled business" may range from a company that has a net loss over a 24-month period that is equal to 20% percent of the company's net worth prior to such loss all the way to a company that has a net loss over a 12-month period that is equal to 100% of the company's net worth prior to such loss. While the latter company is most likely extremely risky, in the right circumstances the former "troubled business" could provide a good investment opportunity that still meets the criteria for qualification under the EB-5 Program. An example of such a company could be a once successful restaurant or hotel in a good location that, due to management or some other reason, has struggled but could be turned around with a cash infusion and a new management or other business strategy. These types of businesses are prevalent, and the fact that they already exist is another reason for their consideration.

Because troubled businesses already exist, investors can avoid making an investment in a vehicle which has the costs associated with starting a new business. Forming a new business is expensive, especially in connection with an EB-5 investment where business plans and pro forma financial projections all have to be prepared from scratch. Existing businesses, while not free of transaction expenses, have built in cost savings from an EB-5 investment perspective by virtue of the fact that they are already existing operating companies.

Finally, another reason that troubled businesses should be considered in the EB-5 context is that the investor should get a higher return on investment in a troubled company due to the risk implicit in the recent operating history of such a company. Since returns to EB-5 investors are normally extremely low, in many cases not covering lost opportunity cost or even the cost of inflation, an increase in potential return may become a compelling feature of a prospective investment by an EB-5 investor.

Similarly, from the perspective of a troubled business, the returns expected by investors under the EB-5 program are very low compared to more traditional forms of financing, which is even more true in the context of a troubled business. It is possible for a troubled business to receive a significant investment for an agreement to pay a relatively small annual return and the return of the corpus of the investment after a number of years. This is because while EB-5 investors do expect to get a return on their investment, the primary reason for the investment is to obtain an EB-5 visa (and U.S. residency). For a troubled business to receive traditional equity financing it would normally require giving up a substantial equity stake in the company. For the same company to receive some type of traditional debt financing would mean paying significantly higher than market interest rates, if such financing were available at all.

While not traditionally used as investment vehicles under the EB-5 Program, with the help of experienced counsel, good financial advisers and proper due diligence, the right kind of "troubled business" may provide a unique opportunity through which EB-5 investors can pursue their goals of U.S. residency, and ultimately, citizenship. Similarly, the EB-5 Program potentially presents such existing operating companies with a source of relatively inexpensive capital through which they may be able to restore financial stability while providing a fair return to EB-5 investors. **TSL**

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1. See generally 8 USC § 1153(b)(5) and 8 CFR § 204.6.
2. 8 USC § 1153(b)(5)(A).
3. 8 CFR § 204.6(f).
4. 8 CFR § 204.6(e).
5. Id.
6. Id.
7. Id.
8. 8 CFR § 204.6(m)(3)-(5).
9. 8 CFR § 204.6(h).
10. 8 CFR § 204.6(e).
11. 8 CFR § 204.6(a).