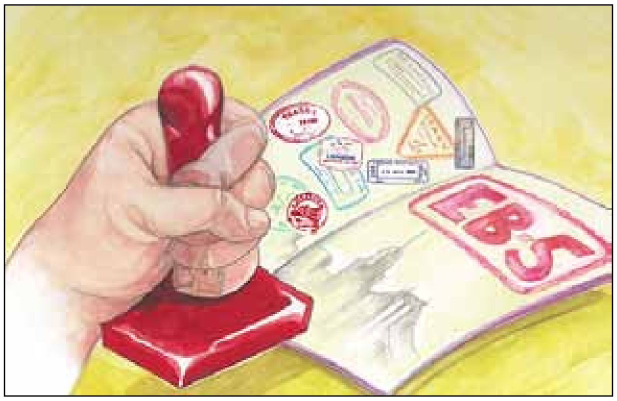
More NYC developers tap cheap EB-5 capital

The green card exchange program opens the floodgates for more foreign money



Call it vis-à-visa financing: New York City developers, big and small, are increasingly tapping into the EB-5 program to secure capital from foreign investors.

The federal program — which was created in 1990 but has grown in popularity since the recession — allows overseas investors to obtain a green card in exchange for providing at least $500,000 in financing for certain (qualified) projects.

The demand for the program, sources said, is being fueled by banks' diminished appetite for risk, along with the new stringent lending regulations mapped out in the Dodd-Frank Act. Those new barriers to financing have driven developers to hunt for alternative sources of affordable capital.

"It's a very low-cost way to fill out your capital stack," said Manhattan-based real estate lawyer Joshua Stein.

He said while mezzanine capital is risky, and therefore expensive to secure — "you might pay around 12 percent" — the interest rates for EB-5 loans are "in the low single digits."

Jordan Barowitz, a spokesperson for the Durst Organization, which has raised more than $150 million in EB-5 financing for various projects, said the program provides cheap capital, which in turn "frees up more equity."

"It allows us to pursue numerous projects simultaneously," he said.

But as with many federal programs, red tape and rules abound.

For starters, EB-5 funds — which come from a slew of countries, including China, England, Vietnam, Mexico and a number of countries in South America — must be approved by the United States Citizenship and Immigration Services.

And the amount of money a developer can raise is determined by a complex formula involving the number of jobs the project will create. That equation usually works out to about 10 jobs for each green card issued to an investor, said David Soares, CEO of Lexden Capital, a Manhattan-based bridge-loan brokerage that has worked with foreign EB-5 investors.

"To get $500,000, [the project needs to provide] 10 jobs," he said.

EB-5's increasing popularity has also spurred some problems. The Securities and Exchange Commission, which enforces federal securities law, has been cracking down recently on unlicensed "finders" who charge a fee to help developers locate capital overseas, as TRD has reported.

If unlicensed finders get paid for matching investors to developers, they're subject to SEC and state fines and could be banned from future securities trading.

That's because brokering a financial transaction requires a broker/dealer license, said Kate Kalmykov, an attorney at Greenberg Traurig who specializes in EB-5. The rules are being "heavily violated," she added.

"There is a big misconception that this is fast money — it is not," Kalmykov said. "There are a lot of hoops to jump through."

Despite those hoops, sources say there are three avenues a developer can take to using EB-5. Determining which is best is largely the product of a developer's size and resources.

Below is a look at each of those avenues, along with the pros and cons of each:

Setting up a regional center

Option No. 1 for tapping into EB-5 financing is a big-league move: It requires setting up a so-called regional center, a company that's legally allowed to receive foreign money.

Silverstein Properties, the Related Companies and Extell Development, which raised funds through its EB-5 regional center for its under-construction commercial condo project the International Gem Tower at 50 West 47th Street, have all gone this route.

The head of Extell's regional center, Shalom Segelman, said the firm nabbed $75 million from foreign investors through the program for the tower, with the majority — 60 percent, he estimated — coming from China, but with funds also flowing in from India, the United Kingdom, France, Mexico and Vietnam.

Segelman — who noted that Extell's regional center is currently searching for capital for another project — said finding investors is not always easy. "These are sophisticated, high-net-worth individuals," he said. He added that there is a misconception that you can arrive in China "and they will just hand you money."

Both Silverstein and Related are also currently in the process of setting up their own regional centers, according to Crain's New York. Silverstein will use the funds for 30 Park Place, a $1 billion condo-and-hotel tower underway in Lower Manhattan; Related will source funds for its massive mixed-use Hudson Yards project, on the Far West Side.

THE REAL DEAL

More NYC developers tap cheap EB-5 capital

The green card exchange program opens the floodgates for more foreign money

Developers must apply to the USCIS to get the green light on setting up a center. That process, sources said, generally involves developing a business plan for the project, detailing how the project will contribute jobs, and drafting project offering documents and immigration paperwork for the investors. Marketing materials for the project must also be underway before a developer can apply to establish a regional center. Nationwide, 453 of these centers exist, according to USCIS' website, though many are used for non-real estate-specific investments.

Greenberg Traurig's Kalmykov estimated that only 30 to 40 of the 450-plus centers are active because many developers use them for only one or two projects.

Mona Shah, a partner at Manhattan-based law firm Mona Shah & Associates, said she knows of 38 active regional centers in New York City. Most of them, she said, opened in the last year.

But forming a regional center is "a time-consuming and long-term investment," said Kalmykov. "The regional center processing times are currently between nine and 12 months, and startup costs begin in the $200,000 range," she told TRD.

Nonetheless, with traditional financing still nowhere near as easy to secure as it was pre-recession and mezzanine finance so pricey, making the investment can be a win-win for big developers. Plus, EB-5 financing is legally less entangling than working with a joint-venture partner or finding equity in any other traditional way, sources said.

Kalmykov explained that for developers with consistent capital needs, paying out the start-up costs is a smart decision because once the center is in place, they can use it to raise funds for other projects.

Renting a center

For developers who can't afford to establish a regional center of their own (or don't want to deal with the hassle), there's another avenue: Renting a center.

Indeed, centers that are not being actively used by their owners can be rented out by other developers.

And some centers only exist to source capital to third parties (often developers) for a fee. For example, the New York City Regional Center — which is run by Manhattan-based real estate attorney George Olsen and Paul Levinsohn, former chief counsel to New Jersey Governor Jim McGreevey — raised $249 million for the Atlantic Yards project, while the Empire State EB-5 Regional Center sourced funds for a hotel in the Catskills and a medical facility in Philadelphia.

Generally, the center finds investors and handles much of the legal legwork for the developer "renting" the center.

While the initial costs for a developer are lower than establishing a center outright, renting a center can come at a hefty price. That's because whoever owns the center generally charges 5 or 6 percent of the capital collected from international sources, said Shah. That can nearly double the cost of capital for a project, sources said.

Durst rented a Florida-based regional center, called U.S. Immigration Fund LLC, to raise $80 million from Chinese investors for the 41-story glass, mixed-use tower it's building at 855 Sixth Avenue, Barowitz said. He declined to comment on how much Durst was charged. (He said the company considered setting up its own regional center but opted against it because "it's a major headache.")

There are some other disadvantages to renting, however.

For starters, sources said, international investors prefer to deal with developers directly, rather than intermediaries at regional centers, for legal reasons. In addition, some regional centers have a bad reputation that often comes from being affiliated with projects that have failed — even if it wasn't the centers' fault, sources said.

"[A bad rep] can really hurt you," Shah said, explaining that it could become difficult to attract foreign investors, who may fear losing their capital.

Buying a center

The third (and final) option for a developer looking to tap into EB-5 financing is to buy a regional center.

A developer in a hurry to get his project underway would consider buying, said Michael Harris, a Florida-based attorney who's worked with EB-5-funded projects. But he noted that there is one major hurdle: Few owners want to sell.

He said his clients have generally offered to pay "a couple hundred grand" to buy centers. "But it is pretty rare because people are reluctant to let go of them," he added.

The transactions are structured like any other asset trade, with buyers often setting up LLCs to mitigate risk.

However, it's the least common of the three options, experts said, noting that while the USCIS technically permits the sale of regional centers, it doesn't encourage the practice. The USCIS New York City office could not be reached for comment.

Meanwhile, there are some risks to buying a center. Harris said a center may be subject to problems with previously built or already-in-the-works projects. Plus, he explained, "there are immigration risks" for the buyer. He said if the new owner doesn't do his due diligence, he might be on the hook for improper conduct that took place before he came in.