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08.13.2013 17:54

EB-5 Investing Is About People, Not Projects

Those putting their money into the program should remember to perform due diligence, and if their questions aren't answered, they should move on

By Dan Healy



Charles Dickens may have been the first person to publicly entertain the Ponzi scheme in his 1844 novel Martin Chuzzlewit. Dickens created a fictional character by the name of Montague Tigg who defrauded investors by paying off early insurance policyholders claims with premiums from new policyholders.

About 80 years later, Charles Ponzi officially made the scheme famous. In subsequent decades, various high-profile frauds followed, with the most memorable in recent history perpetrated by Bernard Madoff, who admitted to orchestrating one of the largest Ponzi schemes in U.S. history.

The essence of this scheme hasn't changed over the years. What was true in Dickens time is true today: Investors should invest in people, not projects.

While not on a "Madoff" scale, the scheme reappeared last week in the context of the EB-5 visa, a government program through which foreign nationals can receive permanent residency in the United States (a "green card") in return for investing at least US\$ 500,000 in a U.S. business that creates ten or more jobs for American workers.

EB-5 investors capital is usually pooled through a designated "regional center," which then provides the funds to a job-creating enterprise, typically in the form of a loan or equity investment. According to the FBI, employees of the USA Now Regional Center in McAllen, in the U.S. state of Texas, allegedly devised a Ponzi scheme in which they took millions of EB-5 investment dollars from clients who thought they were investing in a job-creating project and instead used the money to finance their lavish lifestyle.

Im encouraged to see immigration at the forefront of debate in America, but not for these reasons.

In the years to come, the EB-5 program has the potential to create hundreds of thousands of jobs for American workers at no cost to taxpayers. This innovative economic development tool will play an integral role in keeping the U.S. economy strong, vibrant and competitive with the many other nations around the world who actively court investors and their capital. But as the EB-5 industry matures and program participants find ever more creative applications for EB-5 capital, the programs regulatory infrastructure must also evolve in order to maintain the trust and confidence of all stakeholders, including investors, businesses, regulators, elected officials and, most importantly, the American public. Increased oversight, with a focus on anti-fraud measures and standards for program participation, is essential.

These scams are avoidable. When evaluating any financial product, investors need to take the time to do their homework. Warren Buffett, arguably the greatest investor of all time, said it best: "Never invest in a business you cannot understand."

This sage advice is especially apt for EB-5 investors, who have both their investment and their dream of becoming an American on the line.

As the head of Civitas Capital Group, I oversee about US\$ 300 million in EB-5 capital. I also serve as a director of the Association to Invest in the USA (IIUSA), the leading trade association for EB-5 regional centers. I've seen the good, the bad and the ugly when it comes to EB-5 investments.

In my investing career, I've learned that every deal comes down to the quality and integrity of the people involved. This is all the more true with EB-5 investment sponsors, who must possess both financial and immigration expertise.

So, first things first: research the people managing the regional center. Who is really responsible for making sure the investment performs and the jobs are created? Read the offering documents cover to cover. Request a track record. Ask for professional biographies. If possible, visit the regional centers office and talk to the staff. Do they have sufficient experience in finance, investments and immigration to execute the proposed investment strategy? Have they done so successfully before? Ask for a reference list of attorneys, accountants and public sector partners. Call these references and ask them for more references. Who else knows these regional center managers? What is their reputation? Don't be shy about asking tough questions. If you get any resistance, move on.

If the people pass muster, evaluate the investment itself. How does it work? The answer should not be complicated. If it is, move on. Are the project claims questionable? In a recent U.S. Securities and Exchange Commission (SEC) enforcement action in Chicago, the agency accused a regional center of making a raft of false statements, such as a claim that a 2.8 acre tract of land for a project was worth US\$ 177 million. Such an aggressive claim should have immediately raised red flags and could have been verified with minimal effort. What is the targeted return? If it's zero, which is not unheard of with EB-5 investments, then move on. It is also critical to understand the repayment priority. Do the EB-5 investors get paid back first, second or third? The lower the repayment priority, the higher the financial risk. What are the potential sources of repayment? If the investment is a loan, is it secured by collateral? If so, what is it and how is it valued? Is anyone guaranteeing repayment? Documentation for the answers to these questions should be readily available. If not, ask why. If you don't like or understand the answers to any of these questions, move on.

Last but definitely not least, the EB-5 program is all about job creation. Are the sources of job creation identified and reasonable? The job creation should be well in excess of the minimum legal requirement, and the path to creating those jobs should be as close to a straight line as possible.

Too often, unfortunately, EB-5 investors and their advisors are not asking these questions. The good news is that we are still in the early chapters of the EB-5 story.

As the programs popularity has exploded, investors have become far more sophisticated than they were even two years ago. The public sector also is doing its part. Both the U.S. House and Senate are working on bills which, if passed, would go a long way toward addressing these concerns. In the meantime, U.S. Citizenship and Immigration Services (USCIS), the agency responsible for administering the program, has for the last two years been intensely focused on enhancing the programs integrity. The agency beefed up its technical staff significantly, bringing in economists and business analysts. I can personally attest that the quality of the agencies analysis of EB-5 petitions has improved dramatically in recent months as a result. USCIS has also established a close working relationship with the SEC, with concrete and very positive results, not least among them a very public signal to would-be fraudsters that theres a new sheriff in town.

Although regulation and oversight are important, there will never be a substitute for old-fashioned due diligence. As with traditional financial markets, the governments role is to regulate and punish bad actors, not to pass judgment on the merits of a particular investment – the latter is appropriately left up to each individual investor. For my clients, an EB-5 investment is not just a financial product; it is a life-changing experience. With the stakes so high, investors must demand quality and transparency from regional centers. Only with a clear understanding of a projects potential risks and benefits can investors make informed decisions.

In my experience, the most important element of almost any investment is the people who will execute it. In the wake of frauds like that alleged to have occurred in McAllen, policymakers are focused on this, as they should be. EB-5 investors would be wise to do the same.

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