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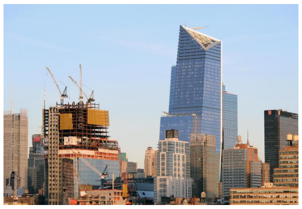
(212) 867-6000

With EB-5 Lending, Borrowers And Lenders Need To Read The Fine Print

December 18, 2017 | Rosenberg & Estis | Travis Gonzalez, Writer



EB-5, the program that exchanges investment in commercial projects and creation of U.S. jobs for U.S. permanent residence, remains a popular financing choice across development projects of all sizes. In New York, SL Green announced earlier this month that it is considering raising more than $200M in EB-5 funding to help finance the construction of One Vanderbilt. Earlier this year, the Hudson Yards megaproject sought $380M to aid in the completion of 35 Hudson Yards, 55 Hudson Yards and a platform capping its eponymous rail yard.

EB-5 financing is not without its risks. Failure to deliver on the project described in loan documentation could result in lawsuits from investors and the loss of residence cards. The latter was the case when New York Wheel construction stalled on Staten Island, which was funded in part by $206M in EB-5 financing.

One of the biggest pitfalls of EB-5 is a failure to ensure the offering memoranda matches the project that is under construction, Rosenberg & Estis attorney Eric Orenstein said. Orenstein often works on the lender side of these transactions. While the need to verify the accuracy of a project description and the type of loan seems like standard procedure, he has seen some clients overlook these details in a rush to break ground on projects.

“It seems like common sense, but most developers do not read these documents,” Orenstein said. “Some do get involved, but lots of developers rely on the regional center to get the information correct, and oftentimes it is not accurate, too specific or too broad.”

Ensuring accurate offering memoranda starts with the borrower. If a developer plans to build a specific asset class, that plan needs to be noted in the loan documentation. While being specific is important for accuracy, being too detailed can also create problems down the line. In the hospitality sector, attaching a particular hotel brand to a project could be risky if that brand backs out or another is chosen for the property.

Borrowers need to make sure the regional center raising the funds is accurately describing the entire transaction, Orenstein said. Failure to do so can prevent a project from receiving senior loan financing, resulting in an incomplete capital stack. Revisions often require investor consent, which can deter some developers.

On the EB-5 lender side, the regional center also has to go back and correct the problem. Senior lenders do not want to be involved in a project where the offering memoranda do not match the project under construction, Orenstein said. Failure to do so could open up the regional center to lawsuits from investors suing for misrepresentation.

Both borrowers and lenders should also verify the type of investment. They should know if EB-5 is being used as mezzanine or preferred equity, and the specific disclosures surrounding the loan. The release conditions for how the EB-5 lender will issue the money should be clear in the offering memoranda.

“Is this a construction loan of no more than 60% loan-to-value ratio?” Orenstein said. “How much equity are you putting in? You have to break down every step of what the transaction would be from a borrower’s perspective first, because the borrower is the first person to review the information to make sure that it fits their business plan.”

When it comes to EB-5, half the battle is managing expectations and ensuring participants across the aisle are on the same page.

“People need to think about all of these pieces so that when you get to your construction loan, everyone has the same expectations, so that you don’t end up in a place where you can’t get a senior loan because no one will give you EB-5, or you look at the offering and the EB-5 is a first mortgage loan and it is not a first mortgage loan,” Orenstein said. “Failure to pay attention to these details could lead to a deal falling apart.”

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