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**“EB-5 Reform on the Horizon – If the Palm House Hotel Debacle Does Not Precipitate Congressional Action, What Will?”**

**By Scholar-in-Residence Gary Friedland and  
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**March 22, 2019**

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## **EB-5 Reform on the Horizon – If the Palm House Hotel Debacle Does Not Precipitate Congressional Action, What Will?**

*By Gary Friedland and Jeanne Calderon<sup>1</sup>*

Many EB-5 stakeholders predict that the recent advance of the controversial “TEA” regulations<sup>2</sup> to the final review stage at OMB<sup>3</sup> indicates that these regulations will be imminently released.<sup>4</sup> They also contend that Congress would promptly enact legislative “reform” to counter the effect of these regulations, especially the increase in the minimum investment amounts. As explained below, we are highly skeptical that the regulations<sup>5</sup> will be finalized in the foreseeable future; instead, we believe they will continue to wallow in regulatory limbo while OMB exercises its discretion as empowered by Executive Order 12866.<sup>6</sup>

The political agenda of those who make these predictions is obvious. Repeatedly, EB-5 proponents intentionally mischaracterize the regulations as “Obama-era” regulations.<sup>7</sup> However, there is no evidence that the reform of the EB-5 Program (the “Program”) or the elimination of TEA abuse was a priority, or even a focus, of President Obama. If the regulations should be labeled, the “Grassley-era regulations” would be more appropriate.

As the industry is well aware, then Chairman of the Senate Judiciary Committee, Charles Grassley (R-IA), an ardent supporter of President Trump and a foe of President Obama, was the driving force behind these regulations. After the first EB-5 reform bill failed at the end of the December 2015, Senator Grassley, at the first Committee hearing on EB-5 reform in February 2016, repeatedly pressed the U.S. Department of Homeland Security to issue regulations

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<sup>2</sup> USCIS released proposed EB-5 Modernization Regulations on January 13, 2017 a few days before President Trump’s inauguration. We sometimes refer to these regulations as the “TEA regulations” because the most significant portion of these regulations focus on the minimum investment amount in projects located within or outside of a Targeted Employment Area (“TEA”).

<sup>3</sup> Office of Management and Budget

<sup>4</sup> Here is a link to one of the most recent predictions: <http://discuss.ilw.com/articles/articles/390181-article-an-open-letter-to-honorable-president-donald-j-trump-on-eb-5-visa-job-creation-program-by-bernard-wolfsdorf>

<sup>5</sup> The regulations are in proposed form. However, for ease of reference, we refer to them as the regulations, unless the context requires a reference to “proposed regulations.”

<sup>6</sup> [Executive Order 12866 of September 30, 1993](http://www.federalregister.gov/documents/1993-09-30/12866-01)

<sup>7</sup> <http://discuss.ilw.com/articles/articles/390181-article-an-open-letter-to-honorable-president-donald-j-trump-on-eb-5-visa-job-creation-program-by-bernard-wolfsdorf>

addressing TEA reform and other important aspects of the EB-5 Program in case legislative reform continued to stall.

In response, USCIS announced in April 2016 that it would be issuing proposed regulations, but it was not until January 2017, after soliciting input from a broad base of EB-5 stakeholders, that the regulations were issued.<sup>8</sup> Senator Grassley’s joint letter with Senator Patrick Leahy (D-VT) dated March 11, 2019 to DHS and OMB reaffirms their unwavering leadership in urging that the final regulations be issued promptly. The letter also reiterates their fervent hope that Congress will act to correct the fraud and abuse pervading the Program.<sup>9</sup>

However, we do agree that if the regulations were finalized and released, undoubtedly in response EB-5 reform legislation would be introduced. EB-5 reform bills have been introduced in Congress several times since 2015.<sup>10</sup> These bills have sought to remedy TEA abuse and impose “integrity” measures. Since April 2016, we have urged Congress to expand the integrity proposals to include immigrant investor protections aimed at addressing the fraud that pervades the EB-5 Program (the “Program”).<sup>11</sup> Although several bills have added these protections, the March 2018 draft bill provided a “watered-down” provision.<sup>12</sup>

The recent series of legal actions relating to the Palm House Hotel project in Palm Beach, Florida should serve as the impetus for swift regulatory or legislative action to impose strong immigrant investor protections. The fraud pervading this failed project has sparked litigation by the EB-5 investors, an SEC enforcement action, Department of Justice criminal indictments of five bad actors (so far), the bankruptcy and auction of the hotel entity and personal bankruptcy by the developer. Not only do these series of cases focus on the typical misappropriation of investor funds by bad actors, but it also documents a fake

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<sup>8</sup> February 2, 2016 hearing: <https://www.judiciary.senate.gov/meetings/the-failures-and-future-of-the-eb-5-regional-center-program-can-it-be-fixed>; and April 13, 2016 hearing: <https://www.judiciary.senate.gov/meetings/thedistortion-of-eb-5-targeted-employment-areas-time-to-end-the-abuse>. See various exchanges with Chief Nicholas Colucci of the Office of Immigrant Investor Program of USCIS. Also see the House Judiciary Committee hearing held on February 11, 2016: <https://judiciary.house.gov/hearing/is-the-investor-visa-program-an-underperforming-asset/>. The House Judiciary Committee members echoed these sentiments and continued to press USCIS to issue regulations

<sup>9</sup> <https://www.grassley.senate.gov/news/news-releases/grassley-leahy-press-trump-administration-eb-5-regulations>

<sup>10</sup> See, for example, [S. 1501](#), and [H.R. 5992](#)

<sup>11</sup> Friedland and Calderon, NYU Stern School of Business, “[Reflections on the Senate Judiciary Committee Hearing on EB-5: Time for TEA Reform](#)” (4/25/2016)

<sup>12</sup> The March 2018 draft bill is analyzed here: Friedland and Calderon, NYU Stern School of Business, “[EB-5 Program: It’s Broken, When Will It Be Fixed?](#)” (4/5/2018)

escrow account, an invalid mortgage (or two) and a variety of other egregious actions perpetrated upon the investors.

Almost four years after the introduction of the initial reform bill, and a series of failed legislative efforts, the Program is in even greater need of repair than when the reform process began in 2015. Unfortunately, we recognize that Congress neither has the will nor motivation to act, as discussed below. Instead, we expect that the same powerful industry group that has successfully blocked the passage of several EB-5 reform bills (the “Status Quo Group”)<sup>13</sup> will prevent the regulations from being issued. That Group is determined to retain the Program in its current form as long as politically feasible, so that its members may continue to dominate the utilization of EB-5 capital for their development projects. Delay is their strategy. If the Group succeeds, sorely needed broad legislative corrective action will be stifled once again.

Industry’s uproar about the imminent release of regulations may simply be another insincere effort to create a false sense of urgency to generate a surge of immigrant investment activity before supposedly new, more onerous governmental regulations might take effect. This false sense of urgency is deployed by bad actors to persuade potential immigrant investors to make knee-jerk decisions to invest, which often contribute to minimization or elimination of performance of necessary due diligence that might otherwise lead to a different investment decision.

If, as we expect, regulations are not finalized and an EB-5 reform bill is not passed by Congress, we urge prompt legislative or administrative action to at least impose integrity rules, especially strong immigrant investor protections, without further delay. Otherwise, abuses like those perpetrated against the EB-5 investors in the Palm House Hotel matter will likely spread and ultimately destroy a Program that lacks integrity.

## I Background

### A. TEA Abuse and Minimum Investment Amounts

Under current law, an immigrant who invests in a project located in a TEA can qualify for a visa by investing only \$500,000, rather than \$1,000,000. The

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<sup>13</sup> The Status Quo Group consists of certain major developers in Gateway cities, their lobbyists and advocates in Congress. See Friedland and Calderon, NYU Stern School of Business, “EB-5 Prescription for Reform: Legislation or Regulation?” (Draft 6/19/2017)

**\$500,000 differential is known as the “TEA discount”. Unlike conventional investors who seek to maximize their risk-adjusted rate of return, an EB-5 investor’s goal is to secure a visa and thus the investor accepts a minimal interest return on his investment, often at rate of ½ of 1% per annum or less, typically structured as a loan when deployed to the project. Consequently, the immigrant seeks to minimize the amount invested to qualify for the visa. In theory, this is a powerful incentive to invest in areas that are unable to attract conventional capital.<sup>14</sup>**

**However, the TEA incentive has been rendered meaningless as virtually all project locations in the United States qualify, even those located in the most affluent areas, such as Beverly Hills and along Billionaires’ Row in New York City. Thus, there is no incentive for immigrants to invest in the project areas that Congress intended to benefit from the TEA incentive. Given a choice between investing the same amount of money offering the same minimal investment returns in projects being built in the most affluent parts of New York City compared to those being built in rural Idaho or downtown Detroit, almost all investors select projects in New York City and other Gateway cities because they wisely perceive these investments to provide the quickest route to visa approval and recovery of their capital investment.<sup>15</sup>**

**The lion’s share of EB-5 capital investment flows to the largest real estate projects in affluent, urban areas, many of which are sponsored or developed by entities affiliated with the Status Quo Group. However, they rely upon the TEA discount, enabled by a tortured, but legally permissible, use of TEA gerrymandering that is the core of the abuse the Congressional reformers have sought to remedy.<sup>16</sup>**

**This flow of capital deprives underserved areas of EB-5 capital and thus, jobs. The most obvious unintended consequence is that TEA abuse further incentivizes the dominant share of the EB-5 capital to flow to the most affluent urban areas in Gateway cities, rather than to the areas targeted by Congress to obtain the benefit. Thus, the TEA discount works exactly in the opposite manner than Congress originally intended – it benefits those areas and projects least in need of a special incentive.**

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<sup>14</sup> Friedland and Calderon, NYU Stern School of Business, “**EB-5 Prescription for Reform: Legislation or Regulation?**” (Draft 6/19/2017)

<sup>15</sup> Friedland and Calderon, NYU Stern School of Business, “**Reflections on the Senate Judiciary Committee Hearing on EB-5: Time for TEA Reform**” (4/25/2016)

<sup>16</sup> *Id.*

Compounding this, most of that capital flows to large projects in affluent urban areas by well-capitalized developers that, in most cases, would have been funded and built without EB-5 capital and thus, the jobs would have been created in any event. This is often referred to as the “but for” test. This distorted flow of capital is contrary to the TEA incentive, but more importantly, contrary to the overall purpose of the Program – to promote the investment of foreign capital to create jobs that would not have been created in the absence of EB-5 capital. Without the injection of EB-5 capital, the projects in the underserved areas are deprived of the opportunity to be built, and thus to create jobs that would not otherwise be created. The experience of the Program demonstrates that EB-5 capital will naturally flow to the most affluent areas. Certainly, the EB-5 Program has benefitted the U.S. economy and created jobs for U.S. workers, but more jobs would be created, and in these underserved areas, if the TEA incentive operated as intended.<sup>17</sup>

#### **B. EB-5 Reform Bill History**

The EB-5 Program was scheduled to sunset on September 30, 2015, as it is a temporary program that has been extended multiple times since 1993, typically for successive three-year terms. However, rather than simply extend the Program as Congress had done each time it came up for reauthorization in the past, Congressional reformers on the Senate Judiciary Committee decided to seize the opportunity to address much needed reforms. The EB-5 community realized reform was necessary to improve the Program’s integrity and transparency, as well as to reduce the dominance by major real estate developers in New York City and other cities that have thrived in the aftermath of the Great Recession.

Senators Grassley and Leahy co-sponsored and introduced to the Senate Judiciary Committee the original reform bill, S. 1501, on June 4, 2015. The most controversial provision in the bill was a very restrictive TEA definition for projects in urban areas. Apparently, key Congressional leaders were close to reaching a deal on the EB-5 reforms. However, one day prior to the expiration of the EB-5 Program, a few powerful Senators blocked a vote on the bill, and the Program was extended without change until September 30, 2016.<sup>18</sup> Since then, a series of EB-5 reform bills have been formally introduced in Congress or privately

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<sup>17</sup> Friedland and Calderon, NYU Stern School of Business, “[EB-5 Prescription for Reform: Legislation or Regulation?](#)” (Draft 6/19/2017)

<sup>18</sup> Pages 3-8 of Friedland and Calderon, NYU Stern School of Business, “[What TEA Projects Might Look Like Under EB-5 2.0: Alternatives Illustrated with Maps and Data](#)” (rev. 2/6/2016) (Working Draft)

circulated in its halls. Each time, the Status Quo Group has successfully blocked the reform effort.<sup>19</sup>

It is common sense that the greater the TEA discount, the greater the incentive for immigrants to invest in a project located in a TEA. Yet, as the legislative process has dragged on, the Status Quo Group has negotiated a steady reduction in the amount of the TEA discount proposed in the attempted reform bills. The proposed administrative solution represents the only interruption in this process. The watering down of the EB-5 reforms as the legislative process starts and stalls is best exemplified by the steady reduction in the TEA discount. It is noted that a surge of investor activity has occurred immediately before each proposed expiration date with expectation that the investor’s investment amount would be “grandfathered” by then current rules and not be subject to the anticipated, more stringent rules as modified by the latest proposal.<sup>20</sup>

Summary Comparison: Minimum Investment Amount and TEA Spread						
	Existing Statute (Unchanged since enactment in 1990)	S.1501 (introduced June 2015); H.R. 5992 (introduced Sept. 2016)	March 2017 Staff drafts of S.1501 and H.R. 5992	Proposed USCIS Regulations January 13, 2017	Senator Cornyn Draft Bill April 2017	Senators Grassley and Cornyn March 2018 Draft Bill
Non-TEA (standard)	1,000,000	1,200,000	1,000,000	1,800,000	925,000	1,025,000
TEA	500,000	800,000	800,000	1,350,000	800,000	925,000
<b>TEA Discount</b>	<b>500,000</b>	<b>400,000</b>	<b>200,000</b>	<b>450,000</b>	<b>125,000</b>	<b>100,000</b>

As previously mentioned, starting in February 2016, Senators Grassley and Leahy pressed USCIS to promulgate EB-5 reform regulations in case EB-5 legislative reform continued to stall.

<sup>19</sup> Friedland and Calderon, NYU Stern School of Business, “**EB-5 Program: It’s Broken, When Will It Be Fixed?**” (4/5/2018); <https://www.grassley.senate.gov/news/news-releases/grassley-big-money-interests-again-block-reforms-corrupt-eb-5-visa-program>

<sup>20</sup> Friedland and Calderon, NYU Stern School of Business, “**Reflections on the Senate Judiciary Committee Hearing on EB-5: Time for TEA Reform**” (4/25/2016)

### C. Proposed Regulations

Belatedly, USCIS attempted to solve the problem by releasing proposed regulations on January 13, 2017 that, amongst other things, would raise the minimum investment level from \$500,000 to \$1,350,000 for TEA projects and from \$1,000,000 to \$1,800,000 for all other projects. The regulations would also effectively eliminate gerrymandering.<sup>21</sup> Thus, investment in many project locations would no longer qualify for the TEA discount.

As expected, the proposed regulations generated a flood of comments in opposition by industry and potential immigrant investors.<sup>22</sup> Until very recently these regulations had not advanced at OMB.<sup>23</sup> In a paper we released in February 2017, a month after the proposed regulations were released, we suggested that in the very unlikely event they were finalized, such action would undoubtedly prompt legislative compromise finally leading to reform because the investment amounts proposed by the regulations far exceed those proposed in any of the major reform bills.<sup>24</sup>

## II Why the Regulations are Likely to Remain in Limbo or Die

Those who portend that release of the regulations is imminent simply cite that past experience demonstrates regulations have historically been released within 30 to 60 days of reaching the final review stage at OMB. However, these commentators ignore several reasons that past experience is unlikely to have any bearing on future course of these regulations.

First, Executive Order 12866 establishes the procedure by which a draft or proposed regulation is reviewed by OMB's Office of Information & Regulatory Affairs ("OIRA").<sup>25</sup> The Order limits the review period to 90 days and allows for a one-time extension for up to 30 days. However, the Order creates many opportunities for OMB to further delay the review process by empowering the Administrator of OIRA, during the review process, to return the regulations to the agency for reconsideration of some or all of its provisions. The OIRA website explains that "[s]uch a return may occur if the rule is not compatible with the law, *if the quality of the agency's analysis is inadequate*, if the rule is not justified by

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<sup>21</sup> <https://www.federalregister.gov/documents/2017/01/13/2017-00447/eb-5-immigrant-investor-program-modernization>

<sup>22</sup> <https://www.regulations.gov/docketBrowser?rpp=50&so=DESC&sb=postedDate&po=0&dct=PS&D=USCIS-2016-0006>

<sup>23</sup> [https://www.federalregister.gov/uploads/2011/01/the\\_rulemaking\\_process.pdf](https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf)

<sup>24</sup> Friedland and Calderon, NYU Stern School of Business, "[EB-5 Proposed Regulations: A Missed Opportunity, Next Steps for Reform](#)" (Rev. 2/14/2017)

<sup>25</sup> [Executive Order 12866 of September 30, 1993](#)



the analysis, if the rule is *not consistent with the regulatory principles stated in Executive Order 12866 or with the President's policies and priorities*, or if the rule unnecessarily conflicts with other Executive Branch agency rules or efforts... The return letter merely explains why OIRA believes that the rule would benefit from further consideration and review by the agency.”<sup>26</sup> Thus, OMB controls the destiny of the review process which can be never ending.

Secondly, the prediction ignores the influence that the President and his real estate interests and friends might have on the future course of the regulations. It is well known that the Trump Administration is friendly to major real estate interests. Many of the major developers in New York City who dominate the Program utilize EB-5 capital to provide inexpensive, patient gap financing for their real estate projects. They have argued that the higher investment levels would kill the Program by dissuading many immigrants from seeking visas under the Program. Furthermore, if a strict TEA standard were applied, the investment in their projects would not qualify for the TEA benefits. Arguably this would place them at a disadvantage because EB-5 capital would theoretically flow to the project locations originally intended by Congress. However, that assumes that the differential between minimum investment amounts within a TEA and outside of a TEA location is meaningful. But as noted above, the most recent “reform” bill circulated in 2018 contained a meaningless differential.

Similarly, predictions ignore the pivotal dual role that Mick Mulvaney plays in the OMB regulatory review process and achieving the Trump administration's stated goal of cutting regulations. Mr. Mulvaney has been the director of OMB since February 2017, and continues to serve in that capacity,<sup>27</sup> even now that he is the White House acting chief of staff. He has faithfully and effectively implemented the Trump administration's regulatory mission.<sup>28</sup>

Thirdly, since the Status Quo Group and industry were united in their bitter opposition to the most recent legislative proposal that would have lowered the investment amounts and narrowed the spread to a point that would be virtually meaningless, undoubtedly the same group is urging OMB to allow the more

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<sup>26</sup> <https://www.reginfo.gov/public/jsp/Utilities/faq.myjsp> Apparently in recent years, few draft regulations have been returned by OIRA to the agency. See <https://www.reginfo.gov/public/do/eoReturnLetters>; Also see [https://ballotpedia.org/Completed\\_OIRA\\_review\\_of\\_federal\\_administrative\\_agency\\_rules#2019\\_completed\\_reviews](https://ballotpedia.org/Completed_OIRA_review_of_federal_administrative_agency_rules#2019_completed_reviews)

<sup>27</sup> <https://www.whitehouse.gov/omb/>

<sup>28</sup> Reportedly, Mr. Mulvaney has been so effective and faithful his title is on the verge of being elevated to “permanent” chief of staff. See <https://www.politico.com/story/2019/03/19/white-house-mulvaney-acting-chief-staff-1226055>

onerous regulations die a natural death or send them back to USCIS for substantial revision.<sup>29</sup>

We agree that increasing the minimum investment amounts to the levels proposed in the regulations would have an adverse effect on EB-5 fundraising, at least in the short term.

Our public comment to the proposed regulations recommended an alternative TEA solution that would leave the minimum investment amounts at current levels, but strictly enforce TEA designations.<sup>30</sup> More specifically, we have proposed a simple solution: (1) retain the minimum investment levels as set by the statute – \$500,000<sup>31</sup> for TEA locations and \$1,000,000 for locations outside of a TEA; (2) revoke the regulation that delegates TEA designation to the individual states, and vest the authority in USCIS to confirm that TEA status is based on a single census tract. Instantly, TEA status and the TEA discount would be meaningful.<sup>32</sup>

If OMB needs a pretext to effectively kill the regulations, it might challenge the regulations' cost-benefit analysis and adopt industry's argument that the regulations would destroy a Program that has "created" a tremendous number of jobs and spurred economic activity.<sup>33</sup> In reality, the number of jobs created by the Program has been vastly overstated, as consistently pointed out by Senator Grassley.<sup>34</sup> It should be noted that the OMB notice of regulatory review of these regulations states:

**"Economically Significant: No."**

The OMB notice also reiterates that there is no legal deadline.<sup>35</sup>

### III Anticipated Congressional Action in Response to Final Regulations

If, nevertheless, the final regulations are released, we expect legislation will be proposed to counter them before the regulations take effect. However, it

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<sup>29</sup> See pages 10-13 of Friedland and Calderon, NYU Stern School of Business, "**EB-5 Program: It's Broken, When Will It Be Fixed?**" (4/5/2018)

<sup>30</sup> <https://www.regulations.gov/document?D=USCIS-2016-0006-0254>; See page 13-14 of Friedland and Calderon, NYU Stern School of Business, "**EB-5 Program: It's Broken, When Will It Be Fixed?**" (4/5/2018)

<sup>31</sup> 8 INA § 203(b)(5)(C); 8 C.F.R. § 204.6(f).

<sup>32</sup> See page 16 of Friedland and Calderon, NYU Stern School of Business, "**EB-5 Prescription for Reform: Legislation or Regulation?**" (Draft 6/19/2017)

<sup>33</sup> Friedland and Calderon, NYU Stern School of Business, "**EB-5 Program: It's Broken, When Will It Be Fixed?**" (4/5/2018)

<sup>34</sup> *Id.*

<sup>35</sup> <https://www.reginfo.gov/public/do/eoDetails?rrid=128847>

seems doubtful that any legislation – especially concerning immigration - will be passed during 2019 given the extreme polarization in Congress. Even though the EB-5 Program is not on the radar of most members of Congress, it is an immigration program nevertheless, and the leading Democrats have consistently taken the position that “DACA”<sup>36</sup> relief is essential before they will entertain comprehensive immigration reform, or any immigration reform. In 2019, DACA relief does not seem any closer than it did at the beginning of the Trump administration.

However, the EB-5 Program engenders unusual political support across the Congressional aisle. For example, Senate Minority Leader Charles Schumer (D-NY), whose constituents include the powerful New York City real estate lobby, has long been aligned with Senator John Cornyn (R-TX) who was the second ranking member in the Senate, and Senator Ted Cruz (R-TX) in their repeated support of the Status Quo Group’s position. These Senators have consistently resisted many of the reforms proposed by Senators Grassley and Leahy.<sup>37</sup>

In contrast to the EB-5 reform position of Senators Grassley and Leahy (formerly Senate Judiciary Committee Chairman and Ranking Member of the Committee, respectively), we would expect the new Committee Chairman, Lindsay Graham (R-SC), to likely adopt the positions espoused by the Status Quo Group, including the powerful real estate lobby, based on Senator Graham’s loyalty to the President. It would not be surprising if House Committee Chairman Gerald Nadler (D-NY) takes a similar position to that of Senator Schumer.

The political divide in EB-5 reform is not along party lines. It is not even rural versus urban, as some suggest. Instead, the divide is affluent urban areas which has attracted the lion’s share of the EB-5 capital versus the rural and economically distressed urban areas. Ironically, residents of rural areas and certain economically distressed areas represent a substantial segment of President’s Trump political support base.

However, a recent change in the dynamics of the Program might lead the Status Quo Group to favor some EB-5 reforms that this Group previously opposed. For example, the Program faces new challenges as a steep decline in the number of Chinese immigrants who are interested in obtaining an EB-5 visa has resulted in less worldwide demand for the EB-5 visa, and thus less EB-5 capital

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<sup>36</sup> Deferred Action for Childhood Arrivals. See, for example, <https://www.uscis.gov/archive/consideration-deferred-action-childhood-arrivals-daca>

<sup>37</sup> See, for example, [Friedland and Calderon, “EB-5 Proposed Regulations: A Missed Opportunity, Next Steps for Reform”](#) (Rev. 2/14/2017)

available to fund development projects.<sup>38</sup> Perhaps, the industry would welcome an increase in the minimum investment levels, but certainly only at substantially lower amounts than set by the proposed regulations. Theoretically, the increase in the minimum investment amount per investor would result in a greater amount of EB-5 capital raised from a fewer number of investors.

## IV Palm House Hotel Debacle

The egregious actions permeating the Palm House Hotel EB-5 capital raise rival, and maybe surpass, the fraud and other abuses committed in the numerous EB-5 fraud actions to date.<sup>39</sup> Fittingly, the acquisition of the hotel by the EB-5 project developer, Bob Matthews, originated with a fraudulent transfer, as recently determined by the US Bankruptcy Court in connection with the bankruptcy case pending against the entity that owns the hotel.<sup>40</sup> As discussed below, this was the second acquisition of the same hotel by Matthews who originally acquired the hotel in 2006 but lost it in a “friendly” foreclosure sale in 2009.<sup>41</sup>

The facts surrounding this unfortunate course of events make it abundantly clear that this was purely a preconceived plan to deceive unsophisticated immigrant investors and misappropriate their funds. A mere review of the facts illustrates the scope of the abuses.<sup>42</sup> These facts form the basis of a myriad of legal actions discussed below.

### A. Facts

Joe Walsh, a self-proclaimed entrepreneur who held himself out as having experience in immigration and EB-5 projects, owns and operates the South Atlantic Regional Center (“SARC”).<sup>43</sup> SARC sponsored the renovation of the Palm

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<sup>38</sup> See <https://blog.lucidtext.com/2019/01/07/fy2018-eb-5-visas-by-country/>

<sup>39</sup> Friedland and Calderon, NYU Stern School of Business, “**EB-5 Securities: New Developments & Updated NYU Stern Database 2018 Edition**” (10/21/2018); Friedland and Calderon, NYU Stern School of Business, “**Understanding EB-5 Securities - NYU Stern Database of SEC EB-5 Securities Enforcement Actions**” (Draft 12/9/2017)

<sup>40</sup> [Bankruptcy Court Order Setting Aside Mortgage](#)

<sup>41</sup> [Matthews Response to USCIS RFE 3/17/2014](#)

<sup>42</sup> The facts are gleaned from a review of the documents in the various state and federal court actions filed in connection with this matter. Some of the facts are based on court decisions. Other facts are based on actions filed by the SEC or Department of Justice. And still others are based on the EB-5 investors’ court papers, which, as mentioned in this discussion, have been validated by the governmental actions.

<sup>43</sup> SARC’s other projects, including a business park in Royal Palm Beach, Florida is also mired in EB-5 fraud claims. The property is in foreclosure. *Chen v. Walsh*, Case 1:18-cv-23894-KMM, (SD FLA, 09/20/2018); <https://therealdeal.com/miami/2018/09/26/eb-5-investors-allege-fraud-in-royal-palm-beach-office-project/>

House Hotel by Bob Matthews, an experienced Florida real estate developer. Matthews and Walsh were unrelated and had no prior business relationship.

From 2012 to 2015, Walsh raised \$45.5 Million in EB-5 capital from 91 investors from China, Turkey and Iran, among other countries.

The offering materials contained representations that Matthews, the developer, had contributed \$22 Million in equity capital and that a bridge loan had been issued or would be issued by a local bank to provide interim financing for the hotel project. However, Matthews did not provide any equity capital.

The documents provided that the funds provided by each immigrant investor would be held in escrow until after the USCIS granted approval of each investor's I-526 petition, the first stage in the immigration process.<sup>44</sup> The funds would then be released from escrow to the EB-5 investment entity controlled by Walsh, the owner of SARC. The EB-5 funds were purportedly designed to replace the bridge loan funds to be used to provide the interim financing while the EB-5 immigration petitions were being processed by USCIS. However, the bridge loan was another fiction – it never existed and was never made.

Sales materials misrepresented that construction was ongoing, and that various celebrities including Tony Bennett, Eric Schmidt and Celine Dion had committed to club membership. Notably the sales material stated that Donald Trump and Bill Clinton were members of the hotel's advisory board.

What was not disclosed is more relevant. Bob Matthews had acquired the hotel in 2006 but lost it in a foreclosure in 2009 when it was acquired by local financier Glenn Straub who took ownership through his entity, 160 Royal Palm, LLC (the "Hotel Entity"). In 2013, Straub entered into a contract of sale to sell the hotel back to Matthews for \$36 Million, payable \$9 Million cash with a \$27 Million purchase money mortgage loan.

Prior to closing, the contract was amended to grant Matthews the option to purchase Straub's 100% equity interest in the Hotel Entity, on comparable price terms and conditions. Matthews elected to purchase Straub's equity interest. At the August 2013 closing, EB-5 investor funds were improperly used to acquire Straub's equity interest, which resulted in Matthews' newly formed entity – Palm House LLC – becoming the owner of Straub's equity interest in the Hotel Entity. The Hotel Entity issued to Straub's LLC a note in the amount of \$27 Million secured by a mortgage against the hotel.

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<sup>44</sup> During the fundraising period, the popularity of the Program had begun to soar, resulting in longer waiting periods for review and approval of visa petitions.

Inexplicably, the mortgage was not recorded until 7 months after the closing, in March 2014. Within three months after the closing, Straub's LLC claimed the Hotel Entity defaulted on the mortgage. It is notable that the only three mortgage payments that the Hotel Entity made were improperly taken from EB-5 investors' funds, rather than provided by funds from the Hotel Entity. Ultimately, Straub's LLC commenced mortgage foreclosure proceedings in Florida state court. Subsequently, a receiver was appointed by the court.

The EB-5 investors allege that Walsh's SARC originally had an escrow account at SunTrust Bank in connection with other EB-5 projects. By the time of the Palm House project, SARC had instead opened a fake escrow account at PNC because Walsh was frustrated by SunTrust's strict adherence to the terms of its escrow account. The Palm House EB-5 investors' funds were deposited into the "fake" escrow account at PNC – in reality, merely a business checking account - and transferred at will by Walsh and facilitated by the vice president of the local PNC branch.

Almost all of the investors' funds were misappropriated – some by Walsh, the Regional Center operator, and the balance by Matthews, the developer, and other alleged fraudsters. Substantially all of the EB-5 investors' proceeds never reached the project. Accordingly, each of the investor's I-526 visa petitions was denied by USCIS and denied again on appeal.

## **B. Series of Legal Actions**

1. Civil action by EB-5 investors: In 2016, the EB-5 investors filed a civil action in federal District Court against the Regional Center operator, the developer and numerous other parties.<sup>45</sup>

Typically, even if an EB-5 investor strongly suspects that his funds have been misappropriated or are likely to be misappropriated, he will be reluctant to file a claim with the USCIS or the SEC or to file a lawsuit against the bad actors. The investor is concerned that, based on USCIS policy, the pursuit of either alternative might cause him to become ineligible to pursue the visa based on his original investment.<sup>46</sup>

However, in this case, the EB-5 investor faced a dilemma that the conventional investor does not. The immigration risk might cause some EB-5 investors to delay reporting a claim or filing a lawsuit. The delay affords the bad actor additional time to divert more investor capital to remote locations – often

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<sup>45</sup> [Palm House Complaint with exhibits](#); Lan Li v. Joseph Walsh, Case No. 9:16-cv-81871 (SD FLA,11/14/2016)

<sup>46</sup> Page 40 of Friedland and Calderon, NYU Stern School of Business, "[Understanding EB-5 Securities - NYU Stern Database of SEC EB-5 Securities Enforcement Actions](#)" (Draft 12/9/2017)

overseas - increasing the likelihood that the investor funds will be lost forever, or at least further jeopardizing recovery of the funds.

The investors in the Palm Hotel case did not face the dilemma posed by the potential impact of the lawsuit upon the processing of their visa petitions. The immigration process had effectively ended. Every I-526 petition had been denied based on the project (rather than the source of investor funds), and the appeal was likewise denied.

The Palm Hotel situation provides an example of the threats bad actors might make to discourage the investors from taking legal action. In the Palm Hotel complaint, the investors allege that Walsh, the Regional Center operator, had previously discouraged them from reporting a claim to the government because such act would adversely impact their immigration petitions and allow their children to “age out,” thus losing their green card eligibility.

Typically, the investors whose funds have been misappropriated would prefer that the SEC file the lawsuit, if one is to be initiated. The investors are likely to perceive the SEC to be more skilled and experienced. In addition, the investors would prefer to avoid the litigation expenses. The investors might also have difficulty in assembling a group of unrelated individuals from various countries to join in a lawsuit and agree upon a course of action. However, the EB-5 investors in the Palm House matter were unwilling to wait and see if the SEC would act, and further jeopardize the recovery of their funds.

2. Matthews files for personal bankruptcy: In March 2017, Matthews personally filed for bankruptcy to obtain the benefit of a bankruptcy stay and prevent foreclosure of his mansion in Palm Beach, Florida.<sup>47</sup> The bankruptcy auction of Matthews’ mansion is scheduled to occur on March 28, 2019. The minimum bid price is \$31 Million.

3. DOJ obtains criminal indictments: More importantly, in March 2018, indictments were obtained by the Department of Justice in coordination with the FBI as brought by the US Attorney’s Office (“DOJ”) against Matthews and three other individuals, including 20 counts of wire fraud and mail fraud by Matthews. Two other defendants pled guilty and face a prison sentence of 20 to 30 years, fines and restitution. In August 2018, a superseding indictment was issued against Matthews to add tax evasion counts against him and his wife, Mia Matthews.<sup>48</sup>

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<sup>47</sup> *In re Matthews*, No. 17-23426 (Bankr. S.D. Fla., filed Nov. 6, 2017))

<sup>48</sup> <https://www.justice.gov/usao-ct/pr/real-estate-developer-wife-charged-tax-evasion>; The criminal case is pending in the U.S. District Court for the District of Connecticut, Case No. 3:18-cr-00048-VAB.

Despite significant allegations in the investors' complaint of fraud and misappropriation of investor funds, Walsh (the owner-operator of SARC), issued a press release hailing the indictment of Matthews as a vindication of Walsh's claim of innocence.<sup>49</sup>

4. **Ch. 11 bankruptcy petition filed by Hotel Entity:** On August 2, 2018, the state court receiver filed a Chapter 11 bankruptcy petition on behalf of the Hotel Entity, as debtor-in-possession.<sup>50</sup>

An affiliate of The Related Companies (the company that has raised the greatest amount of EB-5 capital in the history of the Program)<sup>51</sup> made a "stalking horse bid" in the amount of \$32 Million.

The auction of the hotel was delayed several times. In early 2019, London + Regional Properties ("London Properties"),<sup>52</sup> an international real estate firm emerged as a competing bidder. An auction was held on March 8, 2019, as discussed below.

5. **SEC files enforcement action:** On August 3, 2018, the SEC filed an enforcement action against Matthews, Walsh, as well as Walsh's SARC and related EB-5 investment entity,<sup>53</sup> alleging fraud and misappropriation of funds.<sup>54</sup>

Both the SEC and DOJ actions validate the investors' claims by repeating many of the same allegations as were set forth in the investors' complaint. These cases are proceeding in the court system. The SEC has not yet sought the appointment of an equity receiver to seek recovery of the misappropriated assets.

This case represents a disturbing recent trend in which EB-5 investor fraud occurs despite the supposed "independence" of the regional center and NCE manager, on the one hand, and an unrelated developer who controls the project entity, on the other hand. The SEC enforcement action and the federal indictment in this case illustrate that this scheme to misappropriate the investors' funds by the unrelated regional center and developer can be just as egregious as the numerous cases where one individual owns and controls the regional center,

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<sup>49</sup> Here is a link to the press release: <https://www.marketwatch.com/press-release/a-significantoutcome-has-been-achieved-for-investors-in-the-palm-house-hotel-by-usreda-sarc-and-its-companies2018-03-19>. The Matthews' indictment focused on transactions that occurred in Connecticut. Walsh did not have any connections there. The SEC complaint filed a few months later focused on both Walsh and Matthews.

<sup>50</sup> *In re: 160 Royal Palm, LLC, Case No. 18-19441 (Bankr. S.D. Fla., filed 8/2/2018)*

<sup>51</sup> See page PS-1 of Friedland and Calderon, NYU Stern School of Business, "**EB-5 Project Database: 2017 Supplement with Trends and Observations**" (Draft 8/16/2017)

<sup>52</sup> <http://lrp.co.uk/about-us/>

<sup>53</sup> Palm House LLLP is the New Commercial Enterprise managed by Walsh and his regional center.

<sup>54</sup> **SEC enforcement action Palm House Hotel;** <https://www.sec.gov/litigation/litreleases/2018/lr24224.htm>



**EB-5 investment entity (new commercial enterprise), and developer.<sup>55</sup> It also adds an additional layer of collusion - between unrelated parties - not present in the prior self-dealing EB-5 fraud cases brought by the SEC.<sup>56</sup>**

### **C. Key Recent Events in the Bankruptcy Court Action**

#### **1. Invalidation of Straub LLC's mortgage**

**In anticipation of the upcoming bankruptcy auction, the Hotel Entity (the debtor in the bankruptcy case) sought to prevent Straub's LLC from bidding at the auction. By this time, the mortgage debt had allegedly grown to almost \$40 Million. Straub sought an order to confirm that his LLC was entitled to credit bid the amount of the outstanding loan balance at the upcoming auction.**

**The Bankruptcy Court's order reached an unusual result in a mortgage holder's claim to credit bid. The Court ruled that Straub's LLC mortgage and the recording of the mortgage were fraudulent transfers under Florida law. Thus, the LLC was not entitled to credit bid. Moreover, the Court ruled that the claim against the bankruptcy estate stemming from the mortgage was valued at \$0 for all purposes of the bankruptcy.**

**The court emphasized that, based on the restructured sale, the Hotel Entity owned the hotel before and after the sale of Straub's equity interest. However, the Entity was straddled with a mortgage and other liabilities after the sale that exceeded the value of the hotel.<sup>57</sup>**

#### **2. Bankruptcy sale of the hotel**

**On March 8, 2019, the Bankruptcy Court order approved the sale to an affiliate of London Properties for \$39.6 Million, plus various other fees.<sup>58</sup> The Court rejected Straub's last-minute bid that rivaled the offer, pointing out that this offer was made too late.<sup>59</sup> The closing date for the sale has not been set.**

**The Court determined that creditors have secured claims totaling \$8.8 Million against the Debtor's estate, although it is expected that some of these claims will be challenged by the Debtor or the EB-5 investors. The EB-5**

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<sup>55</sup> See Appendix A, Updated Database of SEC EB-5 Enforcement Actions, Friedland and Calderon, NYU Stern School of Business, "[EB-5 Securities: New Developments & Updated NYU Stern Database 2018 Edition](#)" (10/21/2018)

<sup>56</sup> Friedland and Calderon, NYU Stern School of Business, "[EB-5 Securities: New Developments & Updated NYU Stern Database 2018 Edition](#)" (10/21/2018)

<sup>57</sup> On March 12, 2019, Straub's LLC filed an appeal in the US District Court challenging the validity of the Bankruptcy Court order invalidating the mortgage and determining the amount of his LLC's claim against the bankruptcy estate. In connection with the appeal, Straub sought a stay of the order approving the sale of the hotel. These motions were denied. [Bankruptcy Court Order Motion to Stay Orders re Sale](#)

<sup>58</sup> As of March 20, 2019, the Order was not available. However, the March 14, 2019 Order referenced in the preceding footnote describe the sale approved on March 8, 2019.

<sup>59</sup> [Bankruptcy Court Order Motion to Stay Orders re Sale](#)

investors' claims total approximately \$36.5 Million in principal investments, which are unsecured. The Bankruptcy Court determined that even though the EB-5 investors' proceeds were not invested directly in the Hotel Entity (the debtor), the investors have an equitable lien claim in these assets because the assets were fraudulently misappropriated by the developer and regional center.

#### **D. New Claim Recently Filed Against PNC, the Bank Escrow**

On March 4, 2019, 42 of the EB-5 investors filed an action in Florida state court claiming that PNC Bank and one of its vice presidents aided and abetted Walsh and his Regional Center by creating the "fake" escrow account.<sup>60</sup> Since the complaint was filed by the EB-5 investors and no answer has been filed yet, a further analysis of this case is premature.

Although few lawsuits have been filed against EB-5 bank escrows, the fear of these suits contributes to the unwillingness of most banks to offer EB-5 escrow accounts. However, in the infamous Jay Peak EB-5 fraud case, the Jay Peak receiver, on behalf of the EB-5 investors, sued Raymond James Financial for aiding and abetting the fraud perpetrated against the investors in connection with the maintenance of an EB-5 escrow account. Raymond James settled this suit by paying \$150 Million.<sup>61</sup>

This case and the Jay Peak action are likely to cause even fewer banks to offer EB-5 escrow accounts and related services. Presumably, at a minimum, these cases will cause banks to re-evaluate their internal controls to make sure they have installed, and continue to implement, procedures to monitor the activity of the escrow account, as well as to seek to ensure that the flow of investors' funds and other activities comply with the escrow agreement, other governing documents as well as applicable law.

#### **E. Alternative Sources of Recovery for the EB-5 Investors**

Although the EB-5 investors' dream of acquiring a visa has vanished, they have several potential sources of recovery of their capital investments.

- (1) Proceeds from the sale of the hotel pursuant to the Bankruptcy order.
- (2) The main remedy sought in the SEC enforcement action is recovery of the bad actors' "ill-gotten gains," which are typically directed to the injured investors.

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<sup>60</sup> [Complaint filed against PNC Bank et al.](#)

<sup>61</sup> <https://jaypeakreceivership.com/wp-content/uploads/2017/04/SIGNED-Settlement-Agreement-with-Exhibits-12.pdf>; [https://jaypeakreceivership.com/wp-content/uploads/2017/05/41810676\\_1-2.pdf](https://jaypeakreceivership.com/wp-content/uploads/2017/05/41810676_1-2.pdf);

- (3) Even though the DOJ action is a criminal proceeding, a prime remedy sought by the restitution from the EB-5 actors. This might result in a greater financial recovery than the SEC civil action.<sup>62</sup>
- (4) Proceeds from the sale of Matthews' mansion. The amount of the recovery depends on the ultimate sales price and competing claims of creditors.
- (5) A court award in the PNC action for aiding and abetting the fraud.

EB-5 investors in many other fraud cases have not been so "fortunate."<sup>63</sup>

## V Immigrant Investor Protections Needed Now More Than Ever

It is frustrating that the Palm House Hotel debacle could have been avoided if investor protections were in place of the type proposed by recent EB-5 reform bills.<sup>64</sup> However, the Status Quo Group has repeatedly objected to these provisions, although not as vigorously as they objected to the reform measures to eliminate TEA abuse. Responding to mounting reports of securities and investor fraud involving the EB-5 Program, the EB-5 reform bills, in addition to addressing TEA reform, have attempted to improve the Program's integrity.

We applauded the Congressional reformers for boldly adding an Account Transparency section to the reform bill that was introduced in September 2016 as H.R. 5992.<sup>65</sup>

The provision would have imposed new controls on the flow of EB-5 investor funds. Account Transparency addresses actual fund administration, the area where the recent abuses have surfaced. It aims to (1) deter principals of the Regional Center and related entities from misappropriating EB-5 investor funds; (2) promote early detection by USCIS, investors and third-party inspectors of any unlawful diversion; and (3) enhance government enforcement, discovery and recovery of the misappropriated funds.

The lack of transparency that permeates the Program makes it extremely difficult to ascertain the level of fraud that actually exists. Several factors

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<sup>62</sup> Pages 28 to 31 of Friedland and Calderon, NYU Stern School of Business, "[EB-5 Securities: New Developments & Updated NYU Stern Database 2018 Edition](#)" (10/21/2018)

<sup>63</sup> Appendix A, Updated Database of SEC EB-5 Fraud Enforcement Actions, Friedland and Calderon, NYU Stern School of Business, "[EB-5 Securities: New Developments & Updated NYU Stern Database 2018 Edition](#)" (10/21/2018)

<sup>64</sup> Obviously, the fraud in the Palm House case occurred before the reform bills were introduced.

<sup>65</sup> H.R. 5992 was the House companion bill to S.1501 introduced by Chairman Goodlatte of the House Judiciary Committee (R-VA) with the strong support of Senators Grassley and Leahy.

contribute to the opaqueness: minimal disclosure required by the EB-5 law; lax enforcement by USCIS until recently; the secrecy surrounding the substantial financial savings to developers as well as lucrative fees earned by regional centers and migration agents; the extreme vulnerability of EB-5 investors to fraud; the unwillingness of many members of industry to self-police; the absence of government mandated internal controls; and the lack of an independent watchdog.

The Account Transparency section represented the first legislative attempt to address the misappropriation of funds and other fraudulent actions that have infected the Program. It would be a misnomer to refer to the reform bill as tackling integrity if this type of provision were omitted. A later version of the reform bill released in March 2017 revised the provision to also impose independent fund administration guidelines based on similar principles.<sup>66</sup>

Thus, it was disturbing that the first draft of the March 2018 draft bill glaringly omitted account transparency and fund administration provisions. Fortunately, the revised March 2018 draft inserted “Fund Administration Guidelines.” This one paragraph provision was apparently drafted in haste as no similar provision had appeared in previous reform bills or drafts.<sup>67</sup>

Passing an EB-5 reform bill that includes the “Account Transparency Requirement” would demonstrate a commitment to truly restore integrity to the Program. The Account Transparency Requirement would be the most important of the integrity and investor protections advanced by any of the reform bills.

Transparency and full disclosure are the foundations of the Federal securities laws. From the EB-5 Program’s inception in 1990 until circa 2009, the industry did not even recognize that the immigrant’s investment constituted a security for purposes of Federal securities law. The SEC did not focus on the Program until the use of EB-5 capital became a mainstream capital source after the financial crisis. The first SEC enforcement action was not filed until 2013, more than 20 years after the Program was first established.<sup>68</sup> Furthermore, USCIS does not scrutinize the investor’s actual flow of funds until the final stage of the EB-5 visa process, after the I-829 petition is filed and several years after the immigrant’s funds are invested.

Nevertheless, we do not see any reason to be optimistic about the prospects for EB-5 reform legislation to be passed in the foreseeable future. The

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<sup>66</sup> See Friedland and Calderon, NYU Stern School of Business, “[EB-5 Program: It’s Broken, When Will It Be Fixed?](#)” (4/5/2018)

<sup>67</sup> *Id.*

<sup>68</sup> See also, [https://www.sec.gov/investor/alerts/ia\\_immigrant.htm](https://www.sec.gov/investor/alerts/ia_immigrant.htm)

**current political environment allows the Status Quo Group to unilaterally create a stalemate, and continue the status quo, which for the Group is preferable to any reform.**

**In the interim, the Status Quo Group continues to accomplish its objective. Delay proves to be a successful strategy, while Congress and USCIS allow a broken Program to operate without a fix. A revised reform bill that at a minimum addresses needed integrity reforms should be formally introduced in Congress so that it can be viewed by all with input provided by a wider range of voices than those who seek to weaken reform.**

**Just as legislation inevitably produces winners and losers, the lack of EB-5 reform produces winners and losers - but certainly the winners are clearly not those intended by the reformers. Maintaining the status quo provides further opportunity to raise low cost EB-5 capital under the old rules. More importantly, no controls are imposed to detect EB-5 fraud by bad actors and invites fraudulent activity that imperils the future of the Program. As the title of this article indicates, if the Palm House Hotel debacle does not prompt Congress to introduce integrity to the EB-5 Program, what will?**