Franchise Times®

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Immigrant Attraction

EB-5 program is creative route to capital, but there are hoops

By Dennis L. Monroe

The franchise community has been developing unique tools to secure additional capital. One exciting approach is the use of the EB-5 program (better known as "buying a Green Card"). This legislation was enacted in 1990 to stimulate the U.S. economy through job creation and capital investment by foreign investors.

The EB-5 program provides permanent legal residence to an immigrant who will invest either $500,000 or $1 million in a U.S. business that creates 10 verifiable, new, full-time jobs for U.S. citizens or legal residents. The 10-new-job requirement is upheld stringently in cases where the investors target a stand-alone business. A less demanding—and more popular—option allows investors to invest in so-called Regional Centers, entities created by business owners to promote economic growth in a designated geographical area. In these cases both direct and indirect job creation within the area will count toward the EB-5 requirement.

Aside from making separate, individual investments, EB-5 investors can pool their funds to invest in an enterprise, again with the object of creating at least 10 new jobs per pool member. All jobs created by a pooling arrangement are distributed evenly among investors.

The EB-5 program has attracted a number of investors from Asia—mainly China, South Korea and Taiwan—and has enjoyed considerable success in the hospitality industry. We've seen franchisors who are willing to take the initiative and use the EB-5 program for their franchisee development, actively seeking out groups that can secure the appropriate type of foreign investors.

The franchisor needs to engage, and be involved with, a financial group that has expertise in securing funding under the EB-5 program (the "promoter"). This promoter, with its attorneys, will then put together the appropriate securities offering in the form of a private placement to secure and receive the funds.

The investment vehicle needed to satisfy the EB-5 requirements can take various forms, but the structure I have seen for a franchisee business is a low-interest-rate debt instrument that comes due after five years. The funds received through the private placement are directly invested in the franchisee entity, and these funds are used for any real estate, equipment and soft costs.

In addition to the low-rate debt, the foreign investor normally receives an equity interest in the investment vehicle, which is the franchisee. This franchisee investment entity, which owns the assets, would then enter into an agreement with an operator who is approved by the franchisor for operating the franchisee entity. Normally the operating partner receives a management fee and percentage ownership in the entity, and is obligated under the franchise agreement.

This approach provides the franchisor with a good source of franchisee investment to open stores. The franchisor also maintains control by making sure the operating partner is an approved operator for the franchise concept.

One of the most important parts of the process is the development—site selection, construction and store opening. This process is often overseen by the operating partner within the franchisor's normal approval framework. The foreign investor usually does not have an active role in this process, but remains merely an investor.

This approach is similar to what the franchisor needs to do with private equity investors who have a significant say, particularly the right to remove the operator with the approval of the franchisor. Like private equity, the EB-5 investors will not go on the hook for the franchise obligations. The franchise agreements need to be modified to provide for a five-year walk-away if the enterprise is not working out. This can be coupled with the right of the franchisor to take those sites or possibly give the operating partner a right to take over these stores.

Given the above structure, there are a lot of hoops that need to be jumped through. Securing an attorney who is familiar with and involved in the EB-5 program is necessary. In addition, it is necessary to have full compliance with the various security laws (both private placement and credit investor) and potential state filing requirements. This is a securities offering, and the fact that there is a foreign investor gives rise to additional hoops along the way.

Here is the timeline for the EB-5 investor: In most cases, the immigrant investor will be investing in a shelf-ready investment put together by the promoter or the franchisor. There is a three- to six-month waiting period for investor approval. Once approved, the investor has six months to land in the United States. A filing is required within 20 to 24 months after landing. The permanent U.S. visa approval is 10 to 12 months after the filing of the proof of job creation.

Franchisors need to continue to look at alternative sources of financing to grow their system, and the EB-5 program may be a good fit, particularly if the franchise is one that has a lot of bricks, mortar and significant investment. Think of the EB-5 program as a cheap way of gaining the potential investment dollars with minimal strings attached for the operator and the franchisor. FT

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