5. Capacity

It is the ability of the business to operate successfully and generate the cash needed to repay obligations as they come due. Capacity is determined by assessing whether there is sufficient financial strength and adequate resources to start, maintain and to profitably expand operations. Inherent in "Capacity" is the assessment of business plans that claim to develop cash flows that will achieve pre-defined business ratios. For example, a Debt- Coverage-Ratio ("DCR") in excess of 1.25 is considered by almost all capital providers (banks, venture capitalists, lenders, investors, etc.) as the minimum acceptable ratio. Therefore, a DCR of less than 1.25 would be considered risky.

Lender’s Commentary: From a lender’s perspective, we look to repayment ratios to determine financial ability to make the payments - as agreed in the loan or investment documents. We need to see a debt coverage ratio of at least 1.25. This means that the project will have at least 25% more income (EBIDTA) than required to make the debt or investment payments. A preferred (less risky) coverage ratio would be 1.4. A coverage ratio of 1.6 and above would be considered excellent – (lower risk). See table above for an example of DCR computation.

Additionally, we look at the Operations and Maintenance (O & M) budgets to assess if they are adequate. Also, projects that do not create and adequately fund a replacement reserve will eventually have lots of deferred maintenance issues.

Deferred maintenance creates a very problematic cycle that includes: the property starts looking old, dirty and tired, tenants or customers leave, new tenants or customers require price concessions, less money is available for the O & M / reserves. As the property deteriorates, the Capacity (cash flow) to make the financing payments becomes suspect and the Collateral value diminishes quickly.

EB-5 Investor guidance: Generally speaking, the project’s Capacity to make the payments due the financing sources is directly tied to the operational success of the project. One of the most challenging assessments for a lender is to test all the business and financial plan assumptions to determine if they are reasonable and prudent. Many developer plans will underfund start-up costs, such as: marketing programs, the reserves for the initial operating deficit, working capital, etc. Further, they will often not be conservative enough on the time (and costs) between start-up and stabilization. If the project is thinly or even adequately capitalized and there is a cost overrun on the construction or a delay, some
Capacity = strong customer demand for project or service with good margins of the funds can (and often do) get reallocated. This can have dire consequences on the project’s later financial stabilization period, payment capacity and even job count.

Bottom line: Study all the revenue and expense Assumptions. Challenge them and do not invest in a project if you are not 100% convinced in the revenue assumptions and the timeline projections. If the revenue does not materialize on time, your jobs will be at risk, and so will your Green Card.

In addition to the traditional five C’s of Credit Analysis, there are two additional C’s that need to be evaluated. In many ways, they are unique to an EB-5 investment. They are:

1. The need to ensure that 10 jobs are created for every $500,000 EB-5 investment - within a 24 month period, and;

2. The need to ensure a viable exit (repayment) plan within 3 - 5 years, starting when the investment is put into the project.