

Impact Investing with Solomon Hess Capital Management



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Solomon Hess Capital Management's 2017 Impact Report is now available for download at www.SolomonHess.com. This report highlights the quantifiable impact that the Solomon Hess SBA Loan Fund has made in low, moderate and otherwise economically distressed communities nationwide.

Solomon Hess Capital Management's ("Solomon Hess") expertise analyzing and evaluating SBA 7(a) loans provides our bank investors with targeted CRA-eligible investments AND offers social impact investors the ability to invest in a way that aligns with their values and supports their community development impact priorities. *(continued on page 3)*

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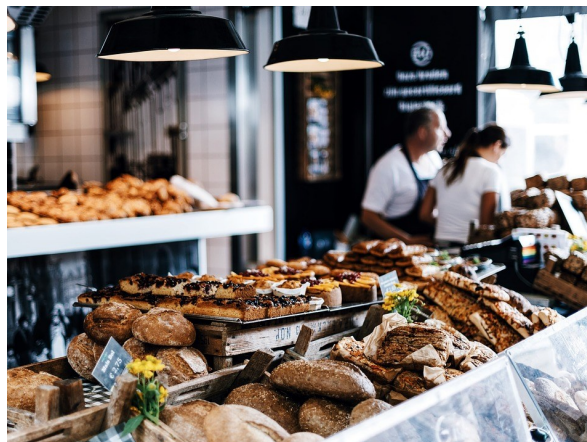
Treasury's Recommendations to the CRA Spur Positive Movement towards Modernization

The U.S. Department of Treasury's release of recommendations to improve the Community Reinvestment Act ("CRA") on April 3 was met with optimism and praise by bankers, regulators and industry representatives who agree that a modernization of the CRA is long overdue. The report makes recommendations in four key areas of the CRA but stops short of identifying specific proposed amendments. A revised and updated CRA framework is still a work in progress and will require further input from constituents. "This report by

Treasury is a good starting point that we will build upon," said Grovetta Gardineer, Senior Deputy Comptroller for Compliance and Community Affairs, Office of the Comptroller of the Currency ("OCC"), at the National Community Reinvestment Coalition Conference on April 9.

The CRA was first enacted in 1977 to ensure that banks serve the needs of the communities they are in and to specifically ensure that low income borrowers have access *(continued on page 2)*

SBA Loan Fund Profile: Brake Bread in Saint Paul, Minnesota



The SBA 7(a) loan to Brake Bread qualifies for CRA as the borrower is located in a moderate income census tract and a CDFI Fund Qualified Investment census tract. This business provides an added community benefit of being focused on environmental sustainability in its business practices. Being a bicycle based subscription service, Brake Bread is a carbon free food delivery service. Moreover, it is committed to becoming a zero waste bakery. Its current weekly garbage is the equivalent of a two-person home. *Left, a bakery.*

An example of the type of loans in the SBA Loan Fund portfolio is the loan to Brake Bread, a bakery committed to building community through sustainable practices in Ramsey County, MN. The bakery focuses on crafting naturally leavened bread and each batch begins with a handful of wild yeast and ends 36 hours later in a loaf pulled from a stone deck oven. Naturally leavened bread provides easier gluten digestion, access to more vitamins and minerals and has a lower glycemic index

for an even release of energy.

Brake Bread was started as a bicycle delivery service by two musicians, Micah Taylor and Nate Hogue. They sold weekly subscriptions for their naturally leavened loaves and pedaled them straight to customers' doorsteps. The bricks and mortar storefront was established in 2016, where a full selection of naturally leavened bread, pastries, and cookies are sold as well as a selection of beverages. *(continued on page 2)*

Treasury's Recommendations (from page 1) to the financial system. The CRA regulations, which establish the framework and criteria for assessing a bank's CRA record, were last revised in 1995. Treasury's goals in developing the current recommendations are to better align the CRA activity with the organizational and technological changes that have reshaped the financial industry and to reduce the costs and complexity of complying with the CRA.

Treasury's report focused on four key areas, the first of which is **to update the definitions of geographic assessment areas to reflect the changed and changing nature of banking**. Treasury advocates for a framework that not only includes areas where the bank is physically located, but also low and moderate income ("LMI") communities outside of where the bank has its physical footprint, and in areas where the bank accepts deposits and does substantial business. Treasury believes that this approach could be applied effectively to traditional banking organizations using alternative delivery channels, wholesale and limited purpose banks and emerging "branchless" banks.



"We want to have a measuring system so there is no doubt about whether banks are in compliance," said Joseph Otting, Comptroller of the Currency, at a securitization industry conference in Las Vegas on February 27. Left, Otting.

The second recommendation raised by Treasury is **to improve the transparency of the CRA evaluation process by providing predictability on what activities will garner positive consideration** prior to a bank's next assessment period. As currently implemented, CRA eligibility determinations are subject to vague and inconsistent interpretations and the long time lag between the exam period and the release of CRA ratings compounds this lack of clarity. Treasury advocates for a framework that includes an expansion in the types of loans, investments and services eligible for CRA credit and that establishes the standards of eligibility with greater consistency and predictability across all 3 regulators.

Third, Treasury offers recommendations **to incorporate less subjective CRA evaluation techniques by establishing clear criteria for grading CRA loans, services and investments**. Treasury advocates that actual "measurement" of CRA activity be reportable in a clear manner like other regulatory standards such as liquidity, capital and leverage. Treasury believes that this approach would allow banks to provide regular updates on CRA performance to the regulators and the public, while at the same time subjecting them to much clearer accountability rules.

Fourth, Treasury proposes **to incentivize bank performance by limiting CRA evaluation downgrades to CRA related**

In its report as an additional issue warranting further exploration by the CRA regulators, Treasury recommends that community development loans receive the same annual consideration as community development investments. Currently, community development loans are counted toward the credit in the year originated whereas community development investments made by those same banks are counted each year that the investment is held. Banks receive CRA credit for community development investments reported during prior assessment periods that remain outstanding at the end of the current assessment period. Banks and community advocates agree that LMI borrowers benefit from access to longer term loans and that the CRA discourages banks from making loans that extend beyond one exam cycle.

Small Business Profile: Brake Bread (from page 1) The company continues to offer subscription services and can also be found at the Midtown Farmers Market every Saturday. In addition to serving the community, Brake Bread also serves a number of wholesale customers such as Mississippi Market and Evan's Organic Eatery.

Environmental sustainability is a core tenant of Brake Bread's business model. It is working towards becoming a zero waste bakery. It is a carbon free food delivery service. With the addition of the storefront, Brake Bread transitioned to

lending violations only. In recent years, a number of large banks received downgrades of CRA ratings due to violations of consumer protection laws. Treasury recommends that the Federal Reserve Board ("FSB") and the Federal Deposit Insurance Corporation ("FDIC") follow the lead of the OCC in this area. On October 12, 2017, the OCC issued an update to its Policies and Procedures Manual to ensure that banks are not penalized in their CRA assessments for practices unrelated to CRA lending activities.

Treasury's report clearly supports the OCC's efforts in spearheading CRA reform. Otting has made CRA reform one of his immediate priorities and while he is pushing to fast-track the process, delays may be incurred to garner interagency collaboration and support. **Next up will be the release of the Advanced Notice regarding CRA**, hopefully as an interagency effort, within the next 2 to 4 weeks. An Advanced Notice is a formal invitation to participate in shaping a proposed rule and starts the notice-and-comment process in motion. It typically gives 60 days for public comment and an additional 30 days for reply comments. "The Advanced Notice, when it is released, will not be a new CRA framework," cautioned Gardineer. "It will be a series of questions designed to elicit even more input to help the agencies develop this new framework." From this, it seems clear that while some progress is being made, specific changes to modernize the CRA are still emerging and it will take time and more input before a new framework is revealed. ■



Brake Bread continues to offer subscription services to residential and commercial customers with delivery via bicycle. Left, bike delivery signage.

compostable packaging and organic recycling. Proceeds of the SBA 7(a) loan were used to finance equipment. This loan supported the creation and/or retention of 2 jobs. This loan is one example of the type of loans in the SBA Loan Fund portfolio. ■

Impact Investing (from page 1) Solomon Hess creates impact by supporting job creation and retention across the nation and by providing access to capital and liquidity in the SBA 7(a) loan market.

Supporting Job Creation and Retention: Permanent job creation and retention is key to reducing poverty and promoting economic development. Our investment in SBA 7(a) loans supports small business growth and the related employment.

Providing Access to Capital and Liquidity in the SBA 7(a) loan market: As one of the largest buyers of SBA 7(a) loans in the secondary market, Solomon Hess is a reliable partner for loan originators, including Community Development Financial Institutions (“CDFIs”). Knowing there is a reliable investor for their SBA 7(a) loans that have strong community impact characteristics, banks and CDFIs are more inclined to sell existing loans and originate new SBA 7(a) loans. This frees up capital and creates new

financing potential for small businesses.

When you invest with Solomon Hess you can target your investment by geography, impact characteristic or a mix of multiple criteria. Our portfolio management team will work with you to determine how we can best meet your needs.

1. Geography: Solomon Hess uses its expertise to target investments in small business loans by geography, down to the zip code level, with a focus on loans made to businesses in LMI areas or otherwise economically distressed regions. A geographic focus may be of interest to an institutional investor looking to support impact in a specific community, such as a regional foundation.

2. Impact Characteristics: Solomon Hess also targets small business loan investments by impact characteristics, including those set out in the box to the right. We focus on investing in small business loans that we believe have a positive community impact.

Please see the Solomon Hess 2017 Impact Report for additional detail and some profiles that provide job creation and other positive community benefits. The report is available at www.SolomonHess.com. ■

Solomon Hess Impact Characteristics

Business Ownership Focus

- Minority Owned or Co-Owned
- Woman Owned or Co-Owned
- Service Veteran Owned or Co-Owned

Business Impact Focus

- Care for Seniors
- Meeting Healthcare Needs
- Children’s Welfare
- Supporting Women & Girls
- Animal Welfare
- Food Production & Agriculture
- Arts & Cultural Programs
- Environmental Sustainability

SBA Loan Fund Profile: D’Image Beauty College in Phoenix, Arizona

Another example of the type of loans in the SBA Loan Fund portfolio is the loan to D’Image Beauty College (“D’Image”), a bilingual beauty college owned and operated by a minority woman located in Maricopa county, AZ. Over 450 students have graduated from the college since it was founded in 2007.

Founder Elvia Jaime is a Mexican immigrant. She experienced difficulty hiring well trained hairstylists for her own salon in 2006. In response, she returned to school to become licensed as a hairstylist instructor and opened D’Image with just five students and herself as the instructor in October 2007. She has since expanded the business to 3 beauty schools, 2 barber schools and a laser institute.

In February 2016, Jaime was the recipient of a gold award from the Global Quality Foundation, an international philanthropic organization. The award recognized the economic opportunities Jaime has created for Latinos through her business. D’Image is the only bilingual beauty school in the metro Phoenix area and the vast majority



D’Image operates multiple locations, all in low income census tracts. Above, a hairstylist.

of students enrolled are Latinos. Her graduates have gone on to find jobs as hairstylists or barbers or have opened their own salons or barber shops. Some have won awards in regional and national hairstylist competitions.

Proceeds of this SBA 7(a) loan were used to finance the property at 2539 North 35th Ave in Phoenix in a low income census tract and a CDFI Fund Qualified Investment census tract. D’Image employs 17 individuals. This loan is another example of the type of loans in the SBA Loan Fund portfolio. ■

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www.dimagebeautycollege.com
www.brakebread.com

SOLOMON HESS CAPITAL MANAGEMENT

431 Park Ave, Suite 401

Falls Church, VA 22046

WWW.SOLOMONHESS.COM

SBA Loan Fund Raises Preferred Return Again for Q2 2018

The SBA Loan Fund raised its Preferred Return for Q2 2018, marking the seventh increase since Q1 2016. The Preferred Return is re-set each quarter and is annualized and net of all expenses and fees (including management fee). For Q2 2018, the Preferred Return is set at 2.50% for targeted CRA investments and 2.60% for non-targeted CRA investments. This increase in the Preferred Return demonstrates the continued strong performance of the SBA Loan Fund's assets in a rising interest rate environment. The SBA Loan Fund has over \$500 million in assets and over 100 bank investors.

2018 Conference Calendar

CRA & Fair Lending Colloquium

November 4-7, Hollywood, FL

www.cracolloquium.com

Contact

Michelle Lai, Investor Relations

703.466.0483

mgolai@solomonhess.com

www.SolomonHess.com

Managing Good Capital Well

Solomon Hess Capital Management ("Solomon Hess") is an alternative asset manager specializing in fixed income. Our mission is to provide investors with community and economic development-focused investment funds that generate both competitive risk-adjusted returns and positive quantifiable community impact. Founded in 2004 and located in Falls Church, Virginia, Solomon Hess has over \$600 million of assets under management. Solomon Hess is Fund Manager to the SBA Loan Fund and investors include banking institutions of all sizes that are seeking Community Development Investment or Lending test credit within the Community Reinvestment Act (CRA) rules via exposure to SBA 7 (a) loans and related assets. Other investment opportunities with Solomon Hess include investing in our Absolute Return strategy fund. We offer our strategy as funds or separate accounts.

The Solomon Hess SBA Loan Fund LLC attempts to provide its investors with CRA credit related to their participation in the Fund. Investment decisions are not always exclusively based on the economic characteristics or investment merit of a specific asset. Certain CRA eligible securities sought by the Fund in specific geographies may not provide as great an economic benefit to the Fund as the same securities located in non-CRA geographies. The Fund may engage in transactions at times for reasons related to CRA considerations that may not be desirable from an investment standpoint. If one or multiple federal banking regulators, such as the OCC, FDIC or the Federal Reserve Board, were to deem an investment in the Fund as not qualifying for CRA credit, the impact to Fund investors could be material.