SOLOMON HESS Capital Management | CRA *news*

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SBA Loan Fund: A Year in Review

2015 marked another successful year for the Solomon Hess SBA Loan Fund as the Fund invested $165 million in 220 small business loans nationwide. The Fund, a certified Community Development Entity, primarily invests in the debt of small businesses that are located in lower income census tracts within our bank investors' assessment areas.

This past year, the SBA Loan Fund added its 95th bank investor and surpassed $400 million in gross assets. The 789 small business loans currently in portfolio have financed businesses that have created over 12,000 jobs, 80% of which are located in lower income communities or employ lower income workers.

Since inception in 2004, the SBA Loan Fund has invested $1.3 billion in over 23,000 small business loans. These small businesses have created or retained nearly 27,000 jobs in 48 states. By investing in the SBA Loan Fund, banks are making a direct and measurable impact in their communities.

"Small businesses are the backbone of our economy. Moving into 2016, we will continue to work with our bank investors to invest in small businesses that promote job creation, retention, and improvement within lower income communities across America," said William Einstein, Chief Financial Officer and Chief Compliance Officer of Solomon Hess Capital Management. ■

Below, the Solomon Hess staff celebrates the holidays. L-R: Isaac Fradin, Michelle Lai, Mike Fallon, Gino Heilizer, Bill Einstein, Rachel Ahn and Catherine Mathew.

CRA Fixed Income Marketplace

Fixed Income - In recent years, the banking industry has seen a growth in the CRA eligible fixed income marketplace. Nationwide funds have risen in popularity due to their positive impacts on local communities and economic diversification.

Banks investing in financial intermediaries, or funds, which lend primarily to lower income borrowers or in lower income areas may be eligible to receive CRA consideration. Generally, these are Low Income Housing Tax Credit funds, public mutual funds and small business loan funds. Each type of fund attracts a different investor based on its CRA objectives, risk tolerance and investment capabilities.

LIHTC - The Low Income Housing Tax Credit ("LIHTC") program was established in 1986 to promote investments in affordable housing. Real estate developers are awarded tax credits from state housing credit agencies which the developers use to raise equity from institutional investors. By investing in LIHTCs, banks garner a dollar-for-dollar federal tax reduction and are eligible to receive CRA investment test credit.

Since inception, the LIHTC program has helped provide over 2 million affordable housing units to lower income renters. Banks can invest in individual LIHTC projects or in funds that have several projects in its portfolio.

LIHTC funds may be appropriate for banks that are comfortable underwriting multifamily real estate and with the long term, illiquid nature of the investment. Furthermore, banks in middle or upper income communities that lack affordable rental properties may want to consider adding a LIHTC project to their CRA portfolios.

Public Mutual Funds - Investing in a publically traded CRA mutual fund that primarily purchases targeted mortgage backed securities is another way for banks to receive CRA investment test consideration. These funds purchase securities in a bank's assessment area while that bank becomes a pro rata owner of the entire fund. Similar to LIHTCs, the public mutual funds primarily measure their impact by the number of affordable housing projects financed.

Typically, the public mutual funds benchmark their performance to a US Aggregate Bond Index. These funds can purchase whatever assets their mandates allow but they generally stick with Multifamily Agency MBS or Single Family MBS.

The public mutual funds may be suitable for banks seeking a diversified holding of MBS who are comfortable with a longer investment duration. These funds could also be appropriate for banks that operate in rural communities in which their depositors have limited home ownership opportunities.

Small Business Loan Funds - Small Business Loan Funds that promote community development offer an alternative CRA investment route than housing or real estate. They invest in the debt of small businesses located in lower income areas and quantify their impact by number of jobs created and the number of businesses financed. Loan funds typically purchase the federally guaranteed portion of floating rate SBA or USDA loans and can target a bank's investment to a census tract or county level. Depending on the fund, banks should receive either CRA Investment or Lending test credit.

By investing in funds, rather than individual loans, banks can diversify their economic risk across the fund's portfolio while still receiving targeted CRA consideration. The biggest economic risk that small business loan fund investors take is premium risk. However, that is mitigated since the underlying loans in portfolio are usually floating rate and federally guaranteed.

Small business loan funds could be appropriate for banks in urban communities that suffer from high unemployment. Banks often pair investments in small business loan funds with housing related projects to support both job creation and affordable housing. Moreover, since loan funds usually purchase floating rate assets, they could be a good fit for banks seeking to deploy capital in a rising rate environment.

Moving forward - We will continue to monitor the CRA fixed income marketplace throughout 2016 and will provide updates when applicable. However, banks should consult with their regulators prior to making an investment for CRA. ■

Manager's Mailbag
CRA & Government Guarantees

QUESTION: Do all CRA investments have a full faith and credit guarantee from the US government?

ANSWER: Generally, a government guarantee is the commitment from the government to back the principal and interest of specific types of debt. Not all CRA eligible investments are government guaranteed. For those that are, the guarantor can be the federal, state, or local government. It is important for CRA professionals to understand which assets are backed by the government and how the guarantees differ.

Implicit and explicit guarantees from the US government are the most common forms of guarantees within the fixed income marketplace. The main difference between the two comes down to the agency or entity that administers the asset. US government agencies that issue or guarantee debt, such as the SBA, USDA or Ginnie Mae, will typically have their bonds be explicitly guaranteed by the full faith and credit of the US government.

An implicit guarantee usually accompanies government sponsored entities, such as Freddie Mac, Fannie Mae and Farmer Mac. Implicitly guaranteed debt is unique in that the guarantee is not categorically stated. However, it is universally believed that the government would intervene before these entities failed. Thus, GSE bonds are deemed to be implicitly guaranteed.

States, cities or counties often guarantee the debt for projects that benefit or take place in their district. Examples include education bonds, public transportation financing or small business loans. Like the federal government, municipalities will back principal and interest payments. However, these guarantees are backed by the revenue generating ability of the project specific municipality, not the US federal government. ■

Manager's Mailbag provides an opportunity for CRA professionals to ask the managers of Solomon Hess a question relating to the current CRA landscape. Have a question you'd like us to address? Email us at questions@solomonhess.com and we'll try to include it in a future newsletter!

Small Business Loan Profile: Compo Steel Products

When Solomon Hess Capital Management reviews small business loans in which to invest, we look for businesses that go beyond the CRA requirements and embody the spirit of the regulations. While not explicitly written anywhere in the CRA Q&A, we believe that the regulators appreciate banks that invest in businesses that make a positive impact on their communities. Here is an example of such a business in our portfolio: Compo Steel Products in Milwaukee, Wisconsin.

Established in 1953, Compo Steel Products is a steel manufacturer that designs and builds electrical enclosures, locomotive parts and custom metal fabrications. With their state of the art laser equipment, they have the capacity to work on all metals and can provide engineering solutions to a variety of industries. Over the years, Compo Steel Products has been awarded several contracts, most notably from General Motors to engineer and construct electrical locomotive lockers. Businesses that contract with Compo Steel Products get to work with an American manufacturer that has been in business for over 60 years.

Compo Steel Products' impact on its local community is even more impressive than its manufacturing capabilities. Its headquarters is located in a low-income census tract that has unemployment rates over three times the national average. At its warehouse, Compo Steel Products employs over 60 people, many of whom are from the surrounding neighborhoods. Some employees have spent time in jail or have been in gangs. To them, Compo Steel Products offers a second chance.

"The owners of this company chose to locate here because they knew this was a distressed area…and that people were just looking for a second chance," said Chief Operating Officer Nick Storniolo[i]. Indeed, by investing in Compo Steel Products' SBA 7(a) loan, Solomon Hess and its bank investors supported a business that created several manufacturing jobs in Milwaukee.

Compo Steel Products employs over 60 workers in Milwaukee, Wisconsin.

Including Compo Steel Products, the Solomon Hess SBA Loan Fund invested in 220 US - based small businesses in 2015. These businesses ranged in revenue, geography and industry type, yet they all impacted their communities in one way or another. "Investing in small businesses, like Compo Steel Products, that have a measurable impact on their local communities is an essential part of our mission at Solomon Hess. In 2016, we will continue to invest in small business that promote community development in lower income communities across America," said Bill Einstein, Managing Director and Chief Financial Officer of Solomon Hess Capital Management. ■

Lending Record

2015 was another successful fiscal year for the Small Business Administration and its 7(a) lending program as it set records with 63,000 loans approved totaling $23.6 billion. Compared with FY 2014, this represents increases of 22% in number of loans and 23% in gross total[ii].

Most impressive was the SBA's service to demographics that lack access to traditional capital. More than half of all SBA 7(a) loans in 2015 went to small businesses in underserved markets and lending to Veterans increased over 100% from the prior year[ii].

"I am proud that Fiscal Year 2015 was one of the most successful years in SBA's history." said Maria Contreras-Sweet, Administrator of the SBA. She continued, "Each and every day, the dedicated men and women of SBA are focused on achieving meaningful results on behalf of the small businesses that create the majority of new jobs and drive our economy forward.[iii] ■

i. wisconsinhousing. "Ideas in Action | Compo Steel" Online video clip. Youtube, 9 Dec. 2013

ii "SBA FY15 Lending Records Reach New Heights | SBA.gov" 30 Oct. 2015.

iii "Statement by SBA Administrator Maria Contreras-Sweet on Small Business Committee Hearing | SBA.gov." 7 Jan. 2016

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Managing Good Capital Well

Solomon Hess Capital Management is an Investment Advisor located in Falls Church, Virginia with over $500 million of assets under management.

Solomon Hess specializes in the small business and community impact sectors. Our investors include Banking Institutions of all sizes who are seeking Community Development Investment or Lending test credit within the Community Reinvestment Act (CRA) rules via exposure to SBA 7(a) related assets.

In 2015, the Solomon Hess SBA Loan Fund invested over $165 million in 220 small business loans throughout communities across the United States. By providing liquidity to the SBA 7(a) secondary market, Solomon Hess and its investors have been able to support businesses that have created or retained approximately 27,000 jobs across 48 states since inception in 2004.