



Above, some members of Solomon Hess. L to R: Mary Tucker, Michelle Lai, Salvador Huitra, Gino Heilizer, Mike Fallon, Ximena Bryce and Catherine Mathew.

## Solomon Hess Offers Turnkey Small Business Lending Solution for CRA

**S**olomon Hess Capital Management (“Solomon Hess”), the fund manager to the Solomon Hess SBA Loan Fund (“SBA Loan Fund”), is now offering SBA 7(a) asset management services as separately managed accounts for banks seeking small business lending credit for CRA. In this structure, a bank seeking small business lending credit would effectively outsource to Solomon Hess the processes of SBA 7(a) loan screening, selecting, pricing, settling and monitoring. Solomon Hess has expertise and experience in these processes and in managing the risks associated with managing the guaranteed portion of SBA 7(a) loans.

**Small business lending for CRA:** The banking regulatory bodies assess the CRA performance of a bank by *(continued on page 2)*

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## OCC ANPR: What’s Next?

**I**n August 2018, the Office of the Comptroller of the Currency (“OCC”) issued an Advance Notice of Proposed Rulemaking (“ANPR”), the first formal step required to revise rules of the Community Reinvestment Act (“CRA”). The ANPR did not propose specific changes to the regulation but contained a set of 31 questions about potential areas for revision. The public comment period closed on November 19, 2018 and over 1,500 comment letters were received from academics, banks and banking trade associations, community and consumer groups and citizens.

The OCC must review public comments before it issues any proposal for new rules. This would be followed by another comment period to be followed by yet

another review period.

When the OCC took the unusual step of releasing the ANPR as a single-agency act, the community’s reaction was to assume that the agencies could not agree and work together to present the ANPR jointly. This raised significant concerns about the regulators not acting jointly on CRA reform going forward. An overwhelming number of comments to the ANPR strongly urged the agencies to work together and cautioned against having agency-specific rules governing CRA which would lead to more confusion and inconsistencies.

Comments from representatives of the OCC, FED and FDIC indicated that the hope is to be able to *(continued on page 2)*

## SBA Loan Profile: Drone Workforce Solutions in New Castle, Delaware



*Proceeds of the SBA 7(a) loan to Drone Workforce Solutions were used to finance working capital. The borrower is located in New Castle county, DE, in a moderate income census tract and a CDFI Fund Qualified Investment census tract. The business is a minority and woman co-owned business. The borrower self-reported that this loan created and/or retained 2 jobs.*

*Right, a drone operator at a construction site.*

**W**hen portfolio managers at Solomon Hess invest in CRA-eligible loans on behalf of bank investors, they try to find loans that not only meet the technical requirements of the CRA program but also the spirit under which CRA was created. Part of the screening process involves research on the loan originator with the goal of supporting mission-driven lenders, where possible.

An example of the types of loans that Solomon Hess acquires is the loan to Drone Workforce Solutions (“DWS”) located in Wilmington, New Castle, DE.

DWS was founded by Theophilus Nix, Jr. and Suzanne Nix to drive and accelerate job creation and new business start-ups in the emerging drone industry. The company not only *(continued on page 3)*

**Small Business Lending Solution** (from page 1) applying the investment, lending and service tests as provided in 12 CFR 25.22 through 25.24. The lending test evaluates a bank's record of helping meet the credit needs of its assessment area(s) through its lending activities by considering a bank's home mortgage, small business, small farm and community development lending. The regulatory bodies will consider both originations and purchases of loans for purposes of the lending test if the loans meet the definition of a small business loan.

*SBA 7(a) loans do NOT automatically qualify as a small business loan for CRA; they still must meet the small business loan definition. If a bank purchases an SBA 7(a) loan, that loan would qualify as a small business loan ONLY IF its original amount is \$1 million or less AND reported as either a "loan secured by nonfarm or nonresidential real estate" or a "commercial or industrial loan." A bank will need to report the loan amount at origination, the location of the loan by census tract and can enter a code indicating "revenues unknown" if it did not consider revenue information to make the credit decision.*

**Separately Managed Account with Solomon Hess:** Investment in the SBA Loan Fund qualifies for CRA under the community development test, either lending or investment. Because the SBA Loan Fund is structured as an investment vehicle, investors are pro-rata shareholders of all the SBA 7(a) loans in the portfolio and all the loans are held in the fund's name. In a separately managed account structure, each bank would have its unique custody account whereby all the assets held in that account would be in the bank's name. The bank would enter into an Investment Advisory Agreement with Solomon Hess, giving Solomon Hess the authority to trade in the account. Solomon Hess would leverage its experience trading the SBA 7(a) asset class and acquire the federally guaranteed portion of SBA 7(a) loans that qualify as small business loans in that bank's target assessment area.

*All aspects of acquiring the loans and settling them to the bank's custody account under the bank's name would be handled by Solomon Hess. Detailed reporting on all the acquired loans would be provided on a regular basis.*



*The SBA 7(a) loan to Kashira Japanese Restaurant is another example of the types of loans Solomon Hess acquires. The borrower is a full-service restaurant located in a moderate income census tract in the Koreatown district of downtown Los Angeles in California. Established in 2015, the restaurant specializes in sushi and ramen noodle soup. Proceeds of the SBA 7(a) loan were used to finance working capital. Left, Solomon Hess team members with the chef-owner of the restaurant in October 2018. L to R: Mike Fallon, Michelle Lai, Chef Hiro and Bill Einstein.*

**Solomon Hess expertise in the SBA 7(a) asset class:** Solomon Hess has developed experience and expertise in managing SBA 7(a) assets from its 14-year tenure as the fund manager to the SBA Loan Fund. In that time period, Solomon Hess has invested in over 3,500 SBA 7(a) loans and has developed the following core competencies in the management of SBA 7(a) assets:

- Strong broker-dealer relationships, giving Solomon Hess access to a large number of SBA 7(a) loans entering the secondary market

- Proprietary prepayment model used in selecting and pricing SBA 7(a) loans with a view to managing prepayment and premium risk
- Expertise and efficiencies in settling physical delivery asset

Solomon Hess would leverage its expertise to provide this outsourced solution for CRA small business lending. ■

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**OCC ANPR** (from page 1) work together and that they were all reviewing the comments submitted to the ANPR.

The exact nature of any disagreement between the agencies remains unclear.

During a congressional hearing in October of last year, FDIC Chairman Jelena Williams said that she would want the final rule to support the original congressional intent behind the CRA. The FDIC supervises over 60% of the nation's banks. In contrast, OCC-regulated banks make up only 21% of the charters though some are the biggest in the industry by asset totals.

On February 1, at "Research Symposium on the CRA" hosted by the Federal Reserve Bank of Philadelphia, Governor Lael Brainard said that while the FED is aware that CRA stakeholders have demonstrated a strong desire for reforms to be implemented consistently across the three banking regulators, the FED is undertaking its own extensive outreach effort to gather the best ideas for

improving the implementation of CRA. Brainard stressed that the FED is "research-driven" and has and will continue to host roundtable discussions around the nation and meet with bankers, community groups, bank advisory councils and national organizations and will synthesize its own findings.

Meanwhile, at a recent meeting of Women in Housing and Finance, Comptroller of the Currency Joseph Otting said that while he is "hopeful" that the regulators can jointly propose CRA reforms by the summer, the OCC is ready to proceed with a CRA revamp on its own if the regulators can not agree. "My preference 110% is to be able to do things jointly," he said. "I have a responsibility to the banks which we regulate and to the communities across America that are benefitting from CRA. And if I really feel that it can benefit those communities and we're restricting that, it doesn't mean we all have to do things the same." ■

## Review of ANPR Comment Letters

Over 1500 comment letters were submitted in response to the ANPR released by the OCC regarding potential areas for revision of the CRA. A review of the letters revealed several major themes.

**Current modernization effort of CRA is important and there is strong support for an update to the rules but not a complete overhaul.** Comments across the board credit the CRA for the significant volume of loans and investments that have supported low and moderate income communities throughout the country. There is strong agreement that the goal of incentivizing banks to meet the needs of borrowers in all segments of their communities and eliminate redlining must be preserved.

**Modernization of bank assessment areas needed but the answer is elusive and complex.** While CRA stakeholders agree that bank assessment areas should continue to include geographical areas that contain branches and that branchless banking activities should also be included, there is broad disagreement on the specifics of how assessment areas are to be redefined. At issue is the degree to which credit should be given to CRA activity outside branch networks so as not to undermine the importance of physical branches.

**OCC's concept of using a single CRA metric generated strong feedback.** Over the past few years, the CRA community has called for more clarity, consistency and predictability of CRA exam procedures. In response, the ANPR introduced the concept of using a single metric to evaluate CRA activity. This single metric was not defined in the ANPR. This concept prompted many strong responses questioning whether a single metric could be effectively applied to banks of all sizes and business models. Among the banks that support the use of a single metric, there was disagreement over what threshold to use. ■

*DWS's SBA 7(a) loan was originated by First State Community Loan Fund, a CDFI that serves Delaware and southeastern Pennsylvania. By acquiring this SBA 7(a) loan in the secondary market, Solomon Hess not only supports the borrower but also supports the lender by providing much-needed liquidity for it to generate more loans that meet its community development-driven mission.*

*Right, students working on a drone in a classroom setting.*



**Drone Workforce Solutions** (from page 1) provides hands-on pilot training programs to would-be and experienced drone operators, but also provides mentoring and coaching support for 12 months after graduation to assist alumni in starting their own drone businesses.

DWS maintains a proprietary online database with hundreds of DWS-validated and FAA-certificated drone operators which it leverages when corporate customers come looking for drone operators to complete specific tasks. DWS serves corporate clients in a wide range of industries including agriculture, construction, law enforcement and security, insurance, telecommunications,

real estate, utility, public safety and emergency management.

This SBA 7(a) loan was originated by First State Community Loan Fund ("First State"), a Community Development Financial Institution ("CDFI") that supports small businesses and community development projects throughout Delaware and southeastern Pennsylvania. As a CDFI, First State is required to provide at least 60% of its lending and technical assistance activity to underserved populations which it defines as those that include women and minority owned companies, low income borrowers and other organizations that serve low-income communities. ■

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## SBA Loan Fund Raises Preferred Return Again for Q1 2019

The SBA Loan Fund raised its Preferred Return for Q1 2019, marking the tenth 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 Q1 2019, the Preferred Return is set at 3.00% for targeted CRA investments and 3.10% 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 roughly \$600 million in assets and over 115 bank investors.

## 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 \$750 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. We offer our strategies as funds or separate accounts.

## 2019 Conference Calendar

CRA & Fair Lending Colloquium

November 10-13, Orlando, FL

[www.cracolloquium.com](http://www.cracolloquium.com)

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*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.*