

Tax Overhaul Shifting CRA Fixed Income Marketplace

The possibility of a tax code overhaul proposed by members of Congress and President Donald Trump is casting a shadow over the Low Income Housing Tax Credit (“LIHTC”) program which is a cornerstone of many banks’ CRA investments. Established in 1986 to promote investments in affordable housing, the LIHTC program awards tax credits from state housing credit agencies to real estate developers who then use those tax credits to raise equity from banks and other institutional investors. By investing in LIHTCs, banks garner a dollar-for-dollar federal tax reduction and are eligible to receive CRA investment test credit. The current administration’s *(Continued on page 2)*



Federal Reserve Chair Janet Yellen stressed the importance of workforce development as a CRA-qualified community development activity in her address at the National Community Reinvestment Coalition annual conference in Washington, DC on March 28, 2017.

Janet Yellen: The Federal Reserve Takes CRA Responsibilities Seriously

Addressing the National Community Reinvestment Coalition (“NCRC”) annual conference on March 28, Federal Reserve Chair Janet Yellen said that the Federal Reserve takes CRA responsibilities seriously. She mentioned that the Federal Reserve continues to improve CRA examination procedures and examiner training while at the same time continues to work with fellow regulators to improve the implementation of the law. Banks are needed, she said, not just to provide home mortgages in low and moderate income neighborhoods but also to support educational

opportunities and bolster the development of small businesses. Yellen then focused her remarks to stress the importance of workforce development as a CRA-qualified community development activity. She noted that unemployment average 13% in low- and moderate-income communities from 2011 to 2015, nearly double the 7% average in higher-income communities. She said that supporting workforce development and other programs to help disadvantaged groups are a core part of the Federal Reserve’s mission, alongside monetary policy and financial regulation. ■

Inside

Tax Overhaul Shifting

CRA Fixed Income Market	1-2
SBA Loan Fund Raises Return	2
Manager’s Mailbag	2
Loan Profiles	3
CRA Conference	4

proposal to reduce the corporate tax rate to 15-20% from the current 35% has already resulted in a collapse of tax credit values in the market. Investors have been valuing tax credits 10-20% lower since Election Day and are pulling back even though the timing of any tax overhaul is currently uncertain. Affordable housing development is a significant economic driver. According to the National Multifamily Housing Council, roughly 100,000 of the 400,000 apartment units built each year receive the tax credit. This could decline if the credit continues to lose value. ■

Did you know?

The recent severe downgrade of Wells Fargo's CRA rating from Outstanding to Needs to Improve based on "the extent and egregious nature of evidence of discriminatory and illegal lending practice" has grabbed national media attention of late. However, the practice of regulators imposing CRA downgrades for evidence of illegal, abusive or discriminatory lending on fair lending has been a long standing one. In the period between January 2002 and September 2007, 14 CRA rating downgrades by the FDIC were a result of fair lending violations – three of these were downgrades to Satisfactory and 11 were downgrades to Needs to Improve. In 2013, 10% of banks that received a Needs to Improve rating were downgraded due to fair lending violations. ■

Solomon Hess SBA Loan Fund Raises Preferred Return Again

In line with the Federal Reserve's quarter point interest rate increase on March 15, the Solomon Hess SBA Loan Fund ("the Fund") raised its Preferred Return to 2.0% for targeted CRA investors for Q2 2017. The vast majority of the Fund's assets consist of the federally guaranteed portion of floating rate SBA 7(a) loans which adjust monthly/quarterly and are indexed to the Prime Rate. The Preferred Return is re-set quarterly, annualized and is net of all expenses and fees (including management fee). This marks the fourth raise in five consecutive quarters. ■

Manager's Mailbag

Limited Scope Assessment Areas

Do limited scope assessment areas matter for CRA evaluation? While CRA examiners will typically look at assessment areas most significant to the bank for evaluation, limited scope assessment areas are becoming increasingly important in the CRA evaluation process. Comments from regulators at the FDIC and the OCC given at the NCRC conference in March indicated that CRA regulation does require examiners to consider a bank's performance in all its assessment areas. At the FDIC, examiners are now being encouraged to include limited scope assessment areas in the evaluation process, particularly those that missed scrutiny

in past exams. A similar approach is being undertaken at the OCC to ensure that examiners do consider a bank's CRA performance in limited scope assessment areas.

The SBA Loan Fund is a nationwide CRA-eligible investment fund for banks seeking targeted Community Development credit. Investors invest with specific targeted assessment areas, which can be the limited scope areas. The Fund will then acquire the federally guaranteed portion of CRA-qualified floating rate SBA 7(a) loans only in those areas. Investors benefit from receiving targeted CRA while being a pro-rata shareholder of a nation-wide Fund. ■

Newsletter Sources:

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www.osect.com

www.valleyfoods.com

Small Business Loan Profiles

When Solomon Hess Capital Management looks at small businesses for capital allocation on behalf of its CRA-motivated bank investors, we try to align the firm’s mission of promoting liquidity for community development loans with the spirit of CRA. 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 in their communities. Here are two examples of such businesses in our portfolio.



Valley Food Systems is a family owned and operated business that manufactures perishable prepared foods for the military and victims of disasters. The business is located in a low income census tract and a CDFI Fund Qualified Investment census tract. Above, members of the armed forces at meal time.

Valley Foods Systems (“Valley”) is a manufacturer of innovative perishable prepared foods for the military and victims of disasters. Established in Youngstown, Ohio, in the 1960’s as a family-run and owned business, Valley produces fresh and frozen meal kits, snack kits and shelf-stable meal kits. It serves Army, Army Reserve, National Guard and Air Guard units in several states. Through its unique proprietary Zero-Waste A-Rations Program, Valley customers receive the exact amount of ingredients needed to produce each meal for that day’s population. In addition to supplying branches of the armed forces, Valley also meets the needs disaster of relief services. In

2005, Valley responded to victims of hurricanes Katrina, Rita and Wilma by producing 1.5 million meals. More recently, Valley supplied 500,000 meals to victims of hurricanes Ike and Gustav. Working with local suppliers, all the contents of Valley’s meal kits are made in the USA. Each kit is assembled on-site at its 30,000 square foot commissary complex in Youngstown.

Valley is located in a low income census tract and a CDFI Fund Qualified Investment census tract. By investing in Valley’s small business loan, the Fund and its CRA-motivated bank investor supports the creation and/or retention of 62 local jobs. ■

Osc Computer Training (“OSC”) is a private vocational school that provides high quality job training and job placement assistance services. Established in 1987, OSC offers 17 certificate programs in Sacramento, CA and is also licensed to provide Distant Education by the State of California Bureau for Private Postsecondary Education. The Fund’s investment in OSC supports the creation and/or retention of 10 jobs and supports workforce development in a low income community. ■



OSC is a private vocational school that provides workforce development education and job placement. It is located in a low income census tract and a CDFI Fund Qualified Investment tract. Above, students.

Impact Record

Including Valley Food Systems and OSC Computer Training the Solomon Hess SBA Loan Fund has invested in over 2,700 US-based small businesses since inception resulting in the creation and retention of over 35,000 jobs throughout investors’ target communities nationwide.

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*We will be at the CRA &
Fair Lending Colloquium!*

**Solomon Hess Capital
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November 5-8, 2017

Nashville, TN

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Managing Good Capital Well

Solomon Hess Capital Management (“Solomon Hess”) is an Investment Advisor located in Falls Church, Virginia with \$595 million of assets under management. Solomon Hess specializes in the small business and community impact sectors. Our 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 Advantage Loan (formerly known as 7(a) loans) and related assets.

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.