SOLOMON HESS Capital Management | CRA news

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SBA Loan Fund in a Rising Interest Rate Environment

Given the aggressive and successive interest rate hikes taken by the Federal Reserve this year in its battle against inflation, which is running at a 40-year high, it is timely to revisit how Solomon Hess SBA Loan Fund (SBA Loan Fund) investors are impacted in a rising interest rate environment.

The SBA Loan Fund is a national community development investment fund that provides investor banks with targeted impact credit under the CRA. The fund acquires the federally guaranteed portion of Small Business Administration (SBA) 7(a) loans where the underlying small business borrower is located in a low– or moderate-income (LMI) or otherwise economically distressed census tract. The SBA Loan Fund was certified as a Community Development Entity (CDE) by the Community Development Financial Institutions (CDFI) Fund in 2005 and has maintained this designation ever since.

SBA 7(a) loans account for roughly 94 per cent of SBA Loan Fund assets. Thus, it is critical to understand the effects rising interest rates have on 7(a) loans as this is how SBA Loan Fund investors will be impacted. *(continued on page 3)*

Inside

CRA Modernization Update: Interagency NPR Released with 90-Day Comment Period

On May 5, the Federal Reserve Board (FED), Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC), collectively "the agencies" released the long-awaited Notice of Proposed Rulemaking (NPR) to modernize the Community Reinvestment Act (CRA) regulations. Industry stakeholders welcomed the agencies' unified approach in the issuance of an interagency effort.

The goal of the NPR is to strengthen and modernize the CRA by providing greater clarity, consistency, and transparency in the application of the regulations. The proposed approach would add more standardized metrics for regulator CRA examinations and more clearly delineate activities that will qualify for CRA credit.

The agencies seek public feedback to the NPR and have provided for a 90-day comment period ending on August 5. A collective of trade associations for the banking industry, including the American Bankers Association (ABA) and the Consumer Bankers Association (CBA) submitted a joint comment letter advocating for a 30-day extension of the comment period citing the importance of the proposed rule and the need for time to formulate meaningful comments and specific recommendations.

In addition, the proposed rules would include more specific standards for online, mobile and branchless banking.

Key components of the NPR include:
(continued on page 2)

SBA 7(a) Loan Profile: Brooklyn Tea Kings, New York

Brooklyn Tea is located in Bedford Stuyvesant, an historically black neighborhood in a CDFI Fund Qualified Investment census tract. This loan was originated by the Empire State Community Development Corporation. Owners opened Brooklyn Tea in December 2018 to provide a quiet location with communal vibes for local residents by serving imported teas, fresh coffee and pastries in a welcoming atmosphere. This is an African American owned and woman co-owned small business that supports the creation and/or retention of two jobs.

As a CDE, it is the mission of the SBA Loan Fund to promote permanent job creation, retention and/or improvement for LMI persons who are employed by small businesses by creating greater financial liquidity and a lower cost of capital within the SBA 7(a) secondary market. The fund is dedicated to sourcing loans from authorized lenders that are also mission-driven lenders. By providing capital to organizations with missions aligned with that of the SBA Loan Fund, more loans can be originated to support underserved end borrowers. The loan to Brooklyn Tea is one example of the kind of loans in the SBA Loan Fund portfolio. ■

CRA Modernization *(from page 1)*

- Setting higher asset size thresholds for small, intermediate, and large banks.
- While maintaining "facility-based" CRA assessment areas as a baseline, expanding the scope of assessment areas to include activities associated with online and mobile banking, branchless banking and hybrid models.
- Developing and maintaining a publicly available list of examples of activities that qualify for CRA credit, and establishing a process for banks to obtain confirmation of the eligibility of certain activities.
- Clarifying eligibility criteria for community development activities, and incorporating concepts currently set forth in interagency guidance directly in the regulations.
- Expanding activities that qualify for CRA credit, including for mission-based entities that serve minority groups, women, and low-income consumers and Native Land Areas
- Emphasizing small value loans and investments.
- Permitting small banks to continue to be evaluated under the existing regulatory framework, with the option to be evaluated under aspects of the proposed framework.
- Establishing four tests for large banks, and applying more detailed versions of those tests to large banks with assets of at least $10 billion.
- Data collection requirements will be only for large banks with at least $10 billion in assets.

Modernization of the CRA is a top priority at the federal banking agencies and the issuance of this interagency NPR is an important step forward.

At the National Interagency Community Reinvestment Conference (NICRC) held virtually and hosted by the agencies March 15-17, top officials at the federal banking regulators reiterated the importance of submitting comments to the NPR and assured conference attendees that all comments would be carefully considered. The agencies provided for a 90-day comment period ending on August 5. ■

FDIC Acting Chair Martin Gruenberg: CRA NPR Top Ten List of Important Provisions

Martin Gruenberg, Acting Chairman of the FDIC spoke at the National Community Reinvestment Coalition (NCRC) held in Washington, DC on June 13 and focused his remarks on the interagency NPR on CRA modernization. Gruenberg said that since the CRA's enactment, it has become the foundation of responsible finance for LMI communities in the United States. He continued to say that "the NPR approved by the federal banking agencies on May 5 would significantly expand the scope and rigor of the CRA and assure its continued relevance for the next generation."

"The CRA seeks to address one of the most intractable challenges of our financial markets — access to credit, investment, and basic banking services for low– and moderate-income communities, both urban and rural," Gruenberg said at the NCRC conference on June 13.

Gruenberg shared what he thinks the ten important provisions of the proposed rule are.

1. New retail lending assessment areas (AA) would be established to allow for CRA evaluation in communities where a bank may be engaging in significant lending activity but where the bank does not have a branch. Goal is to subject all of the bank's lending activity to a CRA evaluation.

2. The bar would be raised for CRA performance on the retail lending test for a bank to earn a high satisfactory or outstanding rating to provide incentives for increased bank lending to underserved communities.

3. Greater clarity, consistency, and transparency will be provided in the CRA evaluation and compliance process for all stakeholders — banks and community organizations. Proposal would adopt a metrics-based approach to CRA evaluations, more clearly define community development activities, and include publication of an illustrative and non-exhaustive list of qualifying activities through a pre-approval process.

4. Proposal would tailor CRA evaluations to bank size, complexity and business type.

5. Large banks would be required to disclose the distribution of home mortgage loan originations and applications in each of the bank's AAs by race and ethnicity using publicly available data under the Home Mortgage Disclosure Act.

6. Potential basis for downgrading a bank's CRA rating will be expanded to include all discriminatory practices, whether or not they are tied to the provision of credit.

7. The importance of minority depository institutions, CDFIs, Women's Depository Institutions, and Low Income Credit Unions in providing financial access to underserved consumers and communities would be officially recognized.

8. The new Community Development Financing test would provide credit for lending and investment activities outside of a bank's branch-based AA. Activities in areas of persistent poverty are provided additional consideration.

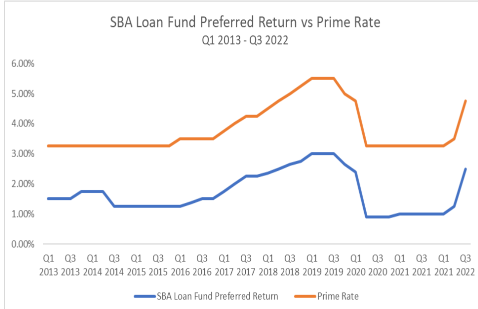
9. Proposed rule would provide consideration for banks that maintain or establish a branch where there are few or no branches in LMI communities.

10. Credit would be given to community development activities designed to strengthen disaster and climate resilience in LMI communities.

"This NPR is an important opportunity to shape the future, and to make CRA stronger," Gruenberg concluded. ■

Rising interest rate environment *(from page 1)* The 7(a) program is the SBA's flagship program where it works with approved lenders and community development organizations to guarantee loans to small businesses that are unable to qualify for conventional financing.

The vast majority of 7(a) loans adjust quarterly or monthly and are indexed to the Prime Rate, which in turn, is tied to the Federal Funds Target Rate (FFTR). This means that as the FED raises the FFTR, the yield of 7(a) loans will rise at the next loan interest re-set date. As a result, the absolute level of yield the SBA Loan Fund provides to investors should also rise. The less obvious impact of rising interest rates is that the more sophisticated small business borrowers faced with rising loan costs may look to refinance their loans under fixed or fixed to float terms and thus prepay their 7(a) loans. The balance of the higher yields against the management or prepayment risk is critical to the management of the SBA Loan Fund which operates as a "mega-pool" of 7(a) loans.



The fund's Preferred Return has historically tracked movements in the Prime Rate. Past performance is no indicator of future success and future success is not guaranteed. Above, historical SBA Loan Fund Preferred Return and the Prime Rate.

The SBA Loan Fund pays a Preferred Return that is expressed as a spread to the Prime Rate and is re-set at the beginning of each quarter and is net of all fees and expenses. The current Preferred Return is 2.5% (Prime less 2.25%). This represents a 1.5% raise since the beginning of the year, while maintaining the spread to Prime at Prime less 2.25%. Past performance is no indicator of future success and future success is not guaranteed. To learn more, visit www.SolomonHess.com. ■

SBA Loan Fund Impact Metrics *as of June 30, 2022*

19,704 jobs

1038 loans

301 loans

231 loans

32 loans

117 loans

SBA 7(a) Loan Profile: Riseability Maricopa, Arizona

The SBA Loan Fund is a CDFI Fund certified Community Development Entity (CDE) that acquires the federally guaranteed portion of SBA 7(a) loans where the underlying small business borrower is located in a LMI or otherwise economically distressed census tract. When portfolio managers at the SBA Loan Fund look to acquire community development loans on behalf of CRA-motivated bank investors, they look for loans that not only meet the technical requirements of the CRA but also the spirit under which it was created.

Another example of the type of community development loan in the SBA Loan Fund portfolio is the loan to Riseability located in Phoenix, AZ. Riseability provides vocational rehabilitation services and assists adult clients who are survivors of brain and spinal cord injury find and secure jobs in the community. The company offers counseling, employment preparation, work performance observations through job shadowing, and finding job placement through vocational rehabilitation practices. Riseability also works with students at their school and within the community to maximize their post-secondary options. Riseability was established in 2004 by Marcos Molinar, a graduate of the University of North Texas. Of all aspects of vocational rehabilitation, Molinar particularly enjoys clinical counseling and job shadowing. Molinar has completed over 55 job shadowing assignments in 22 volunteer roles. Proceeds of the 7(a) loan were used to finance equipment. The borrower is located in a moderate-income census tract. This is a Hispanic-owned small business that supported the creation and/or retention of eight jobs. ■

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SOLOMON HESS CAPITAL MANAGEMENT
431 Park Ave, Suite 401
Falls Church, VA 22046
WWW.SOLOMONHESS.COM

SBA Loan Fund Impact: Supporting Community Development

Since inception in 2004, the Solomon Hess SBA Loan Fund has invested over $2.7 billion in small business loans. These loans, made to over 4,800 small businesses located in 47 states, have helped to create and/or retain over 71,000 jobs. Over 70% of the loans in which we have invested are located in low and moderate income or otherwise economically distressed census tracts. The majority of these loans are made to under-served small businesses that do not have access to conventional commercial debt.

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 $800 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.

Michelle Go Lai

SVP, Investor Services & Marketing

SOLOMON HESS Capital Management

431 Park Avenue, Suite 401, Falls Church, VA 22046

T. 703.466.0483 F. 703.356.8383

mgolai@solomonhess.com www.SolomonHess.com

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.