SOLOMON HESS Capital Management | CRA news

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Solomon Hess SBA Loan Fund: 2023 Year in Review

The U.S. economy exhibited tremendous resilience in 2023, marked by robust consumer spending and strong job growth despite facing the highest interest rates in 22 years. Small businesses, navigating this challenging landscape, benefitted from federal initiatives aimed at enhancing capital for entrepreneurs. For example, the Small Business Administration (SBA) implemented measures to simplify the determination of eligibility for SBA loans to address persistent gaps in small-dollar loans and underserved borrower sectors. Additionally, three new lender licenses were issued to make 7(a) loans available nationally, notably the first time the SBA has done so in four decades. In this environment, the SBA delivered $50 billion in capital, disaster relief and bonding to small businesses and disaster-impacted communities across America. SBA 7(a) loan authorization rose to above pre-pandemic levels in fiscal year 2023.

The Solomon Hess SBA Loan Fund was proud to partner with over 120 bank investors in support of community development within the small business sector. In 2023, the Fund invested over $260 million to acquire the (continued on page 3)

Inside

CRA Modernization: Interagency Final Rule Released

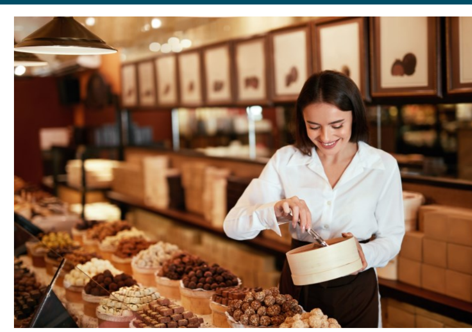
At the CRA & Fair Lending Colloquium hosted by Wolters Kluwer in November 2023, representatives of the regulatory agencies that oversee implementation of the CRA celebrated the issuance of the Final Rule, stating it was "worth the wait." These same representatives assured CRA practitioners that more guidance is needed for both examiners and bankers and that such guidance will be forthcoming in the form of webinars, training sessions, FAQs, and the like. Chart of effective dates of Final Rule is on page 2. Left, stock photo of conference attendees.

On October 24, the Federal Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (FRB), and the Office of the Comptroller of the Currency (OCC), collectively, the Agencies, released a joint Final Rule that makes extensive changes to strengthen and modernize regulations implementing the Community Reinvestment Act (CRA). The Final Rule is a culmination of a five-year, drawn-out process that brings significant amendments to CRA regulations, which have not been meaningfully revised since 1995. The Final Rule is complex, consisting of roughly 1,500 pages. *(continued on page 2)*

SBA Loan Profile: Madison Chocolate Company in Dane, Wisconsin

The portfolio managers of the SBA Loan Fund aim to acquire CRA-eligible loans for bank investors that not only meet the technical criteria of the CRA but also align with the foundation principles that inspired its creation. The SBA 7(a) loan to the Madison Chocolate Company is an example of the kind of loans the Fund looks to acquire.

Madison Chocolate Company is an independent, woman-owned chocolate shop and gluten-free bakery with two locations in Madison. Owner Megan Hile opened the Odana café location in May 2023 to help build a community hub and be a neighborhood anchor for the local business community. This 7(a) loan supported 24 permanent jobs. ■



The SBA 7(a) loan to Madison Chocolate Company was used to finance the purchase of equipment for business operations. The borrower is located in a low-income census tract that is a Community Development Financial Institutions (CDFI) Fund qualified investment census tract in Dane County . The borrower self-reported to the SBA that this loan supported the creation and/or retention of 24 permanent jobs. This is a woman-owned small business. Above, stock photo of a chocolate shop

CRA Modernization *(from page 1)* The Final Rule will take effect on April 1, 2024, but banks will not become subject to most of the requirements, including new assessment area requirements and performance tests, until January 1, 2026. Banks will not be required to comply with new data reporting requirements until 2027.

Under the new rule, small banks will be defined as having total assets of less than $600 million, an increase from the $391 million threshold currently. Intermediate banks will be defined as having total assets between $600 million to $2 billion and large banks as having assets of $2 billion or more. The Final Rule would maintain the current CRA evaluation for small banks, unless a small bank opts in to the Retail Lending Test. Intermediate banks would be evaluated under the new Retail Lending Test and the existing Community Development Test, but would have the option to be evaluated under the Community Development Finance Test. Lastly, large banks would be evaluated under the Retail Lending Test, Community Development Finance Test, Retail Services and Products Test, and a Community Development Services Test. Large and intermediate banks will be subject to strict new performance tests that may make it more difficult for banks to achieve Satisfactory or Outstanding Ratings. Banks with assets of $10 billion or more will be subject to further requirements, including substantial new data collection and reporting.

The most meaningful change from the existing framework is the expansion of geographic areas in which banks may be evaluated for CRA activities. This new requirement will have the most impact on those banks with a nationwide digital banking strategy that have a small number of brick-and-mortar branches. Banks with at least $2 billion in assets and have 80% or less of their lending in traditional, local assessment areas, will be evaluated in newly created "retail lending assessment areas," defined as any metropolitan statistical area or nonmetropolitan area of a state where a bank originated more than 150 closed-end home mortgage loans or 400 small business loans in each of the prior two years, regardless of whether the bank has a physical location in those areas. Banks will continue to be evaluated in facility-based assessment areas, where they have branches and other deposit-taking facilities. Under the Final Rule, banks are supposed to receive consideration for any qualified community development loans, investments, or services, regardless of location. The Final Rule also sets new standardized metrics and quantitative standards and benchmarks for evaluating banks' CRA activities.

The Agencies are committed to develop and maintain a publicly available illustrative list containing examples of activities that qualify for Community Development credit.

While the Final Rule adopts the most significant aspects of the May 2022 Interagency Notice of Proposed Rulemaking (NPR) on CRA, there are some meaningful deviations. For example, the Final Rule will give equal weight to large banks' Retail Lending and Community Development Financing activities. In addition, the number of product lines subject to evaluation in the new Retail Lending Test is reduced and limits the evaluation of mortgage and small business lending assessment areas by increasing the applicable thresholds. Further, the Final Rule does not adopt the NPR's proposal to permit bank CRA rating downgrades based on virtually any illegal practice, even those unrelated to the credit and core objectives of the CRA. The Final Rule instead retains the existing regulatory standard that permits a downgrade only for discriminatory or other illegal credit practices.

Representatives of the Agencies emphasized that while the Final Rule on CRA has been issued, there is still significant work to be done. Admittedly, portions of the rule are still unfinished, such as the methodology to combine the various test benchmarks and metrics into a performance conclusion. Moreover, the illustrative list of Community Development activities has yet to be shared. More guidance will be provided for CRA practitioners and examiners in the weeks and months to come in the lead up for implementation. ■

Bank Trade Groups Sue Regulators to Halt CRA Final Rule Implementation

On February 5, financial services trade groups, including the American Bankers Association, Independent Community Bankers of America, US Chamber of Commerce, and Texas Bankers Association, filed a lawsuit in the Northern District of Texas to call on the court to immediately intervene and issue a preliminary injunction that will prevent the CRA Final Rule from taking effect. The plaintiffs asked the court to issue an order and judgment setting aside the CRA rules as illegal or impermissible.

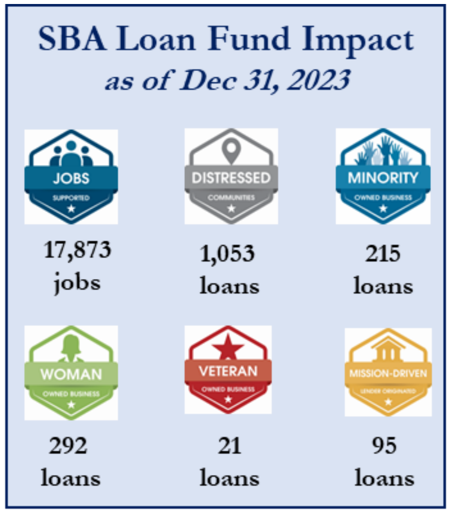
The suit alleges that the CRA Final Rules "work a wholesale and unlawful change to a statutory regulator regime that, for nearly five decades, has successfully encouraged lending in LMI neighborhoods across the United States." The plaintiffs argue that the final rule will result in "substantial and non-compensable compliance costs, which will by their very nature force businesses to immediately forgo other pressing business priorities" and could also result in unintended consequences such as banks closing branches or reducing product offerings. The suit further contends that the Regulators neglected to demonstrate evidence showcasing the advantage of the new regulations and disregarded the industry's concerns voiced during the public comment phase and thus rule breaches the procedural requisites for regulations as delineated in the Administrative Procedure Act.

Agencies to Host NICRC in Portland, March 4-7

The federal banking regulatory agencies are hosting the biannual National Interagency Community Reinvestment Conference at the Oregon Convention Center. This year attendees will learn about current regulatory processes and what to expect under the revised CRA regulation. Click here to learn more.

SBA Loan Fund Year in Review *(from page 1)* federally guaranteed portion of roughly 300 SBA 7(a) loans in the secondary market. These loans supported the creation and/or retention of an estimated 3,700 jobs, the majority of which are in low– to moderate-income (LMI) communities or to LMI persons. Since inception in 2004, the Fund has invested over $3.1 billion in over 5,700 SBA 7(a) loans that supported over 76,000 jobs.

The SBA Loan Fund is a national community development investment fund that provides investor banks with targeted impact credit under the CRA, under Community Development. The Fund acquires the guaranteed portion of SBA 7 (a) loans where the underlying small business borrower is located in a LMI or otherwise economically distressed census tract targeted for CRA credit by investor banks. The Fund was certified as a Community Development Entity (CDE) by the Community Development Financial Institutions (CDFI) Fund in 2005 and maintains this designation to-date. As of December 31, 2023, the SBA Loan Fund had total gross assets of $826 million. Total equity was $671 million and included paid in capital from 127 investors. Looking to 2024, Solomon Hess remains committed to serving investor banks as partners to promote job creation, retention, and improvement for LMI persons who are employed by small businesses across America. ■



SBA Loan Authorization in FY 2023

The SBA is an independent agency of the federal government established in 1953 to help Americans start, grow, and build resilient businesses. It has been a key driver in promoting entrepreneurship and economic growth by providing access to capital to small business owners, particularly the underserved, that would not qualify for conventional financing. For fiscal year 2023, the SBA delivered $50 billion in capital, disaster relief, and bonding to small businesses and disaster-impacted communities across America. The 7(a) program is the SBA's primary initiative for providing financial assistance to small businesses. In FY23, the SBA backed more than 57,300 7(a) loans worth $27.5 billion to small businesses, rising above pre-pandemic levels. In total, nearly 70% of 7(a) loan volume were small-dollar loans of $350,000 or less. ■

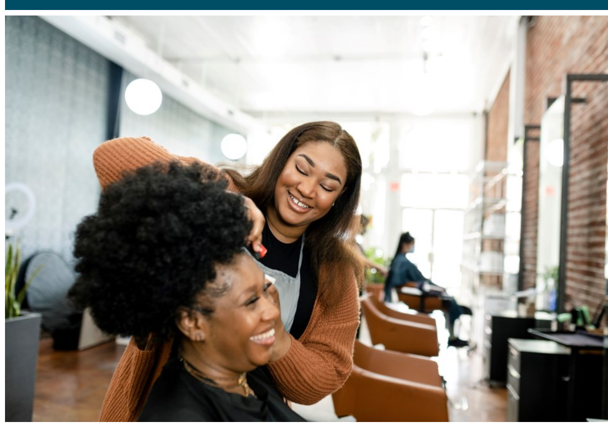
Agencies Release Annual Asset-Size Thresholds

On December 30, 2023, the Agencies issued the 2024 updated asset-size thresholds used to define bank size under the CRA regulations.

Asset-size thresholds became effective January 1, 2024. Small banks have assets of less than $391 million as of December 31 or either of the prior two calendar years. Intermediate small banks have assets of at least $391 million and less than $1.54 billion as of December 31 or either of the two prior calendar years. Large banks have assets of at least $1.54 billion as of December 31 or either of the two prior calendar years.

Asset-size thresholds are adjusted annually based on the average change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), which increased by 4.06 per cent for the period ending November 2023. ■

SBA 7(a) Loan Profile: Hair on Hudson Academy in Dutchess, New York



Proceeds of the SBA 7(a) loan to Hair on Hudson Academy were used to finance equipment for business operations. The borrower is located in a low-income census tract that is a CDFI Fund Qualified investment census tract. The borrower self-reported that this loan supported the creation and/or retention of six jobs. This loan was originated by mission-driven lender Empire Community Development Corporation. This is a minority– and woman-owned small business. Left, stock photo of a hair salon.

Another example of the type of loan the SBA Loan Fund tries to acquire for bank investors for community development is the loan to Hair on Hudson Academy. Located in Poughkeepsie, Hair on Hudson is an accredited cosmetology school that comprises students from diverse ethnic backgrounds and experiences. The school is complemented by a full-service salon studio, providing students the opportunity to apply theoretical learning with hands-on demonstrations that leverage advanced techniques under the mentorship of experienced stylists. Owner Angelline Smalls is an experienced stylist herself who also owns An'tryce Salon. Smalls is dedicated to serving her community and her passion is creating custom wigs for cancer patients. More examples of loans acquired by the SBA Loan Fund can be found at www.SolomonHess.com. ■

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SBA Loan Fund Impact: Supporting Community Development

Since inception in 2004, the Solomon Hess SBA Loan Fund has invested over $3.1 billion in small business loans. These loans, made to over 5,200 small businesses located in 47 states, have helped to create and/or retain over 76,000 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 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.

The Solomon Hess SBA Loan Fund LLC attempts to provide its investors with CRA consideration 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 consideration, the impact to Fund investors could be material. The loans discussed in this newsletter are current holdings of the SBA Loan Fund. The loans highlighted may not be the highest performing in the Fund, but a sampling of small business loans with an impact story. The loans mentioned do not necessarily represent all the loans held in the Fund and the reader should not assume that the loans identified and discussed were or will be profitable. A complete list of holdings for the Fund can be provided by contacting Solomon Hess Capital Management.

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