

**Item 1 – Cover Page**

**Solomon Hess SBA Management LLC**

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**January 1, 2013**

Form ADV, Part 2; our “Disclosure Brochure” or “Brochure” as required by the Investment Advisers Act of 1940 is a very important document between Clients (you, your) and Solomon Hess SBA Management LLC (us, we, our, the manager). This Brochure provides information about our qualifications and business practices.

***This brochure provides information about the qualifications and business practices of Solomon Hess SBA Management LLC. If you have any questions about the contents of this brochure, please contact us at 703.356.3333. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (SEC) or by any State Securities Authority.***

***Additional information about Solomon Hess SBA Management LLC also is available at the SEC’s website [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov) (click on the link, select “investment adviser firm” and type in our firm name). Results will provide you both Part 1 and 2 of our Form ADV.***

We are a registered investment adviser with the Securities and Exchange Commission. Our registration as an Investment Adviser does not imply any level of skill or training. The oral and written communications we provide to you, including this Brochure, are information you use to evaluate us (and other advisers) which are factors in your decision to hire us or to continue to maintain a mutually beneficial relationship.

## **Item 2 – Material Changes**

### **Annual Update**

The Material Changes section of this brochure will be updated annually, and when material changes occur since the previous release of the Firm Brochure.

We may, at any time, update this Brochure and either send you a copy or offer to send you a copy (either by electronic means (email) or in hard copy form).

If you would like a copy of this Brochure, please download it from the SEC Website as indicated above or you may contact our Chief Compliance Officer, William Einstein at 703-637-8414 or Weinstein@solomonhess.com.

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## **Item 4 – Advisory Business**

Solomon Hess SBA Management LLC (Solomon Hess) was formed in 2004 by William E. Einstein and Anthony J. “Gino” Heilizer to act as a management entity for SBA related investment Funds. Mr. Heilizer and Mr. Einstein own their interest in Solomon Hess SBA Management LLC via a holding company, Solomon Hess LLC, of which they collectively own 100%.

Solomon Hess manages nine investment Funds: the Solomon Hess SBA Loan Fund LLC, HEC Opportunity Fund LLC, ESI Investors LLC, ESI Investors II LLC, ESI Investors III LLC, Solomon Hess NMTC I LLC, Solomon Hess NMTC II LLC, Solomon Hess NMTC III LLC, and Solomon Hess NMTC IV LLC, (collectively, the “Funds” and individually a “Fund”). Descriptions of each Fund are included below. Investing in SBA and USDA loans, pools and excess servicing assets continues to be the investment focus of Solomon Hess.

Solomon Hess does not tailor its advisory services to the individual needs of the client; rather, clients invest in the Funds described below, and Solomon Hess manages those Funds according to the stated objectives and strategies of the Funds. Solomon Hess does not participate in wrap fee programs.

In aggregate, Solomon Hess has \$435 million of assets under management as of January 1, 2013, all of which are managed on a discretionary basis.

### **Solomon Hess SBA Loan Fund LLC**

Solomon Hess formed its first investment Fund, the Solomon Hess SBA Loan Fund LLC (SBA Loan Fund), in 2004 to primarily invest in the federally guaranteed portion of Small Business Administration (SBA) 7(a) loans that qualify for consideration under the Community Reinvestment Act (CRA). The CRA is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations.

In 2009, the SBA Loan Fund was awarded a \$50 million allocation of New Markets Tax Credit equity issuance authority from the Department of Treasury. The New Markets Tax Credit Program (NMTC Program) was established by Congress in 2000 to spur new or increased investments into operating businesses and real estate projects located in low-income communities. The NMTC Program attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal income tax return in exchange for making equity investments in specialized financial institutions called Community Development Entities (CDEs). The allocation, awarded to Solomon Hess SBA Loan Fund and which managed by Solomon Hess SBA Management LLC, was used to capitalize four separate Funds (Solomon Hess NMTC I

LLC, Solomon Hess NMTC II LLC, Solomon Hess NMTC III LLC, and Solomon Hess NMTC IV LLC,) that made qualifying loans to low income community businesses.

### **ESI Investors LLC**

In 2007, Solomon Hess established the ESI Investors LLC fund, (ESI) which primarily purchased interest only strips created off of SBA 7(a) loans. This Fund was closed to new investors in 2008.

### **ESI Investors II LLC**

In 2009, Solomon Hess established the ESI Investors II LLC fund, (ESI II) which exclusively purchased interest only strips created off of SBA 7(a) loans. This Fund was closed to new investors in 2009.

### **ESI Investors III LLC**

In 2011, Solomon Hess established the ESI Investors III LLC fund, (ESI III) which primarily purchases the guaranteed portion of SBA 7(a) loans, SBA 504 loan pools, United States Department of Agriculture (USDA) loans and interest only strips created off of these same assets. This Fund was closed to new investors in 2012.

### **HEC Opportunity Fund LLC**

In 2009, Solomon Hess established the HEC Opportunity Fund LLC, (Opportunity Fund) primarily to purchase the federally guaranteed portion of SBA 7(a) loans, SBA 504 loan pools and United States Department of Agriculture (USDA) loans and interest only strips created off of these same assets. This Fund was closed to new investors in 2011.

### **SBA and USDA Loans**

#### *Small Business Administration Loans:*

The United States Small Business Administration (SBA) offers a variety of loan programs for very specific purposes. Solomon Hess manages three Funds that primarily invest in the guaranteed portion of Small Business Administration (SBA) 7(a) loans. Recipients of 7(a) loans may use the loan proceeds to establish a new business, or assist in the acquisition, operation, or expansion of an existing business.

The SBA 504 Loan program is a long-term financing tool designed to encourage economic development within a community. The 504 Program accomplishes this by providing small businesses with long-term, fixed-rate financing to acquire major fixed assets for expansion or modernization.

### *United States Department of Agriculture Loans:*

The United States Department of Agriculture (USDA) offers government guaranteed loans to businesses located in rural communities.

### *Risk Overview:*

Solomon Hess invests in the federally guaranteed portion of these loans; however, these federally guaranteed assets are typically purchased at a premium to the face amount of the underlying loan. The premium paid to acquire the loan is at risk of loss.

### *Interest Only Strips:*

Solomon Hess also purchases Interest Only strips created off of these same types of loans when some of a loan's coupon is separated, or stripped off, from the underlying loan. This occurs most often so that the secondary market dealers can create SBA pool securities that have a common coupon. The cash flow on these strips is federally guaranteed for as long as the underlying loan is outstanding; however, once the underlying loan is paid off, for any reason, including the default of the business operator, the sale of the business, or the refinancing by the business of its existing loan, the cash flow on this investment is terminated.

For a more detailed description of the risks involved in these types of investments, please see Item 8 of this brochure.

## **Item 5 – Fees and Compensation**

Solomon Hess establishes its compensation for the management of the Funds through its Operating Agreements with the Funds and Investor Members. The fee structures for each Fund are described below.

### **SBA Loan Fund:**

Solomon Hess is paid a fee by the SBA Loan Fund of up to 60 basis points (.60%) annually on total, or gross, assets within this Fund, calculated on a GAAP basis. This fee is paid quarterly, in arrears, and is subordinate to a specified preferred return (the "Preferred Return"). For example, if the SBA Loan Fund underperforms in any given quarter, the management fee (60 bps) earned by Solomon Hess can be reduced potentially down to zero. Any amount of the management fee not collected as a result of underperformance of the Fund is not accrued but permanently waived.

Solomon Hess also charges the SBA Loan Fund investors a 10 basis point (.10%) annual fee on invested capital if an investor requests targeted CRA credit. This 10 basis point fee on invested capital is not subordinate to the investors' Preferred Return. As of January 1,

2013, 99% of the investors in the SBA Loan Fund had requested targeted CRA credit. Solomon Hess earns no other fees associated with the SBA Loan Fund. The above fees are paid quarterly, in arrears, via deduction from the SBA Loan Fund's accounts.

*New Markets Tax Credit projects (managed on behalf of the SBA Loan Fund)*

On the New Markets Tax Credit projects that Solomon Hess is managing on behalf of the SBA Loan Fund, Solomon Hess earns an annual management fee of 50 basis points (.50%) and a one-time initial fee generally in the 1-2% range of net assets. These fees are paid quarterly in arrears via deduction from the Funds' accounts.

The fees described above in this section are not negotiable.

**HEC Opportunity Fund, ESI Investors LLC, ESI Investors II LLC, and ESI Investors III LLC:**

On these Funds, Solomon Hess earns a 2% fee on net assets under management. The asset based management fee is calculated as 2% on net assets and is paid quarterly in arrears. The 2% asset management fee is deducted directly from the Funds' accounts each quarter.

The fees described above in this section are not negotiable.

**Other Fees:**

Assets owned by the Funds described above are held by qualified custodians, and fees for custodian services are charged to the Funds. In addition, certain other costs and expenses are incurred by the Funds including audit and accounting fees, administrative service fees, legal fees, and miscellaneous other costs involved in operating the Funds. These costs are charged directly to the Funds and will affect the overall performance of the Funds.

Neither Solomon Hess nor any of its supervised persons accepts compensation for the sale of securities or other investment products.

## **Item 6 – Performance-Based Fees and Side-By-Side Management**

### **Performance Based Fees**

Solomon Hess does not charge a performance fee on the SBA Loan Fund or the New Markets' Funds.

Solomon Hess or its related party, Solomon Hess LLC, charges a performance fee to the HEC Opportunity Fund LLC, ESI Investors LLC, ESI Investors II LLC, and ESI Investors III LLC paid in the form of a "carried interest".

## **Allocation of Investments between Funds**

Solomon Hess currently manages several investment Funds that purchase similar types of assets. These assets primarily include SBA 7(a) loans, SBA 7(a) pools, USDA Loans, and interest only strips created off of these same assets. Conflicts of interest may arise as a result of these Funds investing in similar assets, while only certain of these Funds pay performance based fees. Solomon Hess may have an economic incentive to favor a Fund from which it receives a performance based fee versus a Fund in which it only receives an asset management fee. In order to address these conflicts of interest, Solomon Hess adheres to a detailed asset allocation policy which we make available to our clients upon request.

## **Item 7 – Types of Clients**

Solomon Hess provides investment advice to several pooled investment vehicles (the Funds) that Solomon Hess has established. These vehicles are capitalized by both US domestic banks and individual accredited investors and qualified clients. As Solomon Hess is the sponsor of the Funds we create, we do not have minimum account sizes for these Funds. All investors in the Funds are considered “qualified clients” or “accredited investors”.

## **Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss**

The primary asset in which Solomon Hess invests on behalf of our client Funds is the federally guaranteed portion of SBA and USDA loans. As with any form of investing, there exists a wide variety of different risks including interest rate, market, inflation, currency, reinvestment and liquidity. Since the underlying loans in which Solomon Hess invests are federally guaranteed, many of these risks are mitigated by the federal guarantee; however, since these federally guaranteed assets are typically purchased at a premium to the face amount of the underlying loan, the premium paid by us to acquire the asset is at risk of loss. The premium paid for loans can range between 5%-20% of the underlying loan. Therefore, on each loan we purchase on behalf of our clients, on average 5%-20% of each investment is at risk of loss.

Solomon Hess also purchases Interest Only strips created off of these same types of loans. The cash flow on these investments is federally guaranteed for as long as the underlying loan is outstanding. Once the underlying loan is paid off, for any reason, including the default of the business operator, the sale of the business, or the refinancing by the business of its existing loan, the cash flow on this investment is terminated and the entire remaining investment in that asset needs to be written off.



In order to mitigate the risk associated with the early payoff of these assets, Solomon Hess has developed a prepayment model which takes into account over 20 years of historical prepayment characteristics of SBA and USDA loans. Prior to purchasing any SBA or USDA loan, pool or Interest Only strip, Solomon Hess will run that particular asset through its prepayment model, which makes an assumption of prepayment probability for each month of that asset's term. If the asset, after taking into account the projected prepayment speed from the model, is still expected to earn a sufficient yield to be considered an attractive investment, Solomon Hess will pursue investing in that asset. However these assets can under-perform historical averages. Earlier than expected payoffs can have a detrimental effect on the performance of these Funds. There are a number of reasons why SBA and USDA loans and strips would pay off quicker than they have historically, including an inverted yield curve, an excess amount of liquidity in the commercial lending market, an elevated Prime Rate, changes in U.S. tax laws, a deep recession, asset inflation, and changes to the SBA 7(a) program or other government sponsored small business lending programs.

### **Risk of Loss**

All investments in securities include a risk of loss of your principal (invested amount) and any profits that have not been realized. No investment strategy can assure a profit.

### **Item 9 – Disciplinary Information**

There have been no disciplinary actions taken against Solomon Hess or any members of its management team.

### **Item 10 – Other Financial Industry Activities and Affiliations**

Solomon Hess does not have any other financial industry activities or affiliations.

### **Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

Solomon Hess has adopted a Code of Ethics pursuant to SEC rule 204A-1 for all employees of the firm. The Code of Ethics includes provisions relating to the confidentiality of client information, a prohibition on insider trading, a prohibition of rumor mongering, restrictions on the acceptance of significant gifts and the reporting of certain gifts and business entertainment items, and personal securities trading procedures, among other things. All employees at Solomon Hess must acknowledge in writing the terms of the Code of Ethics annually, or as amended. Solomon Hess will provide a copy of the Code of Ethics to any client or prospective client upon request.

Solomon Hess will, at times, purchase assets for its own account but only if the assets are not suitable for ESI III, the Opportunity Fund or the SBA Loan Fund at that time, or if those Funds do not have the resources or capacity to invest in that particular asset. Only then will Solomon Hess purchase that asset for its own account. If, at a later date, the asset purchased by Solomon Hess becomes attractive to any of the Funds, and Solomon Hess wishes to transfer the asset to another Fund, Solomon Hess will be able to transfer or sell the asset to the Fund using the lower of the Fair Market Value or the amortized cost method for establishing a purchase price for the asset. There are potential conflicts of interest that may arise as a result of principal transactions but we believe these conflicts are mitigated by selling the asset to the Funds at the lower of Fair Market Value or amortized cost.

These principal transactions are fully disclosed to the investors of that particular Fund and this disclosure is maintained by Solomon Hess.

## **Item 12 – Brokerage Practices**

Solomon Hess acquires its assets on behalf of the Funds it manages primarily via a network of broker dealers that specialize in buying and selling SBA and USDA loans, pools and interest only strips. Solomon Hess has professional relationships with all of the major broker dealers active in this industry. Solomon Hess will decide which broker to use on a specific transaction based on many factors including what specific assets that broker has available for sale, the pricing of those assets and the efficiency of the broker's operations and settlement unit. That being said, Solomon Hess does have particular brokerage firms that it prefers to conduct business with as those firms provide Solomon Hess with cost effective execution via volume purchase discounts, good market coverage and excellent settlement support. Solomon Hess does not receive any soft dollar or other inducements to work with any particular dealer and has no affiliations with the broker dealers that it uses.

Solomon Hess does not allow investors to direct brokerage.

## **Item 13 – Review of Accounts**

Solomon Hess's principals supervise continuously the Funds managed by Solomon Hess. These Funds are generally reviewed more formally on a quarterly basis. The quarterly review usually includes assessing Fund goals and objectives, evaluating the employed strategy, monitoring the portfolio, and addressing the need to rebalance. Additional reviews may be triggered by a change in the Fund's goals or objectives, a change in the macroeconomic climate, and/or a change in the performance of the assets of the Fund in question.

## **Item 14 – Client Referrals and Other Compensation**

Solomon Hess has no relationships that provide economic benefits to us outside of the Funds we administer. Solomon Hess has no fee based arrangements with third parties.

## **Item 15 – Custody**

Solomon Hess does not directly hold client funds or securities. However, as a result of our ability to control and liquidate assets within the Fund accounts, we are deemed to have custody of client assets.

Rule 206(4) – 2 of the Investment Advisers Act (known as the “Custody Rule”) requires advisers with custody to maintain client funds and securities with “qualified custodians.” Qualified custodians include banks, registered broker-dealers, and certain foreign custodians. Qualified custodians are generally required to provide at least quarterly account statements directly to the adviser's clients. Solomon Hess maintains client funds at a qualified custodian; however, as an advisor to a pooled investment vehicle (PIV) that meets certain requirements (defined below), we are exempted (under the Custody Rule) from the requirement to have the qualified custodian deliver account statements directly to our clients. Additionally, under Rule 206(4)-2, a surprise examination is required for advisors who have custody of investor funds. An exemption to this requirement exists for certain advisers to PIVs. To use these exemptions related to PIVs, the PIV must be subject to an annual financial statement audit by a PCAOB (Public Company Accounting Oversight Board) registered and inspected accountant; and audited financial statements of the PIV must be distributed to the pool’s investors within 90 days of the completion of the audit. Solomon Hess meets the requirements for these exemptions.

Fund assets are held by qualified custodians. Quarterly statements to Fund investors are created and delivered by Solomon Hess. At year end, the annual financial statements are audited by an independent auditor and distributed to the Fund investors.

## **Item 16 – Investment Discretion**

Solomon Hess accepts full discretionary authority to manage its Funds. When granted authority to manage a Fund, Solomon Hess customarily has the authority to determine which types and quantity of assets that are bought or sold. Any discretionary authority accepted by Solomon Hess is subject to the Fund’s written investment objectives as described in the Offering Documents provided to the investors in the Funds. Solomon Hess will not exercise any discretionary authority until it has been given authority to do so in writing.

### **Item 17 – Voting *Client* Securities (i.e., Proxy Voting)**

Solomon Hess does not vote proxies on behalf of clients as the investments Solomon Hess makes do not generate proxies.

### **Item 18 – Financial Information**

Registered investment advisers are required in some cases to provide certain financial information and/or disclosures about their financial condition. For example, if the firm requires prepayment of fees for six months in advance or has custody of client funds, it is required to disclose any condition that is reasonably likely to impair its ability to meet its contractual commitments to its clients. Solomon Hess has no financial or operating conditions which trigger such additional reporting requirements.

### **Item 19 – Requirements for State-Registered Advisers**

As an SEC registered firm, this Item is not applicable.