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January 20, 2022

Mr. Kevin J. Kramp
Director, Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Proposed Rule – 12 CFR Part 628 – RIN 3052-AD42; *Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures*; 86 Federal Register 47601-47607

Dear Mr. Kramp:

CoBank, ACB ("CoBank") appreciates the opportunity to comment on the Farm Credit Administration's ("FCA") Proposed Rule regarding Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures that was published in the August 26, 2021 *Federal Register* (the "Proposed Rule").

CoBank participated with the Farm Credit Council ("FCC"), which assembled a workgroup from several Farm Credit System institutions, to review and discuss the Proposed Rule. Members of the workgroup included persons who have significant expertise in underwriting, risk management, legal, and evaluation and appraisal services, and insight was sought from persons outside of the workgroup, as well. We fully endorse the points made in the FCC comment letter. This comment letter emphasizes certain of those comments which CoBank believes are critical.

<u>General Comments</u>

We ask that FCA reconsider this regulatory action and significantly modify the proposed regulation. We generally support FCA's attempt to ensure the rules for System institutions are similar to those adopted by the Federal banking regulatory agencies ("FBRAs") with the guiding principle that "the same loan to the same borrower - whether it is made by a commercial bank or a System institution- carries the same risk and should be assigned the same risk-weight."[1] However, in this case, given the limited opportunities for System institutions to make High Volatility Commercial Real Estate loans, the burden for identifying such loans on an ongoing basis greatly exceeds the benefit of identifying the minimal potential adverse impact that such loans could have on the safety and soundness of a System institution. While we appreciate the premise that the FCA intends to "capture only those exposures that have increased risk

[1] Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures, 86 Fed. Reg. 47,602 (August 26, 2021).

characteristics in the acquisition, development or construction of real property,"[2] the HVCRE risk-weighting was designed by the FBRAs to identify commercial real estate loans of a speculative nature (such as office buildings and strip malls without signed lessees), a market in which the System does not actively or materially participate. In other words, the FCA has not established a need for this rulemaking other than consistency with the FBRAs. This is inconsistent with FCA's Regulatory Philosophy outlined in Board Policy Statement PS-59, which states "that benefits of any proposed regulation justify its cost," and "address identified risks in System institutions," as neither of these standards are met with this proposal. If the FCA wishes to discourage the extension of HVCRE loans by System institutions, there are less burdensome ways to accomplish that objective with less potential unintended consequences.

Notwithstanding our general view that there is little basis for this rulemaking, we appreciate the flexibility the FCA has offered and agree with the FCC that additional flexibility and clarification is needed. As a mission-focused organization, CoBank is tasked with serving agriculture and rural America. The proposed regulation presents potential obstacles to effectively meeting this mission, specifically as it relates to rural infrastructure, production facilities, and lending to young, beginning and small (YBS) farmers.

Infrastructure lending is often administered using project financing structures which are not clearly excluded in the proposed regulation. Accordingly, we ask that there be explicit exclusions of these types of loans which clearly benefit rural communities and establishes the rural economic structure which benefits YBS farmers and ranchers. In addition, it is not clear that facility construction loans which are dependent on payments from integrators would be excluded or that YBS loans which often include cross collateralization with parents or sponsors would be exempted. The FCC letter includes a more comprehensive assessment of these needed clarifications and exclusions.

<u>Project Financing Exclusion</u>

We ask that you specifically exclude project financing of public and private facilities from the definition of HVCRE exposure. These loans are critical for serving rural communities and include rural infrastructure projects for power generation, water treatment, and other product facilities where contractual agreements to purchase a sufficient amount of the energy generated, product produced, or water to be treated/provided are in place prior to construction of the facility. Project finance is a specialized form of financing, utilized in a very specific circumstance – the non-recourse or limited recourse funding of an individual asset or set of assets (a "project"). These construction projects may not have the collateral support prescribed by the proposed regulations, but they have significant offsetting strengths which mitigate risk and differentiate them from HVCRE exposures. Some of the more significant distinguishing characteristics are:

[2] Id.

- Loan repayment is typically dependent upon the revenues earned from the relevant project, without recourse to the sponsors. As a result, the loan liability generally is 'off balance sheet' for the sponsors. A credit evaluation must be made of the project independently of the sponsors whereby due diligence is focused on the quality of the cash flow stream derived from contracts and market-based products, as well as the various counterparties involved to build and operate the project. This is achieved both by an absolute requirement for payment, without excuse or set-off, and by the creditworthiness of the project's off-takers (i.e. the purchasers of the electricity, drinking water, or product), which typically carry an investment grade profile.

- The project is typically “ring-fenced” in a separate project company – a special purpose vehicle (SPV) – that is bankruptcy remote from the project sponsors. Revenue generated by the project is tightly controlled by the lenders via cash flow waterfall in a Depositary Agreement, and lenders typically hold security over all material project assets and documents, as well as the sponsors' equity in the project company.

This type of financing differs significantly from general corporate financing, where lenders rely on the strength of the balance sheet of the entire corporate entity, not performance of a single asset or a portfolio of assets. Lenders are primarily focused with the project’s value as a going concern and its ability to fulfill the contractual obligations stipulated under its offtake arrangements, whereas corporate lenders are focused on the overall company’s performance, liquidity and health of the balance sheet. Since the HVCRE definition focuses primarily on the value of the collateral and capital contributions, we are highly concerned that safe and sound project financing arrangements which are highly structured (most of which are structured to an investment-grade profile) could get inappropriately labeled as HVCRE—severely impacting the System’s ability to finance critical rural infrastructure projects, including renewable energy projects which also significantly contribute to ESG initiatives. Again, since the intent of the HVCRE risk-weighting, as designed by the FBRAs, was to identify commercial real estate loans of a speculative nature (such as office buildings and strip malls without signed lessors), project finance is not HVCRE and should be explicitly exempted from the HVCRE definition.

<u>Conclusion</u>

CoBank appreciates the opportunity to comment on the Proposed Rule and to present some of these requests for clarification and additional suggestions to FCA for its consideration. For at least the reasons stated herein and in the FCC’s comment letter, CoBank respectfully requests that FCA amend the Proposed Rule as discussed herein.

Sincerely,

Thomas E. Halverson
President and Chief Executive Officer