January 21, 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:

Farm Credit of Florida, ACA ("Farm Credit of Florida") 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 published in the August 26, 2021 *Federal Register* (the "Proposed Rule").

Farm Credit of Florida participated with a Farm Credit Council ("FCC") assembled workgroup consisting of representatives from a number of Farm Credit System institutions (inclusive of Farm Credit of Florida) that reviewed and discussed the implications and impacts of the Proposed Rule. Members of the workgroup included persons who have significant expertise in underwriting, risk management, legal, and evaluation and appraisal services. Additionally, insight was also secured from professionals outside of the workgroup.

We fully endorse the points referenced in the FCC comment letter attached to this correspondence and in this letter we emphasize certain comments deemed critical by Farm Credit of Florida.

General Comments

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 ability 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 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

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

11903 Southern Boulevard · Suite # 200 · West Palm Beach, Florida 33411
Phone 800.432.4156 · Fax 561.965.9099
FarmCreditFL.com

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 exception to the basis for this rulemaking, while we appreciate the flexibility the FCA has offered, we concur with FCC comment letter that additional flexibility and clarification is needed. Without such clarification or added flexibility, the proposed rulemaking would discourage lending to construct facilities that are mission-focused and/or provide critical support to rural communities.

Future Income

In its proposed definition of a HVCRE transaction, the FCA's third criterion centers on whether the credit facility relies on repayment from future income, with a specific exclusion stating that "credit facilities that will be repaid from the borrower's ongoing business would not be classified as a HVCRE exposure."[3] Additional clarity is needed on FCA's interpretation of "future income" and "income from ongoing business" given that later in the proposed rulemaking FCA implies that future income may be defined as "revenues from third party rents or lease payments."[4] We also request further explanation of whether "income from ongoing business" includes any assets built and operated by the business that developed the property. We are concerned that without specific examples or clear definition, the terms "future income" and "income from ongoing business" will be widely interpreted, which could lead to implementation challenges. Specifically, we request the definitions of "future income" and "income from ongoing business" identify how much income should be relied upon on a percentage basis when determining whether the property is income-producing. We also request that an explicit exclusion be listed in the regulation for credit facilities for which repayment would be from the ongoing business of the borrower. We also ask that FCA consider that repayment may come from multiple sources with rents or leases comprising only a portion of the repayment structure.

Structures on Farm Properties

We respectfully request clarification on FCA's Agricultural Land exclusion from the proposed HVCRE definition; specifically, the intent of specifically carving out "loans for farm property construction" from the Agricultural Land exclusion. FCA's discussion of the rule states "Loans made for farm property construction [*for which the Agricultural Land exemption is not applicable*] would include loans made to finance the onsite construction of industrial, commercial, residential, or **farm buildings**."[5] This statement appears to imply that credit facilities for the construction of poultry barns, dairy parlors, cattle feeding facilities, greenhouses, wineries, sawmills, and many other income-producing bona fide agricultural purposes would not qualify for the exemption and would be considered HVCRE, which contradicts the general premise of the proposed Agricultural Land exclusion. Due to the lower risk typically associated with these types of on-farm facilities we request

---

[3] Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures, 86 Fed. Reg. 47,603 (August 26, 2021).
[4] Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures, 86 Fed. Reg. 47,604 (August 26, 2021).
[5] *Id.*

FCA add the phrase "not related to on-going farming operations" after the term "farm buildings." Many Farm Credit of Florida loan packages are multi-faceted credit facilities with interdependent collateral packages that support both long- and short-term indebtedness. This loan structure reduces the risk of multi-phase, project-based financing where additional risk-weighting and capital allocation may be appropriate. Farm construction projects are often expansions of on-going farming operations, not singular speculative ventures, which are more common in commercial real property projects (e.g., shopping malls or apartment complexes). When a farm construction project is not part of an on-going farming operations, it is often the result of a new borrower first entering into agriculture. We request FCA consider potential young, beginning or small farmers and whether the proposed rulemaking inadvertently creates a barrier for entry into the agricultural industry based on typical System institution programs that offer reduced down payments, acceptance of a higher level of risk, and the higher risk rating which could potentially increase the cost of credit to this important segment of System borrowers.

Additional Proposed Exclusions

Although we appreciate the proposed exclusions to the scope of the HVCRE proposed rulemaking, we request that FCA also consider the proposed additional exclusions detailed in the FCC comment letter, particularly the two outlined below.

First, the current proposed rulemaking encompasses construction loans for "additions or alterations" regardless of materiality. We request FCA consider an exclusion for minor improvements or alterations to real property based on total cost or incremental value of the improvements. As proposed, new small improvement requests not treated through a modification to an existing permanent financing would require HVCRE classification.

Second, we suggest FCA consider an exclusion based on a *de minimus* level of financing as determined by each institution as a percentage of risk funds to allow System institutions to support smaller lending requests that may fall under this proposed rulemaking.

Conclusion

Farm Credit of Florida appreciates the opportunity to comment on the Proposed Rule and to emphasize requests for clarification and additional suggestions to FCA for its consideration. For the reasons stated herein and in FCC's comment letter, Farm Credit of Florida respectfully requests that FCA amend the Proposed Rule as discussed herein and in the FCC comment letter.

Respectfully submitted,

Farm Credit of Florida

W. Eric Hopkins
Chairman of the Board

Marcus A. Boone
Chief Executive Officer

Enc.

January 19, 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:

Farm Credit Council ("FCC") 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").

In order to better analyze the Proposed Rule and prepare a System comment, FCC assembled a workgroup of several Farm Credit System institutions, who met over a period of months to review and discuss the Prepublication Copy of the Proposed Rule, the Proposed Rule, existing regulations, relevant FCA-published materials, and materials and authorities relevant to other lending institutions including the Frequently Asked Questions on the Regulatory Capital Rule from the Office of the Comptroller of the Currency. 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.

This comment reflects FCC's general comments on the Proposed Rule, as well as specific comments and request for clarification on particular provisions of the Proposed Rule, based on FCC's review of the workgroup's inputs and its review and consideration of relevant authorities.

General Comments

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

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

and soundness of a System institution. While we appreciate the premise that the FCA intends to "capture only those exposures that have increased risk 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 exception to the basis for this rulemaking, we appreciate the flexibility the FCA has offered on the use of "as is" and "as completed" real property evaluations and ask for clarification or flexibility in other areas as discussed in the following sections. Without clarifications on the exclusions, the proposed rulemaking would discourage lending to construct facilities that are mission-focused and/or provide critical support to rural communities. We offer that in the normal course of business, System institutions also rate these borrowers in accordance with the level of construction risk. This practice effectively increases the cost of this specific type of lending and provides protection to the institution.

Future Income

In its proposed definition of a HVCRE transaction, the FCA's third criterion centers on whether the credit facility relies on repayment from future income, with a specific exclusion stating that "credit facilities that will be repaid from the borrower's ongoing business would not be classified as a HVCRE exposure."[3] Additional clarity is requested on FCA's interpretation of "future income" and "income from ongoing business" given that later in the proposed rulemaking FCA implies that future income may be defined as "revenues from third party rents or lease payments."[4] We also request further explanation of whether "income from ongoing business" includes any assets built and operated by the business that developed the property. We are concerned that without specific examples or clear definition, the terms "future income" and "income from ongoing business" will be widely interpreted, which could lead to implementation challenges. Specifically, we request the definitions of "future income" and "income from ongoing business" identify how much income should be relied upon on a percentage basis when determining whether the property is income-producing. We also request that an explicit exclusion be listed in the regulation for credit facilities for which repayment would be from the ongoing business of the borrower. We also ask that FCA consider that repayment may come from multiple sources with rents or leases comprising only a portion of the repayment structure.

---

[2] *Id.*
[3] Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures, 86 Fed. Reg. 47,603 (August 26, 2021).
[4] Risk Weighting of High Volatility Commercial Real Estate (HVCRE) Exposures, 86 Fed. Reg. 47,604 (August 26, 2021).

Structures on Farm Properties

We respectfully request clarification on FCA's Agricultural Land exclusion from the proposed HVCRE definition; specifically, the intent of specifically carving out "loans for farm property construction" from the Agricultural Land exclusion. FCA's discussion of the rule states "Loans made for farm property construction [*for which the Agricultural Land exemption is not applicable*] would include loans made to finance the onsite construction of industrial, commercial, residential, or **farm buildings**."[5] This statement appears to imply that credit facilities for the construction of poultry barns, dairy parlors, cattle feeding facilities, greenhouses, wineries, sawmills, and many other income-producing bona fide agricultural purposes would not qualify for the exemption and would be considered HVCRE, which contradicts the general premise of the proposed Agricultural Land exclusion. Due to the lower risk typically associated with these types of on-farm facilities we request FCA add the phrase "not related to on-going farming operations" after the term "farm buildings." System institution loan packages are often multi-faceted credit facilities with interdependent collateral packages that support both long- and short-term indebtedness. This loan structure reduces the risk of multi-phase, project-based financing where additional risk-weighting and capital allocation may be appropriate. Farm construction projects are often expansions of on-going farming operations, not singular speculative ventures, which are more common in commercial real property projects (e.g., shopping malls or apartment complexes). When a farm construction project is not part of an on-going farming operations, it is often the result of a new borrower first entering into agriculture. We request FCA consider potential young, beginning or small farmers and whether the proposed rulemaking inadvertently creates a barrier for entry into the agricultural industry based on typical System institution programs that offer reduced down payments, acceptance of a higher level of risk, and the higher risk rating which could potentially increase the cost of credit to this important segment of System borrowers.

Existing Income Producing Properties

The proposed rulemaking allows for an exclusion for existing income producing properties that qualify as permanent financing. We respectfully request FCA to require that the cash flow "test" to determine the sufficiency of the cash flow generated by the real property to support debt service and expenses is conducted at one time at the origination of the loan, and not to be required again as long as the subject loan continues to be paid as agreed.

Revenue from Third Party Rent or Lease Payments

Certain commercial real property projects are defined in the proposed rulemaking as a credit facility generally "used to acquire, develop, construct, improve, or refinance real property, and the primary source of repayment is dependent on the sale of the real property or the revenues from third-party rent or lease payments."[6] We respectfully request FCA to exclude third-party integrator agreements in the definition; or remove "third-party rent or lease payments" from the proposed definition. We also ask FCA to consider the impact of "third-party rent or lease payments" on

[5] *Id.*
[6] *Id.*

potential young, beginning, or small farmers who may be entering agriculture through the support of a third-party integrator agreement.

Capital Contributions

Certain commercial real property projects are eligible for an exclusion from the scope of HVCRE if the credit facility meets specific criteria, including a specific loan to value limit based on loan category, and 15% of borrower contributed capital to the project. FCA's definition of contributed capital in the proposed rulemaking includes "unencumbered readily marketable assets" and "contributed real property and improvements." We request clarification on FCA's expectation on frequency and extent of documentation on whether an asset is "readily marketable."

Additionally, we note that it is common for System institutions to cross collateralize other real estate collateral to new or existing credit facilities. To qualify for the 15% capital contribution, the proposed rulemaking requires that the real estate collateral is "directly related" to the project. It is common that for agricultural borrowers, the other real estate pledged may not be "directly related" to the project but is agricultural land integral to the overall operation and does not have the same risk profile as unrelated commercial development real estate projects. We respectfully request FCA to permit cross-collateralized real property or improvements to qualify as part of the capital contribution to the project. It is common for related parties (i.e., parents, siblings, etc.) to contribute collateral to support a loan to a young, beginning or small farmer to allow that borrower to obtain financing.

We also request FCA to make a distinction on real estate collateral taken as abundance of caution for purposes of the 15% capital contribution requirement as part of the certain commercial real property projects exclusion. Finally, we ask FCA to consider whether the loan to value limits contained in the proposed rulemaking require System institutions to potentially be more restrictive for its young, beginning and small farmer applicants.

Reclassification Determination

The proposed rulemaking allows a System institution to re-classify HVCRE exposures if two conditions are met, namely, substantial completion of the development or construction of the real property, whether a percentage complete based on project budget or other evidence of completion, and cash-flow generated by the property covers debt service and expenses. We request clarification from FCA on its expectation of the period that follows project completion to determine whether a projected cash flow is acceptable for purposes of reclassification. We also acknowledge that determination of projected cash flows generated from the real property can be difficult to calculate when the property is owned by the business. We request FCA provide further explanation on calculating projected cash flows on the subject real property if not separately provided by the borrower.

Additional Proposed Exclusions

Although we appreciate the proposed exclusions to the scope of the HVCRE proposed rulemaking, we suggest FCA consider five additional exclusions.

First, FCA should explicitly exclude project financing of public and private facilities, including rural infrastructure projects for power generation, water treatment, and other product facilities where contractual agreements to purchase a sufficient amount (as determined by the System institution's lending guidelines) 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 regulation, but they have significant offsetting strengths which mitigate risk and differentiate them from HVCRE exposures. Some of the more significant distinguishing characteristics are:

- Loan repayment is typically dependent upon the revenues earned from the relevant project, without recourse to 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 offtakers (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 (e.g., solar and wind power generation 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.

Second, FCA should explicitly exclude agricultural production or processing facilities where contractual agreements to purchase the agricultural products or food processed are in place prior to construction of the facility. Specifically, loans to finance construction of poultry or other livestock barns that are originated with an integrator contract to support the lending structure.

Third, the current proposed rulemaking encompasses construction loans for "additions or alterations" regardless of materiality. We request FCA consider an exclusion for minor improvements or alterations to real property based on total cost or incremental value of the improvements. As proposed, new small improvement requests not treated through a modification to an existing permanent financing would require HVCRE classification.

Fourth, as discussed above, we request that an explicit exclusion be listed in the regulation for credit facilities for which repayment would be from the ongoing business of the borrower.

Fifth, also as stated above, since other real estate pledged may be agricultural land not having the same risk profile as unrelated commercial development real estate projects, and also because it is common for related parties to contribute collateral to support a loan to a young, beginning or small farmer that allows that borrower to obtain financing, we also request FCA to permit cross-collateralized real property or improvements to qualify as part of the capital contribution to the project. Further, if the preponderance of collateral pledged does not meet the HVCRE definition we request that no identification or additional capitalization would be required. This arises in cases when a loan is collateralized by both HVCRE and non-HVCRE property, but the non-HVCRE property provides the majority of collateral support.

Finally, we suggest FCA consider an exclusion based on a *de minimus* level of financing as determined by each institution as a percentage of risk funds to allow System institutions to support smaller lending requests that may fall under this proposed rulemaking.

Conclusion

FCC 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 the reasons set forth in FCC's comment, FCC respectfully requests that FCA amend the Proposed Rule as discussed herein. Please do not hesitate to contact us should you have any questions.

Respectfully,

Robert Paul Boone, III
SVP & General Counsel, Farm Credit Council