



**FARM CREDIT ADMINISTRATION**

**12 CFR Part 628**

**RIN 3052-AD42**

**Risk-Weighting of High Volatility Commercial Real Estate  
(HVCRE) Exposures**

**AGENCY:** Farm Credit Administration.

**ACTION:** Final rule.

**SUMMARY:** The Farm Credit Administration (FCA or Agency) is amending its regulatory capital requirements for Farm Credit System (FCS or System) banks and associations to define and establish a risk weight for High Volatility Commercial Real Estate (HVCRE) exposures.

**DATES:** The final rule will be effective January 1, 2025.

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#### ***I. Introduction***

##### A. Objectives of the Final Rule

FCA's objectives in adopting this rule are to:

- Update capital requirements to reflect the increased risk characteristics exposures to certain acquisition, development or construction (ADC) loans pose to System institutions; and
- Ensure the System's capital requirements are comparable to the Basel Framework issued by the

Basel Committee on Banking Supervision (BCBS or Basel Committee) and the standardized approach the Federal banking regulatory agencies (FBRAs) have adopted,<sup>1</sup> with deviations as appropriate to accommodate the different regulatory, operational, and credit considerations of the System.

## B. Background

### 1. Farm Credit System

In 1916, Congress created the System to provide permanent, affordable, and reliable sources of credit and related services to American agricultural and aquatic producers. As of January 1, 2024, the System consists of three Farm Credit Banks, one agricultural credit bank, 55 agricultural credit associations, one Federal land credit association, several service corporations, and the Federal Farm Credit Banks Funding Corporation (Funding Corporation).<sup>2</sup> System banks (including both the Farm Credit Banks and the agricultural credit bank) issue Systemwide consolidated debt obligations in the capital markets

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<sup>1</sup> The FBRAs are the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC). In general, under the standardized approach, an institution's regulator assigns fixed risk weights to exposures based on their relative risk characteristics. (See Basel Framework at CRE 20).

<sup>2</sup> The Federal Agricultural Mortgage Corporation (Farmer Mac) is a Farm Credit System institution that was established in 1988 to create a secondary market for agricultural real estate mortgage loans and other rural-focused loans. The FCA has a separate set of capital regulations, at subpart B of part 652, that apply to Farmer Mac. This rulemaking does not affect Farmer Mac, and the use of the term "System institution" in this preamble and rule does not include Farmer Mac.

through the Funding Corporation,<sup>3</sup> which enables the System to extend short-, intermediate-, and long-term credit and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, aquatic producers and harvesters and their cooperatives, rural utilities, exporters of agricultural commodities products, farm-related businesses, and certain rural homeowners. The System's enabling statute is the Farm Credit Act of 1971, as amended (Act).<sup>4</sup>

## 2. Post-Financial Crisis Capital Rulemakings

In October 2013 and April 2014, the FBRAs published in the *Federal Register* capital rules governing the banking organizations they regulate (the U.S. rule).<sup>5</sup> When it was adopted, the U.S. rule reflected, in part, the BCBS's document entitled ``Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems'' (Basel III).<sup>6</sup> Although the U.S. rule has been updated since then, the risk weights generally have not changed.

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<sup>3</sup> The Funding Corporation was established pursuant to section 4.9 of the Farm Credit Act of 1971, as amended, and is owned by all System banks. The Funding Corporation is the fiscal agent and disclosure agent for the System. The Funding Corporation is responsible for issuing and marketing debt securities to finance the System's loans, leases, and operations and for preparing and producing the System's financial results.

<sup>4</sup> 12 U.S.C. §§ 2001-2279cc. The Act is available at [www.fca.gov](http://www.fca.gov) under "Laws and regulations" and "Statutes."

<sup>5</sup> 78 FR 62018 (October 11, 2013) (final rule of the OCC and the FRB); 79 FR 20754 (April 14, 2014) (final rule of the FDIC).

<sup>6</sup> See "Basel III: A global regulatory framework for more resilient banks and banking systems," revised version June 2011, and other Basel III documents at <https://www.bis.org/bcbs/basel3.htm?m=2572>. Prior to the FBRAs' adoption of these regulations, their rules reflected earlier Basel frameworks.

The BCBS was established in 1974 by central banks with bank supervisory authorities in major industrial countries. The BCBS develops banking guidelines and recommends them for adoption by member countries and others.<sup>7</sup> Basel III was an internationally agreed upon set of measures developed in response to the 2007-2009 worldwide financial crisis with the goal of strengthening the regulation, supervision, and risk management of banks. Since that time, the BCBS has revised, updated, and integrated the Basel III reforms into a consolidated Basel Framework (Basel Framework), which comprises of all of the current and forthcoming BCBS standards.<sup>8</sup> U.S. banking regulators are not required by law to adopt the Basel Framework but, as discussed above, the U.S. rule, which the FBRAs continue to update,<sup>9</sup> is Basel-based.<sup>10</sup>

FCA has had tier 1/tier 2 capital rules that are comparable to the Basel guidelines and the U.S. rule since 2016.<sup>11</sup> Beginning in 2010, System institutions requested FCA

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<sup>7</sup> The FBRAs are represented on the Basel Committee, but the FCA is not.

<sup>8</sup> The Basel Framework can be found at [http://www.bis.org/basel\\_framework/index.htm](http://www.bis.org/basel_framework/index.htm), and the BCBS continues to update it as indicated on the website.

<sup>9</sup> On September 18, 2023, the FBRAs issued a notice of proposed rulemaking (FR 88 64028) that would substantially revise the capital requirements applicable to large banking organizations and to banking organizations with significant trading activity. The proposed revisions would be generally consistent with recent changes to international capital standards by the BCBS.

<sup>10</sup> The Federal Housing Finance Agency, which oversees the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, has also adopted Basel-based capital rules.

<sup>11</sup> While FCA's earlier capital regulations incorporated some elements of Basel standards and the FBRAs' rules, particularly the risk weighting of assets in the denominator of the capital ratios, the rule FCA adopted in 2016 aligned the System's capital requirements more closely

adopt a capital framework that was as similar as possible to the capital guidelines of the FBRAs. In particular, System institutions had asserted that consistency of FCA capital requirements with those of the FBRAs would allow investors, shareholders, and others to better understand the financial strength and risk-bearing capacity of the System.<sup>12</sup>

### 3. ADC Lending Risk and HVCRE Risk Weight

Included in the provisions of FCA's 2014 proposed rulemaking to revise its regulatory capital requirements was a 150 percent risk weight for HVCRE exposures due to their higher risk characteristics.<sup>13</sup> As discussed below, HVCRE exposures are defined as acquisition, development, or construction exposures that meet certain criteria, and do not qualify for any of the exclusions, in the definition.

HVCRE exposures have increased risk characteristics supporting a 150 percent risk weight. Key risks to projects during the development and construction phase include, among others, financial risks, contract risks, and environmental risks. Financial risks include, but are not limited to, project delays and cost overruns, sponsor risk,

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with the Basel III framework and with the U.S. rule's standardized approach (which was based on Basel standards). See 81 FR 49720 (July 28, 2016). FCA has amended its capital rules since 2016, most significantly in 2021. See 86 FR 54347 (October 1, 2021). Like the FBRAs, FCA is not required by law to follow the Basel standards. The FCA's rule differed in some respects from the Basel standards and the U.S. rule in consideration of the cooperative structure and the organization of the System.

<sup>12</sup> See 79 FR 52814, 52820 (September 4, 2014).

<sup>13</sup> 79 FR 52814 (September 4, 2014).

project feasibility risk, and contractor risks. While these risks can be a threat to any type of lending, they are of particular risk to construction loans, because they can hinder project completion, and repayment of construction loans usually cannot begin until the project is finished.<sup>14</sup>

Project delays and cost overruns are two key financial risks to construction loans. Supply chain constraints, permit delays, and labor shortages are some examples of factors that can contribute to the delay of projects or their costs exceeding budget. Other financial risks include sponsor, project feasibility, and contractor risks. Sponsors without adequate and relevant industry and project planning experience and expertise increase the risk of a construction project incurring additional costs and delays, including permitting delays. Inadequate sponsor financial strength can impact the availability of sponsor capital when needed for budget overruns. Project feasibility considerations include changes in either supply or demand factors, technology considerations, and competitive forces, which could detrimentally impact the underlying economics of a construction project. Contractor risk can threaten the

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<sup>14</sup> Projects where repayment can begin before completion have fewer risk characteristics and may warrant a lower risk weight. As discussed in Section II.C.1 of this preamble – Scope of HVCRE Exposure Definition – under the third criterion of the HVCRE exposure definition, a credit facility that will be repaid from the borrower’s ongoing business, as opposed to being repaid from future income or sales proceeds from the property, would not be classified as an HVCRE exposure. Moreover, as discussed in Section II.C.2.c of this preamble – Loans on Existing Income Producing Properties That Qualify as Permanent Financings – loans on existing income producing properties that qualify as permanent financings are excluded from the definition of HVCRE exposure.

financial viability of a construction project if the contractor does not have the requisite experience and expertise to complete the project successfully. Contractor inefficiencies or errors can derail a project's timeline or budget. The financial capacity of the contractor is also critical, especially in cases where the contractor is responsible for any cost overruns.

Contract risk is another key category of risk in construction lending. One of the most important contractual agreements in a construction project is the construction contract. While some types of construction contracts shift the responsibility of managing key aspects of the project to a contractor, other contracts can leave the borrower exposed to such risks as fluctuations in input costs and potential contract disputes with sub-contractors.

Another key risk to construction projects is environmental risk. Such risk can arise when site assessments are not properly conducted prior to construction and unidentified environmental issues such as contamination later derail project timelines or budgets, or even threaten the viability of the project. Contamination can also occur after construction has already begun and potentially involve expensive cleanup costs. Beyond contamination, borrowers also face other potential environmental impacts of the project, including the effects

on native habitats for flora and fauna where legal or regulatory protections are in place.

FCA has recently seen certain System institution-funded construction projects particularly challenged due to some of the risks discussed above. Specifically, supply chain disruptions and labor shortages have led to project delays and cost overruns following the COVID-19 pandemic, recent geopolitical events, and increased inflation. Inflationary pressures continue to persist and have impacted the costs of some rural infrastructure projects.

Supply chain constraints and disruptions in project financings across different industries, including the leasing sector, have in some cases resulted in material increases in project costs and construction delays. The impact to costs and schedules has stemmed partly from the inadequate supply of key components but also from increased input costs. Such supply chain issues could pose a credit risk to System institutions if construction timelines are materially impacted and construction costs increase significantly during the construction phase.

As discussed above, various risks have continued to underscore construction lending, some of which have been more evident in recent years. These risks threaten the ability for such projects to be completed in a manner that ensures adequate repayment to lenders. As such,

construction exposures warrant the higher risk weight proposed in this rule.

The FBRAs first recognized the higher risk in construction lending in the higher risk weights they adopted in their capital regulations in 2013-2014. FCA's 2014 proposed HVCRE provisions were very similar to those the FBRAs had adopted. System commenters expressed concern about parts of the proposed HVCRE definition and asked FCA not to adopt the definition. FCA did not adopt the HVCRE provisions in its capital rule in 2016, because it wanted to further consider and analyze HVCRE and the issues related to these exposures. In the preamble to the final capital rule in 2016, FCA said the Agency expected to engage in additional HVCRE rulemaking in the future.<sup>15</sup>

Beginning in 2017, the FBRAs issued several proposed rules on HVCRE exposures to address concerns with the original definition.<sup>16</sup> On May 24, 2018, the President signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),<sup>17</sup> adding a new statutory definition that would have to be satisfied for an exposure to be risk-weighted as an HVCRE exposure. On December 13, 2019, the FBRAs published a final rule, which became

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<sup>15</sup> 81 FR 49719, 49736 (July 28, 2016).

<sup>16</sup> FCA staff submitted a comment letter in response to one of the proposals that communicated concerns with a proposed exemption for agricultural land.

<sup>17</sup> Public Law 115-174, 132 Stat. 1296 (2018).

effective on April 1, 2020, implementing the EGRRCPA requirements.<sup>18</sup>

Recognizing the need to update capital requirements to reflect the increased risk characteristics that exposures to HVCRE loans pose to System institutions, and in accordance with this rule's objective to ensure continued comparability to the Basel guidelines and the FBRAs' rules, on August 26, 2021, FCA published in the *Federal Register* a notice of proposed rulemaking (proposed rule or proposal) seeking public comment on amendments to its capital rules to define and establish a risk weight for HVCRE exposures.<sup>19</sup>

## ***II. Summary of the Proposed Rule, Comments Received, and Final Rule***

FCA's proposed rule was similar to the FBRAs' rule in most respects, with deviations as appropriate to accommodate the different regulatory, operational, and credit considerations of the System. Notably, the proposed rule contained provisions from the FBRAs' final rule that addressed certain concerns commenters raised in response to the FCA's 2014 proposed rule.

As discussed further below, FCA is adopting a final definition of HVCRE exposure with one modification from the proposal based on comments received. The Agency is also

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<sup>18</sup> 84 FR 68019.

<sup>19</sup> 86 FR 47601 (August 26, 2021). The proposed rule included a 90-day comment period. On October 20, 2021, FCA published in the *Federal Register* a notice extending the comment period for an additional 60 days, until January 24, 2022.

clarifying in this preamble certain provisions of the HVCRE rule.

FCA reminds System institutions that this is a risk-weighting regulation only. System scope and eligibility authorities are contained in other provisions of FCA's regulations and in the Act.<sup>20</sup>

#### *A. Summary of the Proposed Rule*

Because of the increased risk characteristics in HVCRE exposures, FCA proposed, consistent with the FBRAs, to assign a 150 percent risk weight to those exposures, rather than the 100 percent risk weight generally assigned to commercial real estate and other corporate exposures.<sup>21</sup>

#### *B. Comments Received*

In response to the HVCRE proposal, FCA received 11 comment letters: One letter from the Farm Credit Council (FCC), with input from a System workgroup, consisting of several System institutions, that was established to review the HVCRE proposal and other related documents (System Comment Letter);<sup>22</sup> one letter each from CoBank, ACB (CoBank Letter),<sup>23</sup> Farm Credit Bank of Texas (FCBT Letter),<sup>24</sup> and AgriBank, FCB (AgriBank Letter),<sup>25</sup> all of which are System

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<sup>20</sup> As stated in the preamble to the capital rule FCA adopted in 2016, "We remind System institutions that the presence of a particular risk weighting does not itself provide authority for a System institution to have an exposure to that asset or item." See 81 FR 49719, 49722 (July 28, 2016).

<sup>21</sup> FCA regulation §628.32(f)(1).

<sup>22</sup> System Comment Letter dated January 19, 2022.

<sup>23</sup> CoBank Letter dated January 20, 2022.

<sup>24</sup> FCBT Letter dated January 24, 2022.

<sup>25</sup> AgriBank Letter dated January 24, 2022.

banks; and letters from seven System associations: Farm Credit Mid-America, ACA,<sup>26</sup> Farm Credit of the Virginias, ACA,<sup>27</sup> Northwest Farm Credit Services, ACA (Northwest Letter),<sup>28</sup> Capital Farm Credit, ACA,<sup>29</sup> Farm Credit West,<sup>30</sup> ACA, Compeer Financial, ACA,<sup>31</sup> and Farm Credit of Florida, ACA.<sup>32</sup> All System bank and association commenters supported the System Comment Letter, and several included identical language seeking clarification on several provisions and requesting further exclusions to the HVCRE exposure definition. Furthermore, no commenters supported any specific provisions of the proposed rule, and they all stated the burden of identifying HVCRE 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. However, System commenters generally supported FCA's attempt to ensure FCA's capital rules are similar to those adopted by the 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.

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<sup>26</sup> Farm Credit Mid-America, ACA Letter dated January 26, 2022.

<sup>27</sup> Farm Credit of the Virginias, ACA Letter dated January 24, 2022.

<sup>28</sup> Northwest Letter dated January 24, 2022. Northwest Farm Credit Services, ACA merged with Farm Credit West, ACA to form AgWest Farm Credit, ACA, effective January 1, 2023.

<sup>29</sup> Capital Farm Credit, ACA Letter dated January 21, 2022.

<sup>30</sup> Farm Credit West, ACA Letter dated January 22, 2022. Farm Credit West, ACA merged with Northwest Farm Credit Services, ACA to form AgWest Farm Credit, ACA, effective January 1, 2023.

<sup>31</sup> Compeer Financial, ACA Letter dated January 18, 2022.

<sup>32</sup> Farm Credit of Florida, ACA Letter dated January 21, 2022.

*C. Discussion of Final Rule and Responses to Comments*

*1. Scope of HVCRE Exposure Definition*

FCA proposed to define an HVCRE exposure as “a credit facility secured by land or improved real property” that met the three criteria discussed below (and that did not meet any of the definition’s exclusions, which are discussed in Section II.C.2 of this preamble – Exclusions From HVCRE Exposure Definition).<sup>33</sup> If a credit facility secured by land or improved real property did not meet all three criteria, it would not be an HVCRE exposure.

The determination of whether a credit facility is an HVCRE exposure is made on new exposures only. New exposures determined not to be HVCRE after initial evaluation do not need to be evaluated again as HVCRE exposures. New exposures include loan originations, modifications, and project alterations that materially change the underwriting of the credit facility (such as increases to the loan amount, changes to the size and scope of the project, or removing all or part of the 15 percent minimum capital contribution in a project).

Credit facilities that meet the definition of HVCRE exposure after initial evaluation may be reclassified as non-HVCRE if they meet the criteria discussed in Section

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<sup>33</sup> FCA regulation § 614.4240(q) defines “real property” as “all interests, benefits, and rights inherent in the ownership of real estate.”

II.C.3 of this preamble - Reclassification as a Non-HVCRE Exposure.

Under the proposed definition, a credit facility is secured by land or improved real property if the estimated value of the real estate collateral at origination (after deducting all senior liens held by others) is greater than 50 percent of the principal amount of the loan at origination.<sup>34</sup> For example, if an institution made a loan to construct and equip a building, and the loan was secured by both the real estate and the equipment, the institution would have to estimate the value of the building, upon completion, and of the equipment. If the value of the building was greater than 50 percent of the principal amount of the loan at origination, the loan would be a "credit facility secured by land or improved real property."<sup>35</sup> If the value of the building, upon completion, was less than 50 percent of the principal amount of the loan at origination, it would not be a "credit facility secured by land or improved real property." Accordingly, it would not be an HVCRE exposure.

As discussed above, a credit facility that is secured by land or improved real property would not be classified as an HVCRE exposure under the proposed rule unless it met

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<sup>34</sup> This proposed definition is consistent with the definition of "a loan secured by real estate" in the FBRAs' Call Report forms and instructions.

<sup>35</sup> A determination that a loan is a "credit facility secured by land or improved real property" does not mean that the loan is necessarily an HVCRE exposure. As mentioned above, a loan also has to satisfy three criteria, and not be subject to an exclusion, to be an HVCRE exposure.

three criteria. If such a facility did not meet all three criteria, it would not be an HVCRE exposure. These criteria are discussed below.

*Description of Three Criteria of HVCRE Definition*

First, under paragraph (1)(i) of the proposed HVCRE definition, the credit facility must primarily finance, have financed, or refinance the acquisition, development, or construction of real property. This criterion would be satisfied if more than 50 percent of the proposed use of the loan funds was for the acquisition, development, or construction of real property. The criterion would not be satisfied if 50 percent or less of the proposed use of the loan funds was for the acquisition, development, or construction of real property. In the case of revolver loans that are secured by land or real property, if more than 50 percent of the proposed use of the revolver funds is for acquisition, development, or construction of real property, the entire loan would satisfy this criterion and potentially be subject to HVCRE classification if it meets the other two criteria and is not subject to an exclusion.

Second, under paragraph (1)(ii) of the proposed HVCRE definition, the purpose of the credit facility must be to provide financing to acquire, develop, or improve such real property into income-producing property.

Finally, under paragraph (1)(iii) of the proposed HVCRE definition, the repayment of the credit facility must

depend upon the future income or sales proceeds from, or refinancing of, such real property. The preamble to the proposed rule explained that under this criterion, credit facilities that would be repaid from the borrower's ongoing business, as opposed to being repaid from future income or sales proceeds from the property, would not be classified as an HVCRE exposure.

*Comments on HVCRE Exposure Definition and FCA's Responses*

FCA received various comments on the proposed definition of HVCRE exposures, including the three criteria. On a broad level the Farm Credit Council, supported by all System bank and association commenters, commented that the rulemaking was not needed due to limited opportunity for System institutions to make HVCRE loans. They commented that the burden in identifying these loans exceeds the benefit of identifying the risk to safety and soundness.<sup>36</sup>

These comments are premised on a misunderstanding of the definition of HVCRE. Specifically, these comments assert that the HVCRE risk weight "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)."<sup>37</sup>

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<sup>36</sup> CoBank Letter dated January 20, 2022, and Farm Credit of Florida, ACA Letter, dated January 21, 2022, reiterated this comment verbatim while Capital Farm Credit, ACA Letter, dated January 21, 2022, reiterated the comment in summary form.

<sup>37</sup> System Comment Letter dated January 19, 2022, page 2.

Contrary to the commenters' assertion, the FBRAs' definition includes more than just speculative commercial real estate loans. The plain language of their definition includes all credit facilities that are secured by land or improved real property and that satisfy the three criteria and are not subject to an exclusion. None of the criteria and exclusions limit the HVCRE definition only to speculative commercial real estate loans. The HVCRE definition, including the three criteria and considering the exclusions, includes, for example, project finance construction and construction of facilities dependent on third-party integrator agreements. System institutions make loans of this nature, and such loans satisfy this definition.

The System Comment Letter also stated that there are better ways to accomplish the Agency's objectives.<sup>38</sup> Two commenters referenced System practices currently in place at System institutions to control risk concentrations in construction exposures including risk-based borrower ratings, concentration and hold limits, and underwriting standards.<sup>39</sup> While the Agency recognizes that System institutions can mitigate their HVCRE risk exposures through risk management practices, regulatory risk weights

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<sup>38</sup> CoBank Letter dated January 20, 2022, and Farm Credit of Florida, ACA Letter, dated January 21, 2022, reiterated this comment verbatim while Capital Farm Credit, ACA Letter, dated January 21, 2022, reiterated the comment in summary form.

<sup>39</sup> Farm Credit of the Virginias, ACA Letter dated January 24, 2022, and Farm Credit West, ACA Letter dated January 22, 2022.

ensure that a minimum amount of capital is reserved by all institutions. In the same way that corporate exposures are generally risk-weighted at 100 percent<sup>40</sup> and certain past due and nonaccrual exposures are risk-weighted at 150 percent<sup>41</sup> despite variations in institutions' credit administration practices, HVCRE exposures should all be subject to the same risk weight, regardless of an individual institution's risk management practices.

The System Comment Letter, supported by all System bank and association commenters, included various questions and comments regarding the proposed third criterion.<sup>42</sup> The Letter requested clarification of the terms "future income" and "income from ongoing business"; asked whether "income from ongoing business" includes any assets built and operated by the business that developed the property; asked the percentage of future and ongoing income relied upon when determining whether a property is income-producing; and requested consideration of the fact that repayment can come from multiple sources. Moreover, the letter requested an explicit exclusion in the regulation for credit facilities for which repayment would be from the ongoing business of the borrower as well as removal of "third-party rent or lease payments" from the proposed definition.

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<sup>40</sup> § 628.32(f)(1).

<sup>41</sup> FCA regulation § 628.32(k)(1) assigns a 150 percent risk weight to past due and nonaccrual exposures, except sovereign or residential exposures, that are not guaranteed or secured by financial collateral.

<sup>42</sup> Farm Credit of Florida, ACA Letter, dated January 21, 2022, reiterated the System Comment Letter's questions and comments verbatim.

Finally, the letter included a request for FCA to consider the impact of "third-party rent or lease payments" on young, beginning, or small (YBS) farmers who may rely on third-party integrator agreements to start themselves in agriculture.<sup>43</sup>

In response to these comments, FCA reiterates that the proposed third criterion was that the credit facility is "dependent on future income or sales proceeds from, or refinancing of," the property for repayment. The proposed regulation did not refer to "income from ongoing business." The preamble to the proposed rule discussed loan repayment from ongoing business as an example of a form of repayment that does not satisfy the proposed third criterion because it is not repayment from future income or sales proceeds from the real property.<sup>44</sup> FCA confirms that if a credit facility was dependent on any form of repayment other than future income or sales proceeds from, or the refinancing of, the real property, including repayment from income generated by any assets within a borrower's portfolio, it would not satisfy this proposed criterion and would therefore not be an HVCRE exposure.

The System Comment Letter specifically referenced assets built and operated by the business that developed

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<sup>43</sup> Section 4.19 of the Act requires each System association, under policies of and subject to review and approval of its funding bank, to prepare a program for furnishing sound and constructive credit and related services to YBS farmers and ranchers. This requirement is implemented by FCA regulations at 12 CFR § 614.4165.

<sup>44</sup> 86 FR 47601, 47603 (August 26, 2021).

the property. FCA clarifies that for the purpose of HVCRE classification, the cash flow of the borrower must be analyzed, not that of the property developer or some other entity other than the borrower. Because this preamble clarifies the plain language of the third criterion, that credit facilities for which repayment would be from the ongoing business of the borrower are not covered by that criterion and are not HVCRE exposures, explicit regulatory language to that effect is not needed.

In response to the question about the percentage of future and ongoing income relied upon when determining whether a property is income-producing and for consideration of the fact that repayment can come from multiple sources (both ongoing and future income or sales proceeds), FCA retains the proposed requirement that if any part of the repayment on a credit facility depends on future income or sales proceeds, the credit facility satisfies the proposed third criterion. FCA believes specifying a percentage threshold for future income other than zero to determine HVCRE status would be overly complicated and burdensome. The Agency recognizes that repayment of credit facilities may come from multiple sources but, for the purpose of HVCRE classification, if any repayment depends on future income or sales proceeds, the exposure would meet the proposed third criterion of the definition of HVCRE.

Regarding the System Comment Letter's request to remove "third-party rent or lease payments" from the proposed definition of HVCRE exposure, FCA notes that terminology is not actually included in the definition. Rather, it is found in the preamble to the proposed rule, in a discussion of "certain commercial real property projects" that would qualify for exclusion from HVCRE.<sup>45</sup> As such, there is no need to remove that term from the definition of HVCRE. However, in Section II.C.2.d of this preamble - Certain Commercial Real Property Projects - the reference to "third-party rent or lease payments" that was in the preamble to the proposed rule has been replaced with a reference to "revenues from future income."

As discussed above, credit facilities where repayment would be from any type of future income, including third-party rents or lease payments, were included in the proposed definition of HVCRE to reflect the risk of such facilities. Excluding third-party rents or lease payments, including third-party integrator agreements, from the definition of future income is not warranted by the risk in those exposures. There is further discussion around exclusions for integrator contracts in Section II.C.2.f.ii of this preamble - Agricultural Production or Processing Facilities with Contractual Purchase Agreements in Place - including the Agency's consideration of YBS farmers.

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<sup>45</sup> 86 FR 47601, 47604 (August 26, 2021).

For the reasons stated above, FCA is adopting as final, without change from the proposal, the definition of HVCRE as a credit facility secured by land or improved real property. In addition, the Agency is adopting, as proposed, the three criteria outlined above. The exclusions from the HVCRE definition, as well as related comments and FCA's responses, will be discussed in the next section of the preamble.

FCA's final rule is similar to the FBRAs' rule in most respects, but it differs in two general areas. The FBRAs' rule clarified the interpretation of certain terms generally to be consistent with their usage in other FBRA regulations or Call Report instructions. The FCA did not propose different interpretations of these terms, nor did the Agency propose to refer to these FBRA references. In addition, FCA proposed some differences where appropriate to accommodate the different regulatory, operational, and credit considerations of the System, while continuing to maintain appropriate safety and soundness. FCA's proposed definition of HVCRE exposure was intended to capture only those exposures that have increased risk characteristics in the acquisition, development, or construction of real property.

## 2. Exclusions From HVCRE Exposure Definition

Under FCA's HVCRE proposal, like the FBRA rule, four broad types of exposures were excluded from the definition

of HVCRE exposure. These types of exposures are discussed in the following sections.

a. One- to Four-Family Residential Properties

Under paragraph (2) (i) (A) of FCA's proposed HVCRE definition, as in a similar provision of the FBRA rule, an HVCRE exposure did not include a credit facility financing the acquisition, development, or construction of properties that are one- to four-family residential properties, provided that the dwelling (including attached components such as garages, porches, and decks) represented at least 50 percent of the total appraised value of the collateral secured by the first or subsequent lien.

Manufactured homes permanently affixed to the underlying property, when deemed to be real property under state law, would qualify for this proposed exclusion, as would construction loans secured by single family dwelling units, duplex units, and townhouses. Condominium and cooperative construction loans would qualify for this proposed exclusion, even if the loan was financing the construction of a building with five or more dwelling units, if the repayment of the loan came from the sale of individual condominium dwelling units or individual cooperative housing units.

This proposed exclusion would apply to all credit facilities that fall within its scope, whether rural home financing under § 613.3030 or one- to four-family

residential property financing under § 613.3000(b). Similar to the reduced risk weight assigned to residential mortgage exposures under § 628.32(g)(1), a credit facility would qualify for this proposed exclusion only if the property securing the credit facility exhibited characteristics of residential property rather than agricultural property including, but not limited to, the requirement that the dwelling (including attached components such as garages, porches, and decks) represents at least 50 percent of the total appraised value of the collateral secured by the first or subsequent lien. If examiners determined that the property was not residential in nature, the credit facility would not qualify for this proposed exclusion.

Loans for multifamily residential property construction (such as apartment buildings where loan repayment is dependent upon apartment rental income) would not qualify for this proposed exclusion.<sup>46</sup>

Loans used solely to acquire undeveloped land for the purpose of constructing one- to four-family residential structures would not qualify for this proposed exclusion; the credit facility would also have to include financing for the construction of one- to four-family residential structures. Moreover, credit facilities that do not finance the construction of one- to four-family residential

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<sup>46</sup> Certain multifamily residential property may meet the "other credit needs" financing available to eligible borrowers as authorized by sections 1.11(a)(1) and 2.4(a)(1) of the Act and referenced in § 613.3000(b).

structures (as defined above), but instead solely finance improvements such as the laying of sewers, water pipes, and similar improvements to land, would not qualify for this proposed exclusion. A credit facility that combines the financing of land development and the construction of one- to four-family structures would qualify for this proposed exclusion.

FCA did not receive any comments on this proposed exclusion and is adopting the exclusion as proposed.

b. Agricultural Land

Under paragraph (2) (i) (C) of its proposed HVCRE definition, FCA proposed to exclude credit facilities financing "agricultural land," as defined in FCA regulation § 619.9025, or real estate used as an integral part of an aquatic operation. FCA regulation § 619.9025 defines "agricultural land" as "land improved or unimproved which is devoted to or available for the production of crops and other products such as but not limited to fruits and timber or for the raising of livestock."

The proposed exclusion applied only to financing for the agricultural and aquatic needs of bona fide farmers, ranchers, and producers and harvesters of aquatic products under § 613.3000 of FCA regulations. It did not apply to loans for farm property construction or land development purposes.

FCA intended its proposed agricultural land exclusion to have the same scope as the agricultural land exclusion of the FBRAs. The FBRAs' definition of agricultural land has the same meaning as "farmland" in their Call Report forms and instructions.<sup>47</sup> They define farmland as "all land known to be used or usable for agricultural purposes, such as crop and livestock production. Farmland includes grazing or pastureland, whether tillable or not and whether wooded or not." Loans for farm property construction and land development purposes are not "farmland" loans, and therefore such loans do not fall within the FBRAs' agricultural land exclusion. Unlike the FBRAs, FCA proposed to expressly include within the agricultural land exclusion real estate that is an integral part of an aquatic operation.

As in the FBRAs' final rule, loans for land development purposes and farm property construction would not have been eligible in FCA's proposed rule for the agricultural land exclusion. Loans made for land development purposes would include loans made to finance property improvements, such as laying sewers or water pipes preparatory to erecting new structures. Loans made for farm property construction would include loans made to finance the on-site construction of industrial, commercial,

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<sup>47</sup> See Federal Financial Institutions Examination Council (FFIEC) 031 and FFIEC 041 - Instructions for Preparation of Consolidated Reports of Condition and Income.

residential, or farm buildings. For the purposes of this exclusion, "construction" includes not only construction of new structures, but also additions or alterations to existing structures and the demolition of existing structures to make way for new structures.

Exposures to land in transition - agricultural land in the path of development - were not automatically excluded from the definition of HVCRE through the proposed agricultural land exclusion. These exposures would need to be evaluated against the three criteria of the HVCRE definition discussed in Section II.C.1 of this preamble - Scope of HVCRE Exposure Definition - as well as all exclusions discussed in this preamble, to determine whether they are HVCRE exposures.

FCA received several comments related to the proposed agricultural land exclusion. The System Comment Letter, and several other comment letters,<sup>48</sup> highlighted the section of the proposed rule preamble that explained the exclusion would not apply to loans for farm property construction, including farm buildings. They stated that not applying the exclusion to the construction of farm buildings was contradictory to the underlying premise of the agricultural land exclusion and did not recognize the lower risk of

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<sup>48</sup> FCBT Letter dated January 24, 2022, Farm Credit of the Virginias, ACA Letter dated January 24, 2022, Capital Farm Credit, ACA Letter dated January 21, 2022, Farm Credit West, ACA Letter dated January 22, 2022 and Farm Credit of Florida, ACA Letter dated January 21, 2022.

these types of "on-farm facilities."<sup>49</sup> The letter requested that FCA add "not related to on-going farming operations" after the term "farm buildings," indicating that the interdependent nature of System loan packages and the fact that farm construction projects are often related to ongoing farming operations reduces the risk of such projects.<sup>50</sup>

As discussed above, the scope of FCA's proposed agricultural land exclusion was similar to that of the FBRAs' (except that FCA's proposed exclusion added exposures to real estate that is an integral part of an aquatic operation). The FBRAs' exclusion includes exposures to "farmland" only and does not include loans for farm property construction. Therefore, the commenters' statement that not applying the exclusion to the construction of farm buildings is contradictory to the underlying premise of the agricultural land exclusion is not correct.

In response to the commenters' request that FCA expand the scope of the proposed exclusion to include the construction of farm buildings related to ongoing farming operations, FCA notes, as discussed in Section II.C.1 of this preamble - Scope of HVCRE Exposure Definition, that farm building construction projects where repayment of the credit facility will be from ongoing farming operations do not meet the third criterion of the proposed HVCRE

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<sup>49</sup> System Comment Letter dated January 19, 2022, page 3.

definition and would not be subject to the increased risk weight. The third criterion is that repayment of the credit facility is dependent on the future income or sales proceeds, or refinancing of, the real property.<sup>50</sup> This risk-weighting treatment reflects the lower relative risk characteristics of these exposures.

On the other hand, farm construction projects where repayment will depend on future income or the sales proceeds from the real property would meet the third criterion of the proposed HVCRE definition. Such projects have increased risk characteristics, justifying a higher risk weight compared to projects with repayment from ongoing operations. They would be assigned a higher risk weight under the FBRAs' rules and would be assigned a higher risk weight under FCA's proposed rule as well.

In discussing the proposed Agricultural Land exclusion, the System Comment Letter, as well as two other letters,<sup>51</sup> requested that FCA consider potential obstacles for YBS borrower entry into agriculture. These commenters stated that farm construction projects by YBS borrowers are often not part of ongoing farming operations and would

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<sup>50</sup> As discussed in Section II.C.1 of this preamble -- *Scope of HVCRE Exposure Definition* - in the case of revolver loans secured by land or real property where more than 50 percent of the proposed use of the revolver funds is for acquisition, development, or construction of real property, the entire revolver would be subject to the HVCRE definition if it also meets the other two criteria and is not subject to an exclusion.

<sup>51</sup> FCBT Letter dated January 24, 2022, and Farm Credit of Florida Letter dated January 21, 2022.

potentially have higher costs of credit if subject to the 150 percent HVCRE risk weight. FCA believes excluding all YBS borrowers from the HVCRE risk weight would present safety and soundness concerns and detract from the objectives of this rule. However, as discussed in Section II.C.2.e of this preamble - Loans Originated for Less Than \$500,000 - the final rule includes an HVCRE exclusion for loans originated under \$500,000, which will benefit some YBS borrowers.<sup>52</sup>

For the reasons stated above, FCA is adopting as final, without change from the proposal, the agricultural land exclusion.

c. Loans on Existing Income Producing Properties That Qualify as Permanent Financings

As in the FBRA rule, FCA proposed, in paragraph (2)(ii) of its definition of HVCRE exposure, to exclude credit facilities that finance the acquisition or refinance of existing income-producing real property secured by a mortgage on such property, so long as the cash flow generated by the real property covers the debt service and expenses of the property in accordance with the System institution's underwriting criteria for permanent loans. FCA also proposed, in part (2)(iii) of its definition of HVCRE, to exclude credit facilities financing improvements

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<sup>52</sup> Page 30 of the 2022 Annual Report of the Farm Credit Administration shows that for all three categories of YBS loans, the average size of loans outstanding as of December 31, 2022, and of loans made in 2022 was less than \$500,000.

to existing income-producing real property secured by a mortgage on such property. The preamble to the proposed rule noted that examiners may review the reasonableness of a System institution's underwriting standards for permanent loans through the regular examination process to ensure the real estate lending policies are consistent with safe and sound banking practices.

Under the proposal, loans such as agribusiness or rural project financing transactions, among other types of loans, could qualify for the income-producing property exclusion if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property in accordance with the System institution's underwriting criteria for permanent loans.

Loans that are not secured by existing income-producing real property, however, would not fall under this proposed exclusion. Such loans often pose a greater credit risk than permanent loans. FCA believes it is appropriate to classify these loans as HVCRE exposures and impose a 150 percent risk weight given their increased risk characteristics compared to other commercial real estate exposures (unless the loan satisfies one of the other exclusions). However, as discussed in Section II.C.3 of this preamble - Reclassification as a Non-HVCRE Exposure, the proposal would allow a System institution to reclassify these HVCRE exposures as non-HVCRE exposures if they

satisfied the two conditions in paragraph (6) of the proposed rule.

FCA received one comment on the proposed exclusion for existing income producing properties that qualify as permanent financings. The System Comment Letter referenced a "cash flow 'test'" to determine the sufficiency of the cash flow generated by real property to support the debt service and expenses.<sup>53</sup> The Letter requested the test be conducted only once at loan origination and not be required again assuming the loan continues to pay as agreed. While neither the preamble to the proposed rule nor the rule text itself explicitly referenced a cash flow "test", FCA interprets the comment as reference to the underwriting analysis performed in determining whether a loan qualifies for this exclusion. The Agency is clarifying that once a loan has undergone this analysis at origination or purchase for the purpose of HVCRE classification, the institution does not need to reassess the loan again for that purpose. However, as with any permanent financing, the institution must have procedures in place for monitoring the ongoing quality of the loan. These procedures could include ongoing loan analysis.<sup>54</sup>

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<sup>53</sup> System Comment Letter dated January 19, 2022, page 3.

<sup>54</sup> FCA regulation § 614.4170 outlines the responsibilities of direct lenders to service the loans they make, including having policies and procedures in place to preserve the quality of sound loans and help correct deficiencies as they develop.

For the reasons stated above, FCA is adopting as final, without change from the proposal, the exclusion for loans on existing income producing properties that qualify as permanent financings.

d. Certain Commercial Real Property Projects

As in the FBRA rule, FCA proposed, in paragraph (2)(iv) of its HVCRE definition, to exclude from the definition of HVCRE exposure credit facilities for certain commercial real property projects that are underwritten in a safe and sound manner in accordance with proposed loan-to-value (LTV) limits and where the borrower has contributed a specified amount of capital to the project. A commercial real property project loan generally is 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 future income. Commercial real property project loans do not include ordinary business loans and lines of credit in which real property is taken as collateral. As it relates to the System, FCA believes this proposed exclusion is most relevant to agribusiness (processing and marketing entities and farm-related businesses) and rural project financing.

To qualify for this proposed exclusion, a credit facility that finances a commercial real property project would be required to meet four distinct criteria. First, the LTV ratio would have to be less than or equal to the

applicable maximum set forth in proposed Appendix A. Second, the borrower would have to contribute capital of at least 15 percent of the real property's value to the project. Third, the 15 percent amount of contributed capital would have to be contributed prior to the institution's advance of funds (other than a nominal sum to secure the institution's lien on the real property). Fourth, the 15 percent amount of contributed capital would have to be contractually required to remain in the project until the loan could be reclassified as a non-HVCRE exposure. The proposed interpretations of terms relevant to the four criteria for this exclusion are discussed below.

i. Loan-to-Value Limits

To qualify for this exclusion from the HVCRE exposure definition, the FBRAs' rule requires that a credit facility be underwritten in a safe and sound manner in accordance with the Supervisory Loan-to-Value Limits contained in the Interagency Guidelines for Real Estate Lending Policies.<sup>55</sup> These Interagency Guidelines require banking institutions, for real estate loans, to establish internal LTV limits that do not exceed specified supervisory limits ranging from 65 percent for raw land to 85 percent for 1- to 4-family residential and improved property.

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<sup>55</sup> See 12 CFR Part 365, Subpart A, Appendix A (FDIC); 12 CFR part 208, Appendix C (FRB); 12 CFR part 34, Appendix A (OCC).

The FCA has not adopted these supervisory LTV limits.<sup>56</sup> Nevertheless, FCA examination guidance from 2009 makes clear that FCA expectations are consistent with the Interagency Guidelines, including the supervisory LTV limits.<sup>57</sup> FCA believes exposures should satisfy these LTV limits to qualify for this proposed exclusion to the HVCRE definition. In paragraph (2)(iv)(A) of the final rule, the Agency proposed to adopt these LTV limits, for the purpose of the HVCRE definition only, in a new Appendix A to part 628.

The System Comment Letter requested that FCA consider the potential impact of these proposed LTV limits on YBS lending. For the reasons discussed above, FCA is not providing an exclusion for all YBS borrowers. However, the final rule includes an HVCRE exclusion for loans originated under \$500,000, which will benefit some YBS borrowers.

For the reasons stated above, FCA is adopting as final this provision of the proposed rule.

ii. Contributed Capital

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<sup>56</sup>Section 1.10(a) of the Act and § 614.4200(b)(1) of FCA regulations require at least an 85 percent LTV ratio for long-term real estate mortgage loans that are comprised primarily of agricultural or rural property, except for loans that have government guarantees or are covered by private mortgage insurance. Under § 614.4200(b)(1), agricultural or rural property includes agricultural land and improvements thereto, a farm-related business, a marketing or processing operation, a rural residence, or real estate used as an integral part of an aquatic operation.

<sup>57</sup>Examination Bulletin FCA 2009-2, Guidance for Evaluating the Safety and Soundness of FCS Real Estate Lending (focusing on land in transition), December 2009.

Under paragraph (2) (iv) (B) and (C) of FCA's proposed definition of HVCRE exposures, borrowers must contribute capital of at least 15 percent of the real property's value to the project to qualify for the commercial real property projects exclusion. Cash, unencumbered readily marketable assets, paid development expenses out-of-pocket, and contributed real property or improvements would count as forms of capital for purposes of the 15 percent capital contribution criterion. A System institution could consider costs incurred by the project and paid by the borrower prior to the advance of funds by the System institution as out-of-pocket development expenses paid by the borrower.

FCA's proposed rule required the value of contributed property to be determined in accordance with FCA regulations at Part 614, Subpart F, which are generally similar to the FIRREA standards adopted in the FBRA rule.<sup>58</sup> Under the proposed rule, the value of the real property that could count toward the 15 percent contributed capital requirement would be reduced by the aggregate amount of any liens on the real property securing the HVCRE exposure. In addition, the preamble to the proposed rule explained that

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<sup>58</sup> See FCA Informational Memorandum, Guidance on Addressing Personal and Intangible Property within Collateral Evaluation Policies and Procedures (§ 614.4245), August 29, 2016. On May 20, 2021, FCA issued a proposed rule on collateral evaluation requirements (86 FR 27308). FCA's Fall 2023 Unified Agenda and Review of Significant Regulatory Actions, which the FCA Board approved on August 14, 2023, indicates that the agency will be considering a re-proposed rule on collateral evaluation requirements in July 2024. Depending on the eventual outcome of the rulemaking, FCA's collateral standards could deviate from the FIRREA standards in the future.

contributed property or improvements would have to be “directly related” to the project to be eligible to count towards the capital contribution. As explained in that preamble, under the proposed rule real estate not developed as part of the project would not be counted toward the capital contribution. FCA received various comments on the contributed capital requirement of the proposed rulemaking which are addressed below.

*Cross-collateralized Real Property and “Directly Related” Collateral*

The System Comment Letter included a request for FCA to permit cross-collateralized real property or improvements to qualify as part of the capital contribution to an HVCRE project.<sup>59</sup> The Letter referenced the common practice of System institutions cross-collateralizing real estate collateral, and particularly the practice of a related party contributing collateral to support a loan to a YBS farmer so the farmer can obtain financing. The Letter explained that while the collateral might not be “directly related” to the project being financed, the collateral is pledged agricultural land integral to a borrower’s overall operation and does not have the same risk profile as “unrelated commercial development real estate projects.”<sup>60</sup>

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<sup>59</sup> The Farm Credit West, ACA Letter dated January 22, 2022, reiterated this comment. The CoBank Letter, dated January 20, 2021, asked for clarification on whether YBS loans, which often cross-collateralize, would be exempted from the HVCRE definition.

<sup>60</sup> System Comment Letter dated January 19, 2022, page 4.

In response to this comment, the Agency is confirming that cross-collateralized property is permitted to count as a capital contribution to an HVCRE project. As explained in the preamble to the proposed rule, the value of the contributed real property must be reduced by the aggregate amount of any outstanding liens on the property for the purpose of calculating the 15 percent capital contribution.

In addition, the Agency has reconsidered its regulatory interpretation in the preamble to the proposed rule that contributed real property or improvements must be "directly related" to the project. Under the final rule, other real property contributed to a project does not have to be "directly related" to the project to count as capital contributions for the purpose of the commercial real property projects exclusion.

In not requiring real property to be "directly related" to a project to count towards the 15 percent capital contribution for the purposes of excluding a project from the HVCRE definition, FCA is deviating from the FBRAs' interpretation of their final rule. After careful consideration, FCA does not believe that the relation of real property to a project materially impacts the risk associated with accessing System collateral. Requiring real property to be "directly related" to the project is therefore not a necessary safety and soundness criterion.

## *Readily Marketable Assets*

In line with the Interagency Guidelines for Real Estate Lending Policies,<sup>61</sup> FCA, in its proposed rule, interpreted the term “unencumbered readily marketable assets” to mean insured deposits, financial instruments, and bullion in which the System institution has a perfected interest. For assets to be considered “readily marketable” by a System institution, the institution's expectation would be that the financial instrument and bullion would be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, an auction or similarly available daily bid and ask price market.<sup>62</sup>

The System Comment Letter asked FCA to clarify how often and to what extent institutions need to document that assets are readily marketable.<sup>63</sup> For the purpose of qualifying as contributed capital for an HVCRE project, the assets must be deemed readily marketable at the time of loan origination only. The assessment to determine whether an asset is readily marketable should address the depth, breadth, and liquidity of the respective markets as well as other liquidity risk indicators.

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<sup>61</sup> See 12 CFR Part 365, Subpart A, Appendix A (FDIC); 12 CFR part 208, Appendix C (FRB); 12 CFR part 34, Appendix A (OCC).

<sup>62</sup> This interpretation is consistent with the definitions of “unencumbered” and “marketable” in FCA’s liquidity regulation at § 615.5134.

<sup>63</sup> The Farm Credit West, ACA Letter dated January 22, 2022, reiterated this comment verbatim.

### *Abundance of Caution Collateral*

The System Comment letter also requested that FCA “make a distinction on real estate collateral taken as abundance of caution for purposes of the 15% capital contribution requirement”.<sup>64</sup> FCA regulation § 614.4240(a) defines abundance of caution, when used to describe decisions to require collateral, as circumstances in which collateral is taken when (1) it is not required by statute, regulation, or institution policy, and (2) the extension of credit could have been made without taking the collateral.

Borrowers must make a 15 percent capital contribution that meets the criteria outlined in paragraph (2)(iv)(B) of this final rule, among other requirements, for their loan to qualify for this exclusion from the HVCRE definition. As discussed above, such collateral can be cross-collateralized and does not have to be “directly related” to the project. Any collateral used to meet this requirement must satisfy the specified criteria, including collateral taken from the borrower in an abundance of caution.

### *YBS Borrowers*

The Agency considered the impact of the contributed capital requirements on YBS borrowers and, for the reasons discussed above, is not providing an exclusion for all YBS borrowers. However, the final rule includes an HVCRE

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<sup>64</sup> System Comment Letter dated January 19, 2022, page 4.

exclusion for loans originated under \$500,000, which will benefit some YBS borrowers.

For the reasons stated above, FCA is adopting, as final, this provision of the proposed rule.

### iii. Value Appraisal

Under paragraph (2) (iv) (B) of FCA's proposed definition of HVCRE exposures, the 15 percent capital contribution would be required to be calculated using the real property's value. An appraised "as completed" value is preferred; however, when an "as completed" value appraisal is not available FCA proposed to permit the use of an "as is" appraisal.<sup>65</sup> In addition, in its proposed rule FCA proposed to allow the use of a collateral evaluation of the real property in situations when the Agency's appraisal regulations<sup>66</sup> permit collateral evaluations to be used in lieu of appraisals. As explained in the proposed rule preamble, FCA's approach to real property valuation deviates from the FBRAs' regulatory language but is consistent with their interpretation of the regulation.

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<sup>65</sup> FCA intends that the terms "as completed" and "as is," as used in the definition of HVCRE exposure, would have the same meaning as in the Interagency Appraisal and Evaluation Guidelines (December 2, 2010), issued by the OCC, the FRB, the FDIC, the Office of Thrift Supervision, and the National Credit Union Administration. Under these Guidelines, "as completed" reflects property's market value as of the time that development is expected to be completed, and "as is" means the estimate of the market value of real property in its current physical condition, use, and zoning as of the appraisal's effective date.

<sup>66</sup> See § 614.4260(c), which sets forth the types of real estate-related transactions that do not require appraisals.

FCA did not receive any comments on this provision of the proposed rule and, as such, is adopting it as proposed.

iv. Project

Under paragraph (2) (iv) (B) of FCA's proposed definition of HVCRE exposures, the 15 percent capital contribution and the appraisal or collateral evaluation would be measured in relation to a "project." As discussed in the proposed rule preamble, FCA expects that each project phase being financed by a credit facility have a proper appraisal or evaluation with an associated "as completed" or "as is" value. Where appropriate and in accordance with the System institution's applicable underwriting standards, a System institution may look at a multiphase project as a complete project rather than as individual phases.

FCA did not receive any comments on this provision of the proposed rule and, as such, is adopting it as proposed.

e. Loans Originated for Less Than \$500,000

FCA is adding an HVCRE exclusion to paragraph (2) (v) of the final rule for loans originated for less than \$500,000. FCA recognizes the potential administrative burden of tracking loans of this size. As reported in the System's Annual Information Statement as of December 30, 2022, 85 percent of System borrowers had at least one loan under \$500,000,<sup>67</sup> for the purpose of HVCRE classification. This

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<sup>67</sup> Page 57 of the 2022 Annual Information Statement of the Farm Credit System shows loans under \$500,000 account for 85 percent of System borrowers and 16 percent of System loan volume at December 31, 2022.

exclusion maintains a balance between providing regulatory relief to System institutions and limiting the potential risk from HVCRE exposures.

The System Comment Letter asked FCA for consideration of YBS borrowers in the final rule. The Letter asserted that the loans of YBS applicants may be defined as HVCRE due to their reliance on third-party agreements for repayment and the fact that they are often not part of ongoing farming operations, and it stated that this classification could be an obstacle for YBS borrowers obtaining financing. The Letter also asked FCA to consider the impact of the LTV limits and capital contribution requirements in the commercial real property projects exclusion on YBS borrowers.

FCA is committed to supporting the FCS's mission to serve YBS borrowers but the Agency must also ensure the safety and soundness of the System. The addition of an exclusion for loans under \$500,000 will benefit some YBS borrowers.<sup>68</sup> In addition, many YBS borrowers and System borrowers in general will continue to have access to loan guarantees through programs such as the Farm Service Agency guarantee programs. The guaranteed portion of these loans will continue to receive a reduced risk weight in

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<sup>68</sup> Page 30 of the 2022 Annual Report of the Farm Credit Administration shows that for all three categories of YBS loans, the average size of loans outstanding as of December 31, 2022, and of loans made in 2022 was less than \$500,000.

accordance with FCA's capital rules and will not be subject to the 150 percent risk weight for HVCRE exposures.<sup>69</sup>

For the reasons discussed above, FCA is adding an exclusion for loans originated for less than \$500,000 to the HVCRE definition.

#### f. Consideration of Additional Exclusions

As detailed below, the System Comment Letter, as well as several other comment letters, asked FCA to consider various additional exclusions from the HVCRE definition.<sup>70</sup> The requested exclusions included project financing of public and private facilities; agricultural production or processing facilities with contractual purchase agreements in place; minor improvements or alterations to real property; credit facilities where repayment would come from the borrower's ongoing business; and de minimis levels of financing. FCA considered each of these requested exclusions as discussed below.

#### i. Project Financing of Public and Private Facilities

The System Comment Letter (supported by the Northwest Letter), the CoBank Letter, and the FCBT Letter requested an exclusion from the HVCRE definition for project financing of public and private facilities, such as rural

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<sup>69</sup> Under § 628.32(a)(1)(i)(B) the portion of an exposure that is directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency is risk-weighted at 0-percent. Under 628.32(a)(1)(ii) the portion of an exposure that is conditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency is risk-weighted at 20-percent.

<sup>70</sup> The Northwest Letter, dated January 24, 2022, encouraged FCA, without discussion, to consider all five exceptions proposed in the System Comment Letter.

infrastructure projects, where contractual agreements to purchase the product produced are in place before a facility is constructed. Commenters expressed concern that the proposed HVCRE definition would include System project financing, and therefore impact the financing of crucial rural infrastructure projects.

The commenters stated that these projects may not have the necessary collateral support required by the proposed rule but highlighted mitigating factors against risk: the credit evaluation of a project independent of the sponsor, focus on the creditworthiness of counterparties to the contractual agreements, and the bankruptcy remoteness of the projects from their sponsors.<sup>71</sup> They differentiated System project financings from other forms of corporate financing in which lenders evaluate the financial condition of corporate entities, not individual projects. In addition, they stated that the FBRAs' intent with the HVCRE risk weight was to capture speculative commercial real estate loans.

As an initial matter, FCA notes that FCA Bookletter-070 - Revised Capital Treatment for Certain Water and Wastewater Exposures - and Bookletter-053 -- Revised Regulatory Capital Treatment for Certain Electric Cooperatives - assign reduced risk weights to certain

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<sup>71</sup> FCA understands the commenters are referring to projects that are structured to be legally separate from the sponsor and not liable for the sponsors' debts in bankruptcy.

project financing exposures, including some exposures in the construction phase.<sup>72</sup> Specifically, Bookletter-070 assigns a reduced risk weight to certain rural water and wastewater (RWW) construction exposures.<sup>73</sup> Bookletter-053 assigns a reduced risk weight to certain electric cooperative construction loans for new baseload power plants. This rule will not affect the reduced risk weights for the project finance construction exposures that these bookletters assign, even for exposures that are HVCRE exposures.

In response to the comments regarding the standalone nature of System project financings, FCA agrees that this characteristic can be a risk mitigant to such projects in isolating them from any financial difficulties of their sponsors. However, the Agency also believes that the limited recourse to project sponsors could be to the detriment of such financings. If the project were to default, the lender could be limited to accessing the project's collateral, and any contributed capital, alone. They may not have any recourse to the project sponsor's assets. More importantly, project finance loans in the construction phase share many of the same risks as other construction loans regardless of recourse to project

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<sup>72</sup> The reduced risk weights are lower than those that would otherwise apply under FCA regulation § 628.32.

<sup>73</sup> In Section II.C.3. of this preamble - Reclassification as a Non-HVCRE Exposure - FCA explains revisions it plans to make to BL-070 before this HVCRE rule becomes effective.

sponsors. These risks are discussed later in this section. FCA does not therefore believe that the independent nature of such financings is a sound enough reason alone to exclude these projects from the HVCRE definition. As discussed in Section II.C.3 of this preamble -  
Reclassification as a Non-HVCRE Exposure - the HVCRE risk weight no longer applies once the project is reclassified as non-HVCRE.

The System Comment Letter also referenced the focus on the creditworthiness of contractual agreement counterparties as another risk mitigant to project financings. FCA agrees the creditworthiness of counterparties to the contractual agreements entered into by public and private projects is key to mitigating the risks of these projects. However, if a project depends on a counterparty's contractual payments to repay its construction phase debt, the inability of the counterparty to meet its obligations increases the risk that the project's loan will default. Counterparty credit risk cannot be avoided and can translate to elevated risk for construction loan projects heavily reliant on counterparties for repayment.

FCA believes there are other risk factors to consider in relation to public and private facility project financing that justify inclusion of these credits in the HVCRE definition. In addition to the counterparty credit

risk mentioned above, some additional risks include project delays, cost overruns, project obsolescence, contractor risk, and risks from shifting market dynamics.

As discussed in Section II.C.1 of this preamble - Scope of HVCRE Exposure Definition - project delays and cost overruns have been a particular challenge to System construction loans recently, including in the project financing sector, and the impact in some cases has been material. If construction timelines and costs continue to be adversely affected, such supply chain issues could pose a credit risk to System institutions. The comment letters did not address these risks.

Further, the reduced risk weights that Bookletter-070 and Bookletter-053 assign to RWW and electric cooperative construction exposures, as discussed above, do not support exempting all project finance construction exposures from HVCRE exposure risk weighting. The reduced risk weights for RWW and electric cooperative exposures, including exposures during the construction phase, are supported by unique characteristics of those exposures that may not exist with other project finance exposures.

As Bookletter-070 notes, RWW plays a critical role in agricultural and rural America, but its infrastructure is aging, and it can be difficult for rural communities to finance improvements. The services provided by RWW facilities are essential, which contributes to the overall

strength and stability of the industry. Moreover, many RWW facilities are able to adjust rates as needed to support repayment, thus reducing the likelihood of default. FCA determined that a reduced risk weight for exposures that satisfied specified quantitative and qualitative safety and soundness criteria would provide more capacity for System institutions to provide RWW funding without taking on excessive risk. Similarly, the reduced risk weight for electric cooperatives that satisfy criteria specified in Bookletter-053 was supported by the unique characteristics and lower risk profile of the industry segment. The reduced risk weights assigned by booklet to RWW and electric cooperative construction exposures do not support excluding project finance construction generally from the HVCRE risk weight.

For the reasons stated above, FCA is not including a general exclusion for project financing in the final HVCRE rule. However, as discussed in Section II.5 of this preamble - Impact on Prior FCA Board Actions - certain project financing loans will not be subject to the HVCRE risk-weight under the provisions of Bookletter-053 and a revised Bookletter-070.

ii. Agricultural Production or Processing Facilities with Contractual Purchase Agreements in Place

The System Comment Letter (supported by the Northwest Letter) asked for an explicit exclusion from the HVCRE

definition for agricultural or processing facilities where contractual agreements are in place, prior to construction of the facility, to purchase the output from these facilities. The System Comment Letter specifically referenced "loans to finance construction of poultry or other livestock barns that are originated with an integrator contract to support the lending structure."<sup>74</sup> Poultry and other livestock facility construction projects are subject to the same risks as any construction project, namely project cost overruns and time delays. These risks are discussed in Section I.B.3 of this preamble - ADC Lending Risk and HVCRE Risk Weight. The commenters did not provide a risk-based justification, or any other justification, for excluding these types of loans from the HVCRE definition, and FCA does not believe such a justification exists.

The System Comment Letter did ask FCA to consider the potential impact on YBS borrowers by not providing an exclusion for loans with third-party integrator agreements. As explained in Section II.C.1 of this preamble - Scope of HVCRE Exposure Definition - a borrower dependent on payments from an integrator for repayment of debt would meet the criteria for classification as an HVCRE exposure unless the loan qualifies for an HVCRE exclusion. As a

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<sup>74</sup> System Comment Letter dated January 19, 2022, page 5. The FCBT Letter dated January 24, 2022, reiterated the System Comment Letter's comment verbatim. The CoBank Letter, dated January 20, 2021, summarized this comment, asking for clarification.

reminder, if repayment of the poultry or other livestock construction loan comes from the ongoing business of the borrower, the loan would not meet the HVCRE criteria. As discussed above, FCA is not providing an exclusion for all YBS borrowers. However, some YBS and other borrowers dependent on integrator agreements for loan repayment will benefit from the exclusion of loans under \$500,000 from the definition of HVCRE in the final rule. In addition, YBS loans may have access to loan guarantees to reduce risk weights.

For the reasons stated above, FCA is not adopting an HVCRE exclusion for agricultural or processing facilities where contractual agreements are in place.

#### iii. Minor Improvements or Alterations to Real Property

The System Comment Letter (supported by the Northwest Letter) stated that FCA's proposed HVCRE definition included construction loans for "additions or alterations" regardless of materiality and requested an exclusion for minor improvements or alterations to real property.<sup>75</sup> The letter indicated that unless a minor improvement request was a modification to an existing permanent financing it would be classified as HVCRE.

As an initial matter, the Letter's suggestion that if a minor improvement request is a modification to an existing permanent financing it would not be classified as

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<sup>75</sup> The Farm Credit of Florida, ACA Letter, dated January 21, 2022, repeated the System Comment Letter's comment verbatim.

an HVCRE exposure is not necessarily correct. As the preamble to the proposed rule explains, when a System institution modifies a loan or if a project is altered in a manner that materially<sup>76</sup> changes the underwriting of a credit facility, the institution must treat the loan as a new exposure and must evaluate it to determine whether or not it is an HVCRE exposure.<sup>77</sup>

In response to the request for an exclusion for minor improvements or alterations to real property, the Agency's exclusion for loans under \$500,000 will provide relief for these types of financings. In addition, the final rulemaking does have an exclusion for improvements to existing income producing improved real property if the cash flow generated by the property is sufficient to support the debt service and expenses of the real property in line with permanent financing criteria. Unless the loan to make minor improvements or alterations will be repaid from future income or sale of the project's real property, it would not fall under the definition of HVCRE.

For the reasons stated above, FCA is not adopting an HVCRE exclusion for minor improvements or alterations to real property.

iv. Credit Facilities Where Repayment Would Be From The  
Ongoing Business Of The Borrower

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<sup>76</sup> Material changes may include increases to the loan amount, changes to the size and scope of the project, or removing all or part of the 15 percent minimum capital contribution in a project.

<sup>77</sup> 86 FR 47601, 47606 (August 26, 2021).

The System Comment Letter (supported by the Northwest Letter) requested an explicit exclusion for credit facilities where repayment would come from the borrower's ongoing business.<sup>78</sup> An explicit exclusion for these credit facilities is not warranted, because such an exclusion is clear from the existing regulatory language.

The definition of HVCRE in the proposed rule includes a criterion that credit facilities where repayment is dependent on future income or the sale of the real estate would be considered HVCRE. Implicit in this criterion is that repayment from the ongoing business of the borrower would exclude a credit facility from being classified as HVCRE. In addition, in the preamble to the proposed rule, FCA explicitly stated that credit facilities that will be repaid from the borrower's ongoing business would not be classified as HVCRE.<sup>79</sup> FCA does not believe changing the final rule to incorporate an explicit exclusion is warranted. Instead, FCA reiterates that a credit facility for which ongoing income covers repayment would not meet the definition of HVCRE.

For the reasons stated above, FCA is not adopting an HVCRE exclusion for credit facilities where repayment would be from the ongoing business of the borrower.

#### v. De Minimis Financings

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<sup>78</sup> The Farm Credit West, ACA Letter dated January 22, 2022 reiterated this comment verbatim.

<sup>79</sup> 86 FR 47601, 47606 (August 26, 2021).

The System Comment Letter (supported by the Northwest Letter) asked FCA to consider an exclusion for a de minimis level of financing determined by each institution as a percentage of risk funds.<sup>80</sup> The final rule includes an exclusion for loans under \$500,000, which as discussed in Section II.C.2.e of this preamble - Loans Originated for Less Than \$500,000 - will provide administrative relief without introducing material risk exposure to the System. The Agency believes establishing a de minimis level as a percentage of capital or some other similar metric would allow for higher potential risk exposure than a dollar threshold would. Large institutions with considerable capital, for example, would be able to amass potentially material amounts of HVCRE volume if a capital-based threshold was set. The \$500,000 exclusion would apply to all loans under \$500,000 regardless of an institution's size or capital levels.

For the reasons stated above, FCA is not adopting an HVCRE exclusion for de minimis financings.

### 3. Reclassification as a Non-HVCRE Exposure

Under the proposal, a System institution would be allowed to reclassify an HVCRE exposure as a non-HVCRE exposure when the substantial completion of the development or construction on the real property has occurred and the

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<sup>80</sup> The Farm Credit of Florida, ACA Letter, dated January 21, 2022, and the Farm Credit West, ACA Letter, dated January 22, 2022, repeated the System Comment Letter's comment verbatim.

cash flow generated by the property covered the debt service and expenses on the property in accordance with the institution's loan underwriting standards for permanent financings. Each System institution should have prudent, clear, and measurable underwriting standards, which we may review through the examination process.

The System Comment Letter requested FCA clarify its expectations for when an HVCRE project can be reclassified. The letter asked for clarification of "the period that follows project completion to determine whether a projected cash flow is acceptable for purposes of reclassification."<sup>81</sup> In addition, the letter requested further guidance on how to calculate projected cash flows for a property "owned by the business" when these are not "separately provided by the borrower".<sup>82</sup>

As stated in the proposed rule, institutions should defer to their loan underwriting criteria for permanent financings when determining if an HVCRE exposure is generating sufficient cash flow to support the debt service and expenses of the real property. FCA does not have an expectation for a specific period following project completion to demonstrate adequate cash flows. Such a criterion should be clearly stated in an institution's loan underwriting standards. Similarly, the Agency is not specifying in the final rule how to calculate cash flows.

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<sup>81</sup> System Comment Letter, page 4.

<sup>82</sup> *Id.*

Regardless of how cash flow information is presented by a borrower, the institution should have processes in place to adequately analyze and project cash flows.

FCA is adopting this part of the proposed rule without change.

#### 4. Applicability Only to Loans Made After January 1, 2025

In consideration of the changes this rule would require, only loans made after January 1, 2025, the planned effective date of this rule, would be subject to the HVCRE risk-weighting requirements. Loans made prior to January 1, 2025 could continue to be risk-weighted as they are under the pre-existing version of the rule.

After January 1, 2025, when a System institution modifies a loan or if a project is altered in a manner that materially changes the underwriting of the credit facility (such as increases to the loan amount, changes to the size and scope of the project, or removing all or part of the 15 percent minimum capital contribution in a project), the institution must treat the loan as a new exposure and reevaluate the exposure to determine whether or not it is an HVCRE exposure.

#### 5. Impact on Prior FCA Board Actions

Existing FCA Bookletter BL-070 authorizes System institutions to assign a 50- or 75-percent risk weight for RWW facilities that satisfy certain criteria, but it does not permit these risk weights for exposures when a RWW

facility is not fully operational due to initial construction or major renovation. RWW exposures subject to a 50- or 75-percent risk weight under BL-070 will continue to receive these risk weights after this HVCRE rule becomes effective.

Bookletter-070 currently provides that exposures not subject to the 50- or 75-percent risk weight are assigned risk weights in accordance with Part 628 of FCA's regulations. Because this HVCRE rule is not yet in effect, these exposures are currently risk weighted at 100-percent as corporate exposures under § 628.32(f)(1) when they are in the construction phase. However, as this booklet is currently written, once the HVCRE risk weight becomes effective such construction exposures would be assigned the HVCRE risk weight if the HVCRE definition were met and no exclusions applied.

Before the rule's planned effective date of January 1, 2025 (which is before BL-070's existing sunset date of November 2025), FCA plans to revise BL-070 to provide that RWW construction exposures not subject to a 50-or 75-percent risk weight under the booklet will continue to be risk-weighted as corporate exposures. FCA plans to revise the risk weight of these exposures because of the unique characteristics of RWW exposures discussed above.

Similarly, electric cooperative exposures assigned 20- or 50-percent risk weights under FCA Bookletter BL-053,

including exposures to some power plants that are in the construction phase, will continue to receive these risk weights under the booklet even after this rule becomes effective. Under the booklet, electric cooperative exposures that are not assigned a 20- or 50-percent risk weight are subject to the "current" (as of the 2007 adoption of the booklet) regulatory risk weight under former § 615.5211,<sup>83</sup> which was 100 percent.<sup>84</sup> Therefore, under the booklet, electric cooperative construction exposures that are not assigned a 20- or 50-percent risk weight will be assigned a 100 percent risk weight and will not be subject to risk weights in Part 628 (including the new HVCRE risk weight).

### **III. Regulatory Analysis**

#### **A. Regulatory Flexibility Act**

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies the final rule would not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the

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<sup>83</sup> FCA rescinded § 615.5211 when the capital rule it adopted in 2016, including the risk weights in § 628.32, became effective on January 1, 2017.

<sup>84</sup> Under former § 615.5211(d) as it existed in 2007, the 100-percent risk weight category comprised standard risk assets such as those typically found in a loan or lease portfolio. In addition, former § 615.5211(d)(1) provided that the 100-percent risk weight category included all claims on private obligors that were not included in another category and § 615.5211(12) provided that the category included all other assets not specified elsewhere.

amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

**B. Congressional Review Act**

Under the provisions of the Congressional Review Act (5 U.S.C. 801 et seq.), the Office of Management and Budget's Office of Information and Regulatory Affairs has determined that this final rule is not a "major rule" as the term is defined at 5 U.S.C. 804(2).

**List of Subjects in 12 CFR Part 628**

Accounting, Agriculture, Banks, Banking, Capital, Government securities, Investments, Rural areas.

For the reasons stated in the preamble, the Farm Credit Administration amends part 628 of chapter VI, title 12 of the Code of Federal Regulations as follows:

**PART 628--CAPITAL ADEQUACY OF SYSTEM INSTITUTIONS**

1. The authority citation for part 628 continues to read as follows:

**Authority:** Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 8.0, 8.3, 8.4, 8.6, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a), Pub. L.

100-233, 101 Stat. 1568, 1608, as amended by sec. 301(a), Pub. L. 103-399, 102 Stat 989, 993 (12 U.S.C. 2154 note); sec. 939A, Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 78o-7 note).

2. Amend § 628.2 by adding paragraph (6) to the definition of "Corporate exposure" and a new definition, in alphabetical order, for "High volatility commercial real estate (HVCRE) exposure" to read as follows:

**§ 628.2 Definitions.**

\* \* \* \* \*

*Corporate exposure* \* \* \*

\* \* \* \* \*

(6) A high volatility commercial real estate (HVCRE) exposure;

\* \* \* \* \*

*High volatility commercial real estate (HVCRE) exposure* means:

(1) A credit facility secured by land or improved real property that, prior to being reclassified by the System institution as a non-HVCRE exposure pursuant to paragraph (6) of this definition:

(i) Primarily finances, has financed, or refinances the acquisition, development, or construction of real property;

(ii) Has the purpose of providing financing to acquire, develop, or improve such real property into income producing real property; and

(iii) Is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility.

(2) An HVCRE exposure does not include a credit facility financing:

(i) The acquisition, development, or construction of properties that are:

(A) One- to four-family residential properties, provided that the dwelling (including attached components such as garages, porches, and decks) represents at least 50 percent of the total appraised value of the collateral secured by the first or subsequent lien. Credit facilities that do not finance the construction of one- to four-family residential structures, but instead solely finance improvements such as the laying of sewers, water pipes, and similar improvements to land, do not qualify for the one- to four-family residential properties exclusion;

(B) [Reserved]

(C) Agricultural land, as defined in § 619.9025 of this chapter, or real estate used as an integral part of an aquatic operation. This provision applies only to financing for the agricultural and aquatic needs of bona fide farmers, ranchers, and producers and harvesters of

aquatic products under § 613.3000 of this chapter. This provision does not apply to loans for farm property construction and land development purposes;

(ii) The acquisition or refinance of existing income-producing real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the System institution's applicable loan underwriting criteria for permanent financings;

(iii) Improvements to existing income producing improved real property secured by a mortgage on such property, if the cash flow being generated by the real property is sufficient to support the debt service and expenses of the real property, in accordance with the System institution's applicable loan underwriting criteria for permanent financings; or

(iv) Commercial real property projects in which:

(A) The loan-to-value ratio is less than or equal to the applicable loan-to-value limit set forth in Appendix A to this part;

(B) The borrower has contributed capital of at least 15 percent of the real property's appraised, "as completed" value to the project. The use of an "as is" appraisal is allowed in instances where an "as completed" value appraisal is not available. The use of an evaluation of

the real property instead of an appraisal to determine the "as completed" appraised value is allowed if § 614.4260(c) of this chapter permits evaluations to be used in lieu of appraisals. The contribution may be in the form of:

(1) Cash;

(2) Unencumbered readily marketable assets;

(3) Paid development expenses out-of-pocket;

or

(4) Contributed real property or improvements; and

(C) The borrower contributed the amount of capital required by paragraph (2) (iv) (B) of this definition before the System institution advances funds (other than the advance of a nominal sum made in order to secure the System institution's lien against the real property) under the credit facility, and such minimum amount of capital contributed by the borrower is contractually required to remain in the project until the HVCRE exposure has been reclassified by the System institution as a non-HVCRE exposure under paragraph (6) of this definition.

(v) Loans originated for less than \$500,000.

(3) An HVCRE exposure does not include any loan made prior to January 1, 2025.

(4) An HVCRE exposure does not include a credit facility reclassified as a non-HVCRE exposure under paragraph (6) of this definition.

(5) Value of contributed real property: For the purposes of this HVCRE exposure definition, the value of any real property contributed by a borrower as a capital contribution is the appraised value of the property as determined under standards prescribed in accordance with FCA regulations at subpart F of part 614 of this chapter, in connection with the extension of the credit facility or loan to such borrower.

(6) Reclassification as a non-HVCRE exposure: For purposes of this HVCRE exposure definition and with respect to a credit facility and a System institution, a System institution may reclassify an HVCRE exposure as a non-HVCRE exposure upon:

(i) The substantial completion of the development or construction of the real property being financed by the credit facility; and

(ii) Cash flow being generated by the real property being sufficient to support the debt service and expenses of the real property, in accordance with the System institution's applicable loan underwriting criteria for permanent financings.

(7) [Reserved].

\* \* \* \* \*

3. Amend § 628.32 by adding paragraph (j) to read as follows:

**§ 628.32 General risk weights.**

\* \* \* \* \*

(j) *High volatility commercial real estate (HVCRE) exposures.* A System institution must assign a 150-percent risk weight to an HVCRE exposure.

\* \* \* \* \*

4. Amend § 628.63 by adding entry (b) (8) to Table 3 to read as follows:

**§ 628.63 Disclosures.**

\* \* \* \* \*

**Table 3 to § 628.63-Capital Adequacy**

* * *	* * * *
Quantitative disclosures	(b) Risk-weighted assets for:
* * *	* * * *
	(8) HVCRE exposures;
* * *	* * * *

\* \* \* \* \*

5. Add Appendix A to Part 628 to read as follows:

**Appendix A to Part 628-Loan-to-Value Limits for High Volatility Commercial Real Estate Exposures**

Table A sets forth the loan-to-value limits specified in paragraph (2) (iv) (A) of the definition of high volatility commercial real estate exposure in § 628.2.

Table A: Loan-to-Value Limits for High Volatility Commercial Real Estate Exposures

Loan Category	Loan-to-value limit (percent)
Raw Land	65
Land development	75
Construction:	

Commercial, multifamily, <sup>1</sup> and other non-residential	80
1- to 4-family residential	85
Improved property	85
Owner-occupied 1- to 4-family and home equity	85 <sup>2</sup>

<sup>1</sup> Multifamily construction includes condominiums and cooperatives.

<sup>2</sup> If a loan is covered by private mortgage insurance, the loan-to-value (LTV) may exceed 85 percent to the extent that the loan amount in excess of 85 percent is covered by the insurance. If a loan is guaranteed by Federal, State, or other governmental agencies, the LTV limit is 97 percent.

The loan-to-value limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and construction of an office building), the appropriate loan-to-value limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. In situations where a loan is fully cross-collateralized by two or more properties or is secured by a collateral pool of two or more properties, the appropriate maximum loan amount under loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each property. To ensure that collateral margins remain within the limits, System institutions should redetermine conformity whenever collateral substitutions are made to the collateral pool.

Dated: March 29, 2024

**Ashley Waldron,**  
*Secretary to the Board,*  
*Farm Credit Administration.*

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