The Demise of an Agricultural Lender: The Case of the Willamette Production Credit Association

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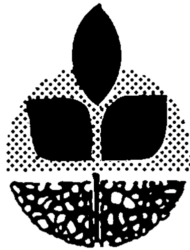

Agricultural Experiment Station
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THE DEMISE OF AN AGRICULTURAL LENDER: THE CASE OF THE WILLAMETTE PRODUCTION CREDIT ASSOCIATION

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ABSTRACT

This document reviews the course of events that led to the eventual liquidation of an institution which operated within the Farm Credit System: The Willamette Production Credit Association (WPCA) in Salem, Oregon. In August 1983, the Farm Credit Administration (FCA) froze the stock of the WPCA and turned its loan portfolio over to the regional Federal Intermediate Credit Bank in Spokane, Washington, for liquidation. The WPCA filed suit against the FCA in Federal District Court, which resulted in an out-of-court settlement that restored WPCA funding in December 1983 and called for a new audit of WPCA books. This process eventually resulted in the formation of the Western Oregon Production Credit Association (WOPCA), which took over many WPCA loans. The former WPCA was officially liquidated in May 1984.

The history of the WPCA is important because it demonstrates the degree of difficulty facing agricultural lenders in current times. Conditions surrounding agricultural credit in the first half of the 1980s have led to nationwide problems for agricultural lenders. The most significant source of agricultural loans is the Farm Credit System, which controls about one-third of all agricultural credit in the United States.

This report includes an introduction to the Farm Credit System, a review of the proceedings involved with the liquidation of the WPCA, and an analysis of major factors affecting farm credit in WPCA territory during the early 1980s.

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I. INTRODUCTION

The recession in American agriculture is having a broad range of impacts and implications. Farm bankruptcies and foreclosures have been widely reported. Depressed farm prices have caused low farm revenues. Increased production costs and high farmer indebtedness, combined with high "real" interest rates, have pushed many farmers to the brink of insolvency and beyond.[1/]

The extemely adverse effects of the agricultural recession are not limited to farmers, however. Industries and institutions that deal with farmers are also under stress, and agricultural lending institutions are not immune. For many lenders, the costs of non-performing loans have risen sharply, producing financial losses and, in a few cases, business failure.

The conditions which spawned the failures of agricultural lenders are as diverse as the regions and the farmers they serve. So any effort at generalization is futile. Still, an examination of an individual business failure can be instructive about complex conditions faced by lending institutions that serve agriculture. The purpose of this publication is to present a chronology of the collapse of one such lender: the Willamette Production Credit Association of Salem, Oregon (WPCA).

The next section of this report briefly describes the Farm Credit System, the family of agricultural lending institutions to which the Willamette PCA belonged.

1/ The "real" interest rate is defined as the nominal rate minus the rate of inflation.

The next section presents the role and recent history of the WPCA as it moved into insolvency. The fourth section assesses general economic problems faced by farm lenders in Western Oregon. The final section summarizes and concludes.

The purpose here is not to accuse or affix blame for problems which led to the demise of the WPCA. Rather, the facts, as can best be extracted from available records, are presented and any judgments are left to the reader.

II. THE FARM CREDIT SYSTEM

Agriculture is extremely reliant on credit, and credit is provided from three basic sources. Commercial banks supply credit primarily for nonreal estate purposes although some real estate loans are also made.

Since banks serve a wide range of credit users, agriculture must compete with non-agricultural borrowers for funds. Agricultural borrowers must meet competitive credit worthiness standards and pay general market interest rates.

At the other extreme is the Farmers Home Administration (FmHA), often viewed as the "lender of last resort." The FmHA provides grants, direct loans, and loan guarantees for low income farmers or farmers who cannot qualify for credit from any other source. Since the FmHA is a federal government agency, its credit services, in effect, are subsidized.

The third major source of nonreal estate credit, and the subject of this report, is the Farm Credit System (FCS), an organization of member-owned cooperatives made up of three main branches: (1) the Federal Land Banks (FLBs), and the Federal Land Bank Associations (FLBA's), (2) the Federal Intermediate Credit Banks (FICB's) and the Production Credit Associations (PCA's), and (3) the Banks for Cooperatives (BC's). The structure and activities of the FCS are discussed in more detail in the next section.

The Farm Credit System is an organization of member-owned lending cooperatives. All segments of the system were originally funded by the U.S. government, starting with a $9 million investment to capitalize 12 Federal Land Banks in 1916. This was authorized by the Federal Farm Loan

Act. Amendments added the Federal Intermediate Credit Banks in 1923, and the Bank for Cooperatives and many regional entities (under the Land and Credit Banks) in 1933 during the depression. More than $120 million in capital stock was purchased by the federal government in the latter amendment. This capital was part of a government effort to stem the great wave of farm foreclosures then taking place.

Over the years, this government capital was paid off. By 1947, the Land Banks had retired all their government debts and, by 1968, the last of the government-owned stock had been repurchased. The system as a whole now has more than $74 billion in outstanding loans or about one-third of total farm debt.[2/] Repayment of the government capital allowed the Farm Credit System to become a federally chartered cooperative which was no longer government owned. This charter was expanded by the Farm Credit Act of 1971 to broaden the types and amount of services the System could offer, and also placed the deputy governors of each branch of the System (FLB's, FICB's and BC's) under supervision of the Governor of the Farm Credit Administration.

The system now consists of 12 farm credit districts, each with a Federal Land Bank (FLB), a Federal Intermediate Credit Bank (FICB), and a Bank for Cooperatives (BC's). Figure 1 shows the organizational structure of the Farm Credit Administration. In addition to the 12 regional Banks for Cooperatives, there is a central BC in Denver, Colorado. BC's make

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2/ In 1984, farm debt totalled $214.6 billion, about $111.6 billion was real estate debt and about $103.0 billion was non-real estate debt. For a more detailed explanation of farm debt, see USDA Agricultural Statistics.

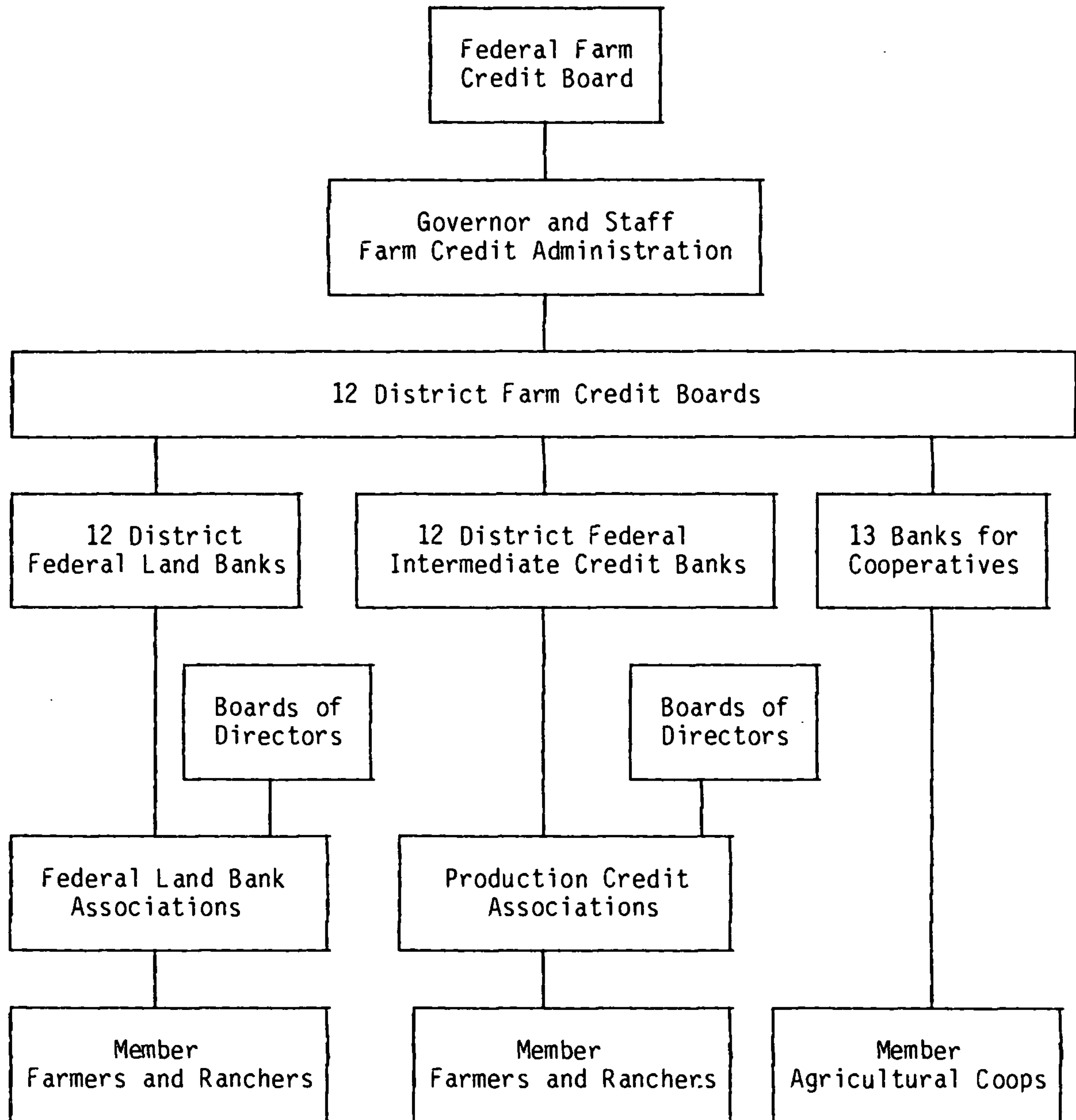

Figure 1. Organizational Structure of the Farm Credit Administration System

SOURCE: Pensen, John B., and David A. Lins. *Agricultural Finance*, Prentice-Hall, Inc., Englewood Cliffs, N.Y. 1980.

loans to all kinds of agricultural marketing, supply and business cooperatives. The 12 FLB's provide mortgage credit up to 40 years through about 520 Federal Land Bank Association (FLBA) offices. The 12 FICB's provide short and intermediate term loan funds to farmers, ranchers, and fishermen through about 420 local Production Credit Associations (PCA's).

Through obligations of all 37 banks, funding is provided by the sale of Federal Farm Credit Banks Consolidated Systemwide Securities. These are sold through the Fiscal Agency for Farm Credit Banks in New York via nationwide representatives in commercial banks and other securities dealers. The securities are in the form of discount notes (5 to 270 days) and six- or nine-month bonds, as well as longer term bonds. Notes are issued in denominations of $50,000 and more; bonds are issued in $1,000 and $5,000 amounts. Short-term bonds are offered every month; longer term bonds are sold once each quarter. The returns on these securities are higher than Treasury bills because they are not obligations of the U.S. government. The Farm Credit Act of 1971 removed income earned from these securities from taxation by federal, state, or local agencies.

Production Credit Associations receive their funds through the Federal Intermediate Credit Banks. Each PCA also has an account with one or more commercial banks (CB's). If a PCA needs more money in this account, it draws from the FICB. Conversely, if there are excess funds, the PCA will pay back some of its drafts on the FICB. The maximum amount of credit the FICB allows depends on the debt-to-capital ratio (liabilities/net worth) and the quality of the loan portfolio (Penson and Lins, 1980).

The maximum loan duration for PCA loans to farmers is seven years, but usually loans are much shorter. Voting stock ("B" stock) is a requisite purchase for those receiving PCA loans for production purposes (i.e., farmers, farm related service suppliers, ranchers, aquatic producers) or anyone in a municipality of fewer than 2,500 people. Farms and ranches may include proprietorships, partnerships, or corporations.

"A" stock is issued to borrowers who don't qualify as voting members. Voting members include farmers, ranchers, fishermen, etc. Nonvoting members who can take out PCA loans are farm equipment suppliers or suppliers of other inputs for agricultural production. These borrowers are not a major factor in PCA business, in terms of stock ownership. "C" stock, or "participation certificates" are also issued and represent converted "B" stock or nonvoting shares for members who aren't "active" (i.e., have not borrowed in more than one year).

PCA loans are often extended as a line of credit with repayment due when the loan closes. This payment usually coincides with a postharvest date which matches the producer's seasonal cash flow; however, installment loans are also made. PCAs generally use a single variable interest rate which is the same for all borrowers. Stock purchase requirements affect this simple rate so that an actual percentage rate (APR) is also reported which reflects this cost. "B" stock for these loans must be held in an amount equal to 10 percent of the total loan value in most cases.[3/] This stock value is usually applied to the final installment of repayment.

3/ "B" stock is required to be 10 percent in almost all Oregon PCAs; some may only require 5 percent, but this is unusual and applies only to small areas under individual PCA's.

III. THE WILLAMETTE PRODUCTION CREDIT ASSOCIATION

Nearly 50 years ago, the Willamette Production Credit Association (WPCA) began providing production credit to farmers in a 13 county area in Oregon's Willamette Valley. The counties included: Benton, Clackamas, Clatsop, Columbia, Lane, Lincoln, Linn, Marion, Multnomah, Polk, Tillamook, Washington, and Yamhill.

From WPCA's inception through 1980, its president was Phillip M. Brandt. He began duties with the Salem-based offices in July 1937. When he retired May 1, 1980, the presidency was assumed by Fred Boyer, who had been with the association since 1956.

Between 1937 and 1980, the WPCA loaned almost one billion dollars to growers and fishermen while charging off less than $500,000 during this time (P. Brandt, 1984). This is evidence of a very strong lending institution because bad loans constituted only about 1/20th of one percent of loan values before 1980. In 1983, this PCA had $105 million in outstanding loans, placing it among the top 15 percent of Production Credit Associations nationwide (P. Brandt, 1984).

In April 1983, the FICB for Region 12 of the Farm Credit System (based in Spokane, Washington) conducted a routine audit of the WPCA. Such interim audits are normally conducted in accordance with FCA regulation 8430 (issued in 1972). This regulation was installed to allow decentralized auditing procedures and required each district board to form a self-monitored, internal control policy for all bank (FICB, FLB, and BC) and association (FLBA, PCA) operations (GAO, 1983). The Farm Credit

Administration (FCA) had formerly performed such audits through its Office of Examinations.

Table 1 outlines important events affecting the WPCA which followed the interim audit mentioned above. The remainder of this section is devoted to a review of these events.

The interim audit of April 1983 indicated that the WPCA had losses of $2.6 million on a loan portfolio amounting to approximately $98 million. In a personal interview with former WPCA president Fred Boyer, the authors learned that the board of directors of the association had no substantial disagreements with the procedures or results of this particular audit. Furthermore, two FCA examiners reviewed the audit in progress (W. Brandt, 1984a). This audit relied on WPCA files.

Some three months later, in June 1983, a special audit of the Willamette PCA was initiated by the Farm Credit Administration in Washington, D.C. On June 30, the FCA delivered the results of this audit to the Spokane FICB, the WPCA, and to the Governor of the FCA, Donald E. Wilkinson. Such audits are allowed under amendments to FCA regulation 8430 which were implemented in 1978 (GAO, 1983).

The June audit disagreed with the results of the April audit by some $6.3 million. It has now been shown that the FCA examiners conducting the June audit substantially reduced the collateral values on an unspecified number of loans which altered their standing from "acceptable" (class I loans) to "adverse" (Class II, III, and IV loans, termed "problem," "vulnerable," and "loss" loans, respectively) (Panner, 1983c). An accounting practice used by these examiners, which as far as can be determined was never used previously in WPCA audits, required that any loan

Table 1. WILLAMETTE PRODUCTION CREDIT ASSOCIATION, Chronology of Events - 1983 & 1984.

1983	
April	FICB conducts audit revealing $2.6 million in charge-offs on WPCA loans.
June	FCA conducts audit indicating charge-offs of $8.9 million.
August 10	FCA governor D.E. Wilkinson declares "B" stock impaired, suspends board of directors, enacts "1140 procedures" which freeze stocks and places WPCA loan portfolio in the hands of the Spokane FICB.
September 22	WPCA Board of Directors files suit against the FCA and the FICB in Federal District Court.
October 5	Judge Owen M. Panner issues a temporary restraining order (TRO) preventing the immediate liquidation of the WPCA by the FCA and FICB.
October 6	FICB cuts off cash disbursements to WPCA.
October 7	Ten-day extension to the TRO added by Panner.
October 17	TRO extended 10 additional days; hearings begin.
October 26	WPCA board reinstated by the District Court. Trial date set for November 23, 1983. Stock impairment nullified, merger with COPCA blocked, WPCA bylaws reinstated.
October 26	FCA governor Wilkinson refuses to restore General Financing Agreement.
October 28	FICB withdraws $1.8 million from Mutual Loss Sharing Agreement.
November 3	Judge Panner issues Opinion of Civil Case No. 83-1413-PA which states the FICB removal of funds is an attempt to "coerce the Court into approving an improper audit."
November 23	Interim agreement signed between WPCA and FICB in an out of court settlement to restore funding for existing WPCA loans. New audit to be conducted by the FICB and completed by December 31, 1983.

Table 1. WILLAMETTE PRODUCTION CREDIT ASSOCIATION, Chronology of Events - 1983 & 1984 (Cont.).

1983 - continued	
November 29	U.S. Senator Mark Hatfield and U.S. Congressman Denny Smith request GAO to investigate the FCA special audit of the WPCA.
1984	
March 9	WPCA proposes conditional liquidation to FICB (requests new Western OR PCA, unimpaired stock, prevention of merger, FICB as liquidating agent). WOPCA board elected and charter submitted to FCA.
March 14	Preliminary results of FCA 1984 audit released to public; charge-offs of $6.6 million.
May 18	WOPCA charter approved only after four (of five) board nominees replaced to appease the FCA.
May 21	WPCA officially liquidated.

with partial charge-offs be transferred from an earning asset status to a non-interest accruing account (WPCA, 1984a).

The reclassification of these loans resulted in approximately 25 percent of the WPCA's loan assets being placed in categories which produced no revenues, while still requiring payment to the FICB for interest on these funds (WPCA, 1984a). The FCA used these guidelines to classify 43 loans as loss loans in their audit, whereas the April audit reported only 15 such loans (Panner, 1983c).

Computations involved in this special audit were not provided to the board of directors of the WPCA at that time. FCA deputy governor Larry Edwards stated that the June audit would not be made available to the public (Statesman-Journal, Salem, OR, October 27, 1983). This audit, conducted by the FCA Office of Examinations, reported a dramatically different picture than the FICB audit conducted shortly before. The losses presented by this report indicated that the WPCA had $8.9 million worth of bad loans on its books.

An early consequence of these results was the call for early retirement of WPCA president Fred Boyer. Therefore, the Association was temporarily without its senior leadership during a time of crisis for the organization.

FCA governor Donald Wilkinson, acting on the grounds that the "B" stock (voting stock) of the WPCA was impaired, as indicated by the June audit, declared the WPCA insolvent on August 10, 1983. He enacted FCA order No. 846 which suspended the WPCA board of directors. This order also instituted 12 C.F.R., Section 611.1140 (the so-called "1140 procedures"), freezing the Association's stock and granting control of the WPCA to the FICB in Spokane. While the WPCA remained open and operating, the order

caused several months of uncertainty about the future of the WPCA that seriously damaged its credibility as an agricultural lender in the Willamette Valley.

At that time, the WPCA's own books showed a positive net worth of \$17,620,383 and a capital stock value of \$10,161,725. Net worth, therefore, exceeded capital stock obligations by nearly \$7.5 million (net worth = assets - liabilities, or \$115,765,910 - \$98,145,547 = \$17,620,383).

Results of the FCA Special Audit
of the WPCA
(June 1983)

August Figures from WPCA Books:

$$\text{Net Worth}_1 = \text{Assets}_1 - \text{Liabilities} = \$115{,}765{,}910 - \$98{,}145{,}547$$

$$= \underline{\$\ 17{,}620{,}363}$$

$$\text{Net Worth}_1 - \text{Capital Stock} = \$17{,}620{,}363 - \$10{,}161{,}725$$

$$\underline{\$\ 7{,}458{,}638}$$

$$(NW_1 > \text{Capital Stock})$$

$$\text{Debt to Capital Ratio} = \frac{\text{Liabilities}}{\text{Net Worth}_1} = \frac{98m}{17.6m} = \underline{5.57}$$

FCA Audit Results:

$$\text{Net Worth}_2 = \text{Assets}_2 - \text{Liabilities} = \$107{,}261{,}623 - \$98{,}145{,}547$$

$$= \underline{\$\ \ 9{,}116{,}076}$$

$$\text{Net Worth}_2 - \text{Capital Stock} = \$\ 9{,}116{,}076 - \$10{,}161{,}725$$

$$= \underline{\$-1{,}045{,}649}$$

$$(NW_2 < \text{Capital Stock})$$

$$\text{Debt to Capital Ratio} = \frac{\text{Liabilities}}{\text{Net Worth}_2} = \frac{98\text{m}}{9.1\text{m}} = 10.77$$

$$\text{CHARGE-OFFS} = \text{Net Worth}_1 - \text{Net Worth}_2 = \$17,620,363 - \$9,116,076$$
$$= \underline{\$\ 8,504,287}$$

The audit which changed the net worth also caused the FICB to control the flow of funds to the WPCA. This was because of a change in the debt-to-capital ratio. When the debt-to-unimpaired-capital ratio of a PCA exceeds 10 to one, the regional FICB can cut off the flow of funds to that association, as eventually happened in this case, pursuant to 12 U.S.C., Section 2074 (c) and 12 C.F.R., Section 614.5240. It was impossible to make new loans under these circumstances.

The June FCA audit showing nearly $9 million in charge-offs caused the debt-to-capital ratio of the WPCA to rise to 10.8 to one.

On September 22, 1983, the law office of Ferder, Ogdahl and Brandt filed a complaint in Federal District Court on behalf of the deposed board of directors of the WPCA to block the takeover by the federal agency. On October 5, 1983, Judge Owen M. Panner issued a temporary restraining order (TRO) for two days which prevented the FCA from immediately appointing a receiver to liquidate the PCA. A 10-day extension was added to the TRO on October 7. An additional 10-day extension was implemented on October 17, the first day of hearings on the case.

Early in these proceedings, Judge Panner denied the defendant's request that the plaintiffs post a daily bond during litigations to protect the defendant's equity. The defendants claimed the WPCA was losing $4,000 a day.

Upon delivery of the initial restraining order, FCA official William Hoffman stated that in light of the WPCA suit, the FCA and FICB were considering blocking the further advancement of any funds from the Spokane bank to the WPCA. These funds were previously commited to the WPCA for meeting farmers' cash needs. Under normal conditions, such cash advances ranged from $150,000 to $500,000 per day (Panner, 1983c). This statement contrasted with an earlier one by Hoffman indicating a ban on disbursements was "not a policy that we would adhere to" (Statesman-Journal, Salem, OR October 8, 1983). Shortly thereafter, the FCA decided to impose just such a ban.

As the hearings continued, Judge Panner required the FCA to provide previously undisclosed documents to indicate how the severe charge-off situation had been figured by their auditors. Some 40 pounds of documents were presented to the court. These papers showed that auditors decreased by 25 percent the value of farm assets on specific accounts. Testimony revealed that values used to estimate collateral were "recovery values" which subtract substantial carrying and sales costs for assets. These values represent a very conservative return for what liquidation of farm assets might bring in actual transactions. Also, some loans were placed in the "loss" category even as borrowers were making regular payments (Panner, 1983c, and Statesman-Journal, Salem, OR, October 19, 1983).

Paul Raush, FCA's reviewer in charge of the special (June) audit, testified that his staff could offer no evidence of "serious effort" to determine fair market value of property used as collateral in many PCA loans. The FCA's own manual, "Examination Objectives and Procedures," requires documentation of how collateral values are derived.

The evidence indicated to Judge Panner that a lengthy court battle was imminent and he suggested that both parties meet out of court to explore solutions. During these meetings, the WPCA proposed a voluntary liquidation, subject to several conditions. The main stipulations in their request were the formation of a new PCA in the same region as the WPCA then served, and protection of the borrowers' "B" stock. This plan was eventually implemented, and funds to western Oregon agricultural borrowers were restored, but not until six months later. The litigation continued and, meanwhile, loanable funds for valley farmers were in short supply.

On October 26, 1983, Judge Panner declared the June special audit without effect and returned the WPCA board of directors to power. A trial date was set for November 23, 1983. A preliminary injunction was issued which protected the WPCA from liquidation. The injunction also prevented the forced merger of the WPCA with the Central Oregon PCA (COPCA), which the oversight agencies were at that time proposing. The order granting the preliminary injunction coincided with the expiration of the temporary restraining order. The order granting injunction also stated that no stock impairment existed, reinstated the WPCA bylaws, and restricted the FCA or FICB from encouraging WPCA area borrowers to switch allegiance to the COPCA in Redmond, Oregon.

The five-member board of directors, chaired by George VanLeeuwen, immediately outlined plans to restore access to FICB funds. Alternatives included borrowing from commercial banks to get two to three million dollars for immediate cash needs, foreclosures as necessary, and restoring loan service to members. The WPCA board determined an interest rate of 14.15 percent in a market where commercial banks were charging ranged from

13 to 15 percent on agricultural loans (Statesman-Journal, Salem, OR, October 27, 1983).

Although the board was officially reinstated, the normal functioning of the WPCA was still frozen because of lack of funds from the FICB. This action occurred because FCA governor Wilkinson refused to allow the FICB of Spokane to reinstate the General Financing Agreement with the WPCA. This agreement must be in effect for the normal advancement of funds.

The day after Judge Panner's ruling, the Justice Department requested a stay of the injunction at the prompting of the FCA governor. The Oregon District Court refused to rule on the request. Still, the federal agencies sought to thwart the protection offered the WPCA by the Oregon court. Not only was a ban on loan funds continued, but the FICB withdrew $1.8 million, formerly granted to the WPCA through the Mutual Loss Sharing Agreement (Statesman-Journal, Salem, OR, October 28, 1983).

The importance of this removal of funds was evidenced in Judge Panner's final opinion issued on civil case 83-1413-PA, dated November 3, 1983: "Defendants' sudden cut-off of previously committed loan funds partakes of an inexcusable (and unsuccessful) effort to coerce the Court into approving an improper audit by threatening hardship to individual farmers."[4/]

Despite steps taken through judicial processes, it seemed the WPCA and FCA were becoming more polarized in their stances. The PCA had borne the

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4/ One explanation for such a harsh action by the FCA is that it was attempting to protect the rating and marketability of Farm Credit System Securities. However, John Campbell, a bond expert with the accounting firm Touche-Ross and Co. (Portland) indicated in an interview that he saw no concern over FCA bonds reflected in bond markets.

burden of proof in showing irreparable harm from the actions of the FCA and that these actions were based on the special audit of June 1983. Testimony had made it apparent that this audit was conducted erroneously. As indicated, the audit was found to be null and void, the August actions of the FCA and FICB were rescinded. But technical control of the funds needed to run the WPCA was not in local hands, even though WPCA board members had prevailed in court.

In mid-November 1983, the FICB in Spokane made significant steps toward restoring cash flow to the WPCA. In an out-of-court settlement, the FICB worked out an interim agreement with the WPCA in which the flow of funds would be restored and a new audit would be performed by the FICB to determine the financial status of the PCA at that time. This action on the part of the FICB in Spokane was not backed by the FCA, which took a reportedly "passive role" in the negotiations. Such discord among the oversight agencies was further revealed when, after a two-week silence, the FCA announced that it would not allow the FICB to conduct the new audit, but its own Office of Examinations would again do the book work. According to the FCA, this audit was to be completed by December 31, 1983. The results were not compiled until May 4, 1984.

Former WPCA president Fred Boyer stated: "Just after Panner's decision, the new president of the FICB was sincere, was cooperative, and wanted to make an effort to resolve the situation."[5/]

Concurrent with these proceedings was a case filed by the WPCA board against the FCA, its governor, Donald E. Wilkinson, and others. Financial

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5/ Larry Butterfield had assumed the FICB presidency about one year earlier.

relief from a $120 million revolving fund in the hands of the federal Farm Credit System was sought. Title IV, Part A, Section 4.0 (a) of the Farm Credit Act of 1971 allows for "investment in the capital stock of various associations within the Farm Credit System." In the Farm Credit Act of 1933, Congress appropriated $120 million to "organize, capitalize, and supervise" the FCS. Through its own resourcefulness, this system repaid the sum in full to the U.S. Treasury over a period of several decades. Subsequent amendments to the Farm Credit Act by Congress put these funds back in the hands of the Governor of the Farm Credit Administration for reinvestment as a revolving fund. Full repayment of the original government appropriations made the Farm Credit System a cooperative organization (albeit federally chartered) which received no directives from the executive branch of the government. The WPCA was not given access to these funds.

FCA officials went on the record to state that their organization would not use the revolving fund because it would have negative implications in confidence in the FCA bond market, source of funds for the national system. They further said that this fund was inadequate to cover all of the needs of various member institutions across the nation and so using it for a small group (several troubled PCAs in the Pacific Northwest) might spur a run on such assistance. The WPCA filed suit because the FCA showed no supporting evidence in refusing use of these funds.

It should be understood that an infusion of these monies to a member cooperative like the WPCA would not be a grant or handout. Rather, the member institution would be required to repay these dollars over time, as was done between 1935 and 1968 for the original government assistance.

Results in the above suit are still pending. Meanwhile, WPCA officials turned their attention to assuring that a fair audit was conducted, which would determine if the local institution was still viable in spite of the long period of frozen cash flows. Rep. Denny Smith (R-OR) and Sen. Mark Hatfield (R-OR) received the support of the General Accounting Office (GAO) in reviewing the procedures of the new audit by the FCA.

Meanwhile, the FCA began to work on the new audit. In mid-January, FCA deputy governor William Hoffman said that his staff had gotten behind by a couple of weeks at the outset because of "confusion over who was to perform the audit," and that further delays were likely because of the "detailed information the auditors were gathering" (Statesman-Journal, Salem, OR, January 16, 1984).

The interim agreement was extended until the end of February 1984. However, this agreement allowed operation of existing loans only and the lack of new revenues was further eroding the WPCA's balance sheet. Also, many Class I borrowers left the system to find financing in more stable institutions.

Seven auditors from the FCA and three from the FICB continued to methodically go through the current WPCA files. They reviewed some 300 loans over a period of about four months.

On March 9, 1984, still awaiting the results of the audit, the WPCA entered into a settlement with the FICB which offered voluntary liquidation of the WPCA. This agreement was contingent upon several conditions set forth by the WPCA board of directors, those being:

1. A new PCA would be formed to replace the WPCA and it would serve the same area as its forerunner.
2. WPCA "B" stock would be redeemed at par value, as would "A" stock (non-voting stock) and "C" stock (participation certificates).
3. The Central Oregon PCA's (COPCA's) charter would not be expanded to include any WPCA territory.
4. The FICB (not the FCA) would appoint the liquidating agent for the WPCA.
5. All Class I and Class II agricultural loans would be sold to the new PCA for the area (WPCA, 1984c).

At this time it was reported that the second FCA audit was "nearing completion." About a month later, in mid-April, FCA deputy governor Larry Edwards said the new audit was going through "final touches" before it could be released. He reported that the WPCA was still financially impaired and that it could not "survive under present structure" and that although uncompleted, the new audit showed that impairment was not as large as revealed in the June special audit (Capital Press, Salem, OR, April 13, 1984).

This information was known to the WPCA board at the time it volunteered to disband, if not well before. The lack of access to regional (Mutual Loss Sharing Agreement) or national (revolving fund) relief for their situation and the long litigation combined to impose irreversible damage to WPCA's financial status. The new audit eventually found a $6.6 million charge-off for loss loans, and the volume of the loan portfolio had shrunk over the months (The Oregonian, Portland, OR, March 14, 1984).

Thus, the stock was found to be impaired. Liquidation of the WPCA would have been forced eventually, had its board not voluntarily done so beforehand.

Several specific gains were made by the WPCA in fighting involuntary liquidation, as was forced on a few other struggling PCA's in the Pacific Northwest in 1983. The FICB had guaranteed the association's "B" stock. A productive agricultural zone in Oregon had a production credit association based in its territory. Some 600 active WPCA borrowers, holding about $80 million in outstanding loans, would have an opportunity to continue these loans with a new PCA in the same area (Statesman-Journal, Salem, OR, March 14, 1984).

Other PCAs in Farm Credit District 12 had not been as fortunate. One example was the merger of the insolvent Southern Oregon PCA with the nearby Klamath PCA. Similar situations arose in Mount Vernon, Washington, and in Twin Falls, Idaho.

The WPCA board of directors had volunteered to liquidate as soon as they were aware of the general results of the second FCA audit. This was thought to be in the best interest of the area growers, in that it would expedite the formation of a new PCA in the Willamette Valley (Boyer, 1984). At that time they chose a board of directors for the new PCA. They also made arrangements to sell their good loans (Class I and II) to the new association.

The FICB and WPCA worked out arrangements to sell $50 million in Class I and II loans to the new Western Oregon PCA (WOPCA). Concurrently, the FICB of Spokane would gain control over about $30 million in Class III and IV loans. The FICB would have to work out repayment schedules or arrange

to foreclose on properties where there was no hope of repayment. Many of the loans in the adverse category that survived these developments would have been foreclosed in an abrupt manner, had the FCA been allowed to liquidate the WPCA in the fall of 1983.[6/] Thus, many forced sales had been avoided. One such case was a loss loan (Class IV) valued at $1.8 million. This loan now has been fully repaid and the borrower is a viable operator (Boyer, 1984).

The FICB was cooperative with the WPCA during its liquidation process. WPCA members submitted statements of their eligibility to form the new association and signed articles of incorporation. They also selected a new board of directors for the WOPCA. Two members, George VanLeeuwen and Fred Kaser, were from the WPCA board. The other board members were to be Rosetta Venell, Dave Harnish, and Peter Dinsdale.

The new charter for the WOPCA was not approved until May 18, 1984. The official liquidation of the WPCA was instituted on May 21, 1984. The delays in the auditing process notwithstanding, the FCA had taken an additional 2½ months to approve the WOPCA charter and the WPCA was making loans during this period to the area's farmers.

According to Dave Harnish, the WOPCA board of directors that WPCA members had elected in March was unacceptable to the FCA. No specific reasons for rejection were publicly cited. Only one member of that group, Dave Harnish, remained on the WOPCA board. He acted as its chairman through the remainder of 1984. This board now includes Robert Kessi, James Bushue, Dennis Koenig, and Sam Eicher. No reason was given for the first

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6/ According to Fred Boyer and William Brandt, in an interview conducted by the authors, August 3, 1984.

required change in board members except that the first board did not meet "certain restrictions on board membership" imposed by the FCA (Capital Press, Salem, OR, May 18, 1984.)

The FICB of Spokane appointed Jerry Wharton to be the liquidator for the lower quality loans held by the WPCA which were not to be refinanced by the WOPCA. Hugh Miller was assigned to be Mr. Wharton's on-site agent in Salem.

Greg Williams, interim president of the WPCA, left in March 1984 for the presidency of the Klamath PCA in southern Oregon. He had taken over from Fred Boyer in May 1983. Phil Brandt, WPCA president for many years before Boyer, returned to the post when Williams left. Brandt and Boyer were assigned roles as consultants to the WPCA during the period of transition, as was former Northwest Livestock PCA president Jerry Herburger. The remaining WPCA staff was largely incorporated into the new organization. Jerry Gleasing was appointed by the FICB as acting WOPCA president until this position could be permanently filled.

IV. ANALYSIS OF FACTORS LEADING TO UNSTABLE FARM CREDIT IN WESTERN OREGON - THE EARLY 1980s

Several events of recent years have combined to cause problems in production credit supply. The next section will attempt to overview the most important of these developments with specific regard to their effects on the WPCA.

The Farm Credit Act of 1971 provided for supplying loan funds to fishermen on the part of many PCA's with coastal waters bordering their territory. This was to help provide a line of credit for boat owners who needed assistance beyond what was commercially available. The WPCA started an aquatic loan portfolio in 1972, serving ports in Clatsop, Lane, Lincoln, and Tillamook counties. The major fisheries in waters off these areas are salmon, bottomfish, shrimp, crab and joint ventures for Pacific whiting.

A series of events has since occurred which caused many aquatic loans to become unproductive for the WPCA. Among these are a decline in salmon stocks, shortened seasons in major fisheries, and the need for new equipment for boat owners to exploit the more viable fish supplies (such as bottomfish). These developments, along with an untimely environmental change in ocean temperatures (El Nino) placed commercial fishermen in a situation with decreasing resource supplies.

Economic circumstances surrounding the fisheries caused many producers to give up on commercial fishing. This resulted in a glut in the supply of vessels and thereby reduced their values. These factors add up to a severe case of overleveraged boat owners with obligations to PCA's.

In November 1983, several Pacific Northwest PCA's including the WPCA, turned their aquatic loan portfolios over the Northwest Livestock PCA in

Portland, Oregon. This PCA services specialty loans, and also aquatic and other loans for Alaskan borrowers. Other PCA's involved were the Southern Oregon PCA in Medford, Oregon, and the Puget Sound PCA in Mount Vernon, Washington. Both PCA's were declared insolvent about the same time as the WPCA was.

Aquatic loans made up about 10 percent of the WPCA's portfolio (Boyer, 1984). There is no doubt that the severe condition of Oregon's aquatic producers added to the stress of these loans on the WPCA's books. Nevertheless, it is generally agreed that the WPCA did a fairly good job of dealing with these loans when compared to the impact of similar circumstances leading to the liquidation of coastal PCA's to the north and south.

Another element affecting the stature of WPCA loans was the recent instability in the fruit and vegetable processing industry in the Willamette Valley. Because of the disappearance of several private processors in recent years, most of this industry in WPCA territory is controlled by two cooperatives, Stayton and Agripac. The latter has had a slower rate of payout to growers over the past few years. Management and fixed cost changes in 1984 corrected some of these problems. However, payout practices definitely added to loan repayment problems for the sector of the farming community involved with this cooperative in the early 1980s.

WPCA files indicate the importance of Agripac's payouts regarding borrower stability. In November 1983, former WPCA president Greg Williams directed his field staff to use projected payouts of 70 percent of cash value for 1982, and 75 percent for 1983 in assessing returns for Agripac growers (W. Brandt, 1984f). These conservative values indicate that the

WPCA was no longer taking full payouts on the part of processing cooperatives for granted when reviewing loans made to farmers dependent on these disbursements.

Part of the trouble with Agripac's cash flow has been its own debts for building new facilities. The majority of these have been plant and equipment expenditures for processing frozen vegetables (Heffernon, 1984). The demand for frozen products has been growing when compared to canned goods demand, but this growth has been erratic from year to year (G. Wilson, 1984). The new investments made by Agripac management may have been somewhat untimely and the result was a burdensome debt load in times of a soft market for processed vegetables and high, real interest rates.

The other major cannery in the Willamette Valley, Stayton, has not been totally untroubled. This cooperative made payouts of just under cash value to its growers in 1983 (Gross, 1984). This is an exception to full (100 percent) payouts for the last several years on the part of this processor.

Horticultural commodities for processing were not the only products that brought lower than expected returns to WPCA-backed farmers in the early part of this decade. One crop commonly cited as a problem for WPCA area farmers is peppermint. This perennial crop is processed into mint oil which can be stored for several years. A buildup of stocks of this oil has developed recently and prices in the early 1980s have reflected this excess supply.

Table IV displays recent trends in peppermint oil prices and production per acre in Oregon:

Table 2. Mint Oil Yield and Price for Oregon.

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Price ($/lb)	16.20	14.75	12.75	9.91	9.40	9.39	9.24	10.10	11.30
Yield (lbs/acre)	57	57	54	54	60	65	64	67	66

SOURCE: Miles, 1985

A recent document showed that 13 counties served by the WPCA grows about half the peppermint in Oregon, which leads the nation in production of this crop (Oregon Department of Agriculture, 1983). Another study reveals that peppermint ranked 14th among Oregon agricultural commodities in terms of value in 1984 (Miles, 1985). These figures demonstrate that peppermint was an important crop to some WPCA borrowers.

Another crop which affected the cash flow of WPCA area growers is grass seed. The Willamette Valley is the grass seed production capital of the world and this production is centered in former WPCA territory. Oregon leads the nation in supplying many grass seed species, including bluegrass, fescue, orchard grass, ryegrass, and bentgrass (Tom Cook, personal communication, 1984).

Prices for grass seed have declined for most of these species from relatively high levels in 1981. One example is bentgrass, which sold for $1.85 per pound in 1981 and was worth less than 45¢ per pound in 1984 (Miles, 1985). Much of this crop is exported to Europe and the price drop can largely be attributed to a strong dollar in those markets.

This report indicates trends in only a few products of a diverse agricultural area. Commodity prices have declined for most products over the last few years, though not as dramatically as in some of the cases noted herein. Oregon agricultural production, in terms of value, showed virtually no real growth between 1981 and 1984.[7/] Profit margins for growers have been further reduced from rising production costs. For instance, farm labor costs increased more than 18.5 percent between 1981 and 1982 in Oregon (Oregon Department of Agriculture, 1983). The overall picture has been one of attrition for Oregon agriculture in this decade.

[7/] Nominal figures for the total value of Oregon agricultural production were $1.940 billion and $1.943 billion for 1981 and 1983, respectively. (USDA. Oregon Crop and Livestock Reporting Service, 1985)

V. SUMMARY AND CONCLUSIONS

Instability in Willamette Valley farm operating credit is certainly caused in part by poor returns in aquatic and agricultural pursuits in this decade. The impact of these problems was revealed in the FICB's routine audit of the WPCA in April 1983. This audit showed $2.6 million in loss loans on the WPCA's books at that time. Such losses did put the WPCA in a financial bind, but probably not enough to threaten its survival.

The decision of the District Court to nullify the FCA's June 1983 audit is very significant in that it showed objective support for the association. Judge Panner wrote:

> In short, there is substantial evidence that the FCA did not adhere to its own auditing regulations when it classified an additional twenty-eight loans down to the loss category and recommended charge-offs of over $8 million . . . there is substantial evidence to support a conclusion that the FCA arbitrarily determined substantial loss values and effectively imposed their conclusions on the Association's staff (Panner, 1983c).

Aware of the fact that the FCA had acted negligently, persons concerned with agricultural credit began to make inquiries as to the reason for this conduct. One such person was U.S. Congressman Denny Smith from Oregon's Fifth District. On behalf of the WPCA and its borrowers, he wrote the governor of the FCA, Donald Wilkinson, in September 1983:

> (the FCA audit of June 1983) placed the loan loss level at $8.9 million, while less than 90 days earlier an FICB examination placed the loan loss level at $2.6 million. How do you account for such a massive increase in the loan loss level in such a short period of time? Also, is it standard to proceed against a

> PCA without allowing the PCA's Board members the opportunity to review pertinent documents and comment on those documents? (Smith 1983a).

The congressman also inquired about the FCA's reluctance to utilize the revolving fund for WPCA assistance. He also stated a need for the FCA to clarify its stance:

> I am not in a position to judge whether economic conditions or management practices have led to the difficulties being experienced in the Farm Credit System throughout the nation. However, I am aware that economic conditions have led the Federal Reserve System and the FDIC to order their bank examiners to take those conditions into consideration when reviewing the loan status of farm lenders. Has the FCA adequately considered those same conditions before proceeding against the WPCA? (Smith, 1983a).[8]

After the District Court ruling which reinstated the WPCA board, Congressman Smith again contacted Wilkinson. He contested the FICB's removal of the Mutual Loss Sharing Agreement funds, which occurred immediately after the preliminary injunction was issued. The Congressman called this a "violation of the spirit of Judge Panner's ruling" and added that "it would be unfortunate if before the trial can be held, the FCA and FICB were to render the WPCA permanently disabled" (Smith, 1983b). Mark Hatfield, Oregon U.S. Senator, joined with Congressman Smith in calling for a GAO review of FCA auditing procedures.

In assessing the troubles of the WPCA, the Association must be held accountable for its own mistakes. Unsubstantiated reports indicate that

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8/ The FCA failed to respond to Smith's inquiry. He subsequently testified before the House subcommittee three times.

some of the difficulties were generated from within. The WPCA has been accused of improperly carrying some marginal borrowers who were inefficient. Loans for the purposes of acquiring properties, new equipment, and for the renovation of production facilities may have been ill conceived in some cases.

American agriculture has always experienced cyclical highs and lows. One must respect the capability of both lender and borrower who survive these times. In the interim, it is a responsibility of a concerned public public to insure that foundations of the system we rely on remain intact, efficient, and productive. In this regard it is evident that users and suppliers of Willamette Valley farm operating credit need to learn from recent errors, pursue new strengths, and appreciate current successes.

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