Check Your Guns at the Door: How to Get Together to Establish a Secondary Market

Catherine Dolan
Director, Community Development Finance
Wachovia Corporation

Who Moved Community Development Finance's Cheese?

Most organizational development professionals are familiar with Spencer Johnson's book *Who Moved My Cheese?* Johnson's tale is simple but insightful and reveals profound truths about change. The four characters in the story live in a maze and they need to look for cheese to nourish them and make them happy. The characters are Sniff, Scurry, Hem, and Haw. "Cheese" is a metaphor for what you want in life, and "maze" is where you look for what you want.

In the story, the characters face unexpected change, and each deals with it differently. The interesting parallels that exist between the story and the current state of community development finance are telling.

In the community development finance industry, the "cheese" is capital. The "maze" is where one looks for capital. Historically, most corridors in the community development maze have led to banks and foundations. That's where the cheese was. Then one day the industry awoke to find that the cheese in these corridors was no longer plentiful and it didn't taste quite as good as everyone remembered from the old days.

While the traditional providers of capital, banks, and foundations will continue to be important sources for "cheese," the industry must find a way to access a new source–the global capital markets.

So what's a mouse to do? Do we mimic the behaviors and thoughts of Hem, who bemoans the fact that someone has taken away his cheese, and it's simply not fair because he is entitled to the cheese? Or do we look at the behaviors of Haw, who learns new processes that enable him to continually adapt to change so that he is better prepared the next time "someone moves his cheese"?

We can learn from the experience of developing countries. Thirty years ago, these countries relied heavily on Western banks for their source of financing. When Mexico defaulted on its bank debt in the early 1980s, the market for future capital to developing countries shut down, particularly in Latin America. And the market did not open again until some smart corporate finance professionals learned how to bypass the banks and tap the global institutional markets. These markets are comprised of pension funds, insurance companies, hedge funds, investment banks, mutual funds, and the like. The investors have different investment profiles than banks–different risk tolerances, time horizons, liquidity requirements, and accounting and regulatory standards, to name a few. Finance ministers in developing countries, with the help of investment bankers and consultants, learned what the new investors wanted and designed products that would appeal to their appetites.

We can also learn from other sectors of the economy. Below-investment-grade companies, credit card companies, and first-time homebuyers experienced a similar reception from the banking industry and also found a way to reach beyond the appetite and risk profile of banks to tap the global capital markets. It may be time for the community development industry to do the same.

So how does the community development industry move beyond the old paradigm governing the availability of capital and get to these new sources? Once again, we can take some lessons from Johnson's story. One of the lessons that Haw takes away from his experience in the maze is that "Old Beliefs do not lead you to New Cheese." He also learns that "The Sooner you let go of the Old Cheese, the sooner you find some New Cheese."

To make a market in a new product or a new sector, size matters. Everyone knows that Government Sponsored Enterprises, or GSEs (Fannie Mae, Freddie Mac, and Ginnie Mae), make markets in home mortgages. They are a large enough source of liquidity for originators of home mortgages that they can set the standards for how mortgages must look to meet their requirements for purchase. Although there is no single capital provider large enough in the community development industry to make the market, if a number of the larger CDFIs, banks, foundations, and insurance companies that are currently active were to join forces, there might be an opportunity to set some standards and protocols that can begin to create inroads into the capital markets beyond the old corridors in the maze. Given their affordable-housing mandate, there is certainly a role for the GSEs, as well.

The key to getting started is to collaborate in making some small but important first steps. Put aside competitive rivalries, political positioning, and pride and reach consensus on practical objectives and efficient protocols. Identify a handful of successful examples of sourcing capital from the institutional markets and focus on replicating what works. Create standards for loan documentation. Adopt common accounting procedures. Collect and report loan performance data on a common platform. Partner with one or two investment banks and law firms to provide enough volume to reach economies of scale.

Many viable ideas such as these were identified at the meeting recently convened by the Federal Reserve. What we need now is courage to move out of our comfort zone and into the maze in search of new cheese.

As Haw came to realize, "It is Safer to Search in the Maze than Remain in a Cheeseless Situation." We should take to heart these simple words and join forces to make an overdue breakthrough into the global capital markets.

Catherine Dolan is Director of Community Development Finance at Wachovia Corporation and is responsible for providing financial solutions targeted at the community development industry across the country. Wachovia's focus is on affordable housing, community service organizations, and economic development.