



Miles Water Commissioner David Weinkauf (left) inspects the new 100,000-gallon storage tank, part of a new water system built using Texas STEP's self-help approach.

A Big STEP for Miles

*Bank Loan Helps Town
Obtain New Water Supply*

INSIDE

**1998 Investments Directory
Now on the Internet**

●
**The Business Case for Pursuing
Retail Opportunities
in the Inner City**

●
**Rural Community Hatches
New Businesses**

●
Filling in the Blanks

Faced with replacing its water supply or paying substantial penalties for non-compliance, Miles was a small West Texas town with a big problem. The city's drinking water exceeded the allowable limits for nitrate, chloride and sulfate and contained large amounts of dissolved solids as well. The town of approximately 800 residents had been operating under a variance granted by the state in 1983 while it worked on its water system.

In 1995 the Texas Natural Resource Conservation Commission (TNRCC) told Miles it was time to find a new water supply, and the city began to explore its options—from reverse osmosis and electron dialysis to drilling new wells. The

most viable alternative was building a connection to the Concho Rural Water Corp., approximately 19 miles away. In addition to laying a new pipeline, the city would need two pump stations and a 100,000-gallon storage tank.

A preliminary engineering study by an Abilene firm put the cost of obtaining the new water supply at approximately \$800,000, a hefty bill for a town with only 358 water connections. When city officials explained Miles could not afford that amount, the TNRCC referred them to the Texas Small Towns Environment Program (STEP) for help in reducing the cost of the project. The TNRCC coordinates Texas STEP, which helps communi-

Continued on page 2



Citizens State Bank President Mark Heinze (right) greets a customer in his office. The Miles-based bank financed the water project.



Using county equipment, Miles water department employees laid the 19-mile pipeline and helped save the city more than \$100,000 in labor costs.

A Big STEP *Continued from page 1*

ties solve urgent water and wastewater problems by fostering self-help and providing guidance, assistance and support.

Using Texas STEP, Miles completed the project in August 1997 for approximately \$350,000 less than estimated, without sacrificing quality. STEP helped the town involve a number of players in completing the project.

Citizens State Bank

For financing, the town turned to Citizens State Bank, part of the Miles community since 1937. The small independent bank, with approximately \$18 million in assets, wanted to help but faced lending limits of about \$150,000. At the request of bank President Mark Heinze, the Texas Banking Commission reviewed the regulations and decided the loan could exceed those limits.

"As an integral part of the community, our fortunes are tied to those of the town," explains Heinze, "and a town needs good water to survive."

Citizens State Bank became a Texas STEP partner by providing a \$450,000 loan at an annual rate of 6.5 percent, to be repaid over 10 years. The loan covered all the costs of the new system—engineering services and materials for 19 miles of pipeline, two pumping stations and a storage tank.

The City of Miles and Its Citizens

Miles Water Commissioner David Weinkauf, the driving force in completing the project, and his assistant acted as the general contractor. By taking separate bids for individual materials—pipe, valves and connectors—the lowest price was secured for each, which saved approximately \$200,000.

Using water department employees to lay the pipe saved Miles more than \$100,000. Runnels County, within whose borders Miles lies, donated the use of a bulldozer and other equipment, saving the town thousands of dollars in rental costs. By using local attorneys who understood the town's financial position, the city saved on legal fees. Other savings came from donations of land for the new storage tank, the use of trucks and trailers to haul the pipe, and the muscle to load and unload it.

"Texas STEP helps towns like Miles that are facing urgent water and wastewater problems assemble the community's resources to solve them," says Carol Limaye of the TNRCC Water Utilities Division. "We help community officials research all approaches, including grants and loans, volunteers and existing resources. On average, a town saves more than 30 percent off the retail costs of its project, with the added advantage of community pride and ownership gained from resident participation." The

Fast Facts

A public-private partnership of the TNRCC, Citizens State Bank, Miles and its approximately 800 residents solved the Texas town's urgent need for a new water supply. Existing wells had high nitrate and sodium levels, resulting in violations of drinking water standards and high testing costs. High chloride levels discouraged use of local swimming pools and car washes.

The scope of the project included constructing a 19-mile pipeline from the Concho Rural Water Corp. to Miles, installing two pump stations, and installing a 100,000-gallon water storage tank.

The partnership was formed under the Texas Small Towns Environment Program (STEP), which helps communities assemble resources to solve water and wastewater problems by using local assets, including volunteerism, grants and loans, and existing resources. The bank's willingness to finance the entire project was key to its success.

| | |
|--|-----------|
| Estimated retail cost of new water supply | \$800,000 |
| Loan from Citizens State Bank (6.5 percent interest for 10 years) | \$450,000 |
| Savings by using resources gathered through Texas STEP | \$350,000 |
| <ul style="list-style-type: none">● Reduced engineering costs● Donated equipment● Volunteer labor● Reduced cost of pipe● Donated land for water storage tank | |

For more information:

Texas Natural Resource Conservation Commission
(512) 239-6120
www.tnrcc.state.tx.us/water/wu/step/index.html

self-help approach has worked for over 200 communities during the past 20 years, proving the concept that the best way to get money is to need less of it.

The Miles City Council realized that raising water rates would not be popular with residents, so they included the public in the process from the start, holding community meetings and keeping the local newspaper informed of developments.

As a result, the project has worked

out very well, according to Heinze. Not only has the quality of the water improved, but water pressure is much stronger now. "It's worked out well for the bank, too," he adds. "The city is having no trouble meeting the repayment plan out of its water revenues." ■

Did You Know...?

1998 Investments Directory Now on the Internet

The Federal Reserve System's 1998 Directory of Community Development Investments can be downloaded from the Fed's Web site, <www.bog.frb.fed.us/dcca/directory>.

The directory profiles 159 community development programs in which bank holding companies and state-chartered banks supervised by the Fed have invested. The profiles cover community development corporations, limited liability companies and limited partnership programs. Capital invested, descriptions of the projects or activities—both planned and under development—and names of contacts for additional information are included.

Printed copies are available by calling (214) 922-5286.

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The Business Case for Pursuing Retail Opportunities in the Inner City

The Boston Consulting Group in Partnership with
The Initiative for a Competitive Inner City



A new study makes a compelling case for the profit potential of retail investment in the nation's inner cities. Research for the study was conducted primarily in six inner-city markets: Atlanta, Boston, Chicago, Harlem, Miami and Oakland. Together these markets provide information applicable to inner cities nationwide. The Boston Consulting Group and the Initiative for a Competitive Inner City (ICIC) worked in partnership to conduct the study. The ICIC is a national nonprofit organization founded in 1994 by Harvard Business School Professor Michael E. Porter following several years of pioneering research on inner-city business and economic development. The Boston Consulting Group donated its services for the study, which was funded by the Alfred P. Sloan Foundation. This article was excerpted and adapted from the report resulting from the new study, which was published in June.

Despite the large and growing market of customers, many retailers overlook the inner city because they underestimate its spending potential and overestimate the risk. The answers to four fundamental questions make a compelling business case for inner-city retailing.

First, is there a market in the inner city, and, if so, what are the most attractive opportunities? Yes, America's inner cities represent approximately \$85 billion in annual purchasing power, or approximately 7 percent of total retail spending in the United States. In many markets more than 25 percent of retail demand is unmet locally. The supply deficit appears most acute within basic categories such as food and apparel (Figure 1).

A concentrated consumer base of shoppers is cited as the primary competitive advantage in the inner city, according to a survey of retail store managers around the country. Because the market is highly concentrated, there is enormous buying power per square mile in these communities despite the lower household incomes (Figure 2).

Second, what are consumers' unmet needs? Results from surveys of consumers and retailers indicate that inner-city demand is largely driven by standard preferences for competitive offerings. In general, participants sought an experience on a par with shopping in the suburbs. Most of the preferences they expressed were common to any market:

- Basic, quality goods and services
- Branded offerings
- Competitive prices
- Clean and stress-free shopping environments
- Courteous and helpful salespeople
- Clear return policies

However, a fundamental characteristic of inner cities is the heterogeneity of its population. This heterogeneity results in a number of submarkets, each with spe-

Figure 1
Many Inner-City Markets Appear Underpenetrated
Average of One Quarter of Demand Unmet

| | Atlanta | Boston | Chicago | Harlem | Miami* | Oakland | Total |
|--|------------|------------|------------|------------|--------------|------------|--------------|
| Retail demand (\$M) | 1,627 | 1,151 | 4,470 | 1,387 | 912 | 1,132 | 10,679 |
| Retail supply (\$M) | 1,301 | 753 | 3,839 | 522 | 1,027 | 825 | 8,268 |
| Market opportunity (demand-supply)(\$M) | 325 | 398 | 630 | 865 | (115) | 307 | 2,411 |
| Opportunity as a percent of demand (%) | 20 | 35 | 14 | 62 | (13) | 27 | 23 |

Unmet demand in excess of 50 percent common in specific ZIP codes

*Excludes two beach ZIP codes strongly affected by tourism.

NOTE: Does not include unrecorded economy.

SOURCE: Retail census data; BCG analysis; Pro DC Select Phone database of phone books, 1995-96.

Figure 2
Power of Concentrated Retail Demand

| | Average retail demand per square mile (\$M) | | | | | |
|------------|---|---------|---------|-------|--------|--------|
| | Chicago | Atlanta | Oakland | Miami | Boston | Harlem |
| Metro | 27 | 4 | 11 | 14 | 12 | 53 |
| Inner City | 57 | 10 | 35 | 40 | 71 | 297 |
| | 2X | 2X | 3X | 3X | 6X | 6X |

SOURCE: ICIC/BCG analysis.

cific preferences. These preferences include:

- In grocery: wide product selection—special meat cuts and specialty vegetables
- In apparel: unique apparel, and tailored sizes, colors and styles
- In pharmacy: tailored hair care and cosmetic products

Tailoring products to these preferences usually translates into premium pricing and presents real opportunities for chains and independents to fill a large and growing market gap.

Third, is retailing in this market attractive? Success is not guaranteed. However, interviews with 63 retail managers nationwide found that many retailers are benefiting from high foot traffic and concentrated spending power and are generating sales per square foot comparable with regional averages or higher. While some operating costs may be more burdensome than in other locations, high volume and preferences for certain high-margin goods translate into attractive bottom-line results.

Fourth, what are the critical success factors and the challenges to success? Success in the inner city requires (1) leadership that believes in the inner-city opportunity and manages with the firm expectation of profitability, (2) operational excellence commensurate with that in non-inner-city operations, including the adoption of proven strategies to deal with shrink, crime and human resources challenges, and (3) sophisticated and flexible strategies to tailor products and services to meet the diverse and, in many cases, growing needs of this market (Figure 3).

The nature of the inner-city retail opportunity varies by sector. In grocery,

there is a tremendous need to increase storing—big box, small box and convenience formats—to fill unmet demand. Additionally, there is an opportunity in the grocery superstore format, particularly in high-traffic locations that serve both inner-city and adjacent urban markets. In the last few years a few grocery superstores have established such “edge” market locations.

In apparel, there is a dearth of world-class formats—specialty shops, big-box stores and outlets. In pharmacy, increased storing and tailored hair care and cosmetic products are in demand. In fast food, many markets appear well penetrated in select food categories but totally lacking in others. There is an opportunity for restaurants to fill in across categories and cater to distinctive tastes and ethnic markets.

The mass merchant or discount department store sector is also significantly underpenetrated in the inner city. Retailers in this segment clearly have the ability to offer the price point and merchandise mix necessary to capture a share of the inner-city market. Opening stores in edge market locations that can draw from a wider urban population is an approach these retailers should pursue.

A significant opportunity is available

to large retail chains and to savvy inner-city entrepreneurs. Many have argued that the reentry of large chain stores in inner cities could threaten the viability of independents. However, our research indicates that inner-city retailing is not a zero-sum game, in which large retailers automatically displace smaller independents.

One respected chain retail executive told us, “Independent entrepreneurs are capable of running circles around larger chains.” By being closer to the marketplace, independent entrepreneurs can better understand neighborhood dynamics; therefore, they can more effectively tailor their offering to the specific needs of shoppers in the inner city. In a niche market, an independent entrepreneur’s size can be an advantage, allowing a quicker response to changing tastes and preferences in the marketplace. Independent entrepreneurs are also positioned to form strong relationships with each of their customers and provide a high level of service.

To capture a share of the inner-city market, independent entrepreneurs can develop opportunistic retailing strategies and execute best retail practices. To maintain share in the face of competition

Continued on page 8

Figure 3
Three Success Factors for Inner-City Retailing

Commitment/leadership

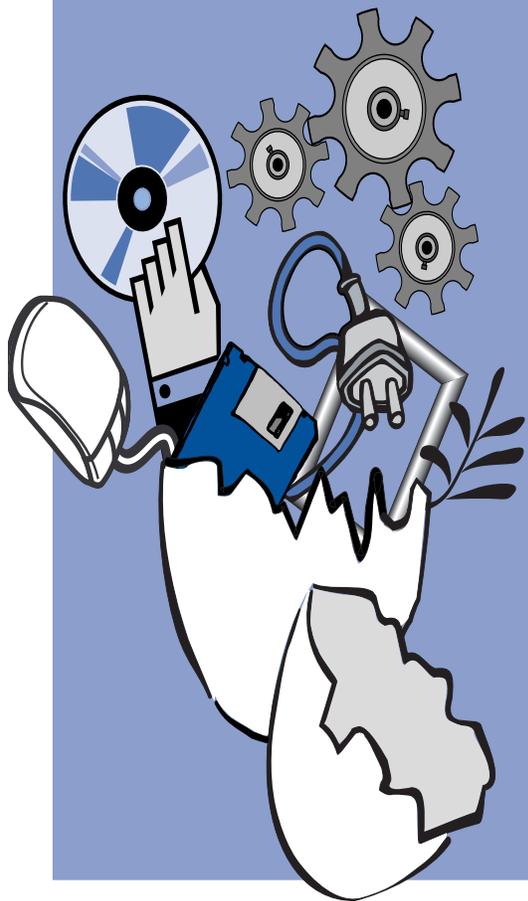
- Believe in viability of inner-city opportunity
- Develop and communicate vision throughout organization
- Set high standards
- Allocate appropriate resources

Tailoring to local consumers

- Understand customer and communities
- Develop operational flexibility to tailor offering to local needs by store
- Create environment where customers feel comfortable and are treated with respect

Operational excellence

- Demand tight operational processes and standards
- Install managers with requisite capabilities
- Advocate strong but sensitive management of employees; hiring, training



Rural Community Hatches New Businesses

Incubator Nurtures Fledgling Enterprises

Since 1990 the Marshall, Texas, Business Development Center has helped entrepreneurs launch 76 new enterprises that have created 200 jobs and brought money into the local economy from across the country. The East Texas community, population 24,000, was reeling from the effects of the mid-1980s oil industry recession when the city was introduced to the idea of rural-based business incubators.

Business incubators provide small entrepreneurial businesses with affordable space, shared support and business development services. With access to copiers, fax machines and computers as well as financing, marketing and management assistance, owners can use their capital for producing and marketing their products. Incubators play a nurturing role in helping young businesses survive and grow during the startup period, when they are most financially vulnerable. Although approximately 500 business incubators exist in North America,

only 27 operate in communities with fewer than 25,000 residents.

In its eight years of operation, the Marshall incubator has hatched a number of successful enterprises. One of the more successful is a company that makes push rods for engines used by the natural gas industry. The manufacturer distributes its products worldwide and employs eight full-time and eight part-time workers. Another successful venture is a tumbling and trampoline academy that recently helped win acceptance for trampoline as a new Olympic event.

The most recent business to leave the incubator is Bear Creek Kitchens, a gourmet foods manufacturer. Robbie and Kim Shoults started assembling and distributing a bean soup mix from the incubator in 1994. By 1998, when they moved into their own 10,000-square-foot building, the Shoults had added to their product line and had six full-time employees. Their client list includes Neiman Marcus, Dillard's and the Norm Thompson catalog.

"We have been at 100 percent occupancy almost since the business development center opened," says manager Charlie Fletcher. The center's 24,000-square-foot 1911-era building can house 16 startups, including some light manufacturing. Fletcher also currently helps six other fledgling enterprises operating off-site.

With the incubator's success, the

Marshall City Council has decided to open a second site, this one fostering high-tech companies. The new 19,000-square-foot center, which will be able to accommodate up to 33 businesses, will open in fall 1999. Funds for the center came from a number of sources, including the Department of Commerce Economic Development Administration, a Housing and Urban Development block grant and contributions from local businesses.

"It's a big step for us," comments Fletcher. "Our high-tech incubator will be one of only four funded for Texas." Marshall is recruiting participants with high-tech skills from all over the country for the new center.

Fletcher helps entrepreneurs find startup capital through the local multi-bank community development corporation (CDC). Since organizing in 1994, the CDC has made 10 loans to embryonic enterprises, many of which have become good bank customers. For example, one young company that borrowed \$30,000 from the CDC to finance its startup recently applied to a local bank for a \$350,000 SBA expansion loan.

Of the 76 businesses started in the Marshall incubator, 80 percent were still in business five years later.

"We can't guarantee a new business venture's viability, but we can improve its odds for success," says Fletcher. ▀



Filling in the Blanks

One House at a Time

"Our sole purpose is to provide affordable housing for those in need, and we do it by building one house at a time," says Barbara Hildenbrand, president of the Community Housing Fund (CHF), in summarizing the group's mission. She and other concerned Dallasites formed the nonprofit in 1992 to rebuild inner city neighborhoods.

In its six years of operation, CHF has earned a solid reputation for building quality, affordable infill housing, often considered a relatively expensive approach to neighborhood revitalization. But it doesn't need to be, according to Hildenbrand.

The nonprofit has found that the best strategy for buying property is to work with potential homebuyers and find lots in the neighborhoods where they want to live. Once a lot is located, CHF contacts the property owner.

"If we're lucky, it has a for-sale sign with contact information," says Hildenbrand. If not, CHF locates the owners by searching deed records or by using a software program called TaxStar, furnished by the Dallas Board of Realtors. On average, CHF pays \$6,000 for its properties.

"When we started," recalls Hildenbrand, "we, like many others who build infill housing, thought we could pick up some inexpensive properties through a city auction. But the city provided only a quitclaim deed, and by the time we spent six months clearing titles and paying back taxes, the lots were not quite the bargains we had hoped for." A warranty deed is necessary for clear title to a property.

CHF builds modest, 1,000-square-foot brick homes with three bedrooms

and two baths. Hildenbrand and her staff serve as general contractor and work with a team of subcontractors to build three or four homes at a time. The volume helps CHF control costs, allowing the organization to sell quality homes for around \$50,000.

FHA loans, which are often used for permanent financing, require 3 percent for down payment and closing costs. Other types of permanent financing have their own requirements. CHF offers a lease-to-purchase option for potential buyers who may not qualify for permanent financing. Through this program the nonprofit holds permanent mortgages on the properties until customers are ready to purchase. The buyers then assume the loans at no cost.

CHF has total lines of credit for interim financing of about \$3.5 million with

lenders such as Bank One, Chase Texas, BankTexas, Compass Bank and Northern Trust. This gives CHF the flexibility to buy properties and materials without the delays associated with requesting a loan for each purchase.

"The key to CHF's success is that Hildenbrand and her staff run the operation like a business," says Gilbert Gerst, vice president and lending manager of the Community Banking Group, Bank One Texas in Dallas. "They understand their market, and they know how to build a house within budget and on time."

Working without fanfare or high-profile publicity, CHF has completed more than 140 houses in the past six years—building one home, for one family, at a time. ▀



The Community Housing Fund is transforming Dallas neighborhoods by replacing dilapidated houses and empty lots with new three-bedroom, two-bath brick homes.



Dallas Fed
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Common Threads

Regional Approaches to
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October 20, 1998

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The conference will feature discussions on stimulating inner city growth, developing affordable housing in urban and suburban communities, investment strategies for banks, approaches to regional economic development, the Community Reinvestment Act and other topics.

Luncheon Speaker

Alice Rivlin, Vice Chair

Federal Reserve Board of Governors

You will receive a registration brochure soon.

Inner-City Business Case

Continued from page 5

from chains, independents also can define a niche position that complements rather than competes with chain offerings. The presence of larger retailers has meant increased foot traffic and profits for inner-city-based entrepreneurs who have created niche businesses with tailored product configurations.

Seizing the Opportunity

Competitive advantage will flow to the early movers in the game—retailers, the local business community, developers, city government and community leaders. For American retailers, the message should be clear. Begin today to invest in and profit from one of the largest and closest emerging markets in the world—U.S. inner cities. Create the capability to select sites, merchandise and employees in inner cities. This is the last big underserved market in the United States. ▀

A copy of the full report, The Business Case for Pursuing Retail Opportunities in the Inner City, is available by calling the Initiative for a Competitive Inner City, (617) 292-2363, or can be downloaded for free from the Internet at <www.icic.org>.



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Perspectives

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