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.

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
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."
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**  
$450,000  
(6.5 percent interest for 10 years)

**Savings by using resources gathered through Texas STEP**  
$350,000

- 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

Did You Know. . .?

1998 Investments Directory  
Now on the Internet


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.

Publication Request Line

You can order publications distributed by the Public Affairs Department of the Federal Reserve Bank of Dallas by dialing the automated assistance line, (214) 922-5254.
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**

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

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, BCS analysis, Pro DC Select Phone database of phone books, 1995–96.
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...
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.
"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."
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>.