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MISSING THE MARK: WHY THE CRA AND NMTC HAVE FAILED TO DEVELOP THE INNER CITY

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I. Introduction

On January 19, 2012, the Dwight neighborhood, a majority African-American part of New Haven, Connecticut, convened to discuss the construction of a fueling station on an empty lot in their neighborhood. The meeting had been called by the prospective landlord at the behest of the City of New Haven. The fueling station would be operated by a large northeastern corporation: Stop and Shop. An objective observer not equipped with more details would fairly assume that the meeting would be fraught with opposition and accusations that a large corporation was taking advantage of a politically weak community. This, however, is a story about a community taking the initiative and controlling its own development.

The prospective landowner was the Greater Dwight Development Corporation (GDDC), a nonprofit community development corporation whose board members were residents of the Dwight neighborhood. Through its board, GDDC runs projects dedicated to the economic development of downtown New Haven. One of its projects is operating the shopping plaza adjacent to the proposed fueling station development, whose anchor tenant is a grocery store

operated by the Stop and Shop chain. Stop and Shop is the only full service grocer in downtown New Haven and GDDC was looking to help it expand its operations. GDDC's hope was that if Stop and Shop committed to constructing a fueling station, it would be more likely to stay in the community. Further, GDDC believed that the project had the added community rehabilitation effect of developing a long-vacant lot. The residents at the public meeting recognized this. During the meeting, they offered overwhelming support for the new development. As they lauded Stop and Shop's contribution to the community, one resident even offered to grab his shovel so that construction could begin immediately.[1]

The vast community support for what would normally be a questionable addition to a neighborhood raises questions about the state of our inner-cities. A fueling station is not an ideal community development project because there are safety and health concerns with fueling stations built in residential areas.[2] They do not necessarily spur development and they produce few full-time jobs. For the community, the real benefit to this particular fueling station was that it would be connected to, and part of, a grocery store that they valued highly. To the Dwight residents, the fueling station represented a significant investment in the neighborhood on the part of Stop and Shop. It signified a commitment to the store and to staying in the neighborhood. Ultimately, the Dwight neighborhood was willing to support a high social cost development if it meant it could keep its grocery store. This type of bargain begs the question: what makes a community value a grocery store the way that the Dwight neighborhood does? If inner-city residents believe that there are no alternatives to the available options, what state is the inner-city in? What have government responses done to improve the inner-city? Is there a better way of attacking the lack of investment in the inner-city? This paper aims to answer those questions.

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[1] Greater Dwight Development Corporation Community Meeting at St. Luke's Episcopal Church, New Haven, CT
[2] Isabel M. Morales Terrés et al., *Assessing the impact of petrol stations on their immediate surroundings*. Journal of Environmental Management, 12 (2010)

This paper is a critique of the two high-profile government programs designed to address inner-city divestment and an examination of alternative methods that address the underlying problem. To address economic blight in the inner-city, the U.S. government has passed two primary measures. The first, the Community Reinvestment Act (CRA), declares that lenders have an obligation to lend to the inner-city. Originally passed during the height of racially motivated lending practices,[3] it has increased bank lending to previously excluded areas to some extent. To its credit, the CRA has effectively diminished racist lending practices and remains a motivating factor behind many bank loans issued today.[4] Despite the progress it has encouraged, the CRA is still only a small piece to a larger puzzle. This paper will establish that the CRA cannot compel the amount of loans necessary to spur economic change because the legislation imposes no real consequences if banks do not meet the credit needs of their communities. Nonetheless, the CRA should play a role as future efforts target the problem more effectively.

The second piece of legislation passed by Congress in an effort to encourage investment in the inner-city is the New Markets Tax Credit (NMTC). The NMTC provides a tax incentive to lenders and investors that place their money in the inner-city. Much like the CRA, the NMTC has increased investment in urban target areas all throughout the country. Its complex structure and small scope, however, have made its effect inadequate. Still, the NMTC is an overall benefit and can serve as a tool in fighting divestment. This paper will establish, however, that the NMTC misses the mark. Instead of luring investment into underdeveloped areas through incentives and punishments, future efforts should focus on creating a healthy investment landscape through the creation of information.

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[3] Richard D. Marisco. Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act. Carolina Academic Press, Pg. 19 (2005).
[4] Marisco, at 97.

The CRA and NMTC are not the answer to inner-city economic underdevelopment because they do not address the poor economic reputation and dearth of investment data available on the inner-city. This paper will demonstrate that banks, investors, and businesses consider the inner-city a risk because of misperceptions perpetuated by commercial data firms on inner-city crime, customers, and because inner-city business data are scarce. The lack of business data and misperceptions create an "information gap" that clouds the true potential of the inner-city. As a result, business decision makers rightly consider inner-city investment a risky proposition. As businesses and banks invest in the suburbs, information becomes more available in those areas and harder to create in the inner-cities. This creates a cycle that the inner-city cannot escape by itself.

In spite of the damage done by the information gap, the inner-city has tremendous business potential and high buying power. In fact, several businesses that have ventured to the inner-city have been successful. If businesses can succeed in the inner-city and the information gap is a primary hindrance to new investment, then an examination of methods to close the information gap is in order.

This paper will look to weigh the benefits and limitations of different information creation methods. One of those methods is demonstrated by the Retail Initiative Limited Partnership 1994 (TRI). TRI created a private equity fund that used community organizations as liaisons between investors and the local community. They utilized the innate knowledge that community groups have of their neighborhood to help close the information gap and start a number of successful developments. TRI also found the limitations of working with groups that had limited expertise as a number of their projects suffered from mismanagement. Another method is the creation of a loan reporting system similar to that instituted by the Home Mortgage Disclosure Act (HMDA). HMDA requires residential loans to be reported to the U.S. government for CRA purposes. A loan reporting system that focuses on business loans could help provide potential investors with more

data on inner-city markets, closing the information gap. Yet, the information gap is vast and information beyond the success of business loans would need to be available to actually increase investment.

Ultimately, the CRA and NMTC do not address the information gap that makes inner-city investment seem less attractive than it actually is. Looking to close the information gap should be the goal of any future government action that targets underdeveloped inner-cities.

In the first section, this paper will establish the fact that inner-cities and Low-Income Communities (LICs) are severely divested: banks still lend disproportionately to wealthier suburbs, businesses still generally avoid opening new retail locations in LICs, and investors do not risk their money with businesses located in the inner-city. The second section will establish that the inner-city is actually a good place to do business. The buying power and high population density common to inner-cities provides an untapped economic resource. Further, the absence of competition provides an advantage to those who first venture into the inner-city. The third part of this paper will examine the Community Reinvestment Act's (CRA) role in ending redlining policies and bringing banks and lenders to LICs. Despite progress on the part of the CRA, this paper will establish that it lacks the teeth and effect to make real substantive change in the inner-city. The fourth part will examine the New Markets Tax Credit (NMTC) and analyze its impact in encouraging investment in the inner-city. It will demonstrate how the NMTC's size and complicated structure do not encourage enough investment in the inner-city. The fifth part of the paper will examine why lenders, investors, and businesses are afraid to invest, despite the presence of the CRA and the NMTC. It will establish that the real cause behind the continued divestment is the information gap. The sixth section will analyze the economic consequences of an information gap. The seventh section will investigate the advantages and disadvantages of possible solutions to the information gap.

II. The Inner-City Remains Largely Ignored By Businesses, Lenders, And Investors

While the suburbs remain a popular locale for lending and investment, businesses fail to enter the inner-city. As a result, LIC residents suffer from poor quality of product and choice. For example, the inner-city of Los Angeles' retail penetration is thirty-five percent in supermarkets and forty percent in department stores when compared to the amount of retail penetration in the Los Angeles suburbs.[5] In other words, for every retail option in suburban Los Angeles, there is less than half of that found in the center of the city.

This persists despite a serious demand for retail. In many inner-city areas unmet demand tops twenty-five percent and, in some instances, reaches sixty percent.[6] This results in "outshopping," or inner-city residents leaving the inner-city to purchase goods at an expense to them and their neighborhood. This is an issue that is well established with inner-city residents. A Boston Consulting Group (BCG) report's inner-city focus group revealed that one of the most common complaints among inner-city residents was the need to travel long distances to suburbs in order to buy groceries or apparel.[7] Due to the lack of options, residents of the inner-city reinforce the urban flight phenomenon by supporting stores found in the suburbs over those found in the inner-city.

When stores or retail centers are present, they are often low-quality or do not meet the demands of their customers. Another of the most popular complaints among the inner-city BCG report's focus group was that they are often forced to shop at "second-rate" stores that sell outdated products.[8] Further, they noticed that stores in their area do not tailor their products to the unique demands of the neighborhood. This is especially problematic when considering the heterogeneity of

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[5] Michael E. Porter, *The Competitive Advantage of the Inner City*. Harvard Business Review, 59 (May-June 1995).
[6] The Boston Consulting Group, *The Business Case for Pursuing Retail Opportunities in the Inner-City*, 8 (June 1998).
[7] Id, at 10.
[8] The Boston Consulting Group, at 10.

inner-cities. National retail stores assemble their product lines with a national audience in mind,[9] yet inner-cities do not necessarily reflect the ethnic, socioeconomic, and taste of the broader American demographic. As a consequence, the goods available to inner-city residents are often poorly tailored to their needs, hurting the businesses present and encouraging outshopping. Poor choice is endemic of the broader issue that businesses are not adequately represented in the inner-city. The overall lack of competition does not encourage stores that are present to meet the needs of their customers. Customers who can do so, travel to purchase better goods, but when your customer-base is relatively poor, there is always going to be a captive market.

Retailers' poor efforts in the inner-city are compounded by the fact that lenders are still ignoring LICs. Access to capital from banks remains minimal because of historical prejudices and practices that have kept banks out of the inner city.[10] The CRA has made a marked improvement in formerly redlined communities, but overall lending in these areas is still outpaced by lending to wealthier traditional mortgage markets. From 1980-2000, lenders extended $353 billion in credit to CRA qualified borrowers.[11] The number is large, but seems insignificant when compared to the lending activity in non-CRA qualified areas. In a period of five years from 1990-1995, banks extended $4.3 trillion in non-CRA credit.[12] Moreover, businesses in the inner-city are estimated to receive half the debt and equity financing received by similar industries located outside the inner-city.[13] Not only have banks not invested in the inner-city, they have continually decreased their presence there. From 1998-2007, banking establishments in the inner-city have decreased by eight percent while increasing nationally by twenty-seven percent.[14] Despite national efforts to reverse the

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[9] Porter, at 25.
[10] The Boston Consulting Group, at 64.
[11] David Listokin, et al. *Making New Mortgage Markets: Case Studies of Institutions, Home Buyers, and Communities*, 22 (Fannie Mae Foundation 2000).
[12] Listokin, at 22.
[13] Inner City Capital Connections. *Capital and job creation: driving investment to America's inner cities. Inner City Capital Connections*. (2010).
[14] Id.

trend of divestment from the inner-city, there continues to be a lack of adequate credit opportunities for businesses located in LICs.

The divestment of inner-cities has an especially profound effect because lack of capital disproportionately impacts inner-city businesses. Without appropriate access to capital, inner-city businesses must depend on alternative financing that can hamper growth. A business located in LICs is five times more likely to finance itself through personal assets and small loans from friends and family.[15] Naturally, these sources of capital tend to be smaller and can evaporate quickly. This forces inner-city businesses to prioritize cash flow over growth. Businesses that depend on cash without an adequate line of credit do not expand or invest in capital improvements for fear of fatally damaging their bottom-line.

Without the capability to expand or invest, inner-city businesses fail to grow. A survey of inner-city businesses reveals that those in the lowest quartile of available capital experience sixty percent less growth than those that receive the highest amount of capital injections.[16] Lack of real access to capital hinders inner-city development and remains an issue despite efforts to cure the problem.

III. The Divestment Crisis In Inner-Cities Is Not Because They Are Incapable Of Supporting Robust Economic Activity

While there is a severe lack of business activity in the inner-cities, it is not because there is a lack of business potential. Some lenders have found that their loans to firms that serve inner-city customers are as, if not more, successful as their non-LIC loans. The customer base, although individually relatively poor, combines to make the buying power of the inner-city comparable to entire large nations. In fact, the retailers that do locate in the inner-city find that this buying power

[15] Inner City Capital Connections.
[16] The Boston Consulting Group, at 11.

makes their inner-city stores among their most successful. So while the inner-city remains largely ignored by the business community, it is for reasons beyond the lack of business potential.

To be clear, the market is not completely irrational. It is only reading the information available to it. There is some difficulty in creating and sustaining business growth in the inner-city. Businesses in the inner-city have slightly higher bankruptcy rates than those in their wider metropolitan statistical areas.[17] Further, African-American owned businesses, especially those located in urban centers, have shown to have lower profits and higher closure rates than non-African-American firms.[18] When examining this information, it is easy to assume that the inner-city is a poor business environment. Yet, as will be elucidated, the inner-city faces a number of barriers that can obscure their true wealth, unfairly scare away investment, prevent the economic development of the inner-city.

It is important to address why businesses left the inner-city in the first place in order to understand why the market has ignored such vast potential. Businesses and investors originally left urban centers because their customers left. During the post-war boom, middle class households began a systematic migration away from urban centers and toward the new and more spacious suburban developments that were being constructed at the time.[19] The suburbs' main advantage was the space they offered. No longer cramped in the overdeveloped urban core, businesses could relocate and develop more land that allowed for better parking, easier access for loading and unloading, and space to fit the new big-box stores that streamlined business.[20]

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[17] Initiative For A Competitive Inner City. *State of the Inner City Economies: Small Businesses in the Inner City.* 6, Boston, MA (October 2005)
[18] U.S. Department of Commerce. *1992 Economic Census: Charactersitics of Business Owners.* Washington D.C.: U.S. Government Printing Office. (1997)
[19] Kameshwari Pothukuchi. *Attracting Supermarkets to Inner-City Neighborhoods: Economic Development Outside the Box.* Economic Development Quarterly. Vol. 19 No. 3, 232. (August 2005).
[20] Id., at 232.

The ability to build standard-sized stores with large floor space allowed businesses to capture large market share with a limited number of retail locations.[21] Larger stores allowed retailers to maximize their total available product and per-customer-sales. As suburban stores became more profitable over the last half-century, sales-per-customer in the inner-city lagged behind.[22] Urban centers became less important to the success of retail chains. As a consequence, they were largely ignored and abandoned. Since then, much like their middle-class, predominantly White customers, businesses have largely turned their back on the inner-city. In their place arose empty storefronts and small businesses that cater to the urban poor and propel urban blight.

Compounding the effect were the difficulties of inner-city development that can still exist today. Sites to facilitate the big-box standard are difficult to find in the densely packed urban cores of American cities.[23] When such sites are available, they often require municipal cooperation in combining land parcels that can be difficult to secure.[24] Further, the development costs of demolishing pre-existing structures and preventing environmental liability are unique to the urban setting.[25] These costs add to overhead, diminish the early profits of new developments, and delay the construction of new stores. At a time when suburban developments were continually expanding, there seemed little reason to invest heavily in the inner-city.

For the most part, the landscape of inner-city investment has changed. The barriers that once existed are much less prominent as cities have learned to court and encourage investment by eliminating developmental red-tape.[26] Further, the saturation of the suburban market has made continued investment into that market less profitable.[27] Now, as businesses seek continued growth and expansion, the underdeveloped inner-city poses a fresh arena for development. Fortunately for

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[21] Id., at 234.
[22] Pothukuchi, at 232.
[23] Id., at 236.
[24] Id., at 234.
[25] Id., at 232.
[26] Id., at 232.
[27] Pothukuchi, at 236.

the inner-city, it is at a point where it is ripe for investment. Decades of neglect have created tremendous unmet demand that can serve businesses looking to invest. Ultimately, while market forces created the current paradigm facing the inner-city, its current state is a consequence of history—not necessarily a true reflection of market forces.

A. Successes In The Inner-City

There is ample evidence that LIC investments can be successful. The common perception about LICs is that the dearth of investment and capital opportunities exists because they are poor places for business. Recent evidence, however, suggests otherwise. An example is provided by an analysis conducted by the Small Business Administration (SBA). The SBA analyzed loans made to growth capital funds that invested in small businesses. Growth capital funds borrowed money from investors and banks and bought equity in a series of businesses located inside and outside of the inner-city. The businesses were mostly in high growth sectors like technology and energy, but some service firms were included. Loans that were repaid were considered successful while defaulted loans were not.[28]

When examining the performance of the growth capital funds that invested in the inner-city, the results were contrary to the common narrative. The funds that had at least forty percent of their investments in LICs were more likely to repay their loans than those funds that were less heavily invested in LICs.[29] Overall, there was no correlation between the default rate and the degree to which the funds invested in LICs.[30] In other words, the inner-city location of the businesses did not jeopardize the profitability of the capital growth funds. The success of growth capital funds demonstrates the viability of LICs and raises questions about why capital still avoids the inner-city.

[28] Sean Greene. *Catalyzing Investment for Domestic Impact: The Impact Investing Initiative of the U.S. Small Business Administration.* Innovations: Technology, Governance, Globalization. 27 (2011).
[29] Greene, at 28.
[30] Id., at 30.

The limitation of this analysis is that growth capital funds are trying to maximize their investment return. They will purposely select investments that are likely to be successful. This self-selection problem will naturally increase the success rate of inner-city firms, since poor performing businesses will not receive investments. On the other hand, the fact that many firms had such a large proportion of their capital in the inner-city, at least forty percent in some cases,[31] demonstrates, at the very least, that an inner-city investment focus is not detrimental to business.

Although it remains true that there is a scarcity of retail options in the inner-city, national retail chains that have chosen to locate there have been successful. Grocery store chains in a number of markets have found that their inner-city stores can achieve anywhere from forty percent to one-hundred percent more sales per square foot than the average of the region in which the inner-city store is located.[32] The Super Stop and Shop in inner-city Boston is one of the highest grossing stores of the chain.[33] The Brooklyn and Newark stores are among the highest grossing of all Pathmark stores.[34] This trend is not specific to grocery stores; it extends to apparel and other industries as well. Foot Locker and K-Mart both have high performing stores located in the inner-city. Inner-city pharmacies have out-performed their regional competitors by demonstrating a forty-five percent higher average in sales.[35] Businesses that focus their marketing efforts in the inner-city can be successful.

B. Business Potential Of The Inner-City

While the paucity of examples lends itself to a sample size problem, the examination of data shows a tremendous amount of unmet demand in American LICs which reveals a missed

[31] Boston Consulting Group, at 11.
[32] Id., at 11.
[33] United States Department of Housing and Urban Development. *New Markets: the Untapped Retail Buying Power In America's Inner Cities.* Washington, DC (1999). (Hereinafter HUD.)
[34] Boston Consulting Group at 11.
[35] Boston Consulting Group, at 12.

opportunity and room for expansion on the current successes of the inner-city. Economists argue that city centers should be retail destinations.[36] Suburban residents who work in the city center, visitors, and city center residents should all be shopping in the city by sheer fact of convenience. Thus, sales in the city core should outpace the demand of the residents of the city's core.[37] This, however, is not always the case. The existence of a "retail gap," in which the demand expected from the area's residents is lower than actual sales, is evidence of a city area that does not have enough businesses to meet demand.

If expected demand is not being met in a city core, it is because of severe outshopping by residents and non-residents who spend significant time in the city. Not surprisingly, large retail gaps exist in many of America's cities. New York, for example, has a $37 ***billion*** gap between expected demand and actual retail sales.[38] Los Angeles, Chicago, Detroit, and Washington D.C. all have retail gaps of at least $1 billion and as high as $9.8 billion.[39] When the analysis is focused solely on inner-city neighborhoods, the retail gaps still exist. The aggregate retail gap for forty-eight surveyed inner-cities was $8 billion.[40] Retail gaps mean fewer employment opportunities and poorer shopping choices for residents. They also present opportunities for retailers to provide services within communities in dire need of jobs, stability, and development.

Why do retail gaps exist? The easy explanation for the retail gap is that inner-city residents tend to be low-income earners who lack purchasing power, or the amount of disposable income available to spend on retail goods. While median incomes of inner-city neighborhoods are on average much lower than their suburban counterparts, the densely populated inner-cities have tremendous purchasing power. A BCG analysis calculated the buying power of the inner-city by

[36] Id., at 12.
[37] HUD, at iv.
[38] HUD., at v.
[39] Id., at v.
[40] Id., at vi.

aggregating the population and average household income of inner-city zip codes. From this, BCG created a demand-per-square-mile metric that found inner-cities to sometimes have as much as six times the demand per square mile as suburban zip codes.[41] From the same calculus, a conservative estimate of the aggregate inner-city purchasing power of the estimated 7.7 million inner-city households was pegged at $85 billion.[42] As a point of comparison, that purchasing power is more than the entire country of Mexico.[43] The concentrated population of LICs gives the inner-city a competitive advantage unmatched by the suburbs and exurbs.

Further, residents of underserved markets have shopping habits that should encourage businesses to locate there. Inner-city residents tend to spend a higher proportion of household income on retail items such as food and clothing, and generally shop more than their suburban counterparts.[44] With high consumer tendencies and buying power, the inner-city offers a distinct advantage to companies willing to serve them. The advantages of the inner-city, however, have been overlooked, to the detriment of the residents of these communities. The inner-cities are not bad for business, whether it be lending or retail. On the contrary, they have been long ignored and demonstrate vast potential.

IV. The Community Reinvestment Act Fails To Properly Address The Divestment Of Inner-Cities

The problem of divested inner-cities is neither new nor unrecognized. The government has been active in trying to steer investment to the inner-cities for decades. Its first attempt, the Community Reinvestment Act, approached the issue by creating an obligation for banks. The enforcement of that obligation, however, was hampered by concerns about credit allocation, the

[41] Boston Consulting Group, at 8.
[42] Id., at 6.
[43] Id., at 1.
[44] HUD, at 4.

placement of real or theoretical quotas on where banks can lend.[45] As a result, the CRA has become a token policy that does not have the impact once imagined.

The CRA was first created in 1977 in order to combat two distinct issues. The first was the practice of redlining, where banks would effectively, and sometimes literally, draw redlines around low- and moderate-income neighborhoods for the purposes of excluding them from their lending target areas.[46] The second issue targeted by the CRA was the practice of capital exportation. This is the practice of banks accepting deposits from low- and moderate-income areas and lending them to other neighborhoods.[47] During the legislative debate over the CRA, the proponents of the legislation cited a number of banks that practiced capital exportation and had damning numbers to support them. One bank, located in the lower-income areas of Washington D.C., lent as much as ninety-nine percent of its deposits outside of the District.[48]

While the issues that the CRA targeted were real, there was plenty of opposition to its institution. The main opposition to the CRA was based on the fear that it would force banks to allocate credit. Credit allocation was seen as a threat to capitalism. Opponents saw this possibility as a disturbance in the free market and believed that it would lead to banks making risky loans.[49] The fear that banking regulators would instill quotas on banks proved to be unfounded, but is a legitimate concern. That said, the CRA itself has been shown to be ineffective in encouraging banks to lend in previously redlined and credit starved areas.

The CRA's weakness can be traced to its original design. The effective part of the statute is only a few lines long and has little strength. The CRA calls for multiple regulating agencies to, "...use [their] authority when examining financial institutions, to encourage such institutions to help

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[45] Marisco. at 19.
[46] Id., at 12.
[47] Id., at 12.
[48] Id., at 13.
[49] Marisco., at 19.

meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."[50] The operating term, "encourage," was selected specifically because it could not be interpreted to require banks to lend in any specific area. As an alternative, the legislative history reveals that the agencies were to assess the credit needs of each bank's local communities and then grade the bank on its lending in that area.[51]

Currently, the CRA's primary method of encouraging banks to lend in low- and moderate-income areas is the CRA grade. A bank can receive four grades: "Outstanding," "Satisfactory," "Needs to Improve," or "Substantial Noncompliance."[52] Banks are evaluated based on their performance in providing their communities with lending, service, and investment.[53] The regulating agencies give banks an individual grade for each test; then the three scores are considered and an overall CRA grade is given.[54] The grades serve as the basis for the other way in which the regulating agencies can encourage banks to lend in low- and moderate-income communities.

The CRA requires regulating agencies to consider their CRA grades when applying for a bank expansion.[55] Every bank has to apply to their regulating agency when opening a new branch or when merging with another bank.[56] When this happens, the regulating agency will open the application to a comment process. Community organizations are then allowed to comment on the bank's performance and argue for or against the expansion. They do not, however, have a private right of action. Regulating agencies are only required to take the comments and grades into consideration, so the effects of the process are unclear.[57] Other than the ability to grade a bank's

[50] Housing and Community Development Act of 1977, 91 Stat. 1147, 12 U.S.C. § 2901 (1977).
[51] Marisco, at 19.
[52] 12 U.S.C. § 2906(b)(2) and 12 C.F.R. § 25.28.
[53] 12 C.F.R. § 25.27.
[54] 12 C.F.R. § 25.43(a)(3), (c) and (d).
[55] 12 U.S.C. § 2903(a)(2).
[56] 12 C.F.R. § 25.29
[57] 12 U.S.C. §§ 2901(b) and 2903(2), and 12 C.F.R. § 25.29.

performance and being able to reject an application for expansion, the regulating agencies have no other power to encourage more investment in formerly redlined areas.

The powers available to regulating agencies are rarely used, and are evidence of the ineffectiveness of the CRA. The agencies are not critical enough and do not accurately grade the extent of lending in low- and moderate-income communities.

For example, in the years 2003-2005, 99% of banks graded received at least "Satisfactory" scores.[58] Furthermore, when banks do apply for an expansion, the CRA grade or the comments provided by local community groups rarely have any effect. Of all applications during the same 2003-2005 time period, only .8% were challenged on CRA grounds.[59] Furthermore, of all applications during that period, only .01% were denied on CRA grounds.[60] The grading system and comment process have a statistically insignificant effect on the behavior of banks. This inability to affect the behavior of banks is reflected in the state of our low- and moderate-income communities and their access to capital.

There is evidence that the CRA leaves several low- and moderate-income communities out of the credit loop. As of 2009, there were 17 million Americans without bank accounts.[61] With population expansion and the continuing slumping economy, this number has probably risen. This leads to the conclusion that a significant sector of the population do not have access to banks or the credit they can provide. Further, minority Americans, who represent the majority of low- and moderate-income communities, disproportionately receive sub-prime loans, even when they qualify for prime loans.[62] When prime loan candidates are not receiving prime loans, it is likely that they are receiving their loans from non-depository institutions that do not offer the same type of credit

[58] Brescia, Raymond H., Part of the Disease or Part of the Cure: The Financial Crisis and the Community Reinvestment Act (April 21, 2009). University of South Carolina Law Review, Vol. 60, p. 617, 2009.
[59] Id., at 637.
[60] Id., at 638.
[61] Marisco, at 149.
[62] Id., at 149.

options that a traditional bank does.[63] The ineffectiveness of the CRA starts from its structure and ends with its results. While the CRA has had some positive effects, another tool to improve credit access in low- and moderate-income communities is imperative.

V. The New Markets Tax Credit Is Too Complicated, Too Small, And Encourages The Wrong Type Of Investment

While the CRA behaves largely as a punitive measure designed to encourage banks to lend in LICs, other tools exist that encourage LIC investment with incentives. The New Markets Tax Credit (NMTC) attempts to lure investors and lenders into the inner-city by providing a credit against their federal income taxes. The economic incentive makes sense, but it is structured in a manner that makes participation difficult. It encourages real estate deals to the detriment of equity investment and creates high transaction costs that push potential players out. As a result, the amount of investment created by the NMTC is too small to have a serious impact. The NMTC can be productive, however, if altered to encourage more equity investment. Nonetheless, the NMTC by itself does not address the root cause of divestment and will need to be a part of a larger strategy to encourage business activity in the inner-city.

The NMTC was passed in the waning years of the economic boom of the 1990s. Part of the motivation for the legislation was based on the availability of the Overseas Private Investment Corporation (OPIC) for American investors.[64] OPIC is a semi-public entity that provides incentives for investing in developing markets around the world.[65] With no domestic counterpart of OPIC, a policy scheme existed where an investor had more incentive to invest in a risky foreign market than within the United States. The NMTC aimed to solve this discrepancy.

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[63] Marisco, at 97.
[64] Megan Bokath. *Take the Money and Run: A Case For Benchmarking in the New Markets Tax Credit Program.* 47 Cal. W. L. Rev. 411, 417 (Spring2011)
[65] Overview, Overseas Private Investment Corp., http://www.opic.gov/about-us (last visited Feb. 2, 2012).

In the legislation, Congress found that, ". . . there are significant untapped markets in our Nation, and many of these are in areas that are underserved by institutions that can make equity and credit investments."[66] The purpose of the legislation was to address both the credit and equity scarcity. The tax credit is founded in the economic theory that lacking ready access to credit and equity serves as an impediment to economic growth.[67] Having credit and equity readily available has several multiplier effects that stimulate growth and economic development.[68] In essence, the increased employment prospects of a new development attract new residents to a community. This creates a demand for better infrastructure and services that, in turn, attract new investors to provide for the new demand.[69] Through the spurred development provided by the new credit, LICs gradually improve. The way that the NMTC functions, however, is not nearly so simple.

The NMTC operates through a complex scheme that ultimately provides a tax credit for investors that make equity or debt investments in projects located in LICs. At its most basic level, the NMTC is a thirty-nine percent credit granted towards the total amount of the qualified investment.[70] The process required to qualify for the tax credit, however, is much more complicated.

The law requires that a NMTC must be applied for by certain approved entities that operate in specifically designated areas. The NMTC works by allowing these approved entities, Community Development Entities (CDEs), to designate investments that qualify for the tax credit. CDEs can be local community organizations or subsidiaries of national companies. Either way, they must first receive a CDE designation from the Department of Treasury's Community Development Financial Institutions Fund (CDFI). To receive this designation, a CDE must have community members on

[66] H.R. Rep. No. 106-706, at 2 (2000).
[67] Michael S. Barr, *Access to Financial Services in the 21st Century: Five Opportunities for the Bush Administration and the 107th Congress*, 16 Notre Dame J.L. Ethics & Pub. Pol'y 447, 453 (2002).
[68] Id., at 453.
[69] Janet Thompson Jackson, *Can Free Enterprise Cure Urban Ills?: Lost Opportunities for Business Development in Urban Low-Income Communities Through the New Market Tax Credit Program*, 37 U. Mem. L. Rev. 659, 701-702 (2007).
[70] § 45D(a)(2)(B).

its governing board and have its business located in a Qualified Low Income Community (QLIC) as defined by the Internal Revenue Code (IRC).[71] The IRC defines QLICs as census tracts with either at least twenty percent poverty rates, a location outside of a metropolitan area where the median family income is eighty percent below the statewide average, or a location within a metropolitan area where the median family income is eighty percent below the statewide or metropolitan area's median family income.[72] Once a qualified CDE has been established, the complications of the process begin.

An investment that qualifies for a NMTC is called a Qualified Equity Investment (QEI) and involves at least three parties.[73] The first party is the CDE, which applies to the CDFI for NMTC allocation. The CDFI considers seven factors when deciding whether a CDE is worthy of NMTC allocation. Most of these factors are related to the ability of the CDE to accomplish the proposed QEI and that investment's market viability.[74] If the investment is designated as a QEI, the tax credit is given to the CDE. The CDE, however, does not use the tax credit. Instead, it transfers the credit to the second party in the transaction, a U.S. taxpayer, in exchange for equity in the CDE. In other words, the taxpayer trades an interest in the CDE for cash and in return receives a thirty-nine percent tax credit on that cash.

At this point, the tax payer has possession of a thirty-nine percent tax credit and the CDE will have a considerable amount of money in the form of an equity investment. This still is not a QEI; in order to become a QEI the CDE must invest "substantially all" of the tax payer's investment into a qualified low-income community investment (QLICI). The most common way of meeting the "substantially all" requirement is by having the CDE invest at least eighty-five percent of the tax payer's investment into the third party of the NMTC formula, a Qualified Active Low-

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[71] § 45D(c)(1)(A).
[72] § 45D(e).
[73] § 45D(e).
[74] Bokath, at 420-421.

Income Community Business (QALICB).[75] The requirements for a QALICB are that its principal operations be in an LIC, and that it be an active business. It can be any trade, business, or non-profit organization that is not involved in a few industries specified in the regulations.[76] There are a number of other requirements spelled out in the regulations, most of which have the effect of ensuring that the investment remains within the LIC as it was originally placed.[77]

Once the CDE has placed substantially all of the tax payer's investment in the QALICB, the tax payer is then entitled to use its tax credit. The thirty-nine percent credit is applied over a period of seven years. For the first three years the tax payer may credit five percent of its investment against its federal tax returns. For the final four years the credit bumps up to six percent of the original investment.[78] The investment must remain in the CDE for the entire seven year period because the credit can be recaptured by the government if the tax payer's equity is redeemed by the CDE before the seven year period.[79]

The structure of the NMTC is problematic. The sheer number of parties and transactions required to qualify for a NMTC lends itself to high transaction costs which limit its effectiveness. As a result, most NMTC transactions result in real estate transactions that involve leverage loans and add a fourth party to the deal.[80] This adds to the complexity of the program and creates the concern that only for-profit self-financed investors are able to participate.[81] For-profit investors will be less likely to be dedicated to the community revitalization aspect of their investment, defeating the purpose of the legislation. Furthermore, the fact that most NMTC deals are real estate transactions

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[75] I.R.C. § 45D(d)(1); Treas. Reg. § 1.45D-1(d)(1).
[76] Treas. Reg. § 1.45D-1.
[77] Id.
[78] I.R.C. § 45D(a)
[79] § 45D(g)(3).
[80] Katie Codey. *Can the New Markets Tax Credit Program Be Transformed Through Leverage of its Real Estate Bias?*, Bridges, Federal Reserve Bank of St. Louis. (Summer 2011).
[81] Julia Sass Rubin, et al. *The New Markets Tax Credit Program: A Midcourse Assessment.* Community Development Investment Review. Federal Reserve Bank of San Francisco 6 (2006)

means that fewer businesses are receiving equity investments than originally believed. As explained above, a lack of equity is one of the primary causes for lack of growth in inner-city businesses.

As it stands, the NMTC program itself is not expansive enough to have a significant impact on inner-cities. Five years after the program's creation in 2000, the CDFI had only awarded slightly over half of the available tax credits.[82] Even worse, on average, about seventy-seven percent of all NMTC applications are denied.[83] When first created, the NMTC program was hoping to create fifteen billion dollars in new investments by 2007.[84] By 2010, the program had only created ten billion in new investments.[85] Simply, the NMTC program does not promote enough investment to have any real impact on the inner-city. Ultimately, while the program has created a financial incentive for LIC investments, it lacks the popularity, efficiency, and scope required to adequately address the state of America's inner cities.

If fixed, however, the NMTC can still play an important role in inner-city investment. A tax credit may not be the best way to spur investment in underserved markets. This does not mean, however, that the government should limit its toolbox in addressing the issue. There are ways in which the NMTC can be tweaked to spur investment that will create more effective assistance to LICs.

Through 2009, sixty-five percent of all NMTC were real estate deals.[86] The reasons behind it make sense. Lenders prefer collateralized deals because they are safer. If the project fails, at the very least they can foreclose on the property and recoup some of their costs. The problem is that urban businesses do not need more real estate. Their main challenge is that they are under-

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[82] Id., at 1.
[83] Cmty. Dev. Fin. Insts. Fund, Promoting Investment in Distressed Communities: The New Markets Tax Credit Program iv (2008), available at http:// www.cdfifund.gov/docs/2008/nmtc/CDFIPromotingInvest.pdf
[84] Rubin, at 1.
[85] Eric Usinger. *Using New Markets Tax Credits To Finance Commercial Real Estate Development.* 20 J. Affordable Housing & Community Dev. L. 269 (2012).
[86] Internal Revenue Service. *Proposed Rules.* Federal Register, Vol. 76, No. 109 (June, 2011)

capitalized. Almost seventy-one percent of urban businesses do not have the requisite capital.[87] On average, they only have a quarter of what they need.[88] By tweaking the NMTC to encourage more equity deals, its impact will be more precisely targeted toward helping urban businesses. As a result, urban businesses will be more likely to engage in the economic multiplier effect that can positively affect the surrounding neighborhoods.

Making the NMTC more equity friendly can also be addressed by changing the required length of the investment. Currently, there is a seven-year credit period in order to qualify for the tax credit.[89] During this time, at least eighty-five percent of the CDE's equity investment must remain in the QALICB or the credit is subject to recapture by the Internal Revenue Service (IRS).[90] This seven-year requirement has been interpreted to demand that investments must be redeemed at the end of the term.[91] In other words, the life of any equity investment is limited to seven years.

The seven-year requirement discourages equity investment and facilitates debt structures more friendly to real estate deals. Lenders can easily construct a loan for a seven-year term that satisfies the requirements of the NMTC. For equity investments, however, a seven year lifespan is extremely problematic. Businesses look for equity investments because of their flexibility. The equity is subordinated to other debt and obligations until there is a liquidity event, or enough cash on hand to repay the equity investor. In a normal business this liquidity event can occur at any time and often is longer than seven years. It is probable, in fact, that many businesses will require more than seven years to secure enough cash flow necessary to repay its equity investor. Forcing equity recipients to repay at the seven year mark, then, can hinder the attraction on the part of the business and investor.

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[87] Initiative for a Competitive Inner City. *Capital Policy: Measuring the Capital Gap.* Inner City Insights, Vol. 1 Issue 3.2 (2010).
[88] Id.
[89] 26 C.F.R. 1.45D-1(c)(5)(i))
[90] 26 C.F.R. 1.45D-1(e)(2)
[91] Community Development Venture Capital Alliance, *Comment in Response to the Advance Notice of Proposed Rulemaking REG-114206-11*, Internal Revenue Service, 6 (September 2011)

The NMTC would be more equity friendly if recipients of investments were allowed to repay their investors when there is sufficient liquidity. This, in turn, would increase the amount of equity NMTC deals and spur growth in urban businesses. Meanwhile, the advantages for real estate deals remain. Lenders would remain free to make loans for whatever term they feel comfortable with. The NMTC becomes a more robust and widely applicable program when it encourages both debt and equity deals equally.

The real problem with the CRA and the NMTC is not that they are low impact initiatives. It is rather that they attempt to spur economic revitalization in ineffective ways. Initially, when the Clinton administration was researching for what would become the NMTC program, it concluded that the main problem for America's inner cities was a lack of credit and equity.[92] The NMTC and the CRA approach this issue differently. The CRA attempts to punish lending institutions that do not meet the credit needs of their communities. The NMTC attempts to financially lure investors into LICs by providing tax benefits. Both these methods, however, have proved to be anemic and lacking. This is because the two approaches seek to increase credit availability without addressing the real reasons why companies and investors do not extend these services to the inner-city. The stick and carrot approach that is the CRA and NMTC fails to lure investors because they do not push back against the corrosive widespread ***perception*** that inner-city investments are high-risk.

VI. Misperceptions And A Lack Of Applicable Business Data Create An "Information Gap" That Is The Actual Cause Of Inner-City Divestment

When the evidence is presented, it is hard to believe that companies are not rushing to invest in the inner-cities. The data show that there is a clear demand that is not being met by retailers and lenders. The CRA and NMTC provide government incentive that should encourage activity in the

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[92] Rubin, at 1.

inner-city. Further, success stories like Stop and Shop and Foot Locker demonstrate that inner city investments are actually quite successful when done correctly. This begs the question: With so many points in favor of inner-city investment, why is there not more of it? The real reason is that there is an "information gap" that scares business activity out of the inner-city.

The information gap, as the term is used in this paper, is intended to convey the combination of knowledge deficits that affect inner-city investment. There is sizeable evidence that companies and investors are sufficiently spooked about crime and fed bad information. When companies are deciding to invest in the inner-city, they lack comprehensive business data. These misperceptions and lack of data combine to create an information gap that makes inner-cities look unattractive as investment targets.

It is important to describe how businesses use data to understand why an information gap propels business out of the inner-city. When deciding to commit large amounts of capital in an area, investors will use commercial data firms to provide information that is considered essential. Normally this data include population density, crime rates, median-income, home ownership, and automobile ownership.[93] Commercial firms will claim that areas with high crime and low median income are poor investment targets; while ignoring the benefits of population density.[94] This standard commercial practice can be misleading in LICs, as many of these data points are difficult to measure, exaggerate their effect on business, or undervalue the viability of the inner-city. The following section will examine the data and demonstrate it is not entirely applicable to the inner-city.

A 1998 report prepared by the Boston Consulting Group revealed a survey of thirty-six retail businesses on the subject of inner-city investment. The retailers reported that shoplifting,

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[93] Pawasarat, J., et al. *Exposing Urban Legends: The Real Purchasing Power of Central City Neighborhoods*. The Brookings Institution Center on Urban and Metropolitan Policy. 3 (June, 2003).

[94] Pasawarat., at 2.

vandalism, and the general perception of crime were "challenges of the inner-city market."[95] This is prevalent among business decision-makers. In an International Council of Shopping Centers (ICSC) survey that catalogued responses from ninety-seven companies, ICSC asked what were the obstacles to establishing a store in an underserved market. An overwhelming ninety-three percent of respondents said that crime was either very significant or somewhat significant.[96] The second closest response was "Insufficient concentration of your target customer."[97] While the fears associated with crime are self-evident, the second response is a little more difficult to unpack. Since inner-cities are some of the densest areas in the country, it is not the scarcity of consumers that companies are worried about. Instead, it is the type of consumer that they consider an obstacle. A company being concerned with the type of customer walking in the door invites a series of insidious conclusions as to what exactly the fear is. Either way, the data show that these fears are largely unfounded.

A. Commercial Data Firms

The investment community's perception that LICs lack target customers is perpetuated by organizations designed to collect information about these areas for investors. As previously mentioned, developers looking to invest in an area rely on information provided to them by commercial data firms.[98] At the behest of the Helen Bader Foundation, researchers compared their own statistical analysis of Milwaukee's neighborhoods with the conclusions of several commercial data firms.[99] They found that commercial data firms, the same firms that investors and developers use for investment advice, were poor advocates for inner-city investment. At best, their

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95 Boston Consulting Group, at 10.
96 Cynthia Stewart, et al. *Development in Underserved Retail Markets*. ICSC Research Quarterly. 20 V. 8, No. 4 – (Winter 2001-2002).
97 Id., at 20.
98 Pawasarat, at 3.
99 Id., at 3.

methodology overlooked the strengths of inner-city neighborhoods. At worst, their data was erroneous and based on malicious stereotypes.

The methodologies of these firms originated after the U.S. Office on Economic Opportunity (OEO) hired a former New York University professor to create an index for measuring poverty. The model, based on average household incomes in geographic areas segregated by zip code, became the foundation for commercial data firms like Claritas, CACI Marketing Systems (CACI), and Experian.[100] This model, however, is flawed in that it ignores the advantages of density. The University of Wisconsin-Milwaukee's Employment and Training Institute (ETI) analyzed the buying power of Milwaukee neighborhoods and came to a much different conclusion than the commercial data firms.

By using median household income, the marketing data firms failed to assess the real buying power of neighborhoods. The high-density neighborhoods, separated by zip code, proved to consume more annually than their suburban wealthier counterparts. For example, the highest ranked neighborhood labeled "Top One Percent" by CACI was estimated by ETI to spend $14.9 million annually per square mile.[101] Meanwhile, four inner-city neighborhoods labeled as "Distressed Neighborhoods" by CACI were estimated to spend between $22.2 million to $38.1 million annually per square mile.[102] The distressed neighborhoods were described as "non-target" areas by the commercial data firms because of the low median-family income.[103] Yet, with an average of 2800 tax filers per square mile, each "non-target" area added up to have significant buying power. Often, their ability to spend far outclassed the wealthier target areas.

While faulty methodology adds to misperceptions about underserved markets, the firms showed other patterns that exacerbated the issue. The Bader Foundation researchers found that

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[100] Id., at 8.
[101] Pawasarat, at 6.
[102] Id.
[103] Id., at 5.

multiple commercial marketing firms inaccurately predicted the demographic shifts they were hired to analyze. In 2004, two different commercial data firms, Claritas and CACI, categorized a diverse Milwaukee neighborhood as significantly declining in population.[104] The belief that an area is declining in population will likely scare away businesses because they will believe that their customer base is shrinking. After the 2010 U.S. Census results became public, the commercial data firms' analysis was proved to be inaccurate.[105] A faulty analysis is not by itself problematic. Any firm can make erroneous calculations. The indicting fact, however, is that the data firms' errors persisted in the face of evidence available at the time they performed their analysis in 2004. At that time, city records such as birth rates, school enrollments, and observations by residents all pointed to a stable neighborhood.[106] The commercial firms' analyses did not take a comprehensive enough approach and characterized a stable neighborhood as a bad location for investment.

When data firms created for the purposes of providing marketing advice cannot accurately collect data, the perceptions of inner-cities are bound to remain negative. The damage to the image of the inner-city target customer is exemplified by the conclusions that the data firms drew about Milwaukee's neighborhoods. After scrutinizing reports by the data firms, it became clear that many of their characterizations of inner-city residents were derived from decades old census data and racial stereotypes.[107] When reviewing the research provided by CACI and Claritas, Milwaukee city officials were shocked to see that many of the marketing designations of Milwaukee neighborhoods perpetuated harmful stereotypes. In a report about a predominantly African-American Milwaukee neighborhood, Claritas described the inhabitants as families who, "buy video games, dine at fast

[104] Pawasarat, at 5.
[105] *ZIP Code 53204 Data*, Zip-Codes.com (February 27, 2012), http://www.zip-codes.com/zip-code/53204/zip-code--53204.asp.
[106] Pawasarat, at 3.
[107] Id., at 4.

food chicken restaurants, use non-prescription cough syrup, and use laundries and laundromats."[108] CACI used similar descriptions that implied common stereotypes for predominantly Latino and African-American communities.[109] Furthermore, this was not specific to the commercial data firms' analysis of Milwaukee. A review of other cities revealed similar descriptions, some even identical to those used for Milwaukee, in hundreds of other cities.[110] These conclusions were based on stereotypes of the inhabitants of these neighborhoods, not on thorough research. Any retail company using this information would only have their perceptions of inner-cities reinforced.

B. Crime And Its Impact On Business

This paper does not intend to make light of crime and its social consequences. Instead, it seeks to investigate how crime affects business decisions. Crime is still a problem for commerce. The United States Small Business Administration reports that thirteen percent of small businesses become crime victims.[111] This number is slightly misleading because it does not segregate inner-city businesses and does not account for the type of crime committed, but it does provide a baseline. In 2007, there were almost 1.5 million incidents of burglary or shoplifting in the United States, costing businesses an estimated $3 billion.[112] In total, crime has been reported to cost businesses up to $128 billion directly.[113] When examining these numbers, it is understandable to conclude that crime disrupts business and that locating in high-crime areas is a mistake.

When examining the impact that crime has on businesses and inner-city businesses in particular, it is necessary to identify the type of crime and the usual targets of crime. While crime has a high total direct cost for businesses, inner-city businesses are not generally the target of high-

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[108] Pawasarat, at 4.
[109] Id.
[110] Id.
[111] Martin S. Bressler. *The Impact Of Crime On Business: A Model For Prevention Detection And Remedy.* Journal of management and Marketing research. 2.
[112] Bressler, at 2.
[113] Id., at 2.

cost crime. For instance, although shoplifting and burglary cost businesses nearly $3 billion in 2007, in the same year businesses suffered upwards of $90 billion in losses from embezzlement.[114] This is coupled with the fact that embezzlement claims are widely underreported, so the real total number of losses is actually unknown.[115] Embezzlement schemes often target the financial industry, and are not common in the inner-city. Unlike burglary and shoplifting, embezzlement has a high per-incident cost and can be debilitating to a business.[116] Crime's most powerful consequence, however, is found in the fear it generates in business decision makers.

The perception of crime has a more powerful effect on the investment practices of companies than the real effect crime has on businesses already located in LIC areas. This is supported by a study published in the ***Urban Studies Journal*** by Robert Greenbaum and George Tita. Greenbaum and Tita set out to examine how a crime surge impacted business decisions.[117] Surges in crime are important because they change the baseline level of crime that residents in the area have normalized into their daily lives. When there is a spike in crime, local media outlets will disseminate the information and, normally, area residents and businesses will react in ways that are different from their routines. This provided Greenbaum and Tita with an opportunity to see whether companies made business decisions within the same period of a crime surge.

Greenbaum and Tita isolated the impact of violent crime surges on businesses in five cities: Miami, St. Louis, Pittsburgh, Houston, and Chicago. By looking at murder counts per zip code over a period of seven years beginning in 1987, Greenbaum and Tita could isolate specific instances where a zip code suffered a "surge" in crime. In their analysis, they included zip codes that experienced extremely low crime in order to compare how businesses were affected in both high-

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[114] Id., at 6.
[115] Id.
[116] Id.
[117] Robert Greenbaum, et al. *The Impact Of Violence Urges On Neighborhood Business Activity.* Urban Studies*,* 41 (13), 2509. (2004)

crime and low-crime areas. After compiling the crime data, Greenbaum and Tita focused on the creation and closures of businesses in the studied zip codes. This helped identify how the crime surge impacted business decisions like relocation or closure. For the purposes of accentuating any possible effect, Greenbaum and Tita also focused their analysis on industries that were especially vulnerable to crime surges, like retail and personal services.

Greenbaum and Tita found that surges in violent crime had no measurable impact on business decisions in zip codes that experienced high amounts of crime; specifically, violence surges created no measurable increase in high-crime area business closures.[118] They found a slight depression in the opening of new businesses over all the zip codes they analyzed. For the high-crime areas, however, much of the depression could be contributed to the existing poor business environment that makes the creation of new businesses a rare event in any case. Greenbaum and Tita found that crime surges had a measurable impact on those zip codes where homicides are rare events. These are zip codes where business activity is normally robust, yet, when there is an increase in crime, closures increased and new businesses did not open.

Greenbaum and Tita's findings demonstrate that crime surges do not impact the profitability of inner-city businesses enough to force closures.[119] The low number of business closures in high-crime areas means that any possible decline in profitability caused by a crime surge was outweighed by the advantages of staying open. Greenbaum and Tita suggest that the low closure rate among businesses located in high-crime areas could be attributed to businesses normalizing the costs of doing business amidst crime and thus being less sensitive to the impacts of crime surges.[120] While the normalization of costs can help explain why some establishments do not suffer from crime surges, the fact that businesses are not forced to close demonstrates that crime's real impact is not

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[118] Greenbaum, at 2509.
[119] Id.
[120] Id.

sufficient enough to decrease profitability. To be clear, crime surges are not good for businesses. According to Greenbaum and Tita, however, their impact is not profound enough to make business unprofitable or unsuccessful.

Crime's effect on low-crime area businesses implies a different outcome that crime creates for businesses. Greenbaum and Tita noted that the most significant effect that crime surges displayed was in low-crime areas. Businesses located in low-crime zip codes experienced a high closure rate and a decrease in the creation of new businesses in the face of a marked crime surge.[121] This result is interesting when compared to how surges affected businesses in high-crime areas. A crime surge is the constant in the two cases, yet businesses decisions are impacted differently.

The difference in behavior lends itself to the conclusion that it is not crime that changes how decision makers behave, but the psychological impact caused by the fear of crime. In areas where customers, employees, and managers are not used to the day-to-day social costs of crime, they are more easily frightened and more likely to make business decisions based on that fear. Thus, while it is impossible to tell how the businesses in low-crime areas would have performed had they remained open, it is a likely conclusion that they could have remained profitable, based on the performance of their high-crime counterparts. Ultimately, then, the fear engendered by a surge in homicides coerced decision makers into potentially unprofitable decisions. Businesses fear the impact of crime without always accurately assessing its real effect.

Along with Greenbaum and Tita's findings, there is more evidence that the existence of crime does not severely hinder the profitability and growth of inner-city business. When businesses located within LICs are asked what effect crime has on their activities, they overwhelmingly deny crime having any significant impact. By aggregating the U.S. Census's ***Characteristics of Business Owners Survey*** results, Timothy Bates and Alicia Robb put together a compelling analysis of crime's

[121] Greenbaum, at 2509.

impact on urban business for the ***Economic Development Quarterly***. The analysis was culled from a collection of Census Bureau surveys that asked business owners located in LICs if crime had a "significant" or "somewhat significant" impact on their business. They found that ninety-seven percent of business owners located in high-crime impact areas serving a broad market reported that crime had either a somewhat significant or no impact on their business.[122] For those owners serving a neighborhood market, ninety-four percent reported crime's impact as somewhat significant or non- existent.[123] These surveys included a wide range of businesses from corner stores to manufacturing that marketed themselves to both inner-city residents and non-residents.[124]

Bates and Robb's findings demonstrate that businesses in the inner-city have managed to negotiate the inherent costs of crime in their areas of business. It is possible that the crime these business owners experience causes some diminished growth because of the external costs of crime. . Tita and Greenbaum found that the cumulative impact of crime and its accompanying social costs in high-crime areas result in three percent less annual growth than their low-crime counterparts.[125] Yet, because businesses are overwhelmingly reporting that crime does not have a significant impact, the business owners have become accustomed and have normalized crime's negative costs. While it is true that crime is more prevalent in inner-cities, there is significant evidence that it does not seriously jeopardize the viability of business establishments located there.

While crime's real impact on business is nominal, the belief that crime hinders business activity remains an impediment to providing adequate credit to inner-cities. This impediment can manifest itself in disturbing ways. An ***Urban Affairs Review*** article reported that commercial investment in Chicago neighborhoods declined as percentages of their populations became

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[122] Timothy Bates, et al. *Crime's Impact On Survival Prospects Of Young Urban Small Businesses.* Economic Development Quarterly (July, 2008)
[123] Id.
[124] Id.
[125] Bates, at 2510.

increasingly African-American and Latino. This correlation held true even when the analysis controlled for income and population changes.[126] In other words, investors became more wary of minority populations regardless of their socioeconomic status. Although crime was not tracked in the analysis, the correlation lends itself to the conclusion that banks saw an increase in minority population as some type of risk. Since LICs are largely composed of minorities, it follows that investors in Chicago performed some sort of calculus based on the perceptions of majority-minority neighborhoods and their relation to crime rates.

In summation, crime has externalities which can hurt businesses in a variety of ways. Its primary impact, though, is the fear that it causes. Businesses in high-crime areas do not seriously suffer from crime. Yet, investors cite crime as a primary obstacle to investing in the inner-city. The fear that crime will debilitate business, in the face of contrary evidence, contributes to the information gap that perpetuates divestment.

C. Inferiority of Available Business Data

While misperceptions created by data firms and an overblown fear of crime contribute to inner-city divestment, a lack of information, or applicable business data, has an equally pernicious effect on inner-city investment. Even those companies that have invested heavily in LICs admit that they do not have adequate information to create successful models that help find successful locations.[127] In depth market analysis of middle- and upper-income communities is common among American businesses.[128] That same type of analysis, however, has not been performed on inner-cities.[129] As businesses or lenders look to invest, they are met with an overwhelming amount of information about the suburbs and a scarcity of information on the inner-city. This can be

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[126] Immergluck, D. *Neighborhood, Race, And Capital. Urban Affairs Review, 34(2) 397-411* (1999).
[127] Immergluck, at 34.
[128] Robert Weissbourd. *The Market Potential of Inner-City Neighborhoods: Filling the Information Gap.* The Brookings Institution Center on Urban and Metropolitan Policy. 12 (2003)
[129] Id.

explained by the fact that traditional market data that are available for the inner-city are generally inaccurate. Through a number of unhappy accidents particular to the inner-city, it is difficult to accurately assess the market viability of LICs.

To better understand why traditional market data are difficult for businesses to produce, it is necessary to investigate the American unrecorded economy. It is important to note that the overwhelming majority of the unrecorded economy, an estimated eighty percent, consists of legal transactions.[130] Drugs and illegal immigration compose a portion of the unrecorded economy, but domestic workers, small businesses, contractors, and remittances are the major component.[131] These transactions are typified by informal cash exchanges that are never formally recorded. Consequently, true economic activity and income is hidden and traditional market indicators, like median income, are inherently inaccurate.

In today's market, many transactions are executed electronically through the use of debit or credit accounts. Cash transactions, however, remain an important part of the economy.[132] Unreported cash transactions can cost the government tax revenues,[133] but they also result in the inability to accurately capture the size and extent of business activity, especially in the inner-city. The inner-city resident's difficulty in accessing banks and credit, and the resulting reliance on cash, help explain the reasons behind the scope of the unrecorded economy.

Many Americans are "underbanked" or completely "unbanked." According to a 2009 Federal Deposit Insurance Corporation (FDIC) survey, an astonishing number of Americans self-report themselves as "unbanked." As defined in the survey, the unbanked are those households that

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[130] Eric Schlosser. *Reefer Madness: Sex, Drugs, and Cheap Labor in the American Black Market. 5* (Houghton Mifflin, 2003)
[131] Id.
[132] Bruce G. Carruthers, et al. *Money and Credit: A Sociological Approach*, 7 (2010).
[133] Joseph Bankman, *Eight Truths About Collecting Taxes from the Cash Economy*, 2007 TNT 210-42, 7 (Oct. 29, 2007).

report that they do not have a checking or a savings account with a traditional bank.[134] The survey found that almost eight percent of all American households do not have access to traditional banking services. The unbanked are more pronounced among minority households: twenty-two percent of African-American households are unbanked and nineteen percent of Latino households are unbanked.[135]

An even larger percentage of Americans are "underbanked," in that while they may have an account with a bank, they rely heavily on alternative financial services such as rent-to-own agreements, pawn shops, pay-day loans, and check-cashing services.[136] An additional eighteen percent of Americans are underbanked, thirty-one percent of African-Americans are underbanked, and twenty-four percent of Latinos are underbanked.[137] As a point of clarification, the underbanked numbers do not include those households that are unbanked. This means that over half of all African-American households are either unbanked or underbanked and that almost half of all Latino households suffer from the same lack of traditional financial services.

The survey found a number of reasons underpinning the widespread lack of access to traditional banks. For those households that reported themselves as unbanked, lack of money or overly high minimum account balances accounted for almost half of all survey responses.[138] For those households with some sort of access to a bank account, the survey asked why alternative financial services were so attractive. Over half of the households surveyed reported that alternative financial services were more convenient or easier than traditional banks for their credit, money order, or check-cashing needs.[139] The survey does not delve into more detail about how the

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[134] Federal Deposit Insurance Corporation. *FDIC National Survey of Unbanked and Underbanked Households*. 1 (December 2009) [Hereinafter FDIC]
[135] FDIC, at 10.
[136] FDIC, at 32. The survey defines this reliance as using rent-to-own agreements, pawn shops, check cashing services at least once or twice a year.
[137] Id., at 15.
[138] FDIC, at 25.
[139] Id., at 42.

convenience of alternative financial services manifests itself. It is not difficult to speculate, however, that the disappearance of traditional banks from urban centers contributes to making banks less convenient.

The inner-city's lack of access to financial services has several implications. Most important among them is the consequential market reaction that pushes inner-city residents toward alternative financial services. Not surprisingly, the unbanked and underbanked are more heavily concentrated among lower- and middle-income households[140] and the inner-city.[141] With a lack of traditional banking services available to them, inner-city residents tend to seek out alternative financing services.[142]

The lack of traditional financial services force people into a primarily cash based economy in the inner-city by denying them proper access to credit. Traditional banking institutions use credit histories as both a measure of creditworthiness and a method of ensuring that their loans are repaid. Before a loan is issued, banks use a borrower's history in order to screen high risk applicants. During the life of a loan, lenders will use the threat of a damaging report on a credit history to ensure repayment. The existence and use of credit histories in this way maintains an active and healthy market where borrowers with good histories receive low-interest loans and those with poor histories borrow at a higher cost.

In a paper for the ***Columbia Law Review***, Richard R.W. Brooks argues that "fringe creditors," the alternative financial services relied upon by the unbanked and underbanked, have the effect of pushing low-income clientele away from traditional banking services by denying them credit histories.[143] Brooks notes that fringe creditors use alternative methods to enforce their credit

[140] Id., at 12.
[141] Id., at 20.
[142] John P. Caskey, *Fringe Banking*. 90-97 (1994).
[143] Richard R.W. Brooks. *Credit Past Due*. 106 Colum. L. Rev. 994. (May, 2006).

contracts; most effectively, they utilize possessory and security interests.[144] Instead of using a history of creditworthiness recorded by banks and lenders, fringe creditors will require collateral that is greater than the value of the loan. For instance, a pawn shop will value a piece of property at $150 and will make loan for $125. If the loan is not repaid in time, the pawn shop will claim the property and sell it to recoup its costs.

Not using credit histories creates two main consequences for the clientele of fringe creditors. First, because there are few other credit options and inner-city residents are often captive to the businesses in their neighborhoods, fringe creditors will have the luxury of charging higher financing rates.[145] Secondly, and almost more damaging, fringe creditors do not record or report their loans to credit agencies.[146] As a consequence, fringe credit customers do not develop a record of successful loan repayments and thus cannot establish credit histories necessary for low-cost loans with traditional banks. The credit-denying effect of the fringe creditor business model, then, has filled the need for credit in such a way that it is more expensive for the customer and damaging in that it makes it difficult for traditional banks to re-enter the inner-city market.[147] In other words, the omnipresence of fringe creditors in the inner-city makes it more difficult to bank the unbanked and underbanked and contributes to a reliance on cash for day-to-day transactions.

Thin credit histories and a prevalence of unbanked and underbanked residents in the inner-city have a direct impact on the information available to lenders and investors. Those residents without bank accounts are naturally more likely to be forced into cash paying jobs and cash friendly transactions. While there is nothing inherently wrong with cash transactions, they are often unrecorded by both parties involved. Large amounts of cash transactions will tend to conceal

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144 Id., at 1003.
145 Charles A. Bruch, *Taking the Pay out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 R. Cin. L. Rev 1257, 1272 (2001)
146 Brooks, at 996.
147 Id.

pockets of wealth in the inner-cities because cash income is often unreported to tax authorities.[148] Indeed, inner-city households are more likely than their suburban counterparts to have a higher proportion of cash income that is not recorded by our tax system.[149] For businesses or investors looking at a target area's business viability, unrecorded transactions are extremely problematic because one of the main data points used by investors is an area's median-income—a statistic derived from tax data.

The sheer amount of these cash transactions that comprise the unrecorded economy is significant enough to make the possibility of undervaluing the inner-city's wealth quite high. While it is impossible to accurately measure the size of an unrecorded economy, several estimates place it between $1 and $2 trillion.[150] [151] The estimate comes from extrapolating historical tax evasion trends and, from that, estimating that in 2010 between eighteen and nineteen percent of income went unreported to the IRS—from this percentage a $2 trillion underground economy was hypothesized.[152] That number, when compared to other economies, is staggering. At $2 trillion, the American unrecorded economy would rank ninth in the world, above economic powerhouses like Russia and Canada.[153] It is not difficult to conceive, then, that if traditional tools used to measure the economic viability of an area overlooks the unrecorded economy, the areas that are most likely to have unrecorded activity will be misjudged and undervalued as investment targets.

Inner-city households are more likely to be part of the unrecorded economy, and thus, are more likely to overlooked by investors. Private contracting, daycare, and under the table sales, the types of transactions that primarily create the unrecorded economy, are much greater within the

148 Internal Revenue Service & U.S. Dep't of the Treasury, *Reducing the Tax Gap: A Report on Improving Voluntary Compliance* 15 (2007)
149 HUD, at 10.
150 Edgar Feige. *"America's Underground Economy: Measuring the Size, Growth and Determinants of Income Tax Evasion in the U.S."*. 17 (January 2011
151 Weissbourd, at 12.
152 Feige, at 17.
153 International Monetary Fund, 2011

inner-city than out of it.[154] As mentioned above, close to half of Latino and African-American households are either unbanked or underbanked. This makes the inner-city more dependent on cash transactions as Latinos and African-Americans disproportionately comprise the inner-city. The primary consequence of the inner-city being heavily involved in the unrecorded economy is that investors will not be able to accurately measure wealth found within its boundaries. As long as investors rely on data firms' measurements, the inner-city will continue to be undervalued and misjudged.

Beyond the wealth concealed by the unrecorded economy lies the inaccuracy of other traditional data points used by investors. The U.S. Census tends to undercount inner-city neighborhoods.[155] With highly mobile populations that often have temporary residences, the Census cannot accurately count inner-city residents. This usually results in an undercount, underestimating the population of LICs. For instance, the 1990 Census did not count five percent of ***both*** Latino residents and African-American residents in New York City.[156]

Undercounts have a dual negative effect. Neighborhoods can be interpreted to be shrinking in size if the undercount is severe enough. The CACI reports illustrate how data firms will label shrinking neighborhoods as poor investment targets. Further, a general under-representation of a neighborhood's population will inherently make it less valuable for investment because there are fewer customers reported. The fact that Census data is most often used by data firms for their population information makes the undercount problematic.[157] This is the information that is passed on to investors and business decision makers. As they make decisions based on faulty and

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[154] International Monetary Fund (2011).
[155] Weissbourd, at 12.
[156] Orson W. Watson, Ph D et al., The Changing Models of Inner City Grocery Retailing (Boston: Intiative for a Competitive Inner City, 2002) 4.
[157] Weissbourd, at 15.

inaccurate information, the lack of business data's contribution to the information gap becomes evident.

To add to the problem, the product of the main federal collection service on business data is poorly applied to the inner-city. The Bureau of Labor Statistics' Consumer Expenditure survey, the leading consumer statistics data source, only provides national level data.[158] Its analyses report consumer trends for the country as a whole. This does not work well with LICs that tend to be ethnically diverse, densely populated, and thus not representative of, or comparable to, a nation-wide sample. This lack of real information on inner-city markets leads to bigger problems for LICs.

VII. The Information Gap Has A Negative Economic Impact That Has Led To The Divestment Of Inner-Cities

The information gap's effect on investment can be explained by economic theory. Market actors make investment decisions based on good information. When that information is lacking, they move to markets that are richer in information. As a result, markets with robust information receive more investment, and are subsequently able to provide more data. This creates a cycle where underinvested markets remain that way as they can never spur enough business activity to create adequate information for investment.

Economic theory argues that underserved markets will be less likely to provide investors with the information necessary to make them confident about their investment.[159] Essentially, smaller sample sizes mean much less reliable predictive data. Business investors want to be able to predict the success of their investment. To this end, they will look to successful business models in their target market. In areas where there are few businesses, this becomes more difficult to do,

[158] Weissbourd, at 13.
[159] Scorsone, E., New Markets as Informational Asymmetries. Economic Development Quarterly. 308 (Aug 2004).

decreasing the likelihood that the investor will choose those areas.[160] Scarcity of information is not just limited to a lack of business transactions. As demonstrated by the real impact of crime on business, concerns about crime and target customers are also based on lack of information. Furthermore, because of the existence of information-rich markets, there is little incentive to produce the requisite data.[161]

This perpetuates the thin information characteristic of the inner-city and creates a vicious cycle in underserved areas.

Information is characterized by high fixed costs with that cost increasing the thinner a market is.[162] A business will look to devote its resources designated for data creation in the most efficient manner possible. This further compels firms out of information-thin markets. Particularly good investment projects may lack the necessary access to capital markets because lenders will avoid the high costs associated with the data creation particular to thin markets.[163] This leaves projects without access to capital, regardless of the project's viability or quality. This results in underserved markets remaining divested because thin markets are avoided by capital providers—not because they are poor investment opportunities.

The effect of limited information in underserved areas creates a cycle where thin markets remain characterized by low amounts of information and active markets remain rich in investment data. In urban areas, underserved markets often border much wealthier and prosperous neighborhoods.[164] As an investor examines an undeserved market bordering a prosperous one, it will find one with sparse data and high information costs and another with abundant data and low

160 Scorsone, at 308.
161 Id.
162 Scorsone., at 306.
163 Stiglitz, J., & Weiss, A. *Credit rationing in markets with imperfect information.* American Economic Review, 71(3), 393-410. (1981).
164 Scorsone, at 6.

information costs. A rational investor will place the project in the market with abundant information. What should be fixed, then, is the lack of information.

The public sector is in the best position to close the information gap associated with LICs. The high fixed cost of information and the fact that the private sector has ignored underserved markets for so long make a private sector solution unlikely. Furthermore, the inherent public nature of data helps level the playing field among private sector actors. As it stands, the only firms that can create the data necessary to invest in thin markets are large and well capitalized companies. If investment information is made public by the government, however, smaller firms will have information access and can increase their participation in underserved markets. This has the dual effect of expanding the pool of possible players in underserved markets and sparking small business activity by opening new markets to them. If lack of information is the root cause behind underserved markets, finding a way to provide that information to private investors can alleviate the problems associated with LICs.

VIII. The Advantages And Disadvantages Of Possible Information Creation Methods

If proper attention can be given to the hypothesis that misinformation and lack of information should be the targets of any remedial action, closing the information gap can be achieved. A heavier involvement of community groups can contribute information to investors. They are in the best position to know their neighborhoods and can provide the data necessary to make wise investments. Community groups alone, however, will not likely close the information gap completely. A business loan reporting system modeled on the Home Mortgage Disclosure Act (HMDA) is another action that can help create useful business data for investors. These two methods have significant benefits and limitations. If applied, however, they could significantly

enhance the type of information available to investors, closing the information gap and increasing investment in the inner-city.

A. Community Groups

Across the urban landscape there are thousands of community development corporations (CDCs) dedicated to economically developing their neighborhoods.[165] As residents of the inner-city, they are natural partners for businesses looking to learn the intricacies of urban markets. They are already engaged in business, educational, or housing activities in their neighborhoods.[166] This experience provides intricate market knowledge that can help investors.

Community partners provide investors with several assets that close the information gap and spur investment. For investors, community partners can take many forms. They can be CDCs, small businesses, municipal organizations, or other non-profit organizations.[167] Community partners can fill the information gap by providing political, community, and financial advantages. Most community organizations have good relationships with the governments of the municipalities in which they are located. This allows them to assist investors in navigating the approval process for encumbrances, easements, and zoning alterations.[168] Moreover, the financial assistance they offer can be substantial. Often times, the community organization can secure grants or favorable land dispositions from their municipality.[169] Their ability to secure subsidies for providing development is unique and essential to investors.

Community groups can also be excellent creators of information, as community organizations often seek out methods of marketing their own neighborhoods. The Whalley Special

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[165] Randy Stoecker, *The CDC Model of Urban Redevelopment: A Critique and an Alternative*, 19 J. URB.AFF. 1, 438 (1997)
[166] Id., at 439.
[167] Anna Steiger, et al. *The Role of Community Partners in Urban Investments.* The Federal Reserve Bank of Boston. (September 2008).
[168] Steiger
[169] Id.

Services District (WSSD), a tax district run by community members dedicated to the commercial development of a New Haven avenue, did just that. WSSD spent a significant portion of their resources conducting a retail study along Whalley Avenue.[170] WSSD's retail assessment found healthy growth in the neighborhoods surrounding Whalley Avenue, along with a steady increase in resident income.[171] Not surprisingly, they also found retail gaps in nine different retail sectors.[172] Since its release, WSSD has used the retail assessment to try to lure businesses to Whalley Avenue. It is exactly the type of information that the private sector has neglected to create, aggravating the information gap. With an innate knowledge of the cities they live in, community oriented groups have a unique ability of identifying neighborhoods and markets for businesses and should be encouraged to do similar work.

A great example of how working with community partners can help businesses close the information gap is The Retail Initiative Limited Partnership (TRI). TRI was born in the aftermath of the Los Angeles riots of 1992. After observing that community owned businesses were left largely in-tact despite the widespread damage, the Local Initiatives Support Corporation (LISC) saw an opportunity.[173] They believed that community-owned businesses garner more respect from the surrounding neighborhood, and as a consequence, were more likely to be successful. As a result, LISC decided to establish TRI and dedicate it to creating a business model that involved community organizations and that created community owned businesses in LICs. Although owned by a non-profit organization, TRI's mission was to show that market-rate investments in inner-city infrastructure could be successful with community ownership and support.[174]

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[170] Whalley Avenue Special Service District. *Retail Assessment & Strategy*, AMS Consulting (March 2009).
[171] Id., at 8.
[172] Id., at 54.
[173] Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.
[174] Id.

The TRI model works by attracting investors and finding capable community partners to manage the projects. The model then invests in the equity of a community based entity that develops or purchases an existing shopping center.[175] The equity partner is required to be part of the community in which the development is built and to manage the day-to-day affairs of the project. As a subsidiary of LISC, a non-profit housing developer, TRI had access to a number of contacts that led them to motivated, capable, and willing local partners.[176] Ultimately, the project led to a number of successes and some failures. The conclusion that market rate investments that use the resources of community partners in low-income areas are viable, however, is supported by the whole of TRI projects.

TRI started the project by recruiting a group of institutional investors to create a private equity fund.[177] The investors included banks and investment wings of more traditional corporations such as GE Capital.[178] To attract the investors, TRI promised two things. First, the investments would be made with the intention of getting market rate returns.[179] In fact, the investments were sometimes made with much higher than market rate returns worked into the equity structures,when compared to what a bank would receive in a standard commercial loan transaction.

Second, TRI could further entice investors to join their fund by removing the due diligence usually necessary with traditional commercial investment.[180] The model was based on equity structure investing. TRI and a community organization would agree to partner in developing a real estate parcel. The partners then created a special purpose entity ("SPE") and split the common share equity of the SPE. TRI required that the split favor the community organization. This kept the day-to-day management of the project out of the hands of TRI and had the happy side effect of

175 Id.
176 Id.
177 Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.
178 Id.
179 Id.
180 Id.

empowering local interests with a community asset. While this structure left the investors in an enviable position, it was TRI's responsibility to find worthy partners and ideal locations. Since the investments would be managed by TRI, investors were free to sit back and collect returns.

New Haven is a good example of how the model worked. The New Haven project split the common interest between TRI and the Greater Dwight Development Corporation (GDDC) with GDDC holding the controlling interest. On top of that interest, TRI had an annual cash-on-cash payment and a required IRR. GDDC accepted the additional costs because, as a small nonprofit, it was unlikely to get traditional financing for the project.[181] It also provided an opportunity for GDDC to receive equity financing. The equity reflected a flexible and long term commitment from TRI that proved to be crucial when complications arose during the term of the investment.

Crucial to the model was the association with community CDCs. The CDCs offered a unique knowledge of the landscape of their neighborhood and helped fill the information gap for retailers looking to fill vacancies in the retail development. In New Haven, GDDC helped the original grocery store tenant of the complex meet with local communities. As a result, the supermarket stocked its shelves in a manner that would uniquely cater to the African-American, Latino, and Orthodox Jewish communities that surrounded the development site.[182] Furthermore, when the original grocery store tenant closed its doors because of a corporate parent's decision, GDDC handled community outcry and found a replacement.[183] After years of managing the project, GDDC looked for new tenants that were willing to cater to the needs and desires of the surrounding community.[184] When the new store opened, the customers returned. Although it is impossible to quantify the impact that GDDC had in maintaining a customer base, its role in finding a

[181] Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.
[182] Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.
[183] Id.
[184] Id.

replacement is integral in understanding how local groups can contribute to helping investors navigate the inner-city. The success of the replacement store is a testament to their contribution.

The overall success of TRI lends credence to the idea that community partners help close the information gap. Over the course of the 1990s, TRI invested in eight large real estate developments throughout the country; all of them located in previously divested communities.[185] TRI invested a total of $17 million of equity. It created close to six thousand square feet of real estate and created roughly two thousand jobs.[186] In its final report to the LISC board of directors, TRI reported that, "Our investment spurred additional major commercial development in surrounding neighborhoods and strengthened residential development."[187] Of the eight investments, all are still open, operating, and majority of them are still owned by CDCs.[188] These successes could not have come about without help from the community partners. Their role in providing critical information was crucial to attracting successful investment to the inner-city.

TRI's model was not perfect and demonstrated several limitations. By using a private equity fund format, TRI was subject to the desires of its investors. As a result, TRI set a time limit on the length of the investments.[189] Placing a timeline on equity investments creates a strain for the recipients. Often times, developments will take time to achieve the prescribed liquidity before investors can be repaid. In certain projects, if TRI was given the freedom to remain in the equity structure, they would have seen larger ultimate returns. Pressure from TRI's investors, however, required them to redeem their equity investments before they reached their maximum return.

In their work, TRI realized that some community partners cannot provide the type of assistance necessary for investment. In their presentation to LISC investors, TRI revealed that one

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[185] Id.
[186] TRI presentation to the LISC Board of Directors (January 2012)
[187] Id.
[188] Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.
[189] Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.

of the lessons learned was, "The value of thorough due diligence on partners and project sites."[190] For TRI, it became clear that some of their community partners did not have the technical expertise to be project developers. Although their partners were knowledgeable about their local communities, they made mistakes in terms of project placement and developer selection.[191] These mistakes drove up costs for some projects and hurt overall TRI profitability. The boards of these organizations are mostly composed of members of the community. Many times, they are not professional business people or developers, and lack the knowledge necessary to run businesses or develop properties. A complete reliance on them risks exposing their weaknesses to the detriment of the investor. This is a natural consequence of working with groups that lack the sophistication of commercial developers.

Community partners work best with investors looking to put equity into the inner-city but are not as useful to banks looking to loan in the same areas. They can directly provide their assets, such as community connections and political sway, with a partner invested in their project. They are less capable of providing lenders or banks with this knowledge. Banks will be responsible for their own due diligence, and unless directly lending to a CDC, cannot utilize the knowledge of community groups. Furthermore, retail chains looking to move to the inner-city will have a difficult time finding a way to work with community groups. Unless they can move to retail centers owned by a community organziation, they are left out of this source of information. Since community groups can only offer equity investors their advantages, there need to be other efforts to help close the information gap and expand overall business activity in the inner-city.

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[190] TRI presentation to the LISC Board of Directors (January 2012)
[191] Interview with Michael Levine, President, The Retail Initiative Limited Partnership 1994, in New York, NY. (Feb. 17, 2012.

B. Loan Reporting System

Other efforts, like a reporting system similar to the one required by the Home Mortgage Disclosure Act of 1975 (HMDA), can significantly close the information gap. HMDA was passed by Congress in order to supplement the CRA. Its stated purpose at the time was to, ". . . provide the citizens and public officials of the United States with sufficient information . . . to determine whether depository institutions are filling their obligations to serve . . . the communities and neighborhoods in which they are located."[192] It achieved this by requiring most financial institutions to report the amount and value of loans that were applied for or approved within "metropolitan statistical areas."[193] These reports are compiled by the regulating agencies and made available to the public annually.[194]

The regulations require more information to be reported. According to §203.4 of Regulation C, lenders must, among other things, also report the race, sex, and ethnicity of the candidate, along with the type of loan and the action taken by the lender.[195] All this information is compiled by the Federal Financial Institutions Examination Council (FFIEC) and made public. The information is then used by regulating agencies to test whether banks are meeting their CRA obligations.[196] While HMDA is not perfect, it does provide a large database for the public and government regulators who are looking to enforce the CRA. It also proves that there is a low cost opportunity to use this type of reporting in a fashion that will help close the information gap.

A reporting system modeled after HMDA, but focused on reporting nonresidential loans, can help close the information gap that contributes to urban divestment. Currently, there is no

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[192] 12 USC § 2801
[193] 12 USC § 2801(a)
[194] 12 USC § 2801(d)
[195] Regulation C 203.4
[196] Richard Marsico, *A Guide to Enforcing the Community Reinvestment Act*, 20 Fordham Urb. L.J. 165, 234 (1993)

requirement for financial institutions to report loans that are not secured by a residence.[197] That means that business loans and real estate loans for non-residential commercial properties are not required to be reported by HMDA. It is exactly these types of loans, however, that the private sector may look to when deciding to lend or invest in a particular area. They can examine the success of businesses by determining whether that business is honoring its debt obligations. To achieve this, the reporting system would need to stray from the HMDA model. As it stands, HMDA does not require the success rate or delinquency rate of loans.[198] Any reporting system that aimed to cure information gaps would need to include this information.

A business loan reporting system has its limitations. Access to the success rates of loans made to inner-cities can offer investors and banks with pertinent information. Unfortunately, there is much more information that investors look for when making the decision to invest capital. A loan reporting system does not address the totality of business data as it cannot inform investors about true inner-city wealth, demand, and spending habits. Further, since many inner-city businesses rely on personal assets to finance their activities, any reporting system will miss the credit performances of small businesses.

Information gaps take a significant amount of resources to cure and will not fix themselves. Encouraging work with community groups and creating a loan reporting system will not likely fix the information gap problem by themselves. To completely cure the information gap, there will need to be a concerted effort by all interested parties. Other efforts by local and state governments to publicize the real effect of crime and the actual buying power of their inner-city residents could also be effective. These solutions are likely to be expensive. Nevertheless, by understanding and realizing that it is the lack of information, not an inherent weakness of the inner-city, which causes

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[197] Regulation C 203.4
[198] Regulation C 203.4

divestment, governments will be making an important step in equalizing the commercial balance of power between socioeconomic classes.

IX. Conclusion

As it stands today, the inner-city remains under-invested, underbanked, and devoid of meaningful investment. This problem persists despite the fact that inner-city businesses have shown to be able to pay off their loans, outperform their regional counterparts, and have high unmet demand. The NMTC and CRA have attempted to cure inner-city divestment. The efforts remain unsuccessful, however, because they attempt to force or entice business activity instead of addressing the reasons for the absence of business activity.

This paper has shown that businesses and lenders shy away from inner-city investment because they do not understand it; they suffer from an information gap. They are fed with misinformation or lack the ability to accurately create adequate business data to lend or invest. As the CRA and NMTC fail to create the information necessary, other methods should be investigated. The involvement of community partners can increase a firm's knowledge of the inner-city. Meanwhile, a reporting system that reveals the successes or failures of loans made in the inner-city can help provide some of the data necessary for lending or investment. Despite their limitations, they are a step in the right direction. There are no easy cures. Yet, by focusing on the actual problem, the information gap, government and business can take advantage of a severely underserved market.

It is important not to minimize the impact information gaps have on the residents of LICs. As the residents of the Dwight neighborhood and BCG's focus group exemplify, the divestment caused by information gaps often force inner-city residents to make decisions that lower their quality of life. When considering the efforts required to spur investment in LICs, we should remember that

there are reasons beyond pure profit and commercial growth that make closing the information gap worthwhile. In a society that is based on egalitarianism but struggles to provide it for all of its members, closing the information gap can provide an opportunity to do so.