

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

To: Members, Committee on Small Business
From: Committee Staff
Date: September 13, 2017
Re: Hearing: “Serving Small Businesses: Examining the Effectiveness of HUBZone Reforms.”

On Wednesday, September 13, 2017 at 11:00 a.m., the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building for the purpose of examining the major components of a comprehensive HUBZone reform bill, H.R. 3294, the “HUBZone Unification and Business Stability Act of 2017” (HUBS Act), introduced by Ranking Member Nydia Velázquez (D-NY) and Chairman Steve Chabot (R-OH). This bill is the bipartisan product of oversight actions conducted by the Committee over the United States Small Business Administration’s (SBA) Historically Underutilized Business Zones (HUBZone Program or Program), which seeks to provide federal contracting opportunities to small businesses in economically distressed areas.

I. Introduction to the HUBZone Program

Authorized in 1997,¹ the HUBZone Program was charged with stimulating economic development by increasing employment and capital investment through the use of federal contracting preferences to small businesses operating and hiring in economically distressed areas.² HUBZone areas are designated by statute, using criteria and information determined by other agencies.³ The HUBZone designated areas include: qualified census tracts (QCTs),⁴

¹ The Program was officially established by SBA on March 22, 1999. HUBZone Act of 1997; Small Business Reauthorization Act of 1997, Pub. L. No. 105-135, § 601-07, 111 Stat. 2592, 2627-36.

² S. REP. NO. 105-62, at 26 (1997), *available at* <https://www.congress.gov/congressional-report/105/senate-report/62>.

³ The agencies responsible for designating HUBZones are: Census Bureau, Bureau of Indian Affairs, Bureau of Labor Statistics, Department of Defense, Department of Housing and Urban Development (HUD), and the Internal Revenue Service. HENRY BEALE & NICOLA DEAS, THE HUBZONE PROGRAM REPORT, i (May 2008), <https://www.sba.gov/sites/default/files/rs325tot.pdf>.

⁴ 13 C.F.R. §126.103 (2017); 26 U.S.C. §42(d)(5)(B)(ii)(I) (2012). The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) of 2016 added 516 new HUBZones in Puerto Rico by removing a 20 percent limitation on QCTs. PROMESA also mandated the Government Accountability Office (GAO) assess and make recommendations regarding SBA’s implementation and impact of the removal of the cap on job creation. Pub. L. No. 114-187, 130 Stat. 549 (codified at 15 U.S.C. § 632(p)(4)(A)(ii)).

nonmetropolitan counties,⁵ Indian reservations,⁶ difficult development areas (DDAs),⁷ base realignment closure areas (BRACs),⁸ major disasters⁹ and catastrophic incidents,¹⁰ and redesignated areas.¹¹

Small businesses located in designated areas may apply for HUBZone certification through the SBA. To certify, a business must: (1) be small by the SBA's standards; (2) have its principal office located within a HUBZone; (3) be at least 51 percent owned by United States citizens; and (4) have at least 35 percent of their employees reside in a HUBZone.¹² A HUBZone-certified small business must recertify every 3 years through the System for Award Management (SAM), and qualify at the time of a contract offer and award.¹³ Additionally, certified small businesses must notify the SBA of changes affecting their eligibility.¹⁴

The HUBZone Program utilizes set-aside contracts, sole-source awards, and contract price preferences targeting contracts to HUBZone small businesses. Set-aside federal contracts can be awarded if two or more HUBZone firms are expected to make a fair and reasonable offer.¹⁵ Sole-source awards are permitted for goods and services federal contracts below \$4 million.¹⁶ A 10 percent price evaluation adjustment is granted when bidding on full and open federal contracts; if a HUBZone firm's bid is up to 10 percent higher than a non-small business's bid, it is deemed lower. There is a statutory goal of awarding 3 percent of prime and 3 percent of subcontract dollars to HUBZone firms.¹⁷ In fiscal year 2016, the federal government met 1.67

⁵ 13 C.F.R. § 126.103.

⁶ BEALE & DEAS, *supra* note 3.

⁷ DDAs are areas designated by the Secretary of HUD and have characteristics making economic development particularly difficult and costly. DDAs currently apply to Alaska, Hawaii, American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands. 15 U.S.C. § 632(p)(4)(B) (2012).

⁸ BRACs are areas where a military installation had closed through a privatization process and includes surrounding areas. Consolidated Appropriations Act, Pub. L. No. 108-447, 118 Stat.2809 (2005).

⁹ Major disasters are declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act and can include natural catastrophes and fires, floods, or explosions regardless of cause which warrant major disaster assistance. 42 U.S.C. § 5170 (2012).

¹⁰ A catastrophic incident can be natural or manmade resulting in extraordinary levels of casualties, damage, or disruption to the population, infrastructure, environment, economy, national morale, and/or government functions. FEMA, NATIONAL RESPONSE FRAMEWORK (June 2016), https://www.fema.gov/media-library-data/1466014682982-9bcf8245ba4c60c120aa915abe74e15d/National_Response_Framework3rd.pdf; National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, § 866, 129 Stat. 726, 929 (2015).

¹¹ Redesignated areas are areas that previously qualified as QCTs or qualified nonmetropolitan counties, but have lost designation due to changes in data or improved economic status. 15 U.S.C. § 632(p)(4)(C) (2012).

¹² 15 U.S.C. § 632(p)(5).

¹³ 13 C.F.R. § 126.300-309 (2017).

¹⁴ *Id.* § 126.501 (2017).

¹⁵ Set-aside federal contracts are reserved exclusively for certain eligible vendors to bid. 48 C.F.R. § 19.1305-1307.

¹⁶ Sole-source federal contracts are awarded to only one vendor. The threshold for sole-source awards for manufacturing contracts is \$6.5 million. *Id.*

¹⁷ 15 U.S.C. § 644(g)(1).

percent of its goal, totaling \$6,864,452,294.54.¹⁸ About 6,000 HUBZone-certified small businesses currently exist.¹⁹

II. Solutions to Challenges Identified by Small Business Owners

a. Establish a New 5-Year Time Model Creating Stability and Reducing Risk for Small Businesses

The HUBZone Map is the SBA's primary interface with the public, communicating HUBZone designated areas. Small businesses are responsible for maintaining their eligibility requirements and rely on the Map to make those determinations.²⁰ A central issue for small businesses is the frequency in which these area determinations change.²¹ HUBZone area determinations are statutorily linked to data gathered from other federal agencies; for instance, unemployment data from the Department of Labor. The SBA updates the HUBZone status of these areas based on new data as it becomes available, which can be as often as annually.²² This poses enormous hurdles for small businesses struggling to meet the HUBZone eligibility criteria.

Two HUBZone eligibility requirements rely on the determination of a HUBZone qualified area: first, the principal office of the small business concern must be located in a HUBZone area, and second, no fewer than 35% of its employees must reside in a HUBZone area. When HUBZone area designations are constantly shifting, small businesses often struggle to remain in compliance and face tough business decisions. For example, deciding whom to hire, where to invest in an office location, and determining how long of a lease to sign are common issues that small businesses face. This ever-changing landscape deters small businesses from relying on and investing in obtaining their HUBZone certification. As a result, the number of qualified HUBZone vendors that the government can procure from is limited, which makes it difficult for the government to meet its 3% HUBZone small business goal.

H.R. 3294 aims to move the HUBZone Program to a new time model, affording small businesses greater stability when choosing to invest in economically distressed areas. All HUBZone area designations would be updated and displayed on the SBA's HUBZone Map in 5-year increments, starting from the year 2020. This provides small businesses and communities the certainty that an area, once determined, would remain in that designation until the next scheduled update in 5 years. Furthermore, to promote transparency and visibility in determining these HUBZone areas, the SBA would be required to make publicly available the data used to populate the HUBZone map, as well as the date on which the HUBZone Map will be refreshed

¹⁸ U.S. GEN. SERV. ADMIN., FEDERAL PROCUREMENT DATA SYSTEM – NEXT GENERATION, SMALL BUSINESS GOALING REPORT, <https://www.fpds.gov> (last visited Feb. 17, 2017).

¹⁹ SBA, DYNAMIC SMALL BUSINESS SEARCH, http://dsbs.sba.gov/dsbs/search/dsp_dsbs.cfm (last accessed visited Feb. 17, 2017).

²⁰ Both the principal place of business and workforce requirements require that these elements are fulfilled in HUBZone designated areas. The Map informs the public as to where those designated areas are located.

²¹ The Government Accountability Office also recognized that the frequency of changes to HUBZone designations present challenges for small businesses. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-751, SMALL BUSINESS CONTRACTING: OPPORTUNITIES EXIST TO FURTHER IMPROVE HUBZONE OVERSIGHT, 30 (2015).

²² ROBERT JAY DILGER, CONG. RESEARCH SERV., R41268, SMALL BUSINESS ADMINISTRATION HUBZONE PROGRAM 13 (2017)

next. To accommodate new base closures or disaster areas that may occur within this five year period, the SBA would update the HUBZone Map to reflect new base area closures and qualified disaster areas as they arise, according to statute. The SBA must also remove redesignated areas after the statutory 3-year extension expires, according to statute. In addition to providing stability to currently participating firms and to local economies impacted by these shifts, this reform may also incentivize small businesses previously deterred to now seek HUBZone certification.

b. Redefine Qualified Nonmetropolitan Counties to Expand the Number of Rural Counties that can Qualify as a HUBZone Area

Small businesses are the backbone of rural communities. Their ability to grow is a key economic indicator of well-being and job creation in America. However, these small rural businesses face challenges unique to them that their urban counterparts may not experience. The United States Senate Committee on Small Business and Entrepreneurship examined these challenges in bipartisan manner during a hearing on April 26, 2017.²³ Chairman James Risch brought the discussion to highlight the fact that “life is not exactly the same everywhere in America.”²⁴ Similarly, Ranking Member Jeanne Shaheen listed a number of challenges to rural small business success, such as access to capital, distance from major infrastructure, spotty broadband and wireless coverage, and that “small business owners... are having trouble getting access to skilled labor.”²⁵

The HUBZone Program designates rural areas as HUBZones through the qualified nonmetropolitan counties area designation. Qualified nonmetropolitan counties must meet statutorily-mandated household income or unemployment requirements. The income requirement states that “the median household income is less than 80% of the *nonmetropolitan* state median income.”²⁶ H.R. 3294 expands the number of qualified nonmetropolitan areas by eliminating the qualifier “nonmetropolitan” from “State median household income.” This will result in expanding the number of HUBZone-qualified rural areas, potentially alleviating some of the issues small businesses in particularly isolated areas face when seeking to comply with the eligibility requirements of the HUBZone Program, such as seeking enough qualified workers to fulfil the 35% employment requirement. Additionally, small businesses struggling to stay viable may be able to relocate to an area closer to major highways and roads without losing their HUBZone certification. This change may also incentivize more rural companies to seek HUBZone certification.

c. Redefine Qualified Disaster Areas to Increase the Time Period in Which these Areas Qualify as a HUBZones and Bringing Parity to Base Closure Areas

Natural disasters, such as Hurricane Katrina, wreak havoc on the local economies. These communities often suffer depressed economic growth for many years following the disaster or

²³ *The Challenges and Opportunities of Running a Small Business in Rural America: Hearing Before the S. Comm. on Small Business & Entrepreneurship*, 115th Cong. (2017).

²⁴ *Id.* at 3 (statement of Sen. Risch, Chairman, S. Comm. on Small Business & Entrepreneurship).

²⁵ *Id.* at 2 (statement of Sen. Shaheen, Ranking Member, S. Comm. on Small Business & Entrepreneurship).

²⁶ 13 C.F.R. §126.103 (2017).

catastrophic incident. Recognizing this difficulty, H.R. 3294 extends the time period in which a qualified disaster area is considered as such, ending on the date when it no longer fits the criteria of a HUBZone-qualified area (i.e. a qualified census tract or qualified nonmetropolitan county). H.R. 3294 further provides the SBA discretion to extend the HUBZone qualification of a qualified disaster area if it does not meet the qualifications for a qualified census tract or nonmetropolitan area. This allows for a potentially longer time frame in which a disaster area may stay HUBZone-qualified and benefit from the federal contracting preferences small businesses in the area could receive.

Military bases are often are substantial job creators, bolstering the local economy. When these bases close, the communities that have developed on and nearby the base can face long-term economic distress. Congress recognized these issues and in response, passed Section 866 of H.R. 1735, the “National Defense Authorization Act for Fiscal Year 2016” making it easier for businesses located in base closure areas to meet the HUBZone 35% workforce requirement.²⁷ H.R. 3294 proposes to modify the definition of a base closure area by aligning it with the definitions of a qualified census tract or qualified nonmetropolitan area. This change would bring parity between these three different types of HUBZone area designations.

III. Solutions to Challenges Identified by Government Watchdogs

a. Implement Reforms Resulting from Findings and Recommendations Made by the Government Accountability Office (GAO)

Current law states that the SBA “*may*” provide for program examinations - the one process that consistently includes reviews of documentation provided by the small business concern proving it continues to qualify for HUBZone certification.²⁸ Before fiscal year 2004, program examinations were conducted on an as-needed basis.²⁹ The GAO reported in 2008 that while the SBA’s policies and procedures were modified to require program examinations as a tool the SBA uses to protect against fraud and abuse, the agency conducts them on only a small subset of firms each year.³⁰ H.R. 3294 strengthens the existing statutory language by mandating the use of program examinations, stating that the SBA “*shall*” conduct program examinations of qualified HUBZone small business concerns to ensure the small business is HUBZone-compliant. Additionally, it codifies the SBA’s policy to utilize a risk-based process for selecting and examining those qualified HUBZone small businesses that pose the greatest risk of fraud to the government. Furthermore, the bill imposes a 30-day deadline on small businesses failing their program examinations to submit documentation to the SBA proving their eligibility, or face decertification.

Additionally, H.R. 3294 responds to GAO’s 2015 report findings that the SBA’s application processing times were delayed; 81% of the initial HUBZone applications submitted

²⁷ *Supra* note 22, at 16.

²⁸ *Id.* §126.402.

²⁹ U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-643, ADDITIONAL ACTIONS ARE NEEDED TO CERTIFY AND MONITOR HUBZONE BUSINESSES AND ASSESS PROGRAM RESULTS 28 (2008).

³⁰ *Id.*

between fiscal years 2009 to 2013 reviewed by the GAO exceeded the SBA's processing goal of 90 days.³¹ Delays in application processing times negatively impact small businesses as they continue expending valuable capital and resources (i.e. on overhead and personnel) while waiting for their applications to be approved or denied. While the SBA has initiated new online certification processes intended to streamline the application process, H.R. 3294 requires the SBA to process applications and verify documents submitted by HUBZone small business concerns within 30 days of receipt of such documents. This also includes documents received in response to challenges against a small business concern's HUBZone status. Time is money for small businesses, and by expediting the SBA's paperwork review, this allows small businesses greater flexibility and freedom to focus on growing their business instead of waiting for certification decisions by the SBA.

The GAO also recommended in its 2015 report that the SBA establish procedures verifying the accuracy of documentation submitted by HUBZone small business concerns when they recertify every 3 years.³² Currently, recertification is largely a self-certification process in which small businesses are not required to submit any information to verify their continued eligibility. This potentially opens the door to fraud and abuse. H.R. 3294 responds to this concern by requiring the SBA to take steps to actively verify that the documents submitted by small business concerns at the time of certification are still accurate 3 years after initial certification and every 3 years thereafter, instead of relying on small business to attest themselves that they continue to meet the program's eligibility requirements. This requirement will increase the SBA's ability to reduce the risk of ineligible firms obtaining HUBZone contracts.

b. Establish Collection and Reporting of Performance Measures by the SBA to Assess the Effectiveness of the HUBZone Program

Lack of data hampers the SBA's ability to provide Congress with a full picture of the HUBZone Program's effectiveness. In 2001, GAO could not conclusively determine whether actual achievements materialized due to data flaws and insufficient reporting guidance.³³ The GAO stated in its 2008 report that the SBA must take steps to assess the effectiveness of the HUBZone Program, noting that the federal government has never met its 3% HUBZone small business contracting goal.³⁴ Similarly, the Office of Management and Budget in its Program Assessment Rating Tool stated that the SBA needed to develop baseline measures for the HUBZone program, encouraging the SBA to focus on more outcome-oriented measures that effectively evaluate the results of the Program.³⁵

Following up in 2008, GAO found the SBA did track measures, but they were indirectly linked to the program's mission of stimulating economic development in economically distressed

³¹ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-17-456T, OVERSIGHT HAS IMPROVED BUT SOME WEAKNESSES REMAIN 5 (2017).

³² U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 21, at 2.

³³ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-02-57, HUBZONE PROGRAM SUFFERS FROM REPORTING AND IMPLEMENTATION DIFFICULTIES (2001).

³⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 33.

³⁵ *Id.* at 35.

communities.³⁶ The SBA's current performance measures track the number of certified or recertified firms, the annual value of contracts awarded to HUBZone firms, and the number of program examinations completed annually. GAO found that the SBA recognized the need to assess the economic effect of the program, but did not devote resources to this end.³⁷ Consequently, the SBA lacks key information it could use to help it better manage and assess the results of the program.

To promote this objective, H.R. 3294 mandates that the SBA identify and publish performance metrics measuring the success of the HUBZone program and also requires the SBA to develop processes incentivizing its field offices to collect and manage HUBZone data within their respective regions. In order for Congress to stay informed, the SBA must also submit an annual report to Congress analyzing the data collected.

IV. Additional Solutions Improving the HUBZone Program

a. Unification of HUBZone Regulations Within the Small Business Act

The HUBZone program statutes are currently located in two separate sections of the Small Business Act: Section 3(p) – Definitions, and Section 31 – HUBZone Program. Significant operative language is found in both sections. For instance, Section 3(p) dictates how HUBZone area designations are determined. Section 31 identifies regulations requiring the SBA to certify and verify information submitted by participating small business concerns. Splitting the statutory language of the Program into two separate sections within the Small Business Act makes little intuitive sense and creates unnecessary confusion. Merging the two sections will have no adverse impact on other sections of the Small Business Act.

H.R. 3294 unifies sections 3(p) and 31 of the Small Business Act, incorporating the HUBZone definitions into the HUBZone program section. This ensures greater clarity in statute and easy reference for all pertinent statutes relating to the HUBZone program. It additionally defines a currently undefined term, “qualified HUBZone small business concern,” which is used throughout the Small Business Act.

b. Freezing HUBZone area designations upon enactment will allow the SBA the opportunity to comply with H.R. 3294 and will grant a reprieve to small businesses losing their HUBZone status until the year 2020

Many small businesses are facing losing their HUBZone redesignated status in the next few years. H.R. 3294 freezes the current HUBZone designations, upon enactment, so these firms that would have lost their HUBZone status in 2018 or 2019 will still be HUBZone-eligible until the new HUBZone Map is recalculated in 2020. This will provide small businesses with enough time to make critical business decisions, such as whether or not to relocate, and will provide the SBA with time to draft and implement regulations complying with H.R. 3294.

³⁶ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-975T, ADDITIONAL ACTIONS ARE NEEDED TO CERTIFY AND MONITOR HUBZONE BUSINESSES AND ASSESS PROGRAM RESULTS (2008).

³⁷ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 33-34.

V. Issues Before the Committee

During the hearing, the Committee expects to hear from the HUBZone Council, a non-profit trade association, and various HUBZone small businesses on the legislative changes proposed by H.R. 3294 as outlined in this memorandum. Specifically, all panelists will be asked if these legislative changes to the HUBZone Program are necessary or desirable, whether this legislation may alleviate existing roadblocks to successful participation in the HUBZone Program, and if additional legislative measures should be considered.