

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

To: Members, Committee on Small Business
From: Committee Staff
Date: September 7, 2016
Re: Full Committee Hearing: "Ensuring Opportunities: Oversight of the HUBZone Program."

On Wednesday, September 7, 2016, at 11:00 a.m., the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building. The Committee will meet to provide oversight of the Small Business Administration's (SBA) Historically Underutilized Business Zones (HUBZone) Program, which seeks to provide federal contracting opportunities to small businesses in areas of the country that are particularly economically distressed. This hearing will provide an update to the Committee on how the program is functioning, and explore ways in which it might be improved.

I. Background

The HUBZone Program was created as a part of the Small Business Reauthorization Act of 1997.¹ The goal of the program was to use government contracts as a resource to encourage small businesses to locate in economically distressed areas and hire employees from those areas.² There are six classes of HUBZones that currently exist.

a. Qualified Census Tracts (QCTs)

A qualified census tract is designated by the Department of Housing and Urban Development (HUD), based on a formula to determine the application of the low-income housing tax credit program. A QCT is a tract in which either 50 percent or more of the households have an income which is less than 60 percent of the area's median gross income, or which has a poverty rate of at least 25 percent. However, no more than 20 percent of a metropolitan statistical area may qualify. If more than 20 percent of an area would otherwise qualify, HUD orders census tracts from highest percentage of eligible households to lowest, and then designates the census tracts with the highest percentages of eligible households until the 20 percent limit is reached.³

b. Qualified Nonmetropolitan Counties

A qualified nonmetropolitan county is a county not located in a metropolitan statistical area in which the median household income is less than 80 percent of the

¹ Small Business Reauthorization Act of 1997, § 601-07, 111 Stat. 2627-36.

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

³ 26 U.S.C. § 42(d)(5)(B)(ii).

nonmetropolitan state median household income, the unemployment rate is at least 140 percent of the average unemployment rate for the United States or for that county's state (whichever is less), or is located in a difficult development area (DDA). DDAs are areas designated by the Secretary of HUD, have characteristics that make economic development particularly difficult and costly, and are located within Alaska, Hawaii, or any territory or possession of the United States outside the contiguous 48 states.⁴

c. *Redesignated Areas*

Created by the HUBZones in Native America Act of 2000⁵, redesignated areas are areas which previously qualified as QCTs or qualified nonmetropolitan counties, but have lost this designation due to the area's improved economic status. These areas may receive a three year extension from the date that the designation is lost.⁶ This ensures that a company doesn't locate to a HUBZone, only for the area to immediately lose its designation. This three year redesignated period also provides some stability for areas that may bounce back and forth between being qualified and not for QCT or qualified nonmetropolitan county status.

d. *Qualified Indian Reservations/Indian Country*

HUBZone status is also given to "lands within the external boundaries of an Indian reservation."⁷ This includes lands covered under the term "Indian Country," portions of Oklahoma designated as former Indian reservations, and Alaska native village statistical areas.⁸

e. *Military Bases Closed Under the BRAC*

In 2005, Congress extended HUBZone eligibility to areas where a military installation had closed through a privatization process.⁹ Recently, Congress has expanded eligibility for this class of HUBZone to census tracts and nonmetropolitan counties nearby or including base closure areas.¹⁰

f. *Qualified Disaster Areas*

Last year, Congress provided HUBZone eligibility for areas that were impacted by a major disaster¹¹ or where a catastrophic incident occurred.¹² If an area loses its qualification to be designated a QCT or a qualified nonmetropolitan county at any point from 5 years

⁴ 15 U.S.C. § 632(p)(4)(B).

⁵ Included within Title VI, the Consolidated Appropriations Act of 2001.

⁶ 15 U.S.C. § 632(p)(4)(C).

⁷ 15 U.S.C. § 632(p)(1)(C).

⁸ Henry Beale and Nicola Deas, "The HUBZone Program Report," Washington, DC: Microeconomic Applications, Inc., prepared for the SBA, Office of Advocacy, May 2008, p. 160, at <https://www.sba.gov/content/hubzone-program-report>.

⁹ Consolidated Appropriations Act, 2005, § 152, 118 Stat. 3456-57.

¹⁰ National Defense Authorization Act for Fiscal Year 2016, § 866, 129 Stat. 929 [hereinafter 2016 NDAA].

¹¹ As declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. 42 U.S.C. 5170.

¹² 2016 NDAA, *supra* n. 10. 129 Stat. 931.

before the major disaster or catastrophic incident, to 2 years after, then the SBA Administrator has the power to declare that area HUBZone eligible.¹³ These areas are treated as HUBZones for not less than 8 years.

Small businesses located within these areas have the opportunity to apply for HUBZone firm status. To obtain HUBZone firm status, a business must be small by SBA standards, have their principal office located within a HUBZone, be at least 51 percent owned by United States citizens, and have at least 35 percent of their employees reside in a HUBZone.¹⁴ To certify as a HUBZone firm, a small business must apply to the SBA, recertify every three years, certify through the System for Award Management, and qualify at the time of a contract offer and at the time of award.¹⁵ Additionally, small businesses must notify the SBA as to any changes that might affect their eligibility.¹⁶

HUBZone firms can receive set-aside federal government contracts if two or more HUBZone firms are expected to make a fair and reasonable offer.¹⁷ Sole-source awards are permitted for contracts below \$4 million (\$6.5 million for manufacturing contracts).¹⁸ A price evaluation adjustment of 10 percent is granted when bidding on contracts through full and open competition. Therefore, a HUBZone firm's bid for a contract will be deemed to be lower than another (non-small business) firm's, even if the HUBZone firm's bid is up to 10% higher than the other firm's bid. In addition, there is a statutory goal of awarding 3 percent of all prime contract dollars, and three percent of all subcontract dollars, to HUBZone firms.¹⁹

In FY2015, the most recent year data is available, the federal government did not meet its 3 percent goal. Rather, only 1.823% of federal contracting dollars went to small businesses within the HUBZone program. This accounts for \$6,422,281,935.91.²⁰ Currently, there are approximately 5,600 small businesses certified with the HUBZone program.²¹

II. Government Accountability Office Reviews

Management of the HUBZone program has drawn interest from the Government Accountability Office on a number of occasions.²² In its 2015 review, GAO found that while the SBA had made some progress in addressing some of the weaknesses with the internal controls of the program, more could be done to communicate with firms regarding HUBZone area

¹³ In the case of a major disaster declared by the President, the Administrator must make this determination within 5 years of the declared disaster. For a catastrophic incident, the Administrator must make this determination within 10 years of the incident.

¹⁴ 15 U.S.C. § 632(p)(5).

¹⁵ 13 C.F.R. § 126.300-309.

¹⁶ 13 C.F.R. § 126.501.

¹⁷ 48 C.F.R. § 19.1305-1307.

¹⁸ *Id.*

¹⁹ 15 U.S.C. § 644(g)(1).

²⁰ https://www.fpd.gov/downloads/top_requests/FPDSNG_SB_Goaling_FY_2015.pdf.

²¹ This number is derived from the SBA's Dynamic Small Business Search Database, available at http://dsbs.sba.gov/dsbs/search/dsp_dsbs.cfm.

²² See e.g., GAO, SMALL BUSINESS ADMINISTRATION: ADDITIONAL ACTIONS ARE NEEDED TO CERTIFY AND MONITOR HUBZONE BUSINESSES AND ASSESS PROGRAM RESULTS (GAO-08-643) (2008), available at <http://www.gao.gov/assets/280/276841.pdf>; GAO, SMALL BUSINESS CONTRACTING: OPPORTUNITIES EXIST TO FURTHER IMPROVE HUBZONE OVERSIGHT (GAO-15-234) (2015), available at <http://gao.gov/assets/670/668468.pdf> [hereinafter 2015 GAO Report].

designations.²³ Additionally, the recertification process used by the SBA was inefficient, causing significant backlogs.²⁴ GAO offered two recommendations to combat these issues.

First, GAO recommended that SBA establish mechanisms to better ensure firms are made aware when changes in a HUBZone designation could affect their participation in the program. GAO suggested SBA ensure that certified firms sign up for an email broadcast system, or include more specific information on certification letters so that firms are better aware how an area's redesignation could impact their participation in the program.²⁵ Second, GAO recommended that SBA examine its recertification process and create more controls. For example, GAO advocated for a "risk-based approach to requesting and verifying firm information, allowing firms to initiate the recertification process, and ensuring that sufficient staff will be dedicated to the effort so that a significant backlog in recertifications does not recur."²⁶

In March, 2016, GAO issued a follow-up report to update the progress SBA had made in response to the recommendations made after previous reviews.²⁷ In this follow up report, GAO noted that SBA had not gone far enough in implementing their recommendations. Specifically, while SBA had taken steps to ensure that newly certified firms are added to an email distribution list, it had not taken steps to include all previously certified firms on the lists.²⁸ This report also singled out continued weaknesses in the programs recertification process. GAO found that SBA largely relies on site visits to root out any potential fraud, as opposed to implementing controls to verify a firm's information. However, SBA only conducts site visits on approximately 10 percent of certified HUBZone firms.²⁹ Simply relying on site visits to a limited subsection of firms does not do enough to ensure that only qualified firms continue in the HUBZone program.

III. Conclusion

The HUBZone program was created with the purpose of providing contracting opportunities to areas of the country most in need to economic development. Nearly 20 years after its creation, this hearing will provide Committee Members with an opportunity to examine the impact the program has had, the problems that have arisen, and potential fixes moving forward. The recommendations put forth by GAO provide a valuable starting point for discussing the ways the program can best achieve its goals.

²³ 2015 GAO Report, *supra* n. 20, at 6.

²⁴ 2015 GAO Report, *supra* n. 20, at 14.

²⁵ 2015 GAO Report, *supra* n. 20, at 25.

²⁶ 2015 GAO Report, *supra* n. 20, at 26.

²⁷ GAO, HUBZone Program: Actions Taken on February 2015 GAO Recommendations (GAO-16-423R) (2016), available at <http://gao.gov/assets/680/676049.pdf>.

²⁸ *Id.* at 2-3.

²⁹ *Id.* at 3.