



Written Testimony of

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On behalf of

The HUBZone Contractors National Council

Before the

House Committee on Small Business

Subcommittee on Contracting and Workforce

“Learning from History:

Ideas to Strengthen and Modernize the HUBZone Program”

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Chairman Knight, Ranking Member Murphy, and Members of the Subcommittee, my name is Shirley Bailey and I appreciate the opportunity to be here today to provide testimony on the Historically Underutilized Business Zones (HUBZone) program.

The HUBZone Contractors National Council (Council) is a non-profit trade association providing information and support for companies and professionals interested in Small Business Administration's (SBA) HUBZone program. We would like to thank the Committee for their commitment to small businesses and for advancing small businesses in the federal marketplace.

The HUBZone Council has existed since January 2000, and strives to contribute to the economic development of disadvantaged communities by reducing unemployment and homelessness by strengthening, improving, and promoting the HUBZone Program and by helping HUBZone-certified companies maximize their success in earning federal contracts.

The Council's membership includes HUBZone-certified small businesses, other small businesses, prime contractors, and other organizations interested in the HUBZone Contracting Program. In addition, the HUBZone Council is an advocate as it relates to procurement and entrepreneurial policy and continues to seek needed modernization of the program from the Congress and SBA. The details of which are included.

### **History of the HUBZone Program**

Economic development in Historically Underutilized Business Zones is particularly challenging. While assistance -including tax abatement, regulatory relief, job training, and other incentives to attract small businesses are helpful – they are not enough. Distressed areas need sustainable jobs and a business needs customers to succeed and create jobs. Creating incentives for the federal government to be the customer, while HUBZone firms establish revenue, invest in communities and create jobs, is a sustainable option for firms located in the nation's poorest communities

Based on this need for jobs and economic development in distressed areas, Senator Kit Bond (R-MO) and a bipartisan coalition including the Chairman and Ranking Member of the House Small Business Committee, Rep. Jim Talent (R-MO) and Rep. John LaFalace (D-NY), and Senators John Kerry (D-MA), Olympia Snowe (R-ME), sponsored the legislation which created the Historically Underutilized Business Zone federal contracting program in 1997. The goal was to provide real economic opportunity in our nation's most blighted areas by "creat[ing] realistic opportunities for moving people off of welfare and into meaningful jobs" in "inner cities and rural counties that have low household incomes, high unemployment, and whose communities have suffered from a lack of investment."<sup>1</sup> The program was also established to assist in replacing lost jobs from our nation's declining manufacturing and industrial sectors.

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<sup>1</sup> U.S. Congress, Senate Committee on Small Business, Small Business Reauthorization Act of 1997, report to accompany S. 1139, 105th Cong., 1st sess., August 19, 1997, S.Rept. 105-62 (Washington: GPO, 1997), p. 25.

In 1996, President Clinton further supported this concept and issued an Executive Order calling for “empowerment contracting”, which sought to give price evaluation credit to small business contract activities by firms in areas of great distress. The goal of the order was, “Fostering growth of Federal contractors in economically distressed communities and ensuring that those contractors become viable businesses for the long term which will promote economy and efficiency in Federal procurement and help to empower those communities<sup>2</sup>”.

The HUBZone program promotes all of these goals The HUBZone Program is the only small business program that focuses Federal contracting dollars on generating jobs, increasing investment and decreasing unemployment in our nation’s most distressed areas. In fiscal year 2014, HUBZone firms reinvested \$3.5 billion back into distressed communities nationwide<sup>3</sup>.

Like other SBA set-aside programs for economically disadvantaged, service-disabled veteran-owned, and women-owned firms, there is a socio-economic utilization goal for HUBZone firms. As such, the HUBZone authorization bill, the Small Business Reauthorization Act of 1997, included a 3% prime contract goal for HUBZone firms, and increased the overall government-wide contracting goal to 23%. The HUBZone goal serves as a benchmark to determine whether agencies are appropriately utilizing the program, and is a floor, not a ceiling.

SBA finalized the regulations to implement the HUBZone program in the summer of 1998 and began accepting program applications in March 1999<sup>4</sup>. Early on, however, it became apparent the program needed an off-ramp. Going from federal assistance in creating jobs to losing that ability shortly thereafter did not serve the purpose of the program. Therefore, Congress passed the Small Business Reauthorization Act of 2000, to provide for a 3-year grandfathering period, or to extend participation for 3 years after an area is no longer eligible. Congress understood that many HUBZone areas rely on the designation to improve employment, and that immediate removal of the designation could hurt an area economically in such a way that it would become eligible for the program once again.

In 2005, Congress expanded the HUBZone program to incorporate areas that have undergone Base Realignment and Closure (BRAC) through the Department of Defense. Large military installations are often a community’s largest and most important employer. The loss of a base can hurt an area for decades afterwards. The incentive the HUBZone program creates for new businesses to revitalize an area is just what a BRAC area needs.

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<sup>2</sup> William J. Clinton: Executive Order 13005 - Empowerment Contracting 21 May 1996  
<http://www.presidency.ucsb.edu/ws/?pid=52845>

<sup>3</sup> American Express, *The Crucial Role Small Businesses Play in Their Communities*, October 28, 2014 (reporting that small businesses returned, on average, 52% of their revenues to the local economy).

<sup>4</sup> Congressional Research Service, Small Business Administration HUBZone Program, R41268, August 4, 2016

Improvements made by Congress throughout the early 2000s enabled the HUBZone program to reach a participatory high of over 14,000 firms<sup>5</sup>, and in fiscal year 2009 the government awarded a record 2.81% of federal contracts to HUBZone firms.

However, data from the 2010 census showed that a large number of areas had improved enough to be removed from the program. These areas contained approximately one-third, or 2,400 HUBZone businesses<sup>6</sup>. While exiting the program should indicate economic revitalization, our nation was experiencing the worst recession in decades. Removing thousands of small businesses from the program designed to provide economic development, during the worst recession since the great depression indicated the program was not working to satisfy the program's goals.

The removal of so many HUBZones businesses led government spending to decline for a number of years. In FY2015, the government only awarded 1.82% of contracts to HUBZone firms; almost a full percentage point below where the program was six years prior. As of February 2017, there are only 6,026 certified firms, which represents a loss of over one-third of HUBZone firms since the 2010 census<sup>7</sup>. The program has not fully recovered because Congress has not addressed challenges in program eligibility.

In fiscal year 2014, HUBZone firms reinvested \$3.5 billion back into distressed communities nationwide<sup>8</sup>. The continued analysis of HUBZone data since 2010 as well as the ongoing failure to meet the goal has increased attention of the program. As detailed below, legislation to revise the program was introduced in the last Congress.

The National Defense Authorization Act for Fiscal Year 2016 also expanded the use of HUBZones in BRAC areas by extending both the area and the length of time an area qualifies. The Act also granted eligibility to Native Hawaiian Organizations, and included qualified Presidentially declared disaster areas that were previously in the HUBZone program.

In June 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) expanded the HUBZone program in Puerto Rico, and required SBA to provide a "risk based approach" to application certification and recertification<sup>9</sup>.

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<sup>5</sup> U.S. Congress, House Committee on Small Business, Status of Efforts to Address Previous Recommendations on the HUBZone program, Statement delivered by William B. Shear available at <http://www.gao.gov/assets/130/122102.html>

<sup>6</sup> SBA, FY2014 Congressional Budget Justification and FY2012 Annual Performance Report, p. 43, at <https://www.sba.gov/sites/default/files/files/1-FY%202014%20CBJ%20FY%202012%20APR.PDF>.

<sup>7</sup> *ibid.*

<sup>8</sup> American Express, *The Crucial Role Small Businesses Play in Their Communities*, October 28, 2014 (reporting that small businesses returned, on average, 52% of their revenues to the local economy).

<sup>9</sup> Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) P.L. 114-187 (June 2016)

## **Background on the Program**

### *Benefits of the HUBZone Program*

The HUBZone program has similar authorities to SBAs other set-aside programs by allowing contracting officers to utilize set-asides and sole source for HUBZone firms. Also, for full and open competition, “the price offered by a qualified HUBZone business shall be deemed as being lower than the price of another offeror if the HUBZone business price offer is not more than 10% higher than the other offer<sup>10</sup>” The Price Evaluation Preference (PEP) is an important tool, but it is often misunderstood or misapplied by contracting officers of federal agencies. Simply put, in full and open competition, a HUBZone bid can be up to 10 percent higher than another offer, and the HUBZone offer should nevertheless be accepted. As discussed later, price-evaluation preferences accounted for only 2 percent, or \$36 million of HUBZone program contract dollars in FY2015 and its use is widely regarded as a rarity<sup>11</sup>.

### *HUBZone Program Eligibility*

To qualify for the program, companies must have a “principal office” in a HUBZone. SBA defines principal office to be the location where the greatest number of employees at any one location perform their work<sup>12</sup>.

HUBZone areas can qualify under one of six criteria including qualified census tracts (QCTs), qualified non-metropolitan counties, difficult development areas, qualified Indian lands, military property closed under the Base Realignment and Closure (BRAC), and qualified disaster areas.

### Qualified Census Tracts

Qualified census tracts are defined based on current eligibility from the U.S. Department of Housing and Urban Development (HUD) for the Low Income Housing Tax Credit (LIHTC) for the most recent year census data is available. To qualify, at least 50 % of households must have income “below 60% of the median gross income of the metropolitan statistical area (in metropolitan census tracts) or the median gross income for all non-metropolitan areas of the state (in non-metropolitan census tracts) or a poverty rate of at least 25%<sup>13</sup>.

### Non-Metropolitan Counties (NMC)

Qualified non-metropolitan counties can become HUBZone eligible by having median household income less than 80% of the non-metropolitan state median household income, based on Census

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<sup>10</sup> Small Business Reauthorization Act of 1997, S. 1139, 105th Cong., 1st sess., August 19, 1997 (Washington: GPO, 1997),

<sup>11</sup> Congressional Research Service, Small Business Administration HUBZone Program, R41268, August 4, 2016

<sup>12</sup> SBA has an exception for construction and service industries, which have exemptions based on their occasional need to assign employees at the contract location.

<sup>13</sup> 13 C.F.R. §126.103 and 26 U.S.C. §42(d)(5)(B)(ii)(I).

data, or an unemployment rate not less than 140% of the average unemployment rate for the state or for the U.S., whichever is lower<sup>14</sup>”. Unlike QCTs, qualified NMC designations are annually determined by SBA.

The qualified non-metropolitan county designation is the only type of HUBZone that is determined by the SBA. The formula is set in law and the data are derived from other agencies, but the designation is made by SBA.

Additional HUBZone eligible areas are Indian Country, HUD-designated difficult development areas (DDA) which are areas with high construction, land, and utility costs relative to area median gross income, Department of Defense property that has undergone BRAC, and areas that were previously HUBZones, and experienced a Presidentially declared disaster.

### Employee Requirements

An additional program requirement is that a least 35% of employees must live in a HUBZone. While other SBA socio-economic programs focus on the characteristics of the owner, the HUBZone program is focused on firm employees. This requirement ensures that jobs are not just located in distressed areas, but HUBZone firms are creating jobs for those living in distressed areas, as well. This allows HUBZone firms to empower communities through sustainable jobs and an economic multiplier effect. This requirement is often the most challenging for firms to comply.

### Redesignation

To improve the program, Congress passed the Small Business Reauthorization Act of 2000, to provide for a 3-year grandfathering period or to extend participation for 3 years after an area is no longer eligible. Congress believed that many HUBZone areas rely on the designation to improve employment, and that immediate removal of the designation could hurt an area economically in such a way that it would become eligible for the program once again.

## **HUBZone Program Impact**

While there are currently only a little more than 6,000 HUBZone firms, these businesses have had substantial impact on their communities. Federal contracts awarded to HUBZone companies directly support 40,000 jobs every year<sup>15</sup> and the average HUBZone company is awarded over \$1 million in federal contracts, a critical revenue threshold in business sustainability<sup>16</sup>.

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<sup>14</sup> 13 C.F.R. §126.103.

<sup>15</sup> Maria Contreras-Sweet, *SBA Fiscal Year 2015 in Review*, October 2, 2015 (Stating that small businesses received \$91.7 billion dollars, supporting 550,000 jobs in the economy).

<sup>16</sup> Small Business Dashboard, available at <http://smallbusiness.data.gov/> (Reporting that in FY 2014, HUBZone contracts totaled \$6.7 billion. The average firm received approximately \$1.3 million).

If each HUBZone qualified area had a single HUBZone business, it would generate an additional \$17 billion in economic activity and support over 100,000 jobs. This is such a large number because almost 90% of HUBZone areas do not have a single HUBZone certified company. Largely due to this underutilization, the government has never met the goal of awarding 3% of federal contracts to HUBZone firms<sup>17</sup>. Failure to meet the 3% goal resulted in over \$4 billion left on the table that economically stressed communities would have benefitted from, just last year.

## **Program Challenges**

### *Program Integrity & Funding*

The HUBZone program has suffered from chronic underfunding since it was first authorized in 1997. When the program was first established, it was authorized between \$5 and \$10 million to set up the program office, conduct outreach to both federal agencies and small businesses, and ensure program integrity<sup>18</sup>. However, the program has rarely received more than \$2-\$3 million in a given fiscal year though it currently costs SBA more than \$15 million to operate the program annually<sup>19</sup>. In FY2016, the program received an appropriation of \$3 million<sup>20</sup>.

While SBA has supplemented program costs through the appropriations provided for general administrative expenses, it is a challenge to improve the program without the necessary support. After years of underfunding the program, SBA has experienced difficulties in building mechanisms to support audit controls that reduce waste, fraud, and abuse. While these changes will help the program, it is imperative that Congress further assist SBA with program administration.

### *Program Utilization*

Throughout the early 2000s both SBA and federal agencies improved their utilization of HUBZone firms. Data from the 2010 census showed that approximately one-third, or 2,400 HUBZone businesses should be removed from the program<sup>21</sup>. While exiting the program should indicate economic revitalization, our nation was experiencing the worst recession in decades when the 2010 Census was conducted – yet thousands of small businesses were removed from the program designed to provide economic development.

By removing so many HUBZone businesses, government spending in the program has declined steadily since 2011, to 1.82% in FY2015. During the great recession, almost 2,400 firms were

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<sup>17</sup> Government Accountability Office, *Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight*, at 37, February 2015. Available at <http://www.gao.gov/assets/670/668468.pdf>.

<sup>18</sup> <http://www.sbc.senate.gov/republican/HTML/agencies/hubzones/hubzone24.pdf>

<sup>19</sup> Congressional Research Service, *Small Business Administration HUBZone Program*, R41268, August 4, 2016

<sup>20</sup> SBA, FY2017 Congressional Budget Justification and FY2015 Annual Performance Report, p. 26, at [https://www.sba.gov/sites/default/files/FY17-CBJ\\_FY15-APR.pdf](https://www.sba.gov/sites/default/files/FY17-CBJ_FY15-APR.pdf).

<sup>21</sup> SBA, FY2014 Congressional Budget Justification and FY2012 Annual Performance Report, p. 43, at <https://www.sba.gov/sites/default/files/files/1-FY%202014%20CBJ%20FY%202012%20APR.PDF>

removed from the program<sup>22</sup>.

#### *Streamline HUBZone Program Data*

Previously, economic data to determine HUBZone eligibility was primarily available through the decennial census. As a result, QCTs most often changed as new economic data became available every ten years. However, the Commerce Department is increasingly utilizing the American Community Survey (ACS) to produce housing and population data annually. In response to annual ACS data, HUD announced it would update eligible census tracts every five years. However, when comparing ACS data from the 2006-2010, the 2007-2011, and 2008-2012 surveys, they found some statistical anomalies.

In response, and to avoid making QCT designations on a single, possibly inaccurate data point, HUD announced QCT designations would be made using all three surveys (2006-2010, 2007-2011, and 2008-2012). Now to qualify for HUBZone, census tracts are required to meet the thresholds in at least two ACS surveys. Additionally, HUD is now updating eligible areas with the release of new ACS data annually.

The burden to qualify a specific HUBZone has increased substantially since the program was created. What used to be a potential change in eligibility that would most likely occur every ten years, is now an annual test. Furthermore, requiring areas to qualify under two different ACS surveys means areas that may be close the margins of eligibility are likely to be left behind.

### **Proposed Legislation**

The Council is interested in advancing legislation seeking to make structural improvements to the HUBZone program. Last Congress, H.R. 5250, introduced by Representative Delaney, addressed the need to provide participating companies program certainty by lengthening the redesignation period from three to seven years. Increased time in the program would build the lasting economic benefit for communities that the HUBZone program provides.

Also from last Congress, S. 2838, the Small Business Transforming America's Regions Act of 2016 was passed by the Senate Small Business Committee. S. 2838 lengthened the redesignation period from three to seven years and authorized governors to annually petition SBA to designate one or more NMCs in the governor's state as a HUBZone. The legislation sought to empower governors to further invest in state economic development by seeking to make NMCs HUBZones.

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<sup>22</sup> *ibid.*

## **HUBZone Council Recommendations to Congress**

The Council appreciates Congressional interest in making improvements to the program and would like to offer the following suggestions.

### Program Certainty

#### *HUBZone Application Improvements*

To ensure compliance, SBA certifies all HUBZone companies. While Congress recently changed some of the elements of certification, SBA's timeline to process applications is far too long. This summer, SBA updated HUBZone program regulations to increase the application review period from 30 to 120 days<sup>23</sup>. Requiring over four months to process and application is far too long.

#### *Increase the Redesignation Period.*

To determine program eligibility, SBA uses data from several sources including the decennial Census and the American Community Survey (ACS). While Census data is updated every 10 years, ACS data is updated annually. For certain areas, this means minor changes in economic data can lead a community's eligibility to change annually.

To create better program and business certainty, increasing the current three-year redesignation period to seven years will allow firms to make more substantial, long-term investments without the fear of losing their status before the business has had an opportunity to succeed.

#### *Support Capital Investment of Principal Office*

Many firms make significant capital investments to locate their principal office in a HUBZone, only to face substantial losses when the HUBZone is re-designated. To resolve this issue, the principal office requirement will remain fulfilled, regardless of redesignation, until the firm relocates or no longer meets other requirements of the program (like the employee residency requirement). This will encourage long-term investment by providing business with certainty and investment protection.

#### *Simplify Employee Residency Requirement for Smallest Businesses*

By changing the current 35% threshold to 33%, one in three employees would be required to reside in a HUBZone. In addition to simplifying the calculation for employers, this also helps small firms to ensure they meet their requirements after the unforeseen departure of one employee.

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<sup>23</sup>U.S. Small Business Administration, HUBZone and National Defense Authorization Act for Fiscal Year 2016 Amendments, Direct Final Rule, August 4, 2016. Available at <https://www.federalregister.gov/articles/2016/08/04/2016-18251/hubzone-and-national-defense-authorization-act-for-fiscal-year-2016-amendments>

## Program Modernization

### *Encourage Investment Throughout Entire Metropolitan Areas*

HUD's Low-income Housing Tax Credit (LIHTC) program limits the amount of qualified census tracts in any Metropolitan Statistical Areas (MSA) to no more than 20 percent of the total population of the MSA. Because of this restriction, many disadvantaged communities have not received a HUBZone designation, because they are better off – relatively – than the surrounding area.

Limiting the number of HUBZones only serves to inhibit program growth. In Spring 2016, SBA Administratively removed the 20 percent limitation on all HUBZones and announced that an additional 2,015 census **tracts** now qualify for the program. SBA's removal of this unnecessary barrier will assist countless small businesses who are interested in participating.

### *Increase Participation in Non-Metropolitan Counties (NMC)*

Fewer than expected NMCs qualify for the HUBZone program due to having more burdensome requirements for median income and unemployment than MSAs in metropolitan areas. While rural areas tend to have lower median income and higher unemployment, non-metropolitan counties are not homogenous. Certain county areas may be better off due to the presence of a single employer, like a college, and could cause the county to be ineligible. Therefore, the NMC qualification levels should be lessened to account for the diversity in rural areas.

### *Increase participation of HUBZone Program to include all Federal Agencies and grant programs to improve infrastructure and community development programs*

Currently, HUBZone firms are not included in small business programs allocated to state programs for infrastructure and community development programs.

### *Participation in Overseas Contracts*

For the first time ever, starting this year, SBA will be counting overseas contracts towards the total eligible dollars for small businesses. This change will create more opportunities for businesses at the State Department, DOD and USAID. Many overseas contracts require foreign national participation which significantly impacts firm's ability to maintain 35% since foreign nationals are currently included in 35% employee residency calculation. The Council also looks forward to working with the committee to ensure HUBZone businesses have access to these opportunities, in particular in fulfilling employee residency requirements.

## **Conclusion**

The HUBZone program was created with the intent of moving individuals into meaningful jobs in communities that have suffered from a lack of investment. It is unlike other SBA programs in that the focus is not on the company, but the community. It is an economic development program.

Since its inception, the program has underperformed. While Congress has addressed expansions of the program to certain places, it has been more than fifteen years since changes were made to the primary program structure. In order for the HUBZone program to reach its full potential as outlined in 1997, the program needs to be modernized. The Council listed a number of proposals in this testimony and is open to working with the Committee on other ideas.

The HUBZone Council strives to contribute to the economic development of disadvantaged communities by reducing unemployment and homelessness and by strengthening, improving, and promoting the HUBZone Program. We would like to thank the committee for their support of our efforts and the efforts of all small businesses seeking to do work for the federal government.