Bloomberg BNA

Federal Contracts Report™

HUBZone Program

This article examines the challenges facing the HUBZone program and offers several recommendations to revitalize the program by updating requirements that have gone largely unchanged since 1997. Recommended changes to the HUBZone law and regulations would maintain the program's integrity while providing more business certainty and removing unnecessary obstacles. With such changes, the HUBZone program will be better equipped to fulfill its potential to extend economic development and job creation to the people and communities most in need.

BNA INSIGHTS: Revitalizing the HUBZone Program

BY JON WILLIAMS AND KATIE FLOOD

Jonathan T. Williams is a Partner with PilieroMazza PLLC in Washington, where he advises contractors on a wide range of government contracting matters and Federal Acquisition Regulation compliance, including the federal procurement programs for small businesses (i.e., the 8(a), HUBZone, Women-Owned Small Business and Service-Disabled Veteran-Owned Small Business programs).

Kathryn V. Flood is an Associate with PilieroMazza PLLC in Washington. She advises contractors on a wide range of government contracting matters and compliance with the FAR, including the federal procurement programs for small businesses.

Nearly 20 years ago, Congress created the HUBZone program in recognition of the need to spur economic development and job creation in underutilized parts of the country.[1] Operated by the Small Business Administration (SBA), the HUBZone program provides certain contracting advantages to small businesses to incentivize those firms to locate and employ people living in historically underutilized business zones, or "HUBZones."[2] As a further incentive, Congress established a 3 percent governmentwide contract spending goal on HUBZone firms.

[1] S. Rep. No. 105-062, Small Business Authorization Act of 1997, at 3 (1997).

[2] HUBZones are "inner cities and rural counties that have low household incomes, high unemployment, and whose communities suffered from a lack of investment." S. Rep. No. 105-062, Small Business Authorization Act of 1997, at 25 (1997).

The early returns for the HUBZone program were promising. Between 1997 and 2009, the federal government made steady progress toward the 3 percent HUBZone spending goal, reaching 2.7 percent in 2009.[3] The program reached a high of 14,000 SBA-certified participants.[4]

In many ways, the early successes are continuing. Federal contracts awarded to HUBZone firms directly support 40,000 jobs every year.[5] On average, HUBZone companies annually compete for and win more than $1 million in federal contracts, providing critical revenue streams to these small businesses and the HUBZones in which they are located.[6] And of the nearly $7 billion in federal contracts won by HUBZone firms in fiscal 2014, it is estimated that $3.5 billion was reinvested in local HUBZone economies.[7]

Yet, for all its promise, the HUBZone program has been significantly underutilized in recent years. Governmentwide spending on HUBZone contracts has generally declined since 2009, to 1.82 percent in fiscal 2015.[8] Additionally, there are now only approximately 5,500 HUBZone-certified firms.[9] And there are nearly twice as many HUBZone locations today as when Congress created the HUBZone program in 1997.[10] In short, the program is not working as well as it could, at a time when it is needed more than ever.

This article examines the challenges facing the HUBZone program and offers several recommendations to revitalize the program by updating requirements that have gone largely unchanged since 1997. The changes we recommend to the HUBZone law and regulations would maintain the program's integrity while providing more business certainty and removing unnecessary obstacles. With such changes, the HUBZone program will be better equipped to fulfill its potential to extend economic development and job creation to the people and communities most in need.

What Is a HUBZone?

SBA must certify a small business into the HUBZone program based on several eligibility criteria, chief of which are the need for the firm to have its principal office located in a HUBZone and 35 percent of its employees living in a HUBZone.[11] The HUBZone Act of 1997 identified HUBZones as: (1) qualified census tracts, which are determined by area poverty rate or household income[12]; (2) qualified nonmetropolitan counties, which are determined by area unemployment rate or median household income; and (3) lands meeting certain criteria within the boundaries of an Indian reservation.[13] Congress subsequently expanded the criteria for HUBZones to add former military bases and counties in difficult development areas outside the continental U.S.[14] SBA uses economic indicators from several sources, including census data,[15] to determine which areas qualify as HUBZones.[16] Because this economic data fluctuates and is updated frequently, many HUBZone locations are in a state of flux.

HUBZone locations also include ''redesignated areas.'' When new economic data indicates a particular area no longer qualifies as a HUBZone, that area is said to be ''redesignated'' and will retain its HUBZone status for an additional three years.[17] For HUBZone areas redesignated prior to the 2010 census, this grandfathering period lasted until the 2010 census data, or for three years after the area lost its HUBZone status, whichever was later.[18] The grandfathering period was designed to give HUBZone firms time to plan for the consequences when an area lost HUBZone status.

Challenges Facing the HUBZone Program

For most of the small-business contracting programs, fiscal 2015 was a good year. The government met the overall 23 percent spending goal for small businesses and continued its recent trend of exceeding the goals for small disadvantaged businesses and service-disabled veteran-owned small businesses (SD-

[3] FY 2009 Scorecard Summary, SBA.

[4] U.S. Gov't Accountability Office, GAO-15-234, Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight (2015).

[5] The SBA estimates that approximately one job is supported for every $160,000 awarded in government contracts. The HUBZone program received $6.7 billion in contract dollars, which supports about 40,000 jobs. *See* Maria Contreras-Sweet, SBA Fiscal Year 2015 in Review, Oct. 2, 2015 (stating that small businesses received $91.7 billion, supporting 550,000 jobs in the economy).

[6] $1 million per HUBZone participant is an approximate average of the $6.7 billion in contract dollars awarded within the HUBZone program, divided by the 5,500 current participants. *See supra* note 5; *infra* note 9.

[7] American Express reports show that small businesses return an average of 50 percent of their revenues into the local economy. Other studies on local multiplier effects support the 50 percent figure. American Express, The Crucial Role Small Businesses Play in Their Communities, Oct. 28, 2014 (reporting that small businesses returned, on average, 52 percent of their revenues to the local economy).

[8] FY 2015 Scorecard Summary, SBA.

[9] On March 7, there were 5,533 certified HUBZone small businesses. Robert Jay Dilger, Cong. Research Serv., R41268, Small Business Administration HUBZone Program (2016).

[10] U.S. Gov't Accountability Office, GAO-16-423R, HUBZone Program: Actions Taken on February 2015 GAO Recommendations (2016).

[11] These and the other HUBZone eligibility criteria are found in 13 C.F.R. § 126.200.

[12] Qualified census tracts are designated by the Secretary of the Department of Housing and Urban Development for the Low-Income Housing Tax Credit program.

[13] HUBZone Act of 1997 (Title VI of the Small Business Reauthorization Act of 1997, Pub. L. No. 105-135).

[14] Difficult development areas have high construction, land and utility costs relative to area median income. The areas are designated annually using a process that compares these costs. Consolidated Appropriations Act, 2005 Pub. L. No. 108-447, Div. K, § 152, 118 Stat. 3456-58 (2004), and Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, § 10203, 119 Stat. 1933-34 (2005).

[15] *See* 15 U.S.C. § 632(p)(4). ''Qualified census tracts'' have the same definition as provided in 26 U.S.C. § 42(d)(5)(C)(ii), which relies on designations made by the U.S. Department of Housing and Urban Development, based on census data available on household income for the census tract. ''Qualified nonmetropolitan counties'' are based on statistics taken from the most recent census for purposes of selecting qualified census tracts.

[16] SBA maintains a HUBZone map website that tracks the current and redesignated HUBZone locations. When a street address is entered, the HUBZone map website will indicate whether the address qualifies for the HUBZone program.

[17] 15 U.S.C. § 632(p)(4)(C).

[18] *Id.*

VOSBs).[19] For the first time, the government also met the 5 percent goal for women-owned small businesses (WOSBs).[20] But HUBZone spending declined again and was well short of 3 percent, a goal the program has never met.[21]

Clearly, the rising tide of small-business spending is not lifting all boats. So why is the HUBZone program falling behind the other small-business programs? For one thing, the fluidity of HUBZone boundaries makes it difficult for small businesses to plan for and maintain compliance with the program requirements.

This was especially true in the aftermath of the 2010 census, which was an extinction-level event for thousands of HUBZone firms. As the new economic data came in from the 2010 census, many HUBZone boundaries were redrawn. In addition, many previously redesignated areas were set to expire from redesignated status as of the 2010 census.[22] Together, the new economic data and the expiration of previously redesignated areas caused the elimination of many HUBZones and mass exodus from the program.[23]

Around the same time as the 2010 census, Congress passed the Small Business Jobs Act of 2010 (Jobs Act).[24] The Jobs Act changed the text of the Small Business Act to make clear that contracting officers may use the HUBZone program or the other small-business contracting programs if the set-aside criteria are met. Prior to passage of the Jobs Act, the Government Accountability Office and the U.S. Court of Federal Claims had found that the Small Business Act required agencies to first consider HUBZone set-asides before any other type of small-business contract.[25] Congress changed the law via the Jobs Act to ensure parity between the HUBZone program and the other small-business procurement programs.

However, the HUBZone program has not enjoyed true parity with the other small-business programs because of several unique aspects of its requirements. For example, it is the only small-business program that depends on the residency of the small businesses' workforce. While the HUBZone residency requirement makes perfect sense in light of the program's goal to spur job creation in certain areas, setting the requirement at 35 percent is overly burdensome.

In almost all cases, 35 percent of a company's workforce will result in a decimal number, which requires firms to round up.[26] As a result, the effective requirement is often higher than 35 percent, and tracking the number of employees necessary to maintain compliance can be difficult.

Additionally, there are several ways in which the HUBZone rules differ from analogous rules applicable to the other small-businesses programs. Unlike all other small-business programs, HUBZone firms must meet the eligibility requirements at the time of proposal submission and at the time of award.[27]

While SBA judges a firm's total number of employees over 12 months for other small-business programs, the HUBZone program measures employees based only on the most recent four-week period.[28] Other small businesses can joint venture with any small business, whereas HUBZone firms may only joint venture with other HUBZone firms.[29] And only HUBZone firms lack the ability to seek review of a HUBZone denial or protest ruling at SBA's Office of Hearings and Appeals (OHA).

Improving the HUBZone Requirements

Part of the challenge facing the HUBZone program is how it addresses changing circumstances. The program is designed to help areas most in need, and those locations necessarily will evolve over time based on economic conditions. That evolution will drive firms from the program as previous HUBZones develop and no longer qualify for the program.

Even with this inherent fluidity, however, the program can still provide more certainty to participants to encourage greater and longer-term investments in these underutilized areas. Currently, if a HUBZone boundary changes, HUBZone firms in that area are forced within a few years to choose between uprooting their business or withdrawing from the program. It is asking a lot of small businesses that they be willing to invest in an underutilized area with the significant risk that the rug will be pulled out from under them in a few short years if the HUBZone map changes.

The HUBZone program would promote more sustained economic development if the HUBZone requirements promoted more sustained small-business participation in the program. To accomplish this goal, we recommend below several changes to the HUBZone provisions in the Small Business Act and the HUBZone regulations. The proposed changes would simplify the requirements and remove unnecessary burdens, making compliance easier to achieve and monitor. The proposed changes would also put the HUBZone requirements more on par with the other set-aside programs, making the HUBZone program a more attractive option for agencies in their set-aside decisions.

Extend the Redesignation Period from Three to Seven Years: Congress recently took a positive first step to provide greater certainty and continuity for HUBZone contractors and federal agencies by proposing to extend the redesignation grandfathering period from three to seven years.[30] With a seven-year grace period, small businesses will be more confident in making invest-

[19] FY 2015 Scorecard Summary, SBA.

[20] *Id.*

[21] *Id.*

[22] SBA, FY2014 Congressional Budget Justification and FY2012 Annual Performance Report 43.

[23] It was estimated that almost one-third of HUBZone firms were eliminated from the program based on the 2010 census.

[24] Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504 (codified at 15 U.S.C. § 657a).

[25] *See Mission Critical Solutions*, B-401057 (May 4, 2009); *Mission Critical Solutions v. United States*, 91 Fed. Cl. 386 (2010).

[26] 13 C.F.R. § 126.200(b)(4).

[27] 13 C.F.R. § 126.601(c).

[28] 13 C.F.R. § 126.103 defines an "employee" for purposes of the HUBZone program as "all individuals employed on a full-time, part-time, or other basis, so long as that individual works a minimum of 40 hours per month." In practice, when SBA assesses a firm's employees for compliance with the HUBZone eligibility criteria, the agency asks the firm to provide its payroll records for the four weeks immediately prior to the eligibility date.

[29] 13 C.F.R. § 126.616.

[30] Small Business Transforming America's Regions Act of 2016, S. 2838 (Apr. 21, 2016). The bill would amend the redesignated area provisions in the Small Business Act to remove an outdated reference to the 2010 census and to increase the redesignation period to seven years. *See also* Growing and Re-

ments in a HUBZone knowing they could have at least that long to reap the benefits of their investment and to plan for the consequences if the area no longer qualifies as a HUBZone in the future. This should also enhance agencies' confidence that a preferred contractor performing a HUBZone project today can remain eligible for a future HUBZone recompete. For these reasons, extending the redesignation period to seven years is a welcome proposal and one we hope will be enacted this year.

Support Capital Investments in Principal Offices Located in HUBZones: Although extending the redesignation period to seven years is a good start, we would like to see Congress provide even more stability for HUBZone small businesses that make significant capital investments in their HUBZone principal office. Even with a seven-year redesignation period, many firms will still be faced with the decision to move their principal office out of a redesignated area or leave the HUBZone program. A system that encourages firms to be nomadic, rather than set down economic roots in one location, is set up to fall short of the broader objective to generate sustained economic development in underutilized areas.

To ensure the improvements in a redesignated area will last, the program should only require HUBZone firms to satisfy the principal office requirement at the time of their initial HUBZone certification and if the firm later moves its principal office.[31] When a small business makes a significant investment to locate its principal office in a HUBZone, the firm has made a real contribution toward the core mission of the program; such firms should not be penalized and forced to move if the area they invested in later loses its HUBZone eligibility. In fact, the location's loss of HUBZone eligibility may be due, in part, to the small business' decision to invest there. As such, the program should reward the small business for its investment by allowing the firm to continue benefiting from the program, even if its principal office location subsequently loses HUBZone status, assuming the firm continues to meet all other HUBZone eligibility criteria.

Change the HUBZone Employee Residency Requirement to 33.33 Percent: The 35 percent HUBZone residency requirement is typically the most difficult requirement for small businesses to manage while they participate in the program. To satisfy the requirement, 35 percent of the firm's employees must live in a HUBZone.[32] This may sound simple enough at first, but it often is not in practice. Employees come and go and move on a regular basis. Plus, in almost all cases, 35 percent will not result in an even number of employees, meaning the firm has to round up the requirement and meet a residency requirement that is greater than 35 percent. These variables present real challenges for small-business owners in maintaining HUBZone compliance.

While such oversight cannot be avoided, it can be made more simplistic and easier to track. To this end, a minor change in the HUBZone residency requirement from 35 percent to 33.33 percent would have a major positive effect. Under the current residency requirement, the average firm with six employees would need to have 2.1 employees (**i.e.**, 35 percent of six) living in a HUBZone. Rounding up, this firm would actually need three out of six employees living in a HUBZone, effectively (and unfairly) increasing the HUBZone residency requirement to 50 percent. But with a simple one-third requirement, the firm would qualify with two employees living in a HUBZone. Therefore, amending the Small Business Act to change the residency requirement from 35 percent to 33.33 percent would greatly improve the simplicity, fairness and certainty of the requirement without appreciably lowering the standard.

Require HUBZone Eligibility on the Proposal Date Only: Unlike the other small-business programs, SBA rules require HUBZone firms to meet the HUBZone eligibility criteria on the date of proposal submission and the date of award.[33] SBA should simplify this rule and make it consistent with the other small-business programs by requiring HUBZone firms to be eligible on the proposal date only. Because SBA created the award-date eligibility requirement by regulation,[34] SBA can implement this change by rulemaking without having to amend the Small Business Act.

From the standpoint of avoiding fraud and abuse, it is understandable to want to ensure that a HUBZone-eligible bidder is also eligible on the date of award. However, the award-date eligibility requirement is especially difficult for HUBZone firms given the unique nature of the HUBZone requirements.

A HUBZone firm can plan to ensure its workforce eligibility as of a proposal date, because the proposal date is known. But award dates are generally unknown, making HUBZone firms extremely vulnerable to an unexpected employee termination that could occur on the eve of an award. And HUBZone firms cannot control how long an agency takes to make an award, either. This makes it difficult to know whether to bid when a firm is approaching a seasonal change in workforce or if its principal office is located in a redesignated HUBZone that could expire between the proposal date and the award.

Furthermore, SBA has several other rules in place to prevent fraud, including HUBZone protests, surprise inspections and eligibility reviews, and the requirement placed on all HUBZone-certified firms to notify SBA immediately upon any material change in HUBZone eligibility.[35] The other small-business program rules have the right approach in their focus on compliance only as of the proposal date. This balances program integrity with the need to provide certainty to small businesses when the small business decides whether to commit its limited resources to a proposal effort. The same cer-

---

viving Rural Economies Through Transitioning HUBZone Redesignation Act of 2016, H.R. 5250 (May 16, 2016) (same).

[31] The term ''principal office'' is not specifically defined by statute. Instead, the statute states that a HUBZone small business must have its principal office ''located in a HUBZone.'' 15 U.S.C. § 632(p)(5). To give small businesses more certainty and reward for investments in HUBZones, Congress could change the text to read that a principal office must be located in a HUBZone ''at the time of the firm's initial application to the HUBZone program, and thereafter only if the HUBZone small business moves its initial principal office location.''

[32] 13 C.F.R. § § 126.103, 126.200(b)(4).

[33] *Compare* 13 C.F.R. § 126.601(c) *with* 13 C.F.R. § § 121.404(a), 127.300(c).

[34] 69 Fed. Reg. 29,411 (May 24, 2004).

[35] *See* 13 C.F.R. § § 126.800 *et seq.* (HUBZone status protests); 126.401 (program examinations); 126.501 (notice of material change in program eligibility).

   ISSN 0014-9063

tainty should be afforded to HUBZone firms in their bid/no-bid decisions.

Requiring award-date eligibility for HUBZone contracts is also problematic for agencies. Agencies undoubtedly have less confidence that a HUBZone contract will survive protest because there are twice as many required eligibility dates, and there could be many months (if not a year) between the proposal and award dates. The reduced certainty compared to the other small-business programs makes the HUBZone program less attractive when agencies make their set-aside decisions.

Judge HUBZone employees based on a 12-month average: When examining a firm's employees for HUBZone compliance, SBA looks at payroll records for the firm's most recent four-week period. Four weeks is not a big enough sample set to constitute a fair measuring stick of HUBZone eligibility. Employees can quit with little or no notice to their employer, and hiring a replacement is often time-consuming, particularly for small businesses. Therefore, a firm may have done an excellent job of employing at least 35 percent HUBZone residents all year, only to see the number dip below 35 percent because of an unexpected employee departure in one month.

SBA's focus on four weeks also exacerbates the difficulty that HUBZone firms face in attempting to ensure that they are eligible on a contract award date. As noted above, the contract award date is typically unknown, making it nearly impossible for HUBZone firms to plan with certainty for their eligibility as of the precise award date. And when you add the fact that eligibility as of the unknown award date will be judged based only on the four weeks immediately prior to that unknown date, you have a situation that is difficult to manage for HUBZone firms. The lack of certainty surely affects agencies in terms of their confidence in and willingness to utilize the program.

Additionally, the four-week measuring period is more susceptible to fraud. Firms can simply hire the necessary number of part-time personnel immediately prior to an eligibility date to ensure that they are eligible during that brief snapshot in time. This does not serve the purpose of the HUBZone program, which seeks sustained economic development and job creation.

SBA should adopt a broader measurement of employees over the immediately preceding 12 months, similar to how SBA judges employees for small-business status.[36] The 12-month lookback is a more reasonable sample size to gauge HUBZone compliance. Twelve months would also give legitimate HUBZone firms more certainty in managing their compliance because they would be less vulnerable to a surprise employee departure in one month. The 12-month measurement would also make it more difficult for less scrupulous firms to game the system with short-term hires.

The Small Business Act does not require SBA to judge HUBZone compliance over the most recent four-week period, so SBA could adopt the 12-month measurement simply through a change to its regulations.[37] Such a change would bring added certainty and promote the integrity of the program.

Other Suggested Changes

Additional regulatory improvements would further revitalize the HUBZone program. One fix is already in the works to allow HUBZone firms to joint venture with non-HUBZone firms.[38] The new rule for HUBZone joint ventures is expected to be implemented this year and is a welcome change to make this valuable contracting tool more accessible for HUBZone firms. This change should also further increase the attractiveness of HUBZone set-asides to contracting agencies.

Congress and SBA should also explore ways to encourage contracting agencies to use HUBZone set-aside procedures and obtain HUBZone spending credit for contracts that will be performed largely, if not entirely, in a HUBZone. Contract performance in a HUBZone can drive economic benefit to that area. Thus, incentivizing and crediting agencies for such contracts makes sense as another way to further the objectives of the program.

Lastly, we recommend giving OHA jurisdiction to hear appeals of HUBZone protest decisions and application denials. OHA has jurisdiction over small-business, 8(a), WOSB and SDVOSB matters, but not HUBZone.[39] OHA review of HUBZone protests and application denials would improve program oversight, develop publicly available interpretations of the HUBZone requirements, and help achieve parity between the HUBZone rules and the rules for the other small-business programs.

Conclusion

The HUBZone program continues to have an important role to play in our economy and among the federal small-business contracting programs because it is uniquely positioned to spur investments and jobs in areas where they are needed most. More businesses and federal agencies would be incentivized to use the HUBZone program if the requirements are updated to provide greater certainty, simplicity and parity with the other small-business programs. Therefore, Congress and SBA should take the steps outlined above to revitalize the HUBZone program so it can realize its full potential.

---

[36] 13 C.F.R. § 121.106(a)(1).

[37] SBA could modify the current definition of ''employee'' in the HUBZone rules to state that ''[e]mployee means all individuals employed on a full-time, part-time, or other basis, so long as that individual works a minimum of 40 hours per month, *on average over the preceding completed 12 calendar months*.'' *See* 13 C.F.R. § 126.103 (emphasis on suggested additional language).

[38] 80 Fed. Reg. 6641-42 (proposed Feb. 5, 2015) (to be codified at 13 C.F.R. § 126.616).

[39] 13 C.F.R. § 134.102.