



U.S. Department of Housing and Urban Development

Community Planning and Development

Special Attention of:

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All Regional Administrators

All Regional Directors for CPD

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All CDBG Grantees

Cross References

Subject: Policy Guidance on Using CDBG Funds for Small Business Incubators.

Incubators which offer both space and assistance to businesses are quickly gaining in popularity, especially in smaller communities. If such a facility is planned, executed and operated by experts, an incubator can be very effective in promoting and developing small and new businesses where the majority of all jobs in the U.S. are currently being created.

This notice explains how Community Development Block Grant (CDBG) funds can be used for the development and operation of an incubator, or for an individual business housed within an incubator. This guidance applies to the Entitlement CDBG program, the State CDBG program, and the Section 108 Loan Grantee program. The portion of this guidance that describes how to meet the national objective of benefiting low –and moderate-income persons through job creation will likely be applicable to most of the assisted activities, yet this is the most complex part of the guidance. Accordingly, prior to the provision of assistance, the feasibility of the incubator and the ability of the CDBG recipient to meet all of the program requirements should be carefully analyzed. ~~Furthermore, a necessary or appropriate determination is required whenever assistance is provided to a developer or operator of a for-profit incubator, or to a for-profit business within an incubator.~~

Although it is recognized that CDBG funds have been used to assist some incubators for several years, this guidance will apply only to those activities for which CDBG funds were first obligated on or after May 29, 1988 (i.e., 30 days after this guidance was originally provided). Incubator activities that were funded before this time should continue to comply with prior guidance disseminated by HUD. ~~This notice should be used in conjunction with the two memoranda from Jack R. Stokvis on economic development activities dated May 19, 1987 and June 2, 1987.~~

Policy Guidance for
Using CDBG Funds for Small Business Incubators

Incubators are multi-tenant buildings that provide affordable, flexible space along with a variety of office and professional services typically to small and/or new businesses. Incubators are different from other types of commercial and industrial facilities in that their purpose is to create an atmosphere conducive to the creation and growth of fledgling businesses. Incubators can be either for-profit or non-profit, and their developers typically focus on either generating a financial profit or new jobs.

CDBG funds can be provided either to the developer or operator of an incubator, or to one or more of the businesses located within the incubator, as long as the activity is eligible and meets one of the program's national objectives. ~~The guidance provided here should be used in conjunction with the two CDBG memoranda on economic development dated May 19, 1987 and June 2, 1987.~~

Examples of Eligible Activities

A wide range of activities that pertain to the development and operation of an incubator or to a business within an incubator are eligible for CDBG funding. Examples of these types of activities are listed below within citations to the CDBG regulations at 24 CFR Part 570, Subpart C:

- acquisition of land and buildings for an incubator (570.201(a); 570.203(a,b)),
- architectural, engineering and design costs for construction or rehabilitation of an incubator (570.201(c); 570.202; 570.203(a,b)),
- construction of a new incubator (570.201(c); 570.203(a,b)),
- demolition of existing buildings to clear land for an incubator (570.201(b); 570.203(a,b)),
- rehabilitation, preservation, or renovation of existing buildings for use as incubators (570.201(c); 570.202(b,d,e); 570.203(a,b)),
- public improvements integral to an incubator including curbs, gutters, water/sewer improvements, street improvements, and lighting (570.201(c)),

- development of feasibility studies, business assistance strategies, market assessments, and tenant selection plans either for a specific business (570.203(b)), or as part of the grantee's incubator project plans (570.205(a)(4)(iii)),
- operational costs, such as utilities and maintenance, and equipment for an incubator or a business within the incubator (570.203(b)),
- technical assistance (570.203(b)).

~~Prior to the provision of CDBG funded financial or technical assistance to a for-profit business for economic development activities, the grantee must carry out a "necessary or appropriate" determination to which the amount of assistance relative to the needs of the business and the public benefit to be gained is considered (570.203(b)).~~

Documenting Eligibility

~~Documentation must be maintained verifying that each assisted activity is eligible; this includes maintaining records for each "necessary or appropriate" determination showing an analysis of the business' need for assistance as well as the public benefit factors considered in making the decision that assistance is necessary or appropriate.~~

Meeting a National Objective

To qualify for CDBG funding, each assisted activity must meet one of the national objectives of the CDBG program. Assistance for the development and operation of an incubator or to a business within an incubator must either benefit low-and moderate-income persons, or prevent or eliminate slums or blight (24 CFR Part 570.208(a,b)). Because of the nature and function of incubators and the businesses within them, it is highly unlikely that an activity would ever meet the urgent needs objective.

1. Low-and moderate-income persons benefit objective: As with any other business assistance, this objective may be met either by the creation/retention of jobs, or by the provision of services to an area containing a sufficient concentration of low-and moderate-income residents.

When CDBG assistance is provided directly to an individual business in an incubator, each such business must meet the objective independently from the other business in the incubator.

When assistance is provided to a developer or operator of an incubator, compliance with the jobs creation/retention requirement can be met by aggregating the jobs created by the businesses occupying the incubator, as described below:

Business “occupying the incubator are:

- those businesses that occupy space in the incubator at the time the CDBG assistance is provided,

PLUS

- any other firms that move into the incubator after the assistance has been provided until enough firms are included in this count so that the total amount of space these firms occupy (or occupied) is equal to the total square footage of space in the incubator.

Count the jobs created by each of the businesses described above as follows:

- for those businesses already housed in the facility when the assistance is provided, count the jobs created for three years from the date of the assistance OR until the business moves to of the incubator, whichever comes first.
- for those businesses that enter the facility subsequent to the time of the provision of assistance, count the jobs created over a three year period from the date of their initial occupancy OR until the business moves out of the incubator, whichever comes first.

In counting jobs, include any jobs created or retained by the incubator and the business, but exclude any positions held by the business owners and any other having a substantial equity in the business.

To help ensure that each business fulfills its responsibilities for meeting its share of the low/mod job requirements and for maintaining the necessary records and providing periodic reports, the agreement between the operator of the incubator and the business must specify these requirements. In addition, the agreement should describe the financial penalties or lease termination if the requirements are not met.

2. Under the slums/blight objective, the assistance may be for the development of an incubator facility:

Which is or will be in a slum or blighted area, if the assistance is for an activity which addresses at least one of the conditions which qualified the area as such (e.g., rehabilitation of a blighted building), or

Located outside of a slum or blighted area, if the assistance is for demolition, rehabilitation, or historic preservation designed to eliminate specific conditions of blight or physical decay on a spot basis. Under this criterion, rehabilitation is limited to the extent necessary to eliminate specific conditions of blight or physical decay on a spot basis. Under this criterion, rehabilitation is limited to the extent necessary to eliminate specific conditions detrimental to the public health and safety. Relocation and property acquisition activities may also be assisted if they are an integral part of the demolition, rehabilitation or historic preservation activities.

Documentation on Meeting National Objectives

Grantees are required to maintain documentation demonstrating that each activity assisted with CDBG meets one of the national objectives:

- Low/Mod Jobs Benefit: When CDBG assistance is to be provided to a business on the basis of low/mod job creation/retention, the grantee must enter into a written agreement with the business prior to the provision of assistance to ensure that adequate documentation will be maintained to show the number and types of jobs created (both projected and actual), what hiring process was used, which low- and moderate-income persons were interviewed for which jobs, and which of the low- and moderate-income interviewees were hired.

A “first source” hiring agreement can be incorporated in the standard lease with each assisted business. These agreements obligate the business to go to a state, county or local government agency, or an ~~Jobs Training Partnership Act (JTPA)~~ entity first when new jobs become available, and to give serious consideration to hiring low- and moderate income-applicants referred by such entities. The assisted business should be required to maintain documentation on which these referrals were interviewed, whether or not they were interviewed, whether or not they were offered a job, and which accepted a job with the business.

- Low/Mod Area Benefit: Documentation must identify the service area of the activity and show that the required percentage of the residents of this area are of low and moderate income. When CDBG assistance is provided to an individual business, these records must be maintained only for that business’ business. When assistance is provided to the operator of the incubator, records documenting compliance with this benefit objective must be maintained for each firm occupying

the incubator until enough firms have been included to equal the total square footage of space in the incubator.

- Area Slums/Blight Objective: The documentation that is required to show that this objective has been met include a designation of the boundaries of the area, a description of the conditions which qualified that area at the time of its designation, identification of the factors that qualified it under the state or local law (including the applicable citation), and the way in which the assisted activity addresses one or more of the conditions which qualified the area as slum or blighted.
- Spot Slums/Blight Objective: The records to be maintained to show how this objective has been met are: (1) A description of the specific condition of blight or physical decay that was treated; (2) For rehabilitation carried out under this category, a description of the specific conditions detrimental to public health and safety which were corrected, and (3) Details and scope of the CDBG assisted rehabilitation, by structure.