THE AMERICAN INSTITUTE OF ARCHITECTS

"Sizing Up Small Business: SBA's Failure to Implement Congressional Direction"

Statement of Ronald M. Reim, AIA

On Behalf of the American Institute of Architects

United States House of Representatives
Committee on Small Business
Subcommittee on Contracting and Workforce
June 4, 2015

Introduction

Chairman Hanna, Ranking Member Takei, and members of the Subcommittee, thank you for the opportunity to testify today on behalf of my firm and the American Institute of Architects (AIA) on the critical issue of the Small Business Administration's (SBA) size standards.

My name is Ronald M. Reim, AIA. I am the Executive Vice President and a founding principal of Oculus Inc., a full service architectural, strategic facility planning, interior design, and move management firm with offices in St. Louis, Missouri, and Dallas, Texas. In addition to serving these communities, we work with a number of federal agencies on a wide array of projects. Our firm did our first federal design work as a team member on a design-build project for the Internal Revenue Service (IRS) in 1995.

Since the height of the economic crisis in 2008, our nation has made tremendous strides towards full recovery, a testament to the resilience of the American economy and its workforce. But, as members of this Committee have seen firsthand, small businesses like mine were particularly devastated by the downturn and are still feeling those effects today. As such, we are grateful for the assistance and resources provided by the SBA.

Our designation as a small architectural practice has helped our company bridge into more complex, interesting, and meaningful projects. We have leveraged our federal experience back to our private sector work. Our government IDIQ contracts have provided exposure in a leadership/management role on more complex projects, different project types, and in different roles. We have excelled at this, built expertise, and worked diligently to expand our capabilities.

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However, we remain deeply concerned about the harsh consequences that changes to size standards would yield for Oculus and the majority of AIA members and their businesses.

The Architectural Profession and the Recession

Architects, overwhelmingly, are small businesspeople. With more than 95 percent of architecture firms in the United States employing 50 or fewer people[1] – and many architects working in one- or two-person firms – the profession is a true embodiment of the spirit of small business entrepreneurism.

Hiring an architect leads to employment in other construction-related fields, from engineers and manufacturers, to steel and electrical contractors. Architects are job catalysts, serving as the engine that drives the design and construction industry. We are the concept creators that allow clients to envision what their future project might be like. Often this creative work is the initial starting point for not only construction but activity in many other sectors, including development, real estate, legal, and banking. A study by the George Mason University Center for Regional Analysis found that every $1 million invested in design and construction supports 22 new full-time jobs.[2]

Activity within the design industry is closely correlated with future construction work; that is, when architects are busy, a similar uptick in the construction industry is likely to follow. The AIA Architecture Billings Index (ABI), a diffusion index derived from monthly surveys of AIA member firms, consistently serves as a leading economic indicator of nonresidential construction trends a full year in advance, and demonstrates the integral role that design firms play in the construction industry.

The ABI, unfortunately, also shows that this critical sector of our nation's economy is still very much in the recovery phase. The index tracks moving averages of the work being done at architecture firms across the country, and each month assigns a score that is a comparison to the previous month's figures. A score of 50 indicates no change in billings from the previous month, while numbers above or below that represent a growth or decline in billings. Since its peak decline in late 2008, the ABI has trended upwards, but for the past several years has continued to hover just above or below this "zero growth" baseline.[3]

The data reflects a sentiment shared by me and many of my colleagues in the architectural profession: although we have come a long way since the depths of the financial crisis, we are not out of the woods yet. With small businesses still feeling the ripple effects of the downturn, there is much work that remains to bring the economy back to full strength. Architects are busiest during periods of real growth when there is new development work taking place. Consequently, many saw their workload evaporate during the recession, and are only now just beginning to see it return.

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[1] *The Business of Architecture: 2012 AIA Firm Survey Report*

[2] *Economic Impacts of Commercial Real Estate* (2014 Edition). Stephen Fuller, PhD. Director, Center for Regional Analysis, George Mason University, from: http://www.naiop.org/~/media/Research/Research/Research%20Reports/Economic%20Contributions%20of%20Commercial%20Real%20EstateMedia%20folder/Full%20Report.ashx?la=en

[3] *Designing the Construction Future: Reviewing the Performance and Extending the Applications of the AIA's Architecture Billings Index*. Kermit Baker, Ph.D., Hon. AIA; James Chu; and Jennifer Riskus. The American Institute of Architects, (pp. 13) from: http://www.aia.org/aiaucmp/groups/aia/documents/pdf/aiab102055.pdf

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During the recession our firm was forced to cut staff sharply and reduce compensation across the board to survive. For the most critical six month period, senior staff had their pay reduced by 20 percent, intermediate staff by 10 percent, and junior and support staff by five percent. As soon as we were able, we began working to restore pay. Our employment numbers dropped from a total of 42 to our lowest point of 15. It was nearly two years before we added our first new employee. We have since slowly grown back to our current size of 26 employees.

In fact, early in the recession, our firm was excluded for a year from the small business designation under the previous architectural firm size limits ($4.5 million in annual gross receipts). A significant amount of what pushed us over the limit was pass-through revenue on both our private/commercial projects as well as our federal work.

A number of external factors have already driven up the costs of doing business for the architectural profession as a whole; modifications to the SBA size standards would greatly exacerbate these problems and elevate the challenges we face to an untenable level.

The Effect of SBA Size Standards on Architects

My firm is grateful for the assistance that the SBA has provided, as are firms at which thousands of AIA members get up and go to work each day. Given the vast number of small businesses that are impacted by the SBA's rulemaking changes, significant attention and scrutiny should be paid to any proposed modifications.

Dramatically increasing these standards, an issue that emerged in 2011 when the SBA proposed a radical transformation of the small business definitions, would create ripple effects much like some of those felt in the aftermath of the economic crisis. That year, the SBA released its proposal to lump together architecture and engineering firms and impose a single, massive size standard that would include all but a small percentage of architecture firms in its classification of "small business." The rule would have dramatically increased competition among firms for an ever shrinking pool of available work, and essentially double down on one of the most pernicious aspects of the financial downturn.

Architecture and engineering firms have very different characteristics. While Oculus Inc. does offer different services under the architectural umbrella (architecture, interiors, move management and planning), we are different in many ways from engineering companies, which have much broader swaths of specific expertise and revenue generating ability. In addition, a significantly smaller percentage of revenue flows through engineering practices to outsiders. Consequently, revenue is a much better indicator as to an engineering firm's size than it is to an architectural firm.

Lumping us together with engineers and raising the definition of a small architectural firm would be crippling to our firm, as well as to a multitude of talented emerging practices, essentially forcing them to compete with firms five or even 10 times their size. It would very likely result in the consolidation of architecture practices and a loss of jobs.

In 2011, the AIA testified before the full Committee in opposition of this very change, and hundreds of AIA members expressed similar sentiments to the SBA. Thankfully, the SBA heard those voices and issued a revised size standard for architectural firms that was more in line with reality. The AIA also was pleased to work with the Committee in 2012 to advance legisla-

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tion, the Small Business Protection Act, to ensure that the SBA would not make the same mistake by limiting its ability to lump together disparate industries into a single size standards.

Because the size standard for architectural firms may be revisited in the near future, I am concerned that the lessons of the past might not be heeded. More than nine of every ten architecture firms, Oculus included, are already classified as small businesses. The challenges described here are ones we face on a daily basis, and even moderate changes to SBA definitions could have dire consequences for thousands of firms if an influx of disproportionately larger businesses were suddenly introduced into the marketplace. In other words, changes in the SBA's size standards could significantly worsen an already challenging environment for small businesses in the architectural field.

Substantially raising the size allowance would, for all intents and purposes, eliminate Oculus' ability to compete for federal government work. It would essentially reclassify mid- to large-sized firms as small firms, David would now be classified the same as Goliath, yet competitively they would be very different, resulting in significantly imbalanced competition.

The current size limitation for small firms provides opportunities for truly small businesses to have a legitimate shot at performing federal work and gaining access to restricted set-aside contracts. This allows an emerging firm to gain project experience, grow, and hopefully someday become a truly large company. Mid-to-large firms, who now add small firms to their teams for selective aspects of projects, would no longer have a reason for doing so, as they themselves would fill the role of the "small firm." This would shut the door to even sub-consulting opportunities. In doing so the SBA would all but eliminate the chance of a truly small firm ever gaining the requisite experience and qualifications necessary to compete for and win a federal project.

Had the proposed 2011 size standard been put into place, my firm, and many others, would still be operating today in a very unbalanced, inequitable environment, being forced to compete with much larger firms for small business set-asides. Most likely, we would make little attempt to grow and develop our expertise to even compete for these projects. Valuable experience, training, and developmental benefits would be lost, and the number of large firms performing the work would likely concentrate. The SBA is required to review and adjust size standards only once every five years. Five years of being shut out of the marketplace can be crippling to a small firm, where cash flow and access to finance are a daily struggle.

That is why it is essential that the SBA gets size standards right. It is also why I am pleased that members of this Committee, led by Reps. Mike Bost (R-IL) and Gerry Connolly (D-VA), have introduced H.R. 1429, the Stronger Voice for Small Business Act. This legislation, which has been endorsed by the AIA, would enable small firms to challenge size standards decisions in the SBA's Office of Hearings and Appeals, instead of being forced to go through a lengthy and expensive legal process. I am pleased that the House incorporated this bill into the National Defense Authorization Act, and I hope it can become law this year.

Use of Receipts as a Metric

Related to the issue of size standards is how subcontractor payments are calculated in the net revenue of an architectural firm. In the past, AIA members have stated that over 50 percent of their gross revenue can be attributed to payments that flow through to subcontractors. Those

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payments increase the firm's gross revenue number, but are not part of the firm's revenue; they are a misleading figure and often paint an inaccurate picture of a business' cash inflows.

In many instances, architecture firms merely serve as a "collection point" for revenues, and pass significant portions of that money onto subcontractors rather than actually seeing it go into the business. This can be particularly true when a firm holds an IDIQ contract with a federal agency, as the architecture firm often serves as the point of contact or the "prime" contractor for all other disciplines, even for work or projects that are primarily engineering. On those projects, a substantial percentage of the fees flow through the architecture firm with little to no direct employment, gain, or profit for the firm.

To suggest that a firm is not a small business merely because it "handles" that revenue, however briefly, before using it to pay other firms is unfair. The SBA could easily address this issue by counting only the revenue that accrues to the firm and not the revenue that is passed through to subcontractors, and we ask for the support of this Subcommittee in recommending the implementation of this change.

Another issue that impacts Oculus and thousands of firms is the SBA's use of receipts as a metric for small business designation. Typically, service industries have a net revenue standard, while a small percentage of manufacturing and sales industries have a standard set at number of employees. Although there is the potential to change the architecture standard from receipts to employees, the SBA is not contemplating this, and it would likely take a legislative effort. We would like your support on changing the architectural standard from receipts to employees, so that it will more accurately reflect the nature of the architecture business.

Conclusion

The SBA is an immensely valuable institution that has helped innumerable small businesses thrive, both within the architectural profession and throughout the American economy. The SBA's vast reach, however, means that even minor changes to its policies can have dramatic consequences, chief among them size standard definitions. Therefore, as the SBA conducts its five-year detailed review of these standards, we ask that the SBA follow the letter and intent of the 2012 law, and ensure that any adjustments made reflect current market conditions.

In conclusion, I would like to thank Chairman Hanna, Ranking Member Takei, and the distinguished members of this Subcommittee for giving me the opportunity to testify before you today. The problems we face as small businesspeople are serious, but so is our commitment to leading efforts to rebuild our country. Thank you for your leadership and continued efforts.

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