theCredential

Understanding Stabilization for the Low-Income Housing Tax Credit Program

by Jill Cromartie, HCCP
Managing Director
Simple Asset Management

The definition of stabilization within the LIHTC sector varies depending on one's role in relation to the asset. For developers, stabilization often signifies an equity installment or revenue generated from the project, such as a developer fee. It may also indicate the repayment of a construction loan, thereby eliminating construction interest costs.

For lenders and investors, stabilization generally assumes that the property has:

1. Completed construction,
2. Achieved lease-up,
3. Maintained occupancy at or above 90% for three consecutive months, and
4. Established predictable financial performance that meets or exceeds underwritten assumptions.

While the term “stabilization” may seem universal, its definition and calculation can differ among lenders, syndicators, and investors. Before lease-up begins, it is critical to understand how each stakeholder defines and measures stabilization. Key variations include:

- Debt Service Coverage Ratio (DSCR)
  - Does the property have to meet the minimum DSCR monthly?
  - Will the DSCR be averaged over time?
  - Will the lender calculate the DSCR in-house or will they require Agreed Upon Procedures with a CPA conducting the analysis?
  - Can one-time rental assistance payments be included in the DSCR?
- Occupancy
  - Is there a minimum occupancy threshold or requirement?
  - Will the occupancy be averaged over a specific period?
- Expenses
  - Operating Expenses
    - Which operating expenses are factored into the DSCR calculation?
    - If a full year of operating expenses are not available and the expenses are not annualized, weather and the time of the year could adversely impact the DSCR.

    - Should DSCR calculations be based on actual expenses or the higher of underwritten versus actual expenses?
  - Property Taxes
    - If property taxes remain unpaid, can they be annualized?
    - If a property tax exemption process is not completed by the time of the DSCR review, it may impact the calculation.

Failure to fully comprehend these requirements can lead to delays in stabilization, resulting in financial and operational challenges.

Additionally, it is best to recognize that stabilization usually means a change in the lender, from a construction loan to a permanent loan. The permanent lender's team may need some of the basic property and construction information to develop a full picture of operations.

Recommendations

1. Request source documents from the owner or developer that outline stabilization criteria.
2. Highlight or create an abstract that summarizes the key requirements for stabilization.
3. Engage with the lender's and investor's asset managers to clarify their evaluation methods, especially in cases of differing definitions.
4. Communicate early and often.

Stabilization often represents an operational milestone. Facilitating a timely lease-up while keeping expenses within the budgeted parameters is the best way to keep all parties satisfied.