

# Satisfying the Need for Speed

Bridge loans can be ideal for clients needing access to fast financing

By Jan Brzeski

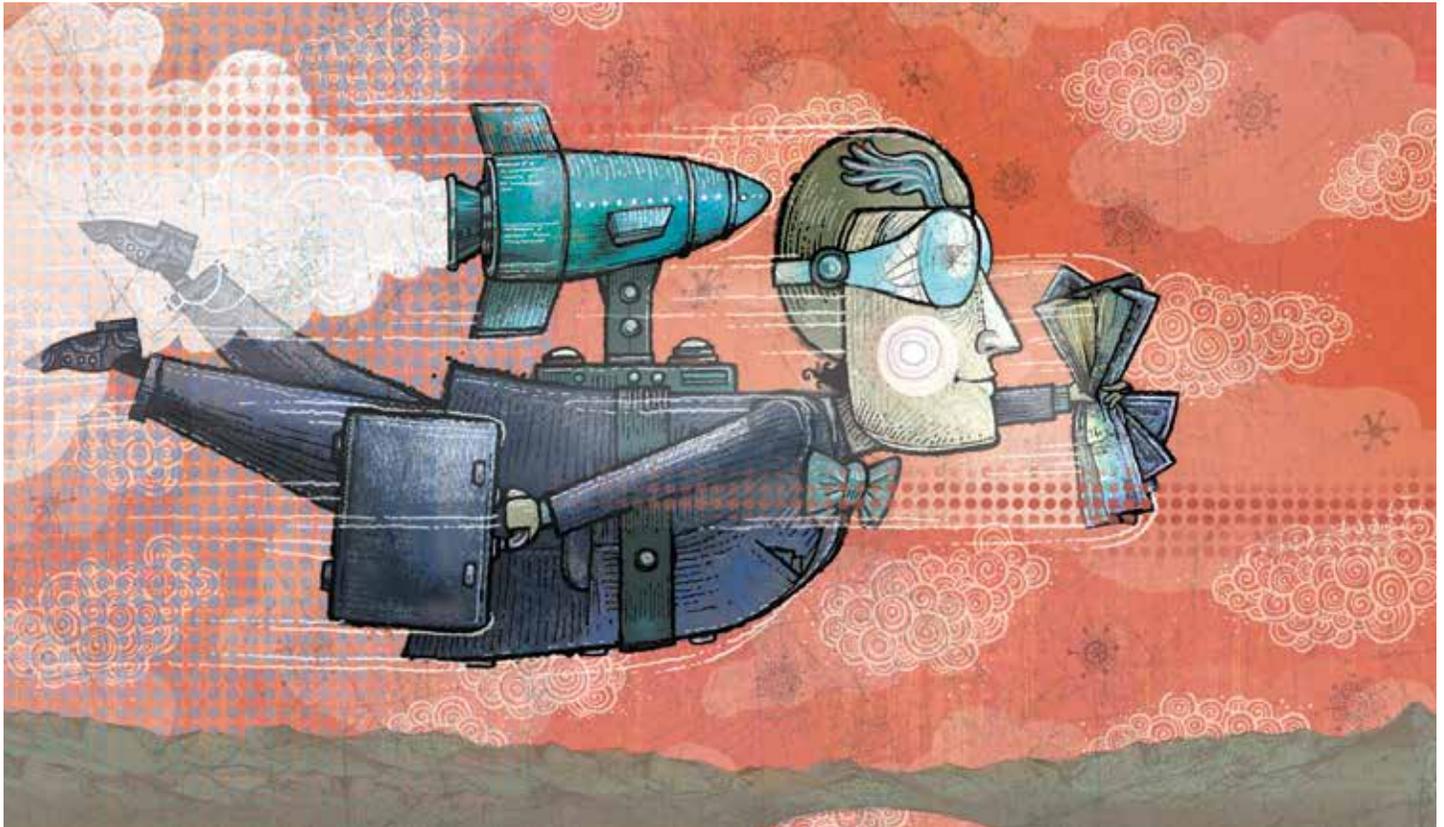


Illustration by Dennis Wunsch

A popular video game, “Need for Speed,” features go-fast cars that cost more than the average automobile. Bridge loans for homebuyers are similar in concept. They cost more than traditional financing, but sometimes it’s worth paying a premium for speed.

In addition, bridge loans can solve problems for homebuyers, mortgage brokers and Realtors. They can provide financing exactly when and where it is needed, without the complexities and time required to close on a conventional loan.

Bridge loans typically carry terms of less than a year. Rates on these loans are higher

than conventional financing rates, and the borrower must have a viable plan to pay off the loan when it matures. Repayment strategies can include selling the home that is being financed, paying off the loan with proceeds from another transaction, or refinancing the bridge loan into a conventional mortgage.

For lenders, bridge loans can be tricky territory. Lenders must have a solid legal understanding about what constitutes a legitimate bridge loan for a homebuyer. After the financial crisis of 2008, federal and state legislators passed a raft of new legislation designed to protect borrowers from

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obtaining loans that were beyond their ability to repay — and to protect taxpayers from costly bank and lender bailouts caused by waves of defaulted loans.

This new legislation was warranted and well-intentioned. Those laws, however, created various unintended consequences — including today's highly regulated market that has made banks extremely cautious about extending loans. Only when every aspect of a loan fits perfectly into the regulatory box will the bank proceed. As a result, the timeframe needed to fund a conventional bank loan today is frequently measured in months rather than weeks. Meanwhile, in the real estate market and everyday life, obtaining funds quickly is often critical. This time pressure creates the need for bridge loans, which can fund quickly and with certainty.

### Case studies

To better illustrate how bridge loans can address the needs of homebuyers, it's worth detailing a few examples that demonstrate how this financing tool can work to the advantage of the borrower.

■ **Example 1:** A homeowner is in the process of selling a valuable home in a prime neighborhood. The home is encumbered by a senior loan of \$1.25 million, and the owner needs to pay about \$1.1 million as part of a negotiated business-settlement agreement with a third party. The home's value is well in excess of \$4 million, and it is already under contract to be sold. The sale, however, has not yet closed and the settlement-payment deadline is imminent. Complicating matters, the borrower's credit is poor.

Based on the equity in the home and a solid validation of the property-purchase transaction, the bridge lender provides a new junior loan with a maturity of just three months. The borrower uses the proceeds to make the required \$1.1 million payment by the deadline — and intends to pay off the new bridge loan once the home sale closes. In this case, the borrower gets the required funds quickly, while the lender receives an

attractive yield — and a fee warranting the effort required to underwrite and fund a short-term loan in less than two weeks.

■ **Example 2:** A borrower recently received a major promotion with greater compensation at her entertainment-industry job, but lacks a solid credit history. She is eager to upgrade from a condominium to a new house, but wants to purchase the home before waiting for the condo to sell. While she can show the lender her employment agreement demonstrating future compensation, her tax returns show a historically lower level of pay.

She obtains a bridge loan that is secured by a blanket mortgage consisting of a first-trust deed on the new house and a junior lien on her condominium. When she sells the condo, the proceeds go to paying down the bridge-loan balance. Subsequently, the owner seeks to refinance into a bank loan. Because the bridge-loan balance is now reduced, and she has some history of earning the new higher pay level, she is able to qualify for a much lower interest rate on the new bank loan, compared to the rate on the bridge loan.

■ **Example 3:** The borrower is a successful real estate investor who has found a home he likes in a desirable market. There is competition for the home, and to ensure his bid will be accepted, he wants to be able to offer a 30-day closing schedule with no financing contingencies. A bridge loan gives him the ability to do so, even though his bank requires more time to fund a mortgage loan.

### Bridge-loan advantages

Experienced and properly capitalized bridge lenders can fund a loan in one to two weeks. Banks usually require six to eight weeks to finalize a mortgage, assuming everything goes smoothly — and this can easily stretch out to several months. One advantage of speed is that, in some cases, homebuyers may be able to negotiate a lower purchase price by offering to close quickly. If a buyer offers to pay 1 to 2 percent less than the asking price for a home, but can close in three weeks with no contingencies — as opposed to a high bidder's eight-week timeframe with a

financing contingency — it might make sense for the seller to accept the lower offer.

In addition to their long loan-closing timelines, banks today often cannot commit to making a mortgage until the moment they are ready to fund it. There always seems to be one more person who needs to review the file, extending the uncertainty. With the best bridge lenders, the person with whom you are working can shake hands confirming the key loan terms and timeline, and you know, absent some major unforeseen issue, your loan will fund on or very close to the agreed-to date.

With bridge loans, the documentation required also is usually less extensive than what a bank seeks. For a bank mortgage, it is not unusual for there to be multiple rounds of documentation and due-diligence requests, with each review having the potential to find some issue with the loan underwriting, which leads to more requests for information.

Bridge loans typically require minimal documentation for investment-property financing in which the borrower is making a large downpayment. The documentation requirements will be more extensive for bridge loans involving owner-occupied homes where the plan to repay the loan involves refinancing into a conventional mortgage. In the latter instance, the bridge lender needs to be comfortable that the borrower will be able to obtain the take-out financing, which requires more underwriting.

### Bridge-loan drawbacks

Bridge loans do not work well in every situation. Among the disadvantages of bridge loans are higher costs and inconsistency in the quality of the lenders.

Bridge loans in California, for example, usually come with high single-digit interest rates, plus an origination fee of 1 to 3 percent of the loan amount, which could add up to double the cost of bank financing, or more. It only makes sense to pay these higher costs in cases where the loan will be paid off relatively quickly.

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In addition, not all bridge lenders are created equal. Some entities that present themselves as bridge lenders might actually be brokers who agree to make a loan without having the money to back it. Borrowers also should be very cautious when asked to pay deposits for bridge loans. Requiring a deposit is actually prohibited by law in the case of most loans for owner-occupied properties, and is a large red flag indicating the lender may not be operating on an aboveboard basis.



Bridge loans have become an important part of the real estate finance landscape. Mortgage originators who understand how to use bridge loans — and who have established relationships with reliable bridge lenders — will be in a position to take advantage of a wider range of opportunities and to overcome unexpected obstacles.

As an originator, it pays to shop for qualified bridge lenders. Meet the key people with these lenders and ask to speak with past clients — preferably clients chosen by you and not individuals preselected by the lender. With speed always at a premium in business and real estate, the best bridge lenders can provide the performance you need, exactly when you need it. ■