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Bridge lenders: what borrowers, brokers need to know

As banks continue the strict underwriting guidelines put in place during the recession, many loans are falling out of these guidelines. If one has a nonbankable loan as a result of either the property or the borrower, there are options available. One option available is a product called a bridge loan.

The premise of a "bridge loan" is to bridge the financing gap for a borrower. These are typically short-term loans anywhere from six months to three years. The idea behind a bridge loan is to provide financing for a borrower to allow time to get into a more conventional product or, in some cases, buy the borrower time to sell the property. Bridge loans have increased in popularity as the downturn in the economy has created many more unique situations for borrowers, including credit issues, tenant issues, etc.

There are many circumstances when a bridge loan is appropriate. Below are the top six reasons we have seen bridge loans utilized.

1. Property/borrower not plain vanilla: Conventional lenders are still funding loans. Their focus is primarily on A paper transactions that are extremely clean. If a transaction is not a plain vanilla transaction, many banks are unwilling to provide financing.

2. Credit issues: As a result of the downturn, many borrowers have minor credit issues. For example, they might have lost a tenant, resulting in reduced cash flow that ultimately led to a late payment on something.

Glen Weinberg
Chief operating officer, Fairview Commercial Lending, Denver

3. Timing: The conventional loan process is very lengthy. Borrowers are required to produce considerable backup information on tax returns, operating statements, environmentals, appraisals, etc. This process can easily take 90-plus days and often considerably more time.

4. Underperforming asset: As a result of the economic downturn, there are a number of properties not performing to their full potential. For example, rental rates on many properties have been reduced in order to keep a tenant or attract a new tenant. When factored into the income approach, this reduced rent can drastically change the property valuation.

5. Discounts: We recently have financed a number of borrowers that had current loans with a bank. These borrowers no longer fit the bank's guidelines and were offered substantial discounts in order to pay off their loans. We have seen discounts from 10 percent to 40 percent.

6. Cheaper than borrowing money other ways: Many times, bridge lending is a cheaper alternative for a small business than other financing methods. As a result of the economy, many businesses have turned to credit cards, inventory/receivables factoring and other methods in order to finance their business needs. These are expensive financing tools when borrowers fall out of traditional bank lending criteria.

One example of a recent commercial bridge loan was for a small-business owner in Denver. A borrower who owned a small retail business approached us. She had a couple of challenging years in 2009 and early 2010 that led to cash-flow issues in her business. She owned the building that housed her retail location free and clear. Even though her business was now profitable, she was unable to get a conventional loan due to the hiccups in 2009 and 2010. The borrower had evaluated other financing options, but needed funds quickly in order to stock up on inventory for the upcoming holiday season. She was able to obtain a two-year bridge loan for the amount needed.

When I did a quick Google search on bridge lenders in Colorado, hundreds of lenders came up. The sheer quantity of lenders was overwhelming. How does a borrower/broker find a legitimate lender? First, try to find a local lender. A local lender will understand the intricacies of the market better than many other lenders. Second, make sure you are actually working with a lender. Does the lender make its own loans and service them? Third, are its upfront fees from the lender? A reasonable fee paid directly to an appraiser or other service provider is normal. Shy away from any lender that asks for a commitment fee prior to closing. Finally, as with any other financial transaction, it is important to recognize a deal that is too good to be true. For example, if a lender/broker states that he can beat a bank even though the borrower's credit is lower than typical bank criteria, it is time to look elsewhere.

Although a bridge loan is more expensive than a traditional bank loan, there are many instances when it is an appropriate financial tool. In the example above, the small-business owner was able to substantially increase her profitability as a result of increased inventory. As a result, the borrower is now in the process of obtaining a U.S. Small Business Administration loan to refinance the bridge lender. Bridge lending in this case helped the borrower bridge the short-term gap in order to become bankable again, which was the original intention of the loan. A bridge loan is a beneficial tool for borrowers when used properly.▲