

Building the Bridge

Understanding how underwriting works for bridge loans could ensure your clients' funding

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THE CURRENT CREDIT CRISIS continues to test mortgage brokers and commercial property investors and owners in numerous ways. Many are finding traditional funding avenues closed when they need financing to acquire or reposition a property.

With this shortage, brokers and their clients may find more success with bridge loans in today's market.



Although bridge-loan underwriting seems to be more art than science, with an understanding of what bridge lenders look for, brokers can determine the viability of specific transactions and assess which properties and situations will qualify for bridge financing.

Bridge loans are designed to meet needs of borrowers who are purchasing or holding properties that are being repositioned, re-tenanted, improved or otherwise redeveloped and who have a clear exit strategy for loan repayment. In the current economic landscape, it is becoming increasingly important for other borrowers, as well. Often, borrowers requiring interest-only periods or seeking quicker closings prefer bridge loans. Borrowers also may use this form of financing for discounted-note purchases, as well as recapitalization and workouts.

Most recently, borrowers with stabilized assets also are using bridge loans to take advantage of opportunities to pay off their existing mortgages at a discount. Although bridge loans are costlier than conventional financing, they let borrowers increase their equity in a property immediately. Borrowers also can improve their long-term cash flow by reducing their leverage.



Typical bridge loans have interest rates from 5 percent to 15 percent, origination fees of 2 points to 4 points and loan-to-value ratios (LTVs) of 60 percent to 75 percent.

They also typically have one- to five-year terms, which may have interest-only portions. They often are priced on a risk-adjusted basis, and pricing will be lower for low-leverage deals with strong sponsors and high-quality assets in performing markets.

Brokers who understand the borrowers' strength — as well as that of the project — and who present the information to a lender coherently and comprehensively will help ensure their clients' funding success.

Know the borrowers

The most critical step in securing a bridge loan for your clients is ensuring you receive the right documentation. If you don't have the information required to understand a transaction fully or to assess its strength, you risk wasting time on a transaction that cannot be funded.

Be sure to review the borrower's strength and experience. The borrower, or sponsor, should have completed projects that are similar to this one in terms of property type, size, scope and location. Lenders typically will not back borrowers unless they have a track record that can provide reasonable assurance for their exit strategy.

If problems occur, sponsors also must have the financial strength to handle them. Get complete personal financial statements for all principals. These should include a detailed breakdown of borrowers' liquid assets, a detailed schedule of the real estate they own, and a list of other assets and liabilities.

The schedule of the real estate that borrowers own should describe each property, including purchase dates and prices, current mortgage balances, monthly mortgage payments, monthly income, and expenses.

In addition, review borrowers' income and credit profiles to determine if they can support their current project load. If they show negative cash flow each year, a drain on their resources could put the project at risk. Do they have any contingent liabilities — such as land lots or unsold condominium projects — that could impact the current project?

Finally, brokers should understand the structure of borrowing entities and the project's key principals.

Know the success factors

Four key factors underpin any project's viability. This is especially true for bridge loans. Projects depend on:

1. **Sponsor or borrower strength**, including background and experience as well as financial standing;

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2. **Leverage**, which means LTV and loan-to-cost or cash equity in deal;

3. **Asset quality and type**; and

4. **Market strength.**

Borrowers' capabilities are one thing; their expectations are something different. Are borrowers willing to contribute substantial cash equity into their deal? If not, move on.

Multifamily and industrial are the two most-favored property types for bridge loans; office and mixed-use follow. Retail and hospitality properties, on the other hand, are increasingly difficult to finance in today's economy because of higher vacancy levels and decreasing asking-lease rates for retail or room rates for hotels.

Multifamily and industrial projects are executed at more-aggressive leverage than office, which can be more highly leveraged than retail and others. Higher-quality assets are more desirable than lesser ones.

When considering market strength, keep in mind that property location will impact pricing and leverage. For instance, an office building in downtown Chicago likely will be financed at better terms than a similar building in Detroit. Apartment buildings in Dallas will attract more-advantageous bridge-financing terms than those in more-overbuilt markets if all other factors are equal.

In fact, some bridge transactions have great difficulty being placed with capital sources

because of their location, despite bridge loans' more flexible nature.

Know the project

Once you understand your borrowers and the keys to their success, examine the proposed project for which they are seeking a bridge loan. Many borrowers provide executive summaries that reflect outdated business plans and pro forma numbers that do not relate to the current situation. Many also request money at terms they know are unavailable.

To avoid any problems here, know your transaction; do not forward out-of-date documentation to the lender without review or comment.

Create a narrative summary of your clients' project timeline, financing expectations and exit strategy. Additionally, your review should include a detailed property description that includes the following:

- **Square footage of improvements;**
- **Lot size;**
- **Number of floors;**
- **As-of-right usage;** and
- **A description of construction materials used in the improvements.**

In addition, be sure to include several color pictures of the property in the loan-request package.

This narrative summary should also include a history of the property and of the project. Describe it in as much detail as possible and summarize all past financing on the project.

In addition, compile a budget that details the entire project costs. This will help to summarize for the lender where the money is coming from to pay for the project costs.

For investment properties, get a current and pro forma rent roll in addition to historical and pro forma income and expense statements. Also include any current purchase agreements, mortgage statements, appraisals, leases, insurance certificates and tax bills in the loan-request package if they are available, as well as any market studies.

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As with conventional financing, it is important to seek the best rates and terms from a variety of bridge-loan sources. Just because these loans typically have more-flexible underwriting criteria does not mean that a specific transaction will be appropriate for every bridge lender.

In today's market, bridge loans are an increasingly important method of financing commercial real estate. Mortgage brokers who invest the time to understand borrowers' loan requests and projects will be able to evaluate projects' viability with common sense — and will better help clients find funding success. **!!!**