



Bridge Loans: Developers' Vehicle of Choice

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The bridge loan is one of the most common real estate-financing vehicles. If you are a real estate developer or investor, you probably have used one. The term originates from its purpose of bridging the gap between two events — typically, acquisition and permanent financing. Bridge loans are used for several purposes, come in many forms and originate from various capital sources for developers.

Uses

Real estate developers and investors use bridge loans to acquire transitional properties, purchase properties to hold for a short time or reposition existing properties. Real estate investors who intend to buy stabilized properties for a long-term hold are better suited with permanent loans. However, most other investors should consider the benefits of bridge-loan financing.

Bridge structure

Bridge loans are not permanent loans — longer-term, fixed-interest-rate loans commonly used for financing stabilized properties. Instead, they tend to be shorter-term, floating-rate financing vehicles. Their terms can be for three months to five years, with most ranging from one to three years in primary terms. Many bridge loans also contain short-term extension options after their primary terms.

Although bridge loans often are considered short-term loans by definition, most in the industry exclude construction loans from the bridge-loan category. Bridge loans might have some construction components, but it is unusual for bridge lenders to offer

many ground-up construction loans. Bridge loans can be recourse, limited recourse or nonrecourse, and they usually don't have any lockout periods or substantial prepayment penalties.

Pricing

Most bridge loans are floating interest-rate loans. Bridge loans typically are indexed to the London Interbank Offered Rate Index (LIBOR) or the prime rate. As an example, a bridge loan could be priced at LIBOR plus 400 basis points or prime plus 1.5 percent, which has been roughly equivalent.

Today's pricing range is wide. Interest rates can be as low as LIBOR plus 200 basis points for stable, high-demand property types and AAA-rated borrowers and tenants. They can be as high as 30 percent for quick-close transactions on C properties. Most bridge loans fall somewhere between the extremes. They also can contain loan fees in addition to the interest rate. Depending on the loan and lender, fees can range from as little as a half-point commitment fee to multiple points upfront and upon exit. Most bridge-loan fees also are somewhere in the middle.

Bridge lenders

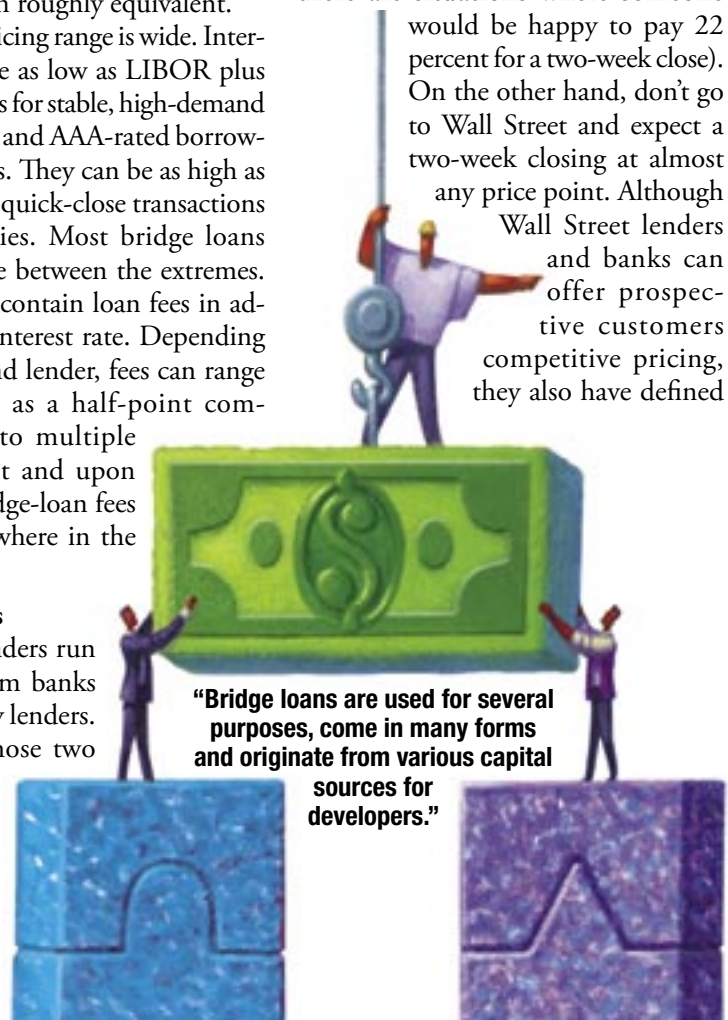
Bridge lenders run the gamut from banks to hard-money lenders. In between those two extremes, you will find credit companies, opportunity funds, Wall Street lenders and other

specialized or broad-based lenders.

All lenders try to match their loan products with the market. For example, many hard-money lenders provide low leverage loans with quick closing capabilities. Don't go to these lenders expecting an 80 percent acquisition loan at LIBOR plus 350 basis points. You might have a better chance if you go to these hard-money providers with a 65-percent-of-cost loan request that you need to close in two weeks and are willing to pay 15 to 22 percent (and there are situations where someone

would be happy to pay 22 percent for a two-week close). On the other hand, don't go to Wall Street and expect a two-week closing at almost any price point. Although

Wall Street lenders and banks can offer prospective customers competitive pricing, they also have defined



bridge-loan parameters and established underwriting bureaucracies. If you fall outside of their respective boxes, you may be out of luck.

Credit companies, as well as opportunity- and bridge-loan funds, usually can provide a wider range of loans, including higher-leverage loans for many property types. These lenders' pricing tends to fall between that of Wall Street and hard-money lenders. Pricing of LIBOR plus 350 basis points to LIBOR plus 1,000 basis points is not out of the question. However, borrowers benefit from the higher leverage and will accept the higher interest rates in exchange for the ability to acquire properties or complete projects with less equity — which can be expensive. There also can be a trade-off between pricing and recourse. Most Wall Street, credit-company and bridge-loan-fund loans are nonrecourse or limited-recourse, as opposed to bank loans, which usually are full-recourse.

Loan examples

■ **Property transitions:** Almost any property transition can be financed with a bridge loan. Borrowers can use it to finance the acquisition of vacant or substantially vacant properties. Their intent is to improve leasing and occupancy and then sell the stabilized property or refinance it into a permanent loan.

Developers can use bridge loans for many types of property transitions. A borrower recently used a high-leverage bridge loan to acquire a boutique hotel that he intended to convert to hotel condominiums. The bridge loan provided more than 85 percent of the acquisition cost of the hotel in a situation where the closest competitive loan quote would have required an additional \$3 million equity investment. The developer successfully pre-sold a substantial number of hotel condominium units and has refinanced the project

with a much larger loan to rehab the property for sale.

■ **Property acquisitions:** Borrowers can use bridge loans to acquire almost every property type, including apartments, office buildings, retail, hospitality, industrial, land and more.

In the past few months, a borrower successfully closed a varied portfolio of industrial properties using a high-leverage bridge loan that provided 80 percent of the more than \$60 million in acquisition costs. A mezzanine loan matched the bridge loan to bring the financing package to 90 percent of cost. The industrial portfolio has been managed and seasoned and now is being refinanced into a permanent loan.

■ **Condominium conversions:** A recent bridge loan was used to acquire and convert an office building into luxury residential condominiums. The transaction cost \$20 million, including closing and rehabilitation costs. The bridge loan provided \$15 million of the required capital, and an investment of more than \$4 million from a boutique mezzanine/equity investor filled the equity gap.

Similar bridge loans helped fund conversion of apartments into residential condominiums.

Bridge loans are useful and necessary financing vehicles that developers can use in quick-close or higher-leverage acquisitions, conversions or transitional situations. Developers should try to work with bridge lenders who have broad desires and flexible loan parameters to help loans fit the projects. With developers routinely achieving bridge-loan financing as high as 90 percent of cost, it appears that bridge-loan financing will continue as the financing vehicle of choice for many real estate developers and investors.

David Ross is senior director of Tremont Realty Capital LLC, a national direct lender and real estate investment-banking firm headquartered in Boston, with offices in Annapolis, Md.; Hartford, Conn.; New York; Chicago; McLean, Va.; and Scottsdale, Ariz. Through its principal and advisory operations, the firm engages in debt and equity placement, direct investment and institutional advisory services. Tremont Realty Advisors also is the manager of the Tremont-GRE Mezzanine Loan Program. Tremont Realty Capital's Boston office is located in the Prudential Tower, 800 Boylston St., suite 401, Boston, MA 02199. Reach it at (617) 867-0700, by fax at (617) 867-0077 or on the Internet at www.tremontcapital.com. Reach Ross at dross@tremontcapital.com. ♦