A guide to alternative bridge lending

Skip Walters of First Source Mortgage Corporation offers a crash course in bridge lending best practices

MARKETS FLUCTUATE, governing parties change, and approvals for land development can take years. Even as interest rates rise and land values remain flat or decline in this market, it's not difficult to understand how commercial bridge lending operates.

A commercial alternative bridge lender lends funds for acquisitions or refinancing purposes on industrial, commercial or residential projects that are being developed or are in the process of ramping up leasing or other forms of cash flow in order to meet the debt service requirements of lower-cost institutional lenders. An alternative bridge loan can also be used for construction financing in the form of draws to complete the project.

Typically, the bridge lender lends money for a short period, usually 12 to 18 months, but sometimes as long as 24 months. These lenders typically require interest-only payments while working toward institutional take-out financing for a much longer term. Simply stated, a bridge loan is a bridge to get to institutional financing. Alternative bridge loans are priced higher than institutional funding, based on the higher perceived risk attributed to the incomplete development or non-stabilized income from the property.

It's important for brokers to know where things stand in bridge lending at this point in time. Interest rates are rising, and land values are flat or even declining in some areas. Homes are not selling for what they did a year ago. Appraisals are based on a direct comparison approach, and most private lenders are extremely cautious about conclusions and who the appraiser is. Too often, the appraisal includes comparable properties that are outdated, and conclusions are largely speculative.

Most alternative and institutional lenders are at their limit with land financing. Unless the subject land is in a populated urban area, the lender can determine from the planner's report that draft plan or site plan approval will be achieved within the term of the mortgage (typically 12 to 18 months) to provide an exit, and the borrower has significant skin in the game, the probability of a land loan approval from an alternative bridge lender is diminished. However, that being said, land loans are being approved, and alternative commercial bridge lenders are closing deals.

How can you better ensure your time is not wasted when you think you want to work on an alternative commercial bridge loan or development financing? First, you should meet with the client directly to better understand their vision and expectations. Try to determine all you can about the asset being either acquired or refinanced.

Ask the right questions. For example, what did the borrower pay for the asset, when was it purchased (get a copy of the APS), and are there any environmental issues? What is the exact size and location of site, and how much of it is developable or what is the process to get to stabilization? Determine what work has been completed since acquisition and how much money has been spent

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and on what specifically.

Does the borrower have a current appraisal? Have they consulted with a planner (if the land is being developed) or completed a feasibility study, if applicable? Does the site currently meet the criteria of the city or township's official plan, or does it need rezoning? Has the borrower met with the city and discussed their plans and timing for approvals? Find out if a pro forma for the project has been completed and review it. Finally, is the borrower requesting a repatriation for any costs spent to date?

Asking the right questions instills confidence. Use this information to better influence client expectations. The questions above represent a short, and certainly not exhaustive, list of information to consider. The answers will provide an important starting point for the lender's underwriting team to assess the risk and viability of the loan. Use this information to draft a short summary, along with a request for the loan amount and term – and don't forget to add the full corporate name and profile of the borrower with the full name of the guarantor and net-worth statement.

You should also comment on the history of the borrower and experience of the guarantor to bolster the likelihood of approval. If you are refinancing a property, you should include details of the existing financing, note why the current lender is to be discharged and give a detailed explanation of the use of funds.

At First Source Mortgage, we insist on meeting all borrowers, even if you have not. We want to hear from the prospective borrower about their vision for the project. Like you, we believe in the necessity of discussing the vision and the feasibility of the project in person with every borrower, as well as inspecting the property. By meeting borrowers in person, you can often flesh out any issues in advance and deal with them immediately rather than when it could be too late. The above due diligence process can kickstart your likely approval, as the information provides a great start for the lender's underwriter.

Once all of this due diligence has been gathered and analyzed, our credit department will then review the underwriter's full report and proceed to our internal approval process. Best practices provide for increased approval and closing ratios, which is what you and your lenders are looking for. CMP

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