What are Bridge Loans?

How do Bridge Loans Work?

By Elizabeth Weintraub

Bridge Loans Are Short Term

Bridge loans are gaining in popularity. When a home buyer is buying another home before selling an existing home, two common ways to find the down payment for the move-up home is through financing either a bridge loan or a home equity loan (or home equity line of credit).

Generally, a home equity loan is less expensive, but bridge loans contain more benefits for some borrowers. In addition, many lenders will not lend on a home equity loan if the home is on the market. Smart borrowers will compare the benefits between the two loans to determine which is a better fit for their particular situation and plan ahead before making an offer to purchase another home.

What Are Bridge Loans?

Bridge loans are temporary loans that bridge the gap between the sales price of a new home and a home buyer's new mortgage, in the event the buyer's home has not yet sold. The bridge loan is secured to the buyer's existing home. The funds from the bridge loan are then used as a down payment on the move-up home.

How Do Bridge Loans Work?

Many lenders do not have set guidelines for FICO minimums nor debt-to-income ratios. Funding is guided by a more "make sense" underwriting approach. The piece of the puzzle that requires guidelines is the long-term financing obtained on the new home.

Some lenders who make conforming loans exclude the bridge loan payment for qualifying purposes. This means the borrower is qualified to buy the move-up home by adding together the existing loan payment, if any, on the buyer's existing home to the new mortgage payment of the move-up home. The reasons many lenders qualify the buyer on two payments are because:

- Most buyers have an existing first mortgage on a present home.
- The buyer will likely close the move-up home purchase before selling an existing residence.
- For a short-term period, the buyer will own two homes.

If the new home mortgage is a conforming loan, lenders have more leeway to accept a higher debt-to-income ratio by running the mortgage loan through an automated underwriting program. If the new home mortgage is a jumbo loan, most lenders will restrict the home buyer to a 50% debt-to-income ratio.

Average Fees for Bridge Loans

Rates will vary among lenders, but following is an average estimate for a bridge loan in California. Interest rates fluctuate, but for this example, let's use 8.5%. This type of bridge loan will carry no payments for four months; however, interest will accrue and be due when the loan is paid upon sale of the property. Here are the fees:

- Administration fee: $750
- Appraisal fee: $375
- Escrow fee: $350
- Title policy fee: $350+
- Notary fee: $40
- Recording fee: $65
- Wire/courier/drawing fee: $75

In addition, there is a loan origination fee on bridge loans based on the amount of the loan. Each point is equal to 1% of the loan amount. Here are average fees. Again, fees will vary.

- $25,000 to $100,000 = .50 points
- $100,000 to $150,000 = .75 points
- $150,000 to $250,000 = 1.0 points

Home Buying Benefits of Bridge Loans

- The buyer can immediately put a home on the market without restrictions.
- Bridge loans may not require monthly payments for a few months.
- If the buyer has made a contingent offer to buy and the seller issues a Notice to Perform, the buyer can remove the contingency to sell and still move forward with the purchase.

Home Buying Drawbacks of Bridge Loans

- Bridge loans cost more than home equity loans.
- Buyers will be qualified by the lender to own two homes and many will not meet this requirement.
- Making two mortgage payments, plus accruing interest on a bridge loan, could cause stress.

Source: http://homebuying.about.com/od/financingadvice/qt/0407BridgeLoans.htm
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