SLATT CAPITAL

BRIDGE LOANS

Commercial real estate bridge loans serve as a valuable financing option for investors by bridging the gap between immediate capital needs and long-term financing solutions. These types of loans are typically utilized in commercial real estate transactions where quick access to capital is needed to fund an acquisition, renovations, or repositioning of an asset.

Bridge loans offer several advantages, including swift access to capital, flexible terms, and a streamlined application process. With bridge loans, investors can capitalize on time-sensitive opportunities without the lengthy approval processes associated with traditional financing. Additionally, bridge loans often allow for more lenient underwriting criteria, making them accessible to a broader range of borrowers and to unconventional properties.

Within bridge financing, the commercial property serves as the collateral for the loan. Lenders assess the property's current market value, its income-generating potential, and the overall condition to determine the loan amount and terms. This asset-based approach allows borrowers with valuable real estate assets to access financing even if they have a non-performing asset. The purpose of being asset based is that in the event of default, the lender can recoup its investment by selling the property or taking possession of the asset - ultimately reducing the lender's exposure to credit risk and increases the likelihood of loan repayment by the borrower.

Now that we have established some background on what a bridge loan is, we can talk about some real estate investment strategies where this loan type comes into play. The most common strategy is value-add, which is a strategy where investors identify opportunities to increase a property's value through targeted improvements, renovations, or operational enhancements. This approach involves acquiring properties that may be underperforming, outdated, or in need of significant upgrades, with the goal of maximizing their potential and generating higher returns on investment. So then how does a bridge loan fit into a value-add strategy? Since investors target underperforming or dilapidated properties, the probability of qualifying for conventional lending is very low; therefore, a bridge loan could be used to acquire the property, allow for the investor to complete their business plan during the term of the loan (either renovate or lease up vacant units), and ultimately stabilize the asset to a performing level. In some cases, the bridge lenders may even be able to provide capital for the renovations of the property, if the underwriting allows for it. Another strategy investors use bridge loans is for a quick close. To make an offer more competitive, an investor may use bridge financing to tie up a property under contract and aim for a faster close of escrow. Investors can do this because bridge lenders usually have a more lenient approval process compared to conventional lenders.

The terms we typically see from bridge lenders can vary. There are multiple capital sources offering bridge loans, and each of them has different underwriting policies and programs. The capital sources for bridge loans fall into the following lender types: debt funds, banks, insurance companies and agency.

Debt Funds

High net worth individuals or accredited investors can invest into a fund that provides commercial bridge loans to borrowers while paying their investors a return on their investment. Debt funds can be small privately run shops or institutional asset managers. Terms of the loans can vary but each fund has a minimum and maximum loan amount, pricing structure can vary from fixed or floating debt, and term lengths ranging from 6-36 months with recourse or non-recourse options. These debt funds can be either aggressive or conservative depending on their investment model, and I would say from an interest rate standpoint they follow risk based pricing – meaning, higher risk = higher rate. For pricing, most debt funds use the SOFR index plus a spread of 300-600 bps.

Banks

Banks typically have a standard bridge program for a tighter credit box that does not encompass a one size fits all product. Many banks will shy away from offering bridge loans on vacant or severely underperforming properties because they use an in-place cash flow financial model to underwrite their debt. They usually will use interest only payments for their underwriting and will not fall below a 1.0-1.15x DSCR. Banks are great for light value add projects, such as

a multifamily property going through organic turnover that may need small renovations to the units as they become available. Most banks will price their debt off the Prime Rate + a spread of 1-3%.

Insurance Companies

Insurance cos have recently entered the bridge financing space and have come to compete with the likes of some debt funds. There are insurance cos that have small balance loan programs and others with an emphasis on institutional quality deals. Insurance cos can range in offers from recourse to non-recourse, terms from 6-36 months, and an asset focus on multifamily, industrial, retail, office and hospitality. Pricing varies depending on the indexes used, but for the most part U.S. Treasury Yield + a spread of 400-600bps is common. There are fixed rate programs and variable rate programs – some variable rate programs may require a rate cap.

Agency Debt

The bridge to agency program focuses solely on multifamily properties and usually has the following structure of 3+1+1, up to 75% LTC but typically tops out ~60% LTC with pricing based off of SOFR, 2% prepay, waived when refinanced into agency with the existing lender, and a SOFR Cap is required, strike rate determined at LOI. Agency lenders use an as stabilized approach – they analyze the year 3 borrower NOI to determine loan amount.