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What is bridge financing?

Jacques Robert
REAL ESTATE LAW

Often, it is not practical to sell your home and purchase a new home on the same day. It takes considerable effort to coordinate the move so that all your possessions are moved out and the property is cleaned for the sale property, and then the new property is cleaned and all your possessions moved in all within a few short hours. Instead, many people choose (and it is highly recommended) that the new property is purchased a few days before the old property is sold. This time between the purchase and the sale allows:

* Your possessions to be moved to the new property over time;

* Any repairs or renovations to the new property to be done while the property is empty; and,

* Gives time to clean the old property before the closing date.

There are many benefits to selling the property at least a couple days after the purchase of a new property. But if you are using the equity from the sale to purchase the new property, how is the purchase funds arranged when the sale occurs after the purchase?

The answer in most cases is bridge financing. Bridge financing is a short term loan to "bridge" the gap between the purchase and the sale of property. The bank will arrange the short term loan. The interest rate on a bridge loan will often be higher than on a conventional mortgage, for example prime + 4.5%. However, the length of time that the loan is needed often results in costs of a few hundred dollars for interest and administrative fees combined. This is money well spent to keep the stress levels to a reasonable level during the move.

To calculate the principal amount of the bridge loan, the bank will do an estimated calculation of the disbursements on the sale, being the payout of the existing mortgage, the real estate agent's fees and legal fees. The bank will then provide a bridge loan for an amount they can recover on the sale after the disbursements. The bridge loan will be advanced to the lawyer on the closing date of the purchase.

When the closing date for the sale, the lawyer will receive the purchase funds from the buyer's lawyer. With the purchase funds, the lawyer will payout the existing mortgage, the bridge loan with interest, the real estate agent's fee and the lawyer's fees. The remaining purchase funds after all the payouts will be paid to the sellers.

Less commonly, instead of a bridge loan, buyers can bridge the gap between the purchase of a new property and the sale of their old property by refinancing or adding a line of credit to a different property they own. For example, a buyer may add a line of credit to or use an existing line of credit on a cottage that they already own to cover the time between the purchase and the sale. However, in this situation, the line of credit will not be paid out by the lawyer and it will be the client's responsibility to pay down the line of credit with the sale proceeds. Further, the line of credit will not be discharged from the cottage property and will remain for future use. Adding a line of credit to a different property than the property being purchased will be considered a separate file with the lawyer because it involves a separate property. Additional legal fees would apply to adding a line of credit to a different property which are typically higher than the legal fees for a bridge loan.

When planning a purchase and a sale, it is important to speak to your mortgage broker early to see if you qualify for bridge financing and to speak with your lawyer to see what legal fees and legal consequences are for the options presented by your bank. By discussing the options with your mortgage broker and lawyer early, you will prevent last minute surprises on your transaction.

co-authored with Robin Goski, associate lawyer

Jacques Robert is an Ottawa real estate lawyer. For more information, visit www.jacquesrobert.com