Could a Bridge Loan Help You?

In the past several years during the housing bubble, homes were selling so fast that sellers rarely had to worry about paying off their old home before buying the new one. Now that homes are no longer selling in a matter of days but rather months, there are some sellers who will find themselves in need of extra funds to pay the old and new mortgages until the old home is sold. If this is your situation, you may consider borrowing a bridge loan.

Bridge loans, also called swing loans or gap financing, were designed to help homeowners “bridge the gap” between buying a new home and selling an old one. This could be particularly helpful if you have to start a new job in a different city or state and can’t wait for your home to sell before buying elsewhere. A bridge loan can help you cover both costs at once.

Bridge loans come in two forms. The first is somewhat like a refinance loan. It is large enough to pay off your existing home mortgage and still have money left over for the loan closing costs, a couple months of prepaid interest loan repayments, and a sum for the down payment on your new home.

The slightly riskier option is to simple add the bridge loan on top of your current loans. In essence, this choice means you will be carrying three mortgage loans at once. These include your original home mortgage loan, your bridge loan, and your new home mortgage loan. Many borrowers will find it hard to make all three payments at once, so you should carefully consider your finances before taking on this type of loan.

Bridge loans are typically only for short-term housing gaps, usually from 6 months to 36 months. They will let you borrow up to a certain percentage of your current home’s value, or a percentage of your equity in the home. If your home does not sell after the first six months or so, you will begin paying interest-only payments on your bridge loan. The loan will be fully paid off from proceeds from your first home sale. If you do sell your home before the payment-free period is up, you can receive the prepaid interest back.

Bridge loans are often best accomplished when you use the same lender as your bridge lender as well as your new mortgage lender. This may be a requirement of the deal, but if not, it may net you discounts anyway.

There are some risks and cautions with bridge loans however. You will generally find that interest rates on these loans range about 2% higher than other loans. (If you sell your home quickly though, you won’t have to pay much of the interest.) Because the risks are also greater to lenders, bridge loans can require you to pay more in points. There may also be pre-payment penalties, so be sure to check the terms before you sign.

If this sounds too costly for you, there are other loan options, like borrowing against your retirement 401k plan. If you do consider on a bridge loan though, make sure you first check with local realtors to find out how long you can expect your old home to stay on the market. This will help you know if the loan will be the best choice for you.