Mortgage Choice

Bridging loans

A bridging loan is a short-term loan that finances the purchase of a new property while you are selling your existing property.

This type of loan can also provide finance to build a new property while you live in your current home. You will normally have six or 12 months to sell existing property and will be subject to your lender's policies.

How does a bridging loan work?

When you take out a bridging loan, the lender usually takes over the mortgage on your existing property as well as financing the purchase of the new property. The total amount borrowed is called the Peak Debt and includes:

- The balance of the loan on your existing home
- The contract purchase price of the new home
- Any purchase costs such as stamp duty, legal fees and lenders fees.

The minimum repayments on a bridging loan will generally be calculated on an interest-only basis, but often this interest may be capitalised until the existing home is sold, that is, it's accrued and added to the Peak Debt.

Once you sell your first property, the net proceeds of the sale (sale price minus any sale costs such as selling agent's fees) are used to reduce the Peak Debt. The remaining debt plus any capitalised interest becomes the End Debt. This End Debt is then paid as you would a regular mortgage.

An example bridging loan

The graph below shows the sale and purchase process for an example bridging loan scenario.

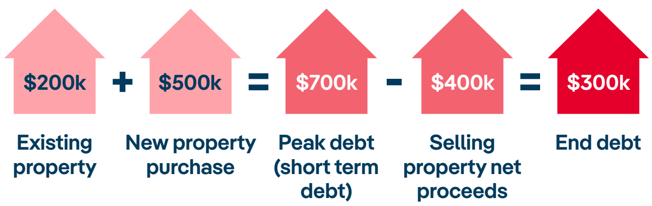

Figure 1: The sale and purchase process for an example bridging loan scenario.

- If the balance of the loan on your existing property is $200,000 and the purchase costs of the new property are $500,000, you may be able to borrow up to $700,000, which will be your Peak Debt.
- You now have a short-term debt of $700,000 until the sale of the existing property is completed. Interest will be paid on $700,000, as opposed to the original $200,000 loan.
- If the net proceeds of the sale of the existing property are $400,000, the borrower will be left with an End Debt of $300,000 (that is $700,000 less $400,000) plus any capitalised interest.

Capitalising repayments

Some lenders may allow you to capitalise the interest on a bridging loan, so you don't have to make loan repayments during the bridging period. This means your Peak Debt increases each month as the interest is added to your loan. Your monthly interest will also be calculated on your Peak Debt including the capitalised interest.

Wherever possible, it is a good idea to make some repayments to limit the amount of additional interest you will be charged.

Lending assessment policy

When lenders assess the funds they will allow you to borrow, they look at the equity in your existing home. The maximum loan-to-value ratio (LVR) is generally 80–90%, depending on the lender.

Most lenders that offer bridging finance do so on the condition that there is an End Debt, i.e. money still owed once your first home is sold and used to repay a large portion of the mortgage.

However, in cases where there will not be an End Debt, such as when you are downsizing your home, the fees associated with your loan will generally be higher.

Some lenders may require evidence that your existing property has been sold (e.g. a copy of the sale contract) as a prerequisite for approval.

Existing loans

If you require bridging finance, your current lender is usually best placed to assist you. However, if your current lender does not offer bridging loans, you'll need to find a different lender that offers this option.

In this scenario, the new lender will take on the existing loan, which means paying out the existing lender. If this happens to be a fixed rate loan, early termination may result in break costs being payable by the borrower.

For expert mortgage advice, talk to your local broker today.