

Bridging Loan Effectiveness in Facilitating Property Development

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ABSTRACT

This study aims to evaluate the effectiveness of bridging loans in promoting real estate. Through in-depth literature research and qualitative analysis, researchers gathered information about the characteristics, benefits, risks, and impacts of bridging loans on real estate development. This study aims to examine (1) What is the role of a bridging loan in bridging the gap between the sale of existing properties and the purchase of new properties in property development. (2) How can the flexibility of bridging loan financing assist property developers in managing loan terms and fulfill working capital needs? The research method used is this research using qualitative methods by using the interpretation of phenomena that occur around. The findings of this study indicate that bridging loans can be effective in facilitating property development. The speed of disbursement of bridging loan funds gives property developers the ability to immediately start or continue their projects without financial constraints. In addition, the flexibility of a bridging loan allows property developers to better adapt their financial strategy during the development process. However, this study also identified several risks associated with the use of bridging loans. Higher interest rates and shorter terms can create financial stress for property developers if they are unable to repay the loan within the allotted time. Therefore, property developers need to carry out a careful evaluation of their ability to meet loan requirements and cope with the associated risks. So this research provides important insights for property developers who are considering using bridging loans as a source of funding for their property development projects. By understanding the effectiveness and associated risks, property developers can make better decisions in managing the finances of their projects.

KEYWORDS

bridging loans, real estate, effectiveness, working capital, financing flexibility, financial constraints

Introduction

Extensive literature research was conducted to gather insights on the effectiveness of bridging loans in the property sector. Several studies have highlighted the positive impact of bridging loans on property development.

According to Smith et al (2009), Bridging loans can speed up the construction process by giving developers direct access to capital. This allows them to start construction activities immediately, reduce delays, and ensure timely completion of projects. In addition, bridging loans help developers meet working capital needs, such as purchasing construction materials and paying labor costs.

The flexibility of financing offered by bridging loans is another significant advantage. Researchers such as Johnson and Brown (2014) emphasize that developers can manage credit terms more effectively, enabling them to optimize cash flows and allocate resources efficiently. This flexibility allows developers to adapt to changing market conditions and respond to unforeseen challenges throughout the project cycle.

However, it is important to acknowledge the risks associated with a bridging loan. Market fluctuations and delays in property sales can make developers financially vulnerable. Researchers such as Chen and Lee (2021) have identified the need for developers to carefully assess and manage the risks associated with taking out a bridging loan to avoid possible financial losses.

In line with research conducted by Smith et al. In 2009, the effectiveness of bridging loans in facilitating property development has come to the attention of researchers. A bridging loan can speed up the construction process by giving developers direct access to capital. The research highlighted that bridging loans allow developers to start construction activities immediately, reduce delays, and ensure project completion on time. In addition, bridging loans help developers meet working capital needs, such as purchasing construction materials and paying labor costs.

Johnson and Brown (2014) also emphasize the financing flexibility offered by bridging loans as a significant advantage. According to their research, developers can manage credit terms more effectively, enabling them to optimize cash flow and allocate resources efficiently. This flexibility allows developers to adapt to changing market conditions and respond to unforeseen challenges throughout the project cycle.

However, it is also important to acknowledge the risks associated with a property development bridging loan. Chen and Lee (2021) have identified the need for developers to carefully assess and manage the risks associated with taking out a bridging loan to avoid possible financial losses. Market fluctuations and delays in property sales can make developers financially vulnerable.

Overall, the research conducted by Smith et al. in 2009, Johnson and Brown in 2014, and Chen and Lee in 2021, providing insight into the effectiveness of bridging loans in facilitating property development. Although bridging loans can provide significant benefits in speeding up construction, providing access to working capital, and offering financing flexibility, it is important for developers to understand and manage the risks associated with

these loans in order to minimize potential financial losses.

Recent research on the effectiveness of bridging loans in facilitating property development has been carried out by several researchers in recent years. For example, a study conducted by Gupta et al. (2022) examined the impact of bridging loans on property development projects in India.

According to this research, bridging loans have an important role in driving the growth of the property sector. These loans can provide the necessary liquidity for property developers to continue development and complete projects on time. The results of the study show that bridging loans are effective in overcoming liquidity problems that may be faced by developers, especially during market fluctuations or delays in property sales.

In addition, research conducted by Wang et al. (2023) investigated the effect of bridging loans on the value of property developed. They found that the proper use of bridging loans can increase property values and result in higher returns for developers. However, this study also emphasizes the need for good risk management and strict supervision of the use of bridging loans in order to minimize potential financial risks.

These studies show that bridging loans have significant potential in facilitating property development. However, the developer needs to take appropriate steps in managing the risks associated with the loan. Some steps that can be taken include conducting a careful risk analysis before taking out a loan, managing cash flow properly, and having an effective exit strategy to deal with possible delays in selling property.

Based on this background, the research problems can be formulated as follows: (1) What is the role of bridging loans in bridging the gap between the sale of existing properties and the purchase of new properties in property development. (2) How can the flexibility of bridging loan financing assist property developers in managing loan terms and fulfill working capital needs?

Research Method

This research is a type of literature review research that seeks theoretical references related to the cases or problems found. According to states that a literature review is a written summary of journal articles, books, and other documentation that explains theory and knowledge, both past and present, and divides the literature into topics and documents as needed. This study uses a qualitative method by using the interpretation of phenomena that occur around. The analysis technique used is a critical reasoning approach. This technique involves interpretation and use of critical reasoning. (Sudarmanto et al., 2021)

The information obtained based on the source is grouped into two parts, namely Primary and Secondary Data. Primary data or often called original data is information obtained from original and first-hand sources. These data must be examined on respondents who act as research subjects or on people who are carriers of information and data. Primary data can be visualized as data from interviews with respondents who act as research objects. Secondary data is data obtained from sources that have been analysed. Some examples of secondary data such as records or documentation from companies, government publications

for example, reports, news, journals, and others. (Rahmadi, 2011)

This method is commonly used to describe the characteristics and populations that are studied in more detail and broadly. Descriptive analysis method is carried out by presenting facts, followed by analysis which not only describes but also provides sufficient understanding and explanation. This method is a differentiator compared to other commonly used research methods because it focuses on discussing an ongoing phenomenon and can provide a clear and detailed description of the object of research. (Fenti Hikmawati, 2017)

This method is carried out by identifying the issues studied significantly. Provide boundaries and formulate a problem clearly. Provide an overview of the purpose and benefits of research. Determine the population and sample to be studied. Carry out data analysis in accordance with analytical techniques that are in accordance with the research objectives. Provide conclusions and suggestions based on the results of the literature study that has been done. (Dameria Sinaga, 2014)

Result and Discussion

The Role of Bridging Loans in Bridging the Gap Between Selling Existing Properties and Purchasing New Properties in Property Development

A bridging loan or bridge loan is a type of temporary loan that is usually used in the context of property development, which means that a bridging loan is a short-term loan category. The main role of a bridging loan is to bridge the financial gap between the sale of existing property and the purchase of new property in property development. In general, this bridging loan is used to repay loans and for various other capitalization needs.

When compared to conventional financing, this type of bridge loan is generally more expensive. To that end, the goal is to offset the additional risk. The interest rate is also higher, which is around 1% (one percent) to 2% (two percent) of the loan amount, some even more than that. The party providing the loan also usually requires collateral for the loan such as property or other inventory.

These loans are usually a type of additional loan, where a bridging loan is an addition to the home loan you already have. This means that during the bridging period when a person is trying to sell his old property, he also has two loans and he will usually be charged interest on both of them.

In general, a bridging loan is a type of loan whose instalments are only interest. The amount of loans provided by banks is also calculated based on the home equity that we currently have. In addition, there is a limit to the loan period and generally has special conditions, such as the bank can charge higher interest rates if the property that we currently own is not sold within the specified time period or even they will participate in the sale of the house that we have if we do not succeed in selling our house by the agreed time limit.

The structure for this bridging loan itself can differ from one bank to another. There

are banks that only require payment of the principal loan until the time of repayment of the new property. During the bridging period, the interest on this loan will be accumulated in our bridging loan balance. So when our property has been sold and the mortgage on it has been discharged, we start making payments on the bridging loan principal (plus interest). Another structure of a bridging loan requires us to make payments on both of our loans since we drawdown this loan.

When the house we currently own has been sold and the mortgage on it has also been eliminated, this bridging loan will usually be converted into an ordinary loan where this loan is only for the house we just bought. For bridging loans, because the interest rates are compounded where the possibility of multiplying because we have two loans, the longer it takes us to sell our old property, in general the greater the interest that rolls over and the larger the loan we have to pay. This is because interest rates are calculated daily but paid monthly, so this can accumulate quickly, depending on the size of our loan.

The thing to note about this type of bridging loan is the length of time for the bridging loan period, which is usually 6 months for buying finished properties and 12 months for buying newly built properties. Banks usually also add conditions to the loan which allows them to charge us higher interest rates if we don't sell the property we own within the agreed timeframe. There are also banks that add clauses that allow banks to participate in the process of selling our homes if, until the specified time period, we still have not sold our homes to pay off the loans we get.

In Australia, banks generally offer 2 types of bridging loans, namely closed bridging loans and open bridging loans. A closed bridging loan is a loan based on an agreed sales date, after which we can pay the remaining principal from the bridging loan. For example, this type is suitable for those of us who already know when the property we are selling will settle. An open bridging loan is a loan that does not involve a definite settlement date, but only a general term (usually 6 or 12 months). This type of bridging loan will be useful for those of us who haven't found a buyer for our property at this time. In general, when we want to apply for a bridging loan, the bank will ask a few additional questions, such as proof that our property has been marketed for sale.

When a property developer wants to sell a property they already own in order to fund the purchase of a new property, there is a period of time during which they must wait until a sale of the property occurs and funds become available. However, in this situation, if the developer is looking to purchase a new property immediately, they may need additional funds to finance the purchase.

This is when bridging loans become relevant. Bridging loans can provide temporary funds to property developers to finance the purchase of new properties before the sale of existing properties is complete. These loans provide a financial "bridge" that allows property developers to purchase new properties without having to wait for funds from selling existing properties.

Bridging loans usually have a short term, such as a few months to a year, and interest rates that may be higher than long-term mortgage loans. This is because a bridging loan is considered a riskier loan for the lender, as the property developer is still in the process of

selling the existing property.

After the sale of the existing property is complete, the property developer can use the proceeds from the sale to pay off the bridging loan. In some cases, if the sale of an existing property generates more funds than the loan amount, the property developer can use the remaining funds to pay for the purchase of a new property or reduce the amount of the loan they have to repay.

Thus, the role of a bridging loan in property development is to provide temporary funds to property developers so that they can purchase new properties without having to wait for the sale of existing properties. This allows property developers to take advantage of business opportunities and streamline the property development process.

Bridging loans for property financing are very rare. In some cases, the lender will only offer a loan of 80% (eighty percent) of the combined value of the two properties.

Following are some of the advantages that can be obtained from a bridging loan in the property world, including:

Bridging Loans can be used to buy new homes and also to place a house on the market without any restrictions.

Get free payments for the next few months.

With a bridging loan, we can buy a new home, even after removing the contingency to sell under certain conditions.

However, apart from the advantages, bridging loans in the property sector also have some drawbacks, including:

Bridging loans are more expensive than home equity loans.

The party borrowing the funds is obliged to fulfill the main requirement, that is, he must have two houses.

The loan fund will be large because it handles two mortgages for two houses simultaneously, plus the additional interest from the bridging loan.

One example of the use of this bridging loan can be found in the company Olayan America Corporation, which wanted to buy Sony Building in 2016. The company took out a bridging loan from ING Capital. Then the loan was approved very quickly, so that Olayan America Corporation was able to make an agreement with Sony Building. The loan is able to help and partially cover the cost of purchasing the building until Olayan obtains long-term funding that is more permanent in nature.

Apart from bridging the financial gap between the sale of an existing property and the purchase of a new property, a bridging loan can also have another role in property development. Following are some of the additional roles that a bridging loan can play:

Allows renovation or repair of property: Bridging loans can be used to finance the renovation or improvement of properties that are being developed. This allows developers to refurbish new properties before sales of existing properties are completed, increasing the property's value and its attractiveness to potential buyers.

Coping with emergency financial situations: Sometimes, in property development, an emergency financial situation can arise that requires additional funds quickly. Bridging loans can be used as a quick solution to meet urgent financial needs that arise in property development.

Provide time flexibility: Bridging loans provide time flexibility to property developers. They can adjust the loan term according to their needs. This allows the developer to rearrange loan repayments once the sale of the existing property is complete and funds become available.

Encouraging business opportunities: In a competitive property industry, bridging loans can help developers make quick decisions and take business opportunities as they arise. By having quick access to funds through bridging loans, property developers can purchase new properties at favorable prices or participate in attractive property auctions.

The use of bridging loans should be considered carefully, as the higher interest rates and risks associated with short-term loans can affect the success of a property development project. Before taking out a bridging loan, it is advisable to consult with a finance professional or property expert to ensure that the decision is appropriate to your specific property development plan and situation.

In general, parties who take advantage of this bridging loan facility are those who are awaiting disbursement of funds, while on the other hand they also have to settle their obligations. That's roughly the picture of the person or company that finally decided to use the bridging loan facility.

Flexibility of Bridging Loan Financing Can Assist Property Developers in Regulating Loan Terms and Fulfill Working Capital Needs

The flexibility of bridge financing provides real estate developers with significant advantages in managing loan terms and meeting working capital needs. In the context of real estate development, a bridging loan can be used to obtain the necessary funds to start or continue a development project without having to wait for the existing property to be sold.

First, a bridging loan offers flexibility in determining the loan term. These loans are usually short-term loans with shorter repayment terms than traditional mortgages. This allows real estate developers to quickly and efficiently get funds to start or continue projects without long waiting times. In addition, the flexibility of transitional loan periods offers real estate developers the opportunity to adjust the repayment period according to the project. We can schedule loan payments based on projected income or plans to sell existing properties. This allows for more efficient cash flow management and optimization of working capital.

In addition, bridging loans also help meet real estate working capital needs. The real estate process often involves costs that must be paid up front, such as the cost of purchasing land, licensing fees, or initial construction costs. In some cases, real estate agents may face a situation where their income stream is not yet available, but these fees must be paid immediately. A bridging loan can help them get the funds they need to cover their shortfall in working capital in the early stages of a project.

With a bridging loan, real estate developers can take advantage of lucrative project opportunities and start or continue projects without having to wait long or face a shortage of working capital. The flexibility of financing through bailout loans offers financing solutions that are fast and adaptable to the needs of real estate developers.

Both corporate and individual businesses that need a quick source of funds for various purposes with collateral for their property (assets) can take advantage of a bridging loan. For example, companies that need working capital in a short time, individuals who have difficulty paying mortgages, or transferring assets temporarily for fresh funds. Unlike the strict banking requirements, the bridging loan is much simpler. All assets can be used as collateral regardless of the assets previously suspended. Its main use is as a need for fast working capital, can take over troubled mortgages, or need urgent funding needs.

In addition, the flexibility of bridging loan financing also offers other benefits for real estate investors. One is the ability to get financing based on the value of the property to be built or renovated rather than the property's current value. This provides developers with more funds than a traditional mortgage.

Bridging loans can also help real estate developers in situations where they need additional financing to complete ongoing projects. When additional costs or unexpected financial problems arise, a bridging loan can be a quick and effective solution to keep the project running smoothly. In some cases, a property developer may use a bridging loan to take advantage of unforeseen market opportunities, such as buying a property at a low price which can then be sold at a higher price.

Apart from providing flexibility in loan terms and working capital requirements, bridging loans can also help real estate investors in the form of a more flexible payment structure. You can make regular interest payments during the loan term or pay interest and principal in full at the end of the loan term. This gives developers more freedom to manage their cash flow according to their projects and financial needs.

However, it is important for real estate agents to consider the risks associated with mezzanine loans. This type of financing may come with higher interest rates and higher administration fees. In addition, developers must ensure that they have a clear plan for repaying the loan, either by selling the property or obtaining long-term financing after the project is completed.

Overall, the financing flexibility of a bridging loan can be a powerful tool for real estate developers to manage loan terms, meet working capital needs, and capitalize on profitable projects. However, it is important that they carefully consider all aspects of this financing and have a solid strategy in place to manage potential risks.

Bridging loans not only allow real estate developers to start or continue projects without having to wait for existing properties to be sold, but also offer flexibility in arranging sources of financing. Real estate agents may choose to combine a bridging loan with other sources of financing such as equity or other debt financing to meet larger working capital needs. By using a bridging loan as part of the financing structure, developers can more effectively meet their financing objectives.

In addition, bridging loans can offer flexibility in terms of financial requirements. These loans are often easier and quicker to obtain than traditional mortgages. Home loans may require a longer process and more stringent terms, but bailout loans can be obtained in less time and with more flexible terms. This allows real estate agents to get the funds they need quickly and without much effort.

In addition, the flexibility of financing bailout loans can also help real estate developers optimize the use of their working capital. In some cases, real estate agents may need to make repairs or upgrades to an existing property to increase its resale value. With temporary loans, they get the funds needed for repairs and take advantage of opportunities to increase real estate values. This helps real estate agents manage their working capital more efficiently and increases their profit potential.

The flexibility of bailout financing also means that real estate carries risks that must be calculated. Interest rates on these loans are usually higher than traditional mortgages, so they can affect the overall cost of the loan. Additionally, if the sale of an existing property is delayed or the project encounters financial difficulties, the developer may be under pressure to repay the loan. Therefore, real estate agents must plan their finances carefully, consider the risks involved and have a solid strategy in place to overcome potential obstacles.

Therefore, before taking a bridging loan, several considerations need to be made, such as considering the total cost of the loan and not just the interest rate. Most people often pursue the lowest interest rates, but many lenders will charge large exit fees, fund management fees and other costs. To be more accurate, you should always do the calculations and ask for details on the total cost of the loan so you can compare loan service providers more accurately.

Apart from that, it is also necessary to plan the method of payment, because the high risk when taking a bridging loan is how to pay off the bridging loan on time. If paying a loan through the sale of property or assets, it must be ensured that the loan period is sufficient to find a buyer and complete the sales transaction of the property or asset, because if you are forced to make a quick sale then the possibility that will happen is that the property or asset will be sold at a price below what it should be.

Conclusions

Based on the discussion described above, a common thread can be drawn towards the effectiveness of bridging loans in facilitating property development. It can be concluded that bridging loans have proven effective in facilitating property development by providing quick access to funds and offering financing flexibility. The effectiveness of bridging loans can be attributed to several main factors.

First, bridging loans speed up the construction process by providing developers with the necessary funds to start or continue a construction project. This helps minimize delays that may occur due to financial constraints and ensures a smooth development process.

Second, bridging loans address temporary financial constraints that developers may face, such as delays in selling property or funding from other sources. By providing

immediate financial support, bridging loans allow developers to address these challenges and avoid negative impacts on their projects.

In addition, bridging loans offer flexibility in financing. Developers can adjust the loan repayment period to suit their project needs. This allows them to raise funds temporarily and pay off the loan using proceeds from the sale of the property or long-term funding, such as a mortgage loan.

However, it is important to consider the risks associated with a bridging loan, including higher interest rates, additional fees, and the possibility of delaying the sale of the property. Developers should carry out a careful financial analysis and consult a financial professional or property adviser before deciding to avail a bridging loan.

Overall, bridging loans can be effective in facilitating property development by providing quick access to funds and offering financing flexibility. However, it is very important to weigh risks and manage finances carefully to ensure the success of a property development project.

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