**Information on Prepayment Penalties**

One of the major questions many have about prepayment penalties is this.**Should you get a mortgage loan with a prepayment penalty?**

**If you plan to refinance or pay off your loan in less than three years, then you should not get a mortgage loan with a prepayment penalty.**

If you intend to keep the loan for more than three years, then you should get a mortgage loan with a prepayment penalty.

Mortgage companies introduced prepayment penalties on mortgage loans as a way to offer lower interest rates to borrowers.

Most mortgages with prepayment penalties have an interest rate one-half percent to one full percent below those without penalties. The actual rate reduction depends on the loan program and term or life of the mortgage.

**Make sure your loan officer understands prepayment penalties.** Ask questions about the penalty terms and amounts. The loan officer should provide you with a complete disclosure of the prepayment. If the loan officer cannot answer your questions or provide the disclosure, you need to get a different loan officer.

Investors that provide people with money for home lending are pension funds, insurance companies, and anyone else with extra money to invest who wants to receive a better than bank interest rate on their savings.

Investors get the better rate by investing in mortgage loans. Investors lend you the money for your home and collect the interest you pay.

**When people pay off a mortgage loan early, the investor must find another mortgage investment.** This costs the investor time and money. Since a prepayment may come in at any time after the borrower signs the mortgage, the investor also faces uncertainty about when he will receive prepayments. To compensate for the lost time, money and aggravation, the investor requires the borrower to pay a higher interest rate.

**Investors agreed to lower interest rates if the lender (the mortgage company) could assure the investor some compensation if the loan is paid off early. This how the prepayment penalties came about.**

Prepayment penalties today usually do not extend beyond three years from the first payment due date. Most prepayment penalties allow you to prepay up to twenty percent of the original mortgage amount in any twelve month period without incurring any penalty. If you prepay more than twenty percent, the penalty is usually six months interest on the amount prepaid in excess of the twenty percent.

For example, if your original mortgage amount is $100,000, you can prepay up to $20,000 in a twelve month period with no prepayment penalty.

If you prepaid $25,000 in a twelve month period, you would owe a prepayment penalty of six months interest but only on the $5,000 excess prepayment.

Note that the term is "twelve month period" rather than "per year." This condition is set up to prevent someone from prepaying $20,000 in month 12 and paying another $20,000 in month 13. In most cases, if the excess prepayment is due to the sale of your home, the penalty will not apply.

**As stated earlier in this article, make sure your loan officer understands prepayment penalties. Ask questions about the penalty terms and amounts**. The loan officer should provide you with a complete disclosure of the prepayment. If the loan officer cannot answer your questions or provide the disclosure, you need to get a different loan officer.