

# You may be penalized for early payoff of your mortgage

**MORTGAGE SHOPPING**



DAVID C. MULLY

**T H I S W E E K ' S H O M E W O R T G A G E S H O P P I N G T I P :**

Beware of prepayment penalties when selecting a mortgage lender and a mortgage program.

Years ago, prepayment penalties were the norm. Over time, it became more uncommon for mortgages to include a prepayment penalty. Because these penalties are beginning to show up again, consumers should add the question "Do you have prepayment penalties on your mortgage?" to their list of questions to ask lenders when mortgage shopping.

There are a few reasons for the

recent move toward prepayment penalties.

First, with the boom in mortgage refinancing in the last few years, servicing lenders have lost a lot of money because many current customers refinanced to a lower rate, often with a different lender. Some of the customers who refinanced may have had the loan only a short time, possibly a few years or less. Lenders are hurt most by these short term loans because the profit they make only begins after they have covered the expense of originating the loan. Without charging a prepayment penalty, they are left without covering the original cost.

Secondly, customers who obtained a no point loan or no point loan closing cost loan may have refinanced too. These loans have all the costs built into the interest rate up front, resulting in an above-normal rate. Lenders offered those loans in hopes of re-

ceiving their up front costs over time in addition to the profits that would emerge after a few years of servicing the mortgage. When borrowers refinance, lenders are again left without the ability to cover originating costs of the loan.

The no point and no point/no closing cost loans are the ones most commonly carrying prepayment penalties today. In addition, adjustable rate mortgages typically carry prepayment penalties. Unfortunately, loan officers don't always offer this information up front when you are deciding on your loan product. Therefore, you need to make sure to read the fine print and ask questions.

Generally, prepayment penalties range from 1% to 2% of the loan balance at the time of payoff. The penalty generally only applies within the first 2 to 5 years of the mortgage. After that, there is no penalty. These parameters vary from lender to lender. Borrowers need to consider their future plans if possible when deciding on the type of loan that is best for them. A poor mortgage decision could end up being a costly mistake. For example, choosing to

pay off ahead of schedule a loan with a balance of \$125,000 could cost up to \$2,500 in penalties for early payoff. Obviously it is something to consider when choosing a mortgage program.

**THIS WEEK'S QUESTION:**

**Q.** We recently closed on our house and had a bad experience with the lender. At the closing, we were told for the very first time that there would be a prepayment penalty if we paid off the loan early. The lender said the penalty would be 1 1/4% of the balance if we paid it off within the first 3 years. We know we are moving in 2 years because of my husband's job transfer. Is this prepayment penalty a normal charge and is there anything we can do about it?

**A.** First of all, I am surprised that the loan officer did not inform you of this fact during your initial application or when you selected your mortgage program. It really should have been verbally noted to you. Unfortunately for you, the prepayment penalty

clause was most likely written on the application forms you signed and therefore, the lender fulfilled his requirement to inform you of it. Often, this type of misunderstanding happens when inexperienced loan officers inadvertently neglect to inform their clients of a prepayment clause. If your initial paperwork does not disclose the prepayment clause, consult your attorney for advice. Hopefully, other readers will learn from your experience and remember to ask this important question at the start of the mortgage process.

**Editor's Note:** Mully will appear as a guest speaker at the upcoming Annual Builders Home, Flower and Furniture

Show at Cobo Hall in Detroit on March 20, 1996 at 4 p.m.

David C. Mully is president of *dem Mortgage Consultants, Inc. in Novi, an independent mortgage lender referral source that specializes in connecting area homeowners with a lender that meets their mortgage needs.* You are invited to send questions and comments relating to mortgages, lenders, or mortgage shopping by writing Mully, P.O. Box 485, Novi MI 48376-0485. You may also call him at (810) 380-0602 or fax him at (810) 380-0603. Current and past column's can be found on *O&E On-Line!* in REALnet at address: <http://oeonline.com/~cmully/>

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