

Mortgage Refinance and Pre-Payment Penalties

Mortgage refinance sounds like a really good idea to a lot of people until they start looking at all of the costs associated with it. When you refinance your home you are looking at paying costs of three to six percent of the principal due on the home. In most cases, three to six percent is a hefty chunk of change and then you may also be looking at pre-payment penalties. Before you went to refinance you may have never even heard of pre-payment penalties, so why are you having to pay them?

Understanding Pre-Payment Penalties

Many times lenders like to protect themselves against people refinancing or paying off a loan on their own before the agreed upon date. A lot of borrowers don't understand this as they assume that the lender would like to get their money any way they can. It's true that the lender wants their money back, but what you fail to realize with this way of thinking is that the mortgage lender is in business for themselves and when you pay off your loan early they stop making money because you are no longer paying them interest. The interest on your loan is how the lender makes their money and they need this money to continue doing business.

The lender will often write a pre-payment penalty into the loan so that if you refinance or you end up coming into some money and you pay off the loan early, that they will get some money to compensate for the loss of the interest that you would have paid them over the course of 30 years or whatever the term of your loan was. Pre-payment penalties vary from lender to lender but they are often a percentage of the principal balance, such as three percent of the remaining principal on the loan. So, if you still had \$80,000 left on your mortgage and you had to pay three percent of it to get out of the loan you would be paying \$2,400, and that is on top of the closing costs associated with the new loan.

It is often these pre-payment penalties that make mortgage refinance unaffordable for a lot of people. Before you start looking into the process too seriously you should inquire as to whether you have a pre-payment penalty or not. This may help you decide if now is the time to refinance or not. If you do have a pre-payment penalty you will need to factor this into the math as to whether the refinance is truly going to save you any money.

If you are able to lower your interest rate enough you may find that refinancing can still save you money, but you should be sure if you do refinance that your new loan does not have a pre-payment penalty. You may never refinance again and you may not pay off the loan early, but it is nice to know that if you choose to do either of these things that you will not be penalized for paying off the loan early. Having to pay the fees once is certainly enough and most lenders will be willing to forgo the penalty stipulation in the loan if you ask for it to be left out, if only you had known this the first time around!

About the Author

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