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Mortgage prepayment penalties can make refinancing more expensive

With interest rates at historic lows over the last three years, many homeowners have rushed to take advantage by refinancing. What some haven't bargained for, however, is the negative impact of prepayment penalties.

"The presence of prepayment penalties can make refinancing more expensive, draining an individual's home equity, or even trapping a homeowner at the higher interest rate, increasing the risk of foreclosure," says Henry L. Shulruff, President of Capital Funding Corporation (CFC). "Your real estate lawyer can explain the details and help steer you away from these penalties, which are often available with so-called 'zero-cost' loans."

A prepayment penalty can be as high as six months worth of interest payments on 80 percent of the balance on your mortgage, according to Shulruff. Most pre-payment penalties expire within one to three years and decrease the longer the loan is held. The presence of prepayment penalties is especially prevalent in sub-prime mortgage loans, 80% of which contain prepayment penalties as compared with just a two-percent rate for conventional loans.

"The prepayment penalty is one reason borrowers must take the time to read the small print," Shulruff said. "Hiring a qualified lawyer to help with this process is essential."

The penalties can have a devastating effect on individual borrowers, Shulruff said. According to the Center for Responsible Lending, some 850,000 families lose an estimated \$2.3 billion annually because of these penalties.

"Many states, including Illinois, have taken the position that such penalty provisions are targeted in a predatory manner at unsophisticated borrowers with little bargaining power," he continued. "To prevent the use of such penalties, many of these states have enacted legislation, which in some cases is more stringent than existing federal legislation."

Many pre-payment penalties apply only to the early payoff of a mortgage as a result of a refinance. "This means the homeowner may sell the property within the prepayment penalty period," he said.

Capital Funding Corporation is a wholly owned subsidiary of Attorneys' Title Guaranty Fund, Inc. (ATG), a lawyer-service corporation that provides a host of real estate related services to lawyers and their clients in Illinois, Wisconsin and Indiana. CFC comprises more than 100 attorneys statewide who help their clients obtain the appropriate mortgage products for their needs. Participating attorneys originate loans as part of the legal representation they provide clients who are purchasing real estate or refinancing existing mortgages.

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