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Yield Maintenance Premium

as a prepayment penalty



What is Yield Maintenance and why is it important to you ?

Yield maintenance is important to you because it can have a walloping affect on the financial well being of your clients. After reading this short explanation, you will know how to advise them on when, and when not to, accept yield maintenance as a prepayment option on their loans.

Yield maintenance is a prepayment premium that allows lenders to attain the same yield when rates go down, as if the borrower made all scheduled mortgage payments until maturity.

Yield maintenance premiums are designed to make lenders indifferent to prepayment when rates move down. This is because yield maintenance pays the lender the equivalent sum of money as if the loan had not been prepaid. Furthermore, yield maintenance premiums also make refinancing unattractive and uneconomical to borrowers, when rates go down.

Bottom line: (this makes it simple).

- **If rates go up, there is no yield maintenance prepayment penalty.**
- **If rates go down there is a yield maintenance prepayment penalty.**

Over the past 30 years we have seen rates consistently moving down. Clients have gotten hurt badly with yield maintenance when they prepay/pay off their loans prior to maturity, as a result of rates being lower than the interest rate originally obtained on their loans.

Over the next 30 years rates most probably will be trending higher. In this case, clients should opt for yield maintenance over traditional prepay penalties whenever they can, as the yield maintenance will be \$0 if rates are higher than their original loans interest rate, when they choose to prepay/payoff their loan prior to maturity.

Yield maintenance is important to you because it affects the financial well being of your clients. You now know how to advise them on whether or not to accept yield maintenance as a prepayment option on their loans.

[*See yield maintenance calculator*](#)

(play with it for a little while to see how yield maintenance works)

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