PFL Academy

Teacher Guide: Chapter 57 — Loan Application Process and Requirements

OVERVIEW

TIME	MATERIALS	PREREQUISITES
45-50 Minutes	Student Activity Packet, Calculator	L-56 Record Keeping, Understanding of credit scores helpful

LESSON FLOW

5 min — **THE CHALLENGE**

- Contrast Carmen (prepared, got 5.8% rate) vs. Marcus (unprepared, got 22% rate).
- Calculate the difference: ~$2,000 in extra interest over 5 years.
- Key insight: Same loan, VASTLY different outcomes based on preparation.

10 min — **CORE CONCEPTS**

- Introduce the Five C's framework—write on board with simple definitions.
- Explain DTI calculation with simple example: $500 debt ÷ $2,000 income = 25%.
- Key thresholds: Below 36% good, 36-43% acceptable, above 43% problematic.

25-30 min — **APPLY IT**

- **Part A (10 min):** DTI calculations. Walk through Jordan's example, then have students complete Taylor's independently.
- **Part B (10 min):** Five C's evaluation. Students play "loan officer" role—encourage realistic assessment.
- **Part C (5 min):** Improvement strategies. Brainstorm what Marcus should do—connect to actionable steps.

10 min — **CHECK YOUR UNDERSTANDING**

- Q3 tests DTI calculation with new mortgage payment—most realistic scenario.
- Q4 (pre-approval power) is critical practical knowledge.
- Q5 asks students to self-assess—great for personal reflection.

DIFFERENTIATION

Support

- Provide DTI formula card: Total Monthly Debts ÷ Gross Monthly Income × 100%
- Pre-fill first DTI example as demonstration.
- For Five C's evaluation, provide sentence starters for explanations.
- Work through Alex's profile as a class before independent work.

Extension

- Calculate total interest paid at different rates (5% vs 10% vs 20% on same loan).
- Research actual documentation requirements for a specific loan type.
- Create a 12-month creditworthiness improvement plan for a weak borrower profile.

- Compare terms offered by different lenders for same borrower profile.

ANSWER KEY

Part A: DTI Calculations

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Jordan:
Total monthly debt: $350 + $220 + $80 = $650
DTI = $650 ÷ $4,500 × 100% = 14.4%
Assessment: GOOD (well below 36%)

Taylor:
Total monthly debt: $900 + $285 + $180 + $150 = $1,515
DTI = $1,515 ÷ $3,200 × 100% = 47.3%
Assessment: CONCERNING (above 43%)

Taylor with new $300 car loan:
New total debt: $1,515 + $300 = $1,815
New DTI: $1,815 ÷ $3,200 × 100% = 56.7%
This DTI is FAR too high—loan would likely be denied.
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Part B: Five C's Evaluation (Alex)

Character (6/10): Credit score 680 is fair, no recent negatives, but limited history reduces confidence.

Capacity (8/10): DTI calculation: $175/mo existing debt. Adding ~$400 car payment = $575/$4,333/mo = 13.3% DTI. Excellent capacity.

Capital (5/10): Only $3,500 savings total with $2,000 down leaves $1,500 reserve—less than one month of payments. Weak.

Collateral (7/10): Car serves as collateral. LTV = $22,000/$24,000 = 91.7%—higher than ideal but acceptable for auto loan.

Conditions (7/10): Auto loan is reasonable purpose, stable employment supports application.

> *Reasonable decisions: Approve at standard-to-higher rate given fair credit and limited reserves; OR approve with conditions (require larger down payment to improve LTV and reserves).*

Part C: Marcus Improvement Strategies

1. Build credit score: Pay all bills on time for 6+ months, reduce credit utilization below 30%.

2. Reduce DTI: Pay off smaller debts, avoid new debt, potentially increase income.

3. Build savings: Create emergency fund + down payment over 6-12 months.

4. Maintain job stability: Stay at current job for at least 1-2 years to demonstrate employment stability.

Biggest impact: Reducing DTI from 45% to under 36% OR building credit score above 650. Both significantly improve approval odds.

Check Your Understanding

1. B (Character). Credit score is the primary measure of your repayment character/history.

2. DTI measures ability to afford the new payment. High DTI = too much income already committed to debt = higher risk of default because less buffer for unexpected expenses.

3. Current debt: $180 + $95 + $425 = $700. With mortgage: $700 + $1,200 = $1,900. New DTI: $1,900 ÷ $5,000 = 38%. This is in the ACCEPTABLE range (36-43%), but borderline. Most lenders would approve but might require compensating factors (higher down payment, strong credit score).

4. Pre-approval shows sellers you're serious with financing ready (competitive advantage), clarifies your budget, lets you negotiate from strength (can walk away from dealer financing if rates are worse), and identifies issues early.

5. *Answers will vary. Look for honest self-assessment of Five C's and specific, actionable improvement steps (not vague like "improve credit" but specific like "pay credit card balance below 30% of limit by September").*

COMMON MISCONCEPTIONS

Misconception	Clarification
"My credit score is the only thing that matters."	Credit score (Character) is ONE of five factors. Someone with 800 score but 60% DTI will struggle. All Five C's matter.
"Checking my credit hurts my score."	YOU checking your own credit (soft inquiry) doesn't affect score. Only lenders checking for applications (hard inquiries) have small, temporary impact.
"Higher income means automatic approval."	Income affects Capacity, but high income with high debt still means high DTI. Lenders care about what percentage of income is available, not raw income amount.
"I should apply everywhere to find best rate."	Multiple applications create multiple hard inquiries. Exception: Rate shopping for same loan type within 14-45 days often counts as single inquiry. Better: get pre-approved, THEN compare.