PFL Academy

Chapter 57 — Loan Application Process and Requirements

THE CHALLENGE

Marcus applied for a loan at 22% interest because he was unprepared—he didn't know his credit score, scrambled for documentation, and missed that he'd recently changed jobs. Carmen, applying for the same type of loan, got 5.8% because she prepared for 3 months, checked her credit, and had all documents ready. Over 5 years, the difference is nearly $2,000 in extra interest. Preparation pays—literally.

LEARNING OBJECTIVES

- Complete a comprehensive loan application with accuracy and required documentation
- Understand how lenders evaluate creditworthiness using the "Five C's"
- Analyze factors that increase or decrease likelihood of loan approval
- Develop strategies to strengthen loan applications and improve approval odds

CORE CONCEPTS

Term	Definition
Debt-to-Income Ratio (DTI)	Monthly debt payments ÷ Gross monthly income × 100%; lenders prefer below 36-43%
Collateral	An asset (car, house) that secures a loan and can be seized if you don't repay; reduces lender risk
Pre-approval	Preliminary evaluation where lender reviews finances and indicates willingness to lend up to a certain amount
Hard Inquiry	When lender checks credit report during application; temporarily lowers score by a few points
Loan-to-Value Ratio (LTV)	Loan amount ÷ Asset's value; lower LTV indicates less risk (e.g., $15K loan on $20K car = 75% LTV)
Co-signer	Person with good credit who agrees to repay if borrower defaults; strengthens weak applications
Underwriting	The detailed process lenders use to evaluate application, verify information, and decide approval/terms

The Five C's of Credit

Lenders evaluate every application using these five factors. Weakness in any area affects approval odds or interest rate.

Character

Credit history, payment track record. Score 740+ = best rates; below 620 = significant challenges.

Capacity

Ability to repay based on income and existing debts. DTI below 36% preferred.

Capital

Financial reserves—savings, down payment, emergency fund. Shows financial stability.

Collateral

Asset backing the loan. Lower LTV = less risk = better terms.

Conditions: Loan purpose, economic environment, special circumstances. Lenders assess if loan makes sense.

APPLY IT

Part A: Debt-to-Income Ratio Calculations

Calculate DTI for each applicant and determine if they meet lender requirements (below 36% = good, 36-43% = acceptable, above 43% = concerning).

Applicant 1: Jordan

Gross monthly income: $4,500. Monthly debts: Car payment $350, Student loans $220, Credit cards $80.

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Total monthly debt: $350 + $220 + $80 = $______
DTI = $______ ÷ $4,500 × 100% = ______%
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Assessment: ☐ Good (below 36%) ☐ Acceptable (36-43%) ☐ Concerning (above 43%)

Applicant 2: Taylor

Gross monthly income: $3,200. Monthly debts: Rent $900, Car payment $285, Student loans $180, Credit cards $150.

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Total monthly debt: $______ + $______ + $______ + $______ = $______
DTI = $______ ÷ $3,200 × 100% = ______%
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Assessment: ☐ Good ☐ Acceptable ☐ Concerning

If Taylor wants a $300/month car loan, new DTI would be:

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New total debt: $______ + $300 = $______
New DTI: ______%
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Part B: Evaluating Creditworthiness with the Five C's

Borrower Profile: Alex

Seeking: $22,000 auto loan with $2,000 down (5-year term)
Credit score: 680 (fair), no late payments in past 2 years but limited credit history
Income: $52,000/year, employed 3 years at same company
Existing debt: $8,000 student loan ($150/month), $500 credit card balance ($25/month)
Savings: $3,500 in savings (including down payment), $800 in checking

Rate each of the Five C's (1-10) and explain:

Factor	Rating	Explanation
Character	/10	
Capacity	/10	
Capital	/10	
Collateral	/10	
Conditions	/10	

Your lending decision: ◻ Approve ◻ Approve with conditions ◻ Deny
If approve with conditions, what conditions?

Part C: Application Improvement Strategies

Scenario: Marcus's Weak Application

Marcus (credit score 610, DTI 45%, $400 in savings, job for 3 months) was denied for a $15,000 personal loan. What should he do to improve his chances in 6-12 months?

List 4 specific actions Marcus should take:

1.
2.
3.
4.

Which improvement will have the BIGGEST impact on approval odds?

CHECK YOUR UNDERSTANDING

1. Which of the Five C's is MOST affected by your credit score?

- A) Capacity
- B) Character
- C) Capital
- D) Collateral

2. Why do lenders calculate your debt-to-income ratio? What does a high DTI tell them about risk?

3. Calculate: Applicant earns $5,000/month gross and has monthly debts of $180 (student loan), $95 (credit card), and $425 (car payment). They want a mortgage that would add $1,200/month. What's their new DTI, and will most lenders approve?

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Current debt: $180 + $95 + $425 = $______
With mortgage: $______ + $1,200 = $______
New DTI: $______ ÷ $5,000 × 100% = ______%
Approval likelihood:
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4. Why does getting pre-approved BEFORE car shopping give you negotiating power?

5. Think about a loan you might need in the next 2-5 years. Assess your current Five C's and identify your weakest area. What specific steps will you take to strengthen that area?

