

Loans Table of Contents

1. The Five C's of Credit
2. What Do You Think is Meant By....
3. Borrowing From Family or Friends
4. Information Needed at Your Loan Application
5. Construction Loans and Real Estate Loans
6. Estimated Closing Costs
7. Getting a Handle on Monthly Mortgage Payments
8. Appendix

Insurance Table of Contents

1. Automobile Insurance
3. Homeowners Insurance
4. Health Insurance Terms to Know; Health Insurance
6. Life Insurance

The Five C's of Credit

When a banker is making a decision on your loan application s/he is making that decision based upon the Five C's of Credit:

Character - Many bankers think the character of the borrower is the primary consideration. Is the borrower a person of honesty and integrity? *Will the borrower pay?*

Capacity - Will the borrower have adequate funds to repay the loan? This is the question lenders are seeking the answer to when they ask income sources and have the borrower provide a Verification of Employment form. *Can the borrower repay?*

Collateral - Does the collateral pledged against the loan cover the amount of the loan? Is the collateral marketable? Usually when you borrow money against a home or other piece of property, that property is used as collateral. If you borrow money to buy a vehicle, that vehicle is used as collateral. If you do not repay your loan as agreed then the lender will take the collateral and sell it to satisfy the balance of the loan.

Capital - The lender will look at the borrowers capital position and see if there are other assets that might be used to pay the loan. The key question here is: *What other sources are available from the borrower to repay the loan if the primary source is no longer available?*

Conditions - Are the conditions affecting the borrower's ability to repay likely to remain unchanged and certainly not change for the worse. Jobs change, illness and accidents occur, and family status changes. All these can affect the borrower's ability to repay. Here the key question is: *What can go wrong?*

And that takes us back to the top - character. Every banker has seen persons of high integrity who are honest and of good character not be able to repay a loan when conditions in their life change.

Adapted from the textbook, Principles of Banking

What Do You Think is Meant By:

Character: _____

Capacity: _____

Collateral: _____

Capital: _____

Conditions: _____








*Neither a borrower nor a lender be
Shakespeare*

Borrowing from Family or Friends

A common source of borrowing is from family or friends. That sometimes may be the best option because family or friends may be willing to lend to you at a lower interest rate. They may be willing to make you a loan when a conventional lender will not because your credit is not good. But, borrowing from friends or family and not repaying promptly can be a good way to lose friends and make you an unwelcome guest at family events. Ask yourself: *Is this loan worth what I could lose if I can't repay it?*

Let us look at some ways that will continue to make this a borrowing option.

Always put the terms of the loan in writing and have both parties sign it. This can be written on any piece of paper, but should contain at least the following:

-  Name of the borrower
-  Name of the lender
-  Amount borrowed
-  Interest rate to be paid
-  Amount to be paid and how often
-  How the loan is to be repaid (it may be in labor rather than cash)
-  Date by which the entire loan is to be repaid

This may not be a legally binding contract, but it states the terms of the loan in a way that both parties understand.

But most important of all, ***always, always*** repay the loan in the terms agreed upon and by the time agreed upon!

Lending to Family and Friends

I am sure a family member or a friend has asked to borrow from you in the past. Sometimes the request has been easy to turn down. It is not hard to tell your brother that no, he may not use your VISA card to charge his tickets to a concert and pay you back when he gets his tax return. But, it is not so easy to tell him no, you will not lend him the money to put a new transmission into his only car that he needs to get to work.

When you are the lender follow the same course you would as the borrower, ***get everything in writing and have both the borrower and the lender sign.*** Here again, it

may not be a legally binding document, but it does state the terms of the loan in a way both parties understand.

Get Pre-Approved for a Loan

Shop for your money first! Do that before you even shop for your new home or new automobile. You can be an aggressive consumer and shop for the best loan terms. You can learn how much debt you will be able to handle. You can learn what further steps you may need to qualify for the loan you want.

Information Needed at Your Loan Application

1. Names, Addresses, Account Numbers, Balances and Monthly Payments for All Revolving Charge Accounts
2. Social Security Number
3. Residence Addresses – Past 2 Years
4. Landlord Names, Addresses and Phone Numbers
5. W-2 Forms for Last 2 Years
6. Most Recent Pay Stubs
7. 3 Most Recent Statements for Each Deposit Account
8. Names, Addresses, Account numbers, Balances and Monthly Payments for All Open Loans
9. Addresses of Other Real Estate Owned
10. Loan Information on Other Real Estate Owned
11. Estimated Value of Furniture and Personal Property
12. Money for Credit Report and Appraisal
13. VA Only. Certificate of Eligibility or DD214
14. Self-Employment/Tax Returns for the Last Two Years (All Schedules)

Adapted from material developed by ARVEST

Construction Loans

Construction loans are relatively short-term credits that are repaid when the builder obtains long-term mortgage financing. The proceeds of the loan are used to buy land, pay architects and contractors for their services, purchase needed materials for building construction, and meet payrolls. Consumers also use construction loans to build their “dream houses.” Frequently, a commercial bank provides a construction loan and another lender or combination of lenders extends long-term mortgage credit when the project is complete. However, a commercial bank may fill both of these lending roles.

Mortgage Loans

Real estate credit, or a **mortgage loan**, is granted knowing payments will be made for many years. The property itself is pledged by the borrower as **collateral** to secure the loan. For example, banks may extend mortgage loans on office buildings, apartment houses, and shopping centers if there is sufficient evidence that regular income from rents in the project will be more than adequate to meet a schedule of regular payments. These scheduled payments include both interest and **principal** payments. The loan balance is gradually reduced over a period of time as the payments are made.

The most common type of mortgage loan is made to individuals wishing to finance the purchase of a home. Sometimes the term *home loan* is used and means the same as a mortgage loan. The home is used as collateral for the loan.

Fixed Rate Mortgage Loans

Are just that – the interest rate on the loan is “fixed” for the life of the loan. When you are able to get a Fixed Rate Mortgage Loan for 6% or less it is a good idea to take it. A fixed rate 6% mortgage loan for 30 years (that means you have 30 years or 360 months to repay your loan) is a desirable loan. *Make sure there is no prepayment penalty so that you can increase your loan payments as your income increases and perhaps pay off your loan early.*

Adjustable Rate Mortgage Loans

On an adjustable rate mortgage the lender can adjust the interest rate on the mortgage during the term of the loan as rate conditions change and in accordance with the loan contract. Typically the interest rate is tied to some indicator such as the Treasury Bill rate and the rate can only be adjusted by a certain amount – say 2 percent – each year. Adjustable rates on mortgages work to the advantage of both the bank and the borrower. If interest rates decline, the borrower gets the benefit of the lower rate. If interest rates rise, the bank’s risks are reduced because the bank can then increase the interest rate.

Estimated Closing Costs Table

Loan Amount	Closing Costs	Loan Amount	Closing Costs
\$30,000	\$1,100	\$75,000	\$1,750
35,000	1,200	80,000	1,800
40,000	1,250	85,000	1,900
45,000	1,300	90,000	1,950
50,000	1,375	95,000	2,000
55,000	1,450	100,000	2,100
60,000	1,525	105,000	2,250
65,000	1,600	110,000	2,400
70,000	1,650	115,000	2,600

You will need your closing costs in addition to your down payment at the time you purchase your home. So, if you are buying a \$80,000 home and putting 10% down, you will need at least \$9,800 - \$8,000 for the down payment and \$1,800 for the closing costs.

Getting a Handle on Monthly Mortgage Payments

Locate the cost of your house in the left-hand column. Now locate the amount of your down payment in the next column. Now on the table on the right find the current interest rate being charged for a 30-year fixed-rate mortgage. As you can see, you would have a lower monthly payment with a 20% down payment than with a 10% down payment. That is, of course, because you would borrow less.

Note the table includes only principal and interest payments, and not property taxes, homeowners insurance, or PMI. Use the following rules of thumb to estimate (very roughly) these costs. Annual property taxes are typically between 1% and 3% of the cost of your home; PMI amounts to about 0.4% of your mortgage per year; and homeowners insurance can range from \$200 to \$1,000 per year. These extra costs can vary dramatically depending on where you live and the amount of your mortgage.

Cost of Home	Down Payment		Monthly Mortgage Payment With Interest Rate Of			
	%	\$	6%	8%	10%	12%
\$50,000	10%	\$5,000	\$270	\$330	\$395	\$463
	20%	\$10,000	240	294	351	411
\$100,000	10%	\$10,000	\$540	\$660	\$790	\$926
	20%	\$20,000	480	587	702	823
\$150,000	10%	\$15,000	\$809	\$991	\$1185	\$1389
	20%	\$30,000	719	881	1053	1234

Based on the above information:

- The annual property taxes on a \$100,000 home would be between \$_____ and \$_____.
- PMI on a \$90,000 mortgage would be \$_____ per year.
- Homeowners insurance would cost between \$_____ and \$_____ per year.

Calculate how much these three expenses would add to your monthly payment on a \$100,000 home against which you have a \$90,000 mortgage.

Property taxes \$ _____

PMI \$ _____

Homeowners Insurance \$ _____

Adapted from material in Get a Financial Life by Beth Kobliner

Appendix

The Fannie Mae Foundation has some excellent publications to help more Americans better understand what it takes to reach the American Dream of acquiring assets.

If you or any of your friends, relatives, or neighbors would like more information on credit or borrowing you may get some well-written information at no cost.

For a free copy of *Knowing and Understanding Your Credit* or *Borrowing Basics What You Don't Know can Hurt You* call Fannie Mae.

When you call ask for the publications by name.

For free copies of *Knowing and Understanding Your Credit* in English, Chinese, Korean, or Vietnamese call 1-800-605-5200.

For free copies of *Knowing and Understanding Your Credit* in Spanish call 1-800-541-6300.

For a free copy of *Borrowing Basics What You Don't Know can Hurt You* in English, call 1-800-605-5200.

For a free copy of *Borrowing Basics What You Don't Know can Hurt You* in English, call 1-800-541-6300.