Marginal Consumer Loan Applicants

Tips to assess borderline candidates

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Borderline Candidates **Yes** or **No?**

If there are warning signs, it's absolutely the smart reaction to be hesitant about approving a borderline loan application. However, it's equally smart to take the time to do a deeper look behind the scenes. The facts may show the candidate offers good longer-term potential and you can earn a new customer. They also may indicate the best decision is to reject the application to protect your organization. In either case, a deeper look offers the details that validate your decision.

This eBook offers specific best practices to help you perform a thorough due diligence on marginal loan applicants.

Residence & Employment:
Deeper Questions

Stability of residence and employment are two important criteria to make a consumer credit decision. Typical standards are two years in the service area and two years of consistent employment. If an applicant does not meet these criteria, explore these areas:

- Ask if the applicant moved into a larger apartment or moved from an apartment into a house. Perhaps the applicant recently moved due to a job promotion.
- Explore if an applicant who has not been at his or her current job for a least a year just switched to a higher paying position.
- Check on why an applicant has been out of work. Maybe the prior employer went out of business due to no fault of the applicant. Or they just landed a high paying new job which would enhance their stability.

New facts can emerge with a full investigation of what caused the individual to change positions or residences.

Debt to Income Ratio Over Max: **3 Tips**

A debt/income ratio that is just over the maximum in an otherwise strong application should not be automatically rejected. Look further with these three tips.

1. Look for runoffs. These are debts that are going to be fully repaid in the next few months. Excluding these debt may bring the ratio under the maximum.

2. Other sources of stable Income. Look at the personal financial statement for other sources of stable, consistent income previously overlooked.

3. Change the proposed terms of the loan. By making the term longer, the monthly payments are reduced and the ratio may meet the guidelines.

When you include these factors, it may change the ratio in the applicant's favor and can help you give a consumer loan to a good prospect.

Counteroffers:
Common Approaches

In some cases, you may feel an applicant is a good credit risk, but that you cannot approve the loan under the terms requested. These common counteroffers create a win-win.

Revise loan terms:

Offer a lower amount. This is appropriate for a line of credit or credit card. With an installment loan, a lower amount may not meet the applicant's needs.

Increase the term of the loan. This reduces the monthly payments and makes repayment easier. You need to be careful to match the term with the expected life of the property.

Request a co-signer or guarantor:

Both are responsible for repaying the entire debt if the borrower can't or won't. A co-signer signs the debt agreement and is responsible for the debt. A delinquency or default affects credit ratings.

A guarantor signs a guarantee and promises to repay if, and only if, there is a default.

Both must be fully informed of the terms of the loan and their obligations. You must perform a credit check on each and have a personal financial statement filled out to determine if the co-signer or guarantor has the ability to repay.

Counteroffers:
Common Approaches

Request collateral:

Lenders prefer to take property as collateral that increases, or appreciates, in value, such as the applicant's residence or investment real estate. It can also include collateral easily valued, such as certificates of deposit and marketable securities.

Collateral does not balance weaknesses in character or ability to repay. Collateral is viewed as a secondary source of repayment. The first source of repayment is the borrowers cash flow.

It is taken to impress borrowers with the necessity of repaying and to give them the added incentive to repay.

Collateral also may be offered by a co-signer or guarantor. In this case, it is necessary to have that person sign a special agreement, called a "hypothecation agreement" pledging the property.

Marginal Applicants: Use the Facts

You have two hats to wear. Helping your organization serve customers and grow business. And protecting your company from risks and bad debt.

It's not easy. But by exploring what's going on behind the scenes, you can uncover the real answers for the best business decisions.

For additional help with this important issue, contact OnCourse Learning Financial Services.

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