

What Lenders Look For When Underwriting Personal Credit

Presentation to the Financial Planning Association of Northeast Ohio

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Consistent Underwriting for Credit: Mortgages, Consumer Loans, Business & Investment Purpose Loans

PRIMARY SOURCE OF REPAYMENT:

Personal Cash Flow

SECONDARY SOURCE OF REPAYMENT:

Liquidation of Collateral

AN OVERVIEW OF KEY FINANCIAL COMPONENTS WHEN LENDING TO INDIVIDUALS

CATEGORIES OF FINANCIAL ANALYSIS

- ✓ **Personal Financial Statement**
- ✓ **Qualifying Personal Cash Flow**
- ✓ **Personal Debt Calculation and Leverage Ratio**
- ✓ **Credit Scores**
- ✓ **Liquidity**
- ✓ **Collateral and Loan to Value Percentages**

PERSONAL FINANCIAL STATEMENT

Personal Financial Statement

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Date of Statement:

Balance Sheet

Assets			Liabilities		
Cash	(schedule 1)	\$	Consumer Debt	(schedule 10)	\$
Marketable Securities	(schedule 2)	\$	Margin/Brokerage Loans	(schedule 2)	\$
Retirement/Contingent Assets	(schedule 3)	\$	Mortgages on Personal Real Estate	(schedule 8)	\$
Cash Value Life Insurance	(schedule 4)	\$	Mortgages on Investment Real Estate	(schedule 9)	\$
Non-Marketable Securities	(schedule 6)	\$	Loans Against Life Insurance	(schedule 4)	\$
Privately-Owned Business	(schedule 7)	\$	Accounts/Notes/Taxes Payable	(schedule 13)	\$
Real Estate - Personal	(schedule 8)	\$	Other Liabilities	(schedule 11)	\$
Real Estate - Investment	(schedule 9)	\$	TOTAL LIABILITIES		\$
Accounts/Notes Receivable	(schedule 12)	\$	NET WORTH (Total Assets - Total Liabilities)		\$
Personal Property	(schedule 14)	\$			
TOTAL ASSETS		\$	Contingent Liabilities	(schedule 15)	\$

QUALIFYING PERSONAL CASH FLOW

DEFINITION: Aggregate personal income that is deemed reliable and recurring

COMPONENTS OF PERSONAL INCOME INCLUDE:

- **Salary and Wages**
 - C-Corp: Bonuses included in this W-2 component
- **Interest and Dividends, net of passthru's – Schedule B**
- **k-1 Distributions (net of capital contributions) – S-corps, LLC's, Partnerships, Trusts**
 - Cash Distributions, Guaranteed Payment to Partners
- **Sole Proprietorship – Schedule C**
- **“Recurring” Capital Gains – Schedule D**
- **Real Estate Activity – Schedule E**
- **Social Security and Pension**
- **Qualified Plan Distributions – (IRA's, 401-k, etc.)**
- **Other Income**

CALCULATING QUALIFYING INCOME

- ❖ Customary to calculate a 24-month average if most recent filed fiscal year income is higher than prior
- ❖ If most recent fiscal year is lower than the prior year, then the lower income is used – not a 2-yr average
- ❖ Make adjustments for changes in historical and/or justified ongoing income and expenses
- ❖ Review last 2-3 years of filed tax returns (business & personal) and actual k-1's, W-2's, paystubs, etc.
- ❖ For closely-held businesses where ownership is >25%, business tax returns required
- ❖ For real estate investors with a portfolio of asset holdings – obtain the Global Cash Flow Worksheet
- ❖ Federal Regulatory and Compliance Policies require lenders to request more financial documentation

CALCULATING PERSONAL DEBT SERVICE

PURPOSE IS TO DETERMINE CURRENT LEVERAGE AND CAPACITY TO SERVICE PROPOSED DEBT OBLIGATION

- Monthly principal, interest, taxes & insurance (PITI) on primary, secondary, or vacation homes
- Monthly principal & interest payment on installment loans (i.e. home equity term, auto, lease, student loans, etc.)
- 3-5% minimum payment billed on credit cards
- Home Equity Lines of Credit: Interest-only payment on outstanding OR based on line commitment
- Securities Based Lines of Credit: Interest-only payment on outstanding loan balance
- Calculate the proposed monthly debt payment on the new loan request

 **COMBINED MONTHLY DEBT PAYMENTS / GROSS MONTHLY QUALIFYING INCOME \leq 43% (D/I Ratio)**

CREDIT SCORES

740 and Up	Top Score: Best Rates & Terms
700 - 739	Excellent Score: Desirable Borrower
680 - 699	Good Credit
660 - 679	OK Credit
641 - 659	Borderline Credit
640 and Below	Needs to Repair Credit

PURPOSE: Determines the “Ability” and “Willingness” to Repay Debt

Credit Scores (FICO) can affect loan and credit card interest rates , rent payments, insurance premiums and loan approvals

5 Factors Affecting Credit Scores:

- **Payment History (35%):** Pay your debts **ON TIME - EVERYTIME**
- **Outstanding Credit Balances (30%):** Keep balances below 30% of available limits
- **Credit History (15%):** Length of time a credit product has been established
- **Types of Credit (10%):** Mix of loan types & credit cards; limit concentration of cards
- **Inquiries – New Credit (10%):** Number of credit report inquiries over a six-month period

THE FOLLOWING ASSETS ARE COMPONENTS OF PERSONAL LIQUIDITY:

- **Cash and Cash Equivalents – checking, savings, money markets, CD's**
- **Unencumbered marketable securities – stocks, bonds, treasuries, municipals, mutual funds, etc.**
- **Cash value of Life Insurance – whole, variable, universal policies**

- **Qualified Assets such as IRA's, 401-k's, SEP's, Profit-Sharing Plans are treated differently**
 - **Unable to serve as Collateral**
 - **Unable to include in judgement on Default**

- **As a Liquidity Covenant for unsecured lending – 2.5 to 3.0 X Loan Request**

COLLATERAL TYPES AND LOAN TO VALUES (LTV)

RESIDENTIAL REAL ESTATE:

- Primary Residence or Vacation Home = 80% LTV (HELOC's up to 85%)

INVESTMENT REAL ESTATE:

- Residential or Commercial = 70-75% LTV (Owner-occupied commercial Up to 80%)

VACANT LAND: 60% LTV

CASH VALUE OF LIFE INSURANCE:

- Whole Life Policies = 90% LTV
- Variable & Universal Policies = 70% LTV

MARKETABLE SECURITIES:

- Non-margin = Up to 70% LTV based on Asset Allocation Mix
- Margin = 50% LTV

FIXED INCOME SECURITIES (Bonds): Up to 80% LTV

CASH AND CASH EQUIVALENTS: 100% LTV

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