Module 3: Applying for a Loan the 5 C's of Borrowing

Teaching Notes:

This module covers the requirements for a loan application as well as the factors that determine whether a loan is approved or denied. Banks and lenders measure the risk of lending to someone; credit scores indicate the level of borrower risk: higher scores indicate lower risk and lower scores indicate higher risk. If the risk is too high, the lender may not approve the loan. This module has various sources of money that can hold positive or negative impacts. For example, obtaining a loan from a family member might mean little to no interest is paid but could lead to a strained relationship if the loan isn't paid on time. Understanding the terms and conditions of a loan BEFORE you sign could save you hundreds. Depending on the type of loan, the personal information required will be different (collateral may not be required for some types of loans). Lenders require this information so they can determine whether the borrower is capable of repaying the loan. The 5 C's of borrowing are credit factors that the lenders use to determine if the borrower is capable of repaying the loan. Understanding what a lender is looking for in a borrower can help potential borrowers increase their chances of being approved for a loan or getting a loan with a better interest rate. The 5 C's of borrowing are

- **Capacity** – The ability to repay the loan.
- **Capital** – Personal money invested in the business or your net worth.
- **Collateral** – If necessary, the assets you are willing to use as repayment in case you cannot repay the loan.
- **Conditions** – What is the money going to be used for? What are the overall economic conditions?
- **Character** – The general impression you make on the lender.

Remind your students to keep track of their cash flows and budgets; if they have an accurate budget they may find that applying for a loan is not necessary. Instead, they can cut frivolous expenses and save to buy the things they want. If applying for a loan is necessary, they already have an idea of where they stand in the eyes of a lender.

Educational Objectives:

- Understand what lenders are looking for in a borrower
- Understand the terms and conditions of different loans
- Understand the 5 C's of borrowing

Discussion Topics:

- What is the relationship between risk and interest rates?
- What are the benefits and/or drawbacks of the different sources of loans?
- What is the difference between a secured and unsecured loan?

Resources:

- **Worksheets:**
  - None
- **Other:** Example loan application from USDA-Farm Service Agency

Outline:

1. Key Concepts
2. Qualities Banks and Lenders Look for in a Borrower
3. Sources of Money
4. Terms and Conditions of a Loan
   a. Repayment Time
   b. Type and Rate of the Interest Charges
   c. Fees and Penalties
   d. Collateral Required?
5. Personal Information Required for Loan Application
   a. Why is it important to have this information?
6. 5 C's of Borrowing
   a. Capacity
   b. Capital/Cash
   c. Collateral
   d. Conditions (of the Loan)
   e. Character
7. Basis Loan Approval
8. Money Management Module Review
   a. Next Module: Money Management Module 4: Credit Scores
9. Reminder to Keep Track of Your Budgeting Exercise

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Acknowledgments: Vicki Hebb, reviewing content, and Russ Tronstad and Stuart Nakamoto, content.

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USDA United States Department of Agriculture
National Institute of Food and Agriculture

This material is based upon work that is supported by the National Institute of Food and Agriculture, U.S. Department of Agriculture, under award number 2013-38640-22175 through the Western Sustainable Agriculture Research and Education program under subaward number EW14-017. USDA is an equal opportunity employer and service provider. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the view of the U.S. Department of Agriculture.