

# Lending Fundamentals



# Basic loan terms

---

**Principal:** A principal or debt is an obligation owed by one party (the debtor) to a second party, the creditor. A debt is created when a creditor agrees to lend a sum of assets to a debtor.

1)

**Tenure :** Tenure is the period or duration for which the loan amount is sanctioned.

Personal loans, car loans, education loans have shorter tenures as compared to home loans. Some banks and financial institutions extend the loan tenure for an extra fee or a slight increase in interest rates.


# Concept of Interest

---

Interest is the amount earned, on money which is lent.

Simple Interest : It is calculated only on the principal amount.

$$\text{Simple Interest (SI)} = P \cdot r \cdot t / 100$$



P = Principal  
r = Rate of interest  
t = Time period in years

# Concept of Interest Contd.

---

## Interest:

- 1) **Fixed rate** : The interest rate of the loan is fixed through the loan tenure.
- 2) **Floating rate**: The rate is dependent on PLR so keep on changing when the PLR changes. Floating rates will be preferred only for long terms loans .

It is defined with two parts:

**Base rate / Anchor rate:** Based on Prime lending rate (PLR)

**Markup / Margin Offset:** It is fixed for one loan and varies from loan to loan

$$\text{Floating rate} = \text{PLR} + \text{Markup}$$

# Basic terms

---

**Installment Loan :** Loan that is repaid over time with a set number of scheduled payments. The term of loan may be as little as a few months and as long as 30 years. A mortgage, for example, is a type of installment loan.

**Loan Payment:** The more you pay in advance, the lower should be the EMI. For every EMI paid up front, EMI amounts should reduce by at least Rs.100 per Rs.100,000 of loan.

Make allowances for the number of EMIs paid in advance.

# Basic terms

---

**Pre-EMI** : The simple interest that one pays on the loan amount till the EMIs kick in. This is usually paid when you are taking possession of the home

**Example** : If you have taken a home loan and it is under construction and you have not got the possession then you have pay the rate of interest (pre EMI)to bank till you get the keys of your home then your real EMI will start

**Charge**: A charge levied by a lender for accepting a loan application and gathering the supporting paperwork.



# Basic terms

---

Late is any payment that is "posted" after the due date. You can still pay on or before the due date and still have your payment process a day or two later to be posted.

For it to show up on your credit report as 30 days late is for the payment to either be later than the next months due date and sometimes it can be sooner if the bank goes by the next months closing date.

It costs you money to pay after the due date. It costs you your credit to go more than 25-30 days after that date

A charge assessed for late payment.

# Repayment Schedule

---

**Repayment/ Amortization schedule** is a table detailing each periodic payment on an amortizing loan (typically a mortgage), as generated by an amortization calculator. Amortization refers to the process of paying off a debt (often from a loan or mortgage) over time through regular payments. Repayment schedule is the heart of any loan system.

Benefits of repayment schedule:

- If the schedule is for home loan, then the person can get benefit on tax
- To know about the particular installment details or for future estimations
- Bank uses it to see the revenue for a particular month



<b>Loan Data</b>	
Loan Amount	\$10,000.00
Annual Interest Rate	13.00%
Loan Period in Years / Tenure	1
Number of Payments Per Year	12

Payment No.	Loan Amount	EMI	Principal Component	Interest Component	O/s Principal
1	10000	893.17	785	108	9,215
2	9215.16	893.17	793	100	8,422
3	8421.82	893.17	802	91	7,620
4	7619.88	893.17	811	83	6,809
5	6809.26	893.17	819	74	5,990
6	5989.85	893.17	828	65	5,162
7	5161.57	893.17	837	56	4,324
8	4324.31	893.17	846	47	3,478
9	3477.99	893.17	855	38	2,622
10	2622.49	893.17	865	28	1,758
11	1757.73	893.17	874	19	884
12	883.6	893.17	884	10	(0)

# Cash Flow

---

**Internal rate of return (IRR):** It is a rate of return used in capital budgeting to measure and compare the profitability of investments. It is also called the discounted cash flow rate of return (DCFROR) or the rate of return (ROR). In the context of savings and loans the IRR is also called the effective interest rate

**NPV:** The **NPV** is simply the PV of future cash flows minus the purchase price (which is its own PV).



# NPV (Net Present Value)

---

NPV is an evaluation tool used to find out if the rate of return of a series of cash flows, is higher or lower than a comparison rate.

There are two conditions when you will need to use NPV:

1. Cash flows in future.
2. Return not known.

# IRR (Internal Rate of Return)

---

The rate which makes the present value of all future cash inflows equal to the outflow or investment today, i.e. makes the  $NPV=0$ , is the yield of the investment.

This is the yield to maturity – i.e. the yield or return after considering all the cash flows from the investment. This is also called Internal Rate of Return (IRR).

# NPV Vs IRR

---

- **NPV** is calculated in terms of currency while **IRR** is expressed in terms of the percentage return a firm expects the capital project to return;
- Academic evidence suggests that the **NPV Method is preferred** over other methods since it calculates additional wealth and the IRR Method does not;
- The IRR Method cannot be used to evaluate projects where there are **changing cash flows** (e.g., an initial outflow followed by in-flows and a later out-flow, such as may be required in the case of land reclamation by a mining firm);

# Onboarding Process

---

## **Affordability:**

- Income
- Assets
- Other loans
- Qualifications
- Dependents
- DTI (Debt to Income)
- DBR (Debt burden ratio)

•

## **Intention:**

- Background
- Intention
- Character
- CIBIL
-



Thank you