

Understanding Debt-to-Income Ratio

Where to Start?

Understanding your debt-to-income (DTI) ratio is a key component of maintaining your overall financial health. With more than 40% of Americans seeking ways to better manage or reduce debt, knowing your debt-to-income ratio can help you make informed decisions about taking on new loans and long-term financial planning.

Your debt-to-income ratio provides insight into how much of your income is dedicated to debt obligations and helps you evaluate whether your current debt level is manageable. Knowing your debt-to-income ratio can also help you to decide if taking on more debt is a wise choice.

Lenders rely on this ratio when reviewing credit applications, as it is an important measure of a borrower's ability to take on additional financial responsibility.

Calculate Your Debt-to-Income Ratio

Your debt-to-income ratio compares how much you owe each month to how much you earn. It is the percentage of your monthly gross income, before taxes, which is used to pay recurring debt obligations, such as rent, mortgage payments, credit cards, loans, and other debt. The following steps will help you to understand how to calculate your ratio.

Step 1

Add up your monthly bills, including:

- Rent or mortgage payment
- Alimony or child support payments
- Student loans, auto loans, and other installment loans
- Credit card minimum payments
- Any other recurring debt payments

Living expenses such as groceries, utilities, gas, and taxes generally are not included.



Step 2

Divide your total monthly payment by your gross monthly income. If you do not know your gross monthly income, you can find it on your pay stub.

Step 3

Convert the result into a percentage by multiplying by 100. This figure is your debt-to-income ratio. Generally, a lower debt-to-income ratio indicates a lower financial risk and greater borrowing flexibility.

Lenders & Your Debt-to-Income Ratio

After calculating your debt-to-income ratio, it is important to understand how lenders will evaluate it when reviewing your application. Below are general guidelines commonly used by lenders.

35% or Less – This is a favorable ratio. Your debt level is considered manageable relative to your income. You likely have sufficient funds remaining, or leftover money for savings, after you have paid your bills.

36% to 49% – There is opportunity for improvement. You may be managing your debt effectively, but reducing your debt-to-income ratio could strengthen your financial profile. A lower ratio may improve your ability to handle unexpected expenses. If you apply for credit with a ratio in this range, lenders may require additional eligibility criteria.

50% or More – Action is recommended to reduce debt. When half of your income is allocated to debt payments, you may have limited capacity to save, spend, or absorb unforeseen costs. If your ratio is within this range, lenders may restrict borrowing options or deny applications altogether.

How to Lower Your Debt-to-Income Ratio

If your debt-to-income ratio exceeds a lender's preferred guidelines, there are several steps you can take to bring it into an acceptable range. Generally, you can improve your debt-to-income ratio by increasing your income, reducing your debt, or lowering your monthly housing costs.

Here are a few ways to increase your income:

- Request overtime hours, if available.
- Ask for a salary increase, when appropriate.
- Look for a side hustle.
- Consider getting a part-time job.

Here are a few ways to pay down your debt:

- Focus on paying down high-interest debt.
- Consider a balance transfer credit card.
- Explore refinancing options for student loans.
- For a short time, decrease your monthly savings and prioritize making extra payments towards debts.
- Reduce discretionary spending, such as going out to eat and unnecessary subscriptions, and instead use the money saved to pay off credit cards or other loans.

Frequently Asked Questions

Does your credit score impact your debt-to-income ratio, and vice versa?

No, debt-to-income ratios and credit scores are two separate calculations that lenders use to evaluate your ability to repay a loan. While both calculations rely on information from your credit report, debt-to-income ratios incorporate your income, whereas your credit score does not. That said, paying down existing debt, such as credit card balances or auto loans, may improve both your debt-to-income ratio and your credit score at the same time.

Is rent included in a debt-to-income ratio?

Yes. If you are currently leasing an apartment or home, your monthly rent payment is typically included in your debt-to-income ratio. Housing costs are considered essential financial obligations, regardless of whether you rent or own. A signed lease for an apartment or condo represents a fixed monthly commitment, similar to a mortgage payment or student loan payments.

Do lenders use gross or net income when evaluating debt-to-income ratios?

Lenders calculate debt-to-income ratios using gross income, which is your income before taxes and other deductions. Using gross income helps lenders to have a universal standard when comparing borrowers.

What debt amount should I include if I pay more than my credit card's minimum monthly balance?

When calculating your debt-to-income ratio, only include the minimum payment required for credit cards, even if you pay the total balance each month.

Do debt-to-income ratios include utilities, groceries, or insurance payments?

No. Debt-to-income ratios focus on reoccurring debt obligations reported on your credit report or required by contract. Everyday expenses like healthcare, child or pet care, internet, and entertainment subscriptions are not usually included.