Financial Empowerment

Debt-to-income calculation

Your debt-to-income ratio is like your blood pressure. Your blood pressure measures the amount of pressure on your heart; your debt-to-income ratio measures how much pressure debt is putting on your budget.

Your debt-to-income ratio is a simple calculation. It is the total of your monthly debt payments divided by your monthly gross income. Gross income is the amount of your income before any taxes or other deductions are taken.

The result is a percentage. This tells you how much of your income is going toward covering your debt.

Another way of seeing the debt-to-income ratio is that it represents how much of every dollar you earn goes to cover your debt.

For example, if your debt-to-income ratio is .45, or 45%, then 45 cents out of every dollar you earn goes toward your debt. This leaves you with 55 cents of every dollar to cover your rent, taxes, insurance, utilities, food, clothing, child care, and so on.

In addition to using the debt-to-income ratio to measure how much pressure debt is putting on your budget, you can also use it as a benchmark if you implement a debt reduction plan. As you pay down your debts, your debt-to-income ratio will also decline. And this will result in money being freed up to use on other things, such as saving for your goals, unexpected expenses, and emergencies.

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Use the following tool and the analysis to figure out your debt-to-income ratio.

Your total monthly debt payment (from Tool 1)	
DIVIDED BY	
Your monthly gross income (Income before taxes)	
EQUALS	
Your current debt-to-income ratio	

Understanding your debt-to-income analysis

If your debt-to-income ratio is higher than these percentages below, it could be difficult to pay all your monthly bills because so much of your income will be going to cover debts. A high debt-to-income ratio may also impact your ability to get additional credit because creditors may be concerned that you would not be able to handle their debt on top of what you already owe.

The following debt-to-income ratio ranges are guidelines. These ranges are not rules. In fact, many creditors set their own guidelines. What is an acceptable level of debt to one creditor may not be to another.

- **For renters: Consider maintaining a debt-to-income ratio of 15% -20% or less.**
  - This means that monthly credit card payments, student loan payments, auto loan payment, and other debts should take up 20% or less of your gross income.
- **For homeowners: Consider maintaining a debt-to-income ratio of 28% -35% or less for <u>just the mortgage (home loan), taxes, and insurance.</u>**
  - This includes the monthly principal, interest, taxes, and insurance (called PITI).
- **For homeowners: Consider maintaining a debt-to-income ratio for all debts of 36% or less.**

- This means that if you have a mortgage and other debts—credit card payments, student loan payments, auto loan payment, and payday loan payments–your debt-to- income ratio should be below 36%.
- If you have court-ordered, fixed payments, such as child support, count these as debt for this purpose.
- Some lenders will go up to 43% or higher for all debt.[34]

If your debt-to-income ratio is above these limits, you may want to use the following tool to develop a plan to reduce your debt and lower your debt-to-income ratio.