



Debt-to-income ratio important as credit score

By [Erin Peterson](#) • Bankrate.com

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By now you know your three-digit credit score is a very important number in your financial life, but did you know there's also a two-digit number that can be just as significant?

It's your debt-to-income ratio, and it can shed a light on, and help you better understand, your true financial picture.

The good news is, getting this number doesn't cost you a penny, and it can be calculated in just a few minutes at your kitchen table.

So, if you think getting insight into your financial life requires sifting through your retirement investments, reading through every fund prospectus and tallying your expenses to the penny, think again.

It's true that nitty-gritty details can make a difference, but you can get a fairly accurate understanding of your financial picture by spending just a minute or two calculating your debt-to-income ratio. By knowing the ratio -- and how to improve it -- you can increase your chances of getting a better mortgage, a better car loan and even better credit card rates.

DTI explained

Your debt-to-income ratio is exactly what it sounds like: the amount of debt you have in the form of mortgages, car loans, student loans and credit card debt, as compared to your overall income.

To calculate your overall debt-to-income ratio, sometimes known as a back-end ratio, add up all of your monthly debt obligations -- often called recurring debt -- including your mortgage (principal, interest, taxes, and insurance) and home equity loan payments, car loans, student loans, your minimum monthly payments on any credit card debt, and any other loans that you might have. Do not include expenses such as groceries, utilities and gas. Take this total and divide it by your gross monthly income from all sources. If you're not good at long division or don't have a calculator handy, go to [Bankrate's calculator section](#) to use our [debt-to-income ratio calculator](#).

Note: Some lenders will exclude the mortgage payment from this equation, but they lower the ratio. The concept is the same: it measures your debt load in comparison to your income.

Let's say you and your spouse together earn \$83,000 per year or \$6,916 per month. Your total mortgage payment is \$1,350, your car loans total \$365, your minimum credit card payments are \$250 and your student loans add up to \$300. That equals a recurring debt of \$2,265 a month. Divide the \$2,265 by \$6,916 and you'll find your DTI is 32.75 percent.

In general, you'll want to keep that number below 36 percent -- a threshold that loan officers and credit card issuers often use as a factor when they determine how much they're willing to lend you. "If you go higher than 36 percent, you are on a slippery slope," says Diane McCurdy, a Certified Financial Planner and author of "[How Much Is Enough?](#)" Lenders might give you money, she adds, "but they'll give you higher interest rates, and if anything goes awry, they'll sock it to you."

So why is that number so important? It's all about proportion, says Laura Russell, a certified financial counselor with [GreenPath Debt Solutions](#). "You can be making a lot of money every month, but if you've got the debt to match it, that can be a problem," she says. "It's important not to overextend yourself." The higher your number, the riskier it is for lenders to offer you loans -- and the more they'll make you pay for them.

Finding leverage

While debt-to-income ratios don't have the kind of buzz that credit scores do, they can play a key role in determining if you qualify for a loan and how much you can get. "Your debt-to-income ratio is one of the tools that banks will use to determine whether they'll lend you money for a mortgage, a car loan or a student loan," says Dave Hinnenkamp, CEO of [KDV Wealth Management](#).

While other factors, such as your credit score and length of time in your home or job, will come into play into this equation, a good debt-to-income ratio can give you leverage to negotiate if other factors aren't in your favor. "The stronger you are financially, the more leverage you have when negotiating interest rates or loan amounts," says Hinnenkamp. "So there is an advantage to keeping that ratio low."

Next: "Cutting your ratio"

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