Tool 2:

Debt-to-income worksheet

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.

The 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. That 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 percent, 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 take steps to reduce your debt. As you pay down your debts, your debt-to-income ratio will also decline. This means money is being freed up to use on other things like saving for your goals, unexpected expenses, and emergencies.

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 a certain percentage, 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 wouldn't be able to handle their debt on top of what you already owe.

The following debt-to-income ratio ranges are guidelines, not rules. In fact, many creditors set their own rules. 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 percent or less.**
  - This means that monthly credit card payments, student loan payments, auto loan payment, and other debts should take up 20 percent or less of your gross income.
  - If you have court-ordered, fixed payments, such as child support, count these as debt for this purpose.
- **For homeowners: Consider maintaining a debt-to-income ratio of 28-35 percent or less <u>just for the mortgage (principal and interest), taxes, insurance, and condo or homeowner association fees.</u>**
- **For homeowners: Consider maintaining a debt-to-income ratio for all debts of 36 percent or less.**
  - This means that if you have a mortgage and other debts – credit card payments, student loan payments, auto loan payment, and other loan payments – your debt-to-income ratio should be below 36 percent. Some lenders will go up to 43 percent or higher for all debt.[49]
  - If you have court-ordered, fixed payments, such as child support, count these as debt for this purpose.

49 See https://www.fha.com/fha_requirements_debt

If your debt-to-income ratio is above these limits, you may want to use *Tool 3: Reducing debt worksheet* to develop a plan to reduce your debt and lower your debt-to-income ratio.

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