How to Calculate your Debt-to-Income Ratio

If you're in the market to buy a house, your mortgage lender will look at a couple of main factors to determine if you qualify. Most people know they check your credit score and credit history, but they aren't aware of the debt-to-income ratio and how it works.

What is a Debt-to-Income Ratio?

Your DTI is a comparison of your monthly debts to your gross monthly income (income before taxes). The higher the percentage is, the higher your risk of default becomes. Lenders like borrowers with a DTI of 43% or less. This leaves plenty of money for living expenses and savings, reducing the risk of default.

What's Included in your Debt-to-Income Ratio?

The only information you need to calculate your DTI is your total debts and total income.

Debts to Include in your DTI

The debts you include are those on your credit report. A few examples include:

- Car payments
- Minimum credit card payments
- Personal loan payments
- Student loans

The DTI also includes the new mortgage you're applying for which includes the principal, interest, real estate taxes, and homeowner's insurance. It also includes any HOA dues and mortgage insurance, if applicable.

Income to Include in your DTI

You can include any income the lender will use for qualifying purposes. Obviously, this includes your full-time income. But if you have any other sources of income that have a two-year history and will continue for the foreseeable future, you may include them too.

Common examples include alimony or child support you receive or side gigs you run with income you can prove.

Calculating your DTI

With these two totals, you can calculate your own debt-to-income ratio using this calculation:

Total debts/Total income = Debt-to-income ratio

Here's an example.

Jan makes $7,000 a month before taxes. Her debts include the following:

- Minimum credit card payments $150
- Car payment $300
- Student loan payment $250
- New mortgage payment $1,750

Jan's debt-to-income ratio is:

$2,450/$7,000 = 35%

How to Lower your Debt-to-Income Ratio

If your debt-to-income ratio is higher than a lender might like, here are a few ways to lower it:

- Pay your credit cards down or off – If you have credit card debt, try to pay it off. If you can't, at least pay them down so your minimum payment drops, and you lower your DTI.

- Pay down other debts – If you have other consumer debts you can pay down to have less than 6 payments, lenders may exclude them from your DTI

- Increase your income – If your income is too low, take on a part-time job or start a side gig. You'll need to show receipt of income for a while, so the sooner you start it the better.

Final Thoughts

Your debt-to-income ratio is just as important as your credit score. Take the time to figure out your DTI and where you stand before thinking about buying a house. You can prepare both your credit score and debt ratio early on to increase your chances of loan approval.