

Report 5

Debt-to-Income – How does the debt-to- income ratio work?

Free Mortgage Information



Debt-to-Income – How does the debt-to-income ratio work?

The debt-to-income ratio indicates how high your debt is as compared to your income. The higher the ratio, the higher a credit risk you are. The ratio is a calculation of your total monthly debt payments divided by your monthly gross income.

EXAMPLE:

TOTAL DEBT PAYMENT = \$600

TOTAL MONTHLY INCOME = \$3000

DEBT-TO-INCOME RATIO = 20% (600/3000)

The acceptable debt-to-income ratios and calculations vary slightly among lenders (some include the sought-for mortgage in their debt payment totals.) However, even if your debt load is high, an excellent credit history (or credit score) can make it possible to qualify for a mortgage loan.

Along with considering your debt-to-income ratio, a lender will analyze your income and debt based on a qualifying ratio that is assigned to each type of loan. This ratio is a debt limit guideline to help determine if your income is sufficient in view of the loan you would like to obtain, first, for housing expenses only (including payment, taxes, insurance and fees) and, second, for recurring debt along with housing expenses. The standard qualifying ratio for a conventional loan is 28/36; an FHA loan usually has a higher qualifying ratio of 29/41. A higher ratio allows for more of your gross monthly income to be applied to each debt category.

For instance:

Debt-to-incomeRatio	Gross Monthly Income	Housing Expenses	Housing plus Recurring Debt
		(4,000 x .28)	(4,000 x .36)
28/36	\$4,000	\$1,120	\$1,440
29/41	\$4,000	\$1,160	\$1,640