

What is a Debt-to-Income Ratio?

A debt-to-income ratio is used by lenders to determine your maximum mortgage amount. Precisely, this ratio is the percentage of your monthly income, before taxes, used to pay monthly debts. Since there are two calculations involved, the number is written as a ratio: 33/38.

Using that example, which is the most common debt-to-income ratio, the front number and back numbers are each significant of different factors. The front number, 33, indicates the percentage of your income that goes out to pay housing costs, such as mortgage payments, HOA fees, insurance, taxes, etc.

The back number, 38, indicates the percentage of your income that goes out to pay all of your housing costs *plus* consumer debt. Consumer debt includes car payments, credit card payments, and installment loans; automobile and life insurance are not included.

Using the common guideline of 33/38, a borrower's monthly housing costs should not exceed thirty-three percent of their monthly income before taxes. When consumer obligations are added to those housing costs, the total should not exceed thirty-eight percent of their monthly gross income.

This, of course, a guideline, and as such, it is flexible. A larger down payment will make the guidelines more flexible; a smaller one tends to make them more rigid. Similarly, wonderful credit loosens the guidelines up, while very little or poor credit elicits stricter guidelines.

Also, the ratio specifics can depend on the loan. For example, VA loans have a 29/41 guideline. FHA loans don't have a front number, but their back number is 41. Most conventional loans do use 33/38.