

How Much Debt Is Too Much Debt?

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It seems there are many significant life events that are difficult to accomplish without taking out a loan or charging a credit card. Student loans are the norm for today's college students, a mortgage is expected for buying a home and new car-owners hardly blink when applying for a car loan.

While loans may be the new standard in major financial decisions, how do you know if you're taking on too much debt? If you do have too much debt, what can you do? The first step you can take to analyze your debt limits is calculate your debt-to-income ratio (DTI), followed by some simple debt-reduction strategies.

Know your DTI. The DTI is an equation made up of your monthly debt payments divided by your monthly gross income. Some helpful guidelines for renters is to limit the DTI to 15-20 percent, while homeowners may increase to 36 percent.

For example, suppose a young woman recently graduated from college, got a job, and now earns \$2,200 per month after taxes. She has student loans with total minimum monthly payments of \$200 and is considering buying a new car with a minimum monthly payment of \$300.

Without the car payment, her DTI is less than 10 percent. With the car payment her DTI is 22 percent. For the woman in our example, the car payment may be risky to take on as it would use up money she could have used for emergencies or other expenses.

Is giving up the car her only option? Not quite. Here are a few things you can do to lower your DTI ratios and open up new opportunities.

Boost your income. It may be the right time to ask for a raise at work or to explore options for working overtime. Many take on a small, part-time job over weekends to earn a little cash here and there that adds up at the end of the month. Baby-sitting, handy work, yard work — use your skills.

Pay off your debt quickly. Even adding \$15 to your debt payments could take years off of your total payments. Need some tips to find a quick \$15? Try this equation: cut back one beverage per week and two restaurant meals per month; how much would you save per month? About \$40, and that's just for one person.

Talk with your creditors. You can bet your creditors want your payments, but nearly everyone is willing to make a deal. If lowering your interest rate will help you give them money, they may be willing to do it. Just ask.

Talk with a professional. If you have many debts and/or a high DTI, consider talking to a credit counselor; they can help you stick to a budget and negotiate with creditors. Or talk to a financial coach at HopeSource free of charge about how to take control of your finances.

Debt doesn't have to own you. Know your limits, prevent overwhelming debt, and take control of your money.

Shianne Lowe currently serves as the Financial Literacy Coordinator at HopeSource in Ellensburg through the Washington Service Corps.