



Debt-to-Credit Ratio – what it is & why it's important

Your debt-to-credit ratio is the amount of credit you're using on your credit cards relative to your credit limits at a given time. It's an important factor in your credit scores, and lenders will usually consider it when they review your application for a loan or credit card.

According to author Ben Luthi with Experian, understanding how your debt-to-credit ratio works and using it to guide your credit usage habits can potentially help you improve your credit scores and improve your odds of securing favorable credit terms.

What Is the Debt-to-Credit Ratio?

The debt-to-credit ratio is another term for your credit utilization ratio. Other terms you may see used to describe the same concept are balance-to-limit ratio and debt-to-limit ratio. Regardless of the term used to describe it, the figure contributes to the "amounts owed" category of your FICO® Score®, which makes up 30% of the score.

Your debt-to-credit ratio helps lenders determine how well you manage your credit card debt. A **high ratio** could indicate that you're carrying high balances on your credit cards month to month, potentially only making the minimum required payment.

High credit balances could also increase the risk of you defaulting on debt payments, which presents a risk to lenders. As a result, you could be charged a higher interest rate on a new loan or credit card, or even get an outright denial.

In contrast, a **low debt-to-credit ratio** could indicate that you manage your debt responsibly, which could increase your scores and cause lenders to view you as a safer borrower.

How to Calculate Debt-to-Credit Ratio

The calculation for your debt-to-credit ratio is simple: Take each credit card you have and divide the balance by the card's credit limit. Then, you'll add up the balances and credit limits across all of your credit cards and do the same calculation to get your overall ratio. (Credit scoring models consider both in scoring calculations.)

How Does a Debt-to-Credit Ratio Impact Your Credit Score?

How much you owe on your debt accounts, including loans and credit cards, makes up 30% of your FICO Score, and your debt-to-credit ratio is an influential factor in that category. As a result, carrying high balances on your credit cards can have a significant negative impact on your credit score.

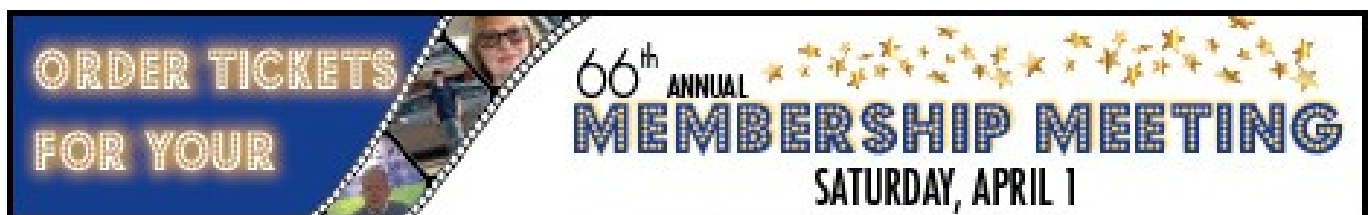
Some credit experts recommend keeping your debt-to-credit ratio below 30%. And while this is a good rule of thumb for a ceiling, it's by no means a goal for the perfect debt-to-credit ratio. The lower your ratio, the better it is for your credit score. Those with the highest credit scores typically have debt-to-credit ratios near 0%, and higher debt-to-credit ratios are generally correlated with lower credit scores.

Keep in mind, though, that your debt-to-credit ratio is just one of many factors that go into your credit score. Your FICO® Score, for instance, is most heavily influenced by whether you've been making on-time payments (your payment history). Other factors that affect your FICO® Score are the length of your credit history, whether you're using different types of credit and recent credit inquiries.

The Bottom Line

Your debt-to-credit ratio is an important indicator of your credit health, particularly in how you manage your credit cards. If you have a high ratio, it could be hurting your credit score and your chances of obtaining good credit terms.

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