Texas A&M AgriLife Extension — Family & Consumer Sciences

Harris County

Small Steps to Health and Wealth

Strategy 13 - Compare Yourself with Recommended Benchmarks (Wealth)

For more information or to schedule Health and Wealth sessions, please contact Elizabeth Trejo:

(713) 274-0950
etrejo@ag.tamu.edu

Texas A&M AgriLife Extension
3033 Bear Creek Dr.
Houston, Texas 77084

*This program and newsletter is adapted from the "**Small Steps to Health and Wealth Program**," developed by Joanne Kinsey, M.S., CFCS at Rutgers, New Jersey Agricultural Experiment Station*

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Your income doesn't determine how financially successful you are. Your choices and priorities do. There is an overwhelming amount of data available but determining where you are financially can be a daunting task. Knowing your debt-to-income ratio and credit rating is a good place to start and can lead to a path of well-being.

Debt-to-income ratio compares your debt to your overall income. It is used by lenders to determine your ability to repay money you have borrowed. It is calculated by dividing total monthly debt (***recurring*** payments) by monthly gross income (before taxes and payroll deductions). If your ratio is **higher** than 42% you may be considered high risk. That doesn't mean you can't get a loan, it means your interest rates will be much higher. Furthermore, most mortgage loan institutions require a debt-to-income ratio **lower** than 43% for financing. A low ratio indicates a good balance between debt and income.

Debt-to-income ratio does not directly affect a credit score because credit agencies don't know your income, but they use similar methods to calculate credit worthiness. They divide your credit account limits by the total amount of allowable credit.

There are two ways to lower debt-to-income ratio: **1.** Reduce monthly recurring debt and/or **2.** Increase your gross monthly income.

When you use credit, you are borrowing money you promise to pay it back within a specified period of time. A ***credit rating*** determines the likelihood of your capability to pay back money borrowed. Your lenders report how well you handle your debt to a credit bureau in the form of a credit report. Your score with the three U.S. bureaus (Equifax, TransUnion and Experian) may vary somewhat because each uses slightly different criteria but all three have a score between 350 (extremely high risk) and 850 (extremely low risk). Experian indicates that average credit scores range from 600 - 750 and "good" credit is considered above 700. From the information in the credit report, the bureau determines a credit score based on five major factors:

1. **Credit payment history – 35%**
2. **Current debts – 30%**
3. **Time length of credit history -15%**
4. **Credit type mix – 10%**
5. **Frequency of applications for credit – 10%**

You should check your credit report for your status and possible fraud. You are entitled to a ***free*** copy annually. Visit the websites below, to find out how to get your copy:

- **Equifax: http://www.equifax.com/**
- **Experian: http://www.experian.com/**
- **Trans Union: http://www.transunion.com/**

Credit today is significant. Protect your score by making payments on time, avoid overextending your credit, keep your outstanding debt as low as possible, limit your number of credit applications, and maintain a longer history of good credit. Most importantly, know what's on your credit report.

Other benchmarks for determining financial status:

Net Worth: calculated by subtracting household debts from household assets. The book, Millionaire Next Door calculates net worth by multiplying age by pretax (gross) income, excluding inheritances, and dividing by 10.

Personalized Benchmarks: setting benchmarks for your own progress based on financial status. Saving 10% of gross income is an example.

Retirement Savings: Pay yourself first. Participate in your employer's retirement plan or invest in an IRA

Credit Tier Breakdown

- **Excellent Credit:** 750+
- **Good Credit:** 700-749
- **Fair Credit:** 650-699
- **Poor Credit:** 600-649
- **Bad Credit:** below 600