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7 Reasons Why You Were Denied a Personal Loan (and 6 Ways to Fix It)

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Being denied a personal loan can be frustrating, but it's important to understand why you weren't approved. Once you know the reasons why your application for a personal loan was rejected, you can take steps to prevent it from happening again. Keep reading to learn more about common reasons why your personal loan application could be rejected and to get tips on how to boost your chances of approval.

7 reasons why you may have been denied a personal loan

When you're applying for a personal loan, approval is not guaranteed. There are quite a few possible reasons why your application may be denied. Fortunately, lenders are required to share the reasons behind their lending decisions with you. By law, they have to send you an adverse action notice within 30 days of your rejection. This document will contain an explanation for the denial.

Here are some possible reasons why a personal loan application could be denied.

1. Your credit score is too low

Your FICO credit score indicates to lenders how likely you are to repay your debts. This score is determined by a number of factors, including payment history, utilization ratio and the age of your oldest form of credit. In general, the higher your credit score is, the more trustworthy a borrower you are thought to be.

Since personal loans are often unsecured loans, meaning they are not backed by any form of collateral, your credit score often plays a very important role in the approval process. As a rule of thumb, if your score doesn't meet a lender's minimum eligibility requirements, your chances of approval are low. Plus, even if you do qualify, you'll likely be charged a higher interest rate than borrowers with better scores.

It's a good idea to research a lender's minimum credit score requirement before applying for a loan. For best results, you'll want to make sure you comfortably exceed that metric. If you don't, it may be worth shopping around for another lender or looking into some alternative financing options.

2. Your debt-to-income ratio is too high

Your debt-to-income ratio (DTI) is another financial metric that tells lenders how likely you are to be able to repay a loan. This ratio measures your total income against all of your existing debts. It shows how easily you'll be able to manage keeping up with an additional monthly payment.

You can check your debt-to-income ratio by dividing the sum of your existing debt payments by your gross monthly income. For example, if you have a total of $3,000 in monthly debt payments and you divide that number by a monthly income of $5,000, you'd have a DTI of 60%.

Generally, lenders look for a ratio of 43% or less, but the lower the percentage is, the more likely you'll be approved for a loan. A ratio of 35% or less is considered "good" by most financial institutions.

3. Your income was insufficient or unstable

In addition to your credit score and DTI, lenders also consider your income when making a decision on loan approval. Essentially, they want to ensure you have enough money coming in to keep up with your monthly payments so you don't default on your loan. Lending unsecured funds can be risky, and if you have a low salary or your income is unstable, the lender may not want to take a chance on you.

Some lenders publish minimum income requirements along with their other eligibility criteria. If your income is on the lower end or is spotty, it may be worth searching for a lender that is upfront about these qualifications so you can be more confident that you're a match.

4. You tried to borrow too much money

After looking at your financials, your lender will determine the maximum amount they're willing to allow you to borrow. This figure is typically based on how much you can comfortably afford to repay each month when taking your current income level and debt obligations into account.

If you request to take out a personal loan that's larger than you can feasibly manage, the lender may reject your application entirely. Rather than aiming for a high amount, it's better to be realistic and request a loan amount that makes sense given your financial situation.

5. You didn't meet the basic application requirements

In addition to setting specific financial eligibility criteria, most lenders also put forth a few basic qualifying requirements you'll need to meet in order to be considered as a borrower. Every lender's requirements will be a bit different, but in general you can expect the following:

- You must be of the age of majority in your state (typically 18).
- You must be a U.S. citizen or qualifying resident.
- You may need to have a permanent address and bank account.
- You may need a working email address.

If you don't ensure you meet the basic requirements before applying, you can expect to be rejected for a personal loan.

6. Your loan application was incorrect or incomplete

Often, handing in an incorrect or incomplete loan application will be considered grounds for automatic rejection.

Along with the application itself, you'll likely be expected to submit some supporting documentation, such as W2's, bank statements or tax returns. This information helps the lender make their decision. Without it, they won't be able to make an informed determination on whether or not you qualify for a loan.

Be sure to read over your application to catch any errors before you apply for the loan, and make sure that you're submitting the correct materials before you send everything in. It may also help to call the lender and double-check that they have everything they need once you've sent in all of your materials.

7. Your loan purpose didn't match the lender's criteria

Sometimes lenders will also impose use restrictions, or limits on how you can use your loan funds. For example, many lenders don't allow their personal loans to be used to cover education costs or business expenses.

Be sure to read the lender's fine print to verify that you intend to use the money from your loan for an approved purpose. Otherwise, your application could be denied.

How to improve your chances of getting approved for a loan

If your personal loan application was denied, don't worry. There are things you can do to better your chances of being approved the next time you need to borrow some money. Here's a look at what you can do to tilt the odds in your favor:

1. Build your credit score first

If you were denied the loan because your credit score was too low, the best thing you can do is build your credit score before applying again.

Let's take a look at some ways you can improve your score:

- Check your credit report for any errors and dispute them.
- Make your payments on time every time.

- Use the debt snowball or debt avalanche methods to pay off credit card debt.
- Wait for negative items to fall off your credit report.
- Apply for new forms of credit sparingly.

2. Improve your DTI ahead of time

On the other hand, if your debt-to-income ratio was the reason behind your denial, you have two options to improve it. You can either increase your income or pay down your debts. However, doing both will likely have the biggest impact.

Using the example from the DTI section above, if you increase your income to $6,000 per month and pay down your existing debts to a total of $2,000 per month, your new ratio will be 30%, which is well within the typical lending range.

Increasing income is more complicated than paying off debt, of course, and can mean asking for a raise, taking on more hours or starting a side hustle. Meanwhile, paying off debt is a straightforward process that involves choosing the right budgeting strategy for you and sticking to it long enough to make progress. If you can't increase your income, aim to pay off as large a chunk of your debt as possible to lower your DTI.

3. Choose a realistic loan amount

In the event that your loan application was denied because you inadvertently requested to borrow too much money, the solution is easy. You simply need to request a lower amount.

As for how much you can ask for, that will depend on your income and how much you can feasibly take on in a monthly payment. Use our personal loan calculator to get a better sense of what your monthly payments could look like at various loan amounts. Then, choose a loan amount that feels comfortable for your budget.

4. Find a cosigner

You may be able to increase your chances of being approved for a loan by asking for a little assistance from others. For example, applying for a loan with a cosigner who has a good-to-excellent credit score can help you secure loan approval and a better interest rate.

That said, it's important to choose a cosigner with whom you have a trusting relationship. After all, if they sign your personal loan agreement, they'll become responsible for the loan if you're unable to make payments. At the same time, their credit score could suffer if you make a late payment.

Make sure that you're both aware of all the potential consequences before signing on the dotted line.

5. Secure your loan with collateral

While most personal loans are unsecured, secured loans do exist. Secured personal loans are often easier to qualify for because they are backed by collateral. Collateral is any asset that the lender can repossess if you default on your loan. Typically, assets used as collateral can include real estate, vehicles, bank accounts, stocks, mutual funds or insurance policies.

The biggest advantage of this move is that it may help increase your chances of being approved, and it can help you secure a more affordable interest rate. However, the major drawback is that the lender is entitled to take possession of your asset if you fall behind on your payments.

6. Prequalify before applying

Prequalifying for a loan can give you a better idea of whether you'll meet the lender's criteria before you apply. Many lenders offer this feature without any impact to your credit score. If you're unsure if you'll make the cut, it may be worth finding lenders who offer prequalification and using their loan offers as a guide.

Still, it's important to note that prequalification is not the same thing as loan approval. It's a way to estimate your chances of being accepted and compare rates from various lenders rather than a hard-and-fast guarantee.

Did you know?

LendingTree's personal loan marketplace can help you prequalify for a loan with multiple lenders. It's 100% free