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Should You Pay Down Student Debt or Save for Retirement First?

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As most people know, Millennials are facing a student loan debt crisis. A recent Lending Tree study found that Millennials born between 1980 and 1995 owe an average of $27,162 on their student loans. Prudent individuals will want to start making payments on their debt as soon as possible, but they often wonder if they should instead be putting that money away in savings, particularly in a 401(k) plan. This is very understandable given that longer lifespans, uncertainty around Social Security and the increased cost of living are impactful reminders that a comfortable retirement will be expensive. However, I counsel my Millennial clients that the general rule of thumb is to pay down debt - including student loans - first.

It can be difficult to know where to start, especially if you have multiple loans. Paying down high interest bearing debt (typically private loans) should be your priority. Federal loans, which bear less interest and are typically more forgiving, can follow.

Now, if you only have non-interest bearing loans to pay off and you are keeping up with your loan payments, you could start to think about diverting some of your earnings to retirement savings (while keeping up with your regular loan payments, of course.) I recommend doing this when your company has a 401(k) plan that pays a match and you have enough capital to take full advantage of it. But again, if you have high interest-bearing debt, paying down these loans in their entirety should be your priority.

Once the burden of mapping out a plan to pay down your student loans is off your shoulders, you should determine your strategy to save for retirement. If you have waited to save for retirement because you couldn’t afford to put any money aside, you should consider contributing more to try to catch up. If you haven’t been able to save for the first three or four years of your career, for example, you’ve lost out on the compounding effects of time over that period. Contributing an additional 2-3% to a company plan or more to your personal IRA will help put you back in the right direction. Remember -- it’s never too late to start saving for retirement.

Now that you've sorted out your plan for tackling student loan debt and retirement savings, don't forget to start thinking about building up an emergency fund, too. I recommend having a savings equal to at least three to six months' salary set aside in a liquid savings account for unexpected expenses like a trip to the ER or car repair.

As a fellow Millennial myself, I know that making these types of money decisions can be overwhelming, but try to stay calm and be patient. Your relatively young age is definitely a plus. If you stick to a smart and strategic plan, you'll be well on your way to a solid financial future.

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