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Millennial Dilemma: Pay Off College Debt or Save for Retirement?

Millennials are in the unique position of navigating college debt and low income simultaneously, all the while being in their best-ever position to benefit from saving money.

Due to the power of compound interest, Millennials-- people in their 20s and early 30s-- stand to gain most from saving now than other generations. But with many demands and limited resources to allocate, how do Millennials prioritize between paying off debt and saving for the future?

The first step is to determine individual cash flow. While they usually have lower salaries than more experienced co-workers, Millennials should focus on how much money they have after expenses. Finding ways to cut expenses can go a long way. Netflix and Sling TV are a fraction of the cost of cable. Cooking dinners and packing lunches yields significant savings over restaurant costs.

Millennials should give serious thought to what expenses can be cut and then make some changes. Cutting expenses by five dollars a day improves annual cash flow by $1,825. And $1,825 invested each year at six percent for the next 40 years adds $300,000 to a retirement portfolio.

Assuming cash flow is positive, how best should it be utilized? For most Millennials, it will be a mix of establishing an emergency fund, paying down debt and building retirement savings. Emergency savings should range from one to six months of expenses and should depend on several factors, including stability of income, number of income sources, and indebtedness, among others.

Millennials need to know their debt situations and the interest rates they are paying on loans. The minimum payment needs to be paid on each loan, with extra cash flow going to loans with an interest rate above five percent. Debt stacking is an effective way to pay down high-interest debt.

For example, assume a Millennial has $900 designated to pay down three loans, each with a $250 minimum payment. A total of $750 goes to minimum payments, with the extra $150 going to the highest-interest loan to pay it down quicker. Once that loan is paid off, the $400 that was paying down that loan is added to the $250 being paid to the second loan. Consolidating student loans should be considered, too.

When overwhelmed by debt, it can be tempting for Millennials to ignore retirement savings; however, it’s costly to do so, since they will not benefit from time in the market and compound interest. Plus, many 401k programs match employee contributions. This is essentially free money that should be used to their advantage.

For Millennials who work at a company that does not offer a 401k or a match, an IRA is a good way to accumulate retirement savings.

Juggling financial demands isn't easy, yet it's important to create a plan and see it through. Deciding how much money to allocate for paying down debt and building up savings depends on individual circumstances. Each situation is unique and a discussion with a Certified Financial Planner can help determine the right solution.

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Kevin Webb is a Certified Financial Planner with Kehoe Financial Advisors of Cincinnati, a 33-year-old financial advising and services practice. Kehoe assists clients in developing and implementing financial strategies to help meet retirement, estate and business planning objectives, business continuation and succession planning. For more information, go to www.kehoe-financial.com or call (513) 481-8555.