Should I Pay My Student Loans Faster or Save for Retirement?

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For a young college graduate, saving for retirement likely isn’t the first thing on the financial priority list.

When the paycheck comes through, there are so many possibilities for it: rent for that first apartment, groceries, bills, social outings, wardrobe upgrades and, of course, student loans.

But retirement planning needs to be on that list.

And if there’s extra money in the budget, deciding where to put it presents a challenge. Is it better to pay down debt as soon as possible, or save it for the future? We reached out to the National Association of Personal Financial Advisors (NAPFA) for help navigating the the tricky issue of which to prioritize — getting debt-free or adding to your nest egg.

If you’re looking at a budget surplus and can spend it on both retirement savings and extra loan payments, go for it. They both come with financial advantages.

By increasing monthly payments on a student loan, the life of the loan shortens, therefore it accrues less interest. That can amount to thousands of dollars in long-term savings.

But building retirement savings becomes much more difficult as you get older, especially if you haven’t been saving as a young person. You don’t want to have to make up for lost time.

Deciding what to prioritize depends on a few things, like your employer’s retirement package and the interest rates on your student loans.

Start Now

If you’re just out of college or will be soon, loan payments and saving should already be on your mind.

“Start paying on student loan debt as soon as possible,” says Christian Mauser, a financial planner in Lancaster, Pa. “Do not wait until your grace period is up, start today.”

As time goes on, the loan balance only grows. In a similar vein, the amount you need to save for retirement each month grows every time you ignore it.

“Even if it is $50 a month, in 40 years when you retire it will be well worth it,” Mauser says.

Each Situation Is Different

When it comes to where you should put extra money, you have to look at what you’re working with.

“I like to use a threshold of 5% for the decision,” says Rob Siegmann, a financial planner in Cincinnati. “If the college loans have a rate of 5% or higher, pay off the college loans. If the rate is less than 5%, or the interest is deferred for any reason, then invest for retirement.”

He said he has an exception to his rule: When your company offers to match 401K contributions, take advantage. It's essentially free money.

"If the employer offers a match on deferrals, the match can be thought of as a salary increase," said Judy McNary, a financial planner in Broomfield, Colo. "I always encourage young people to defer at least enough to take advantage of a match."

Other Things to Consider

Working toward debt freedom can be great motivation to budget wisely. The good thing about student loans, given you can afford your minimum payments, is that they eventually go away. However, saving for retirement is a constant.

"Debt can be managed in many different ways, but you only have one shot at retirement," said Rick Bender, a financial planner in Rockford, Ill.

It's also important to note that you can claim interest from student loan payments on your taxes — an argument against getting rid of them faster.

And while undersaving for retirement can be a burden later in life, oversaving doesn't carry the same repercussions.

"If a new graduate 'oversaves' for retirement, this will give them considerable flexibility down the road," said Brian Fredrick, a financial planner in Scottsdale, Ariz., mentioning options like early retirement, working part time or taking part in an entrepreneurial venture. "If they are behind where they need to be for retirement they could be stuck working longer or at a job they dislike but have to keep for monetary reasons."

In the end, it depends on what feels right for the individual. Large debt can be mentally draining, so if it feels good to attack the debt, it's a reasonable option — just not at the expense of saving. Take stock of your current debt load, including student loans, credit cards and auto loans, by pulling your credit reports for free at least once a year. Also, you can monitor your debt profile and compare it to other Americans using the free Credit Report Card.

"Ideally, someone can get started on some retirement savings even while retiring debt," said Tom Fredrickson, a financial planner in New York. "When debt is overwhelmingly large, it still makes sense to put a little away for retirement because starting early could pay huge returns because of the power of compound growth."

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