

**STARTING OUT** | Actually, twentysomethings

need to do a little of both. *By Jessica Anderson*

## Save or pay off **DEBT?**

**A**T 25, Andrew Wagner has a bright future. He just got a master's degree in international relations, and he has a job with the World Bank.

But Wagner is worried. He has accumulated \$40,000 in student loans and expects to pile on more debt for law school. Once he gets his law degree, he knows he'll face a financial conundrum. "I'm looking at being 28 with a lot of loans and no savings for retirement," says Wagner. "Should I pay off the debt or start saving for retirement?"

Plenty of twentysomethings are asking the same question. On average, undergraduates who borrow leave school owing \$18,900, and graduate students owe an additional \$31,700, according to a recent study by Nellie Mae, the student-loan marketer. Law- and medical-school students borrow twice as much.

Still, when you're squeezing the most out of a starting salary, don't rush to pay off all your student loans. Set priorities by identifying "good" versus "bad" debt and determining where you can earn the biggest return.

When you take on "good" debt, you borrow to help build future wealth, says Bob Schumann, a financial adviser in Gahanna, Ohio. Student loans fit this definition because the asset you're buying will last longer than the debt. "Your college education paves the way for you to make more money throughout your lifetime," says Schumann.

On the flip side is "bad" debt—loans for cars, furniture, clothes or anything that loses its value over time. Credit-card debt is the leading culprit here.

Paying off a credit-card balance on which you're being charged 18% inter-



ERIKA LARSEN/REDOUX

● Andrew Wagner is concerned about repaying student loans.

est is the equivalent of earning 18% on your money. That's tough to beat, so getting rid of high-priced credit-card debt should be your top priority—with one exception. If your employer offers a 401(k) or similar retirement plan, contribute as much as you can to take advantage of any employer match. If your employer kicks in 50 cents for every dollar you contribute, for instance, that's a guaranteed 50% return.

**Open an IRA.** Even if you don't have access to a 401(k) plan, it's smart to start saving for retirement with a Roth IRA, which gives you tax-free income in retirement plus limited access to your money if you need it earlier. "People think they have years to save for retirement, but there really is no substitute for time," says Marnie

Aznar, a financial planner in Morris Plains, N.J. "The earlier you start, the more time your money has to grow."

What's more, you get the psychological satisfaction of having a cushion, whether it's for retirement, next summer's vacation or a house in a few years.

And paying off debt versus saving doesn't have to be all or nothing. On an entry-level salary, you could contribute \$50 per paycheck to your 401(k) (or set up an automatic deposit in a Roth IRA), and put \$50 toward paying off credit-card debt—or saving for a house if you're debt-free.

**Stop fretting.** And what about those student loans? Don't agonize over them, says Aznar. They almost certainly carry a lower interest rate than any of your other debt. You could consolidate your undergraduate and graduate Stafford loans at the current low rate of 3.37%. Once you've done that, paying

them off is equivalent to earning just over 3% on your money—and you can get higher returns elsewhere.

You can also deduct \$2,500 in student-loan interest each year as long as your income is less than \$50,000 as a single filer or less than \$105,000 as a joint filer. The deduction phases out as income rises between \$50,000 and \$65,000 (or between \$105,000 and \$135,000 for joint filers).

If you don't have expensive consumer debt, it's fine to pay ahead on your student loans just to get that monkey off your back. But don't pay them off at the expense of saving for retirement, says Aznar. Your priorities should be repaying credit-card debt and putting as much as you can into a 401(k) or a Roth IRA. **K** —Research:

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