INVESTMENT STRATEGY

WHAT FINANCIAL MATTERS SHOULD COLLEGE GRADUATES TACKLE RIGHT AFTER THE COMMENCEMENT SPEECH?

By Rachel O'Shia, CFP®, CFA

WHAT ARE THE MOST COMMON FINANCIAL CONCERNS FACING NEW COLLEGE GRADUATES UPON GRADUATION?

Some of the most common financial worries are managing student and consumer debt acquired during college, setting a practical budget so that post-college employment income covers expenses, and learning how to manage employer-provided retirement benefits.

Managing student loan options is critical. First and foremost, take advantage of any opportunities for student loan forgiveness. Graduates working in fields such as teaching or public service may be eligible for student loan forgiveness under certain circumstances. The Department of Education's Federal Student Aid website is a great source for determining eligibility.

For federal subsidized loans, interest starts accruing six months after graduation. I suggest waiting to make decisions on refinancing or consolidating subsidized loans until that grace period is over to maximize the interest-free period. Consolidating subsidized, unsubsidized, and PLUS federal student loans can certainly simplify life, and the resulting interest rate is the weighted average of the interest rates on the loans at the time of consolidation. While not ideal due to substantially higher interest paid over the life of the loan, consolidated loans can be stretched out to 30 years if necessary to get the monthly payment to a manageable level. Another option is to choose the graduated repayment plan that requires interest only payments for the first few years, then switches to full interest and principal payments after the initial period. The graduated plan can be useful for those who start at a lower pay level but expect accelerating earning potential.

SHOULD GRADUATES ALSO LOOK AT REFINANCING THEIR LOANS?

Yes, but let the "refinancer" beware. Refinancing student loans with a private lender can potentially reduce your interest rate, particularly if the existing student loans are private, Direct PLUS, or Direct unsubsidized loans for graduate level student loans. The new interest rate is based on the borrower's credit history and will influence whether the interest rate can actually be reduced. There are some drawbacks to refinancing federal student loans, however. Federal student and parent loans come with a number of benefits that are lost when refinancing. Payment plans under private refinancing may not be as flexible, including forbearance in the event of hardship. Private lenders also don't give borrowers in certain public service jobs the opportunity for loan forgiveness, unlike federal loans. With a private lender, if the borrower is permanently disabled or dies, the borrower's estate is still responsible for paying off the loan. Federal loans are discharged at death or permanent disability of the borrower.

When considering whether to repay ahead of schedule, I suggest comparing the student loan interest rate to rates on other outstanding debt and accelerating payments on the highest rate debt.

WHAT SHOULD GRADUATES TELL RELATIVES WHO WANT TO HELP EASE THE TRANSITION?

For those lucky enough to be in that position, graduates can take advantage of the annual gift exclusion, which is $15,000 in 2019. Each parent (or anyone else) can give $15,000 to their graduate (or anyone else) gift tax-free. Additionally, any individual has an $11.4 million lifetime gift tax exclusion so no gift tax would be due up to that point, but a gift tax return is required on annual gift amounts over $15,000. If the graduate will be in the 10% or 12% tax brackets (income below $39,475 for a single tax filer), a great way for both to benefit is by gifting appreciated stock to be sold by the graduate. If total income plus realized capital gain stays below $39,475, the realized gain will be tax-free and the person making the gift is able to remove that unrealized tax liability from their own portfolio.

Another opportunity for "gifting" tax free is for relatives to pay any medical expenses the graduate has directly to the medical provider. Medical expenses aren't counted toward either the annual or lifetime exclusions.

If the graduate has earned income but is unable to contribute the maximum to tax-advantaged retirement accounts, the gift giver might encourage them to use the gifts to contribute to a Roth IRA and/or to increase the amount of paycheck 401(k) deferral and use the gift for living expenses the additional 401(k) deferral amount would have otherwise covered.

For any of these strategies, the gift giver and the graduate should consult with their tax professional to confirm eligibility.

WHAT OTHER RULES OF THE ROAD WILL GET FRESH GRADUATES OFF TO A GOOD START?

You can never overemphasize the need to start saving as soon as possible. And living within your means with the remainder of funds available. When I was new to the workforce, I found it easiest to immediately set up my 401(k) contribution so that I never got used to having that money in my paycheck. I started out at 10%, and each year as I received a raise, I increased my 401(k) deferral by half of my raise until I reached the maximum.

It is also important to set aside accessible funds for emergencies. Should an unexpected expense arise, the last thing one needs is to add to an already sizeable debt by being forced to pay a high-interest rate credit card. While recent graduates are living at home, this may not be as important, but once they are on their own, it will be necessary.

WHAT'S THE BEST WAY TO GET A BUDGET STARTED?

Often, new graduates live with parents for a period of time after college. This is a great time to create a budget. First identify the amount of net income available after 401(k), tax, and insurance paycheck deductions. Then research living costs in your area, including rent or mortgage payment, utilities, property insurance, grocery and personal needs, and an entertainment budget. There may be trade-offs needed, but it is far easier to figure out the trade-offs after thorough research. If a graduate chooses to live at home for an extended period, it's a great idea to increase savings in the amount that would otherwise be needed for living expenses. It's good practice for living within the budget in the future, and helps build a nest egg for perhaps a more comfortable exit from the family home.

ARE THERE OTHER RESOURCES OUT THERE A COLLEGE GRADUATE CAN TAP INTO?

Yes. College graduates should check with their parents to see if they can consult with whatever investment professionals their parents might be using. It's never too early to start.

A favorite part of my career in portfolio management is when I get to offer investment education to multi-generations. Many advisors are happy to offer guidance on choosing and implementing an appropriate 401(k) asset allocation for our clients' family members.

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Rachel is a senior portfolio manager and investment consultant for Commerce Trust Company. Upon gaining a thorough understanding of a client's needs and goals as well as assessing the client's entire financial situation, she works with our investment research team to construct a portfolio to help clients achieve their long-term goals. Rachel comprehensively represents our research and goals-based investment process, starting with the initial assessment and creation of an investment objective to ongoing evaluation and adjustments based on changing market and life circumstances. With a deep knowledge of the market and experience in investment management, she serves clients with thought leadership, insight, and consulting services. Rachel joined Commerce Trust in 2016 and brings over 15 years of investment experience to the company. Rachel earned her bachelor of science degree from Southern Illinois University-Edwardsville and her master of business administration degree from Washington University in St. Louis. She also holds the Certified Financial Planner™ certification as well as the Chartered Financial Analyst® designation. Rachel volunteers annually for Foster and Adoptive Care Coalition's Little Wishes program and served on the Foster and Adoptive Care Coalition's Junior Board from 2012-2014.