PLANNING FOR RETIREMENT:  
THE GROWING IMPACT OF STUDENT LOAN DEBT ON RETIREMENT SECURITY

The National Retirement Risk Index (NRRI) is published by the Center for Retirement Research (CRR) at Boston College, and measures the percentage of working-age households at risk of being unable to maintain their pre-retirement standard of living during retirement. With student loan debt becoming much more prevalent among recent college graduates, the latest NRRI research addresses the impact that higher amounts of student loan debt could have on future retirement preparedness.

The NRRI is produced utilizing data from the Survey of Consumer Finances. In addition to other household finance information, this survey provides detailed data on student loans. In particular, the survey data show a dramatic rise not only in the percentage of households taking on student debt in recent years, but also in the average amount borrowed.

The NRRI research finds that households that have student loan debt are at a much higher risk of not being able to maintain their standard of living in retirement. Further, when the NRRI is projected using recent, higher student debt levels, the CRR finds a significant jump in the percentage of households that will not be on track for a secure retirement.

Findings
Overall, the latest NRRI (2014) indicates that 51.6% of households are at risk of not being able to maintain their standard of living in retirement. As part of its latest research, the CRR examined households with and without student loan debt. (Households can carry student loan debt when parents borrow as well as when students borrow.) The CRR found that 49.2% of households without student debt were at risk of not being able to maintain their standard of living in retirement, and that this percentage was much higher – 60.1% – for households with student loan debt. These findings are based on current student loan debt levels of all working-age households.

However, household borrowing to pay for college has increased in recent years. For households currently ages 30-39 with student loan debt, the average amount of debt they held after leaving college in their 20s was $18,000. Today, households in their 20s with student loan debt hold an average of $31,000. In addition to an increase in the average amount borrowed, the percentage of households who are incurring student debt has increased. When the CRR factored both facets of this increased borrowing into the NRRI, the index jumped nearly 5 percentage points, to 56.2%. Perhaps even more alarming, the NRRI for the 30-39 age group increased from 58.9% to 62.0%, with student loans exacerbating the financial challenges of households already facing lower Social Security replacement rates, fewer opportunities to receive a defined benefit pension, and longer life expectancies. See Figure 1.
Prudential’s Perspective

Without a doubt, a college education is valuable. The median worker with a bachelor’s degree earned $57,252 in 2014, while the median worker with a high school diploma earned $34,736.1 However, families need to borrow wisely when financing a college education, as increased borrowing can impact the future retirement security of students as well as parents.

When the CRR projected the future impact of today’s higher borrowing levels, the number of households at risk jumped nearly 5 percentage points, from 51.6% to 56.2%. The modeling reflects lower home equity at retirement due to the effect student loans have on the ability of a household to purchase a home. It also reflects the impact of student loan repayments on retirement savings.

Therein lies the critical problem, as households are often faced with the issue of paying down student loan debt versus saving for retirement.

For every dollar that would have gone toward retirement savings if not for student debt obligations, households lose the value of that dollar and the investment growth that dollar would have experienced over time. The impact is much more severe when foregone retirement savings also means missing out on employer matching contributions.

To illustrate, consider the following example. A 22-year-old, let’s call him Nate, graduates from college with $31,000 of student loans, which is the average amount of debt among recent college students with loans.2 Nate starts his career earning $45,000, and his company will match $0.50 per $1.00 of 401(k) contributions, up to 6% of pay. Nate’s student loan repayment over
a 10-year period is $318 per month, assuming the current federal loan interest rate of 4.29%. If, because of this loan repayment, Nate doesn’t contribute $225 (6% of his initial salary) to his 401(k) account each month to take advantage of his company match, he would lose considerable potential retirement wealth. Assuming Nate doesn’t contribute $225 each month to his 401(k) for the first 10 years of employment, and further assuming his 401(k) investments would have earned 6%, Nate could potentially lose out on $273,534 of 401(k) wealth at the Social Security normal retirement age of 67. When his foregone company match of $0.50 on every dollar is factored in, he may lose $410,300 of potential 401(k) wealth. See Figure 2.

Figure 2
Lost 401(k) Wealth at Age 67

The example will become a harsh reality for many in the future; a 2013 survey found that 41% of individuals who were carrying student loan debt had postponed contributing to their retirement plans.

Conclusion
Attaining a college degree is a dream of students and their parents alike. However, families should carefully consider how much to borrow to make that dream a reality. Student loans serve as an investment in a student’s human capital to prepare him or her for a career. Student loans can also teach a young graduate fiscal responsibility. However, as this research shows, too much student debt can be harmful to future financial security. If at all possible, the presence of student loan debt should not preclude saving for retirement, at least at a contribution rate that allows an individual to maximize an employer’s matching contribution amount.
Implications

For Individuals and Families

• Prior to selecting a college, carefully consider how to approach financing an undergraduate degree, including becoming familiar with how specific schools provide financial aid. Prudential’s publication, *Paying for College: A Practical Guide for Families*, provides some guidance.

• If loans must be taken to finance a degree, consider how those loans will be paid back given career earning potential and available federal loan repayment and forgiveness programs.

• Whether a parent or young graduate, give careful consideration before contributing to a 401(k) plan at a rate less than the contribution percentage an employer is willing to match; the match is “free money” that, once foregone, can never be recaptured.

For Employers

• Recognize that student loan debt is top of mind with young employees, especially new hires.

• Consider ways to help employees pay off student loans as well as save for retirement.

• Help parents save for college by providing payroll deduction savings vehicles and planning tools.

For Financial Advisors

• Assist individual clients in setting aside enough assets in tax-advantaged vehicles such as 529 plans and Coverdell Education Savings Accounts so as to minimize student loan debt once college is at hand.

• Help clients understand the different ways that various schools approach financial aid, especially merit aid and grant awards, which can lessen the amount of debt a family will take on.

• Ensure that clients are saving adequately for retirement based on their circumstances; at a minimum, contributions should be set at a rate that takes full advantage of an employer’s 401(k) matching contribution.
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3 The 4.29% interest rate is the interest rate on Direct Subsidized and Direct Unsubsidized loans for loans disbursed on or after July 1, 2015, and before July 1, 2016. U.S. Department of Education, https://studentaid.ed.gov/sa/about/announcements/interest-rate