THE GLOBE AND MAIL

Charles Kuno is dealing with a sizable amount of student debt, and he is waiting to get started making investments.
For The Globe and Mail

Pay off student loans or invest? The answer might surprise you

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Published Wednesday, Jul. 06, 2016 05:00AM EDT
Last updated Monday, Jul. 11, 2016 10:50AM EDT

Charles Kuno has made some practical choices in his life. In high school, he enrolled in a special business and technology program. He then opted for the accounting and financial management program at the University of Waterloo – an academic path with good career prospects. And for the first year after graduation, he lived at home.

Despite the rational approach, Mr. Kuno is dealing with a sizable amount of student debt.

He is continuing his practical approach when it comes to paying off the loan. For the time being, he is doing all he can to pay off his debt – and waiting to get started making investments.

However, in this case, his practicality might be overly cautious. Many financial experts say that for most people it makes sense to dip a toe into the investing world, even while still dealing with student debt.

"I think it shouldn't be either/or, it should be both/and," says Brendan Caldwell, president and chief executive officer of Caldwell Investment Management Ltd. in Toronto.

He says beginning to accumulate some financial assets can actually help facilitate paying down debt. "You will feel much better about your debt if you also have assets. And it will help with creditors if you experience a rough patch down the line, such as a job loss or illness."

Kim Inglis says young people should start by doing the math.

Ms. Inglis, an investment adviser and portfolio manager with Reynolds Inglis Group, an independent financial advisory group within Canaccord Genuity Wealth Management, says recent grads should look at the interest rates they pay on their student loans, including the net cost to them (factoring in tax credits and so on), and then factor in their time horizon.

Ms. Inglis notes that the rates on Canadian student loans are low. Students can pick between a fixed rate of prime plus 5 per cent or a floating rate of prime plus 2.5 per cent. Students can also claim interest paid on federal and provincial student loans on their income tax returns.

Then graduates should compare those interest rates to the returns they could earn if they invested the funds. For instance, over a long time horizon, the major North American stock indexes have generated an inflation-adjusted annualized return of between 6 and 7 per cent.

Ms. Inglis provides an example of how the math might work. Let's say a graduate has loans of $30,000 postgraduation and, after paying for their various expenses, they have an extra $400 a month to invest. If they put 100 per cent of that toward paying off their student loan, it would take a little more than 8 1/2years to pay it off. If they instead invested that $400 in a tax-free savings account in conservative investments, earning 4 per cent after fees, they would have $45,000 after eight years. After 10 years, they would have $59,000.

In this scenario, investing the funds goes further than paying down the debt. Rather than having the $30,000 loan paid off but no investments, the grad will have $45,000 in the bank and can effectively pay off the loan in its entirety and still have a good base to start retirement savings.

There will be minimum payments to make on a loan, so students will have to take that into account when weighing their options, but even splitting that $400 into debt repayment and investments works out better in the long run.

While the math is solid, this analysis might be overlooking two factors. The first is the psychology involved in choosing some amount of investing while still carrying a student loan.

The other factor is the assumption that recent grads will be able to find adequate funds to consider these options. With a tough current job market for people in their 20s, along with the rising cost of living in many Canadian cities, many young people will no doubt find it challenging to find available funds beyond their minimum student loan payments.

"Two hundred dollars a month may seem like a lot if you're a barista with two English degrees," says Mr. Caldwell. "But if you have it taken off the top each month, you may not miss it, and it will be important for your peace of mind and flexibility down the road. It will help with the next things you want to achieve and whatever comes along with it."

Mr. Kuno is managing much better than the average barista. He is a staff accountant at a Toronto professional accounting firm with a specialty in the entertainment industry. He has also finished the academic requirements to become a chartered professional accountant. He is making two to three times his minimum monthly student loan payments, and is on track to pay off all his student debt in the next 18 to 24 months.

And he already has his eye on the next goal – he says if he is able to get his student debt down to a reasonable level, he may rework his strategy and start putting money into a TFSA to save for a possible real estate purchase.