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Give Your Graduate the Gift of Years

What is the perfect gift for a newly minted college or high school graduate? Perhaps a trip to a sunny climate to relax after graduation would be most appreciated? Or maybe a gift card to a retail outlet to buy an interview outfit would hit the spot? Or would you rather give your grad the gift of extra years to enjoy their retirement?

Most of us plan for and dream about our retirement years. We expect to retire at 66 (or maybe even 62 or earlier) after 40 plus years of work. We'll enjoy time with family, travel to far away locations, and finally read all the books piled up next to the bed. Today's graduates are facing a much different reality.

Higher student loan debt (the average 2016 grad has $37,172 in student loan debt[1]) and greater cost of living increases than ever before put graduates at a savings disadvantage. For example, some US cities have rent averaging $4,000 a month! In addition, rents nationwide rose 12% between March 2011 and March 2015[2]. According to a Rent.com study, rent costs will continue to increase by 6% over the next 12 months[3]. All of this has contributed to the projected retirement age for 2015 college graduates increasing to 75 from 73 since 2013, according to a recent NerdWallet.com study. Add that to the Social Security Administration's average life expectancy estimate of 84[4] , and there is a worrying possibility of only nine years of retirement for a 22-year-old starting work today.

However, if that same recent college graduate starts saving now and makes compound returns work for her, she could add significantly to her retirement period. For example, if she managed to invest $3,000 a year in a Roth IRA annually from today until she turns 32; her IRA could have approximately $550,000 by the time she hits 65 (assuming an average 8% annual return.) That same investment and rate of return from 32 to 65 would only grow her assets to $437,000.

Furthermore, today's projections are in order to retire at today's normal retirement age of 66 in 2060, your college graduate will need $2.6 million in 2060 dollars. If he sets aside $5,000 (10% on a $50,000 salary) a year in savings, he will accumulate $1.8 million in retirement assets. If he increases that by just 5% to 15%, he will have $2.7 million in retirement assets. Saving 20% gets our grad to $3.6 million, leaving a nice cushion for that retirement adventure, a legacy for the grandchildren, and perhaps some charitable gifting as well.

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1 https://studentloanhero.com/student-loan-debt-statistics-2016/
2 http://www.zillow.com/research/rent-ready-to-outpace-home-values-9457/
3 http://blog.rent.com/property-managers-predict-rental-rate-increases/
4 https://www.ssa.gov/planners/lifeexpectancy.html

Two of the biggest barriers to retirement savings are the high cost of living and student loan debts, as shown above. However, all is not lost in the retirement savings game. As long as an individual is making some money, he can open a Roth IRA. Below are some steps you can take to help them on their way to longer retirement bliss.

First, make sure your grad isn't making more than $120,000 a year as a single person or more than $176,000 if they are married filing jointly. A partial contribution can be made if the individual makes less than $120,000, but more than $105,000 for singles or less than $176,000 but more than $167,000 for married couples filing jointly. Most importantly, they must have earned income. An IRA can't be opened for an individual who doesn't have their own earnings, as they must contribute from their earnings.

Secondly, help your recipient to decide where to open an account. Banks, credit unions, and discount brokerages offer traditional and Roth IRA options. Find one that is convenient, easy to work with, and has low fees. They will also need to gather their Social Security number, date of birth, address, approximate income, and general net worth to open an account. Then, encourage them to open a Roth IRA. Funding a Roth IRA early not only takes advantage of more years of compounding returns, it also is most tax efficient at the beginning of a career with the associated low salary and consequent low tax bracket entry-level jobs often have.

Third, discuss with your grad how much money they can contribute and how much they anticipate they will earn. If the account owner or any other individual isn't contributing to the account, you can contribute up to $5,500 per year (assuming the individual makes at least that amount in the tax year.) Contributions from all sources must not be more than $5,500 total per year. A gift to a Roth IRA does not simply have financial value; it also has the added value of imparting core values of thrift, discipline, and financial foresight.

One caveat, if your recipient has an employer 401(k) account, you should encourage her to contribute to it at least up to the employer's matching dollar amount. It does not impact the amount she can contribute to her Roth IRA and it is free money to get that compound interest really working.

Finally, if you can't convince your 22-year-old that retirement planning is essential, perhaps let her know that the IRS will permit a total of $10,000 to be withdrawn from a Roth IRA towards a first home purchase without any penalties, as long as the account has been open for five years or more. That's tax-free money saved to start them on their way towards home ownership. Surely that's a better investment than an out-of-style suit or a long-forgotten beach trip?

Allen Capital Management/Allen Trust Company can help you with questions regarding this perfect graduation gift. If you are one of our clients, or think you might want to be, please contact us at (503) 292-1041 or via email at allison@allentrust.com.