A Lesson On Financial Considerations For Recent Graduates

With your hard-earned degree in hand, most recent graduates are focused on securing full-time employment and building their career. In addition to these priorities, it's also important to start planning for your financial future. This article outlines some considerations that can set a recent graduate on the path to long-term financial success.

Pay down debt

Today's graduates are starting their careers with better skills and education than previous generations. However, this education also comes at a higher cost and many graduates accumulate significant student debt along their educational journey. Whether from student loans, lines of credit, or credit cards, paying down student debt should be a priority. Focus on paying down the debt that carries the highest interest rate first so that you minimize the amount of interest paid, and try to pay more than the minimum payment due whenever possible.

Develop a budget

A budget helps you understand how much money you have coming in and how you're spending your income. Begin by tracking your expenses for three months. Knowing how you're spending your money allows you to develop a budget that sets priorities for spending and paying down debt, and how much is available to start building your savings and investing strategy. There are many online tools available to help you set up a budget and monitor your spending.

Establish an emergency fund

An emergency fund is a pool of money set aside specifically to cover the cost of unexpected expenses or the loss of income, reducing the need to rely on credit cards, loans or personal savings intended for other financial goals. Work towards building an emergency fund of at least three to six months' worth of living expenses. Your emergency fund should be easily accessible and should be kept separate from your day-to-day bank account. A Tax-Free Savings Account ("TFSA") may be a good option to accumulate your emergency fund savings, as the funds grow tax-sheltered and can be withdrawn tax-free at any time.

Build and protect your credit score

Building and maintaining a good credit history is important as lenders will view your credit report and credit score when deciding whether to grant you a credit card, loan or mortgage, as well as determining the interest rate you'll be charged. Ensure that you're paying your credit cards and loan payments on time, and don't become overextended by taking on too much debt. It's also important to note that a potential employer or landlord may use your credit report to help determine your dependability.

Retirement planning

While retirement may seem a lifetime away, it's important to start saving early because of the tremendous impact compounding will have on the growth of your retirement assets. With a Registered Retirement Savings Plan ("RRSP") your contributions are tax deductible, and once in the plan continue to grow on a tax-deferred basis until the funds are withdrawn. However, starting early is key.

If, at age 25, you begin saving $100 every week in an RRSP, and assuming a compounding rate of return of 5% per annum, by age 65 your RRSP will grow to $663,724. By comparison, if you don't start saving until you are 45 – and you save double the amount (i.e., $200 per week) – your investment will only grow to $357,131 by age 65, even though the total savings amount is the same ($208,000).

If you do require access to the funds in your RRSP before retirement, there are two federal programs that may allow you to make tax-free withdrawals from your RRSP, including:

- The Home Buyers' Plan ("HBP") allows you to withdraw up to $35,000 tax-free from your RRSP to purchase or build a qualifying home. To be eligible, you must be a first-time home buyer, as defined by the Canada Revenue Agency, and the funds must be repaid to your RRSP over a 15-year period. Your annual repayments do not affect your RRSP deduction limit; however, if you fail to repay the required annual repayment amount to your RRSP in any particular year, the repayment amount will be considered taxable income for that year. Please note that the 2019 Federal Budget proposes to extend access to the HBP in order to help Canadians maintain homeownership after the breakdown of a marriage or common-law partnership. This measure will apply to HBP withdrawals made after 2019.

- The Lifelong Learning Plan ("LLP") allows you to make tax-free withdrawals from your RRSP to finance full-time training and education costs, including post graduate degrees, for you or your spouse. The LLP allows you to withdraw up to $10,000 a year, to a maximum of $20,000. If either you or your spouse are disabled, part-time training and education costs are eligible. LLP withdrawals must be repaid to your RRSP within 10 years. As with the HBP, your annual LLP repayments do not affect your annual RRSP deduction limit. If you fail to repay the required annual repayment amount to your RRSP in any year, the amount is considered taxable income.

Insurance

Your ability to earn income through your chosen career is one of your greatest assets. However, if you're unable to earn income due to health issues or a disability, having adequate insurance coverage is important for meeting your long-term financial security. Disability insurance is designed to replace a portion of your income in the event you become disabled due to accident or illness and are unable to work. Even if your employer provides disability coverage as part of their company benefits package, the disability benefits usually cover only a percentage of your income, so it may be beneficial to purchase supplemental disability insurance coverage.

You may also want to consider critical illness insurance, which provides a lump sum benefit if you are diagnosed with an eligible critical illness. The funds can be used to help offset the costs of home care, used to take a sabbatical and recuperate, pay off a mortgage, make adjustments to a home or car to accommodate any special needs, or even pursue private medical treatment outside Canada. How you use the money is entirely up to you.

It's never too early for a financial plan

Developing a financial plan can help prioritize your short- and long-term goals, and determine the actions that can be taken to achieve them. Over time, as your income, personal situation and priorities change, your financial plan can be updated to ensure it continues to reflect your situation.

Beginning your investment journey

With your degree in hand, you're ready to start building your career, and your financial future. A BMO financial professional gives you access to a wide range of investment products and solutions designed to help you build and protect your wealth.

As you begin your investment journey, the need for sound investment advice and guidance is particularly important. BMO financial professionals are committed to building long-term client relationships and providing superior advice and service, so you can make the right investment choices for your future.

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