So your $10,000 in student debt is canceled. Here's what you should do with your new financial freedom. (Clue: Don't splurge.)

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Financial advisers weigh in on what to do if your $10,000 or $20,000 in federal student-loan debt is canceled, and what you should NOT do

The lion's share of the federal student-loan forgiveness will impact people making far less than $125,000 a year.
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President Joe Biden made a long-awaited announcement in August that individuals earning less than $125,000 a year would have $10,000 in federal student loan repayments forgiven, but that would rise to $20,000 if they received Pell Grants in college. What's more, he said people with undergraduate loans would also have a payment cap of 5% of their monthly income.

More than 45 million borrowers owe a cumulative student-loan debt of $1.6 trillion. The White House said it is "a significant burden on America's middle class. Middle-class borrowers struggle with high monthly payments and ballooning balances that make it harder for them to build wealth, like buying homes, putting away money for retirement, and starting small businesses."

Some borrowers have been setting aside money since the pandemic-related student loan payment pause started because they expected to throw a lump sum at their loans once payments resumed, said Grant Meyer, a certified financial planner and founder of GTS Financial in Bloomington, Minn.

For those who qualified for forgiveness, that was a win-win.

Roughly one-third of borrowers, or 11.8 million people, will have their student debt eliminated under Biden's announcement.

Still, Biden's announcement was far from a blanket cancellation. Roughly 20 million people, mostly lower-income borrowers, will have their student debt eliminated as a result of the White House's announcement on Aug. 24. That should make a difference: The Federal Reserve says the average student-loan debt per borrower is $39,351, while the median student-loan debt is $19,281.

"Black and Hispanic borrowers are much more likely than white borrowers to be behind on their loans, and are less likely to have completely repaid their loans," the Fed said, adding, "The burden of unmanageable student-loan debt may be of greater concern, on average, among individuals who are Black or Hispanic than it is for white individuals."

The lion's share of the federal student-loan forgiveness will impact people making far less than $125,000, according to a recent study by the University of Pennsylvania. That study undercuts the argument that millions of wealthy graduates will benefit the most. In fact, Penn says 74% of forgiveness will affect households making less than $82,400 a year.

Here’s what the experts say you should do next:

Invest, invest, invest

Those who qualify under Biden’s federal student-loan forgiveness plan can now use that money for other goals. Meyer recommends investing, especially given the downward trajectory of the market over the last year. “[With the stock market beaten down so much this year, it’s a great time to practice the age-old wisdom of ‘buy low,’” he said.

Jackie Fontana, a CFP and portfolio manager at FBB Capital Partners, suggests investing in U.S. treasuries, or a well-diversified equity ETF. “If they are able to stay in the market for at least 8-10 years, go with an equity ETF. If you may need access to funds sooner than that, consider purchasing U.S. treasuries, which is currently yielding at nearly 3%.”

Look ahead to retirement

"I've seen how student-loan payments hamper clients' ability to save for the long-term," Catherine Valega, a certified financial planner and chartered alternative investment analyst with Green Bee Advisory in Winchester, Mass. "So I would use the cash flow to invest – whether putting more in a 401(k), an IRA (Roth or Traditional), or long-term taxable savings."

"The earlier we can get money working for us, the better off we are in the long-run," she added. A 25-year-old investing $1,000 a year for 10 years, and $2,000 a year for another 10 years, and no longer contributing to a retirement account until age 65 would have $160,000, with a 6% rate of return, according to Her Money, a personal-finance site.

(Read more here from MarketWatch reporter Alessandra Malito on using the extra $10,000 or $20,000 to invest in retirement.)

Pay off that credit-card debt

High-interest debt will hold you back and should be paid off before it gets worse. Fontana from FBB Capital Partners told MarketWatch: "I'd recommend prioritizing paying off any high interest credit card that carries a balance month-to-month," she said. Only paying the minimum every month can hold you back from saving for a house, and also ultimately hurt your credit score.

There is reason to be concerned about credit-card debt. Americans loaded an extra $46 billion on their credit cards during the second quarter and their balances saw the sharpest increase in more than 20 years, according to data released in August by the Federal Reserve Bank of New York. Credit card debts grew 5.5% from the first to second quarter and 13% year-over- year.

Take a chance on a new job or career

Having significant student-loan debt means salary is a key consideration when job hunting, because your paycheck has to cover those payments along with your other monthly essentials. With that debt out of the picture, some people may now be able to take a chance and change careers, Meyer told MarketWatch.

"If you had to focus on salary alone to ensure you could make payments on student loan debt, but now don't have that concern, maybe it's a chance to pursue a dream where there may not be as much focus on salary – or starting out new in a different field where you'll have to work your way up again," Meyer added.

Speed up the road to home ownership

A recent survey by Rocket Mortgages said that nearly 70% of millennial student-loan borrowers who intended to buy their first home roughly within the next decade said Biden's student-loan forgiveness could help shorten their purchase timeline by 1 to 3 years. The rate of home price growth is slowing, but they're coming off a peak in April.

The S&P CoreLogic Case-Shiller 20-city house price index rise slowed to 18.6% year-over-year in June down from 20.5% in the previous month. But buyers — particularly young buyers — still face headwinds from rising interest rates and limited supply in many areas. Analysts say there's little evidence of the kind of slump that happened during the 2008 subprime mortgage crisis.

Think about an emergency fund

"Start saving towards sufficient emergency savings to cover 3 months of living costs," Fontana of FBB Capital Partners said. Some experts even recommend 6 to 12 months of living expenses for an emergency fund. "The specific approach someone should take if they have extra money in their monthly budget depends on their personal financial circumstance," she added.

Graduates may feel like they have less job security with increasing fears of a looming recession, and a spate of job cuts and rescinded job offers by Big Tech. Even with an unemployment rate of 3.5%, the specter of more interest rates by the Federal Reserve in an effort to combat 40-year-high inflation makes workers, particularly entry-level graduates, more vulnerable.

Finally, here's what NOT to do

Don't use the freed up funds "for extra spending money," Valega from Green Bee Advisory said. "That blows it — and defeats the purpose." That can be tempting for younger borrowers who feel unencumbered by other debts and responsibilities. If you have emergency savings, Meyer of GTS Financial added that holding cash is not the best route given record-high inflation.

It's a balance. Valega says the big worry is that people will splurge. It's similar to when you get a raise at work, she said. There's a danger the extra money can lead to "lifestyle creep," or living beyond your means. Typically it's best to not increase your standard of living too much; just add the increased funds to your long term investments, she added.

I shared expenses 50/50 with a friend on vacation. She wants me to split the cost of her credit card's foreign-transaction fees. Is that sharp practice?

'Before we left for the trip, I researched my credit cards and used the one that did not charge a foreign transaction fee.'

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