
Financial Plan for Mr. Kulkarni

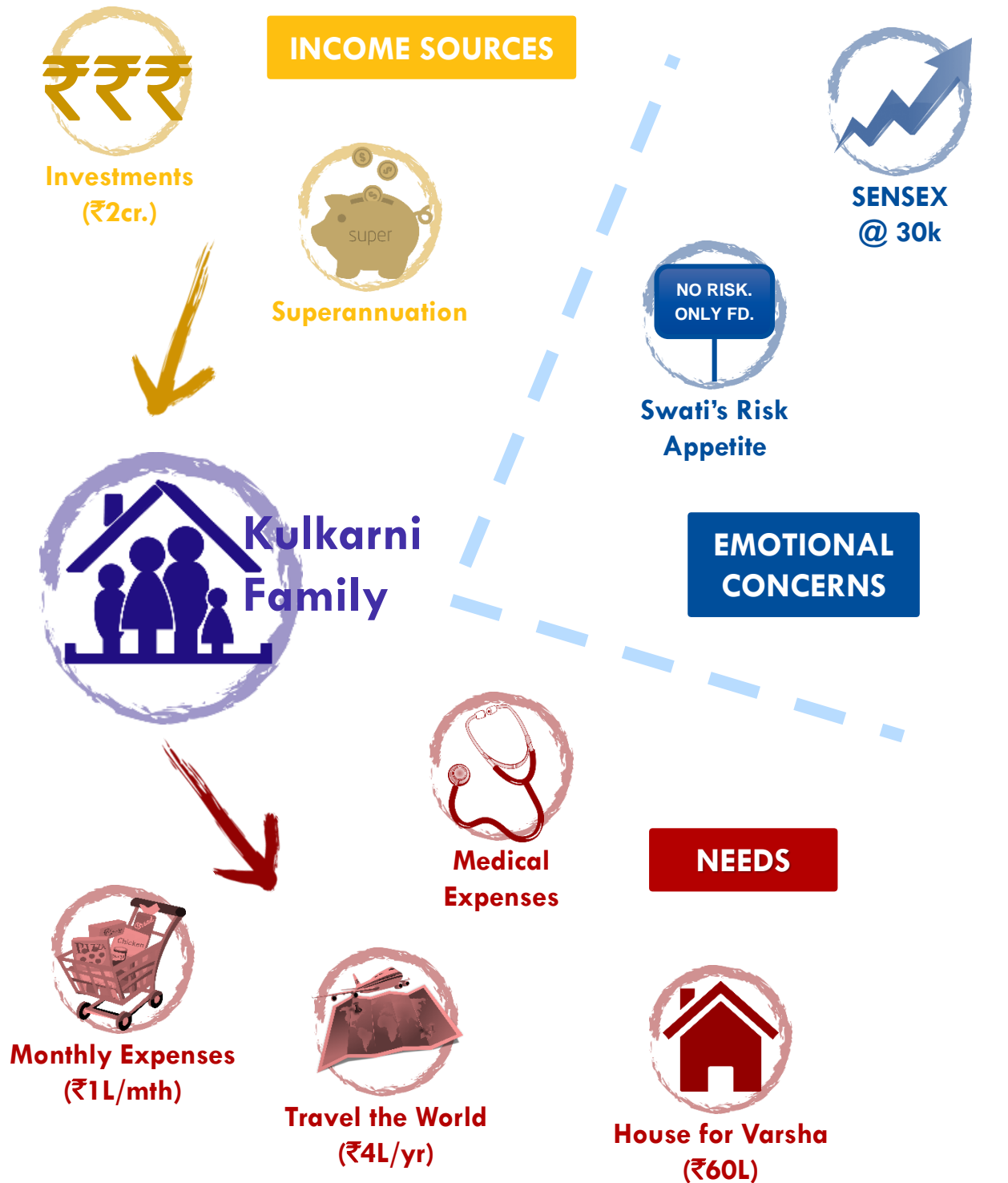
Plan Date: 31 May 2017

(WealthForumEzine Wise Advice Case Competition – 2017)

The Current Situation

Making the daughter feel independent and secure, covering healthcare costs, securing retirement and more...

The Problem, as Perceived by You



The Problem, as Perceived by You

The above image depicts the elements of your financial life as you identified by you. It summarizes your sources of income (your assets), your expected/planned expenditures and certain other emotional aspects of decision making. The details of each element is elaborated below.

Sources of Income



- You have **₹2,00,00,000 in investments**; ₹1,00,00,000 in FDs and ₹1,00,00,000 in Low-Equity Hybrid MFs
 - The decreasing rates on your FDs (8% to 6.5%) is a major concern
 - Also an unbiased comparison of the two investments is needed to decide what to sell you should you have to buy a house
 - You also want to know if there are any other options that you should be considering
-

- The uncommuted portion of your **superannuation fund** pays you ₹25,000 every month



Need for Cash



- Considering that now Varsha and Rohan are also dependent on you, you will need to budget for an increased **monthly expense of ₹1,00,000 per month**
 - Considering the changed employment scenario for Varsha, we assume that she will start earning after 2 years from now. This gives her enough time to cope up with her situation emotionally, to up-skill herself and to find a job
-

- From your experience on **medical expenses** for your mother, you have realised that you need to start factoring in for these expenses for yourself and Swati as well



The Problem, as Perceived by You

Need for Cash (contd)



- You aspire to **travel the world** over the next 15 years
 - While factoring in this budget is also important, this is reality an optional expense with a flexible budget
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- Swati wants to **buy a house** for Varsha. She believes that is critical in making her feel independent and secured after she returned from Nagpur
 - This expense should avoided for a multitude of reasons
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Emotional Concerns

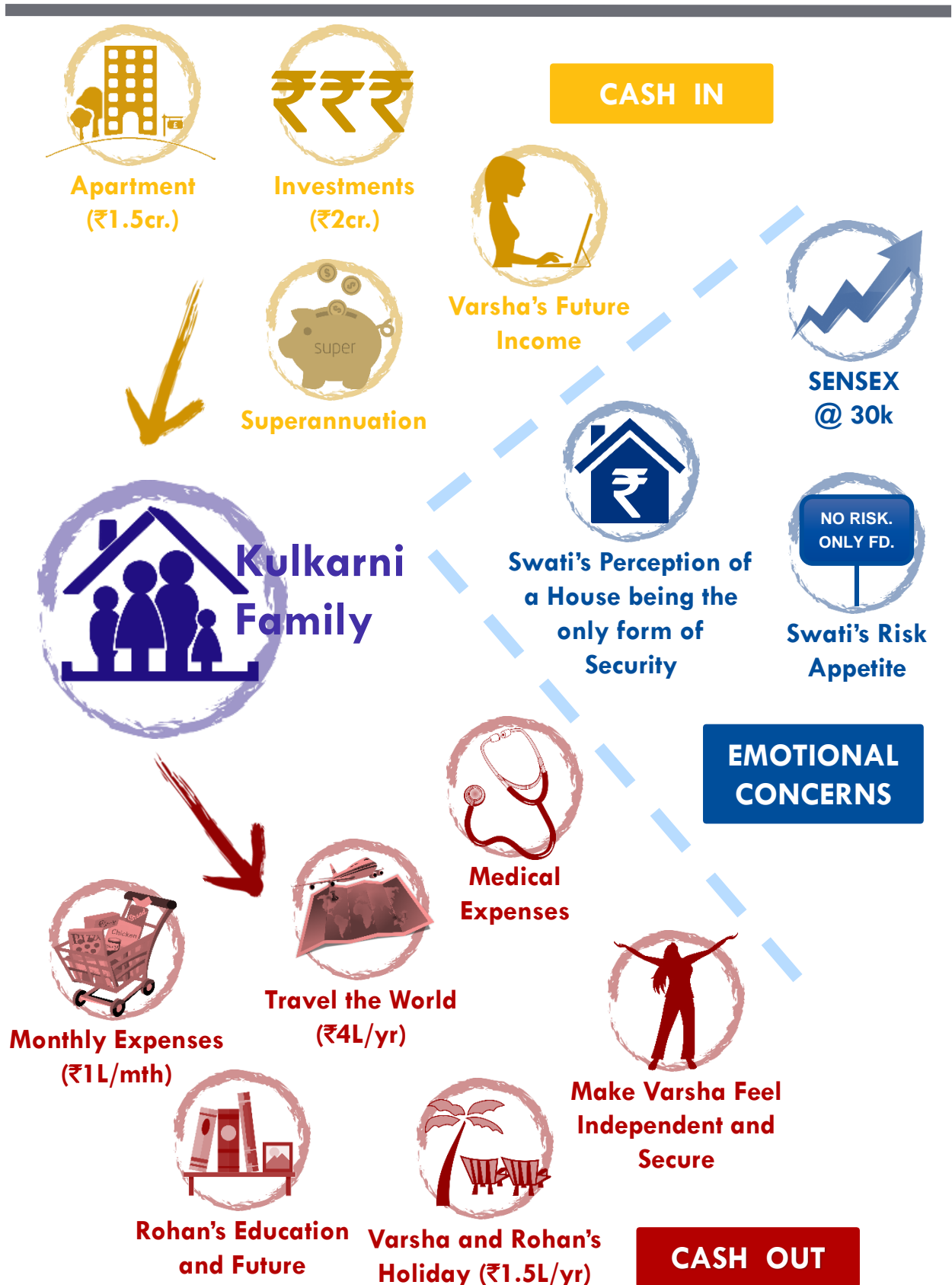


- While you understand that fixed deposits are not the most ideal form of investing your long term surplus cash (especially now, @ 6.5%), you are also concerned that the **Sensex is at an all time high of 30,000**
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- **Swati is** quite **risk-averse** and believes only in investing in fixed deposits
 - We do understand that a small, managed exposure to equity is needed in your long-term portfolio to give that extra push
-



The Problem – Adding the Unstated



The Problem – Adding the Unstated

The above image adds a few other elements to your financial plan. A few elements are modified to show the actual purpose, and a few elements are added to ensure we build a more holistic financial plan for you and your family. Elements that generate cash (Cash In) and those that use cash (Cash Out) are clearly bifurcated.

Sources of Income



- Due to the 5 year gap in her career and dim prospects in the IT industry, we agree that **Varsha** might take some time to start earning an income. However, the truth is that eventually she will start **earning an income**
- Considering the changed employment scenario, we assume that she will start **earning after 2 years** from now in the worst case. This gives her enough time to cope up with her situation emotionally, to up-skill herself and to find a job

- We understand that your **house** currently does not give you any cash-flows
- However, you must still be realistic and **factor in that the house can be sold** of to generate a decent pay-off if the situation demands



Need for Cash



- We must appreciate that buying a separate house for Varsha is actually an attempt to make **her feel independent and secure**
- Buying a house may not be the best or the only way of achieving this:
 - Rather than buying a house, you can make an **investment in her name**
 - You can make her feel more at home in your current house: give her a **separate set of keys**; or **transfer part ownership** to her name; or perhaps (if it's that important) even consider having a **partition made** so that she can have her own space
- What is even more important in this case than a house or assets, is to **spend on courses for her to up-skill herself** for a job in IT or another field



The Problem – Adding the Unstated

Need for Cash (contd)



- We must factor in a **holiday for Varsha and Rohan** as well
 - Given what she has gone through, a holiday in this situation might be even more important
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- You and Varsha together must also start planning and budgeting for **Rohan's future and education**



Emotional Concerns



- While we absolutely agree that it's important to make Varsha feel independent and secure, we must also understand that **a house is not the only form of security** or secure investment
-

Now that we have listed down all the elements of your financial plan, let's see what combination of products and strategies can we consider using to fulfil all your needs.

Your Future – As it Stands Now

We have forecast your future cash flows considering you do what Swati wants you to and nothing in any of your 4 lives changes.

Some Interesting Talking Points while you reason out with Swati

Assumptions

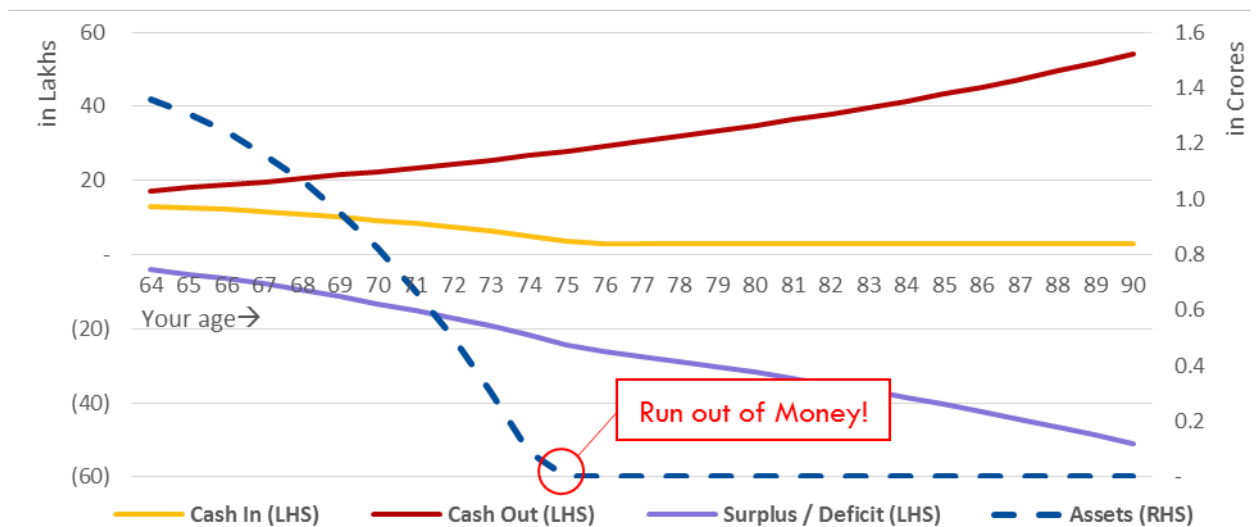


- You keep ₹1,00,00,000 in FDs @ 6.5%
- You sell ₹60,00,000 in Low Equity Hybrid Funds to buy a house for Varsha
- Varsha doesn't earn any income for the foreseeable future

- The additional house will in reality also increase your planned monthly expense of ₹1,00,000 by about 10% to ₹1,10,000 due to the duplication of certain household expenses
- You do not incur any major medical expenses in the family
- You take an annual trip worth ₹4,00,000 every year
- Your expenses increase at assumed inflation rates



Cash Flows



Your Future – As it Stands Now

Result

- If you continue on this track, your family will run out of money **12 years** from now! Use the above chart to reason out with Swati and explain to her why you need a change in course
-

You will most likely run out of money in the next 12 years if you don't change anything and follow through on what Varsha wants!

Risks

- You are **not covered for any unexpected expenses**, especially medical expenses for anyone in the family
 - You will quite likely **outrun your money**
 - You will not be able to **leave behind anything for Varsha** and Rohan except for the two houses (ie. no liquid financial assets)
 - **Rohan's financial future** is at further risk
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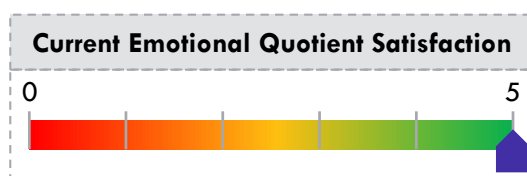
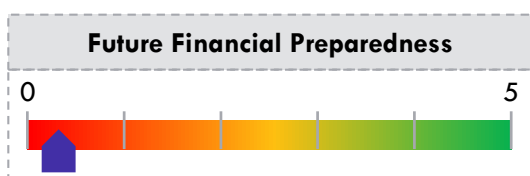
Compromises

- You fund your present expenses at the cost of **not being able to meet future expenses**
 - You will land up building a lot of **stress on Varsha in the future** when she will have to take care of your financial
-

Achievements

- You will be able to manage and fulfil Swati's desire for giving **Varsha a house**
 - You will most likely get to **see the world** the way you want to in the first 12 years
-

Plan Rating



Decision Making – Impact, Analysis and Advice

The pros, cons and the impact tomorrow of the choices you will make today...

Decision Impact and Advice

You have a number of decisions to make in the near future regarding your financial life. Before we advise our recommendations on each of these, we would like you to understand the pros and cons of each of the options you have; and how they will impact you in the future. We will also discuss some of the assumptions we will make about your family's life.

Assets



Investment Options: The ₹2 crores savings that you have can be allocated to any of the below options

- **Invest in Fixed Deposits or Debt Funds or none?:** FDs are indeed one of the safer options in the market. We usually recommend minimal exposure to FDs, and suggest Debt Funds as a tax efficient substitute. However, since you don't have other sources of taxable income, it would be alright to invest in fixed deposits up to an income of 5 lakhs in each name. The safer portion above that should be allocated to debt funds. While debt funds don't have a fixed rate of return, they tend to give you 0.5%-1.0% higher than FDs over time. Considering the current lower rates post demonetisation, **we assume a gross return of 6.5% on FDs and 7% on debt funds.**
- **Low Equity Hybrids (LEH) or Moderate Equity Hybrids (MEH) or none?:** LEHs typically invest 20%-30% of their portfolios in equity instruments and the balance in debt instruments. MEHs have set models to decide the equity allocation based on current market valuations. The equity portion can typically swing from 20% to 80%. They make use of arbitrage strategies for some parts of the debt allocation to mimic the same risk-reward but give you the benefit of equity taxation. Considering the current lower rates on the debt portion, **we assume a gross return of 9% on LEHs and 11% on MEHs.**
- **Equity Funds or no?:** Considering your age and the high reliance on savings to meet expenses, we will rule out such risky options for you.

Tax Efficiency and Impact: At current rates you can invest up to 75 lakhs in FDs in each name without attracting taxes. Also, for LEH and MEH, we will consider only those funds that use arbitrage strategies to give you the benefit of equity taxation. Once we agree on a plan it will be **possible to reduce your tax liabilities to 0** by investing in multiple names. Considering these factors, **all gross returns are assumed to be the net returns**

Decision Impact and Advice

Assets



- **Varsha's Future Income?:** While we completely understand that as a father, and considering her current situation, this is an aspect you would not want to consider in your financial plan. We are not trying to make you rely on her money here, we are merely trying to show you the obvious – that eventually, Varsha is going to start earning a salary. And if you want to fulfil all her needs, this is something you will have to be using. Let's assume that she starts working **after 2 years?** This gives her enough time to cope up with her situation emotionally, to up-skill herself and to find a job. Given her past career record and independent ambitions, we believe it is safe to assume that she will start with a **monthly salary of ₹1.5 lakhs**, which then increases by an average of **15% annually** due to increments and promotions. The attached excel has provisions to model in different assumptions for this.



- **Keep the current house or Sell to take benefits of low rental yields?:** While you might think that the current house cannot be a cash generating asset, this in fact is not true. In India, there is a huge gap between rental yields (2%-3%) and investment yields (6.5%+). This means that if you were to sell the current house and rent a similar out, your annual rent will be about ₹4.5 lakhs (assuming the value of the house is ₹1.5 crore). At the same time, if this ₹1.5 crore that you receive from the sale is invested even in an FD (least returns), you will make ₹9.75 lakhs. In effect you will end up with **an additional ₹5 lakhs annually** for other purposes. This surplus will be even larger if you invest in other options. Further, you can then even consider moving to smaller house (a 1 or 2 BHK) – this will further optimize your finances. While we understand that emotionally this is a bold step, this is an option we must keep in mind in your scenario.
-

Decision Impact and Advice

Assets



Buying a House for Varsha

▪ Should you buy one for her?



- As you rightfully agree, you **already have a bigger** house that will anyways be hers during and after you
- A house is **not the only way** to make her feel secure and independent. There are other ways, some even better, of achieving this
- Your **financial position** currently is not the most comfortable, and it does not support this purchase
- The additional house will in reality also **increase your planned monthly expense** of ₹1,00,000 **by about 10%** to ₹1,10,000 due to the duplication of certain household expenses

▪ How to Convince Swati?

- Apart from points above, you can show the previously shown chart to her
- **Sit down with Varsha:** Since this decision affects Varsha's life, it is important to have her be a part of the decision making. You need to sit down with her and have a frank discussion on what she would want and would make her comfortable. It is quite possible that a house may not be here idea of security and independence. You must also **discuss your financial situation openly** to help her give her opinion.

▪ If you do need to buy, how to fund the house? Self funded or home loan?

- Since your financial position doesn't support the this choice, the only reason you will stretch yourself to do this is to make Varsha feel secure. The additional liability and EMI burden a home loan will bring on for you and her in the future will not meet this cause of security – in fact, it might lead to her feeling unsecure. So we will eliminate the home loan options.
 - As the chart earlier showed you, using up the high yielding LEHs will push you back significantly. IT is extremely important to dip into your FDs for this purpose if at all you need to. This will help salvage the situation partially.
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Decision Impact and Advice

Assets



Other ways to make Varsha feel Secure



▪ Transfer other assets

- **Transfer of assets:** Rather than transferring ₹60 lakhs into a house, you can transfer ₹60 lakhs to her in the form of financial assets (funds)
- **Part ownership of house:** You can make her feel more at home in your current house – give her a separate set of keys; or transfer part ownership to her name; or perhaps (if it's that important) even consider having a partition made so that she can have her own space

▪ Up-skill Varsha

- You rightfully mentioned that a five year **gap in her IT career** would have set her back significantly. We believe that one of the most **important aspect of your financial plan** should be to keep aside some amount for Varsha to up-skill herself. She can pursue certain courses in IT or other industries to develop her skillsets.
- We suggest to set aside **₹30,000 annually for the next 2 years** for this purpose. The attached excel has provisions to model in different assumptions for this.

▪ Planning for her retirement

- While a part of this should be taken care of by Varsha, it is important to start sowing the seeds from now. Based on certain basic assumptions (as listed in the attached excel) for Rohan's education and wedding, it is important to start saving **₹30,000 per month** towards this. You can of course start with a smaller sum.

Expenses



▪ Are the right expenses factored in?

- Given your current financial plan, and based on other decisions you make now, you may even need to **curb these expenses by 10%-30%**
 - If you purchase a second house, your monthly expenses won't be that you planned, there will be duplicating of some expenses. It will **increase your planned monthly expense** of ₹1,00,000 **by about 10%** to ₹1,10,000 due to the duplication of certain household expenses.
 - These expenses are modelled in to increase at standard inflation rates
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Decision Impact and Advice

Expenses



▪ Travel plans on track?

- Unless we plan for some radical changes to your financial position, we are afraid that this is an optional expense that you will have to **compromise** on
 - We suggest that you **cut** your annual travel expenses by about **20%-40%** on an average. You can perhaps cover this by doing a few domestic trips, or some shorter or less expensive destinations?
 - You may even have to consider postponing your **first trip to after 2 years** from here until your financial situation and Varsha's life stabilizes. You can of course take a few short trips for a break instead.
-



▪ How to take care of medical expenses?

Complete Family Floater

- This is another critical aspect that you must plan for. We especially understand your concern after your experience with your mother's health in this regard
- We suggest that you should purchase a **family floater health insurance policy if it is available** (considering you and your wife's age and health). The policy should cover yourself, Swati, Varsha and Rohan.
- Considering your age, and thereby the **higher likelihood of medical complications**, we suggest that you purchase a policy that covers you up to at least **₹50 lakhs**

Cover for only Varsha and Rohan

- In the event that you and your wife are not eligible to be covered under a policy, you should at least purchase a policy to cover Varsha and Rohan
- Considering their young age, a **₹10 lakhs** cover would be sufficient
- You will also need to have about **₹50 lakhs** in safe assets specifically to cover your medical expenses in old age

Revisit Policy in Future

- These policies should be revisited in the future when Varsha gets a job to compliment and top-up the existing group medi-claim cover she may get
-

Decision Impact and Advice

Expenses



▪ **Helping Varsha cope with her emotional situation**

- Given what Varsha has gone through, a **holiday** in this situation might be even more important
 - We must factor in a holiday for Varsha and Rohan as well. They can go on a trip independently or you can club your respective annual trips
 - We assume a more **budgeted expense of ₹50,000 for this to start** with. The lower budget is compensated by a higher-than-inflation annual increase of 10%, so that they can have better vacations as years pass
-



▪ **Securing Rohan's future**

Building a Corpus to Fund his Education and Wedding

- You and Varsha should also consider building a corpus to take care of Rohan's future financial needs for education, wedding, etc
- Based on certain basic assumed expenses (as listed in the attached excel and appendices) for Rohan's education and wedding, it is important to start saving **₹30,000 per month** towards this. Looking at your current financial position however, you can **consider beginning with a smaller amount** and then increase it over the years as Varsha's income grows. The annual increase schedule based on the initial amount is given in the appendix and the attached excel sheet. The excel also has provisions to model in different assumptions.

Cover for Varsha's Life

- It is also important to cover Rohan against any unfortunate events that occur in Varsha's life
 - Based on your current lifestyle and Rohan's future expenses, we recommend a cover of ₹1.5 crores. This policy will cost you approximately ₹32,000 annually. (Details are provided in the attached excel with provisions to model in different assumptions.)
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Your Options

Making the daughter feel independent and secure, covering healthcare costs, securing retirement and more...

Plan I – House for Varsha, Simpler Lifestyle and Partial Medical Cover

If Swati is certain that she needs to buy a house for Varsha, we will have to reason out with her to dip into your FDs rather than LEHs. (While markets are high, you must understand that LEHs help you cover these risks through their models). Even after doing that, you will need to curb your lifestyle to reduce expenses and settle for a less than adequate medical cover.

Assumptions



- You keep ₹1,00,00,000 in LEHs

- You sell ₹60,00,000 in FDs to buy a house for Varsha

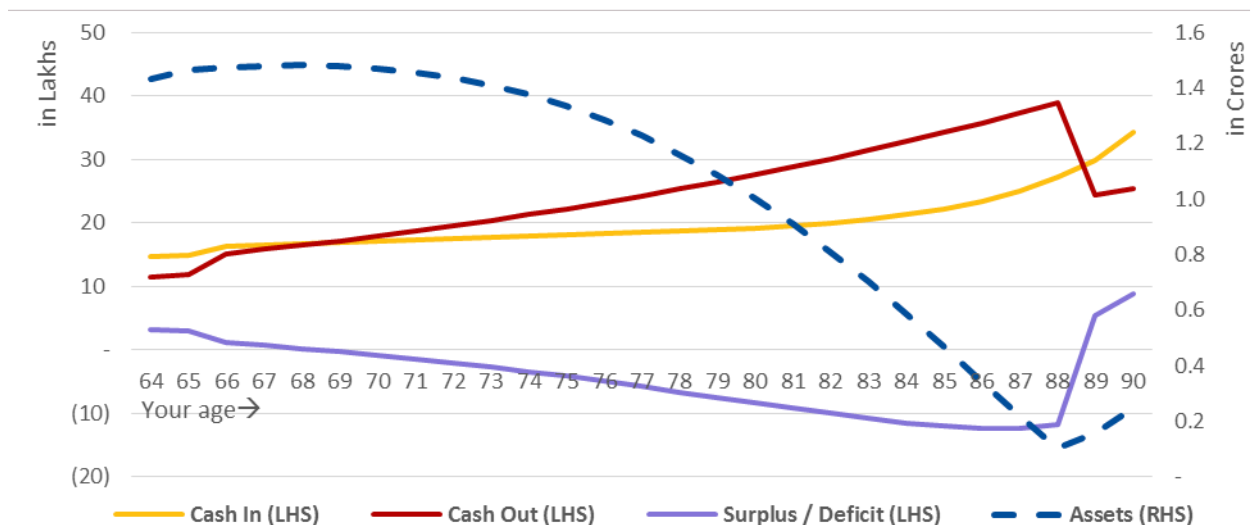


- Varsha starts working after 2 years and makes ₹1.5 lakhs annually with an average 15% increase Y-o-Y

- You cut your increased monthly expenses to ₹1,10,000 by 20% to ₹88,000
- You cut your annual trip expenses by 30% to ₹2,80,000 and postpone your first trip to after 2 years from now
- Assuming you are eligible for health cover, we compromise and settle for a ₹25,00,000 cover for you and Swati and ₹5,00,000 for Varsha and Rohan
- You spend ₹30,000 on courses for Varsha in the first 2 years
- We assume that you and your wife will be around till you are 85 years old
- Your expenses increase at assumed inflation rates



Cash Flows



Plan I – House for Varsha, Simpler Lifestyle and Partial Medical Cover

Result

- You will outrun your money if you don't incur any major unexpected expense (medical and others), but will have a less than desired lifestyle going forward.

Compromising lifestyle and partial risk for medical expenses might possibly get you there!

Risks

- You are **not covered fully for unexpected expenses**, especially:
 - Uncovered medical expenses
 - Increased expenses if you and your wife outlive your expected life of 85yrs and cross the **age of 88 years**
- You will quite likely **outrun your money**
- Rohan's and Varsha's financial future** is at further risk

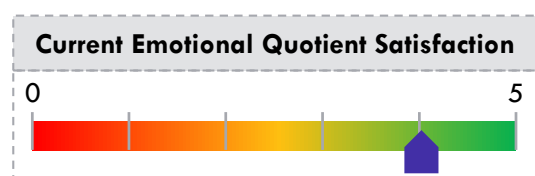
Compromises

- You will have to curb your **lifestyle expenses** and **compromise on your dream** of seeing the world
- Possibility a lot of **stress on Varsha in the future** when she will have to take care of your financial

Achievements

- You will be able to manage and fulfil Swati's desire for giving **Varsha a house**
- You **partially** cover the risk of **medical expenses** in your old age

Plan Rating



Plan II – No Second House, Same Investment Portfolio

If we can convince Swati not to buy a house for Varsha, and agree with her not to reduce the FD investments, you can spend more to cover your medical bills and on Varsha's and Rohan's future. You can also settle by compromising less on your lifestyle.

Assumptions



- You keep ₹1,00,00,000 in LEHs and ₹1,00,00,000 in FDs

- You don't buy a house for Varsha

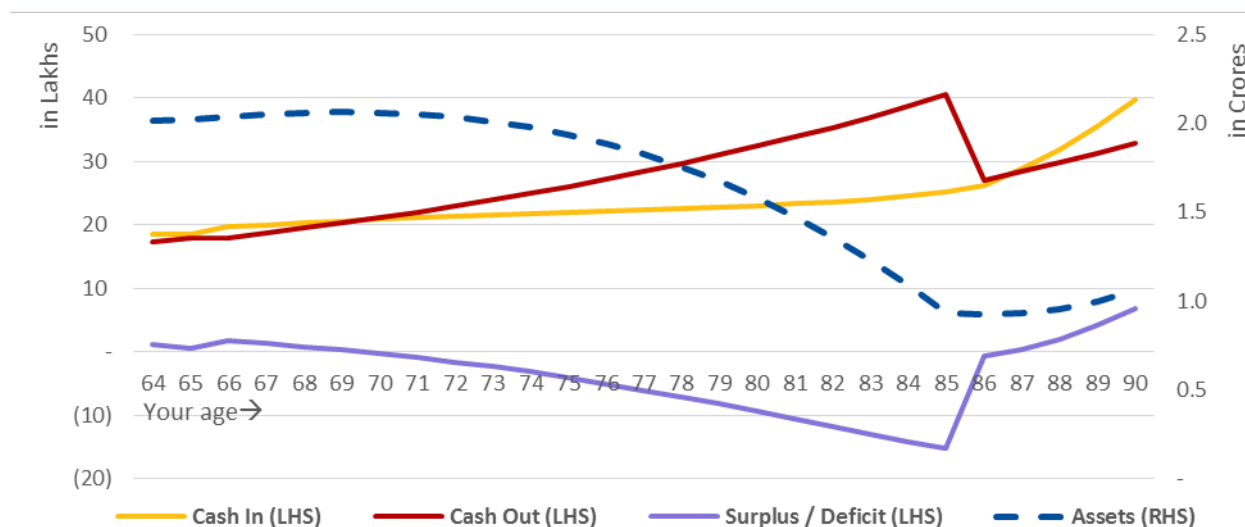


- Varsha starts working after 2 years and makes ₹1.5 lakhs annually with an average 15% increase Y-o-Y

- You cut your increased monthly expenses to ₹1,00,000 by 10% to ₹90,000
- You cut your annual trip expenses by 20% to ₹3,20,000
- Assuming you are eligible for health cover, we take full cover of ₹50,00,000 for you and Swati and ₹10,00,000 for Varsha and Rohan
- You spend more (₹70,000) on courses for Varsha in the first 2 years
- We assume that you and your wife will be around till you are 85 years old
- Your expenses increase at assumed inflation rates
- You start adding ₹1,40,000 annually towards Varsha's future (for Rohan's education/wedding, life cover on Varsha, her retirement and their vacation)



Cash Flows



Plan II – House for Varsha, Simpler Lifestyle and Partial Medical Cover

Result

- You will be fully covered for all medical expenses for the family and be able to live a more fuller life without running the risk of running out of cash

You can outlive your life expectancy without worry and not bother about your medical expenses

Risks

- You don't land up saving much for Varsha and Rohan's future:
 - Rohan's education/wedding expenses, life cover on Varsha, her retirement and their vacation funds are not fully covered

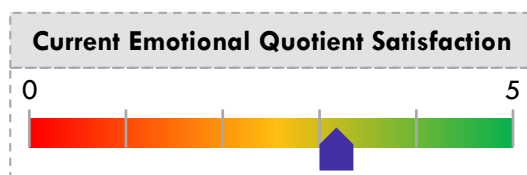
Compromises

- You **don't buy a house** for Varsha
- You will have to curb your **lifestyle expenses slightly**
- Possibly **stress on Varsha in the future** after your time

Achievements

- You are **covered fully** for expenses:
 - Uncovered medical expenses
 - Money lasts even if one of you hit 95yrs
- Beginning of savings for Varsha and Rohan

Plan Rating



Plan IIB – House for Varsha, Simpler Lifestyle and Partial Medical Cover

You can even consider investing a part of your FD funds in MEHs. We can maybe reason out with Swati on how these funds manage equity risks by looking at market valuations and changing their equity exposure.

Assumptions



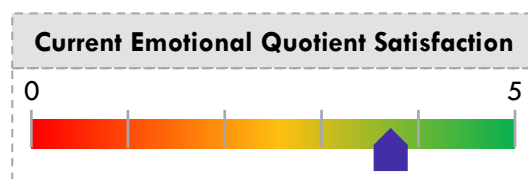
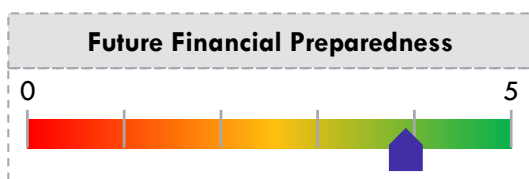
- You keep ₹1,00,00,000 in LEHs, but switch ₹50,00,000 from FDs
- You start adding ₹3,20,000 annually towards Varsha's future (for Rohan's education/wedding, life cover on Varsha, her retirement and their vacation)
- All other assumptions remain same as **Option II**

Result

- You will be fully covered for all medical expenses for the family and be able to live a more fuller life without running the risk of running out of cash

You can outlive your life expectancy without worry and not bother about your medical expenses; and even save some for Varsha!

Plan Rating



Plan III – No Health Cover Available, A Smaller House

In case no health cover is available for you or your wife we need to consider options to manage these future expenses. As mentioned earlier, selling your current house and moving in a smaller house on rent is a great option. Since you already

Assumptions

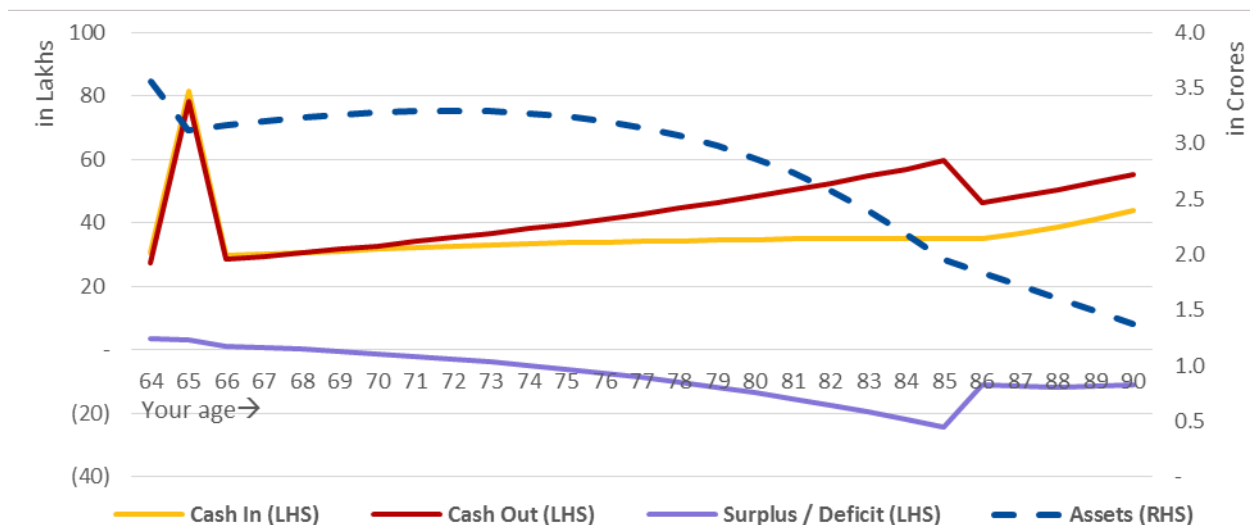


- You keep ₹1,00,00,000 in LEHs and ₹1,00,00,000 in FDs
- Sell your current house and park ₹50,00,000 in FDs for your future medical expenses and the balance ₹1,00,00,000 in MEHs to make that higher yield
- You don't buy a house for Varsha
- Varsha starts working after 2 years and makes ₹1.5 lakhs annually with an average 15% increase Y-o-Y

- You continue your monthly expenses of ₹1,00,000
- You spend on your annual trip as planned – ₹4,00,000
- You take full health cover of ₹10,00,000 for Varsha and Rohan
- You spend more (₹70,000) on courses for Varsha in the first 2 years
- You rent a 2BHK house worth ₹1.2 crores with an annual rent of ₹3.6 lakhs
- We assume that you and your wife will be around till you are 85 years old
- You start adding ₹6,80,000 annually towards Varsha's future (for Rohan's education/wedding, life cover on Varsha, her retirement and their vacation)
- Your expenses increase at assumed inflation rates



Cash Flows



Plan III – No Health Cover Available, A Smaller House

Result

- Varsha's future is fully secure, medical expenses are fully covered, and you can live a full life that you had planned for!
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A bold move to sell the house, but this is one of the best financial options available to you! It will free you of all financial worries!

Risks

- Landlord may hike prices if you stay in the same house for long, but you have a decent surplus to cover this until a point
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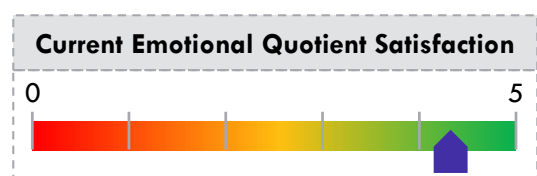
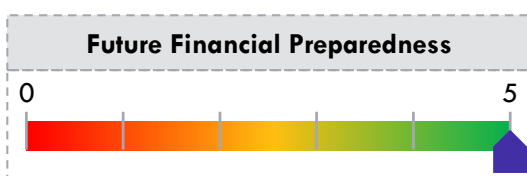
Compromises

- You **don't buy a house** for Varsha
 - You **don't have** your own **house**
 - You may have to keep shifting house every few years – although this can also be a positive attribute
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Achievements

- You are **covered fully** for expenses:
 - Uncovered medical expenses
 - Money lasts even if one of you hit 95yrs
 - You live a **full life**
 - Plenty of savings for Varsha and Rohan to **cover all major future costs and risks**
 - No **stress on Varsha** in the future – she feels completely secure
-

Plan Rating



Plan IV – A House for Varsha, No Health Cover Available, A Smaller House

If you agree to sell your house, you can perhaps consider buying a smaller one for Varsha if Swati insists. Although, not the most ideal option, it is possible if you reduce your vacation expenses slightly and consider her house to be in lieu of other savings for them.

Assumptions

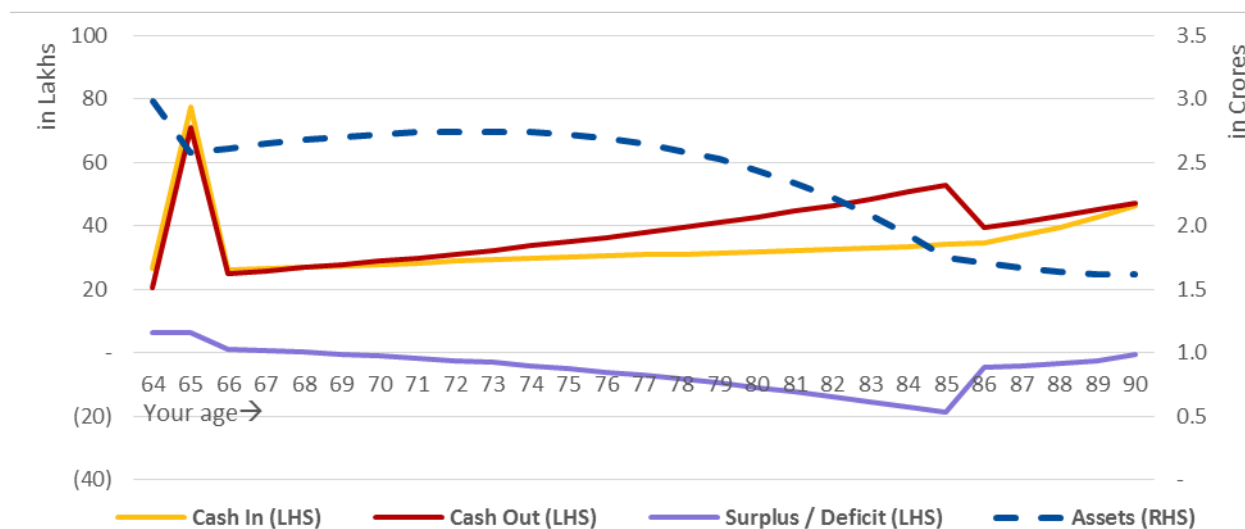


- You keep ₹1,00,00,000 in LEHs and ₹1,00,00,000 in FDs
- Sell your house and park ₹90,00,000 in LEHs to make that higher yield
- You use the balance ₹60,00,000 to buy a house for Varsha
- Varsha starts working after 2 years and makes ₹1.5 lakhs annually with an average 15% increase Y-o-Y

- You continue your monthly expenses of ₹1,00,000 (the increased expenses due to duplication gets offset by the smaller house you stay in)
- You cut your vacation spend by 10% and take the first trip after 2 years
- You take full health cover of ₹10,00,000 for Varsha and Rohan
- You spend more (₹70,000) on courses for Varsha in the first 2 years
- You rent a 1BHK house worth ₹60 lakhs with an annual rent of ₹1.8 lakhs
- We assume that you and your wife will be around till you are 85 years old
- You start adding ₹5,70,000 annually towards Varsha's future (for Rohan's education/wedding, life cover on Varsha, her retirement and their vacation)
- Your expenses increase at assumed inflation rates



Cash Flows



Plan IV – A House for Varsha, No Health Cover Available, A Smaller House

Result

- You will be able to give Varsha a house, live a full life and save some for your kids – all at the same time.

Not the most ideal option, but you will manage financially. And also get to keep Swati happy!

Risks

- Landlord may hike prices if you stay in the same house for long, but you have a decent surplus to cover this until a point
- Not enough liquid financial assets** for Rohana and Varsha in the future

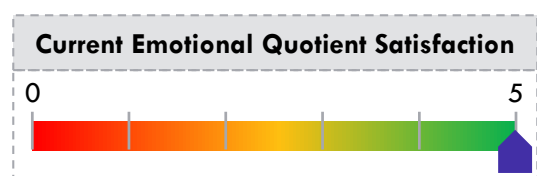
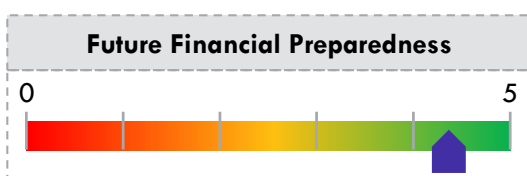
Compromises

- You **don't have** your own **house**
- You need to reduce your **vacation expenses** and slightly compromise on your dream to see the world
- You may have to keep shifting house every few years – although this can also be a positive attribute

Achievements

- You are **covered fully** for expenses:
 - Uncovered medical expenses
 - Money lasts even if one of you hit 95yrs
- You live a **full life**
- Fulfil Swati's desire to get **Varsha a house**
- No **stress on Varsha** in the future – she feels completely secure

Plan Rating



Conclusion and Next Steps

There is never one right options...

Next Steps – Choosing Your Option

There is no single right option for your finances. We need to sit together with your family and figure out what are the priorities and what is more important to you. We suggest that we schedule a meeting to discuss your plans. We can also discuss a few other permutation and combinations that we can discuss with the excel model in front of us.

Detailed assumptions and illustrations are included in the attached Appendices.