Personal Finance

3/6/2012

Name of the Student

Project Name:-…………………………….

Name of the Student:-………………………..

Student Roll No.:-……………………………

University Name:-……………………………..

Personal Finance Planning of Mr. and Mrs. Leonard Maurice

Mr. and Mrs. Leonard Maurice is young couple with two kids. Mr. Leonard is working as an instrumentation engineer whereas Mrs. Leonard is offering her services as an accountant. They are very much interested for their financial planning. When I get in touch with them, I found that Mrs. Leonard, being an accountant keeps a good knowledge of finance and she encouraged Mr. Leonard to get a good planning for their financial future through a professionally qualified and experienced personal financial planner. On the personal ground, I appreciate the couple as they always take care of not only their own needs but they give equal importance to the needs of their parents, siblings and friends.

I need to get a lot of interaction from them to chalk out a better financial plan which must suit them and can convince them to follow. In the process, I found they were always humble and shown their highest degree of interest. This helped me a lot in gathering the information about their past, present and their plans for the future. I changed a few things in their future plan and intimated them while discussing with the reasons and they found themselves fully convinced after long debates. I appreciate the long debates which also helped me in thinking in different ways.

Background Information of Mr. & Mrs. Leonard

Mr. and Mrs. Leonard both are working with two different companies in two different fields. Mr. Leonard is an engineer by profession and Mrs. Leonard is in the field of finance and accounts. The entrepreneur willingness of the couple can be seen from their small internet based e business through which they make a small sum of money a year with optimum utilization of their free time. Their major income is evenly scattered throughout the year except the bonus and commission, which they receive in on quarterly basis.

They are presently staying in rented premises, paying a rent of \$1,500/= a month and have a plan to own a house in the near future. They have their own car which is being used by both of them.

As far as saving and investment is considered, they could manage to save a small amount till time. They could have more, but their responsibilities did not allow them. They have two kids and parents. Kids depend on them. They also help their parents as and when required. Sometimes they also buy some expensive gifts for their parents. Mr. Leo has a sister who is younger. Mr. Leo also wants to share his sister's responsibility with his parents. His wife is also in agreement with him.

They like a good life and after leading a reasonably good quality of life, they want to save. They don't intend to save just for the sake of saving and at the cost of present life.

Financials Goals of Mr. & Mrs. Leonard Maurice

While my discussion for making a better future financial plan, I need to understand their future financial goals. For the purpose, I discussed it in detail with them. The financial goals of theirs have been divided in three categories, which are:-

1. Short Term Goals: - The goals which they want to achieve in less than one year.
2. Intermediate Term Goals: - The goals which they want to achieve in 2 years to 5 years.
3. Long Term Goals:- The goals which they want to achieve in longer term, i.e. 6+ years.

They have an intention to buy new furniture and laptop this year. They also want to go on a holiday during vacation. Further to it, Mr. Leo wants to gift jewellery to his wife on their anniversary and they are also interested in buying a gift for mother. While analyzing the need of all these things, we find that we can categories these internally, based on its priority. They considered furniture at the top priority and laptop as second and remaining as lesser important. Similarly they want to buy a new house and replace their existing car with new one in their intermediate term plan. They also want to go for an international holiday in another few years. Besides this, they want to support their younger sister, who is interested in studying medicine. As a loving child of their parents, they are interested in buying a small car for their parents, if the financials allow. These are the major expenses; they intend to meet in another five years.

As part of their long term goals, they want to give significant importance to their kids. They want to have reasonable saving for this period to meet their parental responsibilities. As part of this they want to expense for the better education for both their children. Along with this, they also want to take the responsibility of the kids' marriage. Apart from this, they want to go on a world tour and change their car.

The cost estimate for all their financial goals has been carried out and presented in the supporting pdf files.

Everything comes with a cost. While going through these costs, I found the most important and critical item from this point of view is their intended home. They want the most suitable house based on the maximum they can afford. For the purpose, I did my first analysis as whether they should go for buying a house or take it on rent. The analysis has been done with their current rent payment amount of $1,500 a month. The other information has also been considered for the calculation such as insurance and opportunity cost on their security deposit with the landlord. While analyzing the cost of similar house in the similar locality which is most suitable for their family, we arrived that it may cost $400,000. The cost of the house can be partly paid cash and partly financed. The quantum of down payment may range 10-20%. Considering various other factors, such as EMI on loan, taxes, insurance, maintenance and estimated annual appreciation in the value of the house, my calculation, which is attached with this paper, concludes that it is better to purchase a house compared with going on rental basis.

Based on this conclusion, I tried to carry out an affordability analysis for a good estimation. House is such an item which cannot be changed frequently. I took an affordability ratio of 30% of their income and estimated a property tax and insurance of $600 a month. Based on all these figures, my attached calculation says that they can go only up to $100,000 for buying a house. As per the prevailing interest rate on home loans in the market, I took it at 7%. They are keen to repay the amount in twenty years, which is a good time period for repayment of housing loan. As per the current financial condition, 10-20% down payment will be asked by the loan providers. For taking a house on rent, we also need to pay amount in advance as security deposit. The amount being asked by the landlord in their place is six months of the rent, which comes to $9,000. They will lose interest on this as the amount can be used elsewhere for earning interest. On the prevailing market conditions, an interest of 5% has been taken. The assumption of 5% can further be justified based on the risk free interest one can earn. Further the calculation based on their current rent outflow compared with value in buying, also says that it is better to have a rented premises. Based on all these facts buying a house seems not to better for the family. They got convinced that they will continue rented premises.

The similar analysis has also been done and annexed herewith for car purchase or lease. In case of taking a car on lease, the cost of leasing comes at $18,500 whereas in case of its purchase , the cost comes at $14,923. Several justifiable assumptions has been taken here such as an interest of 7% on car loan, which is based on the prevailing market interest rate, a period of 60 months for loan repayment, which is most reasonable in case of purchase of a new car and its useful life, monthly lease has been considered as $200, which is being charged by the leasing companies with a down payment of $5,000 and security deposit of $1,000.All the assumptions are well considered based on survey on the market and are well known by people at large. The analysis goes in favor of buying it rather than taking it on lease, with a family budget of $15,000, buying a car gives them better value compared with taking it on lease.

Further they showed me an interest of buying two cars. I objected and requested them to go with one as they stay at this moment very close to their offices and their offices are very close from each other. Buying two cars will not only increase the cash outflow at the moment, will also need more money for its fuel and maintenance. It is not permitted based on the current plan as it will come at the cost of other financial goal. They convinced.

Cash Budget of Mr. and Mrs. Leonard Maurice

A cash budget has been prepared for them based on the best estimates of their current income and expected in the near future. The expenditure pattern was also discussed with them which were then compared with the standard family expenses. Based on all these, the cash budget for the whole year 2012 on monthly basis is prepared and attached. The budget shows that the cash will be in deficit in few of the months in the year such as January, April, July and September, whereas in few months it will be in excess. The deficit in the beginning months, which is a small amount ($200) can be managed with the available cash and deficit in the other months can be easily matched with the cumulative cash balance of the current year. The financial goals of 2012, which includes purchase of furniture & laptop, a holiday tour, and gifts of jewellery for wife and a gift for mother are well incorporated in the cash budget in the appropriate months.

They find the budget as an optimum mix of income and expenses and they are well convinced with the figures. The budget concludes an investment of $6,500 apart from cash saving of $6,875 by the year end.

Insurance Planning

Insurance is one of the parts and parcel of today's life. We all have family commitments and our family leads a happy life as because someone in they is bringing good resources to the house. It is difficult to assume, but if we practically think upon the consequences in case of any unfortunate with the earning family member, we foresee the bad part of life. Insurance cannot bring back the life but help financially to them to a great extent.

The insurance planning has been carried out for Mr. Leonard being the main earning member. The insurance planning considered the household expenses, other needs including debt liquidation etc. The household expenses are reduced to 75% of current, which comes now to $3,000 a month. The reduction of 25% in monthly expenses is considered based on the reducing share of Mr. Leo in case of any casualty. Considering the small inflation, this expense is increased by $200 at an interval of 5 years. The family will also need fund for the kid's education as well as for the liquidation of current loans. The amount has been considered as $10,000 for loan based on the down payment of car ($5,000) being made at the moment. It also considered the amount being received by them from different sources and the net deficit they will face for which the insurance is required. In case of any such causality, the social security being provided by the existing Government facilities as well as by his existing insurance policies have been taken as $3,000 a year for first five years and then increased by ten percent on interval of every five years. The increase has been done based on past experience. Mr Leo also informed me that he is insured by his employer and the insurance company will also take care of the family in case of any incident. Based on all these facts, I arrived at an amount of $3,000 per month which is most convincing to the family also. Taking a period of 15 years from now, they need life insurance coverage of $256,000. The period of 15 years has been considered based on the estimate that the kids of the family will be grown up by then and they themselves will become earners. Mrs Leo would have her own responsibilities then which she can meet with her own salary and other income. This can be purchased by way of term insurance from an insurance company and the premium can be paid annually. Premium for term insurance is very small but it is very useful. Nobody knows what will happen next moment.

Further to it, a disability benefit requirement has been sketched out and the calculation shows a deficit of $750 a month. This can also be arranged with an insurance company. Mr. Leonard can take such an insurance policy which can serve both the purposes.

As far as Mrs. Leonard is considered, who helps her family not only morally and emotionally but also tries to do her best financially. Being an accountant with a small firm, she tries to meet not only the company responsibilities but also help Mr. Leonard with her income. They should also take a term insurance of one third of the value of Mr. Leonard's insurance based on his spouse salary compared with him.

Retirement Planning

The retirement planning is one of the most critical as this is the time when the outflow of funds is sure, but inflow is not. For ensuring such inflow, we need to have a good retirement plan. While discussing the issue of retirement with the fmaily, both of them, who are also the earning members, want to retire as per their respective company policies. They don't have any interest in getting off from work early; neither has they wanted to work till the end of their life. As they are too young now, they find it difficult to think for retirement planning and saving now. I encouraged them to think from now based on the principle of "earlier it is, better it is".

Retirement fund planning has been done considering all the factors in mind. Their current household expenses have been discounted with the estimates on retirement and inflated with the estimated inflation rate of 3% a year. After reducing estimated post retirement income, the calculation shows that they need to save a sum of $3,579 a year for happy retired life.

Now the question comes in our mind, where to save this money. It is better to save this fund either with a company ensuring the retirements or can also be invested into the market through mutual fund route. As this is a very long term investment, I will never suggest keeping the fund in bank accounts for earning interest. The fund can be invested into a balanced mutual fund through systematic investment planning.

Investment Planning

We saw till time that they have a potential savings and investment of $6,500 a year and they are left with a cash balance at the end of the year amounting $6,875 a year. This amounts to a total of $13,375 a year. This amount is apart from the other company contribution of pension, insurance and retirement funds. Our above analysis shows that for a healthy retirement, they need $3,579 of annual savings. For term insurance and disability insurance, we estimate a figure of both the earning members as $1,400. Thus we see that they need to pay almost $5,000 a year for this. The remaining amount with the couple is $8,375 a year. It is required now to make a proper planning for its investment for realizing the medium and long term goals for them. We should not forget here:-

1. The saving potential will increase in normal circumstance.
2. There is a need of keeping some amount in liquid or near to liquid form in case of requirement of meeting certain emergencies.
3. The investment should be made in a good proportion of debt and equity together with a mix of real estate if the amount is material.
4. Choosing the equity is difficult compared with choosing a mutual fund.
5. It is better to go ahead with systematic investment planning in place of buying mutual funds on lump sum basis.

Keeping this in mind, I suggest them to keep cash equal to 3 months household expenses and remaining needs to be invested in debt funds and equity funds. If they are very keen for investing the money directly into the stock market, I would suggest to invest a small proportion, let us say 10% and only in the mix of blue chip companies.

The file has also been created for meeting the midterm objective of buying a house and paying its down payment and for meeting the long term objectives. For simplification and better understanding, the amount of all long term objectives have been clubbed and an average of 14 years is considered for requirement of fund. As per the initial discussion with Mr. Leo, his savings till time is also shown in the files.

For study of his sister, they have already accumulated the fund in the past as they considered it very important and kept it at the top in their priority in their intermediate term goals.

Buying a car for the parents can be materialized with the help of sale of their two old cars and estimated maturity of one of their funds by the mid of 2017.

It seems that they have well planned their intermediate goals and accumulated fund for the same. As they have a plan to buy house beyond five years, they could not manage good money till time for this, which they will do now based on my analysis.

Based on all this, the family can plan their savings at the moment in the following way with the reasons specified:-

1. Three months equivalent household expenses in cash form in a saving account. This will help them in situation of loss of job or other certain unpredicted situations. They will earn lesser interest but will help them in any bad situation.
2. Three months equivalent household expenses in liquid mutual funds. This will help them in case of the above situation last long. The interest will be lesser in this case but better than saving account, and can be proved helpful if the situation goes beyond three months.
3. The couple should target the saving of the above amount first. After this they should save 40% in equity mutual funds. The amount to be invested in blue chip funds of Fidelity and HSBC equally. Equity investment gives a good benefit in longer term and investment through mutual fund is always safe and we get the benefit of diversification in this case.
4. 40% should go in debt fund of JP Morgan and Fidelity equally and they should invest 10% in the choice equity. Investment of 40% in balance fund will earn a moderate income to the family without any risks. Debt funds perform better even in short period. 10% direct investment in equity is based on the request of Mrs. Leo, who

wants to invest money also directly in stock market. This ten percent should go in blue chip companies such as apple, BSYB etc.

5. The last 10% should be kept cash.

The above investment mix will give them the optimum exposure to the equity market and debt market with a reasonable saving for their any contingencies.

Conclusion

The complete analysis of the income and expenditure has been carried out. I compiled the future plans of their family, their financial goals and other requirements. Further to it, a lot of different analysis has been carried out about their plan for buying or leasing a car, renting or buying a property, their retirement plan, insurance needs and investment. All the analysis and details are presented in the attached annexure.

Based on the analysis, we set the future goals for them with complete coordination of their family members. We also prepared cash flow for a year, income & expenditure statement as background paper.

They have a good income compared with their needs and their future financial plans. All their future financial plans are quite much achievable. They just need to invest the money in a better way in spite of keeping it idle in their bank accounts and try to match their expenses with the budget. Mrs. Leonard being a perfect accountant and housewife is very serious about their expenses and future commitments and I hope with my advice to they through this paper, their financial goals can be achieved in time together with they can accumulate required funds for their retirement.

I wish them all a very happy and fulfilled life.

References

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3. Tyson Eric, 2011 , Investment for Dummies
4. Tyson Eric, 2011 , Personal Finance in Theyr 20's for Dummies