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CHILD'S EDUCATION

Are you saving enough?

With the cost of education rising at almost double the average rate of inflation, it is imperative that you begin to save early and invest the money properly

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AS I searched frantically for my school passing certificate to support my daughter's admission application in the same school that I went to, I seemed to find everything that I was looking for, except the school leaving certificate. Now, isn't that familiar? Somehow Murphy's Law always seems to work. Among all the papers that I found was a fee receipt that indicated a total fee of Rs 3,000 per annum in my last year at school. Since my son already goes to the same school, the financial planner in me could not resist the urge to figure out how school education costs have changed. A quick calculation revealed that inflation on school education has been about 14 per cent per annum in the last 20 years and the fee has gone up about 12 times over this period.

Was this a mistake? My understanding of inflation was that over the last 20 years it has averaged around 8 per cent per annum. So to double check I called up my business school alma mater. Again the findings were quite similar: over the last 13 years costs have gone up more than six times, averaging 15 per cent per annum.

Considering that a high-quality education tends to be of paramount importance to most Indian families, and is something that today's parents are unwilling to compromise on, the moot question is: how do you plan for education costs that are rising at a pace that is almost two times the regular rate of inflation?

Step 1: Define the current cost

Take professional help to establish the size of the corpus that you need to create for each of your children. For this purpose, you need to get a fair estimate of costs involved for the programme that you would like to plan for. These would vary depending on the choice of country, type of programme (i.e., undergraduate or post graduate), duration of programme, and so on. Ensure that you account for associated costs other than the tuition fee, such as application cost, hostel cost, travel, ancillary costs like for laptops and other equipment, and special coaching costs at the time of entry and during the course. It would be a good idea to speak to students attending such programmes currently to get a feel of the total costs involved, or even better, the students' parents. Once you have done this, establish whether you would like to support the cost of the entire programme, or support just the initial portion of the programme, after which the child could support it through scholarships and part-time work.

Step 2: Apply an appropriate inflation rate to arrive at the corpus required

With state subsidies for education being reduced the world over and education getting more professional and commercialised, it is likely that inflation on education will continue to be much higher than the regular rate of inflation. It is also essential that you review the inflation rate every few years, as the entry of new programmes could alter costs significantly. For example, with the entry of IB (International Baccalaureate) programmes in India at the school level which were unavailable till a few years ago, the cost of education at the school level has changed dramatically. These changes are not captured by the regular rate of inflation.

Step 3: Set your other life goals simultaneously

Since for a lot of parents the education goal tends to override other goals, there is every likelihood that retirement planning will get compromised so that the highest quality of education is provided. Remember that while the education goal can be achieved through other sources like scholarships and education loans, no such options are available for your retirement goal. Too many retirement goals in India are sacrificed at the altar of children's education and marriage.

Step 4: Identify the appropriate vehicle for building the corpus

No empirical evidence exists to prove that a product that has been branded as a child product is superior to a generic product for meeting the education goal. For example, HDFC has two mutual funds — one is a specialised child offering and the other is a regular balanced fund. Both of them have a mix of stocks and bonds in a similar proportion of approximately 65:35. However, over the last five years the regular balanced fund has delivered a return that is more than one-and-a-half times the return from the child-focused fund.

At the same time, clearly earmark the portfolio as an education portfolio so that this money is not used for any other purpose.

Keep in mind that with inflation on education likely to remain in the mid teens, pure fixed-income products like traditional insurance plans, Public Provident Fund (PPF) and bank deposits are unlikely to help you achieve your target. Therefore, a significant portion of your investments must go into inflation-beating assets such as stocks and equity mutual funds. We would recommend using a combination of an index fund, a diversified equity fund and an international fund for aggressive investors. For more conservative investors a combination of a balanced fund and an index fund is recommended. A combination of using systematic investment plans and value averaging plans to invest in these funds is recommended to mitigate the market-timing risk. Real Estate Funds, once they become available at the retail level, could also be considered in future.

While children's insurance plans are very popular because a large number of them come with the premium-waiver benefit that enables the plan to continue even if the guardian dies, a vanilla term plan can play that role without compromising on the inflation-beating returns that equities can offer.

In addition, ensure that the product you investing for meeting the education goal offers adequate liquidity at low cost. Since in all probability you will be unable to predict whether you will need the corpus when your child turns 18, 19 or 21, you should avoid products that allow you liquidity only at specific ages.

As you reach closer to your goal, move the funds from high-risk equities to lower-risk bonds and deposits.

Lastly, start when your child is very young so that you get both the benefits of compounding and adequate time in the equity markets so that your timing risk is reduced. By breaking what you need to invest into a monthly or quarterly target, you can ensure that your goal is achieved. ◆

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Mumbai-based developer Samrat Pariekh and his wife Meeta want their eight-year-old son Om to become an achitect when he grows up. They have begun saving to meet this goal. But like a large number of parents they are using an insurance product to meet what is essentially an investment goal

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