BUILDING AN EMERGENCY FUND

Creating a financial cushion for stressful times.

Presented by Glazer Financial Network

How would you respond to sudden financial demands? We all define "emergencies" differently, but we are not immune to them. How can we plan to stay afloat financially when they occur?

Most households are not financially prepared for an emergency – not even close. A recent study from the National Foundation for Credit Counseling found that 64% of Americans had less than $1,000 in funds earmarked for a crisis.[1]

While the recession did its part to siphon emergency funds from families, attention must be paid to rebuilding those funds. It may be difficult; it may be inconvenient. That doesn't make it any less of a priority.

Emergencies tend to be linked to long-term debt. Having a designated emergency fund can help you attack that debt. When most people think of financial emergencies, they think of medical problems and burdensome costs that their insurance won't fully absorb – but there are other paths to long-term debt, such as a sudden layoff, a natural disaster, a family issue with financial underpinnings or even an abrupt need to move to another metro area, for whatever reason.

How large should the fund be? You decide. An old rule of thumb is six months of net income or six months of expenses. If you are snickering or laughing out loud at your chances of saving that much, you aren't alone. If your prospects of building a five-figure emergency fund seem remote, try to create one equivalent to two or three months of net income. Any amount is better than none.

How do you do it without hurting your standard of living? Few of us have a lump sum we can just reassign for emergencies. So consider these subtle savings opportunities.

> *You could pay cash whenever possible,* opening the door to incremental savings that credit card companies would otherwise take from you. A few dozen bucks can become a few hundred bucks, then a few thousand bucks over time. Incidentally, in a nationwide survey conducted by Chase Blueprint and LearnVest, 31% of people polled cited credit card debt as a major barrier to achieving financial objectives. The credit card debt carried by this 31% averaged about $5,000. Clearly, living on credit cards will thwart your effort to build a rainy day fund.[2]

> *You could vow not to spend frivolously,* thereby retaining money you might be tempted to throw away on impulse.

> *You could sell stuff* – stuff somebody else, maybe down the street or across the country, might want. Incidental shipping and handling costs could seem irrelevant next to the cash you generate.

> *You could arrange direct deposit or start a seasonal savings account.* The psychology behind both moves is simple: you are less likely to spend money if it doesn't pass through your wallet.

Here's how *not* to do it. Try to avoid building a crisis fund through self-defeating methods. For example:

> *Don't start an emergency fund with a loan.* Do it with your own accumulated savings, bonus money from your job performance, royalties – whatever the origin, use money you have made or and/or saved yourself, not money you have borrowed from lenders or relatives.

> *Don't do it using payday loans or cash advances.* High-interest short-term loans and cash advances on credit cards are often pitched as rescues to struggling households. Thanks to their absurd interest rates, payday loans are not financial "life rafts" by any means. Cash advances on credit and debit cards come with disproportionately high fees. Sadly, people who go in for these loans and advances once commonly go in for them again.

> *Don't refrain from paying certain bills.* Let's say that you have eight debts you have to pay per month. If you only pay three of them each month and carefully alternate which debts get paid down, can you create an emergency fund with the money you avoid paying? Well, yes – but you may imperil your credit rating in the process.

If you don't have a designated emergency fund, you can build it up in the same way that you probably invest: a little at a time, with relatively little impact on your lifestyle. It can be done. It should be done.

Citations.

1 – www.learnvest.com/knowledge-center/5-ways-to-start-an-emergency-fund/ [8/14/12]
2 – www.foxbusiness.com/personal-finance/2012/11/01/seven-reasons-why-need-to-create-emergency-fund-now/ [11/1/12]