Emergency savings

Building emergency savings is an important goal on its own and it goes hand in hand with debt reduction. Think about it – if you have money specifically set aside for emergencies, you won't have to add to your credit card balance, take on new debt or redirect money from another goal when the unexpected happens.

Emergency savings are for:

- Short-term emergencies – one-time occurrences such as repairing your vehicle or replacing an appliance.
- Long-term emergencies – ongoing situations such as a job loss, pay cut, disability or other interruption in earnings.

Short-term emergency savings

If you have a fender bender and have an insurance deductible, how will you pay for it? If your furnace or air conditioning goes out, where will the money come from to repair it? What about an unexpected dental or medical expense? Would you be able to pay it up front or be forced to put it on your credit card?

When you have a short-term emergency fund, you can use your savings to pay for these types of expenses instead of incurring more debt.

How much do I need to save?

This is the million-dollar question – but the answer varies for every situation. Instead, ask yourself, "How much do I need to have set aside to feel more secure?" Answer that question – then decide what approach you'll take to reach your goal. Here are two approaches to consider:

1. Choose a specific dollar amount as a goal – $1,000 is a common level. Think about what kind of emergencies you could weather with $1,000. Maybe you'd feel OK at $500, or would be more comfortable with $1,500 or $2,000. You decide.
2. Put some numbers behind your goal:
   – Add up the deductibles for your home or renters insurance and vehicle insurance.
   – Look back at the last year. How much did you pay for vehicle repairs and other emergencies? Include that figure in your total.
   – Add in the average cost for a household appliance or other potential expense.
   – Total those items and any other potential one-time emergencies and use that amount as your target.

Example

Expenses/short-term emergency fund	
$1,000	Homeowners deductible
$500	Vehicle insurance deductible
$250	Animal hospital/ER
$800	Replace appliance
$700	Car repair totals for last year
$3,250	**Needed in short-term emergency fund**

Once you have your short-term emergency savings, you can set your sights on long-term emergency savings.

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Long-term emergency savings

When you're building a long-term emergency savings fund, the goal is to have enough money to cover your expenses (not your full salary) over several months if your household income is interrupted.

- If you have a budget, you already know your monthly expenses – housing, food, utilities, debt repayments, transportation costs, insurance and all of your other "must-pay" bills.
- If you haven't calculated your monthly expenses, ask your financial coach to review the budgeting resources with you and take time to develop a budget.

How much do I need?

This is where you hear goals like saving enough money for three, six, nine or more months of expenses. Don't let these amounts scare you into doing nothing. Like any goal, breaking it down into smaller parts can help you get started. Ask yourself, "How many months of savings would it take for me to feel secure?"

Tips

- To get started, you may want to set a three-month goal, and once you hit that, set the new goal at six months.
- If you have a job where your pay can vary from month to month, or if you work in an unstable field, you may want to increase the number of months' expenses for which you save.

Is it really an 'emergency'?

Expecting the unexpected – it's why you have an emergency fund in the first place. When a situation arises, ask yourself if it's really an emergency before you tap into your savings fund.

Emergency (examples)	**Not an emergency (examples)**
Unexpected home repairs like no heat when temperatures are freezing or an overflowing toilet that can't be fixed with your DIY skills.	Class reunion is coming and you need a new outfit.
Medical or dental emergency for your family (can include pets).	Christmas.
Car breaks down – and it's your primary transportation.	Opportunity to go on a vacation that wasn't budgeted and saved for.
Flight to a close relative's or friend's funeral.	Your sister wants to throw your parents a 50th wedding anniversary party and you pay your half.
Job loss, disability or other long-term interruption in earning.	Taxes are due – it's one of two sure things! Put money aside throughout the year specifically for taxes.

Source: Learnvest.com/knowledge-center/so-what-really-counts-as-a-financial-emergency

How can I build an emergency savings fund while paying down my debt?

Having an emergency savings fund and paying down debt are both important goals. So how do you prioritize them? Again, there's no one-size-fits-all approach. What's important is that you choose the approach that is most comfortable for you – and go for it.

Approach	Rationale	Pros	Cons
Build short-term emergency savings first.	• Building a short-term emergency fund of $1,000 (or other amount) will help break the cycle of debt if an emergency arises. • Continue paying minimums on credit cards and loans until the short-term goal is reached, then direct the dollars to debt reduction.	• Helps avoid adding to a credit card balance and breaks the debt cycle. • Focus is on one goal at a time. • Emotional lift in having emergency savings.	• Delays debt reduction. • Interest accrues on the debt (growing the balance) while building short-term savings, which could cost more in the long run.
Balanced approach for short-term savings and debt reduction.	• Splitting available dollars between debt reduction and building emergency savings (e.g., 50/50, 75/25). • After emergency savings goal is met, direct all available dollars toward debt reduction.	• Makes progress on both goals. • Reinforces positive saving and spending habits. • Emotional lift in making progress toward both goals.	Interest rates on savings accounts are likely to be much lower than on debt, so splitting the dollars may cost you more in the long run.
Balanced approach for long-term savings and debt reduction.	Once your emergency savings is in place, continue splitting dollars between debt reduction and long-term savings goals.	• Makes progress on both goals. • Especially beneficial for people whose retirement contributions are matched. • Reinforces positive saving and spending habits.	Interest rates on savings accounts are likely to be lower than on debt, so splitting the dollars may cost you more in the long run. (The exception is employer-matched retirement contributions.)
Direct all available dollars to debt.	Taking a nonemotional approach with the numbers shows that focusing on debt first with its higher interest rates would cost less in the long run.	• People who already have savings in place may want to consider directing some of those dollars to debt. • Debt can be paid down more quickly than other methods assuming no additional debt is added.	An emergency that occurs before debt is paid off could add to the debt balance.

Source: Bankrate.com/finance/savings/should-you-pay-debt-before-saving-2.aspx

Make it happen

Follow these steps to help you reach your emergency savings and debt-reduction goals:

1. Decide how much you'll save, breaking your goal into pieces for short-term and long-term savings. Also determine what approach you're most comfortable with when it comes to prioritizing saving goals with debt-reduction goals.

2. With your goal in mind and priorities in place, decide where you're going to keep your money. Keep in mind that emergency funds need to remain fairly accessible.
   – A savings account, money market account or short-term certificates of deposit generally make good sense. Any one of these accounts will give you the liquidity you need, while still earning some interest.
   – Keeping emergency savings floating in a checking account or commingled with other savings dollars is not recommended. Emergency savings are for emergencies only and are best kept in a separate account only for this purpose.

3. Find money to put toward savings. This can be accomplished by doing one or more of the following to help you put money into savings and reduce debt:
   – Find money within your budget.
   – Earn additional dollars.
   – Reduce spending in some areas.

   If you find your budget is really tight, don't be discouraged. Even $10 or $20 a month is progress toward your goal and will add up over time.

   Also keep in mind: Savings can get a kick-start with a tax refund, a bonus check, a rummage sale or a temporary part-time job. Ask yourself what you could do for a few months to earn some extra money to get that short-term emergency savings in place.

4. Make savings automatic by setting up scheduled automatic payments to your savings account. You could set up:
   – A direct deposit from your paycheck. Your employer can let you know how to do this.
   – An automatic transfer from your checking to your savings account. Check out your bank or credit union website to set this up.

A majority of us don't miss the money that's directed this way. Out of sight, out of mind, and into the savings account. Revisit the amount after three or six months. If you don't miss $50 a month, would you miss $75? Automating your savings greatly increases your ability to reach your goal.

Source: Frugalliving.about.com/od/moneymanagement/ht/Emergency_Fund.htm