Understanding Emergency Funds

No one wants to get hit with the unexpected cost of a new roof or have to deal with a period of unemployment between jobs. Those situations are made worse, though, if your family does not have the financial reserves to cope with them. For this reason, an important step on the road to financial security is establishing an emergency fund.

An emergency fund is a set amount of money that is to be used specifically in the case of an *expensive* emergency, like covering family expenses after losing a job or needing to pay for unexpected medical or dental procedures, home or vehicle repairs not covered by insurance, or unplanned travel expenses. It is money that should only be drawn upon when you are covering a “need” and not a “want.” It also should not be used for expected expenses, such a regularly scheduled car maintenance or healthcare deductibles – these should be saved and budgeted for separately.

What amount of money should be in an emergency fund is unique to your family situation, but experts generally suggest that you keep at least three to six months of living expenses in the account. Living expenses include all of the bills and charges that you must pay for to survive: your mortgage or rent, insurance, utilities, transportation, food, debt payments, and other family expenses (e.g., prescription medications or childcare). However, living expenses do not include nonessentials that would not be in play should there be a major catastrophe and you need to cut back; think date nights, dining out, and vacations.

There are a few common situations that would warrant having a larger cash reserve:

If you or your spouse works in an industry where unemployment rates are higher than average or layoffs are more frequent, you should have a larger-than-average emergency fund. The same goes for families in which at least one partner freelances, does contract work, or earns commissions as compensation. If the amount of money coming in each money is not always the same, it is best to overprepare and create an emergency fund with eight or 10 months of living expenses.

Your family's method of investing can also impact an emergency fund requirement. For example, if you are a real estate investor who rents out properties, this warrants a larger safety net in the event that the renters do not keep up their end of the bargain or if significant repair expenses arise.

Furthermore, if you have a family member with a chronic medical condition that requires frequent, unscheduled trips to the doctor's office or emergency room, you will want to set away extra money in case their condition flares up and you need to cover costs. This is especially important if you find yourself in a period of unemployment, when healthcare costs and coverage will likely be impacted. If you have children or care for an elderly parent, your family's costs are automatically higher than those of families without dependents, and their costs will not disappear if you or your spouse were to lose a job. Tailor the amount of your family's emergency fund to your family's size and circumstances.

If you do not already have an emergency fund established, they are not too hard to build:

1. Calculate your emergency fund amount. Aim for at least three months of living expenses, but factor in extra if your family circumstances warrant it.

2. Set a monthly or biweekly savings goal. Take a look at your family's budget and determine how much you can realistically set aside each time you get paid.

3. Move money to your savings account automatically. Set up a recurring payment from your checking account (where you receive your paycheck deposits) to your savings account (where you store your emergency fund). Making your money move automatically will prevent you from spending it and set you up for success.

4. If you find it difficult to set aside monthly savings, you can consider using your tax refund to quickly grow your emergency fund. The IRS can deposit that money into your savings account automatically and give you a big boost on the road toward reaching your savings goals.

> **Note:** If you have debt, you still need to make your monthly payments toward that debt. If you neglect to make these payments, you will find that your debt grows as interest accumulates. If your monthly debt payments do not leave room in your budget for building emergency savings, aim to first create a rainy-day fund ($500 to $1,000). This will give you enough money to cover a minor emergency while still making debt payments. You can work toward an emergency fund after your debt is paid off and you have the cash flow to put more money into savings.

Emergency Fund Tips

- Open a separate account to house your emergency fund. For the most part, an emergency fund should be out of sight, out of mind. Try to find a high-yield savings account where you can store your money to grow and still be easily accessible – but separate from the rest of your finances.
- Know that you do not have to continually add money to an emergency fund. It has a cap, and unless your family situation changes and you decide that you need a larger fund, it does not need to grow based on new contributions after you fully fund it. After your emergency fund is full, you can redirect the money you had been saving to other things.

- If you have to delve into your emergency fund to cover an emergency, make it a priority to replenish it. Lightning may not strike the same place twice, but it has a tendency to strike more than once, so ensuring you have funds ready when you need them is important.
- Once you have your emergency fund created and fully funded, it is important to create a rainy- day fund. This is a smaller emergency-like fund that you can use to tackle smaller infrequent, but expected costs, like a vet bill, a refrigerator repair, or new tires. Rainy-day funds typically hold between $500 and $1,000.

Having an emergency fund prevents you from having to go into debt to cover an emergency by taking out a high-interest-rate loan or putting a large expense on your credit card. It is like a personal insurance policy; you have a pool of reserve money that can cover this type of cost, and you don't have to pay for it out of your regular household accounts. Having life, medical, and car insurance can also protect you financially if the unexpected occurs. Make it a priority to have open conversations about finances, insurance, and contingency plans with your family so that you are all prepared should an emergency situation arise.

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