

Step 4: Emergency Fund

One evening, as Jennifer was fixing dinner and helping kids with homework, her phone buzzed on the counter. She answered Luke's FaceTime call: "Hi Honey."

As Luke's face came into view, she could see his distress: "Uh oh. Everything ok?"

"Well, um... I'm fine, but I don't think the car is. I've just been in an accident."

We tend to think of emergencies as a crisis - something traumatic or earth-shattering. But, it could also be something less catastrophic. An emergency could be something "extra" or unexpected when it comes to your finances.

When Luke finally got home after having the car towed to a repair shop, he and Jennifer talked about what had happened.

Luke: "The guy just pulled out in front of me! Good thing I wasn't going very fast. I'm not sure how much insurance will cover. We'll see, I guess. I'll call the shop in the morning to see what their estimate is. I don't think it's going to be pretty."

Jennifer: "What are we doing to do? We don't have money for repairs. Even if it's not *that* bad, you don't get paid for another 2 weeks and we have bills due soon."

Luke: "I know hon...we'll figure it out." He paused and shook his head. "I guess we could put it on the credit card..."

Jennifer: "But what money are we going to use to pay that off *next* month? I guess we could skip paying the utility bill and miss a payment on the truck. But I don't know what we'll do to catch up after that."

The key idea behind having an emergency fund is to plan for the unexpected. If you plan ahead, then things like dental work, a broken furnace, or car repairs don't have to derail your budget.

How do I start?

The budget from Step #3 is a key tool for establishing an Emergency Fund. It is impossible to methodically save unless you're spending less than you're earning.

Start by saving towards a small goal – maybe \$1000 at first. Remember to put this goal in its appropriate place: ahead of extra payments on debt. It can be tempting to think that freedom from debt is the only way to have room to save for an emergency. But if your budget won't allow you to step up to your debt *and* save methodically, then you might need to reconsider your expenses or look for additional sources of income.

Once you've reached your \$1000 goal, then work towards putting away 3-6 months of expenses. If your job is very stable, your income is consistent, and you regularly earn more than you spend, then 3 months is probably adequate. But if you are the only breadwinner in your home, you are self-employed, or you earn strictly based on commissions, aim for 6 months. This fund is what will get you through the rainy day of a job loss.

Here are a few other ideas to supplement your emergency fund:

- Use your tax return or work bonus to give yourself a good head start!
- Consider selling something you've realized you don't need and adding the proceeds to your fund.

How do I maintain it?

You need to have a line item in your budget that allows you to refill the emergency fund when it gets used. This is another reason the budget you built in Step #3 is so important.

Make sure that your emergency fund is in a place where you can access it in a pinch. Ideally, it would be earning more than the savings account at your bank. It can be helpful to put these funds in a location that is separate from your other funds – this puts up a bit of a mental barrier to keep you from using it on a Black Friday deal or that new pair of shoes you have been longing for. In other words, when you do choose to dip into it, make sure it is for a real emergency!

Now let's visit a little different version of Luke and Jennifer's story...

When Luke gets off the phone with the auto repair shop, he reports the estimated cost to Jennifer. "We can pick up the car next week."

"Well, that's more than I was hoping it would be, but at least we have that much in the money market account. I can request a transfer on Monday so you can pay the bill."

Luke: "I wish we didn't have to use that money for this... but I guess that's what we saved it for, right?"

Jennifer: "Right. And we can be back at that amount in the account in just a few months. We put a few hundred bucks in there every time you get paid."

Luke: "Really? Well, that's a relief! I don't know how we would've paid for this otherwise."

Even before a financial emergency strikes, you can set yourself up to recover well from it. If you have questions about building your own Emergency Fund, contact us. We'd love to have a conversation with you.