Everyone Needs an Emergency Cash Fund (Part III)

Stop Making Excuses and Start Saving for a Rainy Day

Why is it so important? Because you could find yourself out of work due to layoff or strike action, or your refrigerator could explode, or you might have to undergo an emergency root canal. There are many reasons to be prepared. And if you don't have enough cash on hand, you don't want to find yourself looking around the house for valuables to pawn, wracking up credit card debt or getting a loan to make ends meet. The only thing actually holding you back from getting started is procrastination and denial. Here are some common excuses for not saving to a fund and why they don't hold water:

Excuse 1 : I can't afford to set aside money You need an emergency fund the most when you're living paycheck to paycheck. Saving is a function of discipline, not income so get creative. One way to get started is with a tax refund. If your federal tax refund was anywhere close to the typical $2,000 refund, you probably are having too much withheld from your paycheck. Filing a new W-4 form with your employer to cut over withholding can put extra cash into your paycheck that you can steer into your emergency fund each month. Then track your spending for a month to figure out where you can cut back, and divert that money to your emergency fund. If you have direct deposit at work, you can have your employer deposit a portion of your paycheck into a savings account.

Excuse 2 : I can use a credit card for emergencies You can't always count on your credit cards as your emergency source of cash—nor should you. If you use a credit card for an emergency, what you're saying is you want to tread water financially. That's why you have an emergency fund—so you don't have to use debt. For example, if you charged $1,000 to a credit card with an 11 percent rate and paid just the minimum each month ($40), it would take you six years to wipe out your debt and you'd pay about $258 in interest.

Excuse 3: I have other sources of cash If you think your retirement account is a good source of emergency cash, think again. You'll pay penalties and taxes at your income-tax rate if you tap your IRA or 401(k) before retirement. For those of you relying on a home equity line of credit, be careful. If you already have a line of credit, it might not offer as big of a cushion as before because of falling home prices. You may have been approved two years ago for, say, a $50,000 line of credit. But now you might have just $10,000 in equity to draw against. If you don't have a line of credit but are dependent on being able to borrow money on a moment's notice, you could be in for a rude surprise Lenders are offering fewer lines of credit or freezing them altogether. The only people who should be relying on a home equity line of credit are those whose only debt is their mortgage and who will be disciplined enough to pay off the line of credit as quickly as possible.

Where to Put your Money The place to park emergency savings is in a bank savings account. The interest rates on these accounts are not great now, but your principal will be safe and you'll be able to access your money easily. You're not putting money into a savings account to make you rich. You're putting money in the savings account because it's a buffer from high-interest rate debt when unplanned expenses arrive.
