Building An Emergency Fund - A Vital Part Of Financial Planning

None of us have the ability to foresee the future or predict the hurdles which lie ahead of us. This makes building an emergency fund a financial priority.

Building an emergency fund is healthy for your financial well being, since you're rarely given advance notice of a setback or an accident which will keep you out of work for an extended period. It is also a safety net that can save you from bankruptcy or severe financial hardships in the event of an unexpected change in your income or expenses.

Housing a small rainy day fund should be a vital part of an individual's financial goals. This is of high importance if you don't already have readily available funds in your account for covering any unanticipated expenses. They provide financial security because they give you funds to fall back on if you become ill, or if you or your spouse loses your job, you incur large medical bills, or have an unexpected large bill such as a major car or home repair. You do not want to end up in a situation where you have to buy daily necessities on credit and end up payments on groceries you bought two years back on credit, with a further 10-18% interest on it.

Saving your money in an small account for emergencies is definitely a better alternative to taking a loan or cashing in your long-term investments. If you take a loan, there is the additional burden of paying interest. Encashment of your investments before maturity means not only will you lose out the interest, but also some part of the original investment. This will also set you back significantly in your overall financial plan.

Success at building an emergency fund depends on consistency of saving money on a regular basis, and resisting the urge to dip into this rainy day fund for non-emergencies. This money should be kept separate from the general savings account. Otherwise you will be tempted to dip into these monies even if you simply run over your budget at a certain point. A substantial part of this emergency fund account should be invested in low risk funds. This ensures that your investment does not lose its value in case you need the money. Also, it should be extremely liquid, to give you access to the cash easily and quickly if you need it.

The size of the special savings account will depend on your personal situation. People often keep three to six months' salary in the reserve. But you will have to decide on an appropriate amount based factors such as your dependants and fixed monthly expenses.

If you are single with no obligations, and have a reliable support system of friends or relatives during a financial crisis, you might not need a substantial amount stashed in this fund. This is opposed to someone who needs to pay nursing costs for his aging parents and supporting a young family. The more people you support, the more likely you are to have unexpected or unplanned costs.

While making a decision about an emergency fund, you should also take into account the degree of difficulty you'd have in finding a new job if you lost the present one. In case of a two-income household, the contribution of both parties should be weighed while calculating how much you should keep aside.

You may not be able to gather your emergency fund money together at once. Treat it as a financial goal and add to the kitty over time. If you get a tax refund, put it in your special rainy day account. Maybe a part of the bonus at work!

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About the Author

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