

What Is An Emergency Fund And Why Is It Important?



People who have experienced significant and unanticipated expenses pop up to disrupt their lives can testify how glad they were that they had put aside an emergency fund to fall back on to deal with these unpredictable contingencies.

As with most financial challenges, pre-planning your emergency fund will be critical to its success. While collectively, we do poorly

overall as saving nation, there is no reason you can't take steps to ensure you can weather an unexpected storm.

Emergency Fund Defined

An emergency fund is effectively cash or assets that can be easily liquidated in the event you are faced with a financial emergency or unexpected event.

This fund should be sufficient enable you to live for several months should an unanticipated event pop up that poses a need for ready cash reserves, such as losing your job or incurring significant car, medical or household expenses that require a significant amount of money to address.

In these instances, you need immediate access to a reliable safety net fund. Think of it as a personal insurance fund you set and determine yourself.

How Much Is Enough?

One general rule of thumb is to keep three to six months of committed expenses available in your Emergency Fund. You can determine how much you need to suit your personal circumstances and lifestyle.

Typically, Emergency Funds cover mortgage payments or rent, utility and insurance payments, car loan repayments, car insurance premiums, pet vaccinations, health care or medical insurance costs.

The point is to be able to get by until whatever emergency has occurred has been resolved. So, if you lose a job, you will be able to survive for a few months until you are earning an income again.

5 Reasons Why You Need An Emergency Fund

1. Emergency Repairs

People often think about needing their emergency fund to cover repairs like an expired refrigerator or a leaky roof. One of the most common repair situations are car problems can cost hundreds of dollars to fix and you need your car for work. If you don't have the money in the bank, you'll either be walking or taking public transport for a while.

2. Medical Bills

Even with the most comprehensive medical coverage, there are inevitably out-of-pocket expenses related to medical bills when you or a family member is injured or fall ill. Having an emergency fund available to cover unforeseen medical expenses can take some of the financial stress out of an already stressful situation.



3. Being Fired, Resigning Or Being Made Redundant

Losing your job usually has a significant impact on your ability to meet your regular financial commitments. In today's turbulent employment world, the threat posed by unemployment is one of the primary motivations for setting up an emergency fund.

If you have a new job ready for you or are fortunate enough to quickly find a new role, then you may not need your emergency fund. However, if you are out of work for any length of time, having an emergency fund to draw upon will relieve some of the stress associated with changing jobs.

4. Emergency Trip

Anyone who has ever received an early morning phone call advising a loved one in another city is critically ill or has passed away knows just how gut-wrenching that situation can be. You may need to make a trip back home and an emergency fund takes the stress out of worrying about affording last-minute airfares, the hotel accommodation, and a loss of wages while you are away. Dealing with family illness or death is difficult enough, without it becoming a financial burden as well.

5. Natural Disasters

No one ever plans to get caught up in a natural disaster. From bushfires and cyclones to floods, natural disasters can occur at any time. When Mother Nature decides to unleash her full fury on your home, car, or family possessions, an emergency fund can help you avert financial disaster until your insurance cuts in.

Identifying Your Emergency Fund Goals

As with most objectives, having a plan and then sticking with that plan is the best way for your emergency fund to be useful. Look at opening a dedicated account or rent a safety deposit box in your bank if you want to squirrel away cash and easily liquidated assets such as bullion or gems.

You can't be tempted to dip into what was never there and you won't feel the itch to spend it if you put your emergency funds in a separate fund. Once you have accumulated a large enough amount in this account, you can transfer some of your emergency funds out of cash and into a form of easily cashed short-term investments that you can still readily access in times of dire need.

Estimate what your weekly living expenses are on mortgage or rent, utility bills, groceries and car expenses and identify your annual big-ticket costs. You should aim to set aside sufficient funds to cover your living expenses for at least three months.

Resist The Temptation To Dip Into Your Emergency Fund

There will be those occasions when you will be tempted to use your emergency fund to pay for that desperately needed vacation, or to pay off a credit card, put a deposit on a home or cover other major expenses.

Always set out a short list of genuine, unanticipated expenses you are happy to use your emergency fund to cover. Be clear they are real emergencies such

covering living expenses during gaps between jobs, medical or veterinarian emergencies, paying for repairs to your car or home or even unforeseen calls from the tax man.

The point of an emergency fund is to prevent you from having to go into debt in times of dire need or having to scramble to find money at the last minute. Ensure your emergency fund is safely tucked away where you can access it in those times of need.



Saving For An Emergency Fund Or Pay Down Debt

The choice between pulling together an emergency fund and paying down debt is a contentious one. Each option comes with its own pros and cons.

Reducing debt and minimizing the money you pay in interest is always a sage strategy and should be a priority. However, that doesn't prevent you from setting aside a little emergency money each month as well.

It is all about striking a balance between these two laudable objectives. Whichever way you opt to go, you will be establishing a smart money management habit, which will alleviate the need to borrow in the event an emergency arises.

If paying off debts is rightly a priority, look at how much you can safely afford to channel into your emergency fund. If you do eliminate a debt, put the freed-up cash into your emergency fund until you have a healthy balance in it.

An emergency fund is the start of a sensible financial practice and your emergency fund will continue to grow as your debt level shrinks.

Final Observation

While it can be challenging to set up an emergency fund, you will be grateful you had the forethought when that dire emergency arrives on your doorstep. Having the flexibility to deal with a short-term emergency without having to dip into your savings is a godsend. In a turbulent, unpredictable world, unforeseen issues and problems can quickly arise, so gradually building up to financial independence and resilience should be as important a priority as looking after your lifestyle or your health.

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