5 Steps to Financial Triage

The Motley Fool
By Robert Brokamp

We make our financial plans based on the present continuing into the future, and maybe getting a little better along the way. "If I get a raise and a bonus like I got last year," we say to ourselves, "I'll be able to afford a bigger home." Or maybe it's "I seem to have several hundred dollars left over each month, so I can afford paying a $900 monthly car payment." Or perhaps it's "There's $4,000 in our savings account — let's go to Disney (NYSE: DIS) World!" And if the present keeps converting into the future at its current rate and condition, this will probably work out just fine.

But then, life happens. Our income drops (because of job loss or illness) or our expenses skyrocket (because of necessary repairs or illness), and suddenly what worked before will now lead to financial malfunction. My wife and I found ourselves in this situation when she had to spend four months in bed because of pregnancy complications. Her income dropped to zero, and our medical expenses increased.

Even if you're in fine fettle, someone else's tribulations might affect your calculations. As the editor of The Motley Fool's *Rule Your Retirement* newsletter service, I get a lot of thoughtful email from readers about their retirement plans. Recently, a reader had this to say: "I think a major facet of retirement that has to be considered is the cost of assisted living or health care.... My wife is spending about $10,000 a month on proper lodging and care for her parents...." Wow.

So what should you do when life throws you a big-ticket curveball? Take these steps:

1. Eliminate all unnecessary expenses. Depending on the seriousness of your circumstances, you'll have to be ruthless. Quit your cable or satellite television. Cancel your cell phone. Suspend your gym membership. You need your money much more than **DirecTV** (*NYSE: DTV*), **Comcast** (*Nasdaq: CMCSA*), **Verizon** (*NYSE: VZ*), or Gold's Gym does right now. Look at your bank and credit card statements from the past few months for expenditures that you can do without, at least for a while. And, if you must, suspend contributions to investment, retirement, and college-savings accounts (though, in the latter two cases, you might end up paying higher taxes since you'll lose those deductions).

2. Check out your insurance. If you have disability insurance, either an individual policy or through your employer (ask your HR folks), you may be eligible for benefits if you've lost income because of a medical condition. If you find yourself in a situation similar to that of the reader mentioned earlier, go through your relative's paperwork. They may have a long-term care policy, but are no longer lucid enough to remember. (If you have a policy, tell your family members while you still can.)

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3. Contact lenders. You may be able to get a temporary forbearance on your loans. Consider this only if your financial troubles are temporary.

4. Evaluate your resources. If you suddenly need a lot more money than your paycheck can provide, you'll have to borrow money or sell assets to raise money. Which is better? Generally speaking, avoid debt. You're already in a financial hole, and taking on bigger future obligations may make it harder to dig yourself out. But, as always, everyone's situation is different. Here's a general order of places to look for funds:

If you have investments outside retirement accounts that have lost their luster, consider selling. Keep in mind the tax consequences: You'll owe taxes if you've made money, but you'll get a loss (which can offset other gains) if the investment was a dog.

Get back money you're due. If you have a flexible-spending account or have incurred reimbursable business expenses, submit your receipts. If you regularly get a tax refund, adjust your withholding ASAP to increase your take-home pay. Also, if it's tax season, get to work on filing your return.

Sell stuff you no longer need. While even a good yard sale can raise a nice chunk of change, consider getting rid of valuable stuff that you no longer appreciate. A cousin of mine made several hundred dollars selling an old piano on **eBay** (*Nasdaq: EBAY*).

If you must borrow money, borrowing against your home equity will probably provide you the lowest rate, and the interest may be tax-deductible.

The worse kind of debt comes in the form of plastic. But if you end up having to put a lot on your credit cards, play the "0% balance transfer" game for as long as lenders will let you.

5. Tap retirement funds as a last resort. Generally, withdrawals from IRAs and 401(k)s before age 59 1/2 are taxed as ordinary income, plus you'll pay a 10% penalty. Throw in the lost future growth, and that's a steep price to pay. However, in extreme cases, it's unavoidable. You may be able to get the penalty waived in some emergency medical circumstances (check with the IRS). And you can withdraw contributions to a Roth IRA at any time, tax- and penalty-free. Finally, there is the option of borrowing against your 401(k), which may be better than withdrawing the money and paying taxes and penalties, assuming you can afford to start paying it back immediately (the payments will most likely be automatically taken out of your paycheck).

Do preventive care now

If you're not currently in a financial emergency, take steps now to protect your empire against catastrophe. Getting out of debt and building a solid emergency fund are great first steps. We provide even more in our "Disaster-Proof Your Finances How-To Guide," which is a part of the *Rule Your Retirement* service. Give it a free 30-day trial, and you'll receive a complimentary copy of Tom and David Gardner's Money After 40.

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Robert Brokamp does not own any of the companies mentioned in this article, though he did downgrade his cable package and rarely misses the 200 channels he used to receive. The Motley Fool is *Fools writing for Fools*.