Emergency!

The Motley Fool
By Tim Beyers

Surely you've heard that it's a good idea to have two or three months worth of salary tucked away in an emergency fund. Such rules of thumb can be useful, but do you really think it would help much to have two months of salary on hand if, say, your basement flooded? What if you were disabled? What if you were out of work for a year? How do you *really* know what you'll need if disaster strikes?

Flirting with disaster

Most of us simply don't. And I'm among that group; although I think I'm somewhat ahead of the curve because I've taken a rough inventory of the valuables we have in the house and built the cost of replacing them into our homeowner's policy.

But that's not enough. Nor is it enough to simply sock away replacement cash for living expenses. Instead, I think it's worthwhile to create a full-scale emergency financial plan. Start by tracking your available assets and replacement income. For example:

At the altar of sacrifice

From there, it's probably worth pricing disaster. For example, if your basement office were to be wiped out by a flood, you'd probably need a new computer and temporary office space. Assuming your insurance company doesn't pay for that, you should build rent and computer costs into your plan.

That doesn't mean you have to save for it, necessarily. If you maintain good credit, you might be able to take out a low-interest loan with a credit issuer to fund your temporary quarters. Citigroup is one of many banks that offer such loans, and I've taken advantage of them in the past. Credit unions can also be a good source for loans, though my research shows that personal loans currently cost between 11% and 13%, which, while better than a cash advance on a credit card, isn't cheap.

A better source may be the Feds. The Small Business Administration, for example, has a disaster relief program that may apply to you even if you aren't a business owner. More details are available here.

A chastity belt for your cash

Still, your best bet is to save aggressively against an estimate of the most likely emergency costs you'll bear over the next decade, including appliance replacement, home repair, and the like. And

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since you want that cash to be always growing and instantly available, the best choice is a high-yield savings account. These accounts pay generous rates on any balance, even as low as $1 in some cases, and they'll digitally link with your checking account, making accessing the funds pretty simple. ING Direct and HSBC Direct offer my favorite deals in high-yield savings at the moment.

Follow the money

No one wants to think about disaster. We'd rather live in the sun, happily enjoying our lives. Reality is, unfortunately, altogether different. Emergencies arise now and again, and it's important to be prepared for them.

Have other money tips? Tell me. I'm writing new articles on personal finance and investing basics every week as part of our new personal finance newsletter service, *Motley Fool GreenLight*. It's tailor-made for Fools like you who aim to take control of their financial destiny. Want to learn more? Just click here.

Fool contributor Tim Beyers was an avid watcher of the 1970s drama Emergency! Tim didn't own shares in any of the companies mentioned in this story at the time of publication. Check out all of his stock holdings at Tim's Fool profile. The Motley Fool has an ironclad disclosure policy.