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Season 1. Taking more control of your money

Episode 3.

Building an emergency fund

Hi there. Jason here. And in this Money Insight video we're going to talk about emergency funds. Why everyone should have one, the best time to start building one, how much to aim for and how to get started if you've not done so already.

Now just to be clear we're talking about building an emergency fund of your own. A fund you can draw upon without asking anyone else for when you meet with those unexpected bumps on your road to financial success. And we all meet with those from time to time. We're not talking here about emergency help with money to pay for food or any other essentials for daily living. If you don't have enough money to pay your priority bills (like council tax or utility bills or your mortgage or rent or hire purchase payments (on essential items) please stop this video now and follow the help tab on the Salary Finance website to speak to someone who can give you appropriate advice.

The good news is that by working through the ideas in our previous Insight on taking control of your spending, you're already on your way to success with your emergency fund too. As soon as you start earning more than you spend, you've transformed yourself from a spender into a saver. And we know that this feels really good for anyone when they make that change. The big question is once you're earning more than you spend, what do you do with the excess? If you have some expensive debts do you begin by paying those down or by building up an emergency fund? Well, you might think that the logical thing to do is to attack expensive debts first. After all, if you reduce a debt costing you 15% interest by, say, £1,000, you'll save £150 a year on that. And that's a great return on your money.

However, the evidence shows that for a many people that's not the best approach. The fact is that it's really quite common for people to repeatedly fail to pay down their loans if they decide to focus solely on that. And the reason for this is Psychology once more. You see, many of us are prone to a natural but troublesome human behaviour called catastrophic

thinking. You might have heard this called 'all or nothing' thinking but that's just the same thing. And, because of this behaviour our small setbacks can - and often do completely derail our bigger plans.

So, if we focus completely on a goal to reduce our expensive debts but then get hit by some big and unexpected cost, we can 'feel' that our plan has failed and give up on it altogether. What's more, that feeling of failure can contribute to a vicious cycle of debt. So, instead of just re-extending our debt to cover the disaster at hand we might be tempted to extend our debts further to pay for some treats - to soften the pain we feel.

And clearly this is a common issue for anyone trying to overcome a challenging habit around their money or their health. Minor setbacks can often completely knock us off course. If you're a super resilient type and set backs have no impact on what you do, then paying down expensive debt could be your best initial focus. But for many people a different approach will work better. And by building a basic emergency fund before we attack the task of debt paydown, we can break the cycle of repeatedly turning to expensive loans.

The truth is that things happen in life that can mess up our plans. No matter how careful we are. So, let's just acknowledge that. We can't know what our unexpected costs will be, but we can be sure to expect them every now and then. As I've already said, if you're following the guidance in these Insights then you've already made a good start. And you'll have more money coming in than going out. So, when that's running smoothly, you could set up a separate account in which to build your emergency fund.

Or, alternatively, your employer could help with this by enabling you to save into a savings account directly from your salary, before it's paid into your bank account. More details on that are on the Salary Finance website. But, however you set this up, do it as soon as you can. And start by saving what you know you can afford on a regular basis. You can always increase this amount later if your circumstances change and you find you have more spare income. When you start to build your emergency fund it's the savings habit that matters far more than the ideal amount. The amount you aim for over time will be completely unique to you and depend on such things as the stability of your job and the uncertain demands on your money, from yourself, or from any loved ones you support today.

Clearly, the task of getting back on our financial feet after losing a job or splitting with a partner will draw on more funds than a minor fix to our car or the washing machine. As a very rough rule of thumb it makes sense to build an emergency fund to cover between 3 to 9 months' worth of your essential living costs. But to start with I suggest that you aim to save a small amount of say, £500 or possibly a £1,000 if you can. But, whatever your target, it's important to accept that this will take time. And the key is to make a start at a pace you can manage to prove to yourself that you can save as well as spend.

If you've not already built your emergency fund, you'll be amazed at how doing so will boost your confidence with money. And remember this. If you start by saving just £3 a day, which is the price of a takeaway coffee, that's more than one thousand pounds in a year set aside for emergencies. Looking ahead, when your emergency fund is established and continuing to build in value, you can redirect some of your savings to pay down any expensive debts you might have. And it'll certainly make sense to use any big windfalls of money, such as bonuses or inheritances, to pay down some debts along the way too. And when you've repaid any expensive debts you can then explore other savings products to make your hard-earned money work harder too. But these are ideas for future money Insights.

For now, just make a start on your emergency fund if you've not done so already, and use some of your excess income to build yourself a buffer against future emergencies. You'll feel a whole lot better once you've got that in place. Okay, so next time we'll focus on ideas to help you get clear of any expensive debts you might have. See you back here when you're ready for that. All the best for now

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