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If you fear a layoff looms, strengthen your financial foundation now

By John Waggoner

You can't help but notice the little signs at work that layoffs are coming. The closed-door meetings. The vanishing amenities, like the juice machine in the break room. The buzzards in your parking space.

The economy is slowing, and that means you need to be prepared. For the next three weeks, we'll be talking about how to navigate troubled financial times. Today, we'll talk about how to shore up your household balance sheet so you can survive a layoff.

Ideally, the best way to handle a layoff is to get a new job before getting canned, preferably one that will make the survivors insanely jealous.

Failing that, however, you need to make sure that your household can withstand the loss of income while you search for a new job. Your first step: Make a rainy-day fund.

Financial planners often recommend that you keep three to six months' worth of salary as an emergency fund. That's not quite as onerous as it sounds. First, they're talking about the amount of money you need to pay your bills each month, which is — or should be, anyway — less than your actual salary.

If you're in a profession that's in fairly high demand, you may not need to stash away six months' of living expenses. One or two may be enough. "The more uncertainty you have, the more you should save," says Kurt Brouwer, a financial planner in Tiburon, Calif.

Keep the cash in a money market mutual fund or a bank money market account. The average money fund yields just 4.2%, but you're not investing for the yield: You want a safe investment that will give you access to your money whenever you need it.

You will also need to reduce your expenses as much as possible. One of the best ways is to pay down your debts aggressively. Think of your debts as good debts and bad debts. Good debt is your mortgage, or any loan that charges less than 6% or so interest.

Bad debt is pretty much anything that charges more than 6%. A credit card balance that charges 18% interest? Bad debt. A credit card balance that charges 30%? Even Tony Soprano would agree that a 30% interest rate is a bad, bad debt.

Paying off a debt that charges 30% is the rough equivalent of earning 30% on an investment. In tough economic times, you won't find many investments that return 18%, much less 30%.

If you don't have enough in savings to pay off the debt outright, consider taking out a home equity loan and using the proceeds to get rid of your high-interest loans. (This is presuming that you own your home, and that you have equity left in it.) The catch: It's a lot easier to get a loan when you have a job. If you suspect you're going to be laid off, run, don't walk, to the loan office.

If you don't have a home equity loan available, try this approach:

▸ Cut up the card and stop making new charges on the account.

▸ Pay 5% of your balance this month.

▸ Pay the same amount each succeeding month.

Say you had a $10,000 credit-card balance with a usurious 30% interest rate. Your balance, including the obscene $250 in interest that month, would be $10,250. A 5% payment would be $512.

If you can continue to pay $512 a month, your balance after 12 months would be $6,891. You'd pay off your debt in 28 months.

More important, let's say you got laid off six months later. Your balance would be $8,836. If you had to fall back to the minimum payment — we'll say 4% — you'd pay $353 a month, a $159 monthly savings.

If you're really worried about being laid off, then it could make sense to stop pouring money into your 401(k) plan and using it to pay down high-interest-rate debt, Brouwer says. If your company matches your contribution, however, you should contribute at least enough to get the match.

You might also consider refinancing your mortgage to make the payments more affordable. For example, suppose you had a $200,000 mortgage note. Your term is 15 years and your rate is 6%, so your payments would be $1,688. If you refinanced to a 30-year mortgage at 6%, your payment would drop to $1,200.

The drawback, of course, is that you won't have your home paid off in 15 years. On the other hand, you'd reduce your monthly payments by nearly $500 at a time when every penny counts. Once again, the time to get your mortgage refinanced is now — not after you're laid off.

Finally, you'll have to take a hard look at your other expenses to see what you can cut back on. For example, if you're driving a car that has a $500 monthly payment, consider trading it in for something less fancy — and less expensive.

Don't waste your time bickering about who made poor financial decisions. Layoffs make life hard enough without domestic problems added to the mix. "Pull a curtain of charity on the past," Brouwer says. "Fix the problem."

Objectives

- Read the article "If you fear a layoff looms, strengthen your financial foundation now."
- Create a savings plan for the future.
- List ways to cut expenses now before financial strain requires it.
- Brainstorm ways to increase earnings.
- Apply the information to current earnings and spending habits.

Preparation

Each student will need:

- A copy of the article "If you fear a layoff looms, strengthen your financial foundation now."
- A copy of the lesson.
- A finished budget from Lesson 5: Day-to-day financial planning.

1. Read the article and answer discussion questions (20 minutes)

- What steps can you take to make it through financially tough times?

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____

- When should you consider getting a loan if you believe you may get laid off?

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____

- How much money should you have saved in preparation for financial difficulties?

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____

- What advice does the author give regarding harmony in the home and finances?

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____

- Which options would you choose to put into action first? Why?

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2. Saving for a financial drought. (20 minutes)

In Lesson 5, you and your group created a monthly budget. After you evaluated and re-did your budget to make sure it balanced, what were your total expenses for the month? __________

What was your total income per month after taxes? __________

The writer of the article recommends you save between three to six months of your earnings to prepare for rough times like being laid off. Multiply your total monthly expenses by three. Write that total here: __________

Let's look ahead and see how you can begin planning to avoid a financial crisis. There are three ways to increase the amount of money you have available later:

- Earn more money.
- Spend less money.
- Pay down high-cost debt.

Based on your budget from Lesson 5, answer the following questions:

- Do you have any extra money left over at the end of each month? If so, how much? __________
- If you save all of that each month, how many months will it take to save enough to cover three months worth of expenses? __________

Get back into your groups from Lesson 5 and see how you can save more each month. Answer the questions below to help jumpstart your thinking.

- What expenses can you cut?
- Are there items you don't really need?
- Are there services you can cut back on?
- Are there expenses you can share?

Directions: In the first column, list the goods or services you can modify. In the second, list how, specifically, you can modify them to save you money. In the third column, indicate how much the modified good or service will cost you, and in the fourth, indicate how much money that modification will save you (subtract the “new cost” from the original cost).

Good or Service	How to Modify	Savings	New Cost

If you make those modifications, what will your total expenses be each month? __________

Multiply that amount by three and write it here: __________
This is the new total you’ll need to save to cover three months of expenses.

With your newly revised budget, how much will you be able to save each month? __________

How long will it take now to save money to cover three months of expenses? __________

3. Debrief and apply. (10 minutes)

- What were some ways you found to cut your expenses?
- What are some creative ways to earn more income? Remember, based on the budget, you’re already working 40 hours a week.
- If you had a credit card with $5000 on it, the author suggests you make payments that equal 5% of the original total each month. To pay it off, you’d need to pay $250 each month for almost two years. Could your current budget handle that? What other options could you choose to increase your savings while paying down debt?
- After looking at these numbers, are there any lifestyle changes you could make now to help lessen future financial strain on your budget?