

10 sources of emergency cash, ranked from best to worst

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What if unanticipated expenses exceed your emergency reserves? You have options, and I've ranked them from most palatable to least.

1. Your own emergency fund/short-term securities

Emergency funds should be held outside of tax-sheltered wrappers and include highly liquid investments like bank savings accounts, money market accounts, and so on. If you're working, your emergency fund would ideally hold a minimum of three to six months' worth of living expenses; retirees should target one to two years' worth of anticipated portfolio withdrawals.

2. Low-risk assets in taxable account

Your next source of cash is other taxable holdings: investments in brokerage accounts, outside tax-sheltered vehicles. When identifying securities you could sell, focus on liquidity, tax consequences, and transaction fees.

In a best-case scenario, you'd have a short- or intermediate-term bond fund to sell. It's reasonably liquid, and you'd already have paid taxes on most of your gains.

3. Roth IRA contributions

You can withdraw any Roth IRA contributions (the amount you put in, not investment earnings) at any time, without penalties or tax. The big downside, of course, is that you'll have fewer retirement funds working for you.

4. Life insurance cash values

You can withdraw money outright from your whole life insurance or variable universal life insurance policy and have it deducted from the face value. Those withdrawals are tax-free, assuming they don't exceed the amount you've put in.

A less attractive option is to borrow from the cash value of your life insurance. You'll owe interest, payable to the insurance company, and the loan may come with additional costs. You will not owe taxes, but the interest is not tax-deductible.

5. 401(k) loan

Even though you'll pay interest on a 401(k) loan, it gets paid back into your account. And the interest rates can be reasonable. But you'll shrink your retirement savings. If you lose your job, you'll be required to pay the loan back sooner, usually in 90 days. If you can't, you'll owe taxes and a 10% penalty, unless you're 59½ or older.

6. Home equity line of credit

The interest rates for borrowing against your home equity are usually reasonable, particularly if you maintain a good credit rating.

But if you're not a perfect borrower, you could be denied or get an unfavorable rate. And if you end up borrowing more than your equity and have to sell in a hurry, you'd have to cough up the difference. Finally, the interest on HELOCS is no longer tax-deductible unless the funds are used for home improvements.

7. Hardship withdrawals

Funds you take out of a 401(k) via a hardship withdrawal cannot be paid back and you'll owe taxes on any untaxed dollars you pull out. You'll also owe a 10% penalty unless you're 59½ or older or your situation meets one of several exceptions. Those taxes can take a big bite out of the amount that you remove from your account.

8. Reverse mortgage

A reverse mortgage allows homeowners 62 or older to receive a pool of assets that represents equity in their homes. They don't have to repay the loan as long as they're in their homes, but when they leave, the borrowed amount, plus interest, is deducted from the home's value. Rates can vary widely, so shop around and read the fine print; the loans can be costly and complicated.

9. Margin loans

A margin account allows you to borrow against the value of the securities in your brokerage account. You might do this if you don't want to sell the assets at a bad time or incur tax consequences.

Interest rates aren't always attractive, plus margin loans are risky because the securities' value can fluctuate with the market. If your collateral drops below a certain level, your brokerage firm will require you to deposit more money or sell the securities. If you don't have the cash, you can end up in an even bigger financial bind.

10. Credit cards

Some consumers have been able to play credit cards like a fiddle, shifting balances among cards with ultralow teaser rates and incurring little interest. For the rest of the world, credit cards are the single easiest way to wreck your financial standing. Rates are high, and credit card companies want to keep you paying for as long as possible. Thus, the minimum payments they require don't make a dent in your loan's principal.

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