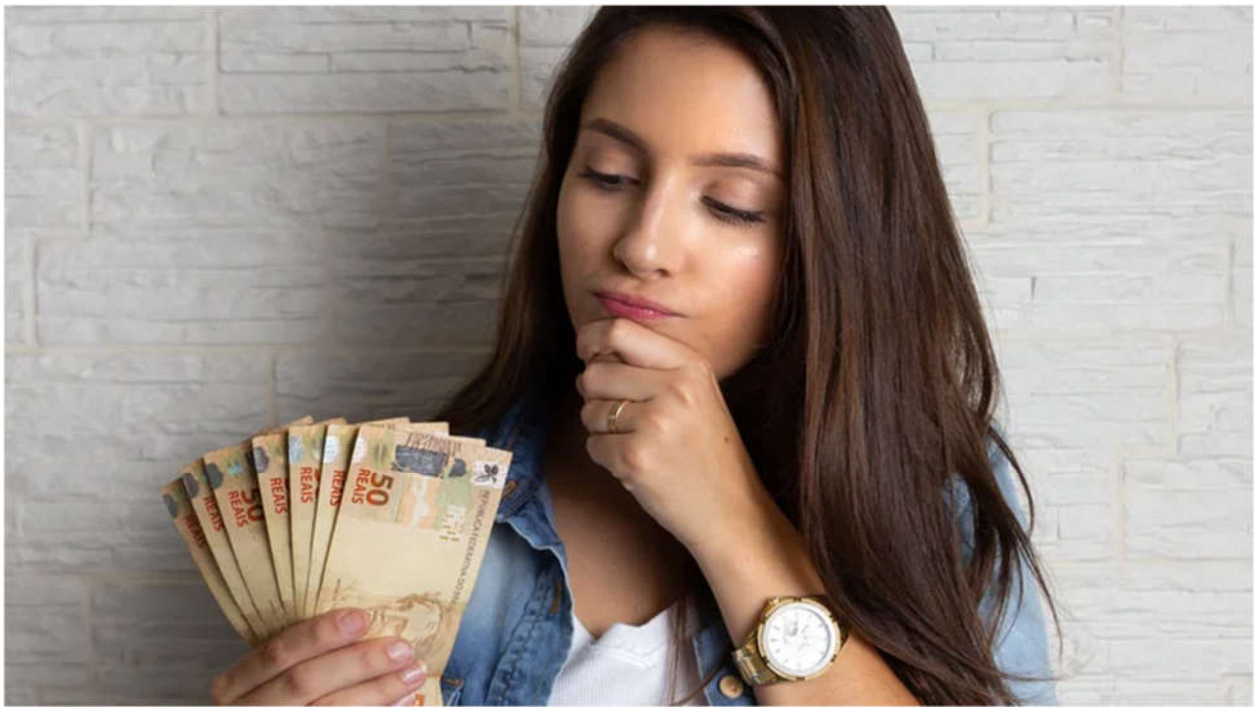
How To Lend Money To A Loved One Without It Feeling Uncomfortable

BY JOSEE NG|JAN. 3, 2023 12:49 PM EST (Quotes by Mary Kelly)

We all encounter tough financial times at specific points in life, such as when making a significant purchase or freshly striking out on our own. And when we need financial assistance, we go to a bank or a loved one to borrow from. Of course, it's easier to borrow from a family member than from a bank. Flexible terms, low or zero interest rates, and more favorable repayment arrangements are some benefits common to family loans, Payactiv points out. Now, put yourself in a lender's shoes and ask: "Will I feel comfortable offering a loved one all those perks?"

In an ideal world, every borrower should pay off their bills on time. However, it isn't always the case in reality. A Creditcards.com's 2022 study demonstrated that 42% of respondents stated they had lost money due to loans given to friends or family members. Being cheated out of money by a stranger or a distant acquaintance is a hard pill to swallow — but all we lose is money. When we lose a loan to a loved one, we lose both our money and the relationship. Therefore, it's hard to give a loved one money without being left with a niggling feeling that something isn't right. If you're torn about lending financial support to a loved one but don't know how to say no either, here's some guidance to help you make an informed decision and feel confident about it.

Only help your family out if you can afford it



It's one thing to want to help someone out financially; being able to afford it is a different ball of wax. "The No. 1 rule of thumb if you're lending to friend, family or foe is to make sure it's money you can afford to lend," says etiquette expert and author Thomas Farley (via CNBC). It's not a good idea to put the well-being of others ahead of yours and get yourself into financial strain. If you're having trouble paying your payments, SmartAssets advises against overextending your credit or risking defaulting on your debt obligations to help a loved one. Being generous at your own expense can make you the next loved one who needs financial assistance and put your family in an awkward situation.

Only when all of your direct expenses — such as housing, healthcare, education, and necessities have been paid for, and you still have some to spare — should you consider helping out a loved one. If the amount of money your nearest and dearest borrows is one that you can do without — or even give away — it won't harm your financial health to help the person. If the person's loan request is so big that you might need to tap into your hard-built savings, the lending risk is too high for comfort.

Assess credit risks before lending

For creditors, default risk is an essential factor when deciding whether to lend or not. If you expect to get your money back, perform due diligence to assess the borrower's capacity to pay you back before lending. Some of the key pieces of information to request of your borrower include credit score, annual income, debt-to-income ratio, and employment status, in addition to a thorough background check, Garnaco points out. You should also ensure that the loan will not be used to fund illegal activities or a lavish lifestyle beyond the borrower's means. If the person has no employment or a job that pays so low that they can't afford to repay you in the foreseeable future, it's up to you to decide how you want to support the person. Beware: give a man a fish, and you feed him for a day; teach a man to fish, and you feed him for a lifetime.

If your loved one is a compulsive borrower who has borrowed from many other sources — including yourself — and has not fulfilled their repaying obligations, do not engage in any new loan transaction. "Learn to turn down requests after lending money a couple of times. Also, politely ask them first to repay the outstanding amount when they approach you for new loans," says financial advisor Viral Bhatt (via The Economic Times).

Document the loan

One way to avoid issues that may arise during the repayment period is to put everything into writing, where the loan terms and conditions are spelled out, NerdWallet points out. This type of contract is known as a promissory note. Although it may seem cold to have a notarized and signed agreement with a family member, having everything on paper helps preempt future misunderstandings and ensure both parties do their best to fulfill their ends of the commitment. The fundamental elements of a family loan agreement might include the amount borrowed and loan purposes, repayment terms, interest rates, and the consequences of a loan default — seizure of collateral or wage garnishment. It's also worth noting that the interest a borrower pays for the loan becomes a taxable gain for the lender, so there will be additional paperwork to sort out here.

A written agreement will also stand you in good stead should you decide to take the matter to court in the wake of irreconcilable conflicts. Family court cases frequently bring up liabilities related to alleged family debts. The court weighs several factors, including whether there was an expectation that the money would be paid back, whether a written loan agreement existed, whether the parties had made any loan repayments, documentation of conversations about the loan and its terms and whether any security was offered, according to Marsdens Law Group.

Be ready for slow repayment

Suppose you don't want to be stressed out about lending to a loved one; set realistic expectations, including expecting slow repayment. Because you're not a bank or a loan shark, there are almost no strings attached, and the loan dynamic is entirely different. With a family-friendly loan, your borrower might not take the sum seriously and not be motivated to repay you, says economist and author Mary C. Kelly (via Investopedia). If your borrower is behind on payments, don't hesitate to collect your payment. It's wise to be direct and firm while being polite; otherwise, your borrower will take your request lightly.

Another option is to text the first reminder one week before the repayment's due date, followed by a second message two days before that day. Once the bill is past its due date, ring the person up or call a meeting. When you meet your borrower, bring the written contract to remind the person that you are on the same page regarding the repayment details. Extend a grace period if you want, tell the person when's the latest you want the money back, and what you will do if you don't receive the repayment by the agreed-upon date. Bankrate advises against waiting too long before bringing up the loan since doing so will make matters awkward in the future.

Expect to lose your money

If your loved one can't pay you back the money as promised, consider restructuring the terms — such as altering installment payments, reducing the debts, or reselling loans — to make it easier for them to repay you. It's easy to get frustrated with non-performing loans, but try to remain calm and explore all the viable options with your borrower before taking the matter to court. You are the lender; whatever you say goes.

Perhaps the most crucial caution worth observing is that you should only lend to a loved one when you don't need the money back. If you don't lend more than you can afford to lose, consider treating the loan as a gift, per LendingTree. Or, you can tell the borrower they can take their own sweet time and repay you the sum whenever they're ready. "Just assume that giving a friend or family member a loan is the equivalent of setting that money on fire," says certified financial planner Megan Brinsfield to NBC News. Gifting your loved one a loan helps the person resolve financial emergencies and strengthens the bond between you two. The moral of the story is: only lend when you're comfortable losing it, and if you're not, do not lend.