

Lend to a Friend (Without Regret) Four things to do when a pal asks for a loan

By Kate Ashford
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(MONEY Magazine) – Whenever a friend or relative asks for cash to get through a tough time, it's hard to resist the noble impulse to help. Indeed, according to a Federal Reserve survey, 8.7% of us now have such loans extended. By some estimates, they total \$89 billion. But loans to friends are notoriously dangerous. If you're inclined to take the risk, here are four things to do before reaching for your checkbook.

NO. 1

Wait 24 Hours

When a request for money comes, face it: You're in a tough spot. Don't give in to the urge to answer right away, especially if there's a lot of money involved. Instead, take a day or two to decide, explaining that while you're sure that you want to help, you need time to look at your finances, consider whether you can help and perhaps talk it over with your family.

NO. 2

Try to Find a Way to Say No

Frankly, the best thing to do most of the time is decline. For starters, there's a big chance you won't be paid back: Some 14% of friend-and-family borrowers default (vs. 1% of those who borrow from a bank). But since this isn't strictly a financial decision, you can't stop there. First consider the amount involved, how close the person is and how dire the need. Then weigh the risk of damaging the friendship if you say no against the risk of losing the money and damaging the friendship if you say yes.

If you settle on no, you owe your friend an explanation, but be diplomatic. Gently noting that your money was earmarked for something essential--a down payment on a home, for example, or tuition--is likely to do your relationship less harm than bluntly stating, say, that your friend has a lousy track record with money or that the last time you lent to a pal it ended badly and you just don't feel comfortable trying it again. However much you choose to reveal your reasons, says Lynne Hornyak, a psychologist who specializes in financial issues, emphasize that you took the request seriously and made your decision at least partly to preserve your relationship. Then offer to help out in nonfinancial ways.

NO. 3

Have a Tête-à-Tête

If you decide to lend the money, protect both it and the personal bond by setting rules. Be specific about when you expect to be paid back in full or map out a realistic installment plan. Address what will happen if your friend misses payments. And decide whether to charge interest. If you'll have to tap funds that are generating returns toward your retirement or other long-term needs, you shouldn't feel sheepish about it.

NO. 4

Get It in Writing

Not every loan to a friend needs to be documented (in fact, seven out of 10 are not). But a written agreement reinforces the idea that the money isn't a gift and prevents misunderstandings. "I've seen these loans done successfully and unsuccessfully," says **Ryan Huey**, a financial planner in Dallas. "The

difference is always whether or not it's in writing." If asking a friend to sign on the dotted line is uncomfortable, explain that it's the best way of ensuring that your relationship outlives the loan.

It may be worth having a lawyer draw up an agreement if the loan is large or complex, but you can buy a standard personal loan contract at nolo.com for \$10. In any case, have it notarized, keep good records, and issue receipts. If you prefer, a company like CircleLending will, for a modest fee, handle the transactions and provide year-end tax statements. (If you're lending more than \$10,000 or the money will finance income-producing activities, the IRS expects you to charge interest--search for AFR on irs.gov for the current rates, now around 4%--and to pay tax on that income.) When all is said and done, the document will serve as a testament to your well-earned friendship.