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Top 10 Tips for Lending Money to Family & Friends

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Most people reading this have been or will be asked for a loan by a friend or family member, and human nature makes it so difficult to say no. We care, we want to help, we want everyone to be happy, and we don't believe that a friend or family member would ever betray us. That's all well and good, but the discord that frequently ensues is likely to be much more uncomfortable than having said no to start.

Time and time again friends and family default on loans, and mainly because they can. When someone defaults on a friend or family member their credit won't be ruined, their car won't be impounded, their house won't be foreclosed, their wages won't be garnished, and they can string us along continuing to promise to make good, and all too often we go for that promise.

We strongly discourage loaning to friends and family because the relationship is far too important to risk, and if it is a good relationship your counterpart should understand your desire to not jeopardize the relationship by issuing a loan.

Nonetheless, if you choose to loan to a friend or family member, take heed of the below tips for increasing your chances of a smooth experience:

1. Include your spouse/partner in the decision; you don't want to risk two relationships!
2. Avoid being an enabler by loaning to someone who only needs money because of their own financial irresponsibility and who would be better off not getting saved.
3. Consider if loaning to this person will impact your relationship with anyone else who is not getting a loan from you.
4. Go in knowing there is a reason this person is not getting a loan from a bank, and that it is high risk.
5. Only loan what you can afford to lose in the event the worst case scenario occurs.
6. Only loan cash as opposed to co-signing on a bank loan or credit card, so your only downside is the cash you loan and not your credit rating.
7. Charge at least the Applicable Federal (interest) Rate ("AFR"); otherwise you are subject to a gift tax.

8. Make it official by having clearly defined terms, being a lien holder on title, and having it in writing, all of which helps ensure the borrower will take their obligation seriously, and helps prevent misunderstandings.
9. Define what will happen if you die; will the loan still be owed to your estate, or will the loan be forgiven, and if the latter does this forgiveness offset any inheritance for equality among beneficiaries.
10. Accept the fact that you won't like how they spend their money when they still owe you money.

We hope you feel good about being in a position to loan money to friends and family if that is the case. We do however urge you to proceed with extreme caution, and do what you feel will be right at the end of the day instead of in the moment.