Think carefully before lending to family

By Vanessa Santilli

No matter how close you are with your relatives, lending money to one of them can lead to some murky situations. Before you reach for a cheque or your wallet, consider the impact on both your finances and your relationships.

There may be very good reasons to make the loan. Your relative may be truly in need. Even if they could get a loan from a bank, borrowing from family is quicker and generally cheaper. "A family loan is usually less paperwork, doesn't involve credit score checks and has a lower or even [0 per cent] interest rate," says Christine White, a money coach with Money Coaches Canada Inc.

And while bad loans create tension for everyone involved, if all goes well, the loan may enhance your relationship with not only the borrower but also with other family members who appreciate you helping out. "As long as you have worked out a repayment plan that fits everyone's needs, it's a good thing," says Perry Krieger, trustee in bankruptcy and senior vice-president at BDO Canada Ltd.

The flip side is that other relatives may hear about the loan and appear at your doorstep looking for financial help, too, says Cynthia Kett, principal of Stewart & Kett Financial Advisors Inc.

And things get even trickier when a relative is unable -- or unwilling -- to pay you back. "One of the major drawbacks to loaning the relative money is the effect it will have on the relationship if suddenly they cannot meet the terms of the repayment agreement," says Krieger.

How to make the choice

Just because a family member is asking for a loan, doesn't mean you have to say yes. At the end of the day, it's your money, and you have no obligation to hand it over.
Before you decide, consider the following:

- **Your own financial security**
  While most of us probably don't like to think ill of our relatives, you must consider the possibility that you will not be repaid. Will you still be financially secure if you never see the money again?

  It's also unwise to loan out all your savings. You could find yourself in a jam at any time, and if you've lent out your emergency fund, you won't be a help to anyone, including yourself.

- **Loan purpose**
  Perhaps your niece needs money for education or to enter the housing market at a reduced interest rate. You could consider that kind of loan an investment. On the other hand, financing a vacation or shopping spree for your spendthrift sister may not be the best use of your hard-earned money.

  "Make sure you aren't going to judge your relative's spending choices," says White. "Resentment will build if somehow they can afford a trip south and you can't."

  One way to know for sure what the loan is for is to pay the money directly to wherever it's going. For example, if you loan money to your niece for university tuition, send the cheque directly to the university tuition office.

- **Repayment schedule**
  Think realistically about how long it may take to get your money back before you agree to the loan. For instance, that niece who wants to go to university likely won't have the funds to pay you back for your tuition cheque until after she graduates and has a job. If you can't live with that, don't make the loan.

- **Interest**
  You'll also want to consider interest. By lending your money instead of investing it or keeping it in a savings account, you are forgoing interest income. It is perfectly fair to recoup those costs by charging your borrower interest. If you decide not to charge interest, realize that you are in effect making a donation to your relative.

Get it in writing
If you do agree to the loan, a written agreement will help head off disagreements by making sure everyone knows what's expected of them. Include the terms and conditions and the repayment schedule.

Even if it is an informal, handwritten document, you and the borrower should both sign it and keep a copy. Such documentation is legally enforceable, should it come down to that, says Kett.

If you eventually find the agreed plan isn't working, you can modify it.
"Possibly break the payments down to smaller, more frequent amounts and align them with your borrower's payday," says White. "Try to set up the payments automatically -- either through recurring bank transfers or post-dated cheques. You don't want to be chasing after family for money."

What if even the modified plan fails to get you your money back? You have two choices: cut the borrower some slack until they are able to start repaying you, or ask them to refinance the loan through a traditional lender, says Krieger.