



## Borrowing from Family & Friends

By Nancy Dunnan

"Neither a borrower nor a lender be; For loan oft loses both itself and friend." —  
*Hamlet, Act I, Scene 3.*

We'd all do well to heed this advice given by Polonius to his son Laertes as he headed off for school.

Nevertheless, there are times in life when it's necessary, even wise, to borrow money—to pay for school, to start a business and certainly to buy a primary residence.

It's a pretty well known fact that finances and friendship don't always mix well. Loans between those who know one another actually have a fairly high default rate. On the other hand, borrowing from family and friends under the right circumstances can be an easy, fast and usually inexpensive source for a down payment. And many parents, grandparents and others truly like to help people buy a first home, especially young people just starting out in life.

### Before asking for a loan

To keep your relative or friend a friend forever, first ask yourself:

1. Do I need this money for a really serious and important reason? (If it's to purchase your first house, the answer is "yes.")
2. Will I be able to pay back the loan? How long will it take me? Where will I get the money?
3. Can my relative or friend *easily* afford to lend me money?
4. Can this person survive if I default? Or would the loss of this money create a hardship for him/her?

About questions 3 and 4: We sometimes think people we know are wealthier than they are. The fact that your best friend has a

beach house and a brand-new SUV does not necessarily mean he or she has lots of spare cash. Business problems, alimony payments, child support, college tuition, medical bills and retirement concerns may also be part of the picture. Or your relative's job may be less secure than you realize. So, never assume anything about another person's financial situation.

### When and how to ask for a loan

To begin with, resist cornering someone at a social gathering, a family reunion, a birthday bash. I know it's tempting. You're eager to get going, but celebratory occasions are just that—for celebrating and not for arranging business deals.

In fact, bringing up the topic at a dinner party or picnic could backfire. Think about it: If you ask your uncle for a loan in front of all the aunts, cousins and other uncles, he's going to feel very, very pressured, and you've given him no time in which to think it over. He may even feel angry at being put on the spot—which certainly won't help you get your loan.

### Think like a CEO

A better strategy: Make an appointment to discuss your request privately. When you do meet, state your case in a businesslike manner, not emotionally. No tears. No crying. No desperate pleas. Explain why you need the money, how much you need and for how long. Spell out where the rest of the money to buy your house is coming from. And, make it very clear that you will pay interest.

### Regarding interest

Many private loans are based on the prime rate, which is the interest rate banks charge their top-rated commercial borrowers. It's a good benchmark and one that is typically

lower than other bank loans and certainly far lower than credit card cash advances. You and your friendly lender may decide to go with that rate or a rate that's slightly higher or lower.

**\$TIP:** Calculate how long it will take you to pay back any given amount and interest rate.

You also need to explain to your friend or relative where you will get the money to pay back the loan. It could be that a new job, a raise or a bonus will provide you with the cash. Or perhaps the sale of a house or other assets will be the solution. If you are counting on your spouse or significant other's salary, make that clear.

If you sense even the smallest bit of reluctance, immediately say something such as, "You don't need to decide today, Uncle Joe. Why don't you think it over, call me if you have any questions and then make a decision at the end of next week."

### **If It's a Go**

When and if you both decide to go ahead, you must handle the transaction in a businesslike manner. That means drawing up a written contract. As Samuel Goldwyn, founder of MGM, said: "A verbal contract isn't worth the paper it's printed on."

Your contract should include the amount of the loan, a repayment schedule, the interest rate and the collateral, if any. You can use a preprinted promissory note, which is available at stationery stores, office supply outlets and banks.

In addition to documenting the total dollar amount, the interest rate, the periodic payment dates and the final payment date, include a clause covering the consequences if the loan is not repaid. It could be something like: "Failure to meet these conditions could result in the forfeiture of the borrower's 1999 Harley-Davidson."

**CAUTION:** Borrowing from a friend or relative doesn't mean you can escape the serious consequences of defaulting on the loan or falling behind on payments. You could lose what you put up for collateral. You could be haunted by a collection agency. You could be taken to small claims court. You could be sued. You could have your wages tapped. Family and friends can be tough when it comes to their money.

Both of you should date and sign the document. Make two copies for yourself. Put one in your safe deposit box and the other in your financial file at home.

Then, note in your calendar when payments are due. Mail your checks well in advance so they arrive on time. Treat Uncle Joe or your lending friend with the same business respect you would treat your bank. You never know: Besides the importance of your personal relationship, you may want to return to this person to help finance that brilliant idea you have for a new business!

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