

Six Points to Consider Before Lending Money

One2One Lending, LLC
www.one2oneLending.com



When the time comes that you decide to lend money to a family member, friend or business associate, this guide will help you through the process.

One2One Lending



Throughout the country and throughout time, people lend money to family and friends. When someone you know is looking for financial help, it certainly seems like the right decision as long as you are financially sound yourself. Lending money can be easy and hassle-free if you know how to do it properly.

Oftentimes, people will make a loan without hesitation, without thinking about all that is involved in the process. Our goal is to teach you how to be a successful lender. We want you to feel confident in lending money to family or friends. We want you to know how to successfully set up a loan that will allow you to be repaid in a timely manner. And most of all, we want you to be able to maintain the friendships you have with the people you lend to.

When the time comes that you decide to lend money to a family member or friend in need, this guide will help you through the process.

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6 points to consider before lending

When lending money to someone you know personally, it's not just dollars that need to be kept in check. It's also the relationship at stake. This list will help you through the loan process.

Be certain this loan will make financial sense for you

Before you lend money, you must first make sure that your own financial situation won't be shaky after the loan is made. Only then should a loan occur.

Is this a practical loan?

In some cases, the money lent to family or friends is never paid back. This can cause a relationship to turn sour. Because repayment is not always certain, consider making the loan simply as a favor rather than making the borrower feel obligated to pay it back.

The tax part of the equation

When you lend money to a friend or relative, you may decide to charge interest. When this interest is collected, it is considered taxable income. Therefore, it is your responsibility to report this on your income tax return. Sometimes this part of the equation is simply forgotten. Before going through with a loan, understand the laws regarding taxes on a family loan.

All sides must be perfectly clear on each and every condition of the loan

A loan to a friend or relative can sometimes leave the impression that it's not a serious business transaction because of a friendly relationship. However, everyone involved should realize the conditions of the loan and how to go about making sure the transition goes according to plan. Review the loan together – the amount the borrower is receiving, the interest rate and the repayment schedule. Proof of the loan is important in the event that the loan is not paid off. This could save you money on taxes.

There's the money; then there's the relationship

The two can often get entangled and cause a mess when money is lent to a friend or relative. It can lead to resentment between the two parties. This can happen when you the lender begin to feel as if it is OK to get involved in the borrower's personal life outside of the loan. Learning to curb these kinds of feelings can maintain or even save a relationship when money is part of the picture.

Before welcoming borrowers, have a set policy

Once friends and family see that you're willing to help someone out by lending money, you may be approached by others about similar favors in the future. Make it clear that any loans you make are to follow a detailed plan. Review all specifications of your loans so you and your borrowers are on the same page. This will help you establish a strict loan process rather than one that borrowers may assume is a just a loose, unprofessional one between friends.

Know your borrowers

There are many factors involved when lending money to family and friends. One of these is simply realizing *who* it is you are lending to.

Before a bank lends money to someone, there are steps the bank takes to understand who it is they are lending to.

You should act in a similar manner when lending money.

Factors to review with your borrowers:

1. Character – Getting a sense of the borrower’s personality is helpful – honesty, responsibility, etc. And to see if the person is or has been in any kind of legal trouble, you have the option of running a background check.

2. Credit History – This is almost always a key factor when lending money to someone. A person’s credit history gives you, the lender, an idea of what to expect in terms of repayment.

3. Personal Income – You want to know the borrower has the means to repay you. Going over the borrower’s financial situation lets you know whether or not repayment is reasonable or not. Ask to check records for any bank accounts or funds the person may have money in.

4. Collateral – This is an insurance measure taken by many banks when lending money. Borrowers can back up their loans with any assets they may have such as a home or car. If repayment does not occur for whatever reason, the collateral will have you covered.



Items to review with your borrower

A successful loan requires all parties being clear on all aspects of the loan.

Lender and borrower need to come to an understanding on what is expected of each other from beginning to end.

Here are some points to discuss to help make this loan a trouble-free process – something that could help maintain your friendship.

1. Loan structure – Depending on the situations of both you and your borrower, you can develop a loan structure that works for both of you. Discuss things like how often you will receive payments and in what amounts, including interest. You and the borrower may decide to start off with small payments and increase the payment amount as time goes on. Or you could stick to a basic plan where each payment is the same throughout. Whatever type of plan you choose, you and your borrower should come to a specific agreement. Once you choose what type of loan, you will want to review the payment schedule with your borrower. Be clear on the dollar amount of the payments and how frequent you will receive payments (weekly, monthly, etc.). Reviewing the payment schedule will help prevent any confusion down the road.

2. Collateral – If collateral is made part of the agreement, you want to have a list of exactly what items represent the collateral. This is your insurance on the loan and will want to have the specifics on paper. Hopefully your borrower will be able to make payments as agreed upon, but sometimes things happen. Having a collateral list on paper will help prevent any disagreement on what it is that serves as collateral.

3. Outsourcing the loan – This is an option if you are worried about the loan interfering with the personal relationship you have with the borrower. When discussing repayment of the loan, the relationship between lender and borrower sometimes can become unstable. A simple way of preventing this is by having a third party handle the payments. This also takes the record keeping out of your hands.

LATE PAYMENTS? How to get repayment back on schedule

Some loans will be repaid without conflict. Others will not.

In the event your loan is not being repaid according to the schedule you and your borrower agreed on, there is a simple way of getting back on track. Follow up with your borrower.

There are different ways of letting your borrower know a payment is due, depending on how late the payment is.

Here is an example schedule of when to notify your borrower about a late payment.



If the payment is one business day overdue,
notify your borrower a payment is due.

If the payment is five business days overdue,
let the borrower know a payment is due and that
(if you decide to write this in to the contract) a late
fee will be added.

If the payment is three weeks overdue,
inform your borrower that the payment and late fee
are due.

If the payment is a month overdue,
inform your borrower that you are marking down
the payment as “missed.”

If the borrower continues to fail to meet the payment schedule, there are a few options you can choose from to fix the problem. Depending on your relationship with the borrower, you may choose to simply forgive the late payments.

Another option is to restructure the payment schedule you and your borrower originally agreed upon. This could mean reducing the amount of each payment or giving your borrower more time in between payments.

If necessary, a rather firm approach could be taken to let your borrower know you still intend on receiving the overdue payments. Have a collection agency send letters to the borrower to inform them of the situation.

In the event of late payments, choose the best option according to your situation and relationship with the borrower.

Conclusion

When lending to friends and family, some may get worried the relationship will never be the same. But, by following this guide, the process will be made much easier for you and your borrowers. And more importantly, your relationships will be preserved.

When lending money, remember to keep it professional regardless of the relationship you have with your borrower. Write down all details of the loan, review it thoroughly to avoid confusion, and keep accurate records of payments. Soon you'll find that lending to family and friends can be a relatively easy, hassle-free process.

