Too Late for Parental Guidance: When You Have to Bail Them Out

(excerpt from Chapter Ten of Trust Me: Helping Our Young Adults Financially*, by Kenneth and Nick Kaye)*

The previous chapter discussed ways to educate your kids, and work with them when times get tight, to prevent their winding up in the kind of debt that will really hold them back.

Unfortunately, it's too late for that advice. Your beloved fabulous kid is already waist deep in debt, or worse. What can you do? In some situations, the best thing you can do is pay the worst of his debts, or all of them, and let him pay you back, at a lower and slower rate than what his creditors require.

However, different kinds of debt and degrees of debt demand different kinds of intervention. Let's begin with the general question: Is it wise to bail our adult children out of trouble they got themselves into? Or should one let them bear the consequences, so they learn?

Assuming this isn't a chronic problem, grab your bailing bucket. Absolutely. The lessons taught by overwhelming debt ("You paid too little attention to the income side of the equation and too little control to the expense side!") aren't taught any better by letting a bad crisis become hopeless. Debt isn't like water standing three feet deep in a basement, which has ruined the books and games stored there but will eventually flow away again and leave the owner with some cleaning up to do. It's a rising flood, threatening to carry off the whole house—literally. Left alone, it doesn't go away, it just gets deeper.

So, if your own financial resources are ample enough, of course you're going to help your child onto dry land. The question is, what kind of help? What's the Deal?

First of all, will you help with a gift (unconditional), a grant (a conditional gift) or a loan? Which of those is more constructive depends on your assessment of the circumstances.

Will these funds buy them out of trouble they should have known better than to have gotten into? In other words, are you reducing or deferring the consequences of irresponsible behavior? If so, a *loan* might be more helpful in the long run, as it prevents catastrophe while still leaving the ultimate responsibility with your child or their partner. (A half-gift, half-loan might be another such solution.) But if the disaster could not have been foreseen—there's no lesson that needs to be learned—obviously a gift is the most generous way to help.

If an addiction of any kind was involved in creating the problem, then the first question is whether it's now being treated. If the addict is rejecting treatment, I would not make a gift *or* a loan, because either form is likely to support nothing but the addiction. But if it is being treated, then a loan makes more sense than gifts or grants, to avoid inducing denial about what got the person in trouble.

> EXAMPLE: Ralph knows that clearing up an addict's debt, without facing the addiction head on, will only enable both the addiction and the debt to grow. When his son-in-law enters treatment, Ralph pays for the treatment itself, no strings

attached. But he offers his daughter and son-in-law a low-interest loan, rather than a gift, to replace their mounting high-interest debts.

Another situation is where your youth needs money for proposed expenditures you're less than thrilled with—not sure they are necessary or wise at this point. A loan might be better for your relationship than a gift would be. Major gifts are for anything parents want their kids to have at this point in life, rather than wait until they can afford it.

EXAMPLE: Susan can't make the payments on a new SUV her father thinks she had no business buying in the first place. He will ease the burden of that GMAC loan with a lower monthly payment DOD (Dear Old Dad) loan. But he refuses to enable her delusions of affluence by turning the car into a gift.

Finally, only call it a loan if both parties sincerely expect the money to be repaid. If your youth is unlikely to pay you back, believing you don't really expect it or will forgive and forget the debt if enough time goes by, then you'd both be better off calling it a gift or grant in the first place.

Gift versus grant examples

A true *gift* isn't supposed to have strings attached. A *grant* comes with certain conditions, as part of a Deal. So if we're talking about a gift that might have some accompanying conditions or limits, let's call it a grant. If no Deal is called for, it's a gift.

EXAMPLE (unemployment help: *gift*): Julia and her husband are a hard-working, disciplined young couple. One of them loses a job when the local plant closes, shortly after they bought their first home. Her parents say, "If you would allow us, we'd like to make your mortgage payments until you've got two incomes again." Their son-in-law thanks them for the offer, but protests, "I don't know when we'd be able to pay you back." "You won't," they say. "This is a family thing."

EXAMPLE (unemployment help: *grant*): The same situation, except Julia's husband would be more employable if he'd finish his degree before rushing back into full-time employment. Knowing he wishes he could afford to keep going for the degree, her parents offer to make the couple's mortgage payments as long as he works part time and takes the needed courses. He says he doesn't know when he and Julia will be in a position to repay you. They say, "Our reward will be seeing you get your degree."

EXAMPLE (grant to a son in college): "We don't want you to lose the apartment *or* to drop out of school because you have to work more shifts. We're going to pay the back rent you owe, *if* you cut up your credit card, promise to pay rent before spending your paychecks on anything else, and put your academics first again."

EXAMPLE (health insurance gift): Kent mentions that he's missed his health insurance payment, among other problems. Unpaid premiums aren't debt; the policy will simply lapse immediately if his parents don't step in. Fortunately, their doing so is unlikely to be "enabling" in anything but a good way. Insurance is something the parents want to pay for, to minimize the financial risk of a catastrophic illness befalling their son. In the same way, they might provide the co-pay for a medical visit, if that's a hardship for Kent right now—without treating it as a loan.

What about the tax implications of gifts? Consult your lawyer if the gift amounts to thousands of dollars, but don't let your decision about how much to give a child be dictated by tax implications. Nor should you diminish the kindness of your gifts by saying you did them for estate planning reasons, or to equalize the gift you made to another child. Each kid's situation at any particular time is its own case.

Loan examples

Compare these situations with the ones above:

> MISTAKE (two poor decisions): Marty and his wife bought a $3,000 bedroom suite as their first-anniversary present to themselves, then couldn't pay their regular bills for several months. Their electricity is about to be shut off. His parents write him a check for enough to cover three months' utilities. They say, "Consider this your first anniversary present from us." You got it: this kind of gift is called *enabling*. The young couple's poor decision led the parents to make an equally bad one.
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> BETTER: Marty's parents offer a loan, sufficient to keep the repo men's paws off the furniture. They charge him a few percent of interest, so he won't forget the time cost of money.

> EXAMPLE: Alicia wants a new laptop. Hers is slow, she says. Maybe so, but how much computing speed does a poet need? "We're not buying you another computer," her parents say. "If you really gotta, gotta have it, we do have sufficient funds to make you a loan at 3 percent interest. You surely can afford $20 a month. At that rate, it will take you ten years; you can pay us back faster when you get a better day job."

> EXAMPLE: Bart parks his car in his parents' garage because he's threatened with having it repossessed. That would be a triple tragedy: he'd lose his ride for as long as it takes to get it back; he'd have to buy it back at auction or reimburse the lender's cost of taking it from him (on top of the original loan, which continues to accrue interest); and the repossession goes on his credit record, where it stays for seven and a half years. Bart's parents definitely want to prevent that from happening. They pay off the car loan in full, and Bart has to make payments to them, at the same rate of interest—but without the threat of repo if he's late with a payment occasionally.

Changing a loan to a gift

It's best to decide in advance whether you're going to be repaid or not. Don't pretend it's a loan unless you genuinely plan to make the youth pay you back when he's able. Of course, you *will* have the option of reviewing that decision when the time comes—deciding to make a gift by canceling the debt—but if you lead the young person to expect that in advance, you're undermining the value of loaning it rather than giving it.

> EXAMPLE: Alicia, the poet mentioned above, is now gainfully employed, but not gainfully enough to buy a car less than ten years old. Her parents give her their four-year-old car, and celebrate her new job by writing off the balance of her debt to them. (This is not enabling; it's boosting.)

> MISTAKE: Rick loaned his daughter $4,000 toward a car purchase. He "secretly" intends, when and if she finishes repaying him, to congratulate her for her responsibility and give her back all those payments. The problem is that he's hinted as much; so Libby pretty much expects she'll get that money back. She doesn't feel the cost of the car.
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> WORSE: Rick changes his mind when the time comes, deciding to keep the

repayment after all (perhaps because he thinks she's made frivolous purchases while taking her time about paying him; or because he now needs the money).

BETTER: If you know you won't enforce the loan, don't pretend it's a loan. It's a gift. Otherwise, treat it as a real loan with precise terms, part of your Deal. Whatever the time period and payback terms are, put them in writing and enforce them. Give your youth the satisfaction of demonstrating responsibility and financial independence. After she's paid you back, you'll have plenty of opportunities to make gifts in the future.

EXAMPLE: Patrick needs $8,000 to relocate from Massachusetts to Texas, where he has a good job prospect. There are moving costs, security deposit, initial rent and living expenses until his pay-checks start. He and his mother estimate that it might be a year before he can start paying her back, and then another sixteen months at $500 a month.

Two years and four months later, Patrick has repaid the debt to his mother. She says, "I'm impressed, though not surprised, by the way you kept our Deal. The fact is, I don't need this money, and you can put it to good use. Please accept it now as a gift."

I think that's a good move (assuming it's true that Mom doesn't need the money)—provided it comes as a surprise. If Patrick had expected it, and she'd later decided, for some reason, not to give the money back to him, it would feel like a betrayal of unspoken expectations. That wouldn't be good for their relationship.

The *worst* way to handle a loan is to leave it ambiguous: "Pay me back when you can." If she never feels she can afford to repay it, you'll call the money a gift—but if she reaches some unspecified level of solvency, you might demand payment? Who'll be the judge of when she can afford to pay you? Will it depend on how much you approve of her lifestyle when the time comes?

Some parents try to manipulate their adolescent or adult children with money, the promise of money, or the threat of withholding money. Don't be one of those. Treat yours like the adults you want them to be.

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