Mortgage Offset Account

An offset account is attached to your mortgage and works like a regular bank account, as you can deposit your salary into it and withdraw money for everyday purchases using a debit card that you will receive from your financial provider.

An offset account is 'offset' against your home loan balance, reducing the amount you pay interest on. You can have your salary paid directly into an offset account – which will immediately count towards the amount of interest you pay.

Generally, offset accounts are only offered with variable loans. Fixed rate loans they generally don't offer the option of an offset account.

Benefits

- Offset accounts can potentially save you a significant amount of interest on your mortgage.
- Offset accounts can reduce the term of your mortgage.
- Offset accounts generally offer a higher interest rate than general everyday access savings accounts.

How it works

Let's say you have a $500,000 home loan balance over a 30 year term at an annual interest rate of 5.4% (variable) repaid monthly.

If you were to retain an average balance of $10,000 in an offset account for that 30 years, you would save approximately $36,000 in interest costs and 1 year off the term of your mortgage.

See below for the full set of assumptions.

What should you look for in an offset account product?

- **An account where 100% of your balance is offset against your loan, calculated daily**. This will ensure you receive the maximum benefit from the strategy. Some accounts only calculate on the lowest monthly balance or the average monthly balance, so it's important to get an account that calculates savings when the balance is also high.
- **An equal interest rate to your mortgage**. This is a common feature of most mortgage offset accounts, but you should ensure the rate will move with your home loan. That way, any interest earned by the money in your offset account will also offset your mortgage interest thereby helping you pay off the loan capital faster.
- **A credit card with a low interest rate**. Often you can get a credit card with a lower interest rate than standard credit cards.

Consequences

- Some lenders may have minimum transaction amounts and withdrawal fees if you decide to redraw money from your offset account. These fees could end up costing you more than the interest you would save.
- While offset accounts often pay higher interest than standard everyday savings accounts, interest rates are still low compared to other types of investments.
- Fees may apply to establish or maintain an offset account. These fees must be weighed up against the interest you are saving by utilising the overall strategy – otherwise the strategy may not be worth it.
- Not all home loans offer an offset facility.

Assumptions used in the above example

1. Loan repayments are assumed to be made at the end of each month.
2. One year is assumed to contain exactly 26 fortnights or 12 month i.e. a year has 364 days rather than the actual 365 or 366.
3. The loan interest rate you enter into the calculator is assumed to be the annual nominal rate of interest, compounded per the loan repayment frequency. For example, for a loan interest of 6.00% p.a. and monthly repayments, the calculator assumes the interest rate charged is (6.00% / 12) = 0.5% per month, compounded monthly.
4. The loan interest rate is assumed to remain the same over the entire term of the loan.
5. The average offset balance is assumed to not change.
6. The loan repayment amount is calculated assuming a standard home loan where both interest and principal is repaid over the loan term.

Date: 1 April 2018