What is an offset account?

an ordinary transaction account that is linked to your loan

What makes an offset account special is the fact that every dollar you have deposited in it "offsets" the balance owing on your loan, which reduces the amount of interest you pay.

An offset account can therefore be used as a very effective tool to pay off a home loan faster.

They have several specific benefits:

For example, if you have $50,000 sitting in your offset account and $300,000 owing on your home loan, you are only charged interest on the difference, which is $250,000.

Higher rate of interest...

The interest that you save on funds deposited in an offset account is calculated at the home loan's interest rate. Since home loan interest rates are generally higher than the interest earned on ordinary high-interest savings accounts, you are getting greater benefit out of having your money in the offset account. Furthermore, interest earned on savings accounts is taxable. Interest savings on your home loan are not.

High flexibility and accessibility...

Because they are generally designed to be used as an everyday transactional account, offset accounts offer a high degree of flexibility and accessibility to funds.

Daily interest savings...

Every day that funds sit in the offset account saves you interest on your home loan. For example, even if your salary is deposited into the offset account on Monday and you withdraw every cent of it on Thursday, those funds would still have offset your loan and saved you interest over the three days that they stayed in the account.

Tax savings...

While you live in your home, all interest that is charged on your loan must be paid out of your after-tax income. As a result, your goal when you are living in your home will generally be to pay down the mortgage as much as possible. However, if you decide to make your home an investment property later on, all interest paid on that loan after that point is then tax-deductible. Therefore, your goal at that stage would be to maximise the loan, and therefore your tax-deductions.

If you live in a property, pay down the loan as much as possible and then move and rent it out, only the loan remaining when you move out will be tax-deductible. For example, if your loan starts at $300,000 and you pay its balance down by $50,000 while you live there, only the remaining $250,000 will be tax-deductible.

If instead you keep that extra $50,000 in your offset account rather than paying it off the loan itself, your loan amount will stay at $300,000 (assuming you are paying interest only). Therefore when the property becomes an investment, your tax-deductible debt would still be $300,000 (instead of $250,000) and you could use the $50,000 as a deposit on a new home.

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