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Offset vs Redraw

Offset accounts and Redraw facilities are two home loan features that serve similar purposes.

Both give you a way to use spare funds to reduce interest charges on your loan balance – but it's essential to understand the differences before you choose one or the other.

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Redraw Facility:

A redraw facility is not a separate account, but is a feature attached to your loan. If you make additional repayments on your home loan above the minimum amount required, a redraw facility allows you to access the additional repayments you've made over and above the required minimum repayment amount. These additional funds can be taken out (or "redraw") – if you need them for renovations, to purchase a motor vehicle, further investing etc…

Key features:

1. Typically associated with both basic and standard variable rate home loans, and some fixed-rate home loans (The majority of fixed-rate home loans have extra repayment limitations).

2. Some lenders may apply minimum redraw amounts or other limitations on the facility.

3. Generally has no fee associated with the use of the feature.

4. You may not have the option to redraw money from an ATM or transact using a debit card (unless the money has been redrawn and transferred into a transactional account)

For example, if your home loan is $500,000 and you deposit $50,000 directly into your home loan account as an extra repayment, you'll only pay interest on $450,000 for each day that the $50,000 balance is maintained. If you need to access the $50,000, you can use your Redraw facility to transfer the funds from your home loan account and into your transaction account, where it can be used accordingly.

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Offset Accounts

This is a separate transaction account linked directly to your home loan. You can use it as your everyday bank account, with easy access to your funds and the ability to make deposits and withdrawals whenever you want to. The money that you have saved in the offset account is deducted from the balance of your home loan before interest is calculated.

Key features:

1. Typically associated with standard variable rate home loans and some fixed-rate home loans (The majority of fixed-rate home loans have extra repayment limitations).

2. Offset accounts work just like your everyday transaction accounts. You can nominate the account to receive your salary, use a debit card to make payments and transfer money in and out of it.

3. Most lenders will charge a monthly/annual package fee for use of an offset account.

4. Some lenders even enable multiple offset accounts to be linked to a single home loan.

5. Lenders provide either 100% offset accounts or partial offset accounts. 100% offset accounts will always be preferred.

For example, if your home loan is $500,000 and you deposit $50,000 into your 100% offset account, you'll only pay interest on $450,000 for each day that the $50,000 balance is maintained.

Advantages of an Offset Account:

Tax implications

There may be different tax implications with using your redraw feature compared to offset account if you decide to rent out your property in the future. If you choose to rent out your home as an investment property, the interest charged on your loan may be tax-deductible. But you may not be able to claim any portion of the loan you have redrawn from your redraw facility for non-investment purposes like a holiday or a private car.

On the other hand, withdrawing amounts from your offset account for such purposes won't affect the tax-deductibility of interest charged on your loan as you have never touched the home loan per se.

If there is a possibility that your home could one day become an investment property, it is suggested you seek financial advice as an offset account could be preferable given the above.

Click here for the "ATO Rental mortgage – interest expenses" fact sheet, which clearly articulates the tax consequences of choosing between an offset account and a redraw facility.

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Offset Accounts (continued)

Flexibility

An offset account is a separate transactional account. You can have your employer deposit your salary into it, and you can transfer money in from other accounts. If you want, you can use your offset account for everyday spendings like groceries and bills by using a debit card. You don't have to keep transferring funds directly into the loan account to reduce the interest charged, unlike if you don't have an offset account.

Whereas a redraw facility is not a separate account but a feature attached to your loan.

It allows you to draw back additional payments (the amount above your scheduled payments) you have made on the loan. A redraw facility may not be as flexible as an offset account. Extra repayments are technically the lender's money as the funds have been repaid on the loan. There can be limitations in accessing the money. Back in March 2020, ME Bank even limited access to the redraw funds: https://www.abc.net.au/news/2020-05-08/me-bank-redraw-changes/12229080

Disadvantages of an Offset Account:

1. Offset accounts typically come with a monthly fee (typically $10 p/m) or via an annual package fee ($395 p/a via the 4 major lenders in Australia). In contrast, redraw facilities are typically provided free of charge.

2. The majority of lenders offer lower interest rates on basic variable home loans (no offset accounts) compared to their Standard Variable home loans (with offset accounts).

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Which is Best for You?

For paying less interest on your home loan:
Both features work fine.

For flexibility and control:
Offset accounts. An offset account gives you much more control over your money. Recently, the Commonwealth Bank adjusted its redraw rule, so your extra repayments reduce over time as they're folded back into the loan. This means you can't rely on accessing all of that money. You still can with an offset account because all funds in an offset account are yours to control and access

For keeping it simple:
Redraw facility. Redraw allows you to set and forget your extra repayments and only pull out funds via redraw in an emergency.

For maximising investment interest deductions.
It's highly likely you'll need an offset account. Of course, speak to the relevant professional for advise around tax or financial planning (i.e. Accountant, Financial Planner or Financial Adviser).