

An Introduction To Offset Banking

If you've been searching for a new bank account or mortgage, you're quite likely to have come across the term offset banking. It's a relatively recent development in the financial world, and has the potential to save certain groups of people large amounts of money. While the concept of offsetting can be used in a wide variety of financial situations, the most common scenario is combining a mortgage or home loan with a current account, and savings account. Sometimes, a credit card and/or a personal loan is added to the mix as well. This is all well and good, but what does offsetting actually mean? Traditionally, we took out a mortgage to cover the purchase of our home. We also had a current account to handle our day to day finances, and if we were financially prudent we'd also have some sort of savings facility to put money aside for a rainy day. In offset banking, these various kinds of account are all rolled into one. Each month, when your salary is paid into the account, it is applied to your mortgage balance, temporarily making it smaller. A smaller mortgage balance means more of your monthly repayments go towards repaying the debt itself, and less towards the interest charged on it. Similarly, any savings you have also go towards reducing your mortgage balance, which will either decrease your monthly repayment or reducing the effective term of the loan. The crucial thing to bear in mind is that your salary and savings are still instantly available for you to use as and when you see fit. There is no lock-in period - all that happens is that if you remove money from your account, your mortgage balance rises again. One way of viewing an offset account is as a huge overdraft that you need to clear over the period of your mortgage term. But how does this help? Historically, your mortgage would cost you a higher rate of interest than a savings account would pay. Even with today's high direct savings rates, this is still generally the case. Instead of earning a lower rate of interest on your savings, you're instead avoiding paying a higher rate on your mortgage. This is clearly going to see you come out ahead in the end, even before taking into account that you'll avoid having to pay tax on savings earnings, which makes the deal seem even sweeter. As an additional benefit, your monthly mortgage repayments are usually not set in stone - you can vary them as circumstances allow, paying more or less depending on how much spare cash you have each month. Your only commitment is to clear the balance by the end of the term (usually before your retirement date). But are there any drawbacks? The main one is that as offset accounts are so flexible, you'll pay a little extra in terms of the base mortgage rate compared to, for example, a five year fixed rate deal. If you take full advantage of the offsetting benefits though, this difference is easily overcome. The second drawback is that the flexibility requires discipline if you're to keep your repayments on track. Ideally, you should only use the flexible payments feature to make overpayments, and keep any underpayments to an absolute minimum. So is offsetting for you? If you need some flexibility in your repayments, for example if your income varies dramatically from month to month, then it's an option worth considering. Similarly, if you often have large amounts of surplus funds, for example if you are self employed and need to put money aside to pay your yearly tax bills, then you could find that your money works much harder for you in an offset account than in a traditional savings account.

About the Author

Nicholas writes for Your Banking Guide, where you can [compare savings accounts](#) and get a [high rate of return](#) on your investment.

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