Australian PropertyInvestor
Newsletter

AUGUST 20, 2015

Is offset or redraw the best?

I had a conversation with a client a few weeks ago that went something like this: "So, you've just signed your property purchase contract, congratulations!" followed by my asking "Will you be living in it or renting it out?" and "Have you got the finance sorted?".

By Pat Mannix and Bec Mackie

My client, let's call her Rachel, has a mortgage broker that she's used before, so we discussed the loan structures and how her intentions for the property can influence the type of loan that may be best for her.

She's planning to move into this property for one to two years and renovate it during that time, before moving on to her next property and renting this one out. There are many things to think about when getting a mortgage but I'm only going to look at the potential tax effects of different loan structures.

As Rachel told me her intention is to live in the property then rent it out the first thing I brought up was an offset account and the differences between offset and redraw. An offset account is actually a separate account linked to your mortgage in such a way that the balance of the account is used to reduce the interest payable on your mortgage. So, by putting all available cash in your offset account, you're reducing the interest paid on your loan (and increasing the principal component of your repayments). This is different to a redraw facility, whereby you make higher repayments, or deposit lump sums, to reduce the amount of your loan and therefore the interest payable.

For most people, the choice of one or both of these facilities is likely driven by rates and fees, but if you're borrowing for an investment property (or potential rental property) then you should also consider these facilities from a tax perspective as the advantages and disadvantages can be substantial.

As an example, let's assume in 12 months' time Rachel receives an inheritance of $200,000 and wants to reduce the interest on her mortgage. Her brother told her that she should just deposit it into her mortgage account and reduce her interest payments, then draw it back out when she buys a new house. She gives us another call to get our advice before doing anything. The table below compares putting the funds into an offset account or depositing them straight into the loan with a redraw facility.

	Offset	Redraw
Loan balance	$500,000	$500,000
Deposit to offset	$200,000	$0
Deposit to redraw facility	$0	$200,000
Interest calculated on:	$300,000	$300,000

As you can see there is no difference in the amount used to calculate the interest each month. Now, let's fast forward to when Rachel has completed the reno and is ready to purchase a new home and rent this one out. She wants to use the $200,000 as her deposit to purchase this new property. Let's see the example:

	Offset	Redraw
Loan balance	$500,000	$300,000
Withdrawal from offset	$200,000	$0
Withdrawal from redraw	$0	$200,000
Total loan amount	$500,000	$500,000
Interest on loan (4.5%)	$22,500	$22,500
Investment loan amount	$500,000	$300,000
Tax deductible interest	$22,500	$13,500

Now you can see the real benefit of the offset account comes when the purpose of the original property changes from private to investment. With an offset account Rachel can claim interest on the full loan amount as she only withdrew the savings from a bank account (albeit linked to her mortgage). As we can only claim interest on money used for investment purposes, the interest on the amount Rachel "redrew" for her new home isn't tax-deductible, meaning a difference in deductions against her new rental property of $9,000.

Remember to speak to your accountant about your personal situation and not take advice from the guys at the pub or footy club, or even in your family!

Pat Mannix and Bec Mackie *have extensive experience dealing with tax and structuring advice for investors including structures in self managed superannuation and direct property. For more information, go to www.gatherumgoss.com*