Peasy
Property, easy.

Principal and Interest vs Interest Only repayments and Offset accounts

The purpose of this guide is to explain quite simply the difference of using an offset account for a Principal & Interest loan versus using an offset account for an Interest Only loan.

Before we start, let's go back to the basics:

WHAT IS THE DIFFERENCE BETWEEN A P&I LOAN AND AN IO LOAN?

For most borrowers, the Principal and Interest (PI) loan is often their first option when getting a loan. It is considered as the "safer" and more "conservative" option as it allows you to start paying down the loan from the very start. However, there are benefits and certain circumstances where an Interest Only loan is advisable and especially when combined with an offset account, it can provide more flexibility with the repayments.

WHAT IS AN OFFSET ACCOUNT?

An offset account reduces the interest payable on your mortgage by the amount held in the account. For example, if you have a $500,000 loan and you have $25,000 in your offset account, the lender will calculate the interest based on the $475,000 instead of the $500,000.

You may already know this, but if you want to learn more about offset accounts and how it works, you can download our guide by clicking here.

WHAT ARE THE BENEFITS OF AN INTEREST-ONLY LOAN AND OFFSET ACCOUNT?

The simplest answer would be – financial freedom! The extra repayments you make in your linked offset account gives you flexibility with your financial strategy.

Since you only need to pay the interest portion of the loan, you will have lower repayments as compared to a Principal and Interest loan.

Here is a practical example: let's say your loan is for $500,000 over a term of 30 years. Usually, banks can approve an initial Interest Only term of 5 years, so during this time, you are literally paying only the interest which on a monthly basis at a rate of 3% would be $1,250.

Now how does the offset come into play? As the interest is calculated on a daily basis and only on the difference between your loan balance and funds in the offset, your repayments will vary from month to month.

Peasy
Property, easy.

Let's say for example that you have $20,000 in savings:

$500,000	−	$20,000	=	$480,000
				Repayments would be approximately $1,200
Loan		**Savings**		**Balance which incurs interest**

WHAT ARE THE BENEFITS OF A PRINCIPAL & INTEREST LOAN AND OFFSET ACCOUNT?

How a P&I loan works is that the repayments are calculated before the loan starts taking into consideration the interest rate at that time and the overall loan term. For example, a P&I loan for $500,000 on a rate of 3% over 30 years would equate to 360 monthly repayments of $2,108.02.

Loan Amount	Interest Rate	Loan Term	Monthly Repayments
$500,000	3%	30 years	$2,108.02

What this means is that if you only make the minimum repayment required per month and you adjust this figure to reflect any rate changes, it will take you the full 30 years to repay the loan.

When using an offset account with a P&I loan, the repayment amount won't vary as it does on an IO loan, but what will vary internally is the interest being charged on each repayment.

For example, the interest on the first month of the loan being active is $1,250 per month, this means that only $858.02 of your repayment is going towards the principal amount of the loan.

Monthly repayments: $2,108.02

Interest	*Principal amount*
$1,250	***$858.02***

Now let's say for example that from day 1 you had $20,000 in your offset account, then the interest is only incurred in $480,000 so the repayment will still be $2,108.02 but only $1,200 is going towards interest and a higher amount of $908.02 is going towards the principal of the loan.

Monthly repayments: $2,108.02

Interest	*Principal amount*
$1,200	***$908.02***

Sounds complicated right? Well to keep it simple: an offset account is a great feature to have as part of your mortgage solution and the more funds you have in there every day, the more interest you will be saving and the quicker you could repay your loan!

Your Peasy broker is here to support you through every step of the process and explain the pros and cons, specific to your situation.

If at any time you have any questions or concerns, feel free to contact us on 1800-3-PEASY.