

The complaint

Mr and Mrs S complain that the contractual monthly repayment (CMP) for their offset mortgage with Lloyds Bank PLC trading as Lloyds Bank (Lloyds) has increased even though the interest rate has decreased. As a result of this, they believe that the mortgage has been calculated incorrectly from the outset.

The mortgage was initially taken out with another company which now forms part of Lloyds. I will refer to Lloyds throughout my decision for ease.

What happened

Mr and Mrs S took out an offset mortgage with Lloyds in 2005 for 25 years. The mortgage was an offset repayment mortgage with a tracker rate of 0.90% above the Bank of England base rate (BBR). As part of the offset mortgage, Mr and Mrs S had a linked savings account, which meant that they could save interest depending on the amount of funds in the savings account. Where there was a savings balance, the amount of interest that was paid on the equivalent amount of the mortgage was deducted from the capital amount owed. The reduced mortgage balance meant that the term over which Mr and Mrs S needed to make repayments reduced.

Mr and Mrs S say that – although interest rates fell in August 2024 – their CMP increased by £90 following this. They say that the CMP should not change due to an overpayment and that the overpayment should just reduce the term, which would mean the CMP stays the same. Mr and Mrs S therefore say that shortening the term in line with the offset mortgage overpayment should never change the CMP.

Mr and Mrs S have provided various calculations and they say that these indicate that Lloyds has been calculating the CMP incorrectly for the last 20 years. They say that Lloyds' calculations are wrong and do not match the sales documentation and they therefore question how Lloyds has determined the CMP and the term reduction.

Mr and Mrs S have said that the interest saved by the offset should explain the shortened term. They say that their calculations indicate the term reduction should be two years, yet the term has shortened by four years. Mr and Mrs S say that cutting the term of their mortgage by more than it should be is increasing the CMP and making increasingly larger demands on their bank account each month for no contractual reason. They say that they would like this to stop.

Lloyds says that as Mr and Mrs S offset their savings account against their mortgage, the funds in the account reduce the interest charged on the mortgage balance. The CMP would remain the same until a 'trigger event' (for example a change in interest rate), but the overpayment would go towards reducing the mortgage term. The term would only be reduced (and the CMP recalculated) upon a 'trigger event'. As a result, more of their CMP (along with the offset credit) is used to reduce the outstanding balance, which means that the mortgage will be repaid earlier than the original term expiry of April 2030.

Lloyds has explained that when interest rates change, it recalculates the CMP taking into account the reduction in the capital and then uses a projected term end date. This means that Mr and Mrs S's new CMP is higher than their previous payment due to the projected term end date now being May 2026.

Lloyds says that the term of Mr and Mrs S's mortgage has reduced in line with the terms and conditions for offset mortgages. It does not agree that there has been an error in the way the offset payments have been calculated and it explained the way that this works. Lloyds offered to remove the offset function if this type of mortgage was no longer suitable for Mr and Mrs S.

Our Investigator looked into Mr and Mrs S's complaint and didn't think Lloyds needed to take any further action. He explained to Mr and Mrs S that the role of this Service was not to audit the account. He also explained how the offset mortgage worked in terms of the balance of the linked account and how this would affect the CMP. Overall, the Investigator concluded that the recalculation of Mr and Mrs S's CMP was in line with the conditions of the mortgage which had been agreed, and he was unable to say that Lloyds had done anything wrong.

Mr and Mrs S disagreed with this, so the case has come to me to make a decision. They maintain that Lloyds' calculations are wrong and that it doesn't understand its own system as the offset can only reduce the term and not the CMP. They say that no form of investigation has been carried out and have provided further calculations and explanations which they say demonstrate that the CMP and term have been calculated incorrectly.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having looked at the evidence, I agree with the Investigator's view for broadly the same reasons and I've explained my reasons further below.

I should firstly say that it is not the role of this Service to audit Mr and Mrs S's mortgage account. If they wish for the account to be audited, then they should instruct a professional to complete this. So, whilst I have considered all of the information provided by Mr and Mrs S, I will not be commenting on all of the calculations they have provided. I'll focus on the matters that I consider most relevant to how I've reached a fair outcome in keeping with the informal nature of our Service.

As Mr and Mrs S's mortgage is a repayment mortgage, part of the CMP goes towards paying the capital and part goes towards paying the interest. On a standard repayment mortgage, this would mean that the CMP would be calculated based on the outstanding capital balance, the remaining term and the interest rate applied.

Because Mr and Mrs S's mortgage is an offset mortgage, this works slightly differently. The CMP is calculated in the same manner as it is for a standard mortgage – how much needs to be repaid over the remaining term at the interest rate that is applicable at the time. However, the funds in the linked savings account mean that Mr and Mrs S may pay less interest, which is then credited to – and reduces – the capital balance faster than would have been expected when the CMP was calculated. As Lloyds can't know how much Mr and Mrs S will have in their offset savings account, it can't factor in any overpayments when it calculates the CMP. This means that as the offset interest reduces the capital balance, Mr and Mrs S need to pay less interest than was anticipated when the CMP was calculated. This results in more of the CMP going towards paying the capital.

The result of the reduced capital balance can have two effects – the term can remain the same as when the mortgage was arranged, and so the CMP will reduce. Alternatively, as is the case for the particular offset mortgage held by Mr and Mrs S, the reduced capital balance reduces the term, which means that Lloyds' system will calculate a revised term to show when the mortgage will be repaid. The CMP is then recalculated according to that revised term.

The terms and conditions for the mortgage state "*The effect of the extra payments you make by offsetting depends on whether you arrange your offset mortgage as a repayment loan or*

on an interest only basis. If it's a repayment loan, you could end up paying your mortgage off years early... in both cases, by offsetting your current account and savings, you make additional reductions to your mortgage balance and so shrink the mortgage interest you pay".

The terms and conditions also set out the effect of the offset mortgage. They state "*The Offset will reduce the amount of interest you have to pay [Lloyds] on each Sub-Account but [Lloyds] will continue to collect the full Monthly Payment, as if the Offset did not apply, until a Trigger Event. This means that you will make larger capital repayments so the actual repayment term may be shorter than the term stated in the relevant Underlying Agreement*". It continues "*If the repayment term has been shortened as a result of the Offset when a Trigger Event occurs, we will work out the new Monthly Payment under each Underlying Agreement on the basis of that shortened term and we will collect that new Monthly Payment until we change it, on the same basis, following the next Trigger Event*".

This means that even where the balance of the linked account has resulted in a reduction of the interest payable, Mr and Mrs S would continue to pay the existing CMP until there was a 'trigger event'.

As I have said above, the balance of the linked savings account can change, Lloyds calculates the expected interest on the basis that there is a zero balance in the linked account. This means that the CMP is based on the maximum amount of interest payable. However, the interest charged is based on the actual balance of the linked account throughout the month. If the actual interest charged is less than the expected interest (which will be the case where there is a balance in the linked account), then the difference between the two will be treated as an overpayment and used to reduce the balance of the mortgage further.

Because the CMP would remain the same until a trigger event, this would have the effect that – in addition to the overpayment of the mortgage balance due to the offset interest saved – there would also be an overpayment of the balance every month (until the CMP was recalculated again) by virtue of the fact that more of the CMP was going towards the balance than estimated (as there would be less interest payable due to the offset interest having reduced the balance the previous month).

By way of example, the mortgage was recalculated in August 2024, with effect from 1 September 2024. (I appreciate that Lloyds manually recalculated the CMP for September 2024 as the automated recalculation had taken place prior to Mr and Mrs S's CMP being paid in August 2024 – I use the figures below only to illustrate how the offset mortgage works.)

The CMP for September was £1,410.88 and the expected interest (based on the linked account having a zero balance) was estimated to be £138.08. This would mean that the remaining £1,272.80 of the CMP would go to paying the capital balance. In fact, when the balance of the linked account was taken into account at the end of the month, this meant the actual interest charged was £96.25. This would have the effect that an additional £41.83 of the CMP would go towards reducing the mortgage balance.

The following month, even less interest would be payable and more of the CMP would be used to repay capital. That pattern would be repeated each month until a trigger event meant the CMP was recalculated. The cumulative effect of these overpayments would mean that the term would be further reduced in line with the terms of the mortgage. This may explain why the mortgage term has reduced by more than expected by Mr and Mrs S.

Although Mr and Mrs S's mortgage was initially taken over a term of 25 years, the savings made due to the offset (both directly and in increasing the amount of the CMP used for capital repayment) mean that the term has reduced over the course of the mortgage. As set out above, the terms of the mortgage set out that the interest savings are used to reduce the mortgage term.

Mr and Mrs S have also complained that Lloyds' calculation of how the term should reduce is incorrect. They say that Lloyds' term reduction of four years amounts to £67,680 (based on £1,410 a month). They say that their offset interest saving is around £11,000. So they question how £11,000 of saved interest can knock £67,680 off the mortgage.

Firstly, I should say that the length of the term reduction is not calculated by simply dividing the total amount of interest saved by the offset by an individual CMP amount. This does not take into account that the CMP has fluctuated over the term of the mortgage and that the interest proportion of the CMP would have reduced over time. This calculation also appears to be taking into account the capital repayment element of the CMP and not solely the interest.

Lloyds has said that it is only able to recalculate the term (following a trigger event) based on a full number of months. So, for example, it would be unable to recalculate based on eight and a half months, so this would be rounded down to eight months as the nearest month. The new CMP would then be calculated by working out how much needed to be paid each month, based on the outstanding mortgage balance over the revised remaining term. So, the term reduction is not based on the CMP, it is the revised term (based on the remaining balance) which impacts the CMP.

Mr and Mrs S's CMP is paid on the 28th of each month. Therefore, if the CMP is automatically recalculated following a trigger event before the CMP is made in that month, the recalculation will not take into account the payment being made (as this is not guaranteed to be received). This is what happened in August 2024, as the recalculation was done on 3 August 2024, before Mr and Mrs S's CMP was due on 28 August 2024. Following Mr and Mrs S's complaint, Lloyds manually recalculated the CMP to take into account that the payment had later been received.

Using the same example from the September 2024 recalculation, at this point the CMP was calculated over a term of one year and nine months, which was the revised term applied in accordance with the terms and conditions of the offset mortgage.

As the system rounds down when calculating the new term, the CMP will increase (however the term will be shorter, resulting in less interest being paid overall). As there is a relatively short term left on Mr and Mrs S's mortgage, the impact of a term reduction will have a greater impact on the CMP at this stage. So, overall, I am satisfied that the mortgage is operating as I would expect it to.

If Mr and Mrs S are struggling to afford the increased CMP following the term reduction, they can contact Lloyds to see what options are available.

As explained by Lloyds, if Mr and Mrs S no longer want their mortgage to operate on an offset basis, they are able to convert to a standard repayment mortgage. This would mean that the interest would be payable on the full outstanding mortgage balance but the term would be set and would not fluctuate in the same way as it does with an offset mortgage, and the CMP would then not be affected by further term reductions. Lloyds has also offered to manually extend the term, which will reduce the CMP (but may increase the total amount Mr and Mrs S pay over the term of the mortgage).

I know my decision will come as a disappointment to Mr and Mrs S, but I can't say that Lloyds has acted unreasonably in the circumstances of this case, and I don't uphold this complaint.

Mr and Mrs S have asked for the formula Lloyds uses to calculate an offset mortgage payment and Lloyds has provided the following:

$$\text{Monthly Repayment} = \frac{\text{Term} \times [\text{Balance} \times (\text{Interest Rate} / 1200)] \times [1 + \text{Interest Rate} / 1200]}{[1 + \text{Interest Rate} / 1200]^{\text{Term}} - 1}$$

$$T = \frac{\log(P \div (P - (I \times (MB - SB))))}{\log(1 + I)} + \frac{SB}{P}$$

Where T = Number of payments remaining; P = Monthly payment; MB = Mortgage Balance; SB = Savings Balance; I = Decimal monthly interest rate

As explained above, and by the Investigator, it is not the role of this Service to provide an auditing service, so I do not intend to check this calculation against Mr and Mrs S's calculations. I provide it merely for information as it has been requested by Mr and Mrs S.

My final decision

For the reasons I've explained above, I don't uphold this complaint and don't require Lloyds Bank PLC trading as Lloyds Bank to do anything further.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs S and Mr S to accept or reject my decision before 23 September 2025.

Rachel Ellis
Ombudsman