SOCIETY OF ACTUARIES
HOUSING IN RETIREMENT
ROUND TABLE ON-LINE DISCUSSION

1. WHAT ARE THE MOST IMPORTANT HOUSING ISSUES AFFECTING RETIREES?

Zenaida: With limited and fixed source of retirement income, retirees need to have affordable housing that meets their needs. For example, they might plan ahead of retirement about the community, size of home, amenities (e.g. close to family, or near medical facilities, public transportation, food and other shopping) and other anticipated needs. Retirees must weigh the costs and benefits of owning versus renting a home, in light of one's financial resources. Both costs to maintain and rent increase with inflation, while owning one's home can provide not only security of having a place to live but the access to home equity when a real need arises. Buying a home when retired is not usually feasible, unless one is paying all cash; on the other hand a home is an illiquid asset so selling is not easily done especially when demand is weak.

Steve C: Well said. I'd add that with increased longevity and years potentially needing assistance, more diversified retirement housing (senior, assisted, continuing care), and geographical dispersion of offspring, planning can get confusing. So one issue is developing advisors and aides to guide people along the way

Don: AARP has done repeated measures of the housing preferences of older people – and we have found every time that upwards of 90% of older people indicate a preference for staying put and never moving. So, one could argue that ideally people should weigh the relative merits of owning and renting or of various locations – but for most older persons, their housing decisions are generally driven by how to remain in their homes. Finding ways to pay for taxes, utilities, and maintenance are some of the most pressing issues for these people – along with the needs to modify their existing housing to accommodate any disabilities they may be experiencing. Decisions to move are very often driven by emergency needs in later life – which may limit the options and the resources to pay for them. We may be seeing cohort shifts in attitudes toward staying put, with boomers more willing to move for life style and economic reasons.

Chuck: If you take a more holistic approach, housing and Social Security are the main engines behind retirement wealth. Portfolio assets, including 401(k)s, pensions and Medicare generally complete the list. Since 80% of early baby Boomers indicated they own their homes, a decrease in house prices has a disproportionate effect on household net worth. A University of Michigan study found that a 13.5% drop in house prices triggered a 9% decrease in overall total net worth. This helps explain, for better or worse, why the retirement security of too many Americans is tied to home ownership and why this situation should be at the top of the list of national policy makers. Looking ahead, pre-retirees should not rely disproportionately on housing wealth to fund retirement, but should focus on a diversified life portfolio, as well as a diversified financial portfolio in non-correlating assets. Living below your means and expecting less in terms of financial asset returns should become the new reality for pre-retirees.

Anna: Let's turn back the clock to a period earlier in life. Often people are encouraged to buy the most expensive house they can afford, or one that is more expensive than that. I believe that we need much better tools and approaches to help people evaluate the implications of buying more house vs. saving more for retirement in a 401(k) plan or an IRA. We should be encouraging people to routinely look at this question. The mortgages of recent times that have permitted low payments in early years and borrowing very large amounts have made this problem much worse than it would otherwise have been.

We should be encouraging people to take a realistic look at what it costs to live in their current homes including taxes, cost of expected maintenance, and the opportunity cost of lost investment income. Even if there are no mortgage payments, if staying in a current home, maybe in a high cost area, will be a stretch, it is probably best to think about downsizing. Many of the retirees we know have downsized from their largest homes, but of course others have multiple homes. For people in high cost areas -- there is the potential to go to a lower cost area, but there are huge trade-offs in relocating. Even if we just look at real estate taxes, there is a very big variation by area.

Often a discussion looks at the options with a bias that staying in one's home purely as if it is the best option. My close family member went from her own home to independent living, to assisted living and to a nursing home over a period of years. I want to offer some personal perspective on some of the important issues that I learned from family experiences. My family members felt trapped in the winter due to snow and ice and they had trouble with the yard. Living in their home became increasing difficult, and independent living was a great choice, particularly after the husband in the family died. The independent living facility chosen was near their former home -- so that my family member was able to continue to see her old friends, go to the activities that she had valued. However, it also offered support services, activities and the chance to make new contacts. My lesson learned was that in a situation where the services offered matched the needs of the individual -- this could be a great choice.

Another lesson learned from family experience is that at different stages of need, access to family members is very important and it is also important that the family members have time and energy to help. Moving can be a critical part of getting access to both services and family. And, the things that were important at one stage of life may be less important at the next. And, as indicated by others, specialized housing can be costly, but in many cases, the cost can be partly or totally offset by the investment income on the proceeds realized by selling a home.

Joe: Important housing issues—well said by others, but to me it seems that housing represents a large and growing share of the wealth retirees will need to fund their retirement years. Unfortunately, housing is an illiquid asset and the needs to tap housing wealth often arise as health emergencies. There is also a lack of good quality, unbiased financial advice that retirees can tap. These issues related to housing are part of a larger social context that encourages consumption over savings.

Sheila: It is always important to remember that seniors are a very diverse, heterogeneous group whose needs vary across the life cycle of retirement. For example, only 57 percent of the bottom income quintile of pre-retirees (ages 55-64) has home equity compared with 95% of those in the highest income quintile. Median Social Security wealth is double home equity wealth for the bottom income quintile, but less than the value of home equity for the top income quintile. (Numbers from Mermin, Zedlewski and Toohey 2008). Nonetheless, the ability to tap into home equity can be more important for the bottom income group that owns because the relative boost in their income could be large (Zedlewski, et al. 2008). Diversity also plays into home ownership costs. Variations in state and local property tax policies, for example, are enormous and can determine whether older adults can stay in their homes or not.

Housing status and home equity should be considered an important part of an integrated retirement income profile. Some older adults will want to adjust their housing costs to their incomes, and some will want to tap into this resource to help finance retirement. The choices need to be diverse to meet the needs of all seniors. Recent events are limiting these choices. Many cannot sell their homes and prices are depressed. Relatively few banks are writing new home equity lines of credit, taking this option away from seniors. More are turning toward Reverse Annuity Mortgages even though closing costs can take 10% of the home equity. This could shine a stronger light on this option and perhaps ways to reduce the cost of these mortgages. Other housing issues include home modifications for seniors who desire to age in place, and increasing demand for home health care workers.

We have relatively little data that allow us to fully understand the housing situation of older Americans. The NRLMA provides data on the number of RAMs, but the latest data cover fiscal year 2008. The Health and Retirement Survey (HRS) provides a snapshot of older Americans every two years (the 2008 data will soon have weights). It will be a long time before we fully understand how the housing slump and the Great Recession have affected older Americans' wealth, mobility and attitudes.

2. IS PAYING OFF A MORTGAGE STILL AN IMPORTANT FINANCIAL STRATEGY FOR RETIREES?

Zenaida: If they own their home, they should ideally be mortgage-free in order to optimize the use of their income for necessary maintenance and other basic needs in retirement. Any home equity that they have should be protected and tapped only for real emergency or catastrophic needs when there are no other available resources. Such equity also provides cushion from a drop in housing prices should an unexpected move become necessary (e.g. assisted living facility).

Steve C: I agree that peace of mind is an important component. But I'd also say it depends on - sources and amounts of income compared to needs - including the mortgage and with due respect for inflation; other wealth they have; propensity for investing (and spending) the theoretical monies freed by the mortgage; mortgage interest rate; tax implications; and the degree peace of mind matters

Don: Tony Webb with the Center for Retirement Research at Boston College did some recent analyses for AARP and concluded: *Households should aim to enter retirement debt-free. Although it may be possible to earn a higher after-tax return on financial assets than the after-tax cost of a mortgage, this additional return will usually involve the risk of loss. Given plausible risk preferences and observed household allocations of financial assets, households should not take on this risk.*

In light of this advice, it is distressing to see that increasing numbers of older persons are entering their retirement years with substantial debts, including mortgage debt. The percentage of households aged 65+ with any debt increased from 34.7% in 1989 to 47.8% in 2004 – and those with mortgages increased from 14.6% to 22.3% in the same period. I haven't done the search to get more recent numbers, but they are almost certainly considerably higher now.

Chuck: Ideally, paying off a mortgage is the best strategy, but this is becoming a rarity. Since 1995, the average debt per U.S. household has increased 45% since 1995, from $40,600 to $58,700. This debt load largely paid for non-mortgage expenses. So for retirement planning purposes, the best strategy going forward is to live below your means, since you will live longer, yet have less job security, more breaks in benefit coverage, and may be forced to move around the U.S. to find work. Given this new reality, which may last until housing equilibrium is restored and the job market recovers, renting could be considered more attractive and practical than home ownership. This could lead to a new sub-culture of American nomads.

Anna: I also like the idea of paying off the mortgage, and also want to encourage more thinking about whether a house is affordable or whether it is time to downsize. I also encourage thinking about this within the context of how much guaranteed income an individual has. An individual with a regular pension in addition to Social Security is in a much better position to think about greater monthly payments than an individual who has Social Security as their only regular monthly income.

Joe: Keeping a mortgage may be OK if most of a retiree's "wealth" is in the form of pensions and Social Security, and the monthly income is sufficient to support the mortgage and other expenses. Keeping a mortgage may be sort of OK if the "wealth" is in the form of tax advantaged savings like 401(k)s. It would not make sense to keep a mortgage if the individual held substantial regular investments (unless the mortgage rate was well below current market rates). Good financial advice may be needed to overcome the "behavioral" issue that a person who pays off a mortgage may feel poorer, even though they are richer on a present-value basis.

Sheila: Just to add more to the basic statistics. Among homeowner households headed by adults age 55 and older, less than half owned their homes with no debt. Only 38% of home owners in the bottom income quartile owned their home debt free. This rises to 49% of those in the second quartile and drops to 44% and 33% of those in the 3rd and 4th income quartiles, respectively. (These are data from the 2006 HRS.) In short, most older home owners do not own their own homes without debt. While it might make sense to encourage seniors to paying off the mortgage, it will take a long time to get there. In the meantime, we need strategies that recognize the full cost of housing for seniors.

3. WHAT OPTIONS ARE AVAILABLE FOR USING HOUSING EQUITY IN RETIREMENT AND HOW EFFECTIVE ARE THEY?

Zenaida: Establishing a home equity line of credit ahead of time can help ensure the availability of emergency funds when savings and other sources are insufficient to meet a catastrophic need. However, borrowing against this line of credit requires installment repayments that are preferably delayed until after the need or crisis is resolved. A reverse mortgage allows a homeowner to tap on the equity of the home without having to repay until one moves, or dies, at which time any remaining indebtedness is paid off from sales proceeds. The fees that are charged can vary widely, and in some cases can be excessive.

Steve C: Aren't lines of credit limited in size and mightn't they affect credit and flexibility in obtaining other financing. A friend just had trouble dropping his without a significant surrender charge.

As I said in my paper, home equity can be a great source for funding long term care, especially with the enhancement of a highly impaired care annuity.

I'd be wary of using home equity too soon in retirement for financing retirement income by using a reverse mortgage. Higher charges and internal build-up of the loan can erode net worth that might otherwise be conserved for later expenses or other family members.

Don: Older homeowners have several options for tapping home in retirement. Selling and moving is one strategy. As I noted above, the vast majority of older homeowners do not take this step unless driven by necessity, though of course some do so for life style and economic reasons. There is at least circumstantial evidence that home equity is playing a large role in funding long-term care needs for those who are driven by necessity. For example, an industry survey found that the median annual cost for assisted living in 2009 was over $34,000 – but the median annual income was only $18,972. While we don’t know entirely how assisted living residents are paying for the difference, it appears that most are drawing on assets and, especially, funds from the sale of their homes.

As noted in the other comments, homeowners can also borrow using home equity loans and lines of credit. The costs of such loans are substantially lower than for a reverse mortgage, so they are preferable for those who qualify and can afford them. However, there are several drawbacks. First, they require monthly repayments, which those with limited incomes may not be able to make. Second, and related to the first, because they require monthly payments, they are also require underwriting that looks at the person’s income stream and past credit history. Finally, the amounts of such loans may be limited and may not address major health or home repair needs.

Reverse mortgages are entirely asset-based loans and have no monthly repayments and, therefore, no financial underwriting – so homeowners with low incomes and poor credit histories can qualify on the same terms as anyone else based on home value and age. Borrowers may also be able to borrow larger amounts than with home equity loans and lines of credit. The down side is cost. Reverse mortgages have very high upfront costs that make them especially costly in the short term or for small loans.

Chuck: Home equity can be used for the down-payment on a smaller home and to fund long-term care, while lines of credit may not be sufficient and can be very susceptible to increases in interest rates. This rate risk is very dangerous to people close to retirement or retirees, and could be accompanied by the danger of rising inflation. It’s also important to note that tapping a home equity loan reduce retirement wealth, which pairs a short-term gain with a longer-term problem.

Anna: For people with expensive homes and not a lot of financial assets, if market conditions are good, I believe that downsizing (and/or going to a lower cost area) and converting some of the money to financial assets is a good option. While working longer is not a housing issue, the practical choice may be between working longer, vs. downsizing.

In some situations, it is also possible to get some income by renting out a room.

Sheila: We should remember that most older adults do not tap into this asset during retirement. (Only 6% of homeowners age 50 to 65 reported that they plan to use home equity to finance ordinary living expenses in retirement, according to survey results reported by Boston College in 2007.) Nonetheless, options should be available. As noted earlier, new home equity loans are now relatively scarce. Also, it should be noted that the interest rate on home equity lines of credit is variable. Right now rates are very low for those that have home equity credit lines, but the rate could go up quickly along with monthly payment requirements. Reverse Annuity Mortgages should remain an option for those that need them. The Housing and Economic Recovery Act of 2008 reduced origination fees on RAMs a bit and standardized maximum loan amounts. Most of these loans are issued by FHA. We need a larger, more competitive market place to reduce the cost of using these loans and to provide greater variability in products.

4. ARE REVERSE MORTGAGES A VIABLE PRODUCT FOR THE FUTURE – WHY OR WHY NOT? HOW CAN THEY BE IMPROVED?

Zenaida: Reverse mortgages can serve as emergency mechanisms for tapping into home equity without the need for immediate repayment, or sell and move out of the home. However there appears to be a wide range of products with varying fees out there, and little knowledge on how to understand product features and/or make an informed choice. More transparency of fees charged for the product and a facility for comparing various product features (e.g. restrictions, penalties) should be provided and maybe required.

Steve C: As above, I agree. Moreover, depending on expected duration, I'd suggest comparing a reverse mortgage with a bigger traditional mortgage, using the excess of the latter to make the mortgage payments.

Don: I'm not convinced that borrowing more money to make your mortgage payments is a good long-term strategy if I understand your comment.

I contributed to a report that looked at the history and potential future of reverse mortgages a couple of years ago (see http://www.aarp.org/research/ppi/econ-sec/Other/articles/2007_22_revmortgage.html if you are interested in this topic). We certainly saw enormous percentage growth in the volume of such loans between FY 2000 and 2006 – though the growth was from a very low base and has largely plateaued in the most recent three years. Interest rate margins have sharply increased in the past year as Fannie Mae, which has been essentially the sole purchaser of such loans, has gone through the financial wringer. Non-federally insured loans have essentially disappeared for much the same reason. To add to the woes, FHA has just reduced the amounts that borrowers can borrow by 10% after CBO determined that future appreciation assumptions in the FHA insurance model were no longer viable – thus making a very expensive product effectively even more costly.

The key to future growth will be 1) getting down the costs through more competitive pricing and 2) introducing product innovations, especially a low cost loan for those who want to borrow relatively small amounts of money. Currently, homeowners must pay FHA an upfront mortgage insurance premium of 2% of the home's value irrespective of how much they borrow, which is a major part of the high cost of these loans. FHA has been looking into a "lite" product that would reduce these upfront costs for borrowers who agree to lower loan limits – which would make these loans somewhat more competitive with home equity loans and lines of credit.

Chuck: Reverse mortgages are innovative products and as other panelists have said, have benefits which could be enhanced if they had lower costs, were more standardized and were more transparent. The FHA should play a large role in making these a more attractive opportunity, including the imposition and enforcement of a provision about tough penalties if they are sold using fraudulent sales practices.

Sheila: I do think reverse mortgages provide an important option, but seniors must be carefully advised on whether and when to use them. The cost can be as much as 10% of a home's value. In 2008, over 112,000 reverse mortgages were issued, compared with about 100,000 in 2007. We don't yet have data on reverse mortgages issued in 2009. Anecdotal reports seem to indicate increasing popularity. Since the FHA issues over 90 percent of these mortgages, they should take a more active role in reducing costs as Chuck suggests. We should have better data that monitor these mortgages, including costs relative to value, etc. Better data will inform retirees, policymakers and help to enforce honesty in these products.

5. WHAT IS THE IMPACT OF FRAUD AND IMPROPER LOANS ON RETIREES?

Zenaida: Research shows that aging is closely associated with a decline in cognitive ability and financial acumen. Retirees are therefore quite vulnerable. Improper loans backed by their home equity can expose retirees to the risk of the loss of their home. Other times, their accumulated life's savings can also be prey to financial fraud. Retirees need protection against schemers whose aim is to divest them of their home and/or lifetime savings without regard for anyone's welfare. Any losses incurred during retirement from a market downturn are hard to swallow, but there remains hope that they can be recovered. Any losses from fraud may be gone forever, even with the added costs of litigation.

Steve C: Yes. And with the Internet, and home equity and more retirees being identified as a/the prime source of wealth, this can only be expected to increase. It doesn't necessarily need to be fraud, per se. Aggressive tactics for use of funds for other purposes are already rampant, e.g. with salespeople being signed up as commissioned "loan officers" for reverse mortgages, and who then pitch using the freed up assets for other sales.

Don: Older homeowners have been subject to some of the worst of the abuses by lenders in recent years – in large part because they often have substantial home equity but low incomes. Too many have been steered into loans they really couldn't afford – and when they couldn't afford the payments, the lenders would churn the loans and make repeated fees on the refinancings. The result has been a downward spiral of equity stripping until the homeowner defaults and loses her home.

With respect to reverse mortgages, the major problems are of two types. The first relates to the issue of cross-selling products – of the sort that Steve documented. Any time you make large sums of money potentially available, there is no shortage of people lining up to sell something. In this case, some of the worst examples relate to sales of high cost, low quality annuities. Since reverse mortgages can be structured as monthly payments for those who want the benefits of an immediate annuity, there is no reason – and a lot of cost – to purchasing an annuity. Worse are deferred and variable rate annuities that are essentially investment schemes that are entirely inappropriate to be paid for with a high cost loan. The same can be said for other types of investments, insurance products (such as long-term care insurance), and home repair scams.

Less of a scam, but nonetheless troubling, is the marketing of reverse mortgages for short-term lifestyle or luxury purposes. When you look at the upfront fees involved, the effective costs of that dream vacation or that new boat can be astronomical – even in the short-term. But the compounding of interest works against you with these loans – so the long-term consequences of taking out such loans early in retirement for such purposes can be even worse. Recent HUD data shows that RM borrowers are becoming younger and younger – and that those who use reverse mortgages early in retirement typically retire their loans after 6 or 7 years. Such borrowers have an average of about 12 years of life expectancy but may have exhausted a considerable amount of their home equity and not have it for emergencies later in life.

Chuck: Since home ownership increases directly with age, it is understandable that older Americans were the largest targets of fraud. This is not surprising since fraud was the main engine behind the sale of exotic mortgages which involved thousands of people in the real estate industry. What is most surprising is that not many people have been prosecuted for acting fraudulently in their professional capacities at both the state and federal levels. This includes the preparation of fraudulent mortgage and bank loan documents which should have attracted the attention of state and national bank regulators. To prevent fraud, exotic mortgages should be explained in plain English in a standard format with clear payment and penalty provisions. State mortgage and bank regulators should be encouraged to prosecute fraudsters.

Joe: A broader issue than fraud is the general lack of good quality, unbiased, fairly priced financial advice for retirees. Unfortunately, the majority of people in the "financial advice" business are more focused on making money than on helping people.

Sheila: There is a recent AARP study on this topic.

6. BASED ON THE RECENT EVENTS, WHAT ARE THE MOST IMPORTANT IMPLICATIONS FOR POLICYMAKERS, PRACTITIONERS, AND RELATED FINANCIAL PROFESSIONALS? ANY OTHER IMPORTANT ISSUES NOT COVERED BY THESE QUESTIONS?

Zenaida: Housing is a major asset and resource for retirees in particular. The recent housing bubble and ensuing instability in the housing market have affected retirees the hardest, especially when combined with financial losses sustained from the securities and banking markets. Policy changes are needed to promote responsible and ethical lending practices, to strengthen credentialing and financial controls, to better educate and protect retirees against fraud vis-à-vis proper product disclosures. Retirees already seek guidance in how best to manage their resources in retirement. They also need to feel secure that they will not lose their lodging and livelihood in their retirement due to forces out of their control.

Steve C: Agree, but this is a tough one. Regulation almost by definition is doomed to weakness, especially in this area. I just went through custodianship for my mother-in-law, and it was not pretty. Regulatory oversight even in this directed area was very expensive and too busy to really do a good job. And short of intense supervision, I'm afraid the cost of regulation and disclosure just won't be able to do it.

Don: Regulation is certainly needed to eliminate some of the most egregious cases of fraud and cross-selling of financial products that are inappropriate for older homeowners. Education is certainly needed – not just to guard against fraud, but to give older homeowners more financial literacy about how to manage their home equity over a lifetime just as you would other financial assets.

Chuck: Regulation is one aspect, but that will be very politically contentious. As we have seen in the past, there have been major problems with financial self-regulation and regulatory capture which did almost nothing to prevent the abuses which are to blame for the current financial meltdown.

But the larger question remains about how America, as a society, wants to treat retirees. This is a broader question which includes health care costs, (the largest single source of personal bankruptcy), job stability, employer obligations to workers, job mobility, the net results of active portfolio management, and the strength of fiduciary responsibilities between brokers and their investor clients. For instance, in the financial services business there is a move to make brokers adopt the same fiduciary standards as Registered Investment Advisers (RIAs) which would make it mandatory to disclose conflicts of interest. These conflicts are currently an inherent part of the mutual fund industry's sales process and result in shareholders being sold mutual funds which may not be optimal for their goals. This is related to revenue sharing and the use of 12b-1 fees which have an impact on a shareholder's total fund return, as well as how an investment is selected in the first place.

This is also an appropriate time to re-visit the role of pensions and examine why they have become an endangered species in the investment world. Were they too expensive to administer? Did ERISA mandate onerous demands? Did the fiduciary standards prove incompatible with practices by the fund managers? Were pensions eliminated to curtail the financial power of organized labor? All of these questions should be answered since many studies have shown that people prefer pensions, which would also re-shape employer-employee relations. This also should generate more new low-cost annuitization products which could be offered by social or fraternal organizations, such as AARP, unions, or national religious groups. Clearly, the nation is re-examining some long-held beliefs about retirement and whether it is possible, even for the most prosperous nation in the history of the world.

Anna: We need to think about to what extent public policy has driven and facilitated people putting most of their assets into housing and whether the tax and policy structure has any unintended consequences. I recommend the paper by Tom Herzog to help us understand how policy has gotten us to where we are today.

Building on CE's comments, I would like to encourage us to think longer term as we focus on the role of housing in retirement.

Joe: Robert Shiller wrote a book a few years ago, "The New Financial Order," in which he makes the case for new products to protect people from many of the kinds of risks that can't be insured against today. Some of his ideas seemed impractical to me, but I do think it makes sense to apply our creative energies to possible new financial products that might be used to insure housing values and enhance the liquidity of housing wealth.

Sheila: Home equity must be considered when assessing the retirement preparedness of older Americans. Ownership usually at least reduces housing costs in retirement (assuming home values turn around soon), and those without mortgages need less income to finance retirement. (The National Academy of Sciences recommended taking home ownership into account when measuring poverty and steps are being taken to implement this recommendation.) Home equity must also be considered when measuring assets to form a complete picture of retirement income security. Congress must consider the reverse mortgage market, including costs and liabilities. Reverse mortgage proceeds provide a tax free monthly income, is this fair? AMR's note about whether policy favors housing over other types of retirement savings is very important.

Zenaida: I agree that home equity needs to be considered when looking at the total retirement picture. However, as I mentioned earlier, many think less about preserving home equity and tapping it only for extreme emergency or as a last resort, than regarding housing as financial wealth that can be spent or lost without view to securing one's basic shelter.

That said, please note that any of the views expressed are my own and not those of my employer or any other governmental agency.