How Housing Wealth Affects Retirement Planning

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Comments on Epstein

This paper summarizes various studies and data sources on trends in homeownership, mortgage debt, and house values to highlight the increasing role that housing wealth plays in overall household wealth. The author then poses a series of questions to help financial professionals assess the degree to which their clients' retirement plans have been jeopardized by the collapse of the housing market. While I agree with most of the author's advice, I have two additional suggestions for how financial professionals can work with clients to readjust their retirement strategies.

The first suggestion is to encourage clients to put themselves on a path to repay their mortgages before retirement. Owning a home free and clear ensures a place to live out retirement, as well as lower retirement living expenses. Yet according to the American Housing Survey, the share of homeowners ages 65 and older who had no mortgages declined from 82 percent in 1993 to only 68 percent in 2007 (U.S. Census Bureau 1995, table 3-15; U.S. Census Bureau 2008, table 3-15). Although historically, most retirees have not used housing wealth to support their consumption (Venti and Wise 2004), and only 6 percent of homeowners age 50 to 65 plan on doing so (Munnell, Soto, and Aubry 2007), not having mortgage debt may increase retirees' opportunities to tap into their housing equity should they need it to finance retirement or to increase their standard of living. A study in this monograph by Feinschreiber and Laiosa finds that about 15 percent of retired homeowners would not be able to extract additional equity from their homes because of outstanding loans.

The second suggestion is to discourage clients from focusing too heavily on housing wealth in their retirement savings plans. After 14 years of increasing home values, the recent housing market crash reminds us that housing wealth is not guaranteed. Between its peak mid-2006 and early 2009, the housing market fell by almost a third according to the S&P/Case-Shiller Home Price Index.[1] Without a doubt, financial markets also involve a significant degree of uncertainty. Between its peak in October 2007 and April 2009, the S&P 500 lost about 44 percent of its value.[2] However, the housing market may be more important than the financial market. Not only because recovering from a housing market decline is likely to take many more years than recovering from a stock market collapse, as the author points out. But also because many more people own homes than stocks, housing has much higher transactions costs than financial investments, and because people can not divest themselves of housing as easily as they can of stocks. All of these factors make individuals particularly susceptible to downturns in the housing market.

[1] The S&P/Case-Shiller U.S. National Home Price Index declined from 189.93 in the second quarter of 2006 to 128.81 in the first quarter of 2009 (http://www2.standardandpoors.com/spf/pdf/index/csnational_value_052619.xls).

[2] The S&P 500 Index Adjusted Close declined from 1565.15 on October 9, 2007 to 872.81 on April 30, 2009 (http://ichart.finance.yahoo.com/table.csv?s=%5EGSPC&a=00&b=3&c=1950&d=06&e=23&f=2009&g=d&ignore=.csv).

Since no one can predict how much housing prices will rise and fall, or how long it will take for housing prices to recover, financial professionals should encourage their clients not to count on their homes in retirement for anything other than a place to live. Except for the recent bubble, historical housing returns have been only slightly higher than inflation. Between 1975 and 1999, the Office of Federal Housing Enterprise Oversight (OFEO) House Price Index averaged a 5.5 percent annual increase[3] compared with a 4.9 percent annual rise in the consumer price index.[4] In contrast, the S&P 500 index averaged a 13.1 percent annual return over the same time period.[5] Instead, financial professionals should work with clients to determine how much savings they need beyond Social Security and pension benefits to maintain a comfortable standard of living in retirement and should recommend that at least a portion of those savings be invested in relatively safe assets. If clients can successfully attain their savings targets, they will not have to alter their retirement plans or expenses if another housing crunch occurs.

[3] Based on the annual percent change in the fourth quarter OFEO House Price Index averaged between 1975 and 1999 (http://www.fhfa.gov/webfiles/2351/1q09hpi_reg.csv).

[4] Based on the annual percent change in the CPI-U averaged between 1975 and 1999 (ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt).

[5] Based on the annual percent change in the S&P 500 Index Adjusted Close on the last day of December averaged between 1975 and 1999 (http://ichart.finance.yahoo.com/table.csv?s=%5EGSPC&a=00&b=3&c=1950&d=06&e=23&f=2009&g=d&ignore=.csv).

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