The Financial Well-Being of American Retirees

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Introduction

The Fidelity Investments Retiree Well-Being Study is a ground-breaking objective analytical study of the financial state of Americans in retirement. The goal of the Retiree Well-Being Study is to bring national attention to the financial status of Americans in their retirement years. The study examines four age groups of retirees and how well these individuals are meeting their financial needs. Moreover, the study examines how much of an effect real estate can have on meeting retirement expenses using various equity extracting strategies. The study is based on a survey of 1,026 retired American households, with retirees aged 57 to 85.[1]

[1] Survey conducted May 2007. Respondents were aged 57 to 85. Spouses may be younger than 57 or older than 85. Household age is determined by the oldest person in a household.

Part 1: Affording Retirement. Who's on Track to Meet Their Financial Needs

The national financial well-being score represents the proportion of total planned retirement expenses the median household is on track to afford. A value above 1.00 means retirees could potentially spend more than their current projected spending. A value below 1.00 means retirees could afford less than their current projected spending.

Overall, the median American retiree household is on track to afford 1.31 times their planned expenses assuming average market conditions and is on track to afford 1.20 times their planned expenses assuming poor market conditions. The level of spending retirees can afford in average market conditions is the *expected* affordable spending level. The level of spending retirees can afford in poor market conditions is the "safe" spending level and is the level that should be used to assess whether a household is likely to meet their spending needs. Thus, overall the median retiree household is in fairly good financial shape, even if an extended market downturn occurs. Nevertheless, there is much more of the story to tell and some retirees will fair much better or much worse than the median household. We divided retiree households into four groups by age[2] to examine how financial capacity varies with age. In comparison:

- Ages 65 and younger are on track to afford 1.19 times planned expenses assuming average market conditions and 1.06 times planned expenses assuming poor market conditions.
- Ages 66 to 70 are on track to afford 1.19 times planned expenses assuming average market conditions and 1.08 times planned expenses assuming poor market conditions.
- Ages 71 to 79 are on track to afford 1.40 times planned expenses assuming average market conditions and 1.27 times planned expenses assuming poor market conditions.
- Ages 80 and older are on track to afford 1.34 times planned expenses assuming average market conditions and 1.26 times planned expenses assuming poor market conditions.

TABLE 1
Financial Well-being Summary Statistics

[2] Household age was used to place the household in an age group.

Table 1	All Retirees (n = 1026)	Ages 65 and younger (n = 154)	Ages 66 - 70 (n = 181)	Ages 71 - 79 (n = 446)	Ages 80 and above (n = 245)
Median affordability of planned expenses - average market	1.31	1.19	1.19	1.40	1.34
Median affordability of planned expenses - poor market	1.20	1.06	1.08	1.27	1.26
Percent of households likely to have "Extra Assets" under **average** and **poor** market conditions. Can spend above 1.25 times planned expenses	54% / 46%	46% / 42%	47% / 34%	58% / 50%	56% / 51%
Percent of households likely to be "On Track" under **average** and **poor** market conditions. Can spend .95 to 1.25 times planned expenses	21% / 23%	23% / 21%	24% / 29%	19% / 22%	22% / 23%
Percent of households likely to have "Modest Risk" under **average** and **poor** market conditions. Can spend .70 to .95 times planned expenses	16% / 20%	19% / 21%	19% / 25%	15% / 18%	15% / 18%
Percent of households likely to have "High Risk" under **average** and **poor** market conditions. Can spend below .70 times of planned expenses	8% 10%	11% / 16%	10%/ 12%	7% / 9%	7% / 8%
Median total household retirement savings	$140,050	$124,686	$112,500	$169,000	$126,000
Allocation to Stocks / Stock Mutual Funds	40%	40%	41%	41%	38%
Percent with pensions (self or spouse)	82%	86%	82%	83%	77%
Median household annual pension amount (of households with pensions)	$20,520	$28,920	$24,036	$18,000	$15,564
Percent with Social Security	96%	89%	95%	97%	98%
Median household annual Social Security amount (of households with Social Security)	$17,088	$17,664	$17,478	$16,944	$16,602
Percent with income annuities	24%	13%	15%	28%	29%
Median household annual annuity income amount (of households with annuities)*	$6,000	$19,194	$4,632	$6,000	$6,300
Percent with employment income	9%	14%	11%	10%	2%
Median household annual employment income amount (of households with employment income)	$8,388	$9,624	$7,194	$8,724	$9,000
Median household age	73	62	67	74	81

* Annuity income may include guaranteed minimum withdrawal benefits (GMWBs).

Note: incomes include both current and expected incomes. Some incomes continue to the end of a person's life (or to the last surviving spouse) while other incomes, e.g. employment income, generally stop a number of years after retirement.

Retiree households are grouped in two ways: by age and by how much of their planned expenses they are likely to afford. There are four categories of financial well-being, ranging from having extra assets to being at high risk of not being able to afford one's living expenses. If an extended period of poor market returns (90 percent confidence level of returns) were to occur, fully 30 percent of American retiree households would be at risk—20 percent with moderate risk and 10 percent with high risk. Even under average market conditions, fully 24 percent of retiree households surveyed are at risk. Of course, many retirees are doing very well too—54 percent are expected to have "extra assets" (able to afford at least 1.25 times planned expenses).

In examining the results by age, we see that generally older households have higher expense affordability ratios—meaning that relative to their planned expenses older households are better off than younger households.

Marginal Contribution of Income Sources to Financial Well-Being

Retirees draw income from a number of sources: Social Security, pensions, personal savings, etc. The table below shows the marginal contribution to financial well-being of each income source. The marginal contribution to well-being is measured as the drop in financial well-being that would occur if a particular income source were removed. For each income source the marginal contribution of income is calculated among households with the applicable income source.

Not surprisingly the top income source is Social Security, followed closely by pensions. For retirees overall, Social Security income can support 49 percent of spending needs and pensions can support 43 percent of spending needs. For the youngest group, pensions actually provide more of the spending need than Social Security, which is counter to expectations. Personal savings has the next largest effect (although much smaller than pensions) and annuities are significant, too. Given the recent decline in pension plans and widespread participation in defined-contribution plans by today's workers, it is certain pensions and personal savings will eventually switch places in order of importance. What may be of some surprise is how little income comes from employment income in retirement.

TABLE 2
Marginal Contribution of Income Sources to Funding Retirement

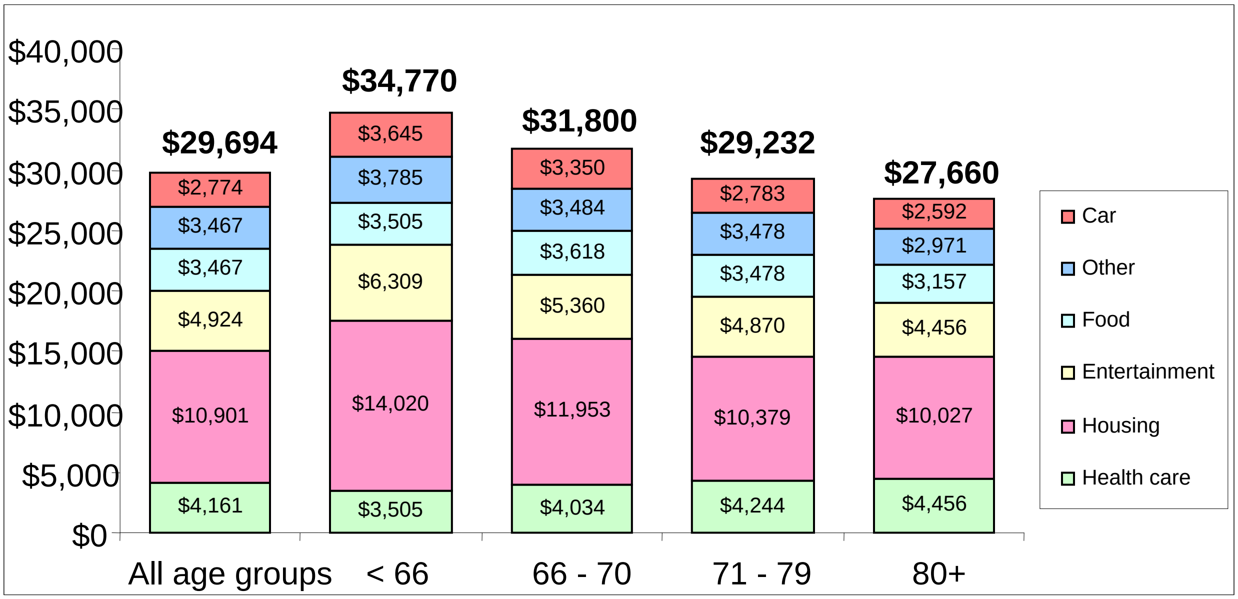
	All Retirees (n = 1026)	Ages 65 and younger (n = 154)	Ages 66 - 70 (n = 181)	Ages 71 - 79 (n = 446)	Ages 80 and above (n = 245)
Median contribution from pensions (of households with pensions)	0.43	0.54	0.40	0.41	0.40
Median contribution from Social Security (of households with Social Security)	0.49	0.39	0.49	0.49	0.51
Median contribution from annuities (of households with annuities)	0.13	0.24	0.11	0.14	0.11
Median contribution from personal savings	0.28	0.20	0.21	0.32	0.35
Median contribution from employment income (of households with employment income)	0.04	0.04	0.03	0.04	0.05

A value of 1.0 would mean 100 percent of spending needs could be met by the income source. All marginal contributions of income sources are calculated using average market conditions.

Retiree's Expenses

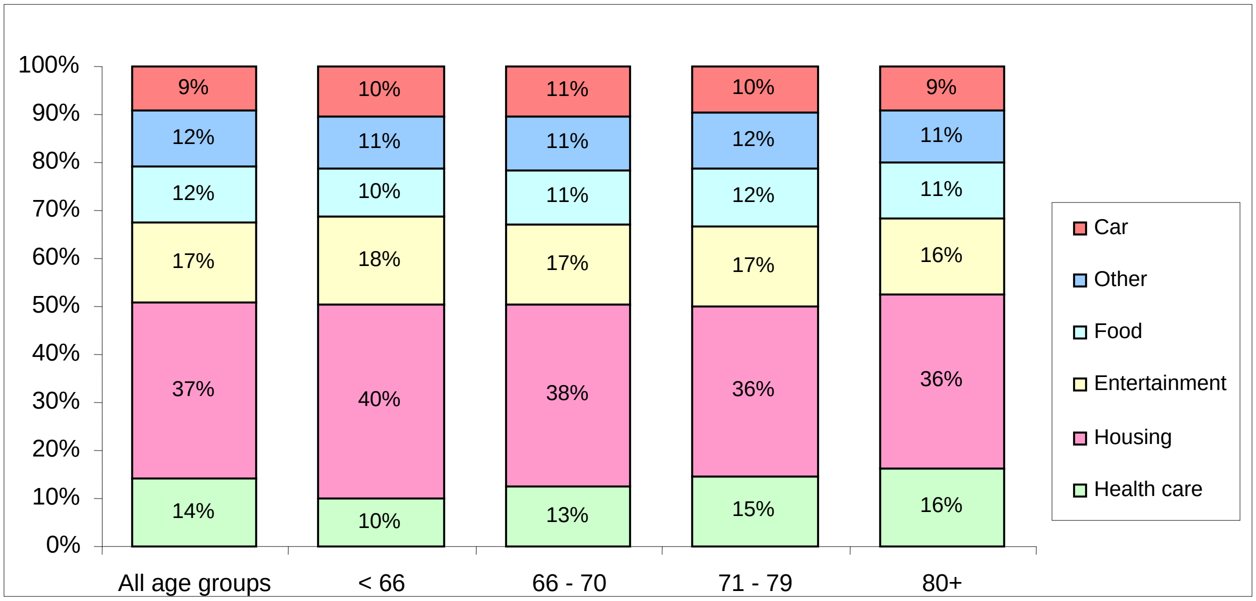
The median total annual expense of surveyed households is $29,694, excluding income taxes. As households age they tend to spend less, despite relative increases in healthcare expenses—the youngest retirees spend $34,770, the next youngest spend $31,800, the third group spends $29,232, and the oldest spend $27,660. The lower spending with age is naturally one of the explanations why older households tend to have higher financial well-being scores.

TABLE 3
Median Current Household Expenses in Dollars



As households age, the composition of expenses changes as well as the absolute amounts. The chart below shows the composition of expenses for the survey respondents overall and then for each age group. Expenses are grouped into six broad types: healthcare (including long-term care), housing, entertainment (including luxuries), food, all other expenses, and automobile (car) expenses. As households age, absolute dollar expenses for healthcare increase and the relative portion of healthcare expenses increases by almost 60 percent. Entertainment and housing expenses decrease both in absolute dollar terms and as a relative percentage of total household expenses. Food and "all other expenses" decline in absolute terms but remain about the same as a percentage of total expenses.

TABLE 4
Median Current Household Expenses as a Percent of Total



Financial well-being scores are calculated using projected household expenses based on reported current expenses. Food, car, entertainment, and ‘other expenses” are projected to increase at the general inflation rate of 2.3 percent (CPI, May 2007). Housing expenses are projected to grow at 1.5 percent above inflation and healthcare expenses are projected to grow at 3 percent above inflation.

Households with a Financial Advisor

Households that regularly utilize a financial advisor, broker or other financial professional to help with investment decisions have significantly higher index values than those that don’t. Median index values for households with an advisor, etc., are 1.46 vs. 1.21 for those without such professional help. Four-hundred fifty households have a financial professional to help them (meaning the respondents said they are heavily reliant or somewhat reliant on an adviser, etc.) while 576 do not (meaning the respondents said they are not very reliant or not at all reliant on an adviser, etc.). The higher index values of households with an advisor, etc. are evident in the sample as a whole and in each of the four age groups.

There are several potential reasons why index values would be higher for households with an advisor, etc. One possibility is that the advisor, etc. is providing superior investment advice and guidance, resulting in a higher accumulation and retention of wealth. Another possibility is that advisors have helped craft a more reasonable and/or secure financial plan than households would on their own—meaning in part that their financial well-being scores are higher because their planned spending levels are reduced from what they would have otherwise been. Still, another possibility is that more affluent households (who tend to have higher scores) seek out professional advice, and have the means to pay for it. The results we see may in fact be a combination of all these factors.

Comparing and Contrasting Expectations with Working Households

In May 2007, we surveyed working Americans on their expectations for retirement. We now compare those expectations with what retirees are currently doing. While worker expectations for some areas are consistent with what retirees are currently doing, most areas are in stark contrast. For example, 24 percent of working households expect to sell their home to help fund retirement (21 percent from sale of home and 3 percent from a reverse mortgage) which is twice the percentage of retirees who have used home equity or plan to use home equity. When it comes to working during retirement, expectations couldn't be different from what current retirees are doing. Sixty-three percent of working households expect that at least one spouse will work part-time in retirement. Even among the two younger retiree age groups, 65 and under and 66 to 70, only 14 percent and 11 percent are working respectively. Of course, some of the difference can be explained by the difference in generations—expectations, needs, desire to work. At least one major difference can be explained by the shift in retirement funding from defined benefit sources to defined contribution sources—the reliance on personal savings. Only 10 percent to 12 percent of retirees aged 70 and under (the two youngest groups) rely most on personal savings, whereas 39 percent of current workers expect to rely primarily on personal savings in retirement (48 percent for generation Xers).

TABLE 5
Worker Expectations vs. Retiree Expectations

	Current Worker Expectations	Current Retirees 65 and under	Current Retirees 66 to 70
Working at least part-time in retirement (self or spouse)	63%	14%	11%
Inheritance for self or spouse	23%	15%	7%
Sale of current home / use home equity*	24%	12%	9%
Reliance on personal savings as No. 1 income source	39% (48% for GenXers)	10%	12%

* For current workers use of home equity (without selling the home) includes reverse mortgages only. For retirees it includes Home Equity Line of Credit (HELOCs) as well.

Note: Retirees may have already received an inheritance. These values are future expectations only.

Part 2: The Potential Role of Real Estate in Retirement

The vast majority of retiree households are home owners (92 percent). As a group, homeowners are better prepared to meet retirement spending needs than non-homeowners. For each age group, homeowners have significantly higher financial well-being scores—even though only a few (9 percent) have used home equity or plan to use home equity. *If* these homeowners were to use home equity, their financial well-being scores would be even higher.

TABLE 6
Homeowners vs. Non-Homeowners

	All Retirees	Ages 65 and younger	Ages 66 - 70	Ages 71 - 79	Ages 80 and above
Number of homeowners	947	142	174	410	221
Median financial well-being index value - average market	1.33	1.24	1.23	1.42	1.38
Median financial well-being index value - poor market	1.21	1.13	1.08	1.27	1.30
Number of non-homeowners	79	12	7	36	24
Median financial well-being index value - average market	0.97	0.93	0.87	1.10	1.00
Median financial well-being index value - poor market	0.95	0.88	0.84	1.08	0.99

Most respondents (66 percent) indicated they have no intention of using the equity in their home to pay for retirement expenses and another 24 percent are unsure. Seven percent said they already tapped the equity in their home and 2 percent said they plan to use home equity in the future. It is likely that some portion of retirees who currently indicate no intention to use their homes will end up doing so either out of financial need or a desire to increase their standard of living. In any case, we must necessarily start with the question—how much of an effect can using real estate have?

We examined the potential effect on a household's financial well-being score of the following real estate actions:

- Using a home equity line of credit (HELOC)
- Using a reverse mortgage
- Downsizing and buying a 25 percent less expensive home
- Downsizing and renting a 25 percent less expensive home
- Downsizing and buying a 25 percent less expensive home, then using a reverse mortgage

In each case the effect was measured by comparing the index value with no use of real estate to the index value with each type of use. The potential value of using real estate was measured in both an average market and in an extended down market. In all cases the real estate action (selling, HELOC, etc.) hypothetically occurs immediately and the proceeds are spread out (consumed) over the entire length of retirement. Of the 1,026 households surveyed, 947 own their home (92 percent). We analyzed the potential real estate effect using the 878 households who both own a home and have not already utilized the equity in their home.

TABLE 7
Potential Retirement Funding from Home Equity

	All Retirees (n = 878)	Ages 65 and younger (n = 128)	Ages 66 - 70 (n = 164)	Ages 71 - 79 (n = 380)	Ages 80 and above (n = 206)
Baseline (no use of real estate) - Average market	1.37	1.26	1.23	1.44	1.40
Baseline (no use of real estate) - Poor Market	1.24	1.18	1.09	1.30	1.31
HELOC - Average Market	0.15	0.06	0.08	0.17	0.26
HELOC - Poor Market	0.15	0.06	0.08	0.17	0.26
Reverse mortgage - Average Market	0.13	0.05	0.08	0.14	0.23
Reverse mortgage - Poor Market	0.11	0.04	0.06	0.11	0.19
Downsizing and buying a 25 percent less expensive home - Average Market	0.12	0.10	0.10	0.12	0.15
Downsizing and buying a 25 percent less expensive home - Poor Market	0.10	0.08	0.08	0.10	0.12
Downsizing and renting a 25 percent less expensive home - Average Market	0.00	-0.08	-0.02	0.01	0.07
Downsizing and renting a 25 percent less expensive home - Poor Market	-0.03	-0.09	-0.04	-0.02	0.03
Downsizing, buying and using reverse mortgage - Average Market	0.20	0.12	0.14	0.23	0.32
Downsizing, buying and using reverse mortgage - Poor Market	0.17	0.09	0.12	0.18	0.27

Note: for the cost of renting a house price to rent ratio of 17.1 was used.

Overall Potential from Real Estate

In Part 1, we presented four levels of financial well-being and reported the percentages of retirees that fell into each level. We now compare those results with the potential well-being levels assuming all 878 homeowners from above tap their home equity in the most effective manner. The potential net effect is a large "up shifting" of well-being levels. Using the criteria of being able to withstand a poor market (90 percent worst confidence level of returns), the percentage of households with extra assets goes to 57 percent from 46 percent and the percentage of the total households surveyed (1,026) at risk goes to 21 percent (14 percent at moderate risk and 7 percent at high risk) from 30 percent. Thus, for current retirees, financial well-being can be significantly improved by using real estate equity. We must be careful though to not set unrealistic expectations for the next generations (current workers). Already, about 15 percent of retired homeowners could not take additional equity[3] out of their homes because of outstanding loans going into retirement. Since use of home equity before retirement has increased in recent years, it is likely that current workers will have less of an opportunity for a financial boost from home equity when they retire.

[3] About 15 percent of retiree households could not take out equity without paying it back—that is they could not take out equity and let the total loan balances grow to the end of retirement.

TABLE 8
Potential Financial Well-Being Groups Using Home Equity

	Using Home Equity Average Market	Current Projections Average Market	Using Home Equity Poor Market	Current Projections Poor Market
% of households likely to have "Extra Assets" Affordability above 125% of planned expenses	63%	54%	57%	46%
% of households likely to be "On Track" Affordability 95% to 125% of planned expenses	20%	21%	21%	23%
% of households likely to have "Modest Risk" Affordability 70% to 95% of planned expenses	12%	16%	14%	20%
% of households likely to have "High Risk" Affordability below 70% of planned expenses	5%	8%	7%	10%

Part 3: Hypothesis Testing

The survey results support a number of hypothesis tests about the financial well-being of American retirees. Many hypotheses were very strongly supported while some had little supporting evidence. In general, we use a criteria of 1 percent probability as meaning "highly significant" support for the hypothesis. The probability value is the probability that the results we are seeing have occurred just by chance. The lower the probability the greater the support for the hypothesis. All tests were constructed before the results were compiled to protect against any inadvertent data-mining.

Financial Well-Being by Age Category

The hypothesis is that well-being scores vary by age category. We tested the difference in the median index values among the four age groups. We found that the median index values significantly differ by age category. As is shown in the summary statistics table, financial well-being scores are higher in the older two age groups than in the younger two age groups. To be sure the results are not due to our definition of household age, we re-did the test using average age of the spouse/partners as the household age. The results were even stronger.

Financial Well-Being by Years in Retirement

The hypothesis is that well-being scores vary by number of years in retirement. The categories are: two years or less, three- to five-years, six- to nine-years, 10- to 19-years, and 20 or more years in retirement. Years in retirement for a household were calculated twice, first as the maximum number of years in retirement and then as the average number of years in retirement. We tested the difference in the median scores values among the five groups. We found the difference in median scores by years in retirement category to be highly significant (<1 percent probability) when average years in retirement was used. With maximum years in retirement the probability is about 3 percent, which is still unlikely to be from chance alone.

Financial Well-Being by Geographic Region

The hypothesis is that well-being scores vary by geographic region. This hypothesis is driven by the fact that there are substantial cost of living differences across the United States. The states were grouped into five regions: the Midwest, Northeast, Southeast, Southwest and West. We tested the difference in the median well-being scores among the five regions. The tests showed absolutely no evidence of differences in well-being scores across regions.

Financial Well-Being by Planning Preparation

The hypothesis is that households who have a formal retirement income plan have higher well-being scores than those that don't. This hypothesis is driven by the observation that when individuals create a formal financial plan they often make adjustments in spending, asset allocation, investment products, etc. to improve their chances of funding retirement. Of course, even if there is a significant difference between the two groups, it is still not *proof* that the difference is caused by planning. Households that are more affluent (higher assets, higher incomes) and have higher scores may be more likely to have a formal financial plan—that is the presence of a financial plan may follow financial well-being. We tested the difference in the median well-being scores under average market conditions between the planners (1.43) and non-planners (1.28). The tests showed that the difference is significant, though not quite at the "highly significant" threshold of 1 percent—the probability was 1.3 percent. So, the indication is that planning does add value, but further investigation is warranted.

Financial Well-Being by Marital Status

The hypothesis is that financial well-being varies across different marital statuses. If the adage that "two can live as cheaply as one" is really true then married couples should have higher well-being scores than non-married households. Households are grouped into four categories by marital status: single and never married, married or living with a partner, divorced or separated, and widowed. We tested the difference in the median scores under average market conditions among the four groups. Single households had the highest values (1.40) and divorced households had the lowest (1.12). Married and widowed households each had index scores of (1.33). Statistically, there is some support for the hypothesis (4 percent probability of occurring just by chance) but it is not "highly significant." Furthermore, even though they may be different, the single households have higher index values than married households, rather than lower as predicted.

Financial Well-Being by Respondent Retirement Age

The hypothesis is that financial well-being varies across households based on how old the respondent was at retirement. In general, individuals who retire later have more time to save for retirement and less time in retirement that needs to be funded. On the other hand, it may be the individuals who have not saved well who are forced to work longer. Households are grouped into five categories by respondent retirement age: under 55, 55 to 59, 60 to 64, 64 to 69, and 70 and over. We tested the difference in the median well-being scores among the five retirement age groups. The tests showed absolutely no evidence of differences in well-being scores across age-at-retirement groups.

Financial Well-Being by Self-Reported Readiness for Retiring

The hypothesis is that households who reported being more ready to retire have higher levels of well-being than those who reported being less ready to retire. For each of the reasons for retiring, respondents were asked how big a factor the reason played in the decision to retire. There were three possible responses: not a factor, a minor factor, a major factor. The responses were all assigned numerical values. The sum of the values for each reason is a household's "ready to retire score." We tested the difference in the median financial well-being scores among three "ready to retire" score ranges. The tests showed absolutely no evidence of differences in well-being scores across self-reported "ready to retire" scores.

Financial Well-Being by Health-Related Reason for Retiring

The hypothesis is that households who retired due to health reasons have a lower financial well-being than those who did not. Respondents were asked whether poor/deteriorating health was a factor in retiring. Households are grouped into three categories based on how much health was a factor: not a factor, a minor factor, a major factor. We tested the difference in the median well-being scores among the three groups. We found the difference in median scores by health to be highly significant. Respondents who indicated health was a major factor had much lower median well-being scores of 1.10, vs. 1.37 for those who said health was not a factor, and 1.27 for those who said health was a minor factor.

Conclusions

The median retiree household is in fairly good financial shape with objective financial well-being scores of 1.31 assuming an average market and 1.20 assuming an extended poor market. So the median retiree household actually has the capacity to spend 20 percent more than they currently are (using the conservative 1.20 extended down market score). Results vary significantly by age, with older retirees generally doing better than younger retirees. The situation is far from rosy however—fully 30 percent of retiree households are either at moderate risk or high risk of running out of money before the end of retirement. For current retirees one of the silver linings is that real estate equity could be used to boost spending if needed. While the majority of retirees do not currently plan to use home equity it is likely this percentage will increase either because of financial hardship or a realization of the ability to safely improve lifestyle without the risk of losing one's home—e.g., using a reverse mortgage.

About the Study of the Financial Well-Being of American Retirees

- Data for the study was collected through a national online and phone survey of more than 1,000 Americans who are retired; aged 57 years to 85 years; with household incomes of $20,000 a year or more; married/partnered with individuals who are also retired.
- Well-being score calculations rely on a proprietary asset-liability modeling engine, which generates the proportion of planned expenses that each individual American household surveyed is likely to afford. The overall score represents the median (or midpoint) of the approximately 1,000 individual household scores produced. Results are not weighted for demographic trends.
- Surveys for the 2008 Index were completed for Fidelity Investments by Burke Inc., Cincinnati, Ohio, between July and September 2007.

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