Housing Wealth Effects, Boomer Refinancing, Housing Debt, Retirement Savings Adequacy—1989–2007

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Comments on Gist, Figueiredo and Verma

This paper digs deeply into the data provided by the triennial Federal Reserve Survey of Consumer Finances in order to provide a thorough analysis "of the effects that the recent housing bubble had on the household financial behavior of different birth cohorts and the consequences of those behavioral choices for boomers' projected retirement security." The paper is based on survey information up through 2007, so what it shows is the impact of the building of the bubble on behavior. Analysis of the impact of the bursting of the bubble could be a valuable follow-on study when the 2010 survey becomes available. The authors' presentation is very much fact-based—they present a wealth of interesting findings—and they leave it to others who may want to speculate on the implications of the findings.

What was particularly refreshing about this paper is how it shatters some of the media-myths about consumer behavior. For example, the popular press in the past few years has been filled with stories about how consumers pulled money out of increasing home equity values, and then squandered the funds on frivolous consumption. However, the survey data (see Figure 19) tells a very different story. For all age-groups combined, about 50 percent of all dollars extracted from home equity were used for home purchase or repair. Another 25 percent went to debt consolidation, and about 15 percent went to investment. That left less than 10 percent that went to consumption. There's a technical argument that some of the debt consolidation could be counted as consumption, but even if we count half of debt consolidation as consumption, the consumption percentage still comes only to around 20 percent of dollars extracted. My personal opinion is that seeing what actually happened to equity extractions, gives me a more hopeful view of recovery from the financial crisis than if most of the dollars had been "thrown away" on consumption.

The paper examines four birth cohorts: pre-boomers (born before 1946), early boomers (1946-1955), late boomers (1956-1964), and post boomers (after 1964). The paper utilizes the seven triennial surveys from 1989 to 2007 to trace the housing-related activities of the four cohorts through time. The authors point out a number of interesting trends and relationships for each of the four groups. Here, I'll focus on a few findings re: the pre-boomer group. The majority of pre-boomers carry zero housing debt, so for this group, the median housing debt is zero (Figure 10). The other groups carry median housing debt ranging from approximately $60,000 to $130,000 with the youngest cohorts carrying the most debt. The last half of the paper focuses on those mortgage holders who refinanced, and of the refinancers, those who took cash out of home equity. When examining these findings, it's important to keep in mind that, for the pre-boomers, this refinancing analysis is focusing on the minority portion of pre-boomers who have mortgages. This subgroup of the pre-boomers is likely different in a number of ways compared to pre-boomers as a whole. My own assessment, based on the evidence presented in this paper, is that the pre-boomers are generally in better shape financially than the younger groups and the declines we have experienced in house values and stock prices will have further exacerbated the differences. This tentative conclusion that the younger groups are in worse shape preparing for retirement is corroborated by other evidence, for example, the National Retirement Risk Index published by the Center for Retirement Research at Boston College.

The authors also utilized combined 2004 and 2007 data and attempted to model the factors leading to decision to refinance and to cash-out. The perhaps surprising result was that, of the 12 factors considered, the variable having the largest positive impact on both refinancing and taking cash out was whether the household had an adjustable rate mortgage (ARM). The authors expressed surprise that the ARMs had such a strong impact. My own view is that perhaps holding an ARM reflects back on differences in decision-maker characteristics going back to the original choosing of an ARM instead of a conventional fixed mortgage. Perhaps those who chose ARMs tended to be more sophisticated, active and aggressive in managing finances than those choosing conventional mortgages. Or perhaps they were just more stretched, could only afford an ARM when they purchased their home, and had more incentive to take advantage of mortgage rates that bottomed out over the 2003-2005 period. The general conclusion the authors reached was that for both the refinancing and cash-out models, “older cohorts with ARMs and high interest rates were more likely to both refinance and cash out, as were those with children, those getting a lower interest rate, and those willing to take financial risks.”

Toward the end of the paper, the authors provide some perspective on equity extractions during the housing boom and compare the impact on wealth with what happened to the housing market after 2007. Based on data through the 4th quarter 2008, the reduction in housing value since 3rd quarter 2007 was about 23 times the reduction in home equity due to consumption of home equity. If we continue to see the 2 percent-per-month declines we have seen so far in 2009, by mid-year the 23 times could become 35 times. This trend further supports the authors’ key conclusion that “the housing crash has done many times the damage to the housing share of net worth and retirement savings than households’ refinancing and extraction of equity.”

This discussion document highlights only a few of the conclusions from the paper. The authors made good use of the wealth of information contained in the Surveys of Consumer Finances in order to produce a very comprehensive paper on housing wealth effects with numerous findings well-supported by the statistical evidence. The paper and accompanying exhibits are worth careful study by anyone wanting to develop a better understanding of this subject area.