# Overview of Housing Wealth, Options, and Spending Issues in Retirement Monograph

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## Introduction

The recent bursting of the housing bubble left many Americans unprepared to deal with its consequences as it reverberated throughout the economy. With falling housing prices, foreclosures, tighter credit, and much of their resources invested in housing, many retirees and workers near retirement found themselves placed in a position of risk that they did not anticipate.

With these events in mind, the Society of Actuaries Committee on Post-Retirement Needs and Risks (CPRNR) issued a call for papers in the summer of 2008 seeking papers that explored housing wealth, options, and spending issues in retirement. For more than ten years, the CPRNR has sponsored research to enhance understanding of how the public perceives and is dealing with the post-retirement period. In undertaking this effort, it became increasingly clear to the CPRNR that housing is a very significant retirement asset and options related to choice and financing of housing are important considerations for retirement planning. As a result, the call for papers that was issued has led to the publication of this monograph, which contains papers received in response as well a relevant paper that appeared in a previously produced monograph. Also included in the monograph are discussions of selected groupings of papers by reviewers recruited to provide commentary on them.

The papers in this monograph provide varied perspectives on many housing and retirement issues of concern to policymakers, financial planners, and homeowners, among others. The papers addressed numerous questions, including the following:

- What is the role of housing wealth in financing retirement?
- What percentage of total spending in retirement do housing-related expenditures represent?
- What are the recent trends in the use of housing wealth?
- How effective are financial planning strategies of utilizing housing wealth to address retirement needs and risks such as health care and long-term care expenses?
- What is the nature and extent of the risk posed by adjustable rate mortgages and by predatory loan practices?
- What are the mechanics and prevalence of reverse mortgages and other similar products?
- What future product innovations might increase the appeal of reverse mortgages and other financial products linked to housing?

## Related Work of the Committee on Post-Retirement Needs and Risks

The prior work of the Committee on Post-Retirement Needs and Risks was also a strong motivator for the effort leading to this monograph. Among the observations from this prior work, it appeared that although housing wealth was extremely important to middle class Americans, it did not seem to represent a primary consideration as they engaged in retirement planning. In fact, many planning tools do not consider it explicitly, leaving a hole in advice that could be provided to middle income Americans. Consequently, this monograph can also be considered as part of a larger effort of the CPRNR to help bridge that gap.

Prior work from the CPRNR highlighting housing issues includes:

- The 2005 **Risks and Process of Retirement Survey** (http://www.soa.org/files/pdf/research-process-retire.pdf) explored how individuals view housing in retirement. The survey found that respondents had not considered, to a great extent, using housing assets or the approaches for doing so to support their retirement. These same issues are again being examined in the 2009 Risks and Process of Retirement Survey.

- The 2009 report entitled, **Segmenting the Middle Market: Retirement Risks and Solutions (**http://www.soa.org/research/pension/research-segmenting-market.aspx**)** describes the critical role that housing wealth plays for middle income Americans. The key findings of that study underscore the importance of the topics that appear in this monograph. The table below, which is excerpted from the study, provides financial profile data for middle income households. Observations from the data that reveal the critical nature of housing wealth to these Americans include:

  - Non-financial assets (mostly housing) are about 70% of total assets (defined as excluding the value of Social Security and defined benefit pensions)
  - Median financial assets are less than 1.5 times median income for middle mass (25% to 75%) of households
  - Median financial assets are more than 3 times median income for mass affluent married households

**Wealth of Middle Income Households – Age 55 to 64**

**Importance of Non-Financial Assets – Primarily Housing Wealth**
**Analysis Based on 2004 Survey of Consumer Finances**

| Household Type | Number of Households | Median Income | Est. Median Net Worth | Non-Financial Assets | Financial Assets | Non-Fin % |
|---|---|---|---|---|---|---|
| | **Middle Mass Household Segments (25% to 75% of all households)** | | | | | |
| **Married** | 5.2 million | $75,000 | $348,000 | $240,000 | $108,000 | 69% |
| **Single Female** | 2.5 million | $28,000 | $111,000 | $75,000 | $36,000 | 68% |
| **Single Male** | 1.4 million | $41,000 | $125,000 | $89,000 | $36,000 | 71% |
| | **Mass Affluent Household Segments (75% to 85% of all Households)** | | | | | |
| **Married** | 1.0 million | $132,000 | $1,300,000 | $884,000 | $416,000 | 68% |
| **Single Female** | .5 million | $58,000 | $415,000 | $299,000 | $116,000 | 72% |
| **Single Male** | .3 million | $79,000 | $465,000 | $349,000 | $116,000 | 75% |

Source: Society of Actuaries – Segmenting the Middle Market: Retirement Risks and Solutions, 2009.

- The 2003 study, Retirement Planning Software (http://www.soa.org/files/pdf/Retirement%20Planning%20Software.pdf), cosponsored by the Society of Actuaries with LIMRA and InFRE focused on how retirement planning software handles a range of risks, particularly post-retirement risks. In this study, a significant portion of the planning software tools evaluated did not consider housing wealth. In addition, the software tools that did consider housing wealth approached it from a wide range of methodology, revealing that there is no agreed upon standard for doing so. A 2009 follow-up study, cosponsored by the Society of Actuaries and the Actuarial Foundation, is nearly complete and appears to corroborate many of the earlier findings.

## Key Findings and Observations about Aspects of Housing in Retirement

The papers included in this monograph as well as related work by the Committee on Post-Retirement Needs and Risks highlight a number of findings and observations about aspects of housing in retirement. The key takeaways include:

**Wealth**

- As mentioned earlier, housing assets are an extremely important component of total wealth in both the United States and Canada, particularly for middle income households. Furthermore, home equity is greater than the invested financial assets of many older adults and it has been often converted to cash and used to finance other spending, sometimes leading to financially detrimental results and longer term problems.

- There was a rapid increase in overall mortgage debt in the 1980s and 1990s with homeowners carrying more debt and less equity later in life and into retirement.

- There are wide variations in housing values and costs including taxes by geographic area.

**Spending**

- Housing is a major part of spending and the largest item of spending for most retirees. Traditional ideas about what is affordable have been displaced in recent years by a “spend more and borrow more” philosophy. As well, the current tax structure may also drive individuals to over invest in housing.

- Many of today’s retirees get by on a combination of a paid for house, Social Security and some emergency funds.

- Adjustable rate mortgages may make budgeting difficult and cause financial problems because their structure tends to ratchet up monthly payments over time. Many borrowers do not have adequate income or savings to support these payments, but hoped that housing values would increase so that they could refinance to a mortgage with more favorable terms. Others do not understand how the loans work and are blindsided when payments increase.

**Options and Types of Housing**

- Specialized housing is linked to various levels of service as well as different levels of care. Options include independent living, assisted living and nursing home care.

- The location of housing is important in determining access to various transportation alternatives, activities, services, etc.

**Fraud and Improper Loans**

- Fraud in the real estate and mortgage industries can have a devastating impact on many families.

- An increase in improper home loans provided to those not prepared to deal with the risk occurred as the number of highly qualified homebuyers was mismatched to the capacity of the industry to make loans. This trend may have been caused, in part, through public policies established to increase home ownership and by expansion in the loan industry, making more loans available. However, this trend may have been prevented by better structuring of the financial risk and rewards for all parties involved in these improper home loans.

- The structure to evaluate and enforce suitability in home mortgage lending has not worked effectively, leading to difficult situations and unsuitable loans.

**Housing Related to the Financial Crisis**

- Sub-prime mortgages and over inflated housing prices were a significant contributor to the financial crisis.

- Housing values do not always increase and in fact, can decline a great deal. Housing bubbles and over inflated prices are not new, and a review of financial history would have warned that upward housing prices are not guaranteed.

- Foreclosures present an enormous difficulty for the families that are subject to them.

**Uses of Equity and Products**

- Reverse mortgages may offer significant income potential to some households, but at relatively high cost and risk. Furthermore, they may help older households remain in their homes, but they limit future housing choices and are presented as a last resort option by some financial planners.

- Individuals, by and large, are not buying long-term insurance to provide funds for the cost of long-term care. However, housing wealth is in many cases accessible should those costs arise in excess of funds otherwise available. In such cases, substandard annuities may provide leverage in using housing wealth to fund long-term care costs.

- The options individuals choose for using housing equity to help finance retirement are far more important for those without defined benefit plans, since they have less regular income during retirement.

- There is much opportunity for further development and improvement of financial products and approaches applied to housing.

## Options For Using Housing Value To Help Support Retirement

There are a number of options for using housing value to provide for retirement needs. It should be noted that there is not a consensus on the best course of action for using housing value for this purpose. Further research needs to be done to define the options, identify the trade-offs, provide a framework for analysis and help individuals make decisions. The ultimate best course of action, of course, will also depend on individual preferences and circumstances.

Options for use of housing value to help support retirement include:

- Paying off the mortgage, if possible, to reduce overall expenses

- Selling and downsizing to a smaller home, freeing up funds for investment or annuity purchase

- Selling the home, investing the proceeds and then renting

- Securing a home equity loan or secondary mortgage on the house

- Obtaining a reverse mortgage

- Renting out extra rooms

- Renting out primary residence and live elsewhere at a lower cost

- Keeping the house mortgage free, and letting its value serve as an emergency fund if needed

## Implications and Next Steps

The following are implications of this effort and suggestions for future work:

- In terms of planning for retirement, additional work is needed to reevaluate the appropriate portions of personal wealth to spend on housing and whether it should be scaled down. This includes the guidelines lenders use to determine when a mortgage is feasible.

- Further work that models the trade-offs between lower spending on housing and more savings put into financial investments, vs higher housing spending and lower savings is needed.

- Improvements are needed in how retirement planning software tools handle housing wealth. Users of these tools who have much of their wealth in housing should be strongly made aware when the software does not address housing wealth.

- Work towards building a consensus around accepted methods to help individuals think through the positioning of housing wealth and its use as part of a total retirement plan would be beneficial.

- To the extent that many of the recent events related to housing were the result of certain policies, a national discussion on future policy in this area would be appropriate.

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We hope readers find the papers and discussions contained herein to be useful and thought-provoking on this subject. Comments on any of the material may be addressed to Steven Siegel, SOA Research Actuary at ssiegel@soa.org