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Housing Wealth and Retirement Savings: Enhancing Financial Security for Older Americans

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Introduction

The rapid rise in home prices in countries around the world has focused new attention on the role that housing and housing wealth plays in enhancing the financial security for families and individuals as they move into their retirement years. This is especially true in the United States where after a decade of steady increases in home values, residential real estate has grown to become the largest single asset class held by households with heads aged 65 or older. With so much wealth tied up owner occupied housing, little wonder that the popular press in the United States provides extensive coverage of the 'housing bubble' and what will happen should that bubble suddenly burst.

Given the importance of housing wealth as an overall component of the wealth holdings of older homeowners, until recently, surprisingly little was known about how housing wealth influences the consumption and investment decisions of households, especially as they relate to retirees. This chapter summarizes available literature on these topics and assesses the pluses and minuses of having housing wealth play such an important role in providing for the income security of older homeowners.

There are many reasons to be concerned about the reliance on housing wealth as a source of retirement savings. Even as homeownership rates continue to rise, millions still rent. Moreover, there can be little doubt that renters in general, and low-income renters in particular, face a bleak retirement future given the relatively limited reach of current social security and other income support systems now in place. But rather than condemn renters to a life of limited wealth accumulation, it is important to create new investment vehicles that will support savings and investment by renters. Just as the current housing finance and tax system makes it relatively easy to invest in real estate, a balanced national housing and income support system should provide expanded opportunities for renters to accumulate wealth by investing in other financial assets.

While the situation facing lower-income renters merits special attention, millions of home owning retired people also face serious challenges. Here it is important to recognize that readily available national data on wealth trends mask significant regional variation. Housing markets are distinctly local in nature. Even as home prices move up sharply in one region, they may lag behind elsewhere. As a result, there is a certain lottery like element to the role that home equity buildup plays as a source of retirement savings, with the winners generally being those lucky

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enough to live in areas where home prices have appreciated most rapidly just as they prepare to move into their retirement years.

While acquiring a home can boost wealth accumulation, many retired people face unmanageable housing payments burdens. Many own their home 'free and clear,' but a growing number are burdened by the increasing amount of debt they carry into later life. Moreover, despite these affordability pressures, many elderly people are unwilling or unable to downsize their consumption of housing. What is needed is the creation of new financial instruments designed to meet the particular problems faced by 'house rich, cash poor' retirees, as well as expanded efforts to create new affordable housing options that best meet the needs of older people.

These observations are a reminder that housing wealth accumulation is no substitute for a comprehensive set of housing and income support policies designed to help households prepare for retirement. Rather than simply provide income support payments to retirees, the best retirement support policy will undoubtedly involve a mix of income transfer programs and housing assistance efforts that enable retired people to sell their homes and tap into accumulated home equity. Failure to think creatively about how best to coordinate income assistance and housing assistance efforts will most certainly result in having pension and income support systems continue to struggle to meet the retirement needs of current and future generations of retired persons, while at the same time leaving hundreds of billions of dollars of home equity to sit idly on the sidelines.

This paper is divided into three main sections and a conclusion. The first section discusses recent trends in wealth accumulation with a particular focus on the accumulation of housing wealth by older households. The next section examines the impact of housing wealth on consumption and investment activities, and demonstrates that for most households, homeownership opens up new pathways for additional wealth accumulation. Given the fact that housing wealth is the largest component of wealth for most households, the paper then turns to a discussion of the several significant risks that threaten to undermine the benefit that older Americans derive from accumulated housing wealth. The concluding section offers some brief observations on policy approaches designed to enhance the ability of housing wealth to add to the financial security of older people.

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Residential Real Estate and the Wealth of Seniors

Housing Equity Key to Growing Wealth for Many Older Homeowners

Over the decade of the 1990s, much of the increase in aggregate wealth holdings was linked to the growth of wealth among home owning households.[1] Median net wealth holdings for homeowners with heads aged 65 to 74 increased over the 1992 to 2001 period by close to $100 thousand to just shy of $250 thousand. Households with heads aged 75 or older posted similar gains, while home owning households with heads aged less than 65 added just $42 thousand in median wealth over the period. In contrast, the wealth of renting households of all ages lagged far behind owners over the period.

Table 1. Wealth Holdings of Older Homeowners Grew Rapidly in the 1990s

(Median Net Wealth in 2001 Dollars)

	1992			2001		
Age of Head	**Owners**	**Renters**	**All Households**	**Owners**	**Renters**	**All Households**
Less than 65	$112,300	$4,400	$48,500	$154,100	$4,500	$67,900
65 to 74	$151,800	$4,400	$122,200	$249,700	$6,000	$176,700
74 or older	$140,400	$7,600	$107,500	$243,000	$7,000	$151,400
All Ages	$123,600	$4,600	$62,100	$171,800	$4,800	$86,100

Source: Joint Center for Housing Studies Tabulations of Survey of Consumer Finances
See also discussion of these figures in Di (2003)

After a decade of steady increase in home values, now residential real estate represents the largest single asset class owned by seniors.[2] According to the 2001 Survey of Consumer Finances, over 80 per cent of all seniors owned a home, and these homes were valued at nearly $3.168 trillion. Including the $781 billion of other residential real estate owned by seniors (largely second homes), the total value of residential real estate owned by senior's increases to

[1] Gross household wealth here is defined as the aggregate market value of financial and non-financial assets, and net wealth is defined as gross wealth less offsetting debt. Financial assets include retirement accounts, stocks, bonds, savings and money market accounts and other financial assets, while non financial includes value of real estate owned, as well as value of business, vehicles and other real property. Offsetting debts include mortgages on residential real estate, as well as credit card and other forms of unsecured debt.

[2] Throughout this paper, seniors are defined as households with head aged 65 or older. Most seniors are retired (or at least have cut back on their participation in the labor market) but some still work. Even so, the data analysis presented in this refers to seniors as a group, and does not discuss differing wealth and consumption patterns of working and non-working seniors.

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$3.95 trillion. As a result in 2001, residential real estate accounted for some 30 per cent of the nearly $13.2 trillion in aggregate asset holding of seniors.

In contrast, only 21.1 per cent of all households with heads aged 65 and older owned publicly traded stocks. Even expanding the concept of stock ownership to combine the direct ownership of publicly traded stocks plus stocks owned indirectly through mutual funds, retirement accounts and other managed assets, the share of seniors owning stocks increases to just 36.8 per cent. Under this expanded definition, seniors own – either directly or indirectly -- nearly $3.4 trillion in stocks, an amount that represents just 25.8 per cent of their aggregate asset holdings.[3] Moreover, since the 2001 Survey of Consumer Finances was taken before the full brunt of the stock market crash was evident, the 25.8 per cent share undoubtedly overstates the relative importance of stocks as a share of wealth holdings of older households.

Mortgage Debt Also Grew for Older Homeowners

Building on strong homeownership gains and house price appreciation, the aggregate value of the nation's owner-occupied housing inventory increased an inflation adjusted 50 per cent to $13.1 trillion from 1989 to 2001. Over this same period there was a corresponding 89 per cent increase in mortgage debt to $4.4 trillion. By 2001, mortgage debt accounted for 33.6 per cent of residential value, up from 26.4 per cent in 1989. In part, this increase in mortgage debt reflects the fact that the tax reform of 1986 eliminated the deductibility of many other forms of interest, encouraging homeowners to substitute mortgage debt for unsecured consumer loans. More recently, favorable interest rates not only encouraged households to take on more debt to buy bigger and better homes, these low rates also prompted a wave of cash out refinancing that enabled homeowners to pay off higher priced credit card and other unsecured forms of debt.

Borrowers of all ages are carrying more mortgage debt, yet the increase among older households has been striking. While it appears from the cross-sectional data in Table 2 that mortgage debt declines at age 35-44, tracking specific age cohorts over time reveals that each succeeding generation is carrying more mortgage debt into their older years (Masnick et al. 2005). For example, only 41 per cent of owner households with head aged 55 to 64 in 2001 had paid off their mortgages, compared with 54 per cent of their same-age counterparts in 1989. At

[3] Joint Center tabulations of 2001 Survey of Consumer Finances. See Aizcorbe et. al (2003) for more complete discussion of terms 'direct' and 'indirect' stock ownership.

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the same time, one in four (or some 26 per cent) of owner households with heads aged 65 or older had not yet retired their mortgage – nearly six percentage points higher than the 1989 figure.

Table 2. Seniors Now Hold More Mortgage Debt

	Share With Outstanding Mortgages		Median Outstanding Balance of Those with Mortgages *(2001 dollars)*	
Age of Head	1989	2001	1989	2001
Less than 35	88.5%	89.6%	$61,000	$77,000
35 to 44	87.7%	87.8%	55,400	80,000
45 to 54	76.2%	78.4%	36,000	75,000
55 to 64	46.2%	58.9%	27,700	55,000
65 or Older	20.7%	26.4%	12,500	44,000
All Ages	63.9%	67.7%	48,500	75,000

Even more remarkable is the level of debt these older homeowners carry into their retirement years. After adjusting for inflation, the median mortgage debt of those older homeowners more than tripled to $44,000 in 2001, while the mortgage debt of slightly younger mortgage borrowers (aged 55 to 64) nearly doubled. Consistent with the general trend to substitute mortgage debt for non-mortgage debt, in 2001 home mortgage debt accounted for 70 per cent of the total debt of owners aged 65 and older – up nearly 20 percentage points since 1989.

Housing Wealth is Widely Distributed

Adding to the importance of housing as a storehouse of wealth is the fact that housing wealth is more widely distributed with respect to income than is true for stock market holdings. Stock market wealth is especially concentrated in the hands of the highest income households, while home equity is an especially important source of wealth holding for those in the bottom fifth of the income distribution. While the top one per cent of stock holders own 33.5 per cent of total stock wealth, the top one per cent of owners of residential real estate own just 13 per cent of the total. In contrast, only 12.4 per cent of households of all ages falling into the bottom 20 per cent of the income distribution own stocks and control just 2 per cent of aggregate stock wealth,

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while 50 per cent of these lowest-income households own a home and hold 15 per cent of aggregate home equity.

Many retired people fall squarely into the group of ‘cash poor house rich’ households. For example, households with head aged 65 or older account for some 8.4 million of the nearly 20 million households falling in the lowest-quintile of the income distribution. Of these lowest-income seniors, 5.8 million (or 70 per cent) are homeowners, but only 6 per cent own stocks, including stock owned indirectly through retirement accounts and mutual funds.

Of course these aggregate national statistics mask significant regional variation in the importance of housing as a storehouse of wealth. Though returns to investments in stock are more or less constant across regions, housing returns can and do vary significantly from one region to the next. While higher house prices may bring with them higher property taxes and insurance costs, they also provide greater potential for home equity buildup – an additional source of wealth accumulation that is not available to households living in regions with more limited home price appreciation.

Cross National Comparisons

The importance of housing as a storehouse of wealth is hardly unique to the United States. In 2001, the aggregate value of residential real estate owned by households in the United States accounted for 32 per cent of gross household asset holdings. For Canada, the comparable figure for housing as a share of gross asset holdings stood at 46 per cent in 1999 (Statistics Canada 2001). Though the information is not strictly comparable, the Reserve Bank of Australia (2000) estimated in 1999 that for the United Kingdom, ‘dwellings’ accounted for 38 per cent of total wealth, while for Australia this ratio was a high as 57 per cent. Finally, data on the composition of wealth holdings in selected OECD Countries for 1998 suggests that housing is also an important component of aggregate wealth holdings in six of the G7 nations (Canada, France, Germany, Italy, the United Kingdom and the United States). Among the G7, (OECD 2000) the exception appears to be Japan, where housing assets apparently comprise only 19 per cent of tangible assets and only ten per cent of total assets.[4]

[4] For further discussion of these data see Doling et al. (2004) ‘Playing Snakes and Ladders: The Gains and Losses for Homeowners,’ A paper presented at the ENHR Conference, July 2 to 6, Cambridge, England. See also Iris Claus and Grant Scobie (2001), Household Net Wealth: An International Comparison,’ The Treasury of New Zealand, Wellington New Zealand, Working Paper 2001/19.

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Of course each of these estimates depends on recent trends in housing markets, stock markets, and other asset markets. Particularly problematic is assessing whether the recent runup of home prices in a diverse set of nations will persist, or will home prices move back down to levels more in keeping with longer term trends. In its most recent report on global house price indicators for 2005, *The Economist* noted that while home prices in the United States appreciated fully 65 per cent in the United States over the 1997 to 2004 period, house price appreciation over this period was even stronger in Australia, Britain, France, Ireland, the Netherlands, South Africa, Spain and Sweden, though the same study also noted that there were some signs of softening (if not outright declines) in home prices in Australia, Britain, and New Zealand.[5]

As an element of wealth building, home price appreciation is decidedly a double edged sword. Home price increases generally boost homeowner's equity and thus add to household wealth accumulation. At the same time, home price appreciation can also reduce housing affordability and limit the number of potential first time homebuyers able to make the transition to homeownership. Somewhat remarkably, despite reduction in overall affordability of home buying, the number of homeowners in the United States – and especially young homebuyers -- continued to move up more or less steadily since 1993. As a result, though the wealth holdings of older Americans moved up sharply over this period, younger generations also experienced an increase in their wealth holdings as well (Joint Center for Housing Studies 2005).

Elsewhere, it appears that affordability problems are having a more serious impact on the overall growth in homeownership. In Australia, for example, the share of households owning their own homes moved steadily upward from around 50 per cent in the 1950s to more than 70 per cent by the early 1990s. Since then, there are clear signs that the upward movement of homeownership is 'unraveling,' as younger Australian's struggle to purchase a home of their own.[6]

Declines in the homeownership rate among younger Australians could have implications not just for how Australians are housed today, but could also adversely impact the financial security of younger generations as they reach their retirement years. Though estimates of trends

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[5] *The Economist (2005)* reported for the five year period 1997 to 2004 home prices appreciated in Australia (113 per cent), Britain (147 per cent), France (90 per cent), Ireland (179 per cent), Netherlands (75 per cent), South Africa (195 per cent), Spain (131 per cent), Sweden (76 per cent).

[6] Mike Berry, 1999 'Unravelling the 'Australian Housing Solution': the Post War Years', *Housing, Theory, Science*, Volume 16, Number 3 pp. 106-123. See also Mike Berry, (2005). 'Show Me the Money: Financing More Affordable Housing,' RMIT-AHUR/NATSEM Research Centre, Melbourne, Working Paper No. 5.

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in wealth holdings by age differ, they agree that wealth accumulation among households aged 45 or less has virtually come to a halt in Australia over the past decade.[7] A future rebound of home buying by younger Australians could slow or reverse the emergence what appears to be a growing generational gap in wealth holdings. Yet for now, the current trend has sparked a vigorous debate as to whether the social safety net will have to adjust, and particularly the role that housing policy must play to help provide for the long term financial security of the currently less wealthy generation of young Australians.[8]

The Impact of Homeownership on Consumer Spending and Investment

Using Housing Wealth to Create New Wealth

For many, purchasing a home is the first step on a pathway to wealth accumulation. Work by Di et al. (2003) suggests that even controlling for factors likely to account for household differences in permanent income and the marginal propensity to save and to invest, homeowners build wealth more quickly than otherwise comparable renter households.

Of course, investment motives are just one of many reasons people purchase a home. Families and individuals in the United States and many other Western European countries view home owning as superior to renting for a variety of social and psychological reasons (Apgar 2004). What is important here is that once they choose to purchase a home, even if the motive hinges on reasons only marginally linked to investment and wealth accumulation, homeowners can borrow against home equity to 'cultivate' new ways to build wealth.[9]

By tapping home equity to start a business, invest in stocks, or spend their money on education, homeowners have the potential to increase income growth and provide for their financial security in their older years. In effect, home equity becomes the central focus of a household portfolio management operation, in which homeowners periodically adjust their assets

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[7] Data presented in Apelt et al.(2003) suggest that from 1993 to 2002, average household wealth in Australia increased from $199,000 to $280,000, with particularly strong increases recorded for households aged 45 or older. At the same time, the wealth of households with heads aged 25 to 34 fell by $71,000 to $121,000, while for households with head aged 35 to 44 total wealth fell $29,000 to $253,000.

[8] For a discussion of the link between home equity accumulation and retirement security see Dolan et al.(2005). 'Home Equity, Retirement Incomes and Family Relationships,' Paper prepared for the 9th Australian Institute of Family Studies Conference, Families Matter, Melbourne, February 9 to 11. See also Apelt, Hall and Young (2003).

[9] For further discussion of the concept housing wealth as a 'cultivator' of new wealth see Di, Zhu Xiao, (2001).

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and debts[10] Of course, it is also possible for investors to borrow against their equity in stocks, bonds, or other financial or non financial assets, the ability of average homeowners to tap home equity to fund acquisition of other wealth generating assets is unique. Indeed, growth of new forms of home equity loans and lines of credit liens has made borrowing against home equity a very simple, fast and reasonably inexpensive activity (Canner et al. 1998).

Despite these benefits of homeownership, the observation that homeowners accumulate more wealth over time than renters is not equivalent to saying the financial returns to homeownership exceed those of other types of investment. Indeed, many argue that buying stock would be a superior investment. Depending on the time period analyzed, return on investment in a home has been shown to lead or lag behind common stocks, though returns on investment in homes generally exceed those of generally safer corporate bonds and U.S. Government Securities.

In the absence of certain knowledge about future trends in the housing market and the general economy, it seems a futile exercise to even attempt to answer the question 'is home ownership or the stock market the better investment?' Instead, the better question is whether purchasing a home – along with its potential for financial leverage – is a good early step to make on the pathway to long-term wealth accumulation. Here the answer appears to be an unambiguous yes.

Even so, homeownership does not necessarily help to build wealth in all instances. Purchasing a unit with mortgage financing further magnifies the risks and rewards of investing in a durable capital asset.[11] The leverage associated with a debt financed acquisition implies that any given percentage increase in property values will generate an even larger percentage increase in the owner's equity in the property. Yet higher leverage also means that even a relatively small decline in housing prices can leave a homeowner with a mortgage that exceeds the value of their home. For credit impaired borrowers, higher leverage also will substantially increase mortgage interest payments. If a borrower is unable to repay outstanding mortgage obligations, or the

[10]For example, a survey of borrowers who took out cash when they refinanced in 2001-2003 (Canner et al. 2002) found that the majority of funds were used to acquire additional assets, including investments made on home improvements (35 per cent) and to purchase a business or other real estate (11 per cent), or make other financial investments such as stocks and bonds 10 per cent), while the rest was largely spent on repayment of other debts (26 per cent) or new consumer expenditures (16 per cent.).

[11] According to Federal Housing Finance Board as reported in Eric Belsky and Joel Prakken, (2004), approximately one in ten of all home mortgages made in 2002 had loan-to-value (LTV) ratios of more than 90 per cent, while slightly more than one in twenty exceeded 95 per cent LTV.

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home they purchased actually declines in value, rather than be a pathway to increased wealth accumulation, homeownership can also be the pathway to default, foreclosure, and financial ruin.

Housing Wealth's Contribution to Household Consumption

Much of the current empirical work on wealth and consumptions still builds on the Life-Cycle Hypothesis (LCH) developed in the 1950s and 1960s.[12] The LCH predicts that in the face of variations in income over the life course, consumers will either borrow against future earnings, or spend out of accumulated wealth to smooth out consumption levels. For example, LCH implies that younger individuals will tend to borrow against expected rising future incomes. As incomes rise during mid life, individuals will become net savers and accumulate wealth that will enable them to maintain spending in later life. Of course, the pace of drawing down assets in later life will depend on the life expectancy, whether or not they would like to make a bequest upon death, as well as how rapidly current income is projected to decline with retirement. As a result, LCH implies that consumption spending will vary not only according to changes in individual and family wealth levels, but also vary depending on the age of the household, desired level of bequests, projected earnings and life expectancy.

Despite being fundamentally a theory about micro-economic behavior, early empirical tests of LCH were based on highly aggregated data. Moreover, even though particular households may have differing views about likely volatility in the future value of various assets, as well as differing views about their willingness to divest any particular asset to fund current consumption, early empirical estimates assumed that the impact on consumption did not vary by type of wealth. For example, in their path breaking paper, Ando and Modigliani (1963) estimate that the current consumption for the United States increases by $60 for every $1,000 increase in total household wealth, regardless of the composition of that wealth.

With improvement in both available data and econometric modeling techniques, over time greater attention has been paid to disaggregating wealth into various components. Estimating differing marginal propensities to consume over varying wealth categories is no easy feat, especially in light of fact that changes in housing wealth and stock market wealth tend to be highly collinear when measured at the national level. In an effort to overcome this collinearity issue, Karl Case, John Quigley and Robert Shiller (2001) used state level data to identify the

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[12] For an excellent summary of the wealth effects literature see Eric S. Belsky and Joel Prakken. (2004).

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independent effects of housing and stock market wealth, and hence were able to take advantage of the significant variation in housing price appreciation that occurs across spatially segmented markets. Using these state level data, Case and colleagues estimated that the marginal propensity to consume out of financial wealth is 2 per cent, while the marginal propensity to consume out of housing wealth is the range of 5 to 9 per cent.

At first blush, these results may seem counter-intuitive. Housing wealth is relatively illiquid, and the transactions costs of selling a home tend to be high, at least when compared with the cost of selling stocks or bonds. Apparently, the recent rise of a wide range of home equity loans and lines of credit has substantially increased the ability of households to translate housing wealth into cash. As a result of these financial innovations, the Joint Center for Housing Studies and Macroeconomic Advisors suggest that households spend on average 5.5 cents a year out of every dollar increase in house value. Moreover, this additional spending hits its long term average within a year of when the increase in house value occurs – much more quickly than households spend gains in stock wealth, which they may view as less secure (Belsky and Prakken 2004).

Cross National Comparisons of Housing Wealth Effects

With house prices on the rise in countries around the world, there are a growing number of cross national studies on the impact on housing wealth on consumption, including several studies that provide separate estimates of the marginal propensity to consume housing wealth and financial wealth. For example, OECD analysis suggests that just as in the United States, changes in housing wealth in the Australia, Canada, the Netherlands, and the United Kingdom also appears to have a significant effect on consumption with the marginal propensity to consume housing wealth ranging from 5 to 8 per cent (Catte et al. 2004). Moreover OECD estimated that Australia, Canada, the Netherlands and the United Kingdom also mirror the United States in that marginal propensity to consume housing wealth appears to be greater than the propensity to consume financial wealth. [13]

In contrast, OECD estimates of the marginal propensity to consume housing wealth in France, Germany, Italy, Japan, and Spain are either small (less than 2 per cent) or statistically

[13] Note that Dvornak and Kohler (2003) using a different data and estimating technique than OECD report just the opposite pattern – namely that in Australia marginal propensity to consume out of stock wealth (0.09)is greater than out of housing wealth (0.03).

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insignificant. In addition, in these countries, the impact of housing wealth on consumption was generally smaller than that of financial wealth.[14]

Hong Kong, China presents yet another pattern (Cutler 2004). There the marginal propensity to consume housing wealth of 3 per cent is more or less in the middle of the range of estimates for the countries examined by OECD, and statistically identical to the estimate obtained for the marginal propensity to consume financial wealth.

Though specific empirical results for individual countries undoubtedly reflect a number of factors peculiar to each country, several structural factors stand out. First, the impact of wealth on consumption seems to vary systematically with respect to the distribution of wealth holdings by people of differing income. For example, Case et al. (2001) argue that the relatively high marginal propensity to consume housing wealth in the United States reflects in part the fact that housing wealth tends to be held by households in all income segments, while stock wealth tends to more concentrated.

Similarly in explaining why the marginal propensity to consume housing wealth tends to be lower in Hong Kong than elsewhere, Cutler notes that this is consistent with the fact that in Hong Kong housing wealth is more skewed toward the rich. Finally Dvornak and Kohler (2003) argue that the reason that the impact of stock market wealth on consumption is generally smaller European Countries than in the United States reflects the fact that stock ownership in the United States is more widely distributed than in Europe.[15]

Theory also suggests that the impact of housing wealth on consumption will be greater in countries with financially more sophisticated mortgage and financial markets that enable consumers to borrow against or otherwise transform illiquid housing wealth into cash. For example, unlike the United States, 'equity extraction' is relatively rare in Japan, a feature which helps explain why Japan appears to have the greatest gap between the marginal propensity to consume housing wealth and the marginal propensity to consume financial wealth of all the major industrial counties studied to date.

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[14] Similar results for the France, Germany, Japan, the United States, and the United Kingdom are reported in Barrell and Davis, (2004).

[15] See also International Monetary Fund. 2000. 'Asset Prices and the Business Cycle,' *World Economic Outlook*, pp. 77 to 112.

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The Changing Impact of Housing Wealth Over the Life Course

The pace of wealth accumulation, and hence the 'wealth effect' is likely to vary over the life course. Families and individuals can begin acquiring assets at any age, but most households typically begin by accumulating financial assets. Starting the wealth building cycle with financial assets makes sense since stocks and bonds are available in small denominations. In contrast, housing is a lumpy investment. While in principle families could purchase a partial ownership share in a home (as in time share vacation homes), more typically young families draw down on any accumulated financial assets and take on substantial mortgage debt to acquire their first home. As a result, the typical first time buyer has put most or all of its 'eggs' in one asset basket (Tracy et al.1999).

Having now made the transition from renting to owning, households are now to free reduce the share of total assets held in residential real estate. In particular as families and individuals age and begin to save for retirement, stocks, bonds, savings and other financial assets grow as a share of total asset holdings. Moreover, as noted earlier, if the value of their home appreciates, they have the option of refinancing their home to take out cash to acquire additional financial assets and or invest in business, education or other income producing assets.

Of course the extent to which the residential real estate as a share of total assets declines depends in part on housing mobility. As long as families continue to trade up to bigger and better homes, housing as a share of total assets will remain high. Once a household begins to settle into a more 'permanent' home, however, the possibility for asset diversification increases and the ratio of the value of owner occupied housing to total assets declines. This is also true as 'empty nesters' down size their spacious housing, though often this downsizing in space involves an increase in housing quality and hence produces little or no reduction in the aggregate value of residential real estate holdings.

Finally with retirement, household will begin to draw down assets to offset loss of income, and their portfolio tends to tilt back in favor of placing more weight on housing. In previous decades, this process might be halted as older owners sold their homes and either purchased a more modest house or returned to renting. While undoubtedly this is happening, many seniors instead are choosing to remain in their homes. For example a recent study by Stephen Venti and David Wise (2000) using data from the Survey of Income and Program Participation, and the Survey of Asset and Health Dynamics of the Oldest Old finds that baring

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changes in household composition, households with a head over 70 typically do not use home equity to support general non-housing consumption. This behavior is consistent with an AARP survey that found that 95 per cent of persons aged 75 or older agreed with the statement 'What I would really like to do is stay in my current residence as long as possible.'

Future Risks

Will the Housing Bubble Burst?

In light of the importance of home-equity as a source of financial security for older homeowners, little wonder that policy analysts and commentators worry about the consequences of a sudden and widespread decline in home prices. In part, the recent increase in home prices simply reflects higher housing quality standards and the larger size of newly constructed homes. Even so, it has been the rapid run up of land prices – supported in large measure by restrictive zoning and land use practices – that have pushed overall housing prices to new record highs in metropolitan areas across the country. Nationwide, the Joint Center for Housing Studies estimated that land price inflation accounted for over 75 per cent of the total inflation-adjusted price increase for homes of this type over the decade 1990 to 2000 (Joint Center for Housing Studies 2002). Of course in areas where zoning and land use restrictions are most stringent, land and housing prices have moved up even faster over the past decade.

Given that higher home prices are rooted primarily in rising land costs, the question remains as to whether continued price pressure will stifle housing demand and precipitate a steep drop off in housing market activity. Just as high price earnings ratio often signal a strong down side correction in the stock market, some pessimists argue that with median home prices rising faster than median household income, it is only a matter of time before housing demand also experiences a sharp downside correction. Once they start to fall, declining house prices could in turn undermine consumer confidence, erode home equity, and send the housing market into a tailspin.[16]

Yet the comparison between the stock market and the housing market is misleading at best. Because people live in, as well as invest in their homes, most owners choose to stay put when prices first show signs of softening. This reduces the number of homes on the market and

[16] For a general summary of 'the bubble' debate see McCarthy and Peach 2004.

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helps bring supply and demand back into balance, thereby forestalling faster and sharper declines. In addition, as incomes at the high end of the distribution continue to pull away from those in the middle, shifts in median income are increasingly a poor proxy for the relative purchasing power of potential home buyers. Indeed, Joint Center for Housing Studies data suggest that despite rapid home price appreciation, various measures of housing cost burdens for higher-income home buyers households – the group that actually constitutes the biggest share of all homebuyers -- were little changed over the decade (Joint Center for Housing Studies 2005).

Growing Inequality in Access to Homeownership

While it seems unlikely that home prices will fall precipitously in the future, it still is true that persistent homeownership affordability problems will continue to limit the ability of low- and moderate-income families to realize the wealth building potential of homeownership. In particular, for many downpayment remains a barrier to home ownership. Lower downpayment requirements help families get around this barrier, but only by having buyers pay higher interest rates and bearing the risks associated owning a highly leveraged asset.

While shared appreciation mortgages have existed for some time, this form of lending needs to be perfected. For example Caplin et al. (1997) propose the formation of ‘housing partnerships,’ a financing arrangement where homebuyer shares ownership with an outside investor. In effect, rather than take on a debt partner through a mortgage, the homeowner would take on an equity partner to help remove the down payment constraint. Such partnerships would significantly reduce the up-front costs and monthly carrying costs of owning a home, and enable families to devote more income to other forms of investments to help them diversify their portfolio.

Even under the best of circumstances, however, it is unlikely that homeownership is a universally obtainable goal. Whether because of lifestyle choices, affordability constraints, or other factors, some households will always remain renters. Yet rather than condemn these remaining renters to a life of limited wealth accumulation, it is important to create new financial instruments that will support savings and investment. For example, it would be possible to create a class of reasonably secure corporate equities that could be purchased on margin and that would provide a non-housing alternative to the currently available highly leveraged opportunity to purchase a first home. With proper insurance to reduce whatever risk exists in these investments,

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along with subsidies that reward thrift, it would be possible to help renters accumulate financial assets just as the current housing finance system makes it relatively easy to invest in real estate.

The Growing Housing Cost Burden of Older Homeowners

Overall, 5.1 million lowest-income seniors -- defined here as households with head aged 65 or older and an income that falls in the lowest 20 per cent of the income distribution – own a home free and clear of any mortgage debt. Even so, given their limited incomes and the high cost of property taxes, utilities and other home operating costs, one in four of these debt free lowest-income owners pay more than 50 per cent of their incomes for housing.

Having to pay down mortgage debt only further increases the housing cost burden of lowest-income older homeowners. For this group, the share paying more than 50 per cent of income for housing rises to nearly 75 per cent. In the past, the early age at which households became debt free served as a cushion to absorb the consequences of falling income in later life. Though improving health and life expectancy has led many to decide to remain in the labor force longer, the added pressure of having to meet mortgage payment obligations should reinforce this upward trend in elderly labor force participation.

Should an older homeowner be unable or unwilling to meet their mortgage obligations, they can always sell their home, retire their outstanding debt and move to a smaller home or become a renter. Unfortunately, limited growth in housing subsidies, along with limited production of housing suitable for older families and individuals, especially the frail elderly, means that downsizing may not be possible in many situations. In situations where neither continued employment nor down-sizing is practical, the housing cost burdens of older homeowners could rise, squeezing out other consumption activity including increasingly important health care expenditures.

Equity Stripping and Mortgage Abuse

The growing availability of home equity loans and lines of credit presents both new opportunities and new risks to equity rich and cash poor older homeowners. In most instances, the new mortgage delivery system has expanded access to prime mortgages on favorable terms. As noted earlier, growth of new mortgage products has enabled many older homeowners to maintain relatively high level of consumption, without having to sell their home to do so.

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Unfortunately, all too often the way these new mortgage products are delivered puts many lowest-income older homeowners at risk. In particular, over the past decade, the home equity lending market has been increasingly served by non-prime lenders driven by brokers, who aggressively 'push-market' loans to high risk families and individuals. Given that older homeowners often have significant equity, even owners with limited ability to repay a mortgage can still get loans, since the loan is backed by relatively high levels of collateral (Joint Center for Housing Studies, 2004).

Of course, in a market where people can comparison shop, a broker may lose business if costs are too high. Unfortunately many older homeowners apparently do not seek out loans, but rather are sold on the idea of borrowing additional amounts of money after extensive outreach or marketing by brokers. Available survey data (Kim-Sung and Hermanson 2003) suggest that these 'push marketing' techniques often leave older borrowers with mortgage loans that are overpriced and/or contain abusive features. In the extreme case 'push marketing' can saddle borrowers with debt that they are unable to repay; a situation that can lead to foreclosure and/or a loss of whatever remaining equity the borrower had in the home.

The Growing Number of 'House Rich, Income Poor' Households.

Next, it is important to encourage older homeowners to make better use of their home equity. Clearly many households are reluctant to sell their home and move as a way to tap home equity. Home equity loans can help older owners convert much needed cash to income, but often leave families unable to meet their mortgage payment obligations. Reverse mortgages can also help older families convert home equity to cash, but with households living longer, the risk associated with many home equity products is that the homeowner will out live the annuity and be forced to move at an advanced age.

Absent a guarantee that a senior will receive the annuity payment until they choose to move or die – as is the case with the Home Equity Conversion Mortgage (HECM) product offered by the FHA -- the market for conventional reverse mortgage products has been limited indeed.

What is needed are new financial instruments designed to meet the particular problems faced by 'house rich, cash poor' households. For example, taking on an equity partner as described above is one way to reduce the payment burden associated with home equity loans.

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Instead of requiring a monthly payment, an investor partner would purchase a share of the future interest in the home. Not only would such a product provide much needed resources to an equity rich and cash poor older homeowner, it would not burden the owner with greater mortgage payment burdens, nor require them to move after some specified period of time.

Conclusion

Housing wealth is likely to continue as the cornerstone of wealth holdings for retired people around the world for some time to come. As the baby boomers age into to their retirement years, the homeownership rate of households with heads aged 65 or higher is likely to rise, as will their housing wealth. At the same time, it is important to recognize that a growing homeownership rate is no substitute for a comprehensive set of housing and income support policies designed to enable all households – rich and poor alike -- accumulate income producing assets that they can carry into their retirement years.

First and foremost, it is important to recognize the plight of the lowest-income elderly renters with both limited incomes and wealth holdings. Buying a home is not a wise decision for everyone. But rather than condemn renters to a life of limited wealth accumulations, it is important to create new investment vehicles that will support savings and investment by lower-income renters. At the same time, it is also important to create new methods to overcome affordability constraints to homeownership. Here it is important to create homebuying options that not only are affordable in the short-run, but buffer these new buyers from the significant downside risks associated owning a highly leveraged asset.

Next, it is important to encourage older homeowners to make better use of their home equity. Clearly many households are reluctant to sell their home and move as a way to tap home equity. Once again what is needed is creation of new financial instruments designed to meet the particular problems faced by 'house rich, cash poor' households.

In addition, to help older homeowners convert their home equity to much needed assistance, it is important that policy makers focus on expanding the supply of affordable rental housing. Having focused so much attention on promoting homeownership, the irony is that when owners seek to cash in on their retirement nest egg, there is a severe shortage of affordable housing to accommodate the move.

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And finally, even while working to improve the ability of families to accumulate housing wealth, it is important to recognize the downside of the current heavy reliance on housing wealth as a source of retirement savings. Accumulation of housing wealth undoubtedly enhances the well-being of many. At the same time, the inability of all households to realize the benefits of homeownership leaves behind gapping holes in the retirement security safety net. Enhanced coordination of income assistance and housing assistance efforts is essential if governments are to meet successfully the challenge of enabling all current and future generations to live out their retirement years with dignity.

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