# The Impact of Diminishing Wealth on Future Consumption: How Housing Wealth Affects Retirement Planning

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## Executive Summary

As a result of almost a decade of steadily improving house prices, housing has become the largest single financial asset among American families, especially among homeowners headed by the age group approaching retirement (usually age 55-64).[1, 4, 5, 10, 18] However, the dramatic and historic decrease in housing values of approximately $400 billion between 2007 to mid-2008 has significantly altered the retirement plans of many Americans.[22]

For baby boomers planning to retire, housing wealth accounts for a majority of net worth. While this figure is skewed according to demographics (education, race, age within the baby boomer segment, marital status, sex), home equity accounts for one-third of net worth at the mean and 50 percent at the median.[11] This makes baby boomers especially susceptible to housing price shocks, both positive and negative, which can significantly affect retirement planning and consumption patterns.

This decrease in home prices has a compounding effect on diminishing individual wealth. This has produced a cascading effect which impacts entire families, especially single or divorced women and widows. This decreased wealth effect is especially acute among people approaching retirement age who will now have to consider extending their retirement dates into the future.

The decrease in housing values is especially important since home ownership increases with age. As a result, older people rely more on their home equity as a source of wealth and as insurance against unforeseen negative life events, such as a serious illness or the death of a spouse. Decreased home values also have resulted in reduced confidence in future retirement planning for people of all ages.

The decline is more important since this loss cannot be quickly recovered through stock market gains, primarily because stock ownership is significantly less prevalent than home ownership. The decline is more important since home value appreciation typically occurs over decades, so recovering the equity that vanished will not be an overnight event.

Another developing problem is that as housing prices slowly recover, there should be a glut of houses on the market as more baby boomers return to their planned retirement dates, along with new entrants into the retirement pool. If this scenario develops, it could create an oversupply of new houses which could further decrease asking prices, posing another challenge to retirement planning.

This paper acknowledges that the current housing problem must be considered alongside other critical issues related to retirement planning, including longevity risk, asset allocation, health care availability and costs, withdrawal rates, and inflation.

Each of these factors individually warrants serious review in any retirement planning activity. The combined effect of these events, accompanied by the decrease in housing wealth, dramatically increases the instability of financial security in retirement. This situation poses significant challenges to financial professionals engaged in retirement planning.

These changes are disrupting the lives of many Americans and are causing the following problems:

- Workers are extending their retirement dates indefinitely into the future.
- They are postponing major medical treatments.
- They are decreasing discretionary expenditures since access to their home equity lines of credit have been reduced or discontinued.
- There is a disproportionate impact on households led by single parents, divorced individuals, and widowers who are experiencing even more difficult times.
- There is an increasing reliance on reverse mortgages to finance retirement.
- Retirement planning is becoming more reliant on non-traditional factors such as housing-related events, including interest-rate changes and construction activity in their region.
- Elderly homeowners are increasingly becoming more reliant on their home equity as a source of retirement income.

The goal of this paper is to help financial professionals and plan sponsors recognize that retirement planning is being influenced by an assortment of new factors that traditionally have been outside of their scope. These changes stem from the significant decrease in housing wealth, which can only be aggravated by negative economic events, such as the resurgence of core inflation, rising energy prices and political uncertainty.

This paper identifies the problems related to the decrease in housing wealth and focuses on its ramifications for retirement planning. It then suggests ways in which financial professionals can work with clients to readjust their retirement planning strategies to work through this historically difficult market period.

This situation makes this problem more acute since a house has become the cornerstone of wealth accumulation worldwide. Any change in its short- or long-term value must be reflected in the entire retirement planning process, including wealth management creation and decumulation strategies.

Each of these events should be part of any comprehensive retirement plan or retirement discussion conducted by financial professionals.

## Defining the Situation: How Housing Wealth Affects Retirement Planning

The recent unprecedented decline in housing prices points toward a significant decrease in housing wealth for millions of Americans. While this is a traumatic financial and emotional event, it also poses dramatic new challenges for the 78 million Americans born between 1946 and 1964 who are approaching retirement.

To help clients adequately prepare for their retirement years, financial professionals need to acknowledge the new challenges that the decline in housing wealth has created, and then develop an action plan which addresses these concerns directly.

This paper identifies ways in which decreasing housing wealth is negatively impacting retirement readiness and suggests specific ways financial professionals can address them in the retirement planning process.

As the baby boomer generation approaches retirement age, more attention will be focused on the sources and importance and stability of retirement wealth. This wealth is commonly comprised of a combination of Social Security, Medicare, pension plans, 401(k) plans and, increasingly, house prices. Retirement experts and academics also factor other financial and non-financial wealth components into this calculation, including human capital (expected labor earnings), personal savings, life insurance, annuities, and gifts and inheritances.

**CHART 1**
**The Decline in Personal Savings Rates**
**Personal Savings as a Percentage of Disposable Personal Income as of 6/26/08**

Source: U.S. Department of Commerce, data as of 6/26/08.

While these wealth sources differ by race, sex, household status, and income, the reality is that this group of individuals "has saved virtually nothing for retirement."[1] This problem arose for a variety of reasons as evidenced by an overall low savings rate and small 401(k) account balances. This problem will only be aggravated by an increase in the Social Security retirement age, the reduction of employer-sponsored pension plans, a changing tax structure, and longer life spans.

The two areas of concern in this otherwise grim picture are wealth sources derived from home equity and Social Security. For most American households, these are the two greatest sources of total wealth. But for the first time in 63 years, owners' equity in household real estate fell below 50 percent, according to data from 1945 to 2008.[21]

As a result, any shock to either one of these two key wealth drivers—home prices and Social Security—presents a major disruption to the retirement plans of many Americans and negatively impacts retirement adequacy and preparedness.[2]

Of these two components, Social Security benefits range from replacing approximately 45 percent of wages for the least wealthy individuals to replacing approximately 10 percent of wages for the wealthiest individuals. Home equity (defined as purchase price less the mortgage balance) accounted for 9- to 14-percent of total wealth.[3]

Home ownership comprises such an essential part of overall individual household wealth that it affects many key life decisions, including whether people will continue working. This has an especially significant impact on women. Since the need for financial assets affects a person's decision to continue working as they approach retirement, home ownership plays a significant part in making this decision.

Numerous academic and government studies show that home equity has a paramount role in determining overall household wealth, especially among people over age 55 who have the highest percentage of home ownership. A 2002 study found that 82 percent of those in the study who were age 60 to 64 owned their own residence, with a typical home equity of $120,000.[4] A 2004 survey of consumer finances found that Social Security accounted for 42 percent of total wealth for a typical family approaching retirement (sample household headed by a person aged 55 to 64), followed by the principal residence (21 percent of total wealth).[1]

A 2001 Survey of Consumer Finances found that over 80 percent of all Americans over age 65 owned a house, with the aggregate value of this property estimated at $3.17 trillion. This same survey found that seniors (people aged 65 or older) collectively own another $781 billion in other residential real estate, such as second homes. In contrast, only 21 percent of senior households owned publicly traded stocks, which accounted for about 26 percent of total asset holdings.[5]

## TABLE 2
## Wealth Holdings of Typical Household

### Wealth Holdings of a Typical Household Prior to Retirement, Survey of Consumer Finances 2004

| Source of Wealth | Amount in Dollars | Percent of Total |
|---|---|---|
| Primary house | $125,208 | 21 |
| Business assets | $10,370 | 2 |
| Financial assets | $42,014 | 7 |
| Defined contribution | $45,244 | 8 |
| Defined benefit | $96,705 | 16 |
| Social Security | $251,983 | 42 |
| Other non-financial assets | $26,402 | 4 |
| Total | $597,926 | 100 |

Note: The "typical household approaching retirement" refers to the mean of the middle 10% of the sample of households headed by an individual aged 55-64.

Source: CRR calculations from U.S. Board of Governors of the Federal Reserve System. 2004. Survey of Consumer Finances. Washington, DC.

## Housing Wealth and its Affect on Key Retirement Decisions

While home ownership is a key measure of wealth, it also produces strong sentimental and psychological effects. These effects directly shape the key decisions people make about whether to use their home equity and whether they want to continue working as they approach retirement age.

A study of current retirees indicates they have not tapped their home equity to pay for current living expenses. Instead, the common belief is that the house (70 percent of which are owned mortgage-free by people over age 65) can be used as "insurance" against health-related emergencies, the death of a spouse, or as part of a family bequest.

A 2007 Harris Interactive study found that 75 percent of those questioned said they had no plans to use house equity for retirement needs.[1] Other people said they wanted to keep their house as opposed to selling and then paying rent, which could increase. These expressed preferences to keep the house and avoid taking out equity contradicts the long-held lifecycle model of consumption, which found that older people consume more since they can leave less when they die.

However, when people who had inadequate retirement savings and a mortgage were asked if they would use their home equity to pay retirement expenses, the probability of accessing this equity increased significantly. This practice should increase in the future since the next generation of people approaching retirement is less prepared than the older people (aged 60-65) in the 2007 Harris Interactive survey.

Owning a large amount of home equity also affects other key decisions regarding work patterns for older Americans. These decisions include:

- Whether couples and single people feel the need to work to meet monthly mortgage payments.
- Whether couples feel the need to work and own their house since they receive favorable treatment under Medicaid-means-tested benefit programs. While these means tests vary by state, the house is not often included in the asset limits that are used to evaluate eligibility for Medicaid or Supplemental Social Security.

One study found that home ownership, including the amount of equity, affected the need of older women to continue working in old age. This decision to continue working was also highly dependent on marital status, wealth, and education.[6] As a result, any decrease in house value, combined with the need to meet mortgage payments, could significantly alter retirement plans.

This decision has a disproportionate impact on women due to their historically different role in the labor force. Women traditionally have shorter or more interrupted work histories than men due to child bearing and rearing. They also earn lower wages and have a higher rate of participation as caregivers to aging parents. This creates a more severe impact on women's

retirement security. It may also help explain why 30 percent of single women (who represent a majority of U.S. households in old age) fall into the category of poor or near-poor.[7]

**Sources of Housing Wealth**

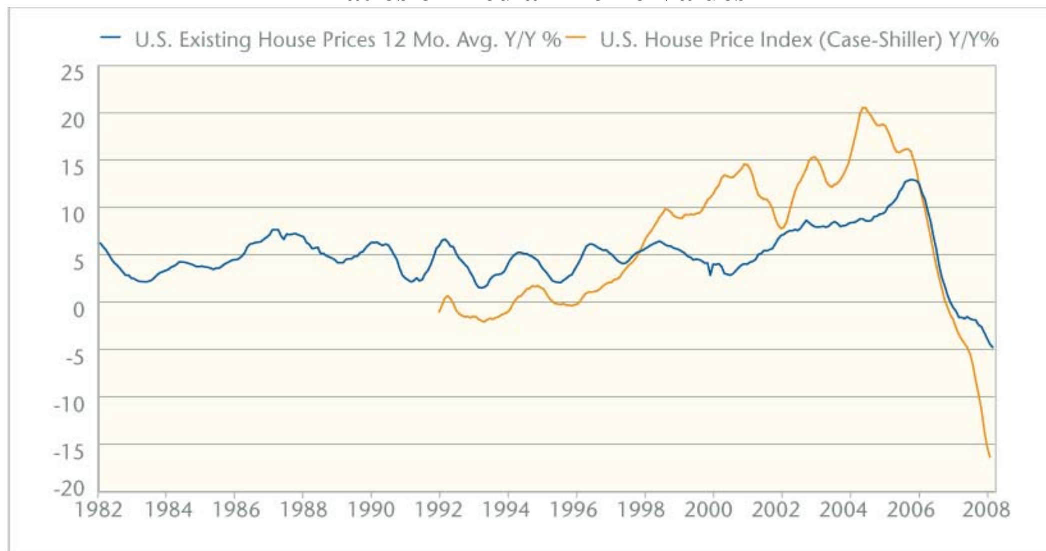
The dream of home ownership has been a persistent feature of American society since Thomas Jefferson promoted land ownership as an essential element of nation building. After World War II, ownership became more available and affordable through a combination of GI loans, the expansion of the Federal Housing Authority (with its relatively low down payment policy), and the development of dedicated residential suburban tracts.

As the middle class expanded, the residential real estate industry continued to expand its residential product offerings, while in the late 1970s, the residential mortgage industry began to develop a wider variety of loans with different down payment, term, and interest rate combinations to make home ownership more available to a wider audience.

These innovations, combined with lower interest rates, helped increase home ownership from 64 percent in 1995 to 69 percent in 2005. This increase reversed a home ownership trend that was nearly flat for 30 years.[8] By 2008, 67.8 percent of Americans owned their own homes.[9]

As home ownership increased, real estate values began a gradual escalation, with median home prices increasing 48.6 percent nationwide from 2000 to 2005, according to the National Association of Realtors.[10] In California, the median price increased by 117 percent. During the period from 2000 to 2005, the gap between median home values compared to median home incomes of households headed by people aged 30 to 34 had increased in 49 states, most notably in the West.

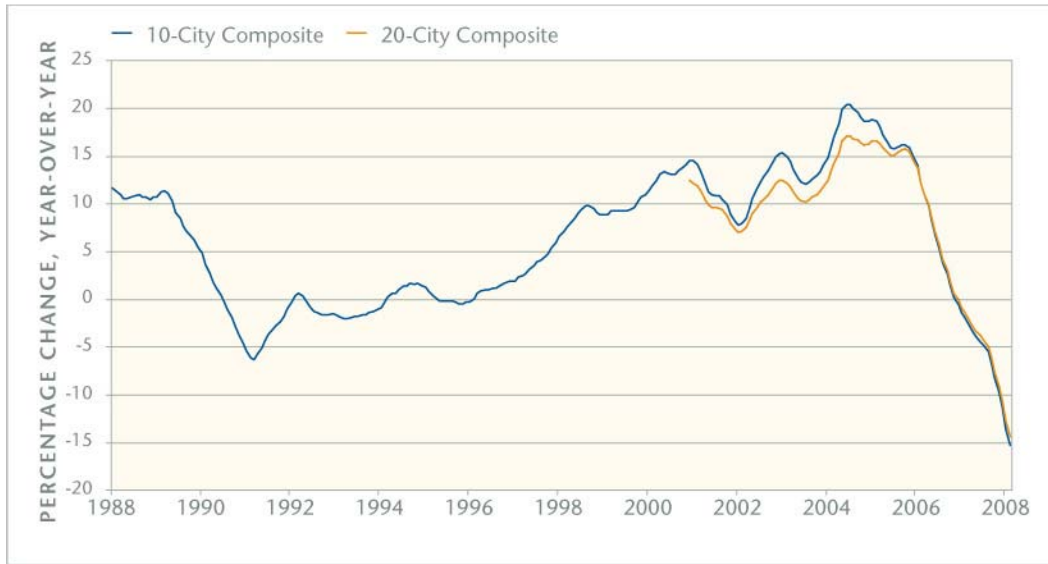
**CHART 3**
**Ratios of Median Home Values**




Source: U.S. Census Bureau.

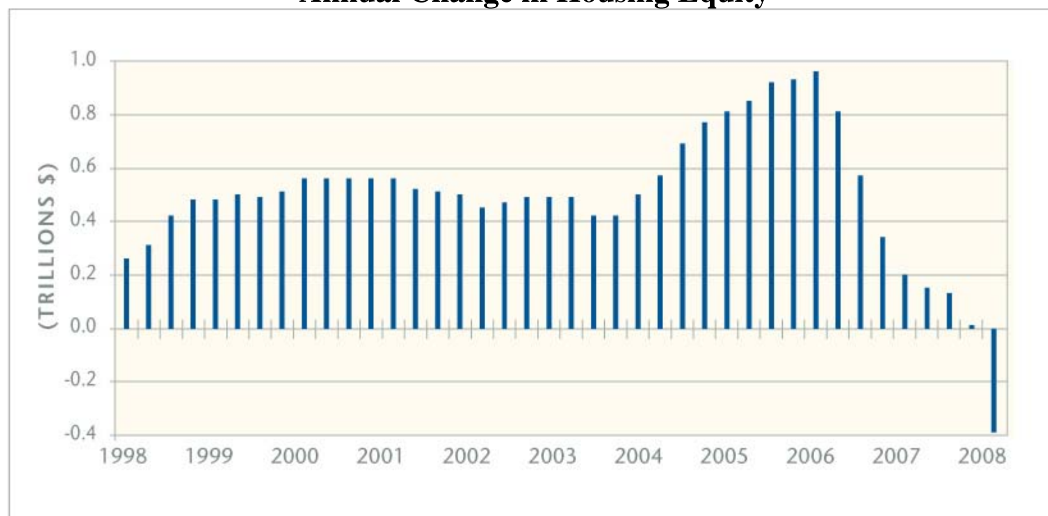
Prices peaked in the second quarter of 2006, as measured by the Case-Shiller Index. In 2007, prices began to fall in certain urban areas and then nationwide. This eventually resulted in a significant decline caused by a number of problems stemming from lax mortgage underwriting standards, the use of aggressive mortgage industry interest rate products, and a strong reliance on continued double-digit house price increases.

**CHART 4**
**S&P/Case-Shiller Home Price Indices**




Source: Standard and Poor's.com.

**CHART 5**
**Negative Wealth Effect for Homeowners**
**Annual Change in Housing Equity**




Source: Moody's Economy.com, Principal Global Investors, April 2008.

By July 2007, the deficiencies in the mortgage industry combined with such factors as steadily declining spread rates in the credit markets and the popularity of new structured debt products had all combined to create a worldwide credit crisis. As this affected the U.S. housing market, it is estimated that the decline (through early 2008) eliminated an estimated $400 billion in housing value nationwide.[4]

**TABLE 6**
**Home Ownership by Age**

| | **All Ages** | **<55** | **55-64** | **65-74** | **75+** | **65+** |
|---|---|---|---|---|---|---|
| 2004 | 69% | 62% | 79% | 81% | 85% | 83% |
| 2001 | 68% | 61% | 83% | 83% | 76% | 80% |
| 1998 | 66% | 59% | 80% | 81% | 77% | 79% |
| 1995 | 65% | 57% | 82% | 79% | 73% | 76% |
| 1992 | 64% | 56% | 78% | 79% | 77% | 78% |
| 1989 | 64% | 57% | 80% | 78% | 70% | 75% |
| 1986 | 65% | 59% | 73% | 83% | 67% | 76% |
| 1983 | 64% | 57% | 77% | 79% | 69% | 75% |

Source: CRR calculations from U.S. Board of Governors of the Federal Reserve System. 1985, 1994 and 2006. Survey of Consumer Finances. Washington, D.C.

As people age, home ownership patterns change. A 2006 study found that before age 75, home ownership rates remain essentially flat. However, after age 75, people are more likely to sell their homes and vehicles. By the time people reach age 90, home ownership drops to 40 percent.[4] The study said this is the "most significant" change—the sale of houses and vehicles—in household portfolios for the study group. The proceeds from these sales are often then deposited into bank accounts and CDs.

## The Role of Housing Wealth on Retirement Planning

For baby boomers planning to retire, housing wealth accounts for a majority of total net worth. While this figure is skewed according to demographics (education, race, age within the baby boomer segment, marital status, sex), home equity accounts for one-third of net worth at the mean and 50 percent at the median.[11] This makes baby boomers especially susceptible to housing price shocks, both positive and negative, which can significantly affect retirement planning and consumption patterns.

According to a 2004 University of Michigan Health and Retirement Study of individuals between the ages of 51 and 61 in 1992, 80 percent of early baby boomers (people born between 1948 and 1953) indicated they owned houses, while only 30 percent indicated they owned stocks. This stock wealth accounted for only 13 percent of their net worth. As a result, most people in this study were highly vulnerable to housing price shocks. Among the least educated group in this study, housing wealth accounted for an even greater share of their total net worth. As a result, housing price shocks among early baby boomers could cause "substantial wealth losses."[11]

In one simulation showing the effect of a decrease in housing prices for early baby boomers, a 13.5 percent drop in housing prices produced a 9 percent overall decrease in total net worth. For households in the median of the survey group, the median net worth loss would be 13 percent.[11]

In contrast, a more recent study released in October 2007 found that for every 10 percent increase in housing wealth (as measured by changes in house value), expected retirement dates were shortened by between 3.5 to five months.[12] However, this study also found differences between men and women in planning their retirement dates as a result of increases in housing wealth. Women tend to revise their retirement dates without relying as much on the housing wealth effect.

Another complicating factor affecting housing wealth has been the significant assumption of greater mortgage debt among homeowners. While more people are carrying more mortgage debt, the increase among older households is significant.[5] In 1989, 54 percent of households headed by people aged 55 to 64 had paid-off mortgages, but in 2001 that figure had decreased to 41 percent. In this same study group, 25 percent of households headed by people 65 or older were still paying off their mortgages. For people aged 55 to 64 holding mortgages, the median mortgage debt was $55,000 in 2001, an increase of $27,300 from 1989. For older mortgage holders over age 65, the median debt was $44,000, an increase of $31,500 from 1989.

As a result of the increase in mortgage debt and falling housing prices, many retirees and pre-retirees fall into the camp of being "cash poor, house rich." This group also faces the challenge of converting house equity into disposable income, often through a reverse mortgage (which is discussed later in this paper), while also treading through a declining or slowly recovering housing market.

**Housing Wealth and Consumption Patterns**

Both housing appreciation and depreciation affect consumption patterns of goods and leisure. Academics believe these patterns largely follow the Life-Cycle Hypothesis, developed in the 1950s and '60s, which posits that income variations over a person's lifetime are equalized by either borrowing or spending from existing wealth to smooth out consumption levels. In practice, younger people will borrow in anticipation of future incomes, while people in mid-life reduce spending to accumulate wealth in anticipation of maintaining a level spending pattern in old age. Other variables that affect the Life-Cycle Hypothesis spending patterns are household ages, bequests, projected earnings and life expectancy.

More recent studies and modeling of consumption patterns based on increased housing and stock market wealth found that there is a greater propensity for consumer wealth to be generated from an increase in housing (in the range of 5- to 9-percent) versus gains from financial assets (2 percent). One study found that households spend about 5 percent of every dollar in annual house price appreciation and this spending level accelerated at a faster rate than gains from stock appreciation.[5] The study believed that accessing house equity appreciation was made easier through the greater variety of home equity loans that have become available. Another key result affecting housing patterns is that more seniors are not accessing their home equity to fund retirement. A study conducted by the AARP found that 95 percent of people over age 75 said they wanted to remain in their current home for as long as possible.[13]

The impact of spending more home equity combined with a desire to maintain a house for as long as possible makes retirees and pre-retirees more susceptible to real estate declines.

## The Current Housing Market and Recovery Scenarios

Recent data indicates that the housing market will continue to suffer steep price declines which could last into 2009. The Standard & Poor's/Case-Shiller Index for Q1 2008 found that existing home prices nationally fell 14.1 percent from a year earlier, versus an 8.9 percent decline in the fourth quarter 2007. House prices in 20 metropolitan areas fell 14.4 percent in March 2008 from a year earlier, and 2.2 percent from February 2008, according to the S&P Case-Shiller Index.[14]

As of May 2008, house prices nationally were off 16 percent from the peak reached in the second quarter 2006. Since 2000, prices rose almost 90 percent to their peak, which was reached in the second quarter 2006. They have since declined to levels reached in the third quarter 2004. However, due to an oversupply, analysts expect house prices to decline at least 10 percent more before a bottom is reached. A study by ISI, an economic consulting firm, predicted that house prices should fall another 16 percent in order to bring prices back in line with nominal income increases of 5 percent on a year-over-year basis. This ratio is expected to be reached by 2010.[15]

Declines in house prices should persist since pre-retirees will not be able to absorb the supply of housing stock offered by retirees as they sell their homes. One study found that while housing market corrections have historic cycles lasting three- to seven-years, any new housing recovery would be shaped by very different demographic changes.

As a result of the current housing market bubble, any new housing cycle correction could take over 20 years to reach an equilibrium state, where buyers and sellers are proportional. The reason: When baby boomers aged 65 to 75 begin to sell their houses, there will be three sellers for every buyer.[10] This will create a "generational housing bubble" on top of the speculative housing bubble that developed from 2005 to 2007. This shift (more sellers than buyers) could start as early as 2010 and last until 2030. In the past, without this major change in demographics, housing corrections historically lasted three- to seven-years.

This new generational housing bubble would differ on a state-by-state basis as the number of older homeowners declines relative to younger home buyers, but its overall impact will be the same: there will be too many sellers to sustain house price increases.

This situation also would have a profound effect on suburban areas where there is a preponderance of stand-alone, single family homes.

Based on historical experience, the upcoming generation of retirees should continue to put their homes on the market after the death of a spouse.

### Housing Wealth Creation among People under Age 35

While this paper thus far has focused on housing wealth as it affects people approaching retirement, researchers have noted changes in first-time home ownership patterns as they affect wealth creation among younger people (under age 35).

A study by the Federal Reserve Bank of Chicago found that the share of household heads under age 35 in 2004 was at its lowest level since World War II.[8] In addition, due to innovations in the mortgage industry, development of a secondary mortgage market, and changes in Federal Reserve Board regulations (most noticeably Regulation Q), more people have been able to buy more expensive homes.

This phenomenon has been accompanied by a decrease in the median income of first-time home buyers. From 1976 to 1996, median real income dropped by 7 percent, and by 2005, real median income had dropped by 15 percent. Yet despite these lower income levels, beginning in the early-2000s, new home buyers could finance a house purchase with a significantly lower value-to-income ratio. In order to afford these more expensive homes, the study found that buyers were paying two times more of their after-tax income on mortgage servicing in 2005 versus 1976.[8]

So while home ownership continues to have emotional and financial significance, the trade-off between first-time buyers spending more of their after-tax income on mortgage servicing may mean that less money is available for retirement savings. This means an implied bet that house prices will continue to appreciate at a rate exceeding other more liquid market investments, or at least that the home will continue to serve as a main source of future wealth creation.

## How Housing Wealth Affects the Financial Planning Process

Since housing wealth comprises the single largest asset for elderly homeowners, any decrease in this wealth has a disproportionate effect on retirement planning from both a financial and psychological perspective.

As a result, financial professionals should consider the following facts when creating or revising financial plans for clients who are approaching or are in retirement:

### Increased Mortgage Debt Levels among Seniors

Homeowners are taking on more mortgage debt in addition to rising levels of consumer debt. This trend has shown a significant increase since 1995 as the average debt per household increased by 45 percent over the decade, from $40,600 to $58,700. Some of the largest debt increases occurred among the older age group. This is a significant change and means that homeowners are carrying more housing debt into their later years, while the number of older homeowners who have paid off their mortgages is declining. This is partly the result of homeowners of all age groups who are tapping into their home equity as a source of current funding.[20]

### Housing Market Recovery Times and Scenarios

Economic recoveries have historically followed three basic patterns, and are classified by letters which also describe the pattern of expansions and contractions in the business cycle. A "U-shaped" recovery contains a trough that can extend until growth factors accelerate upward. A "V-shaped" recovery has a faster recovery period, while a "W-shaped" recovery would see a period of decline followed by a recovery and then another decline. This is also a known as a "double-dip recession" and is considered a more serious economic event, often accompanied by accelerating layoffs and falling demand for goods and services.

Housing recoveries may share the same patterns as economic recoveries; however, the key variable that affects both asset recovery patterns is time. Both are difficult to predict and can only be measured after the recovery has developed.

The current housing price decline came after a 14-year cycle of increasing prices, which was the longest continuous housing price increase since World War II. In the first quarter of 2008, prices fell by 14 percent, the largest year-over-year price decline in 20 years. This price decrease is happening at a rate that is fives times faster than the last housing recession, according to the Standard & Poor's/Case Shiller National Home Price Index.[20]

The severity of this decline has also generated significant attention. Some dire estimates say it will take four to eight years to recover, while a more optimistic scenario projects a 12- to 18-month time frame. The estimated loss in housing could be between $460 billion to $1 trillion.[20]

The following table illustrates the amount of time it takes to recoup a loss of 10-, 20-, and 30-percent on a hypothetical house priced at $250,000 if money was invested in a 60/40-percent model portfolio. This example excludes taxes, depreciation and any mortgage payments that would be paid on the house.

**TABLE 7**
**Recovery Times to Recoup a House Price Loss**

| Amount of Loss | Dollar Amount of Loss | Time Period to Recover in Years | Time Period to Recover in Months |
|---|---|---|---|
| 10% of $250,000 | $25,000 | 10.3 | 123 |
| 20% of $250,000 | $50,000 | 15.2 | 182 |
| 30% of $250,000 | $75,000 | 19.2 | 230 |

**Assumptions:**

S&P 500 Composite Total Return: $6,000 initial amount on 12/31/1975. Transfers to maintain allocation at 60 percent will be made every 12 months. Fees attributable to any transfers made were waived. The effects of income and capital gains taxes are not demonstrated.

Lehman Brothers Aggregate Bond Index: $4,000 initial amount on 12/31/1975. Transfers to maintain allocation at 40 percent will be made every 12 months. Fees attributable to any transfers made were waived. The effects of income and capital gains taxes are not demonstrated.

Initial sales charge of 5.5 percent.

Source: Thompson Financial.

As table 7 shows, the minimum recovery time needed to recoup a $25,000 loss on a house valued at $250,000 using a 60/40-percent portfolio would be 10.3 years. This time period could be reduced in a more aggressive, and riskier, portfolio. However, it is often inappropriate for people close to retirement to assume more investment risk.

Since real estate recovery times vary greatly by location, this time period could be reduced. However, this is an unknown factor that could be exacerbated given the excess supply from other owners who have delayed putting their houses on the market.

Given the other behavioral finance and emotional factors that come into play when investors suffer a financial loss, it is difficult to imagine whether a homeowner would voluntarily sell their house for a loss unless they were suffering from extenuating circumstances. This situation will create a difficult challenge for retirees who rely heavily on housing equity. It will also significantly impact retirement planning.

## Reverse Mortgages

Since approximately 2003, reverse mortgages have become an increasingly popular way for homeowners who are over age 62 to access their home equity. The most popular form of reverse mortgages allows loans to be taken as a lump sum, line of credit, lifetime income, or payable for a certain time period. The most popular is a line of credit. Loan amounts depend on the age of the homeowner, interest rates, and the house price. If a loan is based on a National Housing Act of 1987 program, the loan amounts have limits ranging from about $200,000 to $362,000.[16]

Other private reverse-mortgage programs allow some private homeowners to receive larger amounts since they are exempt from the federal housing act guidelines. While reverse mortgage amounts can be substantial, they alone are not considered sufficient to provide an adequate retirement income. Interest rate volatility and home price decreases also have an impact on determining reverse mortgage loan amounts.

## Psychological and Emotional Considerations

Academic studies have found a shift in the attitude of elderly homeowners toward their primary residence. Numerous earlier studies, including one dating back to 2000, have found that older homeowners did not consider their home a source of wealth to be tapped in retirement and would prefer to remain in the house for as long as possible.[1, 13, 17] They considered it a place to live and as part of a family bequest. As a result, consumption decisions were not based on accessing house equity.

However, a more recent 2007 Harris Interactive-Boston College study of homeowners aged 50 to 65, whose main breadwinner was still working and planned to retire in the next 10 years, said they would not use their home equity if they had sufficient retirement income. However, if retirement income was insufficient, or if they had an outstanding mortgage, the survey group said they would be more inclined to access their home equity either through a downsizing, using a reverse mortgage, or a home equity loan.[1] Another interesting fact is that having a child who lives nearby or being childless both significantly reduce the probability of selling a house.[18]

## Changes in Health Status and Death of a Spouse

While this topic is not fully explored in this paper, health considerations play an important role in the decision of elderly homeowners to sell their house. This is especially true if the husband is the surviving spouse. Declines in an owner’s health status, including a nursing home stay or a decrease in mobility, are also good predictors of a future house sale.

## Reduced Inheritances

While the academic papers have not studied this effect, since housing wealth comprises such a large percentage of household wealth, any decrease in home sale prices should be reflected in bequest amounts.

### The Role of Insurance

One of the greatest determinants of whether a house is sold occurs when the owner's health declines or they enter a nursing home. If the homeowner has outside health, life or long-term health care insurance to reduce the risk of uninsured medical expenses, they can reduce the probability of selling the house. This has a significant impact on preserving housing wealth and reducing psychological stress during a health event.

Obtaining Medicaid nursing home assistance also has a housing component since those rules disqualify housing assets from being used to cover the cost of Medicaid nursing home services. In these cases, the spouse who is not in the nursing home may be more likely to sell their house and use the proceeds to pay these expenses.

## Action Steps for Financial Professionals

As a result of the decline in housing wealth that is affecting future retirees, here are a list of suggested questions that may help financial professionals gain more information about their clients' status and whether they are changing their retirement plans:

- Have you estimated how much your house has depreciated within the past two years?
- If so, how much has it declined?
- How much did housing equity contribute to your retirement plans?
- How much did your housing equity contribute to your overall wealth?
- Has this housing price decline affected your planned retirement date?
- How long do you think it will take for housing prices to recover in your neighborhood?
- If so, how many more years do you plan to work?
- As a result of this decline, are you postponing any major medical treatments?
- Are you still making contributions to your 401(k) plan? Are you taking early withdrawals?
- Are you contemplating a reverse mortgage?
- Is it appropriate to reconsider your investment strategy in light of the decrease in housing wealth?
- How has this decline in your housing wealth affected your investment risk tolerance?
- Has the decrease in housing wealth affected your legacy planning?
- Do you have outside sources of health, life or long-term heath care insurance to reduce the risk of incurring uninsured medical expenses?
- Are you staying informed about your client's debt levels as part of your regular client reviews?
- Are you continuing to emphasize the need for long-term investment planning of an overall portfolio?
- What is your client's source of retirement income? What portion, if any, of this income will be derived from a reverse mortgage?

These questions are dependent on a number of key factors, including your client's marital status, health, residence, location, number of real estate assets, investment assets, and overall wealth. These questions are suggested as starting points for further discussion.

## Conclusion:
## How the Housing Market Decline Affects Future Retirement Planning Scenarios

Due to the disproportionate amount of personal wealth contained in housing values, any significant decrease in these prices will have a cascading effect on the plans of current and future retirees. This presents a number of challenges to retirees and financial professionals who must now adjust their retirement planning, including many of the key components of that plan, such as possible portfolio reallocations, strategies to tap into home equity, devising new savings plans, and downsizing.

Housing values are the cornerstone of wealth building not only in the United States, but in most developed nations worldwide. As a result, the current decline in housing wealth not only affects those planning to enter retirement, but current retirees as well. The current situation will prompt retirement planning professionals to use both proven and new strategies to find solutions to this significant, long-term problem. This paper was designed to outline the significance of this problem from a retirement planning perspective, and suggest a line of discussion for finding appropriate individual solutions.

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