Retirement Implications of Housing Wealth and Spending

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Abstract

Like food and clothing, housing or shelter has traditionally been regarded as a basic expenditure of living. Government incentives to promote home ownership, such as affordable housing and deductibility from taxable income of mortgage interest and property taxes, among others, have resulted in growth in the choice of owning a home rather than simply renting. The growth in home equity ushered in a new concept of housing wealth or investment, with homeowners tapping on such equity (i.e., borrowing against equity) to finance other spending. The recent debacle in sub-prime mortgages has exposed many of the dangers lurking behind the treatment of housing, not so much as an investment, but as a source of more borrowing.

This paper will explore comparative trends in home ownership versus renters, the associated levels of housing expenditures, and the extent of equity borrowing where applicable. The ultimate goal is to stress the need in retirement to cover basic housing needs, and the risk of using housing for other purposes beyond those needs.

Introduction

Buying a home is a major life decision for most people depending on their lifestyle and purpose. Unlike other basic life expenditures, however, the factors driving decisions to owning a home, as compared to renting for example, are complex. There is a multitude of personal preferences and choices, often with major financial and economic consequences.

Many have come to view housing as an investment, not just consumption, especially when market prices rise sufficiently to offset the costs of homeownership relative to renting. Indeed expectations of ever-rising prices have led people who borrow to finance their purchase to believe that their home equity has nowhere to go but up, and to regard their home both as an inflation-protection tool and an assured income resource in retirement. In actuality because of current borrowing practices there is the real risk of loss not only of one's investment but more importantly of one's shelter. As evidenced by recent disarrays in the financial markets, there is a real threat to the security of homeownership that goes beyond the level of basic housing costs.

Over time government regulations, whose primary purpose is to encourage homeownership in the United States by making homes affordable to all Americans, have been promulgated. Consequently, there ensued not only an unprecedented growth in homeownership but also housing prices fueled in large part by widespread growth in opportunities for gainful dealing among market intermediaries in the financing and securitization sectors as well as investors posing as home buyers who thought of flipping homes as a quick way to get rich.

Housing as shelter is a basic tenet that has gotten lost in the booms and busts of the housing market. Housing has taken the form of discretionary spending, such as luxury upgrades or multiple dwellings used as a residence. It has also taken the form of investing, which like stocks and equity securities can be volatile, speculative and subject to market uncertainty. The natural market forces of supply and demand that drive rational housing trends, have been unduly influenced by market incentives that result in irrational behavior and unsustainable markets. Americans facing retirement need to ensure first and foremost an affordable place to live that meets their needs. The provision for housing costs and other basic needs is paramount, and the use of housing for discretionary spending or wealth accumulation, must be wisely managed to ensure the security and guarantee of one's shelter in retirement.

U.S. Government Role in Housing

Income taxes[1]

Since the 1913 enactment of the U.S. income tax code the mortgage interest deduction has been a favorite for American taxpayers who borrowed to finance the purchase of their homes. The benefit of this tax deduction was enhanced further by the rise in marginal tax rates. Figure 1 shows marginal tax rates (as a matter of interest, income share for the top 0.1 percent is also shown) in the United States, where the top marginal rate peaked at 94 percent in 1944 toward the end of World War II, and is currently at around 38 percent (Saez, 2005).

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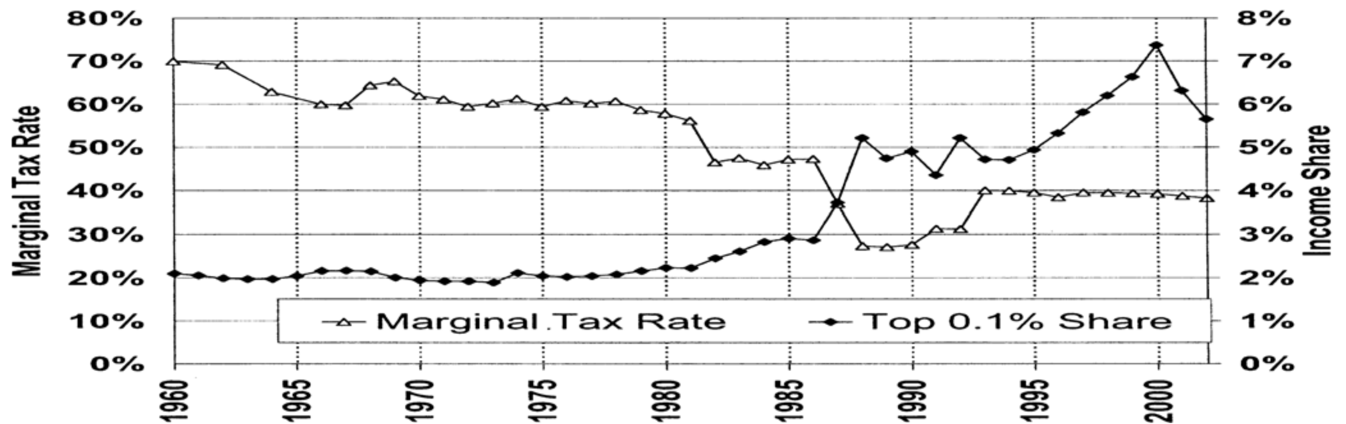
[1] Data from the Encyclopedia of Earth: History of taxation in the US, last updated January 26, 2007.

Figure 1
United States (Excluding State Income Taxes)[2]



It was also made more attractive with the passage of the Tax Reform Act of 1986 which eliminated deductibility of interest on all debt except on home acquisition or equity. This in turn may have led to the rise in borrowing against home equity to finance unrelated outlays including travel and personal luxury items, among others.

In 1951, legislation was passed that allowed homeowners to exclude capital gains from the sale of a principal residence if they purchased another residence costing at least as much within two years (Garriga, 2006). Beginning in 1964, taxpayers could take a one-time exclusion of $125,000 of capital gain if they were at least 55 years old. In 1997, new legislation instead allowed homeowners to exclude up to $250,000 for individuals ($500,000 for couples filing jointly) in taxable gains on the sale of a principal residence every other year.

Most states' income tax policies on housing are consistent with the federal tax code.

The favorable tax treatment of home financing and gains on sale has certainly facilitated a great deal of activity in the housing market, including trading-up to accommodate growing family needs, downsizing in light of need for less space or desire to rent or for a change to special housing to address personal needs, or relocating to be close to family or because of job change, for example. However, the special tax treatment has also made way for other housing market activities relating to the purchase of luxury homes, and secondary or multiple homes for leisure or vacation, rental or investment.

Over the years other federal measures and programs have evolved to encourage homeownership, based in part on the beneficial tax treatment of mortgage loans but also on socio-economic goals to promote community growth and development across the United States.

[2] Source: Saez computations using micro tax return data and TAXSIM calculator.

Federal Housing Programs

In response to the economic conditions at the time, the federal government created the Homeowners Loan Corporation (HOLC) in 1933 to reduce the rates of foreclosure in the early years of the Great Depression vis-à-vis refinancing or recovery loan grants (Collins, 1999). Another program, the VA (Veterans Administration) program was created at the end of World War II to help veterans buy homes without a down payment (Garriga, 2006).

The insurance concept of loan guarantees was introduced in 1934, when the FHA (Federal Housing Authority) was formed and empowered to issue policies that would insure risk to mortgage lenders, thereby enabling much lower down payments, interest rates and closing costs for homebuyers.

The year 1938 marked the beginning of a secondary market for mortgages (Garriga, 2006). The Federal National Mortgage Association (FNMA, or Fannie Mae) was created to purchase FHA-insured mortgages so as to enhance market liquidity and credit ease, also lowering liquidity premiums paid by borrowers. By 1948, FNMA was also purchasing VA-insured loans. In 1968, FNMA was restructured as a government-sponsored enterprise (GSE), or a financial services corporation backed by the full faith and credit of the U.S. government, whose function it is to enhance the flow of credit to a targeted segment of the economy, which in this case was the residential mortgage borrowing segment. In that same year, the Government National Mortgage Corporation (GNMA, or Ginnie Mae) was created to assume some of FNMA's functions. Two years later, GNMA began issuing mortgage-backed securities (MBS,) which are formed from and collateralized by groups of mortgage loans with similar characteristics. GNMA "passes through" to investors, or purchasers of MBS, the underlying monthly cash flow from interest and principal repayments. By 1981, all three GSE's were issuing MBS.

In 1970, the Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac) was formed, and also began issuing FHLMC-guaranteed (not a direct government obligation) participation certificates representing an undivided interest in a pool of conventional, non-assumable 30-year, fixed-rate mortgages.

The Housing and Community Development Act of 1987 was signed into law in 1988, enabling seniors age 62 and over who own a qualifying residence to tap into their home equity, tax-free, in the form of (a) a lump sum (b) multiple payments (c) line of credit or (d) in combination, with loan repayment deferred until sale of home (e.g., move out, death) but not to exceed the sale value of the home. This act, also known as Federal Housing Authority (FHA) reverse mortgage legislation, authorized the Department of Housing and Urban Development (HUD) to insure these loans through the FHA home equity conversion mortgages (HECM). A single national loan limit of $417,000 announced in October 2008 replaced previous HECM loan limits that have varied by county, ranging from $200,160 (rural) to $362,790 (highest home value areas). Since 1989 there were more than 450,000 American senior homeowners who took out HECM loans.[3]

[3] NRMLA (http://www.reversemortgage.org/).

FNMA became not only the largest investor of home mortgages; it was also a major investor of reverse mortgages. In 1996, FNMA created the Home Keeper reverse mortgage as a conventional market alternative to the HECM, such as for individuals with higher property values, condominium owners, and seniors wishing to use a reverse mortgage to purchase a new home. Eligible property types include: owner-occupied single-family homes, condominium units, units in qualified planned unit developments, properties held in trust and qualified leasehold properties; cooperative units are not eligible. For example, in 2006, FNMA's maximum mortgage limit of $417,000 was higher than the then locally applied FHA maximum mortgage limit.[4]

There were also housing programs set up to expand the community outreach for home purchase and development (Collins, 1999). In 1968, the federal government enacted fair housing legislation that outlawed racial discrimination in the purchase or rental of housing. In 1974, the Equal Credit Opportunity Credit Act enabled the Federal Reserve to deny bank mergers on grounds of violation of fair housing laws. In 1977, the Community Reinvestment Act (CRA) was passed obligating lenders to be sensitive to local credit demands. In 1990, the Home Mortgage Disclosure Act required lenders to disclose approval and rejection rates by race, gender and income. In 1995, regulations were implemented to strengthen the CRA by focusing the financial regulators on the performance of lending institutions in helping to meet community credit needs.

Under the Department of Housing and Urban Development (HUD), three affordable housing programs were created (Garriga, 2006). The Homeownership Zone (HOZ) helped with reclamation and economic revitalization projects in 1996 and 1997 through funding subsidies. The Home Investment Partnerships Program (HOME) was formed in 1990 to provide state and local government grants toward rehabilitation and assistance to low-income homebuyers and renters. In 2003, a new HOME initiative authorized formula grants to help first-time homebuyers overcome financial hurdle of requisite down payments, closing and rehabilitation costs. The Self-Help Homeownership Opportunity Program (SHOP) funds non-profit organizations such as Habitat for Humanity and other volunteer-based homeownership programs for low income families.

In 2003, the governmental supervision of the Federal National Mortgage Association (FNMA, or "Fannie Mae") and Federal Home Mortgage Loan Corporation (FHMLC, or "Freddie Mac"), two of primary agents guaranteeing sub-prime loans, was moved within the U.S. Department of the Treasury. By 2008, these GSEs as well as a number of financial institutions that have been deeply involved in unscrupulous mortgage lending are in trouble or have gone bankrupt, leaving the U.S. economy sliding into a potentially deep recession and the federal government faced with the unenviable task of restoring confidence in the financial markets, while homeowners and other stakeholders try to sort through not only their investment losses but potentially the loss of their home and livelihood as well. It would appear that lending institutions and investors had quickly come to view mortgages as a popular financial instrument that can be leveraged off of the active housing markets for huge gains. With the steady rise in MBS, this led to further securitization and other financial derivatives that became increasingly complex. As the housing market grew and prices rose, the ensuing frenzy gave rise to

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[4] Ibid.

increasingly lax underwriting and spurious deal making with little or no due diligence, leading to what could come to be the worst mortgage crisis of all time.

Homeownership in the United States

The rate of homeownership in the United States has grown from below 50 percent in the first half of the 20th century to around 65 percent from 1960 to 1995 and close to 70 percent at present. The trends in homeownership rates vary by demographic characteristics (age, family status, ethnic group) as seen in Figure 2 (Garriga, 2006). It would appear that, despite the modest rise in homeownership rates over the last 20 years, such rates remain the lowest for young, low-income households and minorities.

Figure 2
Trends in U.S. Homeownership Rates 1985-2004[5]

	Rate in 1985	Rate in 1994	Rate in 2004	Percent Change 1985-1994	Percent Change 1994-2004
U.S. Total	63.9	64.0	69.0	0.2	7.8
Age less than 35	39.9	37.3	43.1	-6.5	15.5
35-44	68.1	64.5	69.2	-5.3	7.3
45-54	75.9	75.2	77.2	-0.9	2.7
55-64	79.5	79.3	81.7	-0.3	3.0
65 and over	74.8	77.4	81.1	3.5	4.8
By family status					
Married couple family	78.2	78.8	84.0	0.8	6.6
Other families–male	57.8	52.8	59.6	-8.7	12.9
Other families–female	45.8	44.2	50.9	-3.5	15.2
Non-family–male	38.8	43.1	50.5	11.1	17.2
Non-family–female	51.3	54.5	59.9	6.2	9.9
By ethnic group					
Non-Hispanic White	*	70.0	76.0	*	8.6
Black	*	42.3	49.1	*	16.1
American Indian	*	51.7	55.6	*	7.5
Asian/Pacific Islander	*	51.3	59.6	*	16.6
Hispanic or Latino	*	41.2	48.1	*	16.7

* Not available.

[5] Data from the Housing Vacancy Survey, Table 15, U.S. Census Bureau, 2005.

For the period from 1986 to 2006 the number of consumer (housing) units in the U.S. grew from 94.0 million to 118.8 million. Figure 3 shows the characteristics of homeowner and renter units, combined and separately. Most of the growth in housing units came from homeowners. Homeowners are older and larger in family size on average, compared to renters. Renters have a higher percent in the minorities when compared to homeowners. There was an interesting gender shift in reference person toward more females in recent years across all housing units.

Figure 3
Trends in U.S. Homeownership by Housing Tenure 1986-2006[6]

	1986	1996	2006
All consumer units (in millions)	94.0	104.2	118.8
Average number in unit:			
- Persons/earners	2.6/1.4	2.5/1.3	2.5/1.3
- Children under 18/elderly 65 and over	0.7/0.3	0.7/0.3	0.6/0.3
- Vehicles	2	1.9	1.9
Reference person:			
- Age	46.7	47.7	48.7
- Percent male/female	66/34	60/40	46/54
- Percent black/white and other	11/89	12/88	12/88
Homeowner units (in millions)	58.3	66.3	80.0
Average number in unit:			
- Persons/earners	2.8/1.5	2.7/1.5	2.6/1.4
- Children under 18/elderly 65 and over	0.7/0.4	0.7/0.4	0.6/0.4
- Vehicles	2.4	2.3	2.3
Reference person:			
- Age	51.4	52.2	52.2
- Percent male/female	74/26	66/34	47/53
- Percent black/white and other	7/93	8/92	9/91
Renter units (in millions)	35.7	37.9	38.8
Average number in unit:			
- Persons/earners	2.2/1.1	2.3/1.2	2.2/1.2
- Children under 18/elderly 65 and over	0.6/0.2	0.7/0.2	0.6/0.2
- Vehicles	1.2	1.2	1.1
Reference person:			
- Age	39.1	39.8	41.5
- Percent male/female	55/45	51/49	45/55
- Percent black/white and other	17/83	19/81	19/81

A 1997 comparison of metro and non-metro housing by tenure and type of residence is presented in Figure 4. (USDA)

[6] Data from the Consumer Expenditure Survey of Average Annual Expenditures and Characteristics of all Consumer Units, U.S. Department of Labor, Bureau of Labor Statistics (BLS), 1986, 1996 and 2006.

Figure 4
Tenure and Type of Residence for Metro, Non-Metro and Non-Metro Low-Income Wage-Dependent Households, 1997[7]

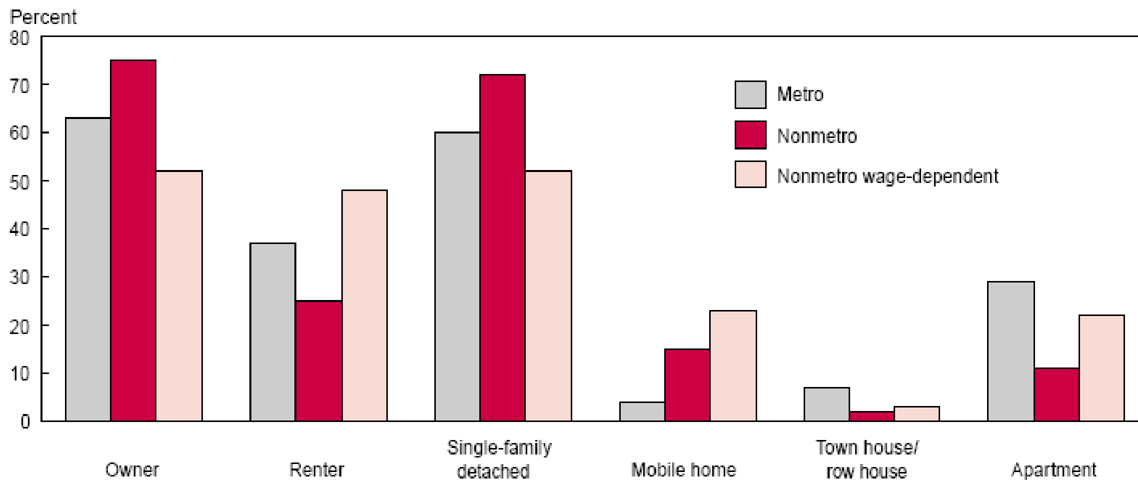

Figure 5 shows a further breakdown of older ages 55 and over by tenure status between 1985 and 2003. For the same period, Figure 6 shows the distribution within each age group by unit type (Blake, 2005).

The homeownership rate appears to peak at age 62 to 74, and declines as older households may be shifting towards renting, moving in with family members or into special senior housing. By unit type, the single-family (SF) detached is most popular across all ages, suggesting that older ages 62 and over may be choosing to age in place.

Figure 5
Older Age Distribution by Tenure Status (Percent) 1985-2003[8]

Householders Age	Tenure Status	1985	1987	1989	1991	1993	1995	1997	1999	2001	2003
55-61	Owners	78.6	79.5	79.1	80.5	80.3	78.8	79.7	80.3	80.3	80.4
	Renters	19.8	19.1	19.1	17.8	18.3	19.6	18.8	18.4	18.3	18.4
	No-Cash Rent	1.6	1.4	1.9	1.7	1.5	1.6	1.5	1.3	1.4	1.2
62-74	Owners	78.4	79.6	79.9	80.8	80.9	81.2	81.6	82.6	82.6	82.6
	Renters	19.7	18.5	18.4	17.8	17.5	17.2	16.8	16.0	16.0	16.0
	No-Cash Rent	1.9	1.9	1.7	1.5	1.5	1.7	1.6	1.4	1.4	1.3
75-84	Owners	68.1	70.3	72.2	74.2	74.8	76.9	78.9	80.0	80.3	79.8
	Renters	28.6	26.5	25.3	22.9	22.6	20.7	18.9	18.1	17.4	17.9
	No-Cash Rent	3.3	3.2	2.5	2.9	2.6	2.4	2.2	1.9	2.3	2.3
85 and over	Owners	56.8	56.6	56.1	56.9	59.0	66.1	64.2	69.5	72.2	73.0
	Renters	37.2	37.4	38.0	37.7	34.4	29.9	31.4	26.4	24.0	23.5
	No-Cash Rent	6.0	6.0	5.9	5.4	6.6	4.1	4.4	4.2	3.8	3.5

[7] Data calculated by Economic Research Service from the 1997 American Housing Survey, HUD and Census Bureau.
[8] Data from AHS analysis by ICF Consulting for HUD.

There are many factors that enter into deciding whether to rent or own a home, mostly personal preferences (e.g., proximity to one's job, schools, public transportation system, cultural versus nature activities) but financial considerations are paramount. For example, many view renting costs as money lost forever, compared to homeownership as tax-favored investing in building equity (i.e., from a combination of appreciation in house prices less housing and transaction costs, and less ultimate payoff of any mortgage financing). For owner occupied residences, homeowners benefit from each year's deductibility from taxable income of mortgage interest and property taxes, and for those who qualify, under current tax law, a large tax exemption on capital gains realized when the home is sold. In this manner, homeownership becomes both a place needed for one's basic shelter, with or without discretionary consumption, and an investment with potentially high returns however also not without risks.

Figure 6
Distribution of Housing Unit Type by Age (Percent) 1985-2003[9]

Householders Age	Unit Type	1985	1987	1989	1991	1993	1995	1997	1999	2001	2003
Under 35	SF Detached	45.0	43.9	44.4	42.6	42.5	42.1	41.8	41.8	43.2	44.4
	SF Attached	5.3	6.6	6.5	7.5	7.5	7.6	7.7	9.2	9.6	7.6
	Apartment	42.9	42.1	42.4	42.6	42.7	42.8	42.6	41.3	40.0	41.7
	Manufactured	6.8	7.3	6.7	7.4	7.3	7.5	7.8	7.7	7.2	6.2
35-44	SF Detached	69.7	68.2	67.4	66.6	66.4	66.5	66.7	66.9	66.2	67.4
	SF Attached	4.5	5.0	5.1	5.6	5.4	5.0	5.6	6.4	6.5	5.7
	Apartment	21.4	22.2	22.5	22.5	22.9	22.4	21.9	20.6	20.5	20.3
	Manufactured	4.4	4.6	5.0	5.2	5.3	6.1	5.8	6.1	6.9	6.5
45-54	SF Detached	72.5	73.2	72.2	71.1	72.2	72.2	71.5	71.2	71.6	71.7
	SF Attached	4.2	4.5	4.7	5.2	4.7	5.1	5.3	6.0	5.9	5.0
	Apartment	18.5	17.4	18.1	18.3	18.0	17.6	17.1	17.2	16.4	17.2
	Manufactured	4.8	4.8	5.0	5.4	5.1	5.1	6.0	5.6	6.1	6.1
55-61	SF Detached	72.7	72.3	72.7	72.8	72.4	71.4	71.5	71.4	71.7	71.6
	SF Attached	4.2	4.9	4.6	4.7	5.2	4.6	4.8	6.2	6.1	5.9
	Apartment	18.7	17.2	17.3	16.9	17.1	17.7	16.4	14.9	15.2	16.2
	Manufactured	4.4	5.5	5.4	5.5	5.2	6.4	7.2	7.4	7.0	6.2
62-74	SF Detached	68.8	70.0	70.2	70.3	70.7	70.4	70.9	71.7	71.3	71.8
	SF Attached	4.7	4.9	4.8	5.2	4.9	5.0	5.1	5.5	5.7	5.1
	Apartment	21.0	19.1	18.8	18.6	18.4	18.2	17.4	16.1	15.8	15.5
	Manufactured	5.6	6.0	6.2	5.9	6.0	6.4	6.7	6.7	7.1	7.5
75-84	SF Detached	60.8	62.3	62.1	63.4	64.2	65.4	67.3	67.6	68.1	68.0
	SF Attached	4.0	4.5	4.6	4.8	4.8	5.3	5.0	5.5	5.8	5.6
	Apartment	30.4	27.5	27.1	25.4	24.3	23.1	22.0	20.8	19.4	19.6
	Manufactured	4.8	5.7	6.2	6.3	6.8	6.3	5.6	6.2	6.8	6.7
85 and over	SF Detached	49.0	45.7	46.5	46.8	46.7	57.8	55.7	60.7	60.6	62.6
	SF Attached	3.6	5.5	6.1	6.1	5.8	5.4	5.4	6.5	6.1	4.7
	Apartment	36.7	37.7	36.1	36.2	36.5	31.0	32.3	27.7	27.1	26.7
	Manufactured	10.7	11.1	11.4	10.9	11.0	5.8	6.5	5.1	6.1	5.9

[9] Ibid.

The senior housing sector is a specialized market generally composed of five segments: active adult communities and senior apartments (both for-sale or for-rent); independent living facilities (ILFs), assisted living facilities (ALFs), skilled nursing facilities (SNFs) and continuing care retirement communities (CCRCs). These are typically age-restricted communities that provide varying level of care and amenities (such as housekeeping and personalized support services) with the living setting and which are subject to complex regulatory requirements at the federal, state and local levels (Lynn).

In 2004, the median age of all properties in the top metropolitan statistical areas (MSAs) is 19 years, with assisted living and/or nursing care less than 10 years (Edwards, 2004). Figure 7 presents a snapshot of the senior housing market segment in the third quarter of 2008.

Figure 7
Occupancy Rate for Senior Housing
(Properties Open 24 Months or Longer) – Q3 2008[10]

Property Type	Mean Occupancy (%)	Number of Properties	Number of Units (*Beds)
Independent Living	89	534	77,643
Assisted Living	88.5	1,399	103,775
Nursing Homes	84	985	122,991*
CCRCs	89.5	162	59,328
Independent Units in CCRCs	90.5	157	41,497
Assisted Living Units in CCRCs	88.5	129	8,049
Skilled Nursing Beds in CCRCs	87	136	9,782

In the following sections, we will explore trends in housing costs, debt and prices.

Housing Expenditures

Affordability is a key factor in deciding whether to rent or to buy a home, and when buying a home whether or not to seek financing and how much. Traditionally, homebuyers are expected to have some savings to use to make a down payment and then take out a mortgage loan to help finance the purchase. From the lenders' perspective, affordability is a measure of the borrower's ability to repay the loan and thus, the mortgage application usually goes through a

[10] Data from National Investment Center for the Seniors Housing & Care Industries (NIC) where occupancy rates are weighted by the number of properties reported by each major provider (no more than 10 percent of the sample).

qualification, approval and underwriting process to affirm that the borrower is not only able but also willing (based on past credit history) to repay the loan.

Typically, the qualification of a homebuyer for financing is relative to property value and prevailing interest rates. To meet income requirements the borrower must have income large enough to service the loan and new expenses in addition to existing debt, as well as upfront cash to meet purchase transaction requirements. A homebuyer who can afford a down payment of 20 percent or more of the purchase price of the house, has steady income, low other debt and good credit history may find it easier to qualify for mortgage financing than another buyer with less than 10 percent down.

Figure 8 illustrates sample calculations of house affordability. (Guttentag, 2007).

Figure 8
How Much House Can You Afford With a 7 Percent 30-Year Mortgage?[11]

To Spend This Amount on a House	You Need At Least This Monthly Income	To Cover This Monthly Housing Expense	Other Monthly Debt Payments Should Not Exceed	And You Need at Least This Much Cash	To Meet a Down Payment Requirement	And Closing Costs
$400,000	$11,200	$3,133	$895	$54,400	$40,000	$14,400
$350,000	9,800	2,741	785	47,600	35,000	12,600
$300,000	8,400	2,350	670	40,800	30,000	10,800
$250,000	7,000	1,958	560	34,000	25,000	9,000
$200,000	5,970	1,671	475	17,600	10,000	7,600
$150,000	4,480	1,253	355	13,200	7,500	5,700
$100,000	3,040	850	240	6,880	3,000	3,880

[11] The calculator assumes that: (a) Minimum monthly income is based on a ratio of monthly housing expense to income of 28 percent (b) Closing costs include points of a total of 4 percent of the loan (c) The maximum monthly debt service payment is 8 percent of minimum monthly income (d) Monthly housing expense includes principal and interest, mortgage insurance, taxes and hazard insurance (1.825 percent of purchase price) (e) Down payment requirement is 10 percent (prices of $250,000-400,000), 5 percent (prices of $150,000-200,000) and 3 percent (price of $100,000) (f) Mortgage insurance premium rates are 79 basis points with 3 – 5 percent down payments, and 53 basis points with a 10 percent down payment.

For most first time buyers seeking affordable housing, program incentives have led toward low to zero down payment and unfortunately also lax mortgage loan underwriting practices.

The trends in average pre-tax income and average expenditures (including income taxes) by housing tenure are presented in Figure 9. The distribution of expenditures by type of spending shows that housing costs clearly remain the biggest share (close to one-third) of total spending for both homeowners and renters, although the share is slightly increasing over the period from 1986 to 2006, and also slightly higher for renters.

Among homeowners, 60 percent held a mortgage in 1986, compared to 59 percent in 1996 and 64 percent in 2006.

Figure 9
Trends in Average Income and Expenditures by Housing Tenure 1986-2006[12]

	Homeowners			**Renters**		
	1986	**1996**	**2006**	**1986**	**1996**	**2006**
1. Average income before taxes ($)	31,014	45,654	72,988	16,478	24,708	34,847
Distribution of income by source (% Total)						
Wages	75.6	76.4	79.0	80.1	82.0	81.8
Self employ	7.3	6.9	6.3	3.5	3.6	4.7
Pensions, Social Security	10.8	12.8	10.7	7.7	6.8	7.9
Investment income	4.5	2.3	2.9	1.9	1.0	0.6
Other income	1.9	1.5	1.2	6.9	6.7	5.0
2. Average expenditures w/ income taxes ($)	30,967	43,230	59,420	17,944	25,961	33,106
Distribution of expenditures by type (% Total)						
Income taxes	9.0	9.1	5.4	6.1	6.9	2.5
Food	12.8	12.2	11.5	14.5	14.2	13.9
Alcohol	0.9	0.7	0.9	1.5	1.1	1.2
Housing	***27.0***	***28.2***	***31.3***	***30.9***	***31.6***	***35.6***
Clothing	4.9	4.5	3.5	5.9	5.5	4.5
Transportation	18.8	17.4	16.8	18.0	16.9	16.6
Health care	4.6	5.2	5.7	3.7	3.6	4.3
Entertainment	4.5	5.2	4.9	4.2	4.2	4.0
Personal care	1.1	1.4	1.1	1.2	1.5	1.2
Insurance, pensions	8.7	8.8	10.9	6.6	6.8	8.4
Charity	3.1	2.7	3.9	2.1	2.0	3.0
Education	1.1	1.2	1.7	1.5	2.0	1.9
Miscellaneous	3.3	3.3	2.4	3.8	3.9	3.0

[12] Data from the Consumer Expenditure Survey of Average Annual Expenditures and Characteristics of all Consumer Units, U.S. Department of Labor, BLS, 1986, 1996 and 2006.

An analysis of housing expenses is shown in Figure 10. For homeowners, about 50 percent of housing costs is attributable to costs of mortgage, property taxes and maintenance. This compares to close to two-thirds in percent of renters' housing costs from renting. Except for furnishings which are slightly higher as a percent of total for homeowners than renters, other shares of housing costs are comparable between these two groups.

One may extrapolate that, if the homeowner is free of mortgage debt, either by purchasing with all-cash, by full repayment of any outstanding mortgage debt or by foregoing refinancing for major remodeling, the average amount of housing expenditures for homeowners, absent P&I, can come close to those for renters. Furthermore, the housing share of total expenditures for homeowners can be reduced by nearly 30 percent, which can then be diverted to spending needs other than housing or saved for retirement.

Compared to renters, homeowners thus have the opportunity and wherewithal to better manage their housing costs. For example, housing expenditures applied toward long term or necessary upgrades work toward avoiding hefty increases for avoidable major repairs in the future. Building home equity and savings from also helps ensure a source of revenue that can be tapped for future housing costs and special new housing needs that may arise later in retirement.

In Figure 11, homeowners' loan-to-value ratios are estimated based on an assumed mortgage loan interest rate of 5 percent and varying periods of years remaining on the loan, where the "loan" amount (mortgage, home equity) is set equal to the present value (PV) of P&I payments and the "value" is the market value (MV) of the owned home. When interest rates are low, a homeowner may benefit from refinancing to either get cash back, or to lower P&I payments. In such cases, transaction costs (points charged by the lender) must be weighed against the financial benefits to the homeowner.

For example, a one percent change in interest rate (from 5 percent) results in a change in P&I of 9 percent with 25 years remaining, 6 percent with 15 years remaining and 3 percent with five years remaining.

Figure 10
Distribution of Housing Costs by Housing Tenure 1986-2006[6]

	Homeowners			Renters		
	1986	**1996**	**2006**	**1986**	**1996**	**2006**
1. Average housing expenditures ($)	8,362	12,200	18,585	5,548	8,204	11,787
<u>Distribution of housing expenses by type (% Total)</u>						
Shelter	50.6	53.3	56.5	64.3	64.5	67.7
Owned	***44.2***	***48.5***	***51.8***	*	*	*
Mortgage P&I	27.4	27.1	29.8	*	*	*
Property tax	8.0	12.0	13.1	*	*	*
Maintenance	8.8	9.3	8.8	*	*	*
Rented	*	*	*	***58.9***	***61.5***	***65.2***
Other	6.0	4.5	4.1	4.8	2.3	1.6
Utilities	24.1	22.8	21.6	18.7	19.3	18.0
Supplies	4.7	4.6	4.1	3.5	3.4	3.2
Furnishings	15.4	13.8	11.4	9.4	9.3	7.3
Operations	5.2	5.4	6.4	4.1	3.4	3.8
2. Average market value owned home ($)	79,551	114,140	270,879	*	*	*
3. Monthly rental value of owned home ($)	498	787	1,296	*	*	*

* Omitted.

Figure 11
Homeowner Loan-to-Value Ratios 1986-2006[13]

	1986	**1996**	**2006**
1a. Average Mortgage P&I	$2,291	$3,306	$5,538
1b. Present value of P&I (Loan-to-Value %)			
25 years remaining	$32,289 (41%)	$46,594 (41%)	$78,052 (29%)
15 years remaining	$23,780 (30%)	$34,315 (30%)	$57,483 (21%)
5 years remaining	$9,919 (12%)	$14,313 (13%)	$23,977 (9%)
2. Average Market Value (MV)	$79,551	$114,140	$270,879

Homeowners who do pay down their original mortgage loans on schedule (or faster) can increase homeowners' equity (wealth). However homeowners who repeatedly refinance their loans or tap their home equity for various reasons, such as to undergo luxury home improvements that may not be recouped in the current housing market or for leisure and travel, could end up being in higher debt and/or for longer, possibly into retirement.

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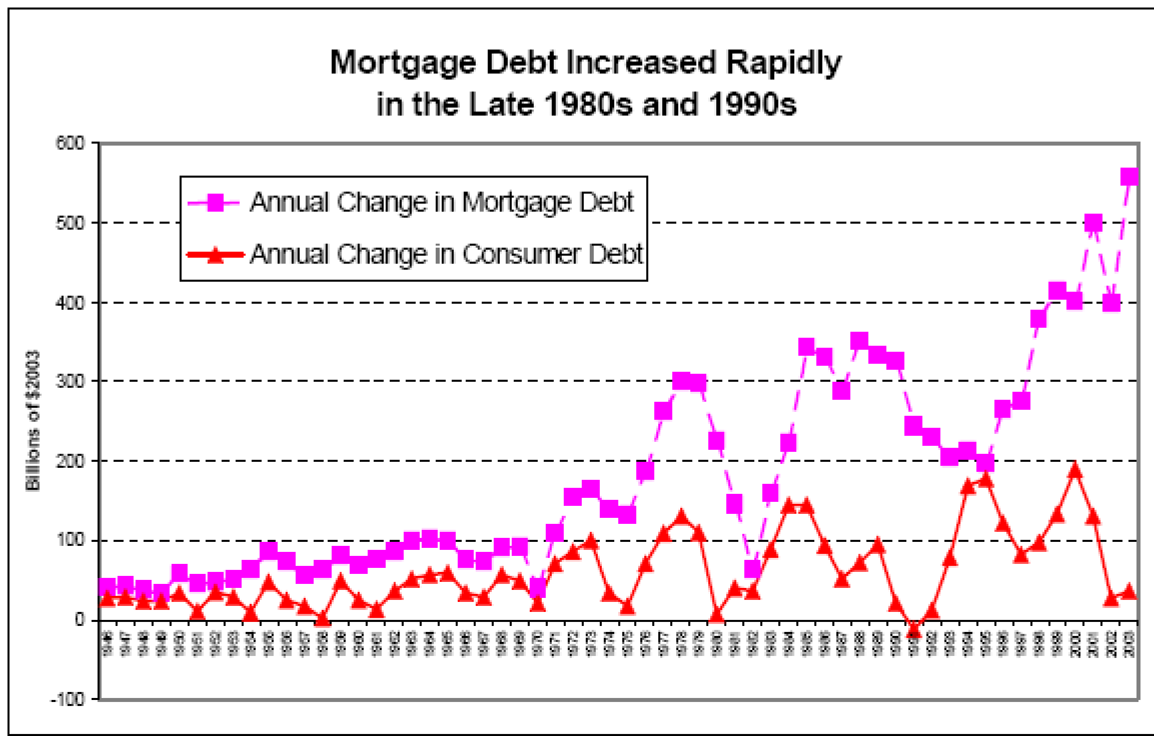
[13] Author's calculation (P&I and MV of owned home are from Figure 7).

Housing Debt

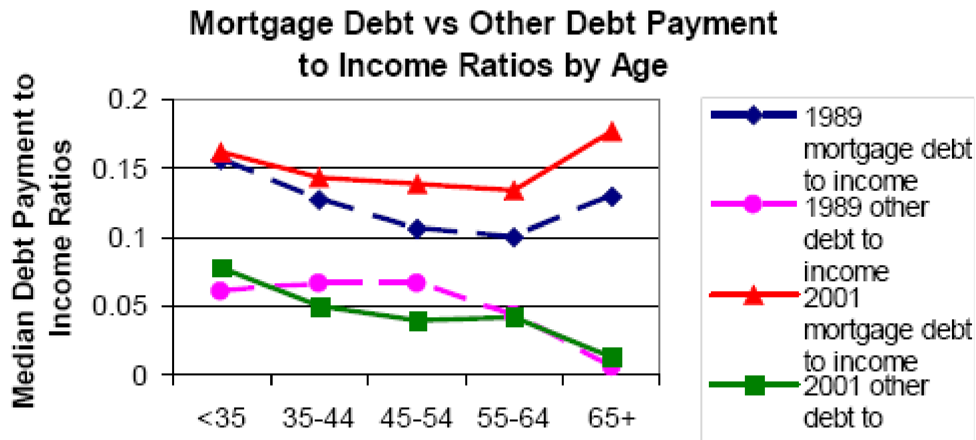
Recent trends show that more and more homeowners carry more debt (and less equity) even as they age, or go into retirement. Figure 12 shows the rapid growth in mortgage debt relative to consumer debt over the period from 1945 through 2003. Figure 12 shows the increase in mortgage debt payment to income ratios by age cohort between 1989 and 2001, relative to other types of borrowing. (Masnick, 2005)

Figure 12
Trends in Mortgage Debt 1945-2003[14]



[14] Data from Federal Reserve Board Flow of Funds, table B. 100, Balance sheet of Households and Nonprofit Organizations.

Figure 13
1989 and 2001 Mortgage and Other Debt Payment to Income Ratios[15]



As many homeowners find out, increasing debt combined with falling prices during bad economic times can result in shrinking and even negative equity. This means that if they sell their home, they will likely need to come up with additional funds to repay their loan. Furthermore, if the mortgage loan is sub-prime (e.g., low down payment, interest-only for an introductory period, variable interest rates) this means that the borrower's monthly mortgage payments could spike unexpectedly leading to the homeowner not being able to pay their loan, and hence face the risk of foreclosure by the mortgage lender and worst of all, becoming homeless.

Figure 14 shows foreclosure rates as of yearend 2007. (AARP).

Figure 14
Foreclosure Rates (in Percent), End-2007[16]

Age	All Consumers	Consumers With LTV > 100%
<50	0.50	0.85
50-61	0.26	0.54
62-69	0.21	0.33
70+	0.20	0.45
50+	0.24	0.49
U.S. average	0.39	0.72

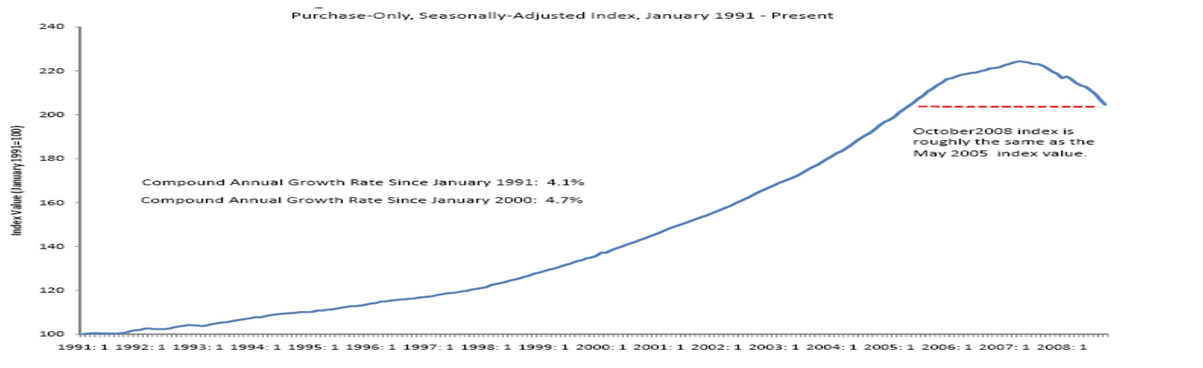
[15] Data from Harvard University Joint Center for Housing Studies tabulation of 1989 and 2001 Survey of Consumer Finances Data.
[16] Data from AARP Public Policy Institute.

Housing Prices

The last decade shows an unprecedented rise (boom) in housing prices, followed by a steep fall (bust) beginning in 2007, as seen in Figures 15 and 16 (FHFA). Homeowners not only saw their housing wealth dissipate, but those who were carrying large debt secured by their homes saw their outstanding debt exceeding their rapidly deteriorating equity. If they can manage to service their debt, they can wait and ride out the housing slump. If they are unable to make scheduled loan payments selling at a low price may be an option but they have to shell out more cash to repay the bank in full, or they can face bank foreclosure for non-payments and lose their home.

Some researchers find that non-financial assets, mainly housing, have constituted from two-thirds to three-fourths of the total value of assets among households aged 55 and older. (Abkemeier, 2009) The impact of a decline in housing prices and home equity can be profound, particularly for many seniors who are still carrying mortgage debt into retirement when usually there are limited resources and low probability of continuing or returning to gainful employment.

Figure 15
Monthly House Price Index for US[17]



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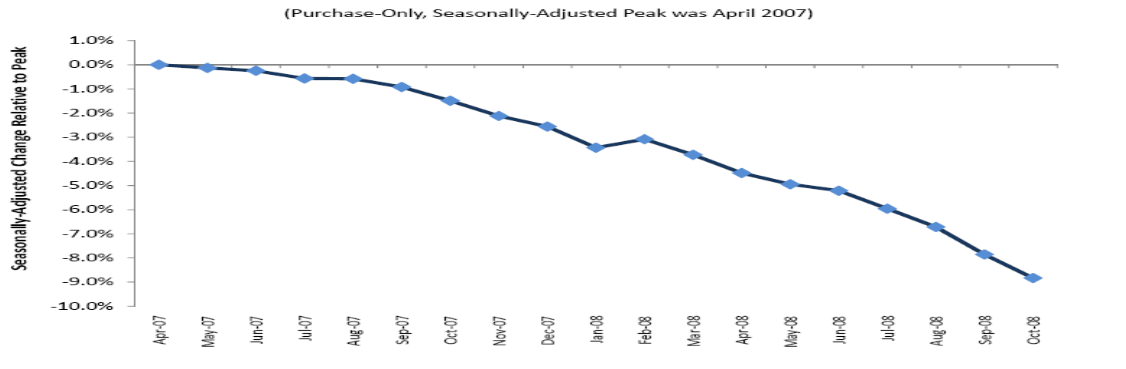
[17] Data from Office of Federal Housing Finance Agency (FHFA), formerly called Office of Federal Housing Enterprise Oversight (OFHEO).

Figure 16
Cumulative Seasonally-Adjusted Price Change Relative to Peak[18]



[18] Ibid.

Conclusion

Housing costs constitute a major part of basic life expenditures whether one is a renter or homeowner. The value of homeownership is founded in large part on building equity - from appreciation in value, repayment of mortgage debt, careful management of discretionary spending, making necessary maintenance outlays and home improvements. The value of housing as basic shelter is already subject to personal preferences and behavioral influences that can vary by region and cohort – such as type of housing, urban or non-urban location, special health needs or amenities, proximity to work, for example. Contrary to myth that housing prices can only go up, the value of housing as an investment can and does fluctuate - like financial assets e.g., stocks, they are subject to changes in the economic cycle, supply and demand.

Many elderly expect housing to constitute a major portion of retirement assets, but also recognize that housing costs can be a major share of total spending. Thus, protecting the value of one's home is also ensuring provision for enough savings and equity to cover future basic housing costs – this requires careful management of the use of home equity for irrational discretionary spending or speculative investment that can place one's basic shelter at risk of loss.

The risks for the elderly who look to their housing equity as a major resource in retirement, any exposure to rising housing costs and erosion in equity would come at a time when they have reduced fixed income and special needs. For many, working in retirement may not be a realistic option, but then they may have very limited or no other choices.

Recent trends in American homeownership belie the support for the American dream that has been provided through regulatory and financial incentives, together with the mistaken belief that housing values will always increase. Mortgage debt has traditionally been used to help purchase one's home, with the expectation of rising future income to pay down the loan over a period of years. Historically such mortgage debt and other borrowing are paid off when one is nearing or at retirement, when income from wages decrease or disappear, and the homeowner is then able to rely on the equity accumulated in the home as a resource if needed. However the fast rise in unaffordable mortgage debt used to finance homeownership has given rise to unsustainable housing costs and losses from foreclosure.

Any policy incentives to promote homeownership must require due diligence on both buyers and lenders to ensure truly affordable and sustainable housing, with focus on the use of the home as basic shelter rather than discretionary consumption or speculative investment. Otherwise many retirees may find housing not as a major resource, but instead face a major housing burden and/or risk the loss of their basic shelter, in retirement.

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