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DO PEOPLE PLAN TO TAP THEIR HOME EQUITY IN RETIREMENT?

By Alicia H. Munnell, Mauricio Soto, and Jean-Pierre Aubry*

Introduction

Many of today's workers are at risk of having insufficient resources in retirement. The reason for this gloomy picture is a rapidly changing retirement landscape defined by a rising Social Security retirement age, a sharp decline in traditional pensions coupled with modest 401(k) balances, and longer life spans. Yet, in spite of these trends, Americans have not responded by saving more on their own. Outside of employer-sponsored pension plans, individuals save virtually nothing for retirement.

The one potential bright spot is housing equity, which is the major asset for most families. While most retired households do not currently tap equity, this approach may be a luxury that future retirees will not be able to afford. As the baby boomers retire and the retirement income system contracts, housing equity is likely to become an increasingly important source of support.

To see if attitudes are changing about the potential for using one's home to cover living expenses in retirement, this *brief* reports on a survey that asks older working people today the role they think their house will play in their future. The results show that most households do not plan to access their home equity to cover regular living expenses. The house is seen as insurance against old-age contingencies and as a way to leave a bequest to children or charity. But the characteristics of those who say "yes" to tapping home equity suggest that more will do so in the future.

The House Is an Important Asset

Typically, households purchase homes early in their lives financed by a substantial mortgage. Households build up equity in their house during their working years by paying down their mortgage and by enjoying capital gains. Even though they may trade up to a larger house as their family grows and perhaps take on additional debt, the plan is often to end up mortgage free at retirement. In 2004, about 70 percent of homeowners 65 and older were mortgage free (see Table 1). And for those who still had a mortgage the outstanding amount had been substantially reduced.

Table 1. Homeownership and Mortgage Debt by Age of Household Head, SCF 2004

Age	Percent home-owners	Median home value	Percent of "mortgage free" home-owners	Median mortgage value
25-34	49.9%	$137,000	9.1%	$108,000
35-44	68.3	160,000	8.0	110,000
45-54	77.3	170,000	16.3	97,000
55-64	79.1	200,000	35.6	83,000
65+	83.3	140,000	69.6	43,000
All	72.2	160,000	30.9	95,000

Source: Authors' calculations from U.S. Board of Governors of the Federal Reserve System, *Survey of Consumer Finances* (SCF), 2004.

* Alicia H. Munnell is the Director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Mauricio Soto is a senior research associate at the CRR. Jean-Pierre Aubry is a research associate at the CRR.

The house is the major asset for most families. Table 2 presents the wealth holdings for the typical household approaching retirement. Other than the wealth represented by Social Security benefits, the equity in the house (gross house value less mortgage) clearly dominates all other assets. It amounts to about three times financial assets accumulated outside of employer-sponsored plans.

Table 2. Wealth Holdings of a Typical Household Prior to Retirement, SCF 2004

Source of wealth	Amount	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

Note: The "typical household approaching retirement" refers to the mean of the middle 10 percent of the sample of households headed by an individual aged 55-64.
Source: Authors' calculations from the 2004 SCF.

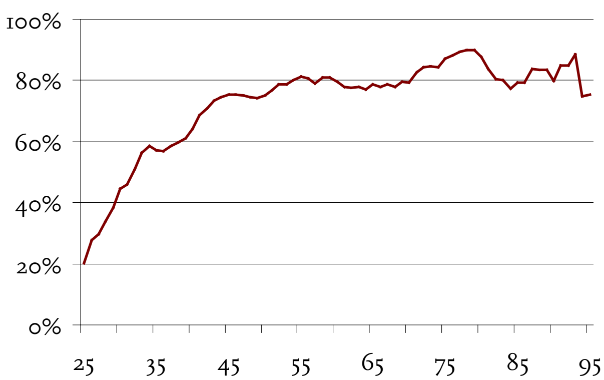
Current Retirees Do Not Tap Their Home Equity

Repeated analyses of survey data show that in the absence of a change in family structure, most older households are unlikely to move. In fact, homeownership rates remain virtually unchanged after age 55 (see Figure 1). Even those who move are more likely to move into a larger house than a smaller one.[1] That is, people do not tap their home equity as a source of support in retirement. This reluctance seems to contradict the traditional life-cycle model which says that households should draw down their accumulated assets so that they have little left when they die. Since housing is a major component of accumulated assets, the model suggests that households should be reducing their housing consumption, not increasing it.

Some observers have tried to explain why older households are so reluctant to move. One obvious reason is that people have a deep-seated attachment to their house and presumably their neighborhood. In a report of focus groups of older people regarding Medicaid estate planning, a common theme was the importance of passing on the family homestead. "First and foremost, you don't want to give up your home. That's a big thing giving up your home." "I think the house should be kept sacred." Even one member who thought that expectations must change described the prevailing view of the home among older people: "That sentimental attachment to your home and things that are customary is one of the chronic afflictions of older age and has to be overcome."[2]

In addition to the psychological factors, older people who own their own home are protected from potential rapid increases in rents that they might face if they sold and entered the rental market. One study found that homeownership rates were much higher in rental markets that demonstrated a lot of volatility.[3] Given the fact that housing costs are such a large portion of the budget of older households, older people should be particularly worried about big changes in this expenditure.[4]

Figure 1. Homeownership Rates by Age, 2004



Note: 5-year moving average of homeownership rates.
Source: Authors' calculations from the 2004 SCF.

Another economic reason why older households may not want to sell their home is that the house is treated favorably under Medicaid and other means-tested benefit programs. Provisions vary by state, but often the house is not included in the asset limits used to determine eligibility for either Medicaid or Supplemental Security Income.[5]

While the preceding explanations are reasons why older people may not want to sell their house, the question remains why when they do sell their homes they buy something that costs as much or more. One possibility rests with the reason for selling. The first most important is poor health, and studies that follow households into significantly older ages do find some downsizing among people in their eighties or beyond, usually as a result of widowhood or serious illness.[6] But the second most important reason is to move closer to family.[7] Buying a new house or condominium near children may well require spending more, even if the amount of space may be less. The third major reason for moving is "amenities," which may involve moving to a resort area and higher costs.

Thus, the story from previous research is that older households generally do not sell their homes and when they do they usually increase rather than reduce their home equity.[8] This behavior can be quite rational in the following sense. The house serves as a form of insurance for older households. If everything goes well, they can live in their home — protected from rent hikes — and leave their home to their children when they die. If events turn bad and they are faced with a major illness, they can retain their home even if they have to turn to Medicaid to cover nursing home expenses for one member of the household. The remaining spouse can continue to live in the home. At the death of the remaining spouse, the state may attempt to recover long-term care expenses out of housing equity. Any amount over this repayment can be bequeathed to children or their heirs. In the worst case, their financial needs force them to sell, and the cash helps them meet health care and other costs. Thus, for current retirees the house serves as a buffer against contingencies, and if events work out well the house will be left as a bequest.

New Survey Reveals Older Workers' Attitudes Towards Their House

In order to see whether those who will retire in the next ten years plan to use their home equity in different ways than current retirees, the Center for Retirement Research contracted with Harris Interactive to conduct a survey that examined the house as a potential source of retirement income. For details about Harris Interactive and the survey methodology, see the back page of this *brief*. The survey was conducted online between January 24 and February 2, 2007. The sample consisted of 2,673 individuals aged 50 to 65 who were homeowners, whose primary earner was not retired, and who said that they played a major role in the household's financial decisions. The responses were weighted to control for sample selection — not everyone is online, for example — and to make the sample representative of the population of the nation. The sample characteristics are comparable to those of the 2004 *Survey of Consumer Finances* (see Appendix Table A1).

Table 3. Planning to Use Home Equity for Ordinary Living Expenses?

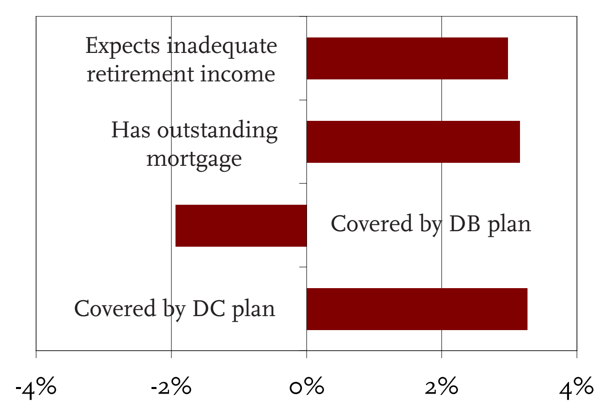
Response	Age			
	50-54	55-59	60-65	All
Yes	5	7	6	6
No	69	73	77	72
Not sure	26	20	17	22

Source: Authors' calculations from the Center for Retirement Research at Boston College (CRR)-Harris Survey, 2007.

The survey asked the direct question: "Are you planning to use any of your home equity to finance ordinary living expenses in retirement (such as food, clothing and travel)?" Almost three quarters of the respondents said no, most of the rest were unsure, and only a handful said yes (see Table 3).

A Probit equation was used to identify the characteristics that affected the probability of answering "yes" to the question of planning to access housing equity. The results indicate — not surprisingly — that expecting an inadequate retirement income increases the probability of using home equity as a source of retirement income (see Figure 2). Interestingly, having an outstanding mortgage also increases the probability of accessing home equity. Households that enter retirement with mortgages might be more comfortable with financial instruments and less attached to their home equity than those who enter

Figure 2. Factors Affecting Probability of Using Home Equity for Ordinary Living Expenses During Retirement



Source: Authors' calculations from the CRR-Harris Survey, 2007.

retirement mortgage-free. Or having a mortgage could be just another indication of being inadequately prepared for retirement.

Pension type also seems important. Relative to having no pension, being covered by a defined benefit plan reduces the probability of using home equity during retirement; being covered by a defined contribution plan increases this probability. Defined benefit pensions offer a constant and relatively secure stream of retirement income, which allows households to maintain their housing equity untouched. Defined contribution plans, on the other hand, might be perceived as a less reliable source of retirement income, increasing the likelihood that households will tap into their home equity during retirement. (The impact of other variables is shown in the full equation in Appendix Table A2.)

Those who responded affirmatively regarding plans to tap home equity were asked a follow-up question regarding how they planned to access their equity. As shown in Table 4, the vast majority planned to access home equity by downsizing. Of the remainder, a few plan to take out a reverse mortgage, which allows homeowners to borrow against the equity in the home and repay the loan and accumulated interest — often through the sale of the house — once they move or die. Others say they plan to opt for a home equity loan, even though these loans require regular payments of interest (and sometimes principal). Reverse mortgages tend to look less attractive and home equity loans more attractive as respondents approach retirement.

Table 4. Plan to Tap Equity: Various Approaches

Response	Age			
	50-54	55-59	60-65	All
Downsizing	54	55	60	55
Home equity loan	6	14	20	11
Reverse mortgage	16	18	5	15
Not sure	25	13	15	18

Source: Authors' calculations from the CRR-Harris Survey, 2007.

As noted, about three quarters of those surveyed say that they do not plan to tap their equity. Those 'no' respondents were then asked what they planned to do with the equity in the house. Nearly half said they would use it as a last resort for living expenses or to finance nursing home care or other health emergencies (see Table 5). Another 20 percent said that they planned to leave their house as a bequest either to their children or to a charity. This pattern of response among current workers nearing retirement mirrored closely how current retirees treat their home equity.

Table 5. Do Not Plan to Tap Equity: Intended Use of House

Response	Age			
	50-54	55-59	60-65	All
Insurance against living and health expenses	41	47	48	44
Bequest	20	19	18	20
Other	9	8	13	9
Not sure	30	25	20	27

Source: Authors' calculations from the CRR-Harris Survey, 2007.

Conclusion

The survey results suggest that those approaching retirement today have a view towards their house that mirrors that of those already retired — they do not plan to affirmatively access their home equity but rather plan to hold on to their house for insurance against unplanned living or health expenses or to leave as a bequest. But given that the retirement landscape is becoming more treacherous, that picture may well change. Indeed, the equation suggests that being inadequately prepared for retirement, having to rely on a defined contribution plan, and having a mortgage are all positively related to plans to tap home equity in retirement. These factors — inadequate preparation, reliance on defined contribution plans, and having a mortgage in retirement — are all on the rise, suggesting that a similar survey five years from now will show significantly more people planning to tap their housing equity to cover living expenses in retirement.

Endnotes

1 Venti and Wise (1989, 2004); Merrill (1984); and Feinstein and McFadden (1989).

2 Curry, Gruman, and Robison (2001), originally cited in Skinner (2004).

3 Sinai and Souleles (2005).

4 See Butrica, Goldwyn, and Johnson (2005).

5 In Massachusetts, for example, the primary residence generally does not count towards an asset limit in determining financial eligibility for Medicaid-financed long-term care. The primary residence triggers ineligibility only if the equity interest is over $750,000 and a spouse or child is not still living in it. See Massachusetts Office of Health and Human Services (2007).

6 See Sheiner and Weil (1993) and Venti and Wise (2001 and 2004).

7 Choi (1996).

8 This argument can be found in Skinner (2004).

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APPENDIX

Appendix

Appendix Table 1. Descriptive Statistics of the Survey Sample vs. the 2004 Survey of Consumer Finances

Type	CRR-Harris Survey		Survey of Consumer Finances, Homeowners 50-65*	
	Mean	Median	Mean	Median
Net value of home	264,357	140,000	235,220	132,625
Income	116,593	74,062	128,022	77,183
Defined contribution balance	351,944	130,000	231,617	97,838
Has an outstanding mortgage	0.77	1.00	0.74	1.00
Defined contribution plan	0.80	1.00	0.70	1.00
Defined benefit plan	0.60	1.00	0.48	0.00
Nonwhite	0.17	0.00	0.15	0.00
Couple	0.80	1.00	0.72	1.00
College or more	0.38	0.00	0.43	0.00
Inadequate retirement income	0.46	0.00	0.37	0.00

* The SCF figures have been converted from 2004 to 2007 dollars to make them comparable to the survey statistics.
Source: Authors' calculations from the CRR-Harris Survey, 2007.

Appendix Table 2. Factors Affecting the Intention to Tap Home Equity in Retirement

Variable	Marginal effect	z-stat
Expects inadequate retirement income*	0.030	2.70
Has outstanding mortgage*	0.032	2.54
Covered by Defined Benefit plan*	-0.019	-1.76
Covered by Defined Contribution plan*	0.033	2.57
Net home value (in $100,000s)*	0.003	2.89
Age*	0.002	1.66
Annual income (in $10,000s)	0.000	0.74
College educated*	0.020	1.88
Nonwhite*	0.029	1.85
Married or living with partner	-0.002	-0.18
Pseudo R^2	**0.0479**	
Number of observations	**2002**	

* Statistically significant at least at the 10 percent level.
Source: Authors' calculations from the CRR-Harris Survey, 2007.

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The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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Contact Information

Center for Retirement Research
Boston College
Hovey House
140 Commonwealth Avenue
Chestnut Hill, MA 02467-3808
Phone: (617) 552-1762
Fax: (617) 552-0191
E-mail: crr@bc.edu
Website: http://www.bc.edu/crr

Methodology

Harris Interactive® conducted the study online within the United States between January 24 and February 2, 2007 among 2,673 adults (aged 50-65). Figures for age, sex, race, education, household income, and region were weighted where necessary to bring them into line with their actual proportions in the population. Propensity score weighting was also used to adjust for respondents' propensity to be online.

All surveys are subject to several sources of error. These include: sampling error (because only a sample of a population is interviewed); measurement error due to question wording and/or question order, deliberately or unintentionally inaccurate responses, nonresponse (including refusals), interviewer effects (when live interviewers are used) and weighting.

With one exception (sampling error) the magnitude of the errors that result cannot be estimated. There is, therefore, no way to calculate a finite "margin of error" for any survey and the use of these words should be avoided.

With pure probability samples, with 100 percent response rates, it is possible to calculate the probability that the sampling error (but not other sources of error) is not greater than some number. With a pure probability sample of 2,673 adults one could say with a ninety-five percent probability that the overall results have a sampling error of +/- two percentage points. However that does not take other sources of error into account. This online survey is not based on a probability sample and therefore no theoretical sampling error can be calculated.

About Harris Interactive®

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