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The Insecurity of Aging: The Retirement Savings Crisis and the Hazards of Homeownership

big.bright.minds.2019
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These are my own views, and not necessarily the views of the Federal Reserve Bank of St. Louis, Federal Reserve System, or the Board of Governors

Overview

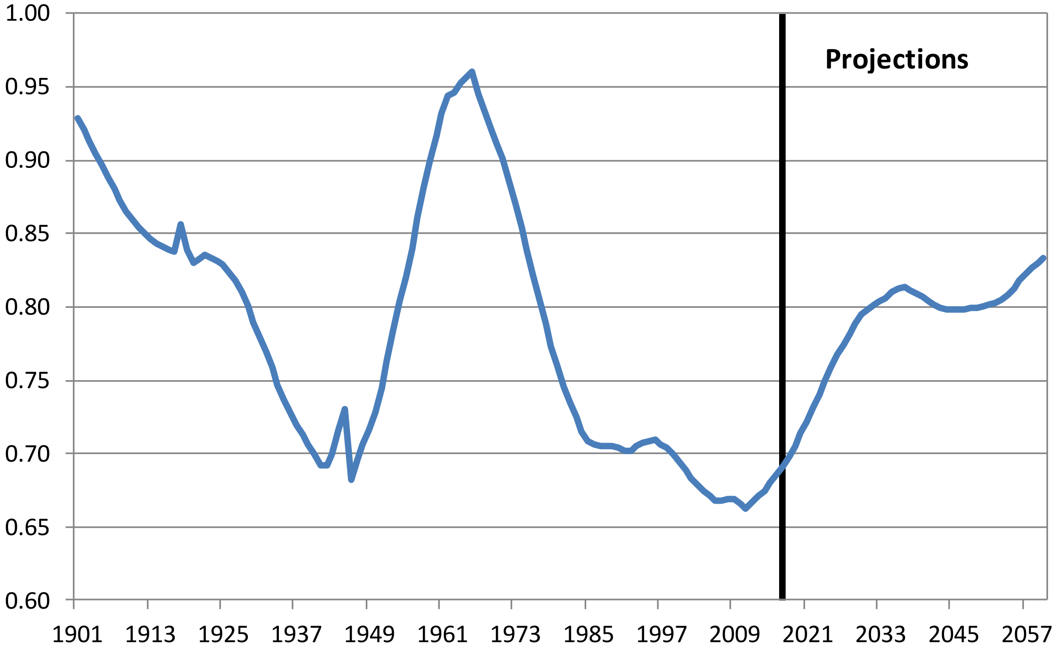
- Changing U.S. Demographics
- The Retirement Savings Crisis
- Innovations and Reforms
- Homeownership Inequities
- Improving Access to Home Equity

The Demographics They Are A-Changin'

Dependent Population Expected to Grow

Dependent-Age Population (<20 and 65+) per Prime-Age Person

Ratio

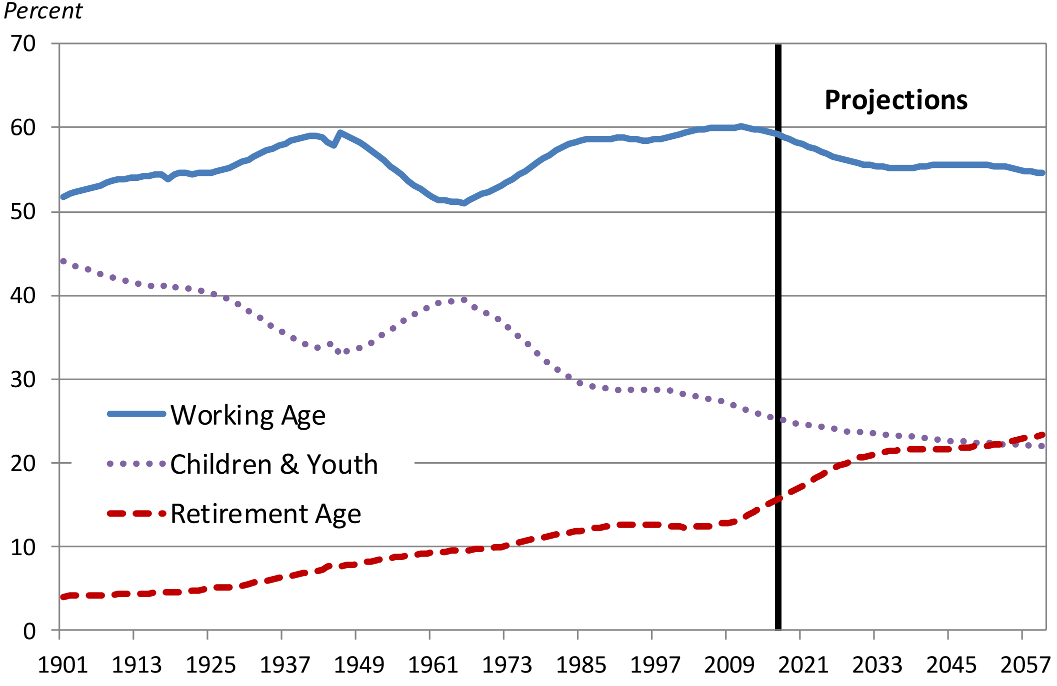


Source: Census Bureau/Haver Analytics, Projections as of December 2017.

- Dependent individuals (younger than 20 and older than 65) are expected to rapidly rise as a share of the population in the next few decades.
- This will have important implications for the population and the economy.

Projected Surge in Retirees

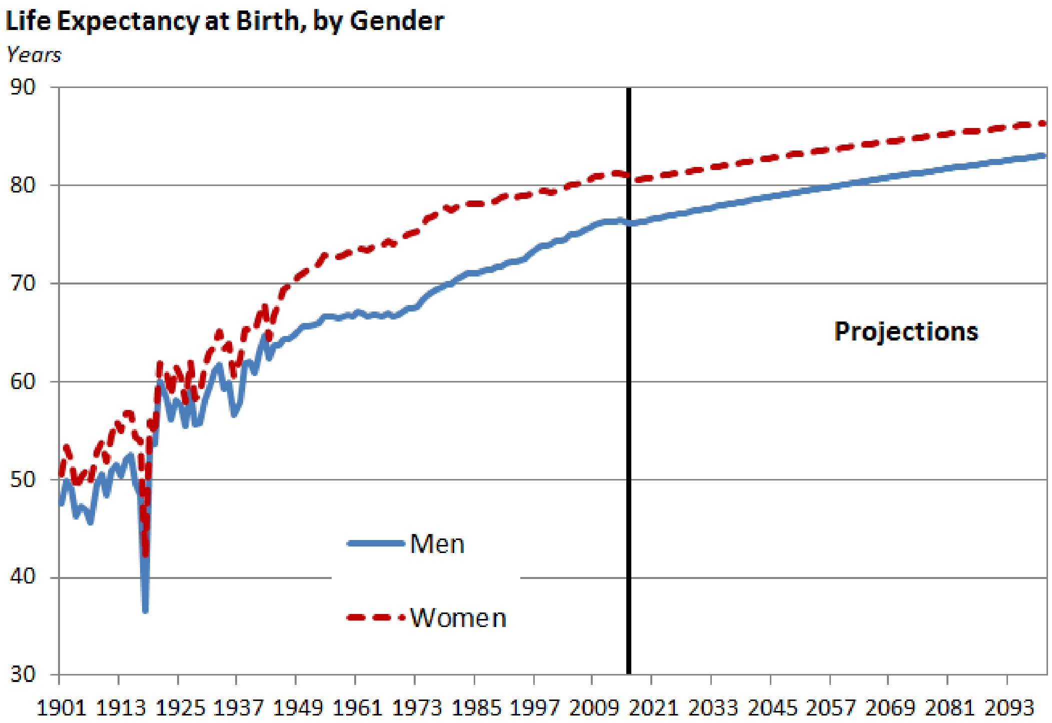
Population Shares, Actual and Projected



Source: Census Bureau/Haver Analytics, Projections as of December 2017.

- The surge in the dependency ratio will be primarily driven by greater share of population reaching retirement age.
- Additionally, the U.S. fertility rate has been declining slightly.

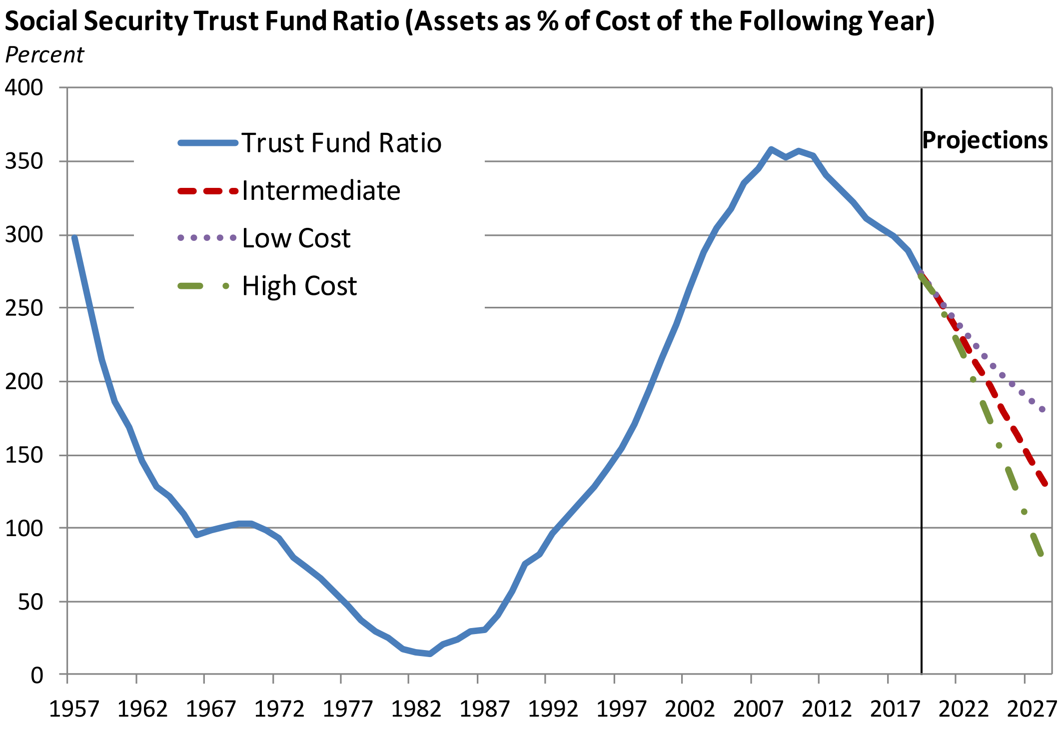
Longer Retirements Expected



Source: National Center for Health Statistics, Projections from SSA, Bell and Miller (August 2005).

- The average life span increased dramatically during the 20th century.
- Life expectancy is expected to increase further, and the rate of that increase has surpassed earlier forecasts.

SS Outlays Growing Faster than Income



Source: Social Security Administration/Haver Analytics, Projections as of April 2019.

- Demographic and other factors are going to stress the social safety net in the form of social security and other programs.

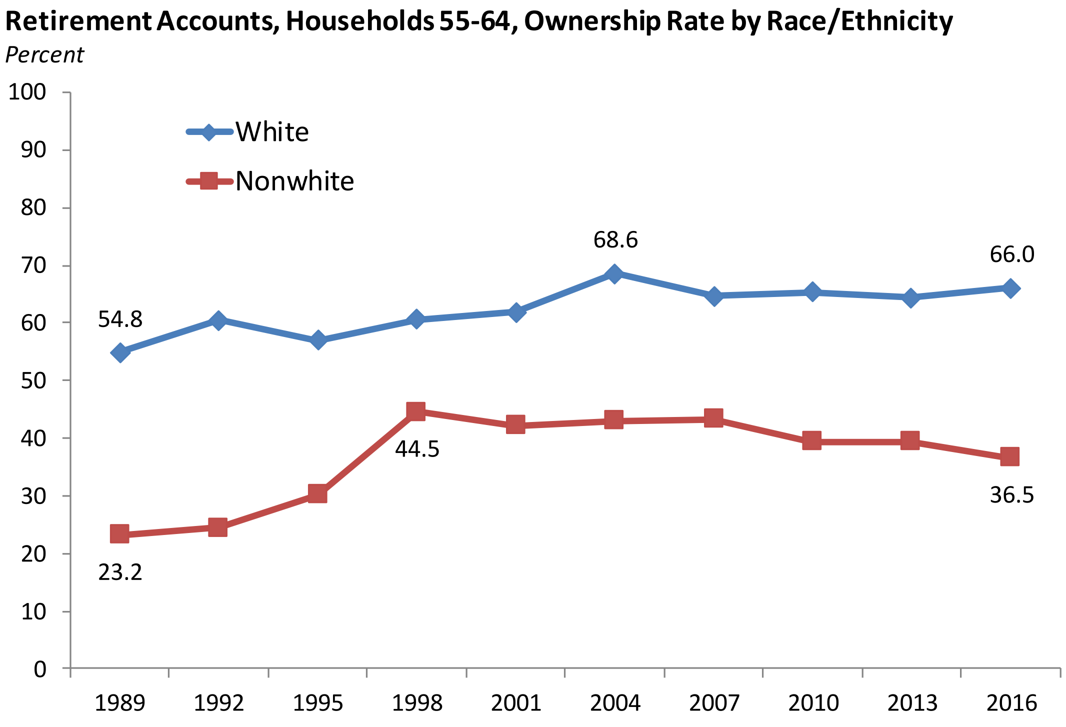
- Supplemental poverty measures indicated that SSI kept about **18 million** seniors (65+) out of poverty in 2018.

The Wobbly Stool of Retirement Security

How Prepared are Americans for Retirement?

- According to the 2018 SHED, only 36 percent of non-retired adults think their retirement savings plan is on track.
- Furthermore, 25 percent of non-retired individuals reported that they had no retirement savings or pension whatsoever.
- Among those with retirement savings, only 22 percent have money in *defined benefit* pensions.
- Of those aged 60 and older, 13 percent have no retirement savings or pension; 45 percent think their savings are on track.

Coverage Gap, Whites vs. Non-Whites

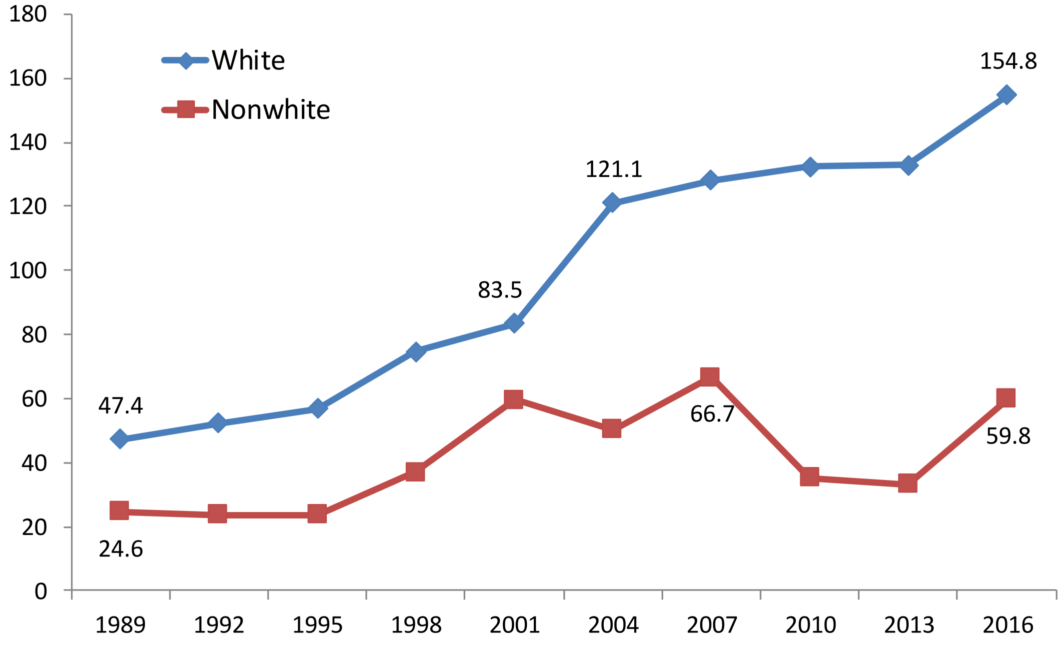


Source: Federal Reserve Board's Survey of Consumer Finances.

- Ownership of *defined contribution* (DC) plans has long differed between white and nonwhite families.
- The gap was narrowest in 1998 and has since gradually expanded to 29.5 percentage points in 2016.

Funding Gaps, Whites vs. Non-Whites

Retirement Accounts, 55-64, Median Value by Race, Conditional on Ownership
Thousands of 2016 $



Source: Federal Reserve Board's Survey of Consumer Finances.

- *Of those families that own DC plans*, the typical white and nonwhite family differs dramatically in funding.
- As of 2016, the typical white family had 2.6 times the level of funding.

Long-Term Savings Require Short-Term Stability

- In 2018, **39 percent** of adults would borrow or sell something to cover an unexpected $400 expense.
- This short-term financial insecurity precludes long-term savings.
- Thus, improving retirement preparedness must proceed hand-in-hand with other efforts to improve financial well-being.

INNOVATIONS AND REFORMS

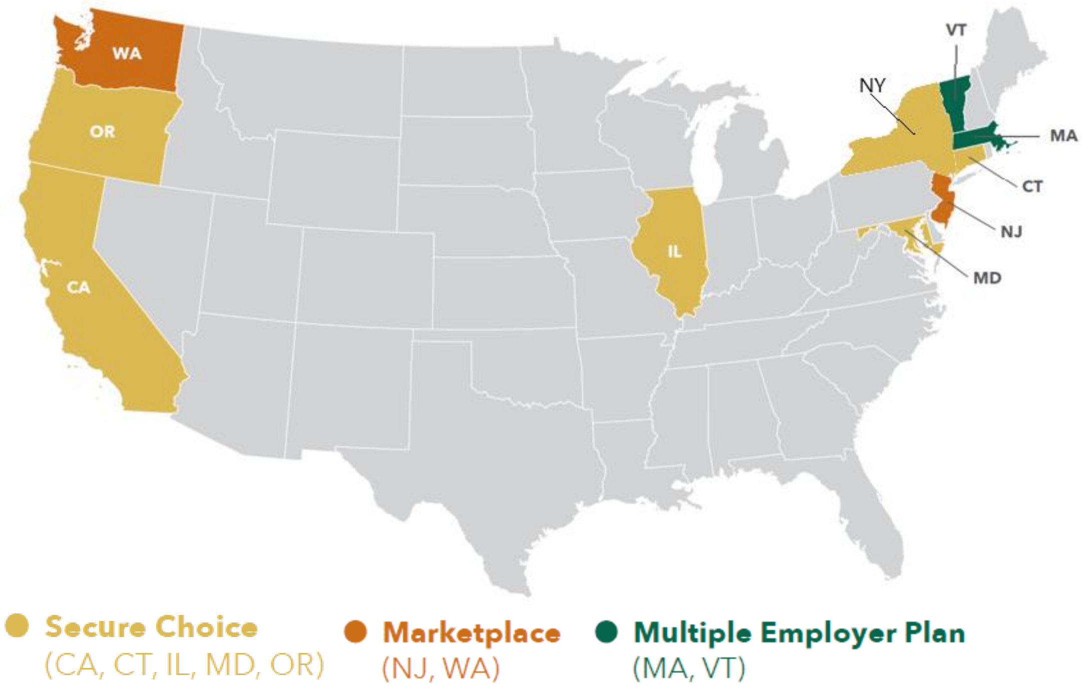
Potential Innovations and Reforms

- Strengthening the 401(K): Building on what works.
- Making plans more portable: Simplify rollovers.
- Create a sustainable future for the social security trusts.
- State-run IRA plans to close coverage gap.
- Sidecar accounts to address expense volatility, preserve retirement funds.

A Sustainable Future for Social Security

- SSA estimates that Old Age and Survivors Insurance Fund will be depleted in 2035.
- Solutions consist of 2 options: raise revenue or cut benefits.
  - Raise tax rate paid by employer and employee.
  - Raise or remove earnings cap.
  - Change benefits formula; Raise retirement age; Change COLA.
  - Find new revenue streams.

State-Sponsored Retirement Plans



Sources: Mitchell, David S., "Building a More Robust and Inclusive U.S. Retirement System Amid a Changing Economy," The Aspen Institute, September 27, 2017; AARP Public Policy Institute, State Retirement Savings Resource Center.

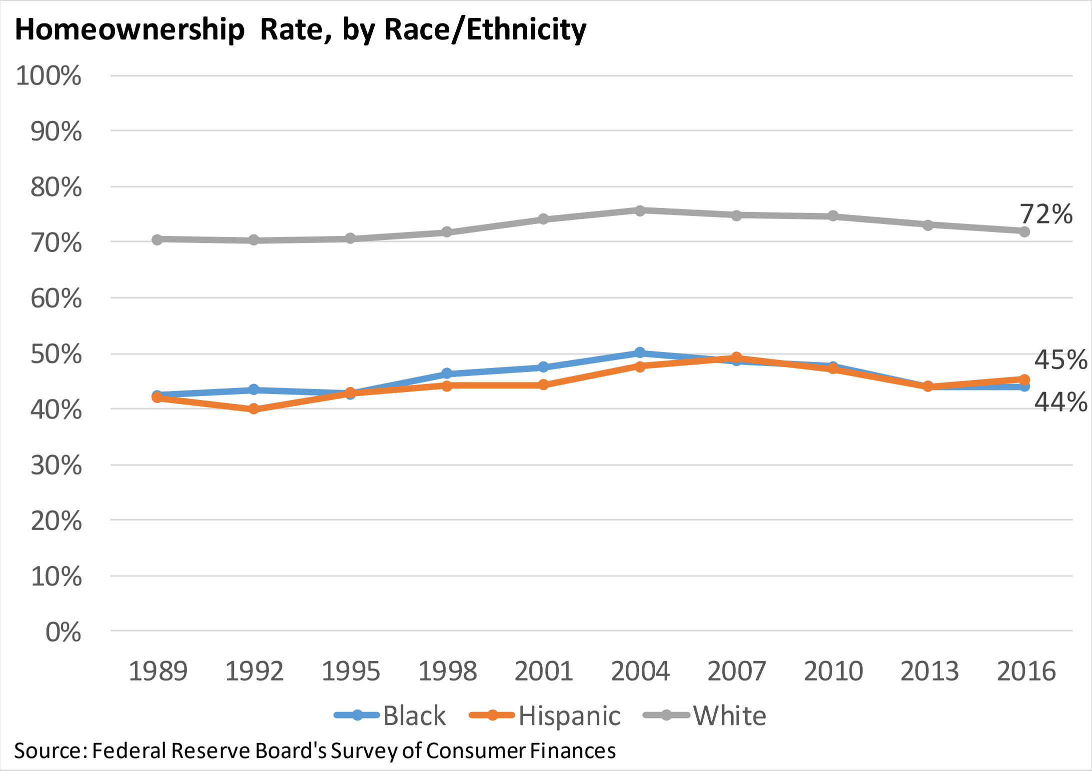
- Attempt to close the coverage gap with a plan that combines sound governance with portability.
- Secure Choice model: employers that can't or choose not to offer employer plan, their employees are auto-enrolled in state plans.

Sidecar Accounts

- Life's unexpected costs drive some DC owners to draw down retirement funds to meet short-term needs.
- The concept is as follows: Workers fund a short-term savings account reserved for emergencies.
- Once sufficient savings buffer is achieved, further contributions are automatically diverted to traditional retirement account.
- Sidecar accounts that are fully integrated into retirement products are being actively researched and tested.

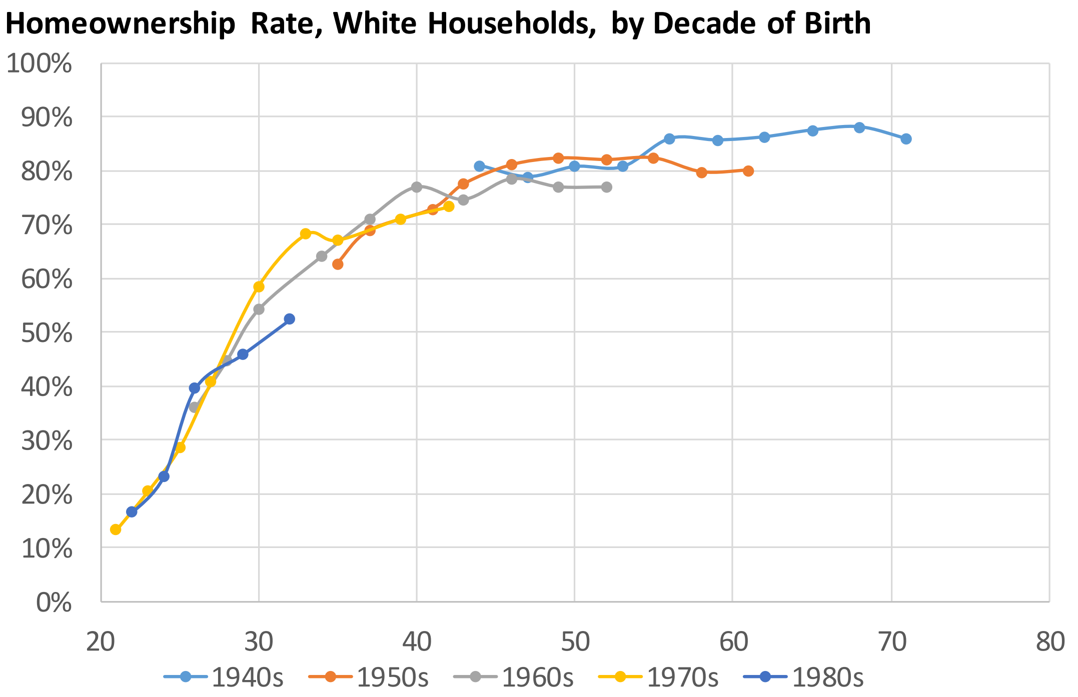
The American Homeownership Society

Homeownership Varies Strongly by Race/Ethnicity



- Homeownership rate is relatively sedimentary, with the exception of the housing bubble.
- Large gaps (27-28 p.p.) exist between racial/ethnic groups.
- Much more information lies below the surface by demographic factors…

White Households Have High Rates of Ownership, Even Younger Generations

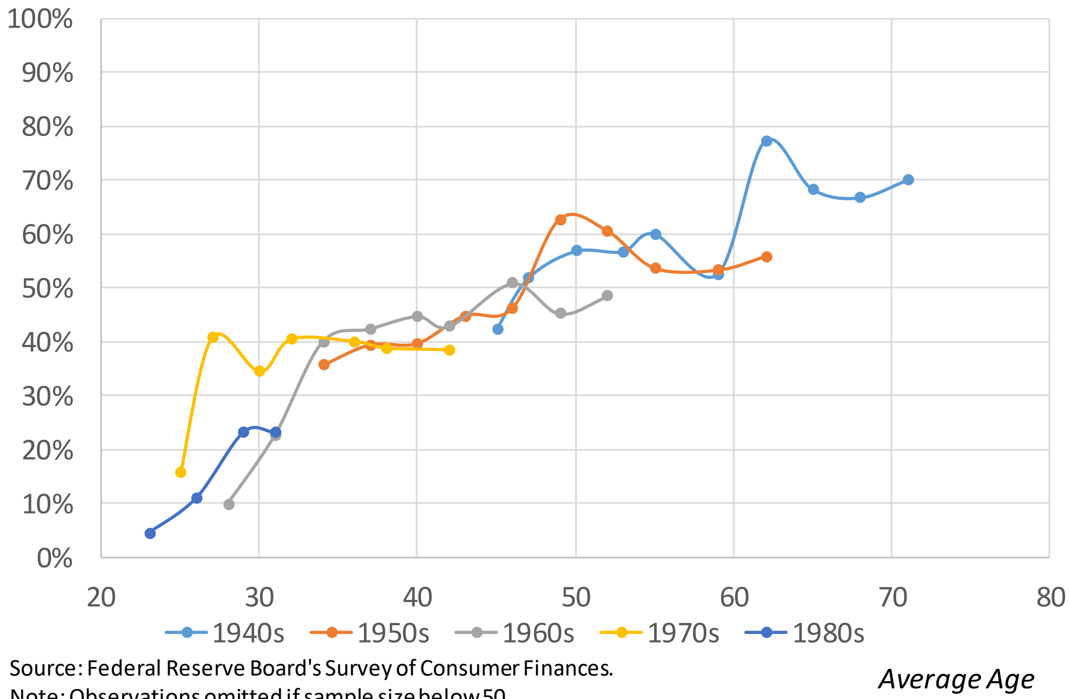


Source: Federal Reserve Board's Survey of Consumer Finances.
Note: Observations omitted if sample size below 50.

- Homeownership follows a pronounced life-cycle.
- Among whites born in the 40s and 50s, 80-90% own housing assets.
- More than half of white older millennials (born in the 80s) have become homeowners.

Black Homeownership: Lower and More Susceptible to Downturns

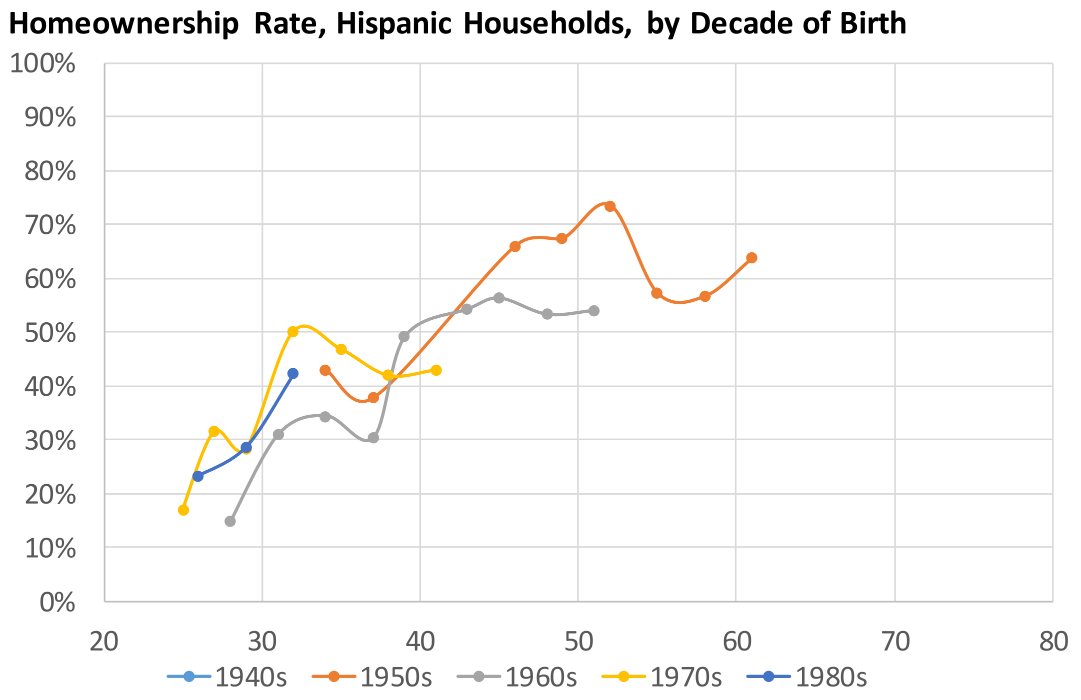
Homeownership Rate, Black Households, by Decade of Birth



Source: Federal Reserve Board's Survey of Consumer Finances.
Note: Observations omitted if sample size below 50.

- Substantial decline in homeownership among older cohorts.
- Suggestive of harmful exits following housing crisis.
- Black millennials (23%) have much lower rate than white millennials (52%).

Hispanic Homeownership: Higher but Also Vulnerable



Source: Federal Reserve Board's Survey of Consumer Finances.
Note: Observations omitted if sample size below 50.

- Notable declines following Great Recession for 50s and 70s cohorts.
- Hispanic millennial homeownership is much higher than expected.
- Even relative to the historically high rates observed for the 70s cohort.

Inequity in Housing

- *Sustainable* homeownership has long been out of reach for many black and Hispanic families.
- The historical legacy of explicit housing discrimination hampers black and Hispanic homeownership and home equity today (Aaronson et al. (2019); Howell and Korver-Glenn (2018)).
- Predatory financial products continue to be a concern in the low-to-moderate income segment of the housing market (Carpenter et al. (2019)).

Cash Poor, But House Rich

Housing Wealth: Frozen Retirement Income

- Housing wealth can help seniors supplement incomes and buffer financial shocks in retirement.
- Roughly **5.7 million households** (14.8%) aged 62+ have at least $40,000 in home equity and less than $10,000 in financial assets.
- Much of this wealth remains untouched due in part to preferences, but some of it remains locked due to high costs of selling the home and renting, downsizing, or borrowing through a mortgage.

Reverse Mortgages

- Take-up of reverse mortgages is very low: 2% of population aged 62 and older.
- Reverse mortgages can reduce barriers to borrowing that are due to having a low income or weak credit history.
- Remains unknown by majority of seniors, and among those that are aware, many don’t understand and/or trust them.
- However, actual borrowers that were surveyed (Moulton et al. (2017)) had high level of satisfaction.

Design Improvements

- Two product options could help meet the needs of different consumers and reduce risk (Moulton and Haurin (2019)):
  - Small-dollar reverse mortgages: those with little other financial wealth to turn to for liquidity, to handle unexpected costs.
  - Streamlined forward-to-reverse mortgages: empirical preference for paying off forward mortgages, serves as a type of annuity, freeing up monthly cash flow.
- Other improvements include risk-based underwriting and preventative servicing.

Conclusion

- U.S. is on the eve of large-scale demographic shifts, the safety net will be increasingly stressed.
- Pensions and personal savings appear to be inadequate for large share of Americans, especially among minority families.
- While more work remains at the federal level, programs at the state-level are working towards closing coverage gap.
- Homeownership inequities by race/ethnicity continue to be a pressing issue; focus on *sustainability* rather than just entry.
- For many households home equity is largest source of wealth, less costly ways to access that may improve financial stability of seniors.

Responses

- Expansion of state-sponsored retirement plans to close the coverage gap.
- Strengthen plans: default contribution rates, automatic enrollment, and escalation.
- Adoption of side-car accounts on existing retirement accounts to address short-term liquidity needs.
- Improving *housing* experience among black and Hispanic families: support for renters; more sustainable homeownership.
- Providing simpler reverse mortgages as a way to access home equity for seniors short on liquidity.

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