Retirement Implications of Housing and Wealth Spending – 1

Zenaida Samaniego, FSA, MAAA

Comments on Samaniego

The author discusses the implications for retirement due to the recent housing bubble, and paints a picture of the boom in house prices from 1996–2006 as the buildup to an accident waiting to happen. She chronicles the changing view of housing over the years from:

1. Basic shelter, to

2. An attractive investment and a way to build wealth, to

3. A source of borrowing for consumption and the building of further wealth.

Programs and economic changes which promoted home ownership and the associated benefits of improved community growth and development, also had what we now see as the unfortunate side effects of promoting the investment view of housing. The author provides a comprehensive description of the ingredients leading up to the housing boom and it's worth enumerating them here to provide a broad view of the forces that have been at work:

- A variety of government programs to promote home ownership going back as far as the 1930s.

- The creation and government support for FNMA, GNMA and FHLMC.

- The tax deductibility of mortgage interest and property taxes (as well as the removal in 1986 of tax deductibility for consumer loans), plus more favorable capital gains treatment for owner-occupied homes.

- The development of the mortgage-backed securities market (providing more sources of funding, but also separating mortgage originators from the ultimate mortgage owners).

- An accommodative interest rate stance maintained by the Federal Reserve following the bursting of the dot-com bubble.

- A growing belief that housing prices could only go up (which affected the views of home buyers, lenders, the ratings agencies, and investors in mortgage debt).

- The lowering of standards in reviewing mortgage applications and the growth of sub-prime mortgages (the sub-prime market was nonexistent before the mid-1990s and grew to 1/5th of all new mortgages by 2005).

- The opportunities allowed unscrupulous individuals to participate in various ways in the housing boom.

We are all too familiar with the expansion phase of the bubble created by this conducive environment:

- Home ownership rates increasing from 64 percent in 1994 to 69 percent in 2004, with the most significant gains for younger homeowners.

- Rapid growth in second homes, luxury homes, and homes purchased for investment (flipping) or rental.

- An explosion in mortgage debt beginning in the mid-1990s.

- An increase in real home prices of 86 percent from 1996–2006.

And now, of course, we are aware of the other side of this buildup with house prices trending toward a drop of 30 percent from peak values in 2006 and the attendant problems of increased delinquencies and foreclosures. The anecdotal evidence certainly suggests that retired and near-retired individuals have not been immune from the impact of these housing market problems.

Related to this latter point, Figure 5 in the paper shows trends in percentage home ownership by age. For the 55-61 age group the percentage of home ownership was practically level from 1985 (78.6 percent) to 2003 (80.4 percent). However, for the 85+ age group the percentage grew from 1985 (56.8 percent) to 2003 (73.0 percent). The author notes that a much higher percentage of the elderly are choosing to "age in place," which further emphasizes the importance of housing in the lives of retired individuals.

In general, the author makes a strong case that policy incentives to promote home ownership need to do a better job of focusing on "the use of the home as a basic shelter rather than discretionary consumption or speculative investment."

> *Of the papers noted in the list of references, one that is definitely worth reading is the Robert Shiller (2007), "Understanding Recent Trends in House Prices and Homeownership." Shiller examines the boom in house prices from 1996–2006 and makes the case that the most important influences have involved the psychology of home buyers and investors rather than economic fundamentals. He looks at the process being more involved with feedback loops, "new era" stories, and more of a social epidemic than being the result of a response to economic fundamentals. His description of the housing bubble bears a haunting resemblance to his description of the dot-com bubble in his prescient book, "Irrational Exuberance."*