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Executive Summary

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WHAT IS THE IMPACT OF FORECLOSURES ON RETIREMENT SECURITY?

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This paper investigates the impact of the collapse in the housing market on retirement security. We do this by comparing vulnerability to housing shocks across cohorts nearing retirement in different years of the *Health and Retirement Study* (HRS) and by using recent questions about housing distress in the HRS and the *Panel Study of Income Dynamics* (PSID). The HRS is a detailed longitudinal survey of households with a member aged 51 and over that has taken place every two years since 1992, the latest available data being that for 2008. The PSID is a longitudinal study of households of all ages that began in 1968, the latest available data being for 2009.

We begin by analyzing gross housing assets and mortgage debt across different birth cohorts. We focus on households aged 51-56 in 1992, 1998, and 2004, and the same households aged 57-62 six years later, with an extrapolation to 2010, based on house price changes in Metropolitan Statistical Areas between 2008 and 2010. In real terms, mean housing wealth of households aged 57-62 grew from $175,617 in 1992 to $220,786 in 1998 and $268,417 in 2004, with a projected decline to $213,407 in 2010. Mortgage holdings trended up substantially throughout the period – 47 percent of households held a mortgage in 1992, reaching 61 percent in 2010. Mean mortgage debt among households with a mortgage also increased throughout, from $56,088 in 1992 to $121,595 in 2010. As a result, mean housing equity, which grew from $140,133 in 1992 to $200,315 in 2004, declined to only $121,810 by 2010. Succeeding birth cohorts will face larger mortgage payments in retirement and will be less able to consume housing wealth by trading down and consuming housing equity.

We then consider the prevalence of housing distress among older households and associated risk factors. Among HRS households with mortgages in 2008, 3.0 percent were two or more months in arrears, and 0.75 percent were in foreclosure, well below the national average rates at the same time of 4.8 and 3.3 percent. An additional 4.7 percent considered it very or somewhat likely that they would fall into arrears within the next six months. Households in arrears had higher mortgage payments, higher payments as a percent of income, and lower house values, leading to significantly lower home equity. The PSID also reveals that older households experiencing mortgage distress are more likely to have a variable rate mortgage.

To further investigate factors associated with mortgage distress, we estimate a probit model on the HRS sample. In order to deal with the small sample size, we include the group that reports that arrears are somewhat or very likely within the next six months together with the group that is in arrears or foreclosure. We find that a 10-percent increase in log household income reduces this risk by about a tenth of a percentage point. Experiencing a layoff between 2004 and 2008 significantly raises the risk of being in arrears or foreclosure, by 6.2 percentage points. Experiencing a worsening of health between 2006 and 2008 also raises this risk significantly (at the 10 percent level), by 2.8 percentage points. Local housing conditions matter, as reporting that the local housing market is good significantly reduces the likelihood of arrears, by 4.8 percentage points.

It is interesting to note that, even after controlling for economic status, education and race affect the risk of arrears or foreclosure. Being a college graduate significantly reduces the risk of arrears by 4.5 percentage points, relative to having a high school degree. Being black raises the risk by 14.9 percentage points, relative to being white, and being of another race raises it by 12.0 percentage points. Meanwhile, being Hispanic raises it by 5.0 percentage points. This is somewhat surprising and may reflect poor mortgage terms offered to ethnic minorities, as suggested anecdotally in some media reports.

We then use our econometric model to forecast arrears and foreclosures among older households. Based on predicted changes in house prices and employment, we project that mortgage arrears among households nearing retirement will increase to 3.4 percent in 2010 and 4.4 percent by 2012.

A potential concern is that, although older households may have relatively low levels of housing distress, they may be called upon to help other family members in trouble, thereby depleting their own financial resources. Their ability to do so may have increased as illiquid defined benefit pensions have been replaced by more liquid defined contribution accounts. We find that 6.7 percent of HRS respondents reported having a family member who fell behind on his or her mortgage payments. Among the ones with a family member experiencing such trouble, 42 percent reported giving help to this family member, and 58 percent did not. Respondents with family members in distress had lower household income ($46,665 at the median versus $52,294) and lower financial wealth in 2006 ($7,000 at the median versus $18,000) in comparison to respondents with no family members experiencing housing distress. However, within this group, those who gave help were significantly younger and more likely to have a college education than those who did not. However, liquid financial wealth did not have a statistically significant effect on the likelihood of giving help. Thus, we cannot conclude from the evidence that older households are raiding their retirement nest eggs to assist family members in housing-related financial difficulty.

To summarize, older households are experiencing, and will likely continue to experience, much lower rates of arrears and foreclosures than the population as a whole. But, succeeding birth cohorts are arriving at retirement age with substantially less housing equity, more mortgage debt, and higher mortgage payments. The reduction in housing equity will matter to the extent that households wish to consume housing equity by downsizing, exiting to a rental, or taking out a reverse mortgage.

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