



Boomer Retirement Portfolios after the Housing Bubble

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Is the Baby Boomer Generation prepared for retirement?

The common perception is that they are not. Although recent academic research contradicts this, a recently published study from Barclays Global Investors says common perceptions reflect reality.

Furthermore, once the effects of reduced government benefits and decreased home values are considered, some segments of the population – particularly the middle class – are in real trouble.

The end of the housing bubble has deflated the retirement plans of many baby boomers. Barclays' study, *The Future Shock of Retirement*, shows that housing plays a relatively consistent role across the spectrum of retirement portfolios and that current and future retirees are likely to be exaggerating the amount of home equity available for consumption in retirement. Over the long term, those who planned on living off their homes are likely to face increased home price volatility.

Barclays' study was authored by Jonathan Cohen, Matthew Scanlan, and Matthew O'Hara. We spoke with Cohen on May 15 about their findings.

Background and Methodology

Cohen and his co-authors used data from the Health and Retirement Study (HRS), which is a national panel data set of individuals over the age of 50. The authors focused their attention on individuals that were aged 51-61 at the time of the last survey. This panel has been tracked since 1992, and represents the key database for current retirement studies. The data is as of 2004, at which time there were 3,424 households surveyed in the data set.

Barclays ranked the comprehensive wealth of all 3,424 respondents in their study, dividing them into wealth deciles for summary purposes. They then took averages across comprehensive wealth, and all its subcomponents, to assess the relative contribution of each component of a retirement portfolio. Finally, the authors converted comprehensive wealth into annuitized wealth, to better illustrate the real, long-term purchasing power. Decile 1 represents the poorest and decile 10 represents the wealthiest segments of the population. The data is summarized in the table below:



PERCENTAGE OF MEAN-SCALED VALUES OF WEALTH, BY DECILE

Decile	Comprehensive wealth	Expected present value of wage income until age 62	Financial wealth, excluding IRA and DC accounts	Non-financial wealth	DC and IRA account balances	Expected present value of DB pension income	Expected present value of Social Security income	Expected present value of annuity contracts and life ins	Expected present value of transfers
1	88,604	15.5%	-3.5%	19.7%	2.2%	2.6%	47.2%	0.1%	16.4%
2	205,143	26.3%	1.2%	17.7%	3.4%	3.2%	36.5%	0.3%	11.4%
3	324,220	28.0%	2.2%	18.9%	2.9%	5.8%	33.6%	0.3%	8.3%
4	454,930	31.8%	4.1%	19.3%	5.1%	5.6%	27.8%	0.4%	5.9%
5	602,510	31.6%	5.7%	20.4%	6.0%	7.8%	25.8%	0.4%	2.2%
6	772,348	33.9%	4.6%	18.9%	6.8%	9.1%	24.0%	1.0%	1.7%
7	1,020,471	33.7%	5.4%	19.5%	7.7%	10.1%	21.5%	0.4%	1.7%
8	1,361,978	34.9%	6.0%	20.2%	8.0%	10.5%	18.2%	0.8%	1.3%
9	1,928,380	34.2%	8.0%	21.0%	10.6%	9.2%	14.7%	1.0%	1.4%
10	4,439,580	24.7%	10.3%	26.6%	9.4%	17.1%	9.5%	1.6%	0.9%

Source: BGI.

The study notes several key observations from this data. First, Social Security benefits make up a sizeable portion of retirement portfolios, especially among the lower deciles. But, even among the higher deciles, Barclay's notes Social Security is a "surprisingly large fraction of total wealth." Of greater concern is that, among the higher deciles (especially deciles 6-8, which would generally be considered upper middle class), Social Security constitutes a greater portion of retirement assets than does other financial assets combined (defined contribution plans, IRAs, defined benefit plans, and annuities).

"Housing, government benefits, and current wages form the linchpin of retirement security for the middle class in our society, rather than saving, investments, and employer-sponsored retirement plans," claims the study.

Home equity is relatively constant across deciles, ranging from 9% to 14% of total wealth. (Home equity is included in non-financial assets, which also include vehicles, businesses, and investment real estate, less any outstanding debt secured by these assets.) Cohen notes the data pre-dates the collapse of the housing market, and today's values would lower these percentages somewhat. However, the data show that housing values are generally proportionate to



income and overall wealth, and do not constitute an unusually high proportion of retirement assets.

Wage income is the largest or second largest component of retirement assets. Although the sample is in its peak income years (age 51-61), it is a concern since relatively few years are left before retirement. Further, of those who retire earlier than planned, about 54% do so because of health problems or a disability¹. With a heavy reliance on current wages funding boomers' retirement and an assumption that working more years would solve wealth shortfalls, this clearly spells danger.

After the Housing Bubble... With Fewer Government Benefits

Barclays' study goes beyond previous research by examining the effect of two "shocks" to retirement portfolios.

Extensive unfunded liabilities in the Social Security and Medicare systems make it highly unlikely that today's benefit levels will be enjoyed by future retirees. A net reduction in benefits is inevitable, although it will not affect all deciles evenly. Barclays chose to assume there will be a means-tested reduction in Medicare benefits and, as a result, wealth deciles 6-10 will need to purchase additional private insurance, at a cost of \$7,000 per year.

Cohen said "the biggest flaw in previous research is that people assume current benefits will persist into the future, and this clearly cannot happen."

Barclays' study also examined the role of home equity in retiree wealth. As we note above, despite the bull market in real estate that ended in 2007, home equity still comprises a relatively small portion of retirement assets. Barclays chose to model the effect of declining home values by assuming that 41% of home equity would not be available for "consumption" as a retirement asset.

¹ http://www.ebri.org/pdf/briefspdf/EBRI_IB_04-2008.pdf



The effect of these two “shocks” is shown below:

ADJUSTED, MEAN-SCALED ANNUITIZED INCOME, BY DECILE

Decile	Original wealth	Medicare cost	Reduction in available housing wealth	Total reductions	Adjusted wealth	Wealth reduction	Wages, pre-adjustment	Wages, post-adjustment
1	5,540	—	(485)	(485)	5,055	-8.7%	15.5%	17.0%
2	11,960	—	(754)	(754)	11,206	-6.3%	26.2%	28.0%
3	17,473	—	(1,270)	(1,270)	16,203	-7.3%	27.1%	29.2%
4	23,168	—	(1,761)	(1,761)	21,407	-7.6%	31.5%	34.0%
5	27,980	—	(2,349)	(2,349)	25,631	-8.4%	30.7%	33.5%
6	34,602	(7,000)	(2,693)	(9,693)	24,909	-28.0%	32.2%	44.7%
7	42,567	(7,000)	(3,138)	(10,138)	32,430	-23.8%	31.9%	41.8%
8	55,978	(7,000)	(4,244)	(11,244)	44,734	-20.1%	33.5%	41.9%
9	76,923	(7,000)	(5,414)	(12,414)	64,510	-16.1%	32.5%	38.7%
10	176,250	(7,000)	(9,624)	(16,624)	159,626	-9.4%	22.1%	24.4%

Source: BGI.

The upper middle class, represented by deciles 6-8, loses between 20% and 29% of their total wealth, due to these two shocks. Their dependence on current wages as a source of retirement assets becomes even more dramatic. “This is a dangerous situation, given the relatively short period of time in which people of this age group have to earn and save, and given the sensitivity of employment and wage levels to economic downturns,” says the study. Cohen finds this particularly dismaying, and said that “these shocks will be felt by those least able to afford it.”

In raw terms, deciles 3-8 make up about one half of the American population and will see their retirement assets decrease by 25%.

The lowest deciles are in trouble with retirement assets at the same time they are struggling with the poverty line. Cohen notes that “government support will be a significant component of how they make do over the long term. Our forward looking adjustments allow for that, and means testing of social security won’t impact the lowest deciles.”



What Boomers Should Expect

Cohen believes the “near term picture is dicier for many on the doorstep of retirement, especially those counting on home equity and downsizing strategy for retirement.”

“Retirees seeking to monetize their housing assets in today’s market will face daunting challenges,” says Cohen. But he believes this is a short-term effect, and advisors with longer-term horizons could presumably assume that home asset values would keep pace with inflation and GDP growth. “Ten or twenty years is a long time, enough to overcome the erosion in today’s market,” says Cohen.

Cohen cautions that while recent home price volatility is painful, it is not necessarily the case that this will permanently impact retirees: home prices could always recover in the future. He says “the larger point is to expect greater volatility in home prices going forward, because of the supply-demand imbalance created by boomers that are coming into retirement.”

Cohen offered one final prediction - the recent bursting of the housing bubble will have behavioral effects on retirement decision making. Even though the data shows the overwhelming majority of retirement portfolios are not heavily dependent on housing values, boomers will feel less wealthy. “Expect to see boomers planning on working more years, or simply consuming less in the early years of their retirement,” says Cohen.

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