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The House: Is it an Asset or a Liability?

Leora Friedberg, Wei Sun, and Anthony Webb *

Most households enter retirement as homeowners and only sell or downsize after entry into a nursing home or death of a spouse. This has been viewed as a puzzle by many researchers, as homeownership in old age constrains liquidity and hence makes it more difficult to smooth consumption. It is worth considering these explanations in more depth, as recent birth cohorts are entering retirement with greater housing wealth but also greater mortgage debt.

For some, mortgage debt may reflect a preference for housing consumption that became more affordable, for example, due to the long era of low nominal interest rates that recently ended. Those households choosing higher housing consumption may optimally delay retirement, hold substantial financial wealth, and exhibit the capacity to maintain post-retirement consumption. The policy concern is that some households may be poorly positioned to carry mortgage debt. Further, minority and low socioeconomic-status households may be disproportionately at risk of holding debt levels that impede their ability to maintain consumption as they age, especially when minorities, in particular, take on worse mortgage terms. These factors may make home ownership a burden to some households.

We document key patterns in housing and financial assets data of aging households, and then we develop a quantitative intertemporal optimization model of consumption and dissaving choices during retirement in the presence of mortgage-financed illiquid housing. This allows us to explore the role of long-term care risk, means-tested Medicaid, and bequest motives as possible explanations for the value of illiquid housing wealth in retirement.

We begin our analysis by documenting cross-cohort trends in housing assets and liabilities. Among individuals ages 64 to 66 (which is at or just after retirement for most of the sample) in successive cohorts of the Health and Retirement Study, house values, mortgage holding, and mortgage balances have risen. For example, median house values among homeowners rose from $167,852 for birth cohorts who turned 65 in 1989 to 1995 to $216,336 for birth cohorts turning 65 in 2013 to 2018. The share of homeowners with mortgages increased from 37.9% to 50.8%, and the median mortgage balance among mortgage holders approximately doubled, from $46,677 to $108,523, all in 2022 dollars.

We then compare socioeconomic characteristics of households with different size mortgages. We find that Black households with mortgages have extremely low median financial assets. While Hispanic mortgage holders do as well, they are less likely to hold mortgages than Black

* **Leora Friedberg** is an associate economics professor at the University of Virginia. **Wei Sun** is an associate conomics professor at Renmin University of China. **Anthony Webb** is a research director at the New School for Social Research.
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households are. White households with mortgages hold comparatively ample financial assets relative to Black and Hispanic mortgage holders, yet they hold less in financial assets than do white households without mortgages, and their assets remain insufficient to cover their mortgage debt. These results suggest that underrepresented minorities, and perhaps many others, appear likely to experience financial stress in meeting their mortgage obligations in old age.

Our final set of empirical results focus on possible responses of households that hold a greater share of housing in their balance sheets. Conditional on both demographic characteristics and house value, larger mortgages are associated with holding lower values of financial assets, suggesting that on average, more leveraged households are not able to accumulate additional assets to cover their greater obligations. In addition, such households retire later, experience greater declines in consumption during retirement, and sell their homes earlier, compared to households with smaller mortgages or none at all.

We then develop an intertemporal optimization model of consumption and dissaving choices during retirement. The model includes long-term care risk, means-tested Medicaid, and a luxury bequest motive. The model demonstrates that mortgage-financed, illiquid housing is valuable for households that face long-term care cost risk. The value is small for households in the lowest financial asset quartiles (using data on mortgage-holding households at retirement from the HRS), amounting to 5% or less of the mortgage, but it reaches 18% of the mortgage balance for households in the second-highest quartile of financial assets and 52% for households in the highest quartile. Illiquid housing provides little additional bequest value, however, when we parameterize bequest motives based on recent research.

In sum, we find that mortgage-financed housing wealth may be an asset for some households, especially those with relatively high financial assets at retirement, who gain from its use as a hedge against long-term care cost risk. It may be a liability for others, though, especially minority households with meager financial assets, as we observe households with higher mortgages entering retirement with lower financial assets, retiring later, experiencing larger declines in consumption during retirement, and selling their house earlier as they age. ❖

Michigan Retirement and Disability Research Center
Institute for Social Research
426 Thompson Street, Room 3026
Ann Arbor, MI 48104-2321
Fax: (734) 615-2180
mrdrcumich@umich.edu www.mrdrc.isr.umich.edu

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