

# THE CENTURY FOUNDATION

## Issue Brief

### THE IMPACT OF HOUSING AND INVESTMENT MARKET DECLINES ON THE WEALTH OF BABY BOOMERS

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The bursting of the housing bubble in 2007, the financial meltdown in 2008, and the most severe recession since the Great Depression have destabilized the economic security of the baby boom generation of Americans—those born between 1946 and 1964—just at the time when they are approaching retirement. Savings plans, 401(k)s, Individual Retirement Accounts, and other investments have become depleted not only because of the market's decline, but also because individuals withdrew funds during the crisis, often incurring penalties in the process. Even more significant for most baby boomers, the housing equity that they expected would be their major asset in retirement has plummeted in value and remains far lower than it was just a couple of years ago.

Prior to the housing and investment market collapse, many baby boomers benefited from a surge in asset prices over the past two decades, enjoying large increases in the value of their homes and retirement savings plans. Although the stock market has recovered somewhat in recent months, the baby boomers have little time left before retirement to rebuild the wealth they lost in the past couple of years. As a result, many boomers will be even more dependent than they anticipated on Social Security, Medicare, and, for some, Medicaid, to provide them with a degree of security after they stop working. The

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experience during the economic crisis underscores the importance of preserving, and even strengthening, these essential social insurance programs.

## **HOW BIG WAS THE IMPACT ON BABY BOOMER WEALTH?**

Efforts to assess whether households have accumulated adequate savings for retirement are fraught with methodological difficulties and data shortcomings, and tend to be the subject of significant academic disagreements. Some studies show that a large portion of the baby boom cohort has not accumulated sufficient retirement savings and other assets to be adequately prepared for retirement. A 2007 *McKinsey Quarterly* article found that only about a quarter of boomers are prepared for retirement, while other studies estimate that 45 percent of boomers will be “at risk” in maintaining their standard of living during their retirement.<sup>1</sup> These studies highlight how stagnating incomes, low savings rates, the shift in employer pensions from defined benefit to defined contribution plans, and weak public knowledge about matters related to financial planning all have left a large share of the baby boom generation poorly positioned to provide for themselves after they have stopped working. This lack of retirement security seems to afflict the baby boom generation in particular. Studies of the preceding, pre-boomer cohort that retired before the economic recession reached less-pessimistic conclusions. One study suggests that three-quarters of pre-boomer households had sufficient resource in 2004 to maintain their standard of living in retirement.<sup>2</sup>

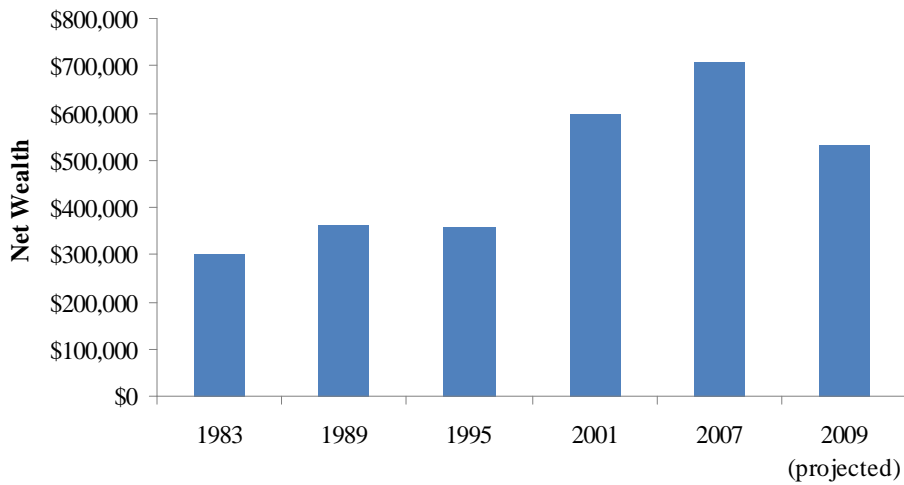
There is little doubt that the declines in housing values and investment markets have greatly worsened the situation for those who soon will be seeking retirement. In 2008 alone, housing prices dropped an average of 33 percent, greatly depleting the wealth of the majority of baby boomers, who have relatively little savings beyond what they have invested in their home. Concurrently, the 40 percent drop in equity markets in 2008 had a devastating affect on higher net worth baby boomers, for whom stock ownership is the predominant form of wealth. While more concrete data on the actual wealth destruction

that baby boomers experienced during the recent crisis will not be available until 2011, some estimates constructed so far suggest dire circumstances for retiring baby boomers.

*The net wealth for households with a head aged 50 and over decreased by 25 percent between 2007 and 2009—amounting to an average loss of approximately \$175,000 per household.*

In a study for the Center for Retirement Research at Boston College, Barry Bosworth and Rosanna Smart estimated that U.S. households with a head aged 50 and over lost a substantial portion of the real wealth gains made in the twenty-five years preceding the financial crisis.<sup>3</sup> Figure 1 shows that, between 1983 and 2007, these households experienced large gains in their real wealth positions, much of this a result of a shift toward a greater proportion of financial holdings and, for wealthier households, financial assets subject to capital gains. The bursting of the housing bubble and the collapse in equity prices destroyed a large portion of these gains. Older households, whose wealth was protected slightly by having a higher share of their net worth in fixed assets and larger equity positions in their houses relative to younger households, still lost nearly 30 percent of their housing wealth between 2007 and 2009. Moreover, the losses were felt equally across education and income groupings—wealthier, more-educated, older households lost a greater proportion of their wealth due to investment declines, while the losses for lower-income households with a head age 50 and over were more closely linked to home equity losses.

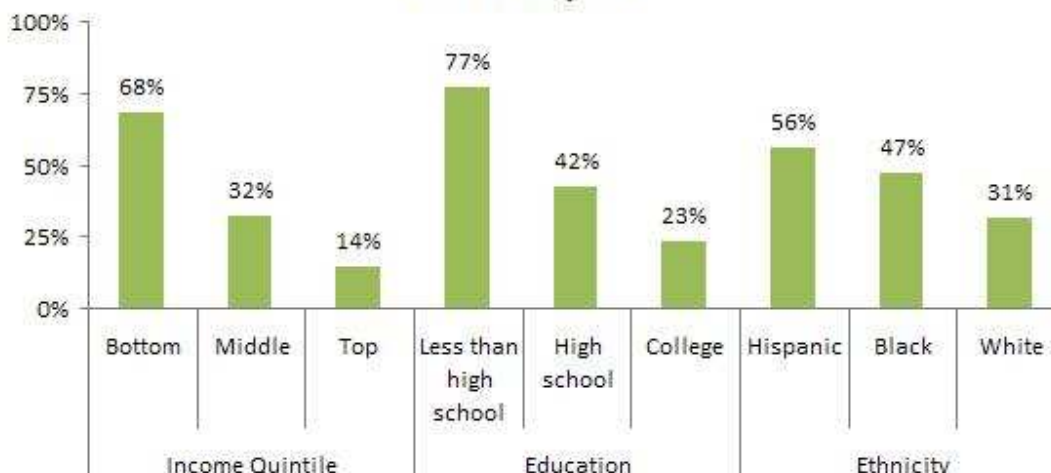
**Figure 1: Average Net Household Wealth with a Head Age 50 and Over**



*Source:* Computed by authors from various waves of the Survey of Consumer Finances

These estimates exclude the expected wealth baby boomers will receive from defined benefit plans and Social Security—two sources of income that were not directly affected by the financial meltdown. In Figure 2, we see that Social Security is critically important for the most vulnerable households with a head aged 55 to 64: it constitutes 68 percent of total wealth for the bottom quintile of wage earners, 77 percent for households where the head of household does not have a high-school degree, and 47 percent and 56 percent of wealth for black and Hispanic households, respectively.<sup>4</sup> Bosworth and Smart estimated that, when expected wealth from these programs is included, real wealth declined by 18 percent between 2007 and 2009 for households with a head aged 50 and over.<sup>5</sup> While the inclusion of Social Security and defined benefit plans lessens the impact of the financial crisis on wealth, this only underscores the critical importance of preserving these retirement security programs.

**Figure 2: Median Ratio of Social Security Wealth to Total Wealth for Households Ages 55-64 by Income, Education, and Race in 2001/2004**



Source: Urban Institute calculations from combining the 2001 and 2004 Surveys of Consumer Finance and DYNASIM3 microsimulation model.

Note: Wealth includes the expected present value of future Social Security and pension benefits, retirement accounts, net owner-occupied housing, real estate, businesses, and financial assets.

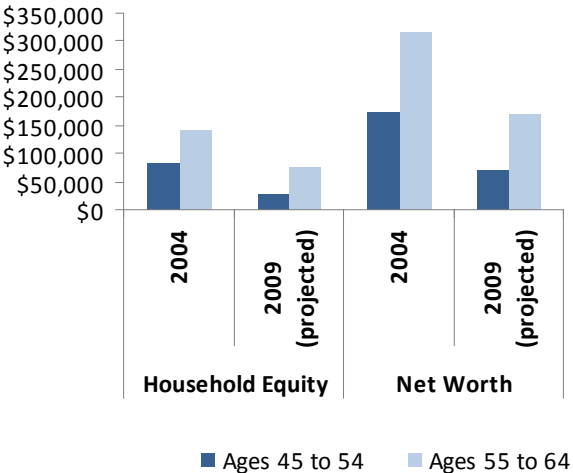
To arrive at estimates of changes in household net wealth, Bosworth and Smart align wealth records from the 2007 Survey of Consumer Finances (SCF) with components of the Federal Reserve 2009 Flow of Funds (FoF) data from the second quarter. A joint Federal Reserve and U.S. Treasury endeavor, the SCF is conducted every three years to provide a detailed picture of household wealth of U.S. families. FoF data, on the other hand, is collected quarterly to follow trends in aggregate household net worth and its components. Bosworth and Smart then extrapolate trends in the FoF data to project 2007 SCF wealth estimates forward to 2009. Finally, their estimates of expected defined benefit pensions and Social Security wealth for current workers use data presented in a 2008 Urban Institute study that uses data from the 2001 and 2004 SCF and a microsimulation model to compute expected lifetime earnings.<sup>6</sup>

***Home equity losses account for much of the loss in household wealth across the baby boom generation.***

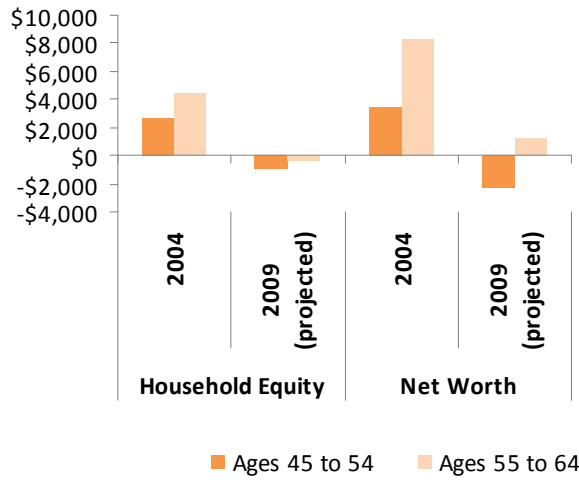
According to research by Center of Economic Policy and Research (CEPR), prior to the housing crisis, real estate equity—the difference between a home’s value and the remaining loan balance—accounted for nearly half of median net wealth. As a result of the plunge in housing prices, however, many baby boomers now will have little or no equity in their homes. In Figure 3, we see that the most

conservative estimates from CEPR find that median household equity in real estate fell from \$83,600 in 2004 to \$27,100 in 2009 for households with a head aged 45 to 54—a drop of 68 percent. For boomers closer to retirement, aged 55 to 64, equity values fell 47 percent, from \$142,000 in 2004 to \$75,300 in 2009, a drop that is larger in absolute value, but proportionally smaller than households with a head aged 45 to 54. Similarly, Figures 4 and 5 reveal that home equity losses were substantial for both the bottom and top income quintiles in 2004. One important factor in assessing the impact of housing value declines is the amount of leverage used for home purchase. As CEPR states, “if a homeowner has \$40,000 equity in a \$200,000 home, and the home falls 20 percent in value, then the \$40,000 decline in the house prices has destroyed 100 percent of the homeowner’s equity.”<sup>7</sup>

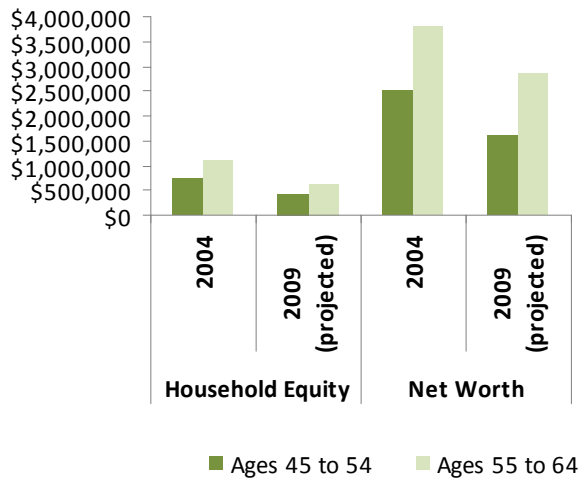
**Figure 3: Median Household Equity in Real Estate and Net Worth in 2004 and 2009**



**Figure 4: Bottom Quintile Household Equity in Real Estate and Net Worth in 2004 and 2009**



**Figure 5: Top Quintile Household Equity in Real Estate and Net Worth in 2004 and 2009**



*The declines in housing and equity values have had a much more threatening impact on the less wealthy.*

As Figure 4 above shows, the projected housing and investment declines have left baby boomers in the bottom quintile of wage earners with *negative* net wealth in 2009—primarily because much of their wealth was tied to home equity. While households with a head aged 55 to 64 fare slightly better than their younger counterparts, a net worth of \$1,200 is hardly enough of a cushion to survive on in retirement, and this group also has less time to make up any losses before retirement. Moreover, the graphs above show that,

while the stock market collapse (as distinct from the housing bubble) did cause boomers to lose much of their net wealth, the majority of financial equity losses were born by the wealthier households that owned a greater proportion of financial assets. In Figure 5, we see that home equity losses only account for a small portion of the large declines in net worth for both boomer cohorts.

The CEPR study uses 2004 SCF data to make projections about household wealth. They use the Standard & Poors Case-Shiller Home Price 20-City Composite index—the most common measure used to track changes in the residential real estate market in twenty metropolitan regions in the United States—to build projections for home equity declines. Their most conservative estimate of home equity declines assumed that February 2009 nominal home prices remained at the November 2008 index levels—a level more conservative than the actual 3 percent to 4 percent decline between November 2008 and February 2009. For financial assets, the study assumed that the S&P 500 was at 1,100 in September 2009, a level slightly higher than the actual high for that month. These assumptions translate into a 21 percent drop in real house prices between 2004 and 2009 and a 13 percent decrease in real equity prices.

#### **THE LARGEST PORTION OF WEALTH LOST BELONGED TO BABY BOOMERS**

According to the global management consulting firm A.T. Kearney, of the total \$4.1 trillion lost in cash, securities, and pensions from 2007 to 2008, 63 percent belonged to baby boomers aged 45 to 64. Roughly 38 percent of those losses were shouldered by older boomers close to retirement—those between the ages of 55 to 64.<sup>8</sup> The devastating impact of a large financial meltdown occurring at a time when nearly one-third of the U.S. population is nearing retirement highlights the overreliance on equities as a long-term investment and the need for greater financial literacy and retirement preparedness. As Figure 6 shows, retirees and boomers alike hold only a small portion of their assets in cash and therefore have been acutely impacted by the financial meltdown. Their combined cash holdings of 15 percent is 10 percent lower than those aged 15 to 44, and the analysis by A. T. Kearney reveals, “as of year-end 2007, the typical 50-year-old had 48 percent of his 401(k) assets in equity funds and another 11 percent in company stock.”<sup>9</sup> Strong

stock market performance leading up to the crisis resulted in more equity exposure than was sensible, especially for the wealthiest of boomers.

**Figure 6: United States - Total liquid assets by age group and year**

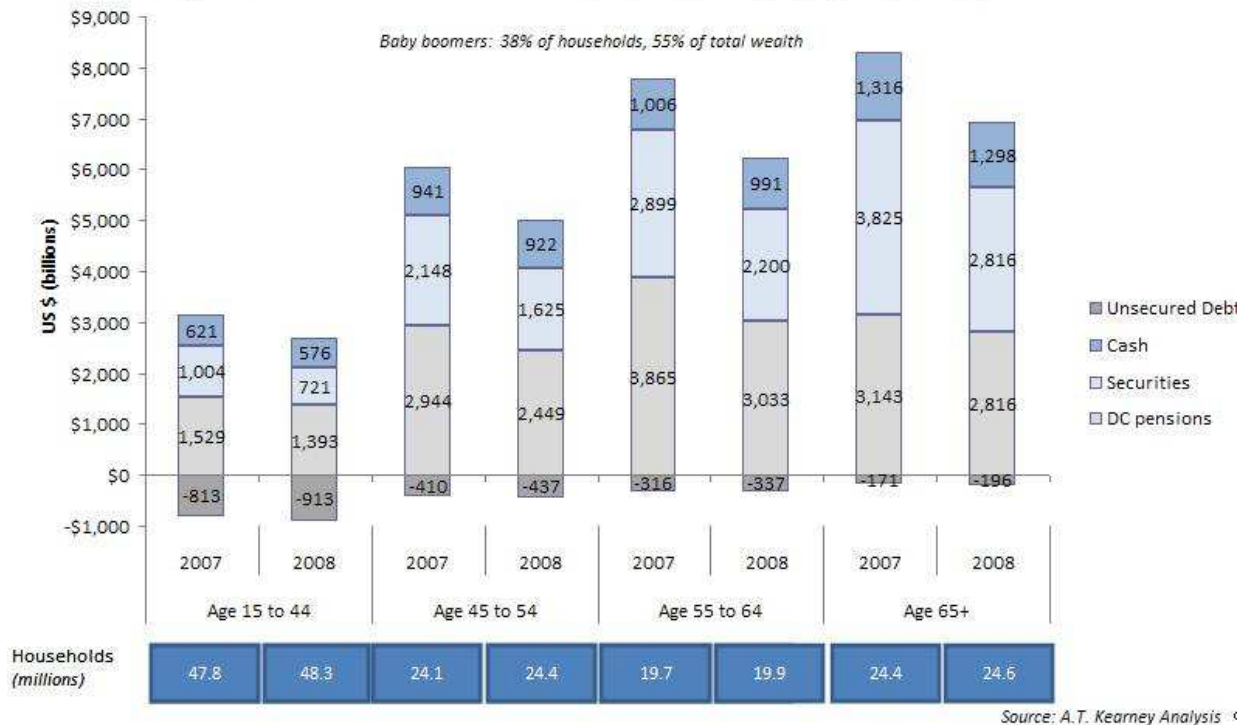


Figure 6 also shows that baby boomers hold roughly 55 percent of total asset wealth in the United States and accordingly were hard-hit by the recession. The combined loss of \$2,631 billion for the entire baby boomer cohort between 2007 and 2009 is nearly five times the \$565 billion lost by those aged 15 to 44, and is roughly twice the \$1,380 billion lost by those above age 65. Though the A. T. Kearney analysis is optimistic that the decline in financial assets will be recovered when markets rebound in the coming years, it does highlight the concern for boomers and their ability to regain losses in a short period of time

To arrive at these estimates, A.T. Kearney relied on an internal proprietary methodology for segmenting and sizing the U.S. population by age, assets, and allocation of assets. They conducted a wealth distribution analysis to identify where pools of assets were concentrated and the movement of households between wealth groupings. Compared to the CEPR study, which utilizes the S&P 500 to estimate changes in financial wealth, the A.T. Kearney report emphasizes that index gains and losses are not a suitable proxy

for estimating the losses of individual investors. According to their analysis, the average U.S. portfolio lost 18 percent between 2007 and 2008, compared to a much more precipitous stock market decline of 53 percent. Under these assumptions, they believe their estimates of the declines in financial wealth paint a more realistic picture than other studies that impose market declines on wealth holdings.

## **THE IMPORTANCE OF SOCIAL SECURITY AND MEDICARE**

The early indicators of the crisis are clear: the retirement outlook for a large segment of the baby boomer cohort is grim. Many will choose to remain at work longer and others will try to return to work at a time when an extremely weak labor market offers limited employment opportunities. In general, they will be more reliant on Social Security and other government protections than imagined just a few short years ago. As Figure 2 reveals, low-income, minority, and less educated boomers already rely heavily on Social Security.

Spending for Medicare and Social Security undoubtedly will increase as more of the 78 million baby boomers begin to retire. This will certainly spur critics of these programs to call for benefit reductions or the elimination of the programs entirely. As the debate over strengthening the finances of these programs moves forward, however, it is clear that the recent crisis underscores the need to preserve current benefit levels.

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- <sup>1</sup> David Court, Diana Farrell, and John E. Forsyth, "Serving Aging Baby Boomers," *McKinsey Quarterly* 4 (2007): 103–13; Alicia H. Munnell, Anthony Webb, and Francesca Golub-Sass, "Is There Really a Retirement Saving Crisis? An NRRI Analysis," Center for Retirement Research at Boston College Issue Brief 7-11, August 2007.
- <sup>2</sup> William G. Gale, John Karl Scholz, and Ananth Seshadri, "Are All Americans Saving 'Optimally' for Retirement?" The Brookings Institution and University of Wisconsin-Madison, 2009, <http://www.aeaweb.org/aea/conference/program/retrieve.php?pdfid=488>.
- <sup>3</sup> Barry Bosworth and Rosanna Smart, "The Wealth of Older Americans and the Sub-prime Debacle," Center for Retirement Research at Boston College, November 2009.
- <sup>4</sup> Gordon B. T. Mermin, Sheila R. Zedlewski, and Desmond J. Toohey, "Diversity in Retirement Wealth Accumulation," Brief Series, No. 24, The Retirement Policy Program at the Urban Institute, December 2008.
- <sup>5</sup> Bosworth and Smart, "The Wealth of Older Americans and the Sub-prime Debacle."
- <sup>6</sup> Gordon B. T. Mermin, Sheila R. Zedlewski, and Desmond J. Toohey, "Diversity in Retirement Wealth Accumulation," Brief Series, No. 24, The Retirement Policy Program at the Urban Institute, December 2008.
- <sup>7</sup> Dean Baker and David Rosnick, "The Wealth of the Baby Boom Cohorts after the Collapse of the Housing Bubble," Center for Economic and Policy Research, February 2009, 6.
- <sup>8</sup> "The Real Impact of the Global Financial Crisis on Baby Boomers," A. T. Kearney, November 2009.
- <sup>9</sup> *Ibid.*, 10.