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Comment Steven F. Venti

Housing is the largest single asset in the portfolios of most households in the United States and the United Kingdom. This chapter takes up, once again, the important question of what happens to housing as households age. The analysis is very well done, so much so that I have nary a complaint about their methods. The findings first add to the large and growing body of evidence that housing eventually declines at older ages. This finding is shown to be robust to the choice of four different ways to measure housing. The authors then address a more unsettled and perhaps more important question: why do households downsize? I will devote most of my comments to what their findings tell us about the motives for housing decumulation.

Housing is a peculiar asset because it has both consumption and investment aspects. This dual role makes it difficult, as a matter of theory, to pin down what motivates households to accumulate, hold, and—at some point in the life cycle—to decumulate housing assets. Of particular importance is the lack of consensus on whether retired households intend to spend-down home equity to replace earnings or whether they want to hold on to housing assets for other purposes. Most financial planners consider most nonhousing assets such as IRAs, pensions, and financial assets as "saving" for retirement in the sense that these assets will be used to replace earnings to finance general consumption in retirement. A typical target, recognizing that consumption may fall after retirement, is that income from savings should replace 80 percent of pre-retirement earnings. When it comes to housing the treatment of housing assets is more ambiguous. Some financial advisors "count" housing assets as saving for retirement; others do not. Similarly, some financial software programs designed to help investors set retirement goals include housing wealth; others do not. And the vast academic literature on the "adequacy of saving" has been equally inconsistent (see, e.g., Bernheim 1992; Engen, Gale, and Uccello 1999; Gustman and Steinmeier 1999, and Scholz, Seshadri, and Khitatrakun 2006). Some studies ignore housing wealth, some include it, and others assume some arbitrary fraction of housing wealth should be considered among the assets that will be used to finance consumption in retirement.

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If households are asked whether they plan to decumulate housing assets to finance consumption in retirement they invariably answer "no." Survey data on planning shows that most households do not plan to move out of their houses. Unless they refinance or take advantage of reverse mortgages—both rare among the elderly—they do not plan to downsize. For example, in the 2004 Health and Retirement Study (HRS), respondents were asked the question: "What are the chances that you will sell your house to finance your retirement?" They were asked to respond using a scale ranging from zero to 100 where zero equals absolutely no chance and 100 equals absolutely certainty. The responses are graphed in figure 12C.1 for all respondents and in figure 12C.2 for respondents over the age of sixty-five. The majority of respondents who own homes do not anticipate selling their house to finance consumption. Over three quarters of those over the age of sixty-five and owning homes do not plan to sell their homes to finance consumption in retirement. Another survey, by the American Association of Retired Persons (AARP 2003), asked a sample of persons a similar question: "How likely do you think it is that you will be able to stay in your current home for the rest of your life?" The results, shown in figure 12C.3, show that over 80 percent of owners and over 80 percent of all persons over the age of sixty-five believe it is likely that they will remain in their current residence the rest of their lives. These respondents not only do not plan a housing transition to finance general consumption, but also do not anticipate a shock that will force them to downsize.

Although households may not plan to run down housing assets, whether they actually do is an empirical question. This chapter provides a great deal of information to address this question. Briefly, the study uses two surveys, the Panel Study of Income Dynamics (PSID) in the United States and the

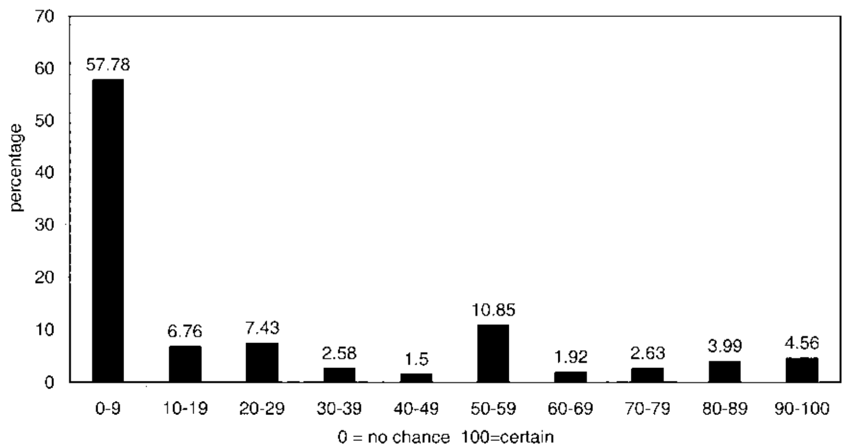

Fig. 12C.1 What are the chances that you will sell your house to finance retirement? (all respondents)

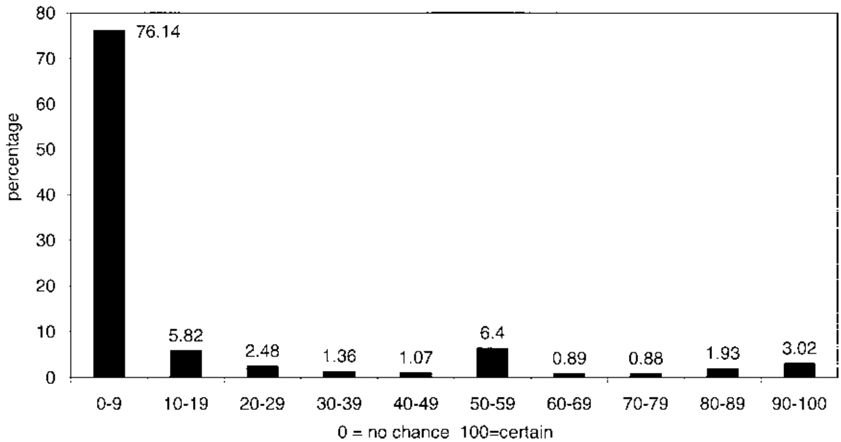

Fig. 12C.2 What are the chances that you will sell your house to finance retirement? (over age 65)

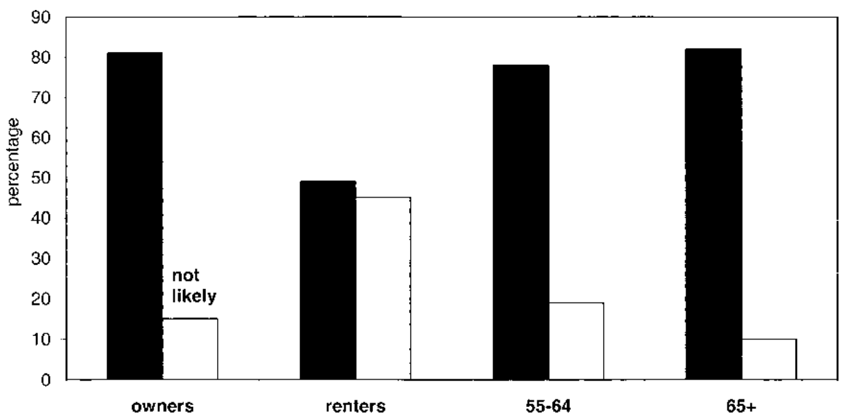

Fig. 12C.3 How likely do you think it is that you will be able to stay in your current home for the rest of your life?

British Household Panel Survey (BHPS) in the United Kingdom to study the housing transitions linked to downsizing. An improvement over past work is that four measures of housing transition are used. These are whether a household moves and then, conditional on a move, the change in the number of rooms, the change in the value of the house, and the change in house price volatility. For each measure, some downsizing is observed at older ages. The extent of downsizing is in the same range as that found in previous studies that focused only on homeownership or home equity (see, for example, Venti and Wise [2004] or Heiss and Börsch-Supan [2005]). The change in house price volatility is a particularly novel feature. In some models greater volatility puts nonhousing consumption at risk so some households may choose to relocate to reduce risk exposure.

Having documented that some modest downsizing does occur, the authors then ask if downsizing can be accounted for by changes in financial and demographic circumstances faced by the household. A wide array of "shocks" that may trigger a transition are included (although perhaps the most important—a change in health status—is not included due to data limitations). The empirical results suggest these shocks have similar effects in the United States and the United Kingdom. In almost all specifications the lowest transition rates are for households that experience no changes in circumstances (i.e., continuously married, continuously with children, continuously working, etc.). A change in marital status is by far the most important determinant of moving and, conditional on a move, is also an important determinant of changing the number of rooms and changing housing wealth. Changes in household size also have strong effects, particularly on the number of rooms. A recent change in house price volatility had little effect on transitions in either country. This result is somewhat surprising since previous research has identified this factor as an important source of transitions for younger households. However, escaping volatility should not be a concern for the elderly, who do not plan to move unless there is a strong bequest motive or a desire to extract home equity to finance nonhousing consumption.

These results clearly show that downsizing is associated with major events such as widowhood, divorce, or job change. How are we to reconcile this with the finding that households do not plan to downsize? One explanation may be that households neither want nor plan to downsize, but underestimate the probability they will face an event that will force them to readjust their housing in the future. An alternative explanation is that households view (and use) housing to insure themselves against catastrophic shocks that they recognize may occur later in life. They do not plan to use housing wealth, but they know it is there if needed. They neither plan nor expect to ever use their housing wealth in much the same way that most purchasers of automobile accident insurance, if asked, would say they neither plan nor expect to ever make a claim. In this case housing may best be viewed as an asset of last resort, not to be counted among the assets funding the 80 percent replacement rate promoted by financial advisors, but still available if hit by a shock in late life.

Both of these explanations for downsizing in the absence of a stated plan to do so suggest that households that do not experience significant changes in financial or demographic circumstances should not be expected to reduce housing in any dimension. A nice feature of the regression specification is that the authors include a set of age variables that allow us to determine if households downsize in the absence of shocks. Unfortunately, no clear pattern emerges from these estimates. For example, after controlling for the effects of shocks, table 12.13 shows the number of rooms declines steeply with age in the United States but the decline is much more modest (and not statistically significant after age sixty) in the United Kingdom. And after controlling for shocks, table 12.14 shows there is essentially no decline in home value in the United States, but home values in the United Kingdom decline rather steadily with age.

In general, the estimated age effects are different for physical and financial dimensions of downsizing and different for the United Kingdom and the United States. One possible explanation, as the authors acknowledge, is that health care costs and changes in health conditions are not accounted for in these estimates. Perhaps the biggest financial shock that older persons in the United States may face is large out-of-pocket health expenditures, including nursing home expenses. Skinner (2007) estimates that about 6 percent of U.S. households faced out-of-pocket medical expenses in excess of half of their income in a single year (2004) and this percentage is expected to increase rapidly in the future. De Nardi, Jones, and French (2005) show how health expenses rising with age will accelerate the drawdown of all assets. Whether health costs and changing health conditions can explain the decline in housing at older ages in the United States and the United Kingdom is a possibility the authors plan to address in future work using the HRS and English Longitudinal Study of Aging (ELSA).

In summary, the results of this study clearly show that downsizing of housing occurs in several dimensions in both the United States and United Kingdom. Events such as widowhood, a change in marital status, a change in number of children, or a change in work status are shown to trigger housing transitions. Whether downsizing is completely accounted for by these changes in financial and demographic circumstances is still an unresolved issue, leaving open the question of how housing fits into the life cycle planning process. The authors have made substantial progress advancing our understanding of downsizing by older households. Their future work using survey data (HRS and ELSA) that contain better measures of health care costs and conditions should complete our understanding of what motivates households to downsize.

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