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Household Debt & Financial Well-Being in Retirement

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Summary

National media stories repeat the claim that Americans are woefully unprepared for retirement. Retirees and people close to retirement have taken on more debt than previous generations and could face financial fragility in retirement. Yet, recent trends in housing and financial asset appreciation indicate the financial well-being of older Americans may in fact be improving rather than worsening. Without understanding both this demographic group's debt and their assets, it is impossible to know whether retirees are better off or not.

This study looks at how household debt and net asset levels, and debt-to-asset ratios have evolved for those over age 50 and explores the role that debt plays in the financial well-being of retirees. The data used come from the RAND Health and Retirement Study (HRS) panel data from 1992–2016.

Key Findings

- Since the 1990's, the amount of debt held by near-retirement age people has increased, but so have assets. Increasing debt may be manageable if assets – like housing values – are also increasing in value.
- Debt to asset ratios also rose over this time period.
- Increasing debt-to-asset ratios suggest that retirees will be less financially secure in retirement.
- Satisfaction with retirement has remained relatively constant over time, regardless of debt levels. This suggests that debt levels do not necessarily impact retirement satisfaction, and that younger generations may be more comfortable holding more debt in retirement. This indicates that further research is needed on how debt is used to manage financial security in retirement.
- The story of debt in retirement is more complex than often portrayed in the popular press, and creates an incomplete picture of the true financial landscape faced by many future retirees.

Each generation faces unique economic challenges when saving for retirement. Some generations experience strong economic growth and generally rising wages, while others face recessions and other unexpected shocks to asset and debt accumulation. Americans' preparation for retirement is a complex story. While debt burdens are increasing for the near-retirement age population, so are assets, and so there may not be a "retirement crisis" on the horizon.

Practitioner Ideas

Individuals have a unique relationship to debt that is based on their life experiences, financial situation, and their personality. Events like the Depression or Great Recession can lower individuals comfort level

with carrying high debt. Others may be more comfortable with higher debt levels and take out student loans or small business loans to invest in their future earnings.

A debt-to-asset ratio is a business accounting term that divides the total amount of debt a company owes by the value of all their assets. The higher the ratio, the higher the financial risk for that business. Practitioners can consider using this metric to help their clients understand and figure out their own financial situation and risks too:

- Create a spending plan that includes income and expenses, including minimum monthly debt payments and the total amount of debt. Ask your client about their ideal debt situation. How do they know when debt is manageable or when it is causing too much stress?
- Provide a personal net worth worksheet for your clients. A net worth statement tells you the value that is left after subtracting liabilities, like a mortgage, car loan, and credit card debt, from the household's assets, such as equity in a home or the balance in a savings account. The ideal would be to have more assets than liabilities, especially later in life when assets could be used for future income. Note that a net worth worksheet may not be a good learning tool for all clients, especially younger households with high debt levels or lower income households with fewer assets.
- If clients are looking at taking out a future loan for a car or home, you can also help them calculate their debt-to-income ratio. The ratio is the dollar amount of debt owed divided by gross monthly income. Then the ratio number is multiplied X 100. A higher ratio number means that a household spends more money on debt and has less money available for monthly living and savings. Qualified mortgage lenders look for a debt-to-income ratio that is less than 43%.
- Discuss future financial plans with clients. If they have debt, look at the timeline for repayment and strategies for saving along the way. If clients are closer to retirement age, help them compare their debt to the value of their assets and explore how their assets might support them in the future. Will they plan to sell and downsize their house to use some of that money to pay monthly expenses in retirement? How important is it to them to leave a bequest?

Key Resources

Consumer Financial Protection Bureau. *Calculate your debt-to-income ratio*
https://www.consumerfinance.gov/ask-cfpb/what-is-a-debt-to-income-ratio-why-is-the-43-debt-to-income-ratio-important-en-1791/

National Endowment for Financial Education. *Smart About Money: Calculate Your Net Worth Worksheet*
https://www.smartaboutmoney.org/Tools/Worksheets

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