National Reverse Mortgage Lenders Association

Western Regional Meeting

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Economic Update: Debt and Spending

NRMLA Western Regional Meeting
Huntington Beach, CA
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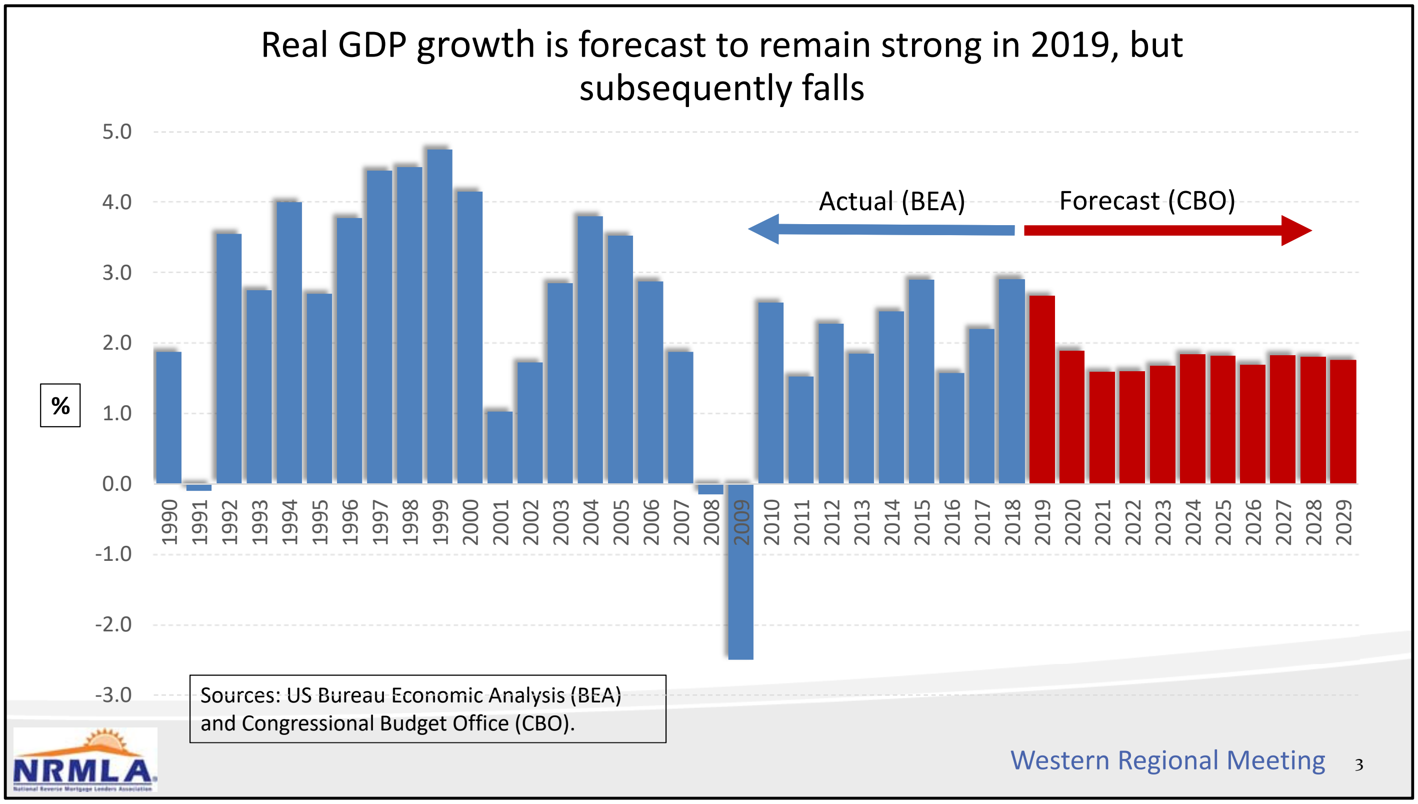
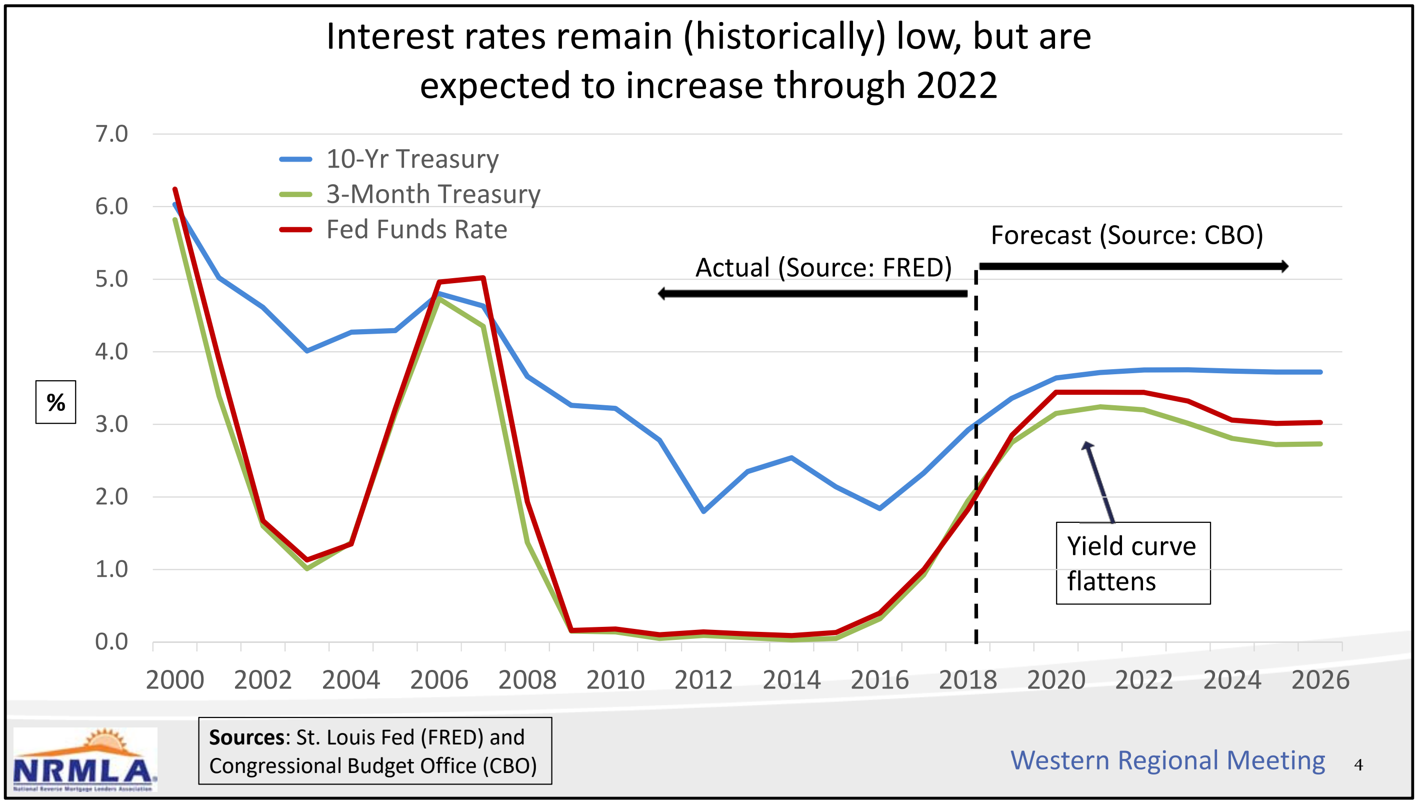
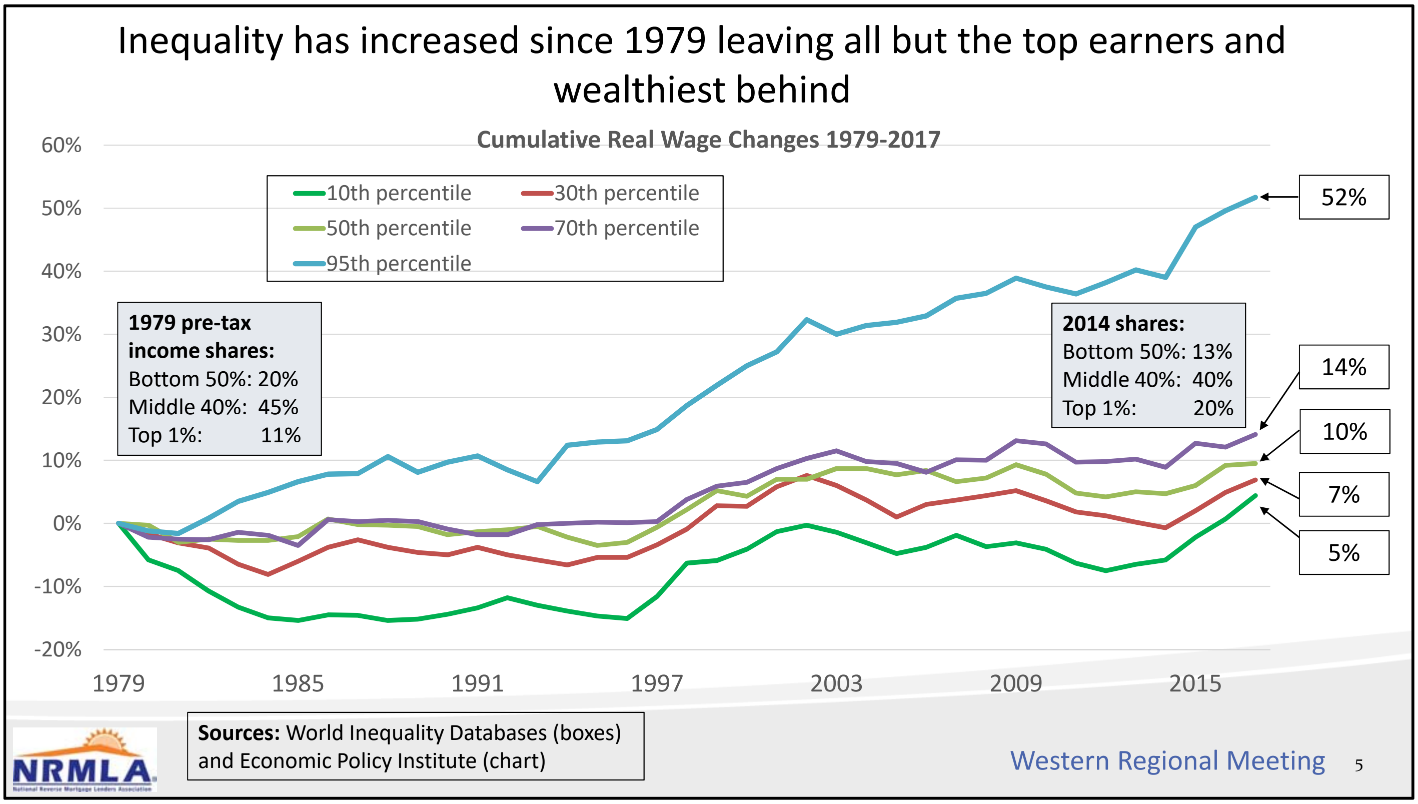


- CBO released its 10-year forecast for real GDP in January.
  - Strong numbers expected to continue—CBO's current 2019 forecast (2.7%) is slightly lower than it's forecast from August 2018 (2.8%).
- Growth slows to 1.9% in 2020 and 1.6% in 2021 (with similar rates through 2029).
- Long post Great Recession expansion may come to an end in 2020. Why?
  - **Federal Deficits**: 2017 deficit of 3.5% of GDP ($665 billion). Grew to 3.9% ($779 billion) in 2018. Deficits predicted to grow to 4.9% in 2019-28.
    - **Debt** held by public: 76% GDP (= $15 T) up to 96% (= $29 T) in 2028.
  - Potential **trade wars** still linger.
    - **China**: US sources 20% of its manufactured imports from China. But tariff increases have been largely offset by a 13% depreciation in the Yuan relative to the U.S. dollar.
    - NAFTA 2.0 (USMCA) needs approval for 2020 implementation.
  - **Slowdown in other economies**—China slowest growth (6.4%) since 1990 (with fixed investment spending in 9-yr downward trend), European Central Bank acknowledged growing downside risks, BREXIT, Bank of Japan—deflation risk.
- **Modern Monetary Theory**: Is this the most recent fad?
  - Shouldn't we be fixing the deficit when there is full employment?
  - CBO long-term outlook: Payments on debt will be 6.3% of GDP in 2048.
  - Fed interest payments ≈ Social Security budget at that point.
  - Fed spending would be 29% of GDP (levels not seen since WWII).

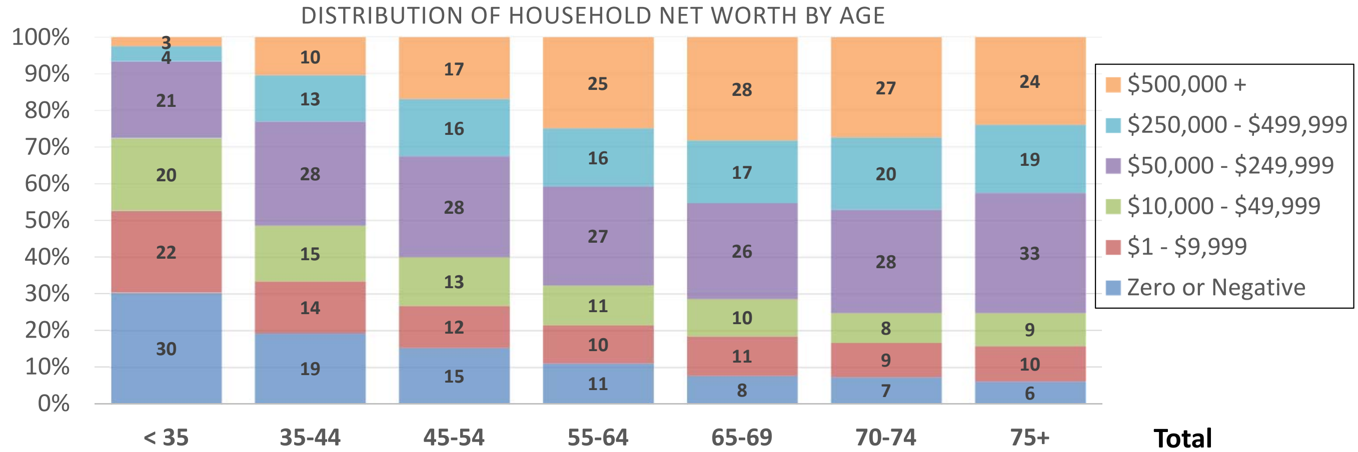


- Fed Chairman Powell's message: **Patience** with regard to additional monetary tightening, **continued data dependence** with a close watch on inflation.
- FOMC adopted a more **dovish stance**. Expect next hike to be in Q3. Previously expected two hikes this year.
- Current Fed Funds Rate (2.25-2.5%) gives the Fed leeway in case of recession to use policy lever.
- CBO forecasts have rates increasing quickly due to faster growth.
    - The **yield curve** is also expected to flatten (but not invert—that often signals a recession).
- Previously, forecasts were flat after increase. Now, with increased deficits and slower economy, CBO forecasts that rates will decrease after initial increases.
- Things to remember:
    - Rates are still historically low
    - The Fed has ≈ $4 trillion of securities on its balance sheet from QE. Continuing to deleverage
    - Deficits will increase in the short run due to tax changes
    - As US debt increases, rates should increase.



- Are we all **better off** than last year? Than our parents?
- **Inequality has risen**:
  - Pre-tax income share of top 1% was up to 22% in 2015.
    - Their wealth share was 40% in 2016 (while it was slightly negative for the bottom 50%).
  - **GAO report on retirement security: 55% of households age 55-64 have less than $25,000 in retirement savings, including 41% who have zero.**
- **Wages and salaries increased 3.1% in 2018 and increased 2.5% in 2017.**
  - Minimum wage increases in 19 states on Jan 1 affected approximately 5.2 million workers.
- Still, among ALICE (Asset Limited, Income Constrained, Employed) households, 16 million live in poverty and more than twice that number earn "less than what it takes to survive in the modern economy."
- Many social scientists believe the **increasing inequality is due to poverty traps.**
  - Chetty et al: 90% of children born in 1940 would earn more than their parents but only 50% of children born in the 1980s can expect to.
- **Bottom line:** If people have less real income, have they saved enough for retirement years?

As Americans age their net worth increases with home equity playing a key role



	< 35	35-44	45-54	55-64	65-69	70-74	75+	Total
Median Net Worth	$7,700	$55,400	$98,800	$163,300	$193,400	$209,200	$194,900	$81,900
Excluding Own Home Equity	$4,700	$21,900	$33,900	$61,400	$66,300	$62,600	$45,700	$25,200

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Source: Census Bureau, Survey of Income and Program Participation, 2014 Panel, Wave 2 (released Sept 2018).

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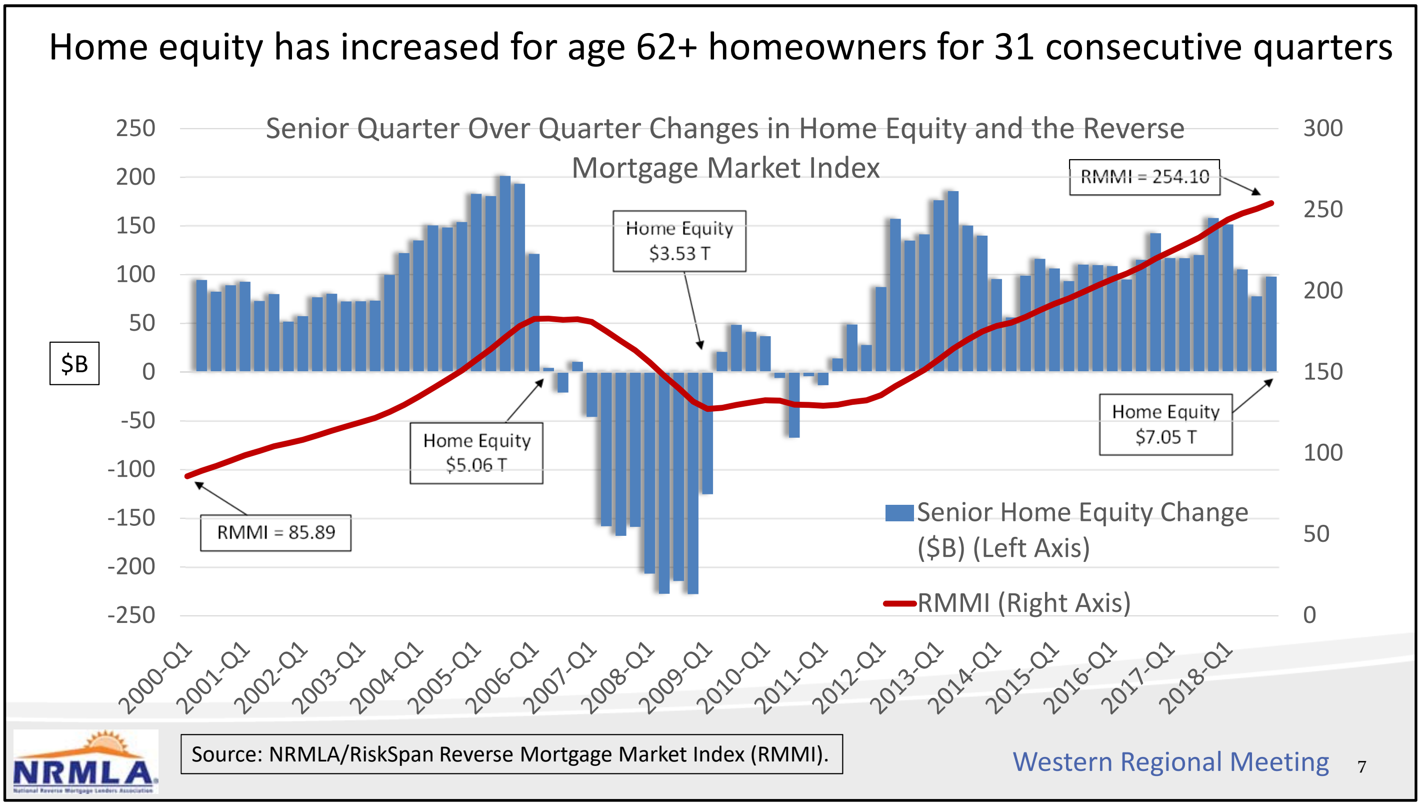
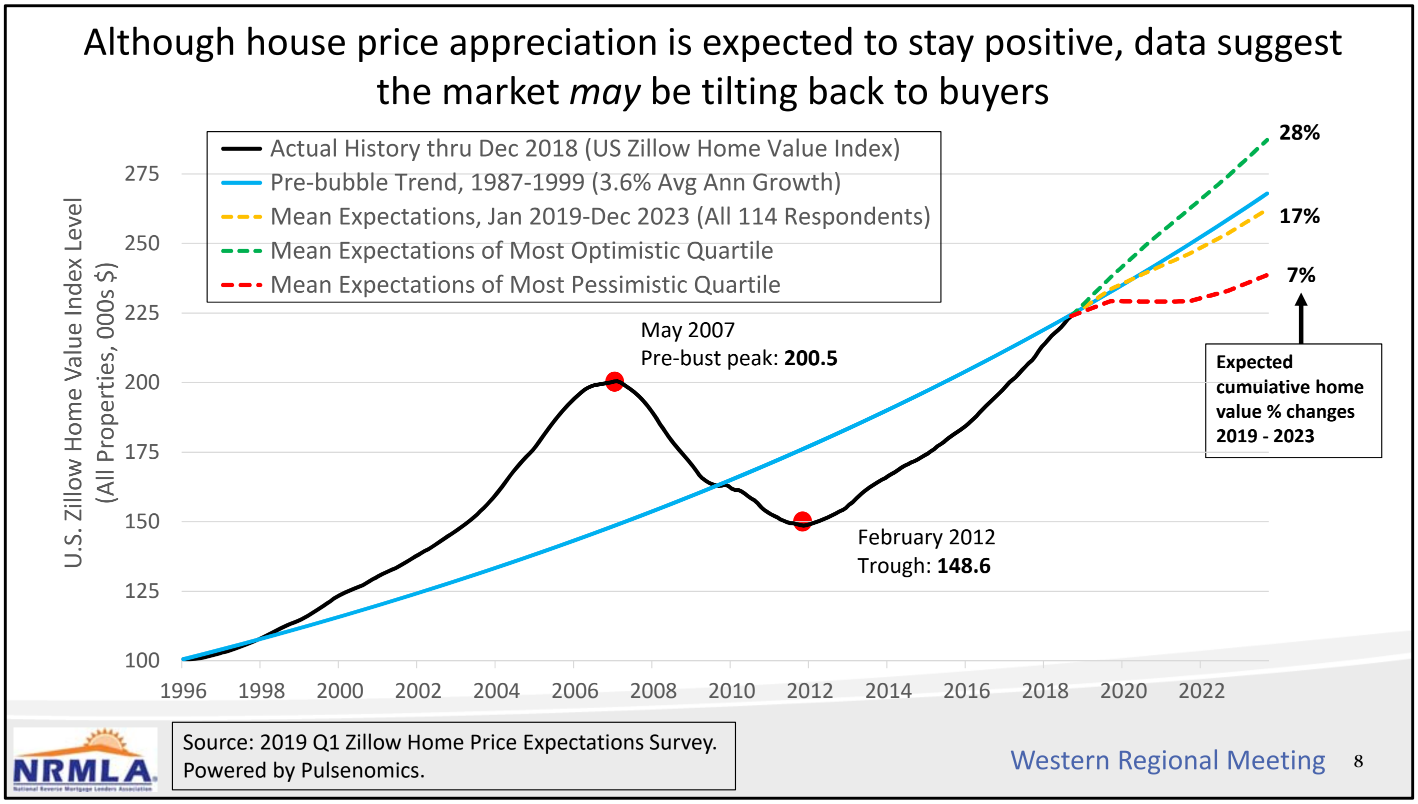
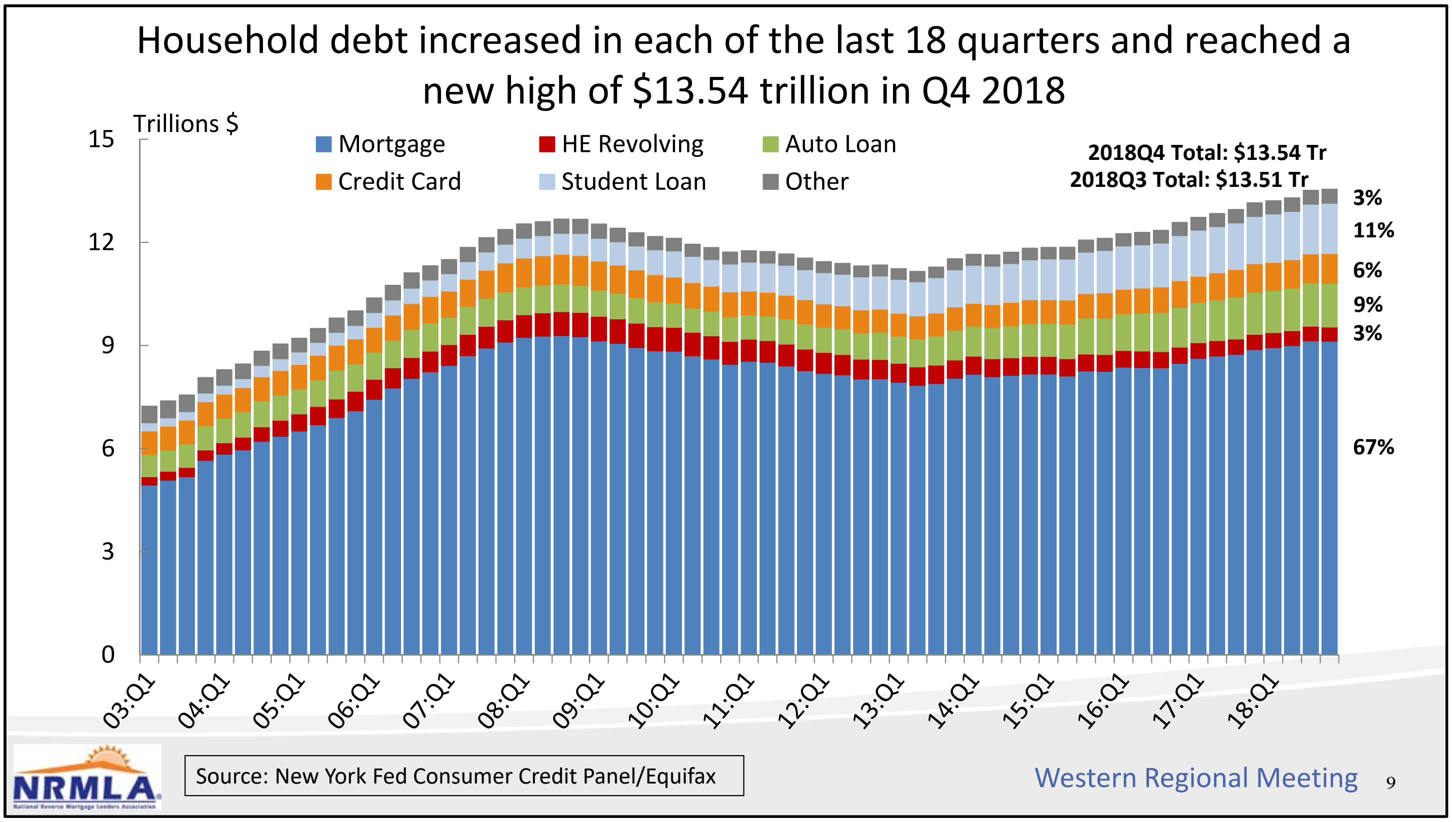
- What is our wealth situation?
- Before we discuss debt and spending, how much do Americans own?
  - **Focus on medians**—averages are skewed.
  - Medians are **$82k** (**$25k**). Corresponding averages are **$257k ($169k).**
- Inequality:
  - Homeowners have a median of **$205k**. Renters have **$2k**.
  - No high-school **$5k**, high-school **$36k**, BA **$149k**, Grad/prof **$315k**.
- Focus on the **65-69** and **70-74** age groups:
  - When exclude own home equity, net worth ↓ by **66%** and **70%**.
  - **45%** and **47%** have net worth over $250k.
  - **71%** and **75%** have net worth over $50k.



- Opportunities for seniors to take on additional debt is summarized by the quarterly RMMI.
- RMMI has tracked the reverse mortgage market since 2000.
  - Analyzes and reports on trends in senior home values and home equity levels.
  - Most recent RMMI, published in March 2019 (for 2018 Q4), hit an all-time high at **254.10**. Reflects record senior home equity of **$7.05 T**.
    - Note that <u>total</u> home equity is **$15.54 T**
      - Pre-crisis it was **$13.40 T**, bottomed out at **$6.12 T**.
  - Note that senior home equity has been less volatile than total.
    - Fell by **30%** versus **54%** for total.
    - Is up **100%** from 2009 Q1, total equity is up **154%**.
    - Less leverage (i.e., lower LTVs) for seniors. Older, more established neighborhoods.

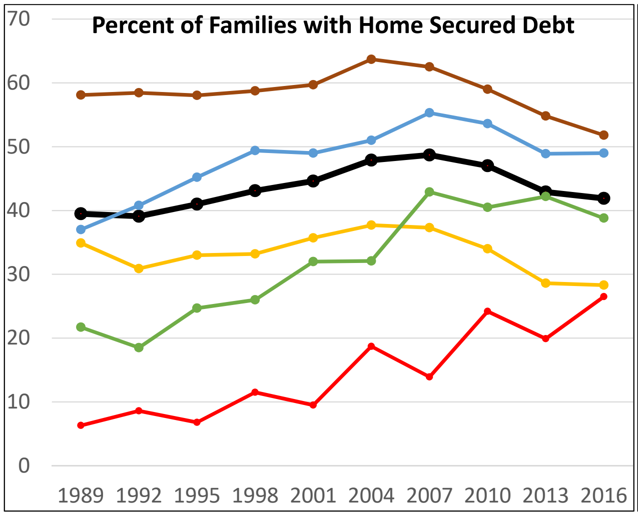


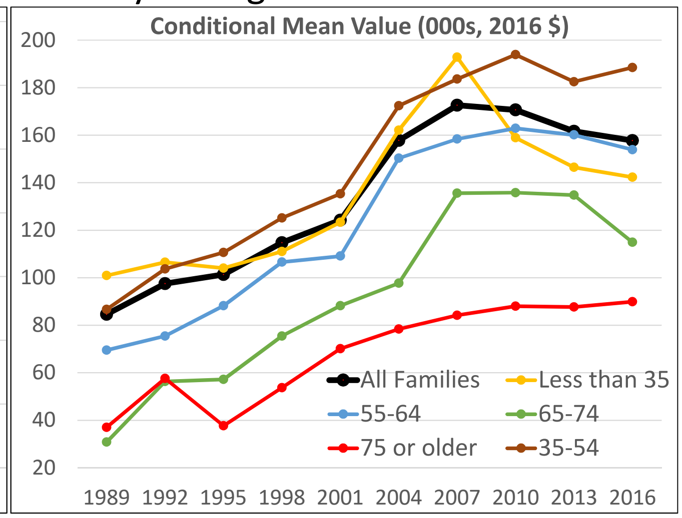
- House price appreciation shows signs of slowing down.
    - Blue line shows **3.6%** average annual growth.
    - Yellow is the mean expectations—is at **3.2%**
        - Optimistic **5.1%**, pessimistic at **1.3%**.
- **Months of supply** have rebounded from **3.6 months** in Jan 18 to **4.1** in Jan 19 (Redfin).
    - Six months is often considered a “balanced” market. This was last so at the start 2012.
- New starts (at **1.23 million**) are almost 300k below the 1.5 million needed to satisfy demand. Especially as millennials accelerate household formation.
    - As interest rates increase, will there be fewer incentives to move?
- Recently, data suggest the balance may be **starting to tilt back toward buyers**.
    - **Home-value growth is slowing** in more than half (19) of the nation's 35 largest metros, and price cuts are becoming more common.
    - But even in those markets where appreciation has slowed, it remains above its historic average rate and sellers continue to have the upper hand, particularly at the most affordable price points.
    - Three out of four economists surveyed (by Pulsenomics) said the national housing market would not shift to a buyers market until 2020 or later.



- Household debt has increased by more than 21% since 2013 and reached a record $13.54 trillion in 2018 Q4.
- Despite this growth, **household debt service payments** (relative to disposable income) are below 10%, and **90+ delinquencies** continue to hover around 3%.
    - It would appear that current debt levels do not pose an excessive risk.
    - For comparison, at the **last peak** 2008 Q3 ($12.68 Tr), the debt payments to disposable income ratio was 13% and 90+ dlqs were climbing rapidly to 7% (and eventually reached 8.7% in 2010).
- While **home secured debt** 90+ dlqs are low (at 1.1%) we cannot ignore the **disconcerting trends** for other components:
    - In the last 5-years **student** and **auto loan** debts grew by 35% and 50% (to $1.46 Tr and $1.27 Tr respectively).
    - The decrease in **credit card** debt that followed the financial crisis has been eroded—at $870 B it is up $200 B from 2013.
    - 90+ dlqs for auto loans have slowly trended upward since 2012 (to 4.7%), and the 90+ level for student loans remains high at 11.4%.
    - The flow into 90+ delinquency for credit card balances has been rising and remains elevated (at 5.0%).

Seniors are more likely to hold home secured debt and to hold more of it than 20 or 30 years ago





- Seniors aged 75+ were ***four*** times more likely to hold home secured debt in 2016 than in 1989.
- The value of debt held by seniors aged 65-74 grew by ***270%*** (in real terms) and by ***140%*** for those aged 75+ over this period.

Source: Survey of Consumer Finances

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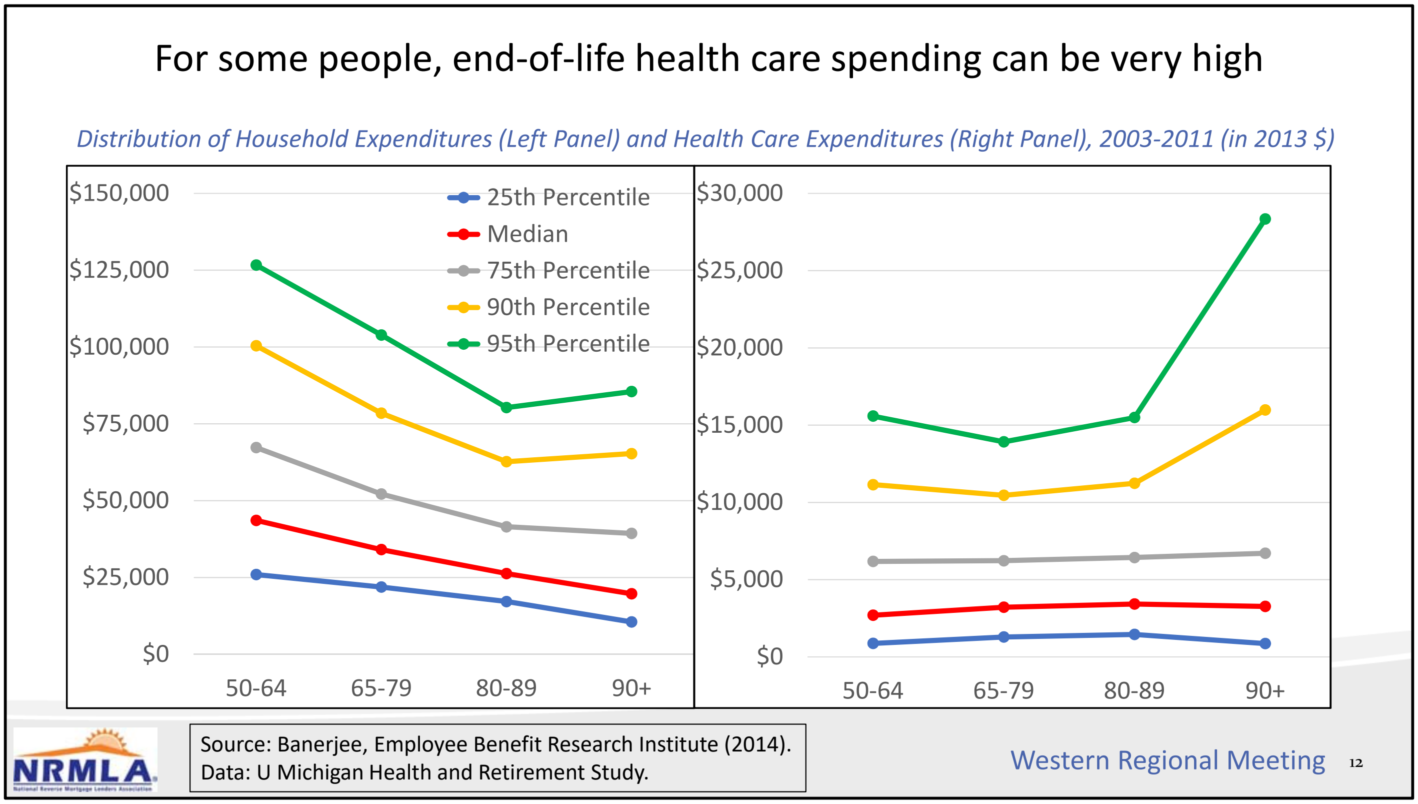
- Percentage of families with home secured debt has fallen since 2007. This is driven primarily by younger families.
  - After steep rise, households aged 65-74 have stayed at an elevated 40%.
  - Major increase for 75+ households. In 2016 survey more than 26% held home secured debt.
- Levels also up for those holding debt (see bullet on slide).

As seniors age, average expenditures decrease more slowly than net income

Item	All	Baby Boomers 1946-1964	Silent Generation 1928-1945	Greatest Generation 1927 and earlier
Average number of people in household	2.5	2.1	1.6	1.3
Homeowner without mortgage (%)	27%	37%	61%	62%
Renter (%)	37%	23%	20%	35%
Money income after taxes	$63,271	$66,542	$38,004	$30,471
Average annual expenditures	$58,460	$62,439	$43,912	$37,783
Housing	$19,325	$19,407	$14,531	$19,025
Food and Alcoholic Beverages	$7,407	$7,749	$5,661	$3,569
Apparel and services	$1,771	$1,666	$995	$594
Transportation	$9,252	$9,561	$6,689	$3,822
Health care	$4,710	$5,689	$6,394	$5,541
Entertainment	$2,941	$3,214	$2,198	$885
Personal insurance and pensions	$6,938	$8,055	$2,432	$899

Source: Consumer Expenditure Survey, 2017 (Midyear), Bureau of Labor Statistics.

- On average, net income < expenditures for the two oldest generations—they need to tap savings (or other resources).
- For all three groups, housing is the biggest expense, accounting for over 30% of total spending.
    - **40%** of boomers have mortgages vs. **19%** for the silent generation.
    - Housing expenses jump to over **50%** of income for oldest generation as more households rent.
        - **Average rent** spending is **$2,200** for the silent generation and **$8,300** for the greatest generation.
- Transportation expenditures decline with age as households own fewer vehicles.
    - Drilling with CE data, older seniors are also less reliant on car rentals, taxis and public transportation.
    - It thus appears they travel less.
- Health care expenditure decreases, on average, from **$6,394** (silent generation) to **$5,541** (greatest generation).
    - However, on a **per-capita basis**, they increase from **$4,000 to $4,300**.



- The median (in the left panel) falls as seniors age.
- Overall median expenditures drop by **55%** across the four age groups.
    - From **$44,000 to $20,000**.
- The expenditure distribution narrows as seniors retire and age through their 80s.
- But widens as spending tick up for the highest spending groups in their 90s.
- To understand why, look at the distribution of health care expenditures in the right panel.
    - Until age 90, the distribution appears relatively even, but then fans out as health spending increases sharply for the top two groups in their 90s.
    - Banerjee notes: “[f]or some people, end-of-life health care spending can be very high.”

When building a budget for our borrowers, we need to ensure that no spending categories get overlooked

Inter-Generational Intra-Family Cash Transfers by Older American Households 2008-2010 (Adjusted to 2014$)

Age Group	Percent Making Transfers	Average Amount	Average-2nd Income Quartile	Average-Top Income Quartile
50-64	51%	$16,272	$7,411	$27,378
65-74	39%	$13,639	$7,784	$21,072
75-84	33%	$14,704	$9,849	$22,864
85+	28%	$16,836	$13,474	$24,601

Source: Banerjee, Employee Benefit Research Institute (2015).
Data: U Michigan Health and Retirement Study.

- Over the two-year period between 2008-2010 over **40%** of older households **gave** transfers to children and grandchildren.
    - Only **5% received** transfers from younger family members.
- Intra-family transfers to younger generations are thus a net expenditure for many seniors.
- Note that for households over age 65 the median transfer amount is zero.
- However, when transfers are made they are sizable.
    - For example, of the 33% of age 75-84 households that made transfers in the two-year period, the average amount was $14,704.
    - Transfers are also higher for higher income families.