

Why Voluntary Saving For Retirement Is Short-Changed, and What Can Be Done About it

Saving for retirement involves sacrificing something of value today in exchange for something of value in the future. Economists have long argued that this decision is biased in favor of current values because they are more certain than future values, and also closer at hand. Saving for retirement is an extreme example because of uncertainties regarding how much and when the savings will be needed, and how much of it should be allocated to the retiree's estate.

The consequence is pervasive procrastination in saving for retirement by low and moderate-income consumers. For many, this results in impoverishment later in life.

The mandatory savings plan administered by Social Security is an important offset but it doesn't cut very deep, and it might depress voluntary private savings by providing a rationale for ignoring it. What is needed are programs to encourage private savings. The deficiency is not an absence of savings instruments, there are plenty of those, what is lacking is the incentive to use those instruments to save for retirement.

Encouraging The Incentive to Save For Retirement

People are motivated to save when:

- Anticipated future benefits are known.
- Costs of realizing those benefits are known
- The wait period until benefits occur is known.

As an illustration, many mortgage borrowers save by making extra payments on their mortgage using a calculator on my web site. The calculator is the most frequently visited page on the site, probably because it meets the three conditions specified above. It allows the user to specify the future benefit, which is the elimination of mortgage debt within some time period. It shows the exact cost of realizing that benefit, which is any pattern of extra payments that meets the debt elimination objective. And the wait period is as long as the borrower wants it to be.

My experience with the extra payment calculator raised a question in my mind as to whether it was possible to develop a similar tool, meeting the requirements specified above, that would encourage consumers to increase their total savings for

retirement? The answer has turned out to be “yes”, my colleague Allan Redstone and I have designed such a tool. We call it the Retirement Saver (RS).

The bottom-line output of RS is the monthly spendable funds available to the retiree from all sources through the retirement period, plus the estate value at any point in the process. RS shows how any savings plan designed by the retiree before retirement affects those outputs. Spendable funds are an appropriate proxy for retirement benefits because they will support any activity the retiree wants to pursue when the time comes.

Illustration: A Savings Plan For a Non-Affluent Homeowner

The table below was created on December 5, 2022. The illustration is for a male of 40 who has \$100,000 of financial assets, a house worth \$400,000 with a \$200,000 mortgage balance who adopts a saving plan of \$500 a month, rising by 2% a year. The table shows how his initial monthly spendable funds is affected by his saving plan, and by the addition of a HECM reverse mortgage.

Impact of a Retirement Savings Plan and a Reverse Mortgage on Initial Spendable Funds Available to a Male of 40 at Varying Retirement Ages

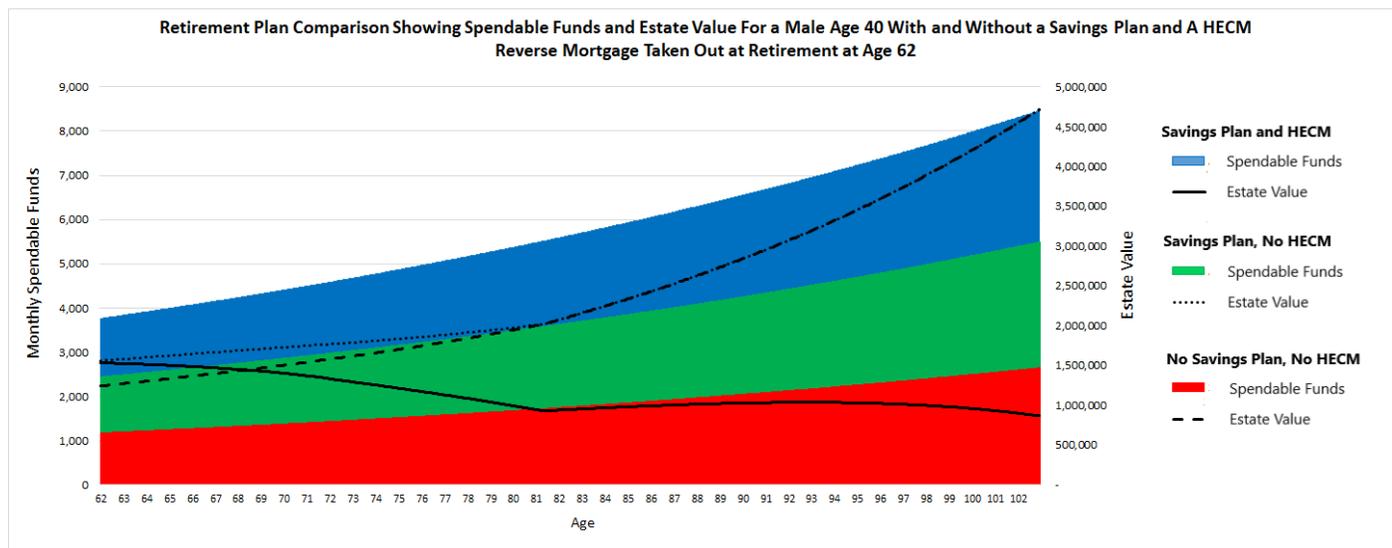
Retirement Age	No Savings Plan and No Reverse Mortgage	With Saving Plan	With Saving Plan and Reverse Mortgage
62	\$1,179	\$2,448	\$3,749
65	1,723	3,515	5,063
70	2,922	6,005	7,974
75	4,492	9,612	12,027

Note: The annuity prices and reverse mortgage prices used in the calculations are as of December 5, 2022. The savings plan is \$500 a month increasing 2% each year. The user is a male of 40 with financial assets of \$100,000 earning 6% who has a home worth \$400,000 appreciating 4% a year, a mortgage balance of \$200,000 at 4.125% and a mortgage payment of \$1,000. Spendable funds begin at retirement and increase by 2% a year. An annuity is purchased at retirement for different amounts in the three cases, with payment deferred 10 years. The annuity has a cash refund option. Underscored items are configurable.

The note to the table shows the wide range of assumptions that are involved in the calculation. It was calculated using our new [Retirement Saver Calculator](#), which is now available at The Mortgage Professor website. The calculator allows anyone to develop a retirement plan that is based on the features and assumptions that are applicable to them.

Spendable Funds and Estate Value Displayed Graphically

The table shown above has two limitations. First, it shows the initial spendable funds amount at retirement, but not the changes that occur in later years. Second, it does not show the retiree's estate value. Both are displayed in the time series chart shown below covering the same retiree features.



The chart shows how the savings plan and the reverse mortgage contribute to the growth of spendable funds over time, and how the estate value is affected by these choices. The savings plan actually increases estate value in the early years but the reverse mortgage has the opposite effect. How this affects a decision on whether or not to include a reverse mortgage in the plan depends on the consumer's attitude toward estate value.

Managing the Plan Over Time

A retirement plan is almost surely going to be affected by changes in interest rates and other developments during the period between the age at which a savings plan is adopted and the expected age at retirement. Using the plan successfully requires that the retiree update the plan, perhaps once a year or whenever the financial landscape undergoes a significant change. Those using a web site on which their plan is saved will access that site whenever they want to revise the plan, or perhaps merely to check on how the plan is progressing.

How to Begin the Process

Since a retirement savings plan involves looking ahead for several decades, the plan should be based on the best guess of how the consumer's finances will evolve

over that period. As those assumed conditions change, the savings routine can be adjusted as needed and a new retirement plan will emerge.

The mistake to be avoided is to delay beginning the process until conditions are more favorable. There are always reasons to delay, today it might be the incipient inflation and/or fear of an impending recession. If necessary, the consumer can begin a savings plan in which savings are nominal or even zero for some period before they become positive. The key is to begin.

Home Equity Growth as a Savings Component

Consumers who have a significant portion of their wealth in their home should aim to supplement their periodic savings by increasing their home equity during the period before retirement. Unless the consumer wants to leave the home equity in her estate, that equity can be converted into a reverse mortgage credit line to supplement spendable funds during retirement, as illustrated in the table and the chart. While the home equity on which reverse mortgages are based is impacted by general market trends over which individual retirees have no control, owners have discretion over maintenance and improvements that affect the value of their own particular house.

The key to making the reverse mortgage an effective component of a retirement plan is to phase systematic draws on the credit line into the plan, which is exactly what the example shown above has done. Homeowners who draw the maximum amount available from their reverse mortgage at the first opportunity sabotage their retirement.

Because of the favorable response we have had to the Retirement Saver Calculator, I have decided to make it available to any web site that would like to offer it to their users. There would be no charge for installation, and updates based on changes in annuity and reverse mortgage prices will also be free.

Calculator Availability and Usage

The [Retirement Saver](#) calculator can be accessed on my Mortgage Professor website. It is also available to any web site that would like to offer it to their users. There would be no charge for installation, and updates based on changes in annuity and reverse mortgage prices will also be free.

Third parties who accept this offer, whether they are web-based lead generators, depositories or advisory firms, will probably find it useful to maintain updated

versions of each client's account projected forward. Depositories in particular could make this a feature of their IRA accounts, where the account-holder can monitor how their rising account balance impacts their retirement funds. This will solidify the depository's relationship with the client, and position itself to advise on the conversion of a projected retirement plan into an actual plan when the time comes.