

## Homeownership: Should Advisors Ignore the Elephant in the Room?

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### Abstract

There appears to be an advisor blind spot to the presence of a very large asset found in most households: the home. Add to this the finding that households in the United States have a widespread problem of retirement inadequacy (Board of Governors of the Federal Reserve System, 2019). While the use of reverse mortgages and home equity later in life is more recently at the forefront of financial planning to help with this inadequacy, there should also be lifestyle discussions when a client is buying a home and throughout home ownership (such as decisions as refinancing, obtaining a home credit line, and moving to a larger home) to make better financial decisions on home throughout life. Qualitatively, lifestyle choices are for the client to decide, but it is up to the financial planner to show tradeoffs in priorities for a client to reach their most favored goals; and these decisions should include the home, which is often a client's most valuable asset (Blanchett, 2017). Blanchett states, "Despite being one of the most valuable assets in the world and one of the largest assets on many households balance sheets, real estate, in the form of homeownership, presents considerable risks that are generally poorly understood" (p.7). Just as a financial analyst can recommend a favorable stock that may not fit in a client's overall financial picture as determined by a financial planner, a bank's debt-to-income calculation of how large a payment a client can afford may also not be best for that client based on their current and expected future cash flows. A home should be covered through many aspects of financial planning, such as educating clients on mortgage options (e.g., fees, interest rates, lines of credit, refinancing, reverse mortgage), recommending a real estate debt level (along with non-mortgage debt), while working and while retired. It is prudent for a financial planner to know the real estate market enough to be able to judge optimal times for additional investment or selling and providing advice on tax and estate transfer strategies of a home. However, do financial planners receive education on this matter? Do they have software support? Is this advice incorporated into a fee structure? This article covers the importance of the home, client reactions to changes in home value, and contemplates why the home is not covered during a client's whole life cycle.

### Significance

#### Homeowners' Perspective

**Home as a financial buffer.** Between 2016 and 2019, there was a significant increase in home ownership (Bhutta et al., 2020). During this time, household median net worth also jumped. Evidence of homeowner treatment of home equity as a financial buffer is stated by Hurst and Stafford (2002) from earlier studies by Carroll, Dynan, and Kane (1999), Skinner (1996), and Engelhardt (1996). These studies show that consumers change behavior (increased savings or curtailing consumption) based only on a housing downturn, not home appreciation. This clearly indicates that homeowners equate housing equity as a method to contend with housing market contractions, as they perceive their house value decreasing as a financial buffer.

**Home as a means of consumption.** Home value perceptions relate to the availability of home equity. While most home equity funds are used to purchase another home or refinance, the next largest use of assets pulled out from a current home is for paying down non-mortgage debt, with some portion is used for home improvements (Greenspan et al., 2008). This is stated surprisingly succinctly by Greenspan speaking before Congress about homeowner's use of house value: "Drawing on home equity in this manner is a significant source of funding for consumption and home modernization" (para. 12). Figure 1 presents the flows of home equity extraction (solid blue line, left scale) in the U.S. in billions of dollars along with the Shiller' Real Home Price Index (dashed green line, right scale)." (Pancrazi and Pietrunti, p. 39), with Greenspan's interesting calculation of home equity, pulled out of a home "as a four-

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quarters moving average of Gross Equity Extraction divided by the Consumer Price Index” (May 2015, p.39). A study by Chetty et al. (2017) shows that spending less on a home increases liquid wealth. This is a natural subsequent action, but Chetty et al. (2017) determined that liquidity “would rise by 1 percentage point—6% of the mean stock share” when a client decreased home spending by 10% (2017). This study is useful for advisors, who could educate clients on the efficacy of considering less spent on home wealth, especially at a time when liquidity is needed. Even more recently, He, Ye, and Shi have shown that, in China, home equity definitively increases consumption by 3% when home equity rises by 10% (2019).

**Home equity for additional homes (or refinancing).** This is the major reason for homeowners pulling out equity, which is all well and good, but are the efficacy of these transactions overseen by a financial planner? Further questions should be investigated: Is the home being bought of good quality or refinancing at a good time? What is the estimated term of owning the new house? What are the long-term plans of the homeowner? While these questions, when the home is substituted with portfolio assets, would be covered by a financial planner, why is a potential home also not subjected to inspection as to whether it is falling in with a client’s long-term goals, especially with some extravagant home values of today? While clients, of course, make their own final decisions and a home can be an emotional purchase, there is no reason why an advisor cannot at least educate a client on the financial aspects of buying and selling a home and should do so exhibiting their fiduciary duty. Lately, reverse mortgages have entered the realm of advising for those 62 years of age and above, entering one aspect of home ownership into the planner/client realm. Should there not be additional advice given on home or rental ownership throughout the client’s life cycle? Further, where are the financial planning education and software inclusion on home ownership? These appear to be lacking.

**Rental property different from owner-occupied housing.** Flavin and Yamashita also consider rental property value, as well as home equity, but separately due to the advantages and disadvantages of owner-occupied versus rental holdings. The service of a home as it provides a living space must be considered when looking to tap into home value. Flavin and Yamashita do actually compute the extra value above the service it provides in order to consider the rest as a portfolio asset. More recently, rental income and its tax benefit (now superseding the personal home benefit with the increase in the standard deduction and less use of itemization) and possible estate planning benefit is a real possibility for client real estate decisions. Pelizzon notes that very little research has been done on incorporating real estate risk and reward/loss into a portfolio that contains the home as an asset (p. 405). Is the financial planner educated on and aware of the advantages and disadvantages of rental versus private home ownership?

**Leveraging home equity.** Using the example of the last recession (2006-2008) and the lead up to it, Mina et al. found that homeowners accessed an average of one-quarter of home equity available before the 2006-2008 recession for consumption. A large number of young people and those with low credit scores (interpreted to also be those in lower socioeconomic situations) sought to use home equity, causing a large default in the housing market downturn during the recession. An estimated 39% of all household defaults during the recession were related to home equity defaults (2011).

**Debt level and alignment with goals.** The debt level and appropriateness of a real estate investment for a client is a vital part of financial planning. While situations vary greatly, questions that should be answered by a financial planner may include: Where would a client be financially if they spent less on housing and invested more into retirement funds? What would be the effects of paying off the house early and eliminating the interest cost on the debt? Should the client buy a rental property instead of a larger personal residence? Is that dream home in retirement affordable on retiree income? These questions and a myriad of others require the planner to bring up real estate options, of which the planner should be aware.

### Financial Advisors’ Perspective

**Clients’ house as a financial asset.** From a BusinessWeek article by Dean Gatzlaff (2005), it is said that investors should not only think about their financial portfolios but add in the value of all other assets (balance sheet derived) in creating diversification. It is stated that real estate does well in times of inflation, when stocks and bonds typically do not; this, thus, lowers risk and maintains return for an integrated portfolio with assets included. His specific recommendation, in the common situation of a homeowner with just under 50% of net assets being their home, is that these investors make a 60/40 portfolio of stocks/bonds. If a mortgage is more than 50% of the value of the home, that status of debt should be noted with a  $\frac{3}{4}$  rise in bonds and  $\frac{1}{4}$  rise in stock allocations for each dollar above, and if less than 50%, bonds should be decreased  $\frac{3}{4}$  for every dollar less. If owning a home outright, Gatzlaff says

that the allocation should be “10% bonds, 30% home equity, and 60% stocks” (2005, p.1). He also notes that income-producing properties should also be added into the mix if owned. Fischer, Gatzlaff, Geltner, and Haurin also have a scholarly paper on calculating the restricted liquidity of real estate as a part of a portfolio, as an issue shown in the next category.

**Liquidity and marketability factors.** This question underlies the ignoring of home/rental value in relation to use toward client goals and a need to consider real estate’s liquidity and marketability factors. Hurst and Stafford (Michigan Retirement Research Center) studied the access to home equity and found that lower interest rates initiated many homeowners to refinance. They grouped the participants into two groups, those who refinanced to maintain a lower mortgage cost and those who used funds during refinancing for consumption due to low retirement funds. Lower interest rates prompted 19% more individuals with consumption reasons to access home equity and to use 60% of the refinancing funds (Hurst and Stafford, 2002, pgs. 31-32). The necessity of financial planning is obvious here, largely for consumption-restrained individuals who need to plan for future consumption to take advantage of refinancing when there are lower interest rates. Most importantly, in the same study, Hurst and Stafford explore the timing of home equity access, which should be planned to best take advantage of low interest rates and high home values. A client may need home equity funds at a future time when interest rates may be high and possibly home values lower, restricting the amount of home equity that would be accessible (2002, p. 5). In choosing the right home equity product for a client, it is incumbent on a financial planner to educate a client on home equity conversion mortgages (HECM; through an FHA-approved lender), other reverse mortgages, and home equity lines of credit (HELOCs). Hanewald-Thomas and Sherris consider the home equity choices by subtracting those options from the need for dealing with longevity risk, obtaining long-term care, the value of the home, and interest rate risk (2013, p. 1). Though this study is from Australia, the considerations remain the same, but there are some varying products available in the U.S. The HECM in the U.S. removes downside risk, as it is a nonrecourse loan (if the home value goes below the reverse mortgage amount, nothing is owed). This product, then, provides protection against downside risk and is available as a line of credit or annuity payments, but is only available to clients when they are 62 years old or older. Of course, for any of these products, a period of low interest rates and high home values is the best time to take advantage of the plans; to not wait for an emergency when higher interest rates and lower home values would restrict the amount of funds available. Again, it is necessary for financial planners, in considering a client’s full set of assets and the economic climate, to know these options and educate clients on the best option.

**Knowledge of the real estate market.** Bringing real estate into a financial planning conversation necessitates the planner knowing the real estate market, including current interest rates. A planner can suggest optimum times to sell or buy a home, and for suggesting tax and estate planning options. Just as a planner would research a financial investment for viability, so too a client’s large real estate investment should be inspected for the best use of the client’s funds.

**Fee structure hindrance and fiduciary duty.** There are many tasks that a financial planner performs without specifically being paid. The burden of taking on expertise and advising on real estate in light of the broad client picture may be straining the fee structure if a planner is paid by assets under management. If this is a problem, then the home could be treated as an asset, or a per service or per hour fee structure could be considered. Again, where is the education for financial planners to provide real estate advice? To put into perspective, real estate, in any case, should not be ignored, as it falls under a planner’s fiduciary duty to provide a comprehensive plan to a client, and the home is one of a client’s largest assets.

### Methodology

Herring wrote her dissertation on retirement readiness, using a powerful tool highlighting race, gender, generation, and housing (2019). The idea is that the retiree meets 73% of pre-retirement income during retirement, or they do not. Following is her combined work, and then singling out housing for purposes of this paper.

**Data.** Survey of Consumer Finances waves combined (2001, 2004, 2007, 2010, 2013, 2016 & 2019). *Serviceable Households* (CFP Board, 2018). Households with Financial Assets > \$100,000 OR Income > \$100,000. *Dependent Variable* (Herring, 2019) Meets Retirement Goal = 1 if (Post Retirement Income > = 0.73 x Pre-Retirement Income), 0 otherwise assuming,

- Savings rate = 10% of pre-retirement income
- Rate of return on all financial assets = 8% (before retirement), 6% (after retirement)

- Income growth rate = 1.4% of pre-retirement income
- Use only financial assets and savings for retirement
- Receive average social security benefit with COLA = 3.3%
- Full retirement age = 66 (if born prior to 1960), 67 (if born after 1960)
- Mortality = 90 years

Following, Herring (2019) shows seven levels of home ownership, followed by logistic regression (clustered robust SE) and average marginal effect (Delta Method SE) of the data (2019).

**Table 1.**  
Seven Levels of ownerships based on Herring (2019).

HOUSE BY FINANCIAL ASSETS CATEGORIES	Waves of Survey of Consumer Finances							Total
	2001	2004	2007	2010	2013	2016	2019	
[1] No House or House Value = 0 (11%)	300	246	263	267	293	361	390	2,120
[2] House Value < 1/2 of Financial Assets (22%)	654	466	451	550	622	773	748	4,264
[3] House Value > 1/2 of Financial Assets, but < 1x (20%)	561	531	534	526	591	583	583	3,909
[4] House Value >= 1x Financial Assets, but < 2x (19%)	499	537	546	476	488	603	502	3,650
[5] House Value > 2x Financial Assets, but < 10x (21%)	528	677	799	516	545	511	617	4,194
[6] House Value > 10x Financial Assets, but < 100x (6%)	139	179	216	177	157	175	228	1,271
[7] House Value > 100x Financial Assets (1%)	9	23	34	27	25	18	25	161
Total	2,691	2,659	2,843	2,539	2,720	3,024	3,093	19,568

**Table 2.**  
Logistic regression (clustered robust SE) and average marginal effect (Delta Method SE) based on Herring (2019)

Meets Retirement Goal [0,1]	Logistic Regression		Av Marginal Effect	
	Coeff	Clustered Robust SE	dy /dx	Delta-Method SE
Ln Income	-0.75***	(0.028)	-0.10***	(0.003)
Ln Net Worth	0.09***	(0.008)	0.01***	(0.001)
House Value by Financial Assets [Ref: 1]				
2	1.68***	(0.387)	0.15***	(0.046)
3	0.08	(0.385)	0.01	(0.048)
4	-0.55	(0.386)	-0.07	(0.049)
5	-1.35***	(0.386)	-0.20***	(0.050)
6	-1.98***	(0.395)	-0.30***	(0.052)
7	-2.18***	(0.478)	-0.33***	(0.067)
Race [Ref: White]				
Black	-0.35***	(0.109)	-0.05***	(0.016)
Hispanic NW	0.12	(0.122)	0.02	(0.016)
Other Races	0.16	(0.105)	0.02	(0.013)
Married [Ref: Single]	0.10	(0.073)	0.01	(0.010)
Age	-0.17***	(0.004)	-0.02***	(0.000)

Number of obs = 11,513  
Wald chi2(24) = 1790.26  
Prob > chi2 = 0.0000  
Log pseudolikelihood = -5125.4806  
Pseudo R2 = 0.2919

(Std. err. adjusted for 11,513 clusters)

**Table 3.**

Logistic regression (clustered robust SE) and average marginal effect (Delta Method SE) based on Herring (2019)

Meets Retirement Goal [0,1]	Logistic Regression		Av Marginal Effect	
	Coeff	Clustered Robust SE	dy /dx	Delta-Method SE
Education Years	0.06***	(0.012)	0.01***	(0.002)
Have Ret Liquidity	0.09	(0.092)	0.01	(0.012)
Total Work Years	0.07***	(0.005)	0.01***	(0.001)
Have Mortgage	-0.31***	(0.072)	-0.04***	(0.010)
Pays Rent	-0.78*	(0.382)	-0.10*	(0.051)
SCF Wave [Ref: 2001]				
2004	0.18	(0.093)	0.02	(0.013)
2007	0.32***	(0.092)	0.04***	(0.013)
2010	0.25**	(0.091)	0.03**	(0.013)
2013	0.32***	(0.094)	0.04***	(0.013)
2016	0.37***	(0.093)	0.05***	(0.013)
2019	0.55***	(0.095)	0.07***	(0.013)
Intercept	12.7***	(0.611)		

Number of obs = 11,513

Wald chi2(24) = 1790.26

Prob > chi2 = 0.0000

Log pseudolikelihood = -5125.4806

Pseudo R2 = 0.2919

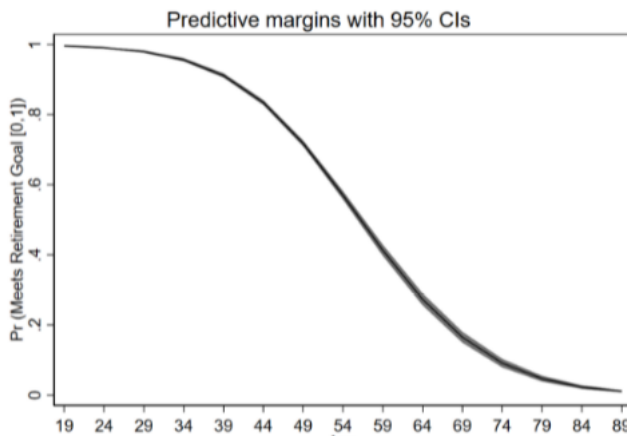
(Std. err. adjusted for 11,513 clusters)

Following is the probability of meeting the retirement goal, or not, considering all factors and calculated by age.

**Figure 1.**

Probability of meeting the retirement goal, or not, considering all factors and calculated by age (Herring, 2019)

Marginsplot of Probability of Meeting the Retirement Goal Over Current Age

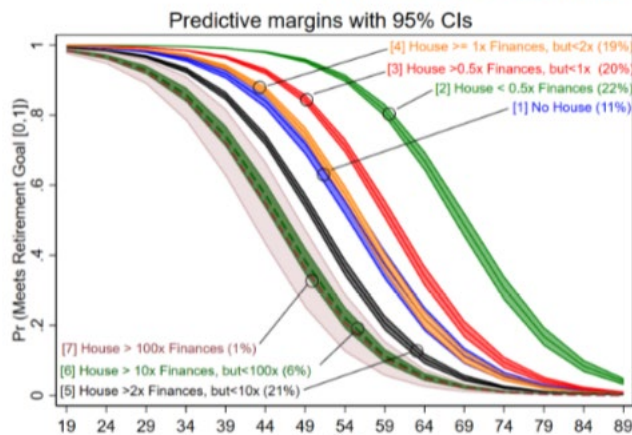


Here, retirement probability is over age, using the seven levels of home ownership. It can be seen that level 2 [between 0.5x and 1.0x (house value)/(financial assets)] is the greatest factor and for retirement success.

**Figure 2.**

Probability over age by house value

Marginsplot of Probability Over Age By (House Value/Financial Assets)



### Future Study

A questionnaire sent to practicing financial planners should be implemented to see how financial planners are using home equity in their conversations with clients, plotting home value in software, and receiving education on real estate. Questions that could be elaborated are:

- Are you currently giving comprehensive advice on real estate for your clients, such as the purchase price of a home or rental property, or a method to transition housing value from their residence to their retirement income through downsizing or a reverse mortgage?
- If yes, how are monitoring their investment? Are you using a software program? If yes, which one? Have you developed your own spreadsheet?
- If yes, how are you paid for this service?
- How were you educated to make “implications” recommendations for your clients on residential or investment real estate?

### Conclusion

Current financial planning education and practice does not adequately cover crucial aspects of homeownership or recommendations needed on real estate (personal residence or investment properties). This study uncovers home value perception and effect on homeowners with advisor suggestions for dealing with a client’s home equity. Majority of serviceable households are homeowners and homeownership increase with income and wealth. In that sense, homeownership should be aligned with financial planners’ practices, business models permitting. Research into near retirement home equity use is plenty, but there is little research on how advisors should account for home equity from the first home and throughout a client’s life. Another barrier is the fee structure of advisors, which may not include advising a client on a home throughout that client’s life cycle; even though it may be proved to be a fiduciary duty to do so.

### Acknowledgements

Great thanks to Aman Sunder and Dalisha Herring for the work used in the Methodology section. Unending appreciation and remembrance of Anita Nickerson, who provided enthusiasm and practical knowledge in pursuit of this research and could not see it completed.

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