THE COST OF RETIRING POOR:

COST TO TAXPAYERS OF UTAHNS RETIRING POOR

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SUMMARY

Over the last few decades, employers have shifted more responsibility to workers in saving for retirement. Recent studies show declines in employer sponsored retirement plans, and dramatic shifts away from defined benefit plans in favor of defined contribution plans.[1] Many workers are finding themselves near retirement, with insufficient sustainable financial resources.

Federal, state, and local governments currently offer an array of publicly funded assistance programs for these citizens. As the retiring population is expected to increase at an alarming rate over the next several years, policy makers should pay careful attention to forecasting growth in government outlays for these programs.

This study investigates the effect of individual financial preparedness of Utah's new retirees on direct benefit expenditures for select programs over the next 15 years.

We conclude that modest improvements in savings rates among bottom tier savers can greatly improve retirement readiness and reduce government expenditures on public assistance programs.

Key Findings:

- *18% of retirees in the next 15 years will retire with more debt than savings.*
- *Nearly 1 in 10 new retirees qualifies for more than $2500 per year in direct government assistance.*
- *Total cost to taxpayers for new retirees will top $3.7 billion over the next 15 years.*
- ***73%** of total these costs are expended on 1/3 of the retiring population.*
- *A 10% increase in net worth of the 1/3 least prepared for retirement will save taxpayers $194 million through 2030.*

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1 See, for example, Ghilarducci, T., and Saad-Lessler, J., and Bahn, K. (2014) "Are U.S. Workers Ready for Retirement? Trends in Plan Sponsorship, Participation, and Preparedness." Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Working Paper Series.

DATA & METHODOLOGY

We use the American Community Survey (ACS)[2] and Survey of Income and Program Participation (SIPP)[3] as the primary data sources for our analysis. SIPP data provides a national model for household level net worth. Both surveys are household-level surveys containing a variety of demographic and financial data variables.

We follow an 8-step process to estimate total new expenditures for the selected government programs.

Step 1: Modeling Net Worth

Many public programs have income tests and some have asset tests for eligible recipients. To estimate total assets we build a statistical model using SIPP data for all nearly retired[4] survey respondents nationwide. State-level estimates are not available for Utah in the SIPP data set.[5] The multiple regression model includes the household reference person's age, most recent year of income, gender, and household type[6] (see equation 1). Net worth includes all cash and retirement accounts and real property value. With these variables, we are able to estimate the relationship between income and demographic variables on the one hand, and net worth on the other hand. In other words, we can predict a respondent's net worth if we know their income, age, and household type.

Equation 1: Predicted Net Worth

$$\widehat{net\ worth} = \alpha + \beta(age) + \beta(income) + \beta(household\ type)$$

Critical Result of Step 1: Net worth regression function

Step 2: Predicting Utahns' Net Worth

SIPP data is not available at the state level for Utah. Therefore, we use Utah household-level data from the ACS data set to estimate the net worth of Utah's households. We insert Utah's values of age, income, and household type from the ACS in to the regression equation estimated in step 1. The result of step 2 is a household-level estimate of net worth for all types responses for state level estimates. Utah responses to SIPP are insufficient for state-level estimates.

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[2] ACS 2013 1 year estimates

[3] SIPP 2008 wave 10

[4] We define "nearly retired" as all citizens 55 to 65 years old.

[5] SIPP is a nationally representative sample of all US households. Some larger states have sufficient

[6] Household types are: Married family, single male family household, single female family household, single male non-family household, and single female non-family household.

of households and income levels in Utah.

Critical Result of Step 2: Predicted net worth by household

Step 3: Estimating Liquid Assets

Some public assistance programs require an asset test. These programs vary on whether home value is or is not included in net assets. To separate these components of net worth, we subtract reported real property value from net worth using ACS data. The result of this step is a separate estimate for liquid assets and for real property assets (homeownership).

Critical Result of Step 3: Predicted liquid assets by household

Step 4: Projected Gross Income

For this analysis, liquid assets include all retirement accounts and related income. These, along with social security benefits, form the two primary components of income.

For projecting Social Security benefits we use the 2014 Social Security benefits tables reported on the Social Security Administration (SSA) website.[7] Given age, income, final year of

income, and marital status, the tables yield an estimated gross monthly benefit for each type of Utah household.

To estimate income from liquid assets, we calculate a generous annuitized guaranteed payment for the given asset level. We calculate monthly income if all liquid assets were dedicated to a 30-year fixed annuity with guaranteed 5% return for each household. Given historical interest rates, this annuity generously overestimates potential income at every liquid asset level, thereby minimizing program eligibility and expected government outlays.

Critical Result of Step 4: Projected gross monthly income – social security benefit and annuitized liquid assets

Step 5: Forecasted retired population

Using ACS data, we determine the number of Utahns that will turn 65 each year from 2015 to 2030 based on year of birth. We do not include population growth due to migration in to or out of the state. We also do not correct for those who stay in the workforce after age 65. These workers are not generally relevant to our analysis because they carry high incomes that

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[7] http://www.ssa.gov/pubs/EN-05-10070.pdf

disqualify them for most of the selected programs.

Critical Result of Step 5: Projected number of individuals entering retirement age by year.

Step 6: Estimating Program Costs

Six public programs are considered in cost calculations for our analysis.

These include:

- *Supplemental Nutrition Assistance Program (SNAP)*
- *Supplemental Security Income (SSI)*
- *Medicare Cost Sharing Program (Utah Medicaid)*
- *Utah Home Energy Assistance Target (HEAT) Program*
- *Utah Retirement Income Tax Credit*
- *Property Tax Abatement*

Each of these programs were evaluated for program eligibility requirements and total direct benefits offered.

Wherever assumptions in our model were necessary, we chose the more conservative approach. For example, eligibility was calculated for each individual retiree but total household income was used for eligibility calculations. Individual projections were used to avoid family size complexities and to avoid double counting household-level benefits for some programs.

It is important to note that we also did not include any administrative costs for the selected programs. Only direct expenditures to the beneficiary are included in this analysis. As such, our cost estimates are likely much smaller than overall costs.

Critical Result of Step 6: Estimated total annual government benefits per new retirement age Utahns by year.

Step 7: Calculating total government outlays.

As a final step, we calculate expected total benefit received by each percentile of the population. For example, the top 1% of the population—in terms of estimated program benefits—spends in total the product of the estimated number of new retirees, 1%, and the estimated benefit for that percentile of "spenders."[8] Total government outlays are the sum of all percentile expenditures for all years.

***Critical Result of Step 7:* Calculating total government expenditure through 2030.**

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[8] "Spenders" in this case refers to the amount these individuals receive—or the government spends—in program benefits.

SECTION 1: NEW RETIREES

**NUMBER OF UTAHNS
TURNING 65 BY YEAR**
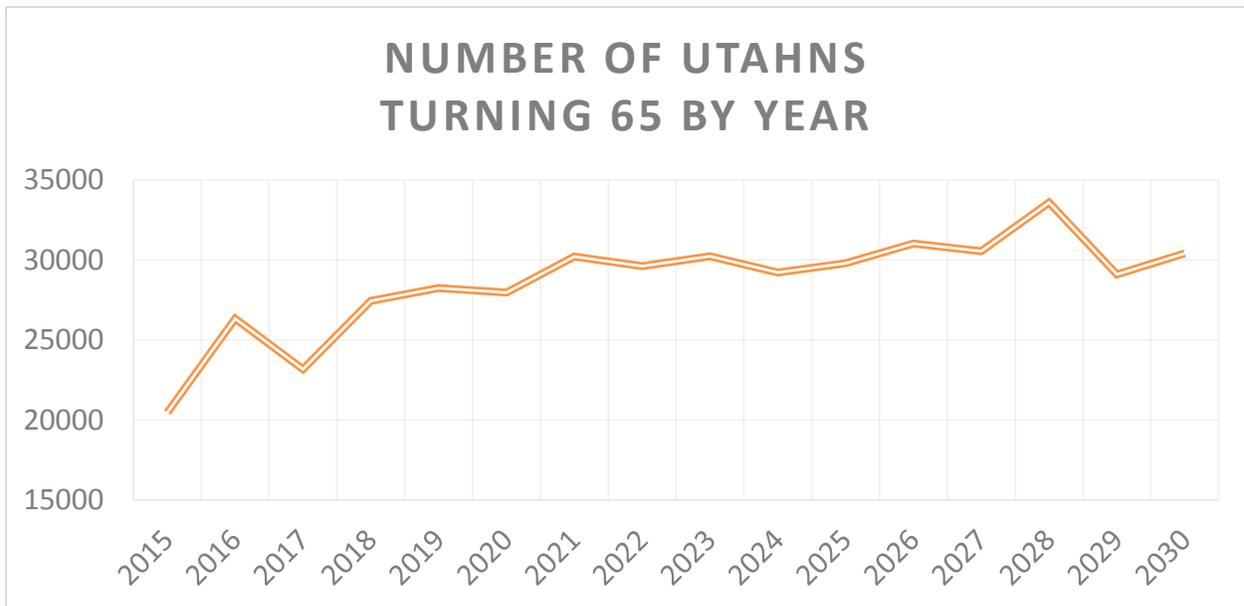
Source: US Census American Community Survey (ACS) 2013 1 year estimates.

Utah can expect steady growth in the retirement population over the next 15 years. In 2015, more than 20,000 Utahns will reach age 65, becoming eligible for a large number of retirement benefits. That number will climb to more than 30,000 in 2021, peaking at 33,000 in 2028 and settling around 30,000 by 2030.

The cumulative growth of retirement-age Utahns over the period accounts for more than 457,000 additional retirees.   A 2012

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report by the U.S. Administration on Aging notes that by 2030, nearly 17% of all Utahns will be age 60 or older, a 29% increase over 2012 proportions[9].

[9] Policy Academy State Profile accessed at: http://www.aoa.acl.gov/AoA_Programs/HPW/Behavioral/docs2/Utah.pdf

SECTION 2: ASSETS

NET WORTH AND LIQUID ASSETS
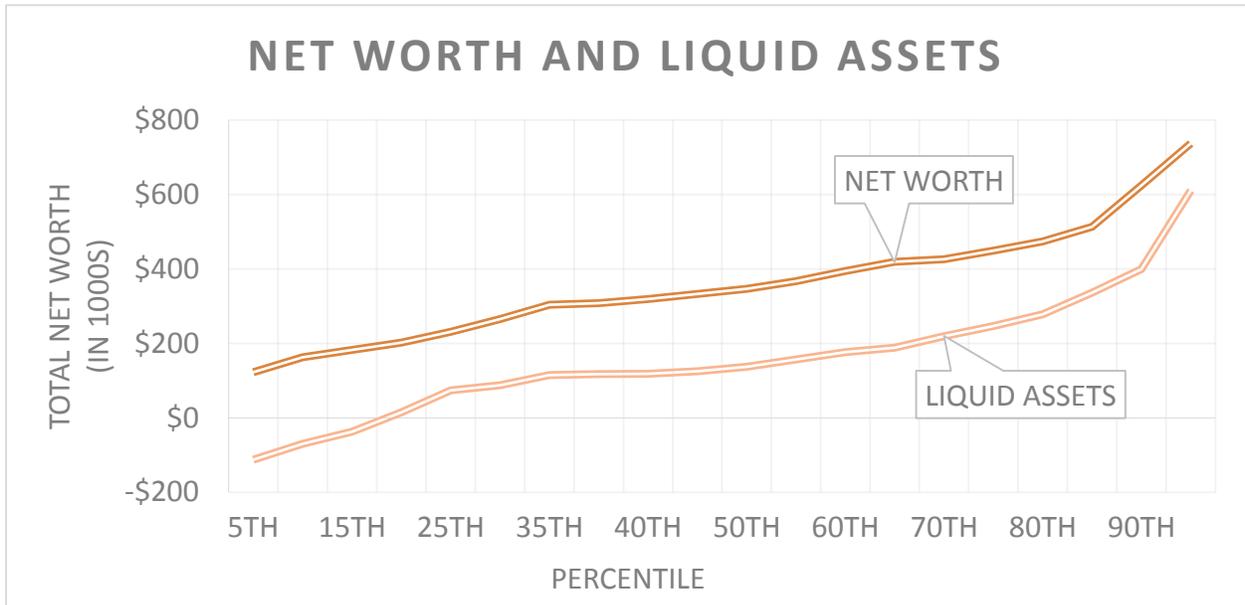
Source: Regression results from Survey of Income and Program Participation (SIPP) 2008 wave 10 data using all households where the reference person is 55 to 65 years old. Net Worth = Age + Gender + Income + Household type. Liquid Assets = Net Worth – Real Property Value.

Wealth distribution is particularly relevant among retirees. As older workers become dependent on accumulated wealth for daily living, those with smaller net worth are less able to meet basic needs and therefore more dependent on public programs for assistance.

Additionally, not all wealth is equally important in retirement. Many Utahns' primary source of savings is their own home. As such, liquid resources above and beyond home values are critical for

providing ongoing income in retirement. Our model suggests that nearly 1 in 5 retirees enters retirement with negative liquid assets. These individuals begin retirement with more debt than cash and savings in a reasonably accessible investment account.

The median newly retired household has accumulated approximately $346,000 in total net worth, of which $137,000 is in the form of liquid assets. However, our model shows substantially more

savings concentrated in the upper tier of nearly-retired Utahns.

Utahns in the 80th percentile for savings have accumulated an estimated $473,000 in net worth, of which $278,000 is in liquid assets. However, Utahns in the 20th percentile for savings have accumulated an estimated $201,000 in net worth, of which $14,000 is in liquid assets. As such, the bottom 20% of retirees begin retirement with over 94% fewer liquid resources than those in the top 20% of retirees.

A significant reason for the disparity is inequality in the percentage of total assets that are liquid assets. For the middle 50% of

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retirees, liquid assets comprise about 60% of total net worth. However, for the bottom 25% that statistic falls dramatically. Retirees in those net worth categories typically have almost no liquid assets at all. At the top end of the spectrum the opposite occurs. Liquid assets make up about 82% of total assets for individuals in the 95th percentile of all retirees.

LIQUID ASSETS AS PERCENT OF NET WORTH
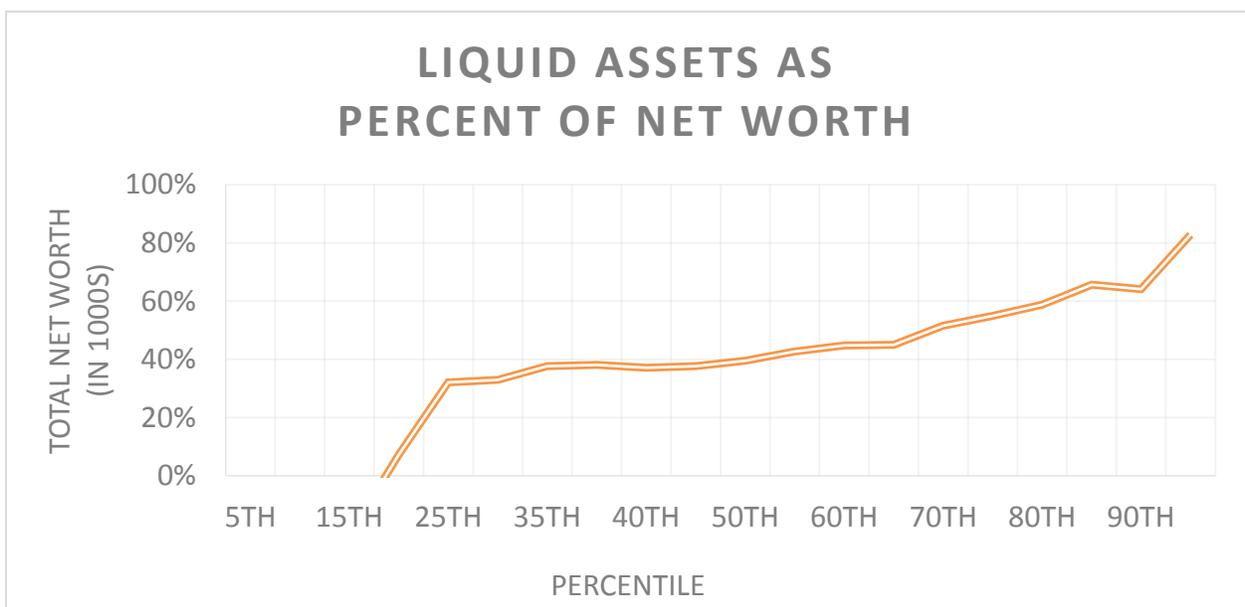
SECTION 3: PROGRAM COST

Selected Public Programs	Maximum Benefit
Property Tax Abatement	$924
Utah Retired Tax Credit	$450
Medicare Cost Sharing Program (Utah Medicaid)	$7,859
Home Energy Assistance Target	$450
Supplemental Security Income	$8,796
Supplemental Nutrition Assistance Program	$2,328

Combining results from the net worth model and asset calculations with income projections,[10] we determined total benefits from the 6 program selected for this analysis.

Almost all Utahns are eligible for some form of public assistance.

93% of new retirees through 2030 will be eligible for at least $300 a year in total government benefits[11]. More than a third of retirees will cost the government $650 or more per year. The top 20% of spenders cost the government more than $3200 per year, on average.

COST PER YEAR OF THE MOST COSTLY 20% OF PROGRAM BENEFICIARIES

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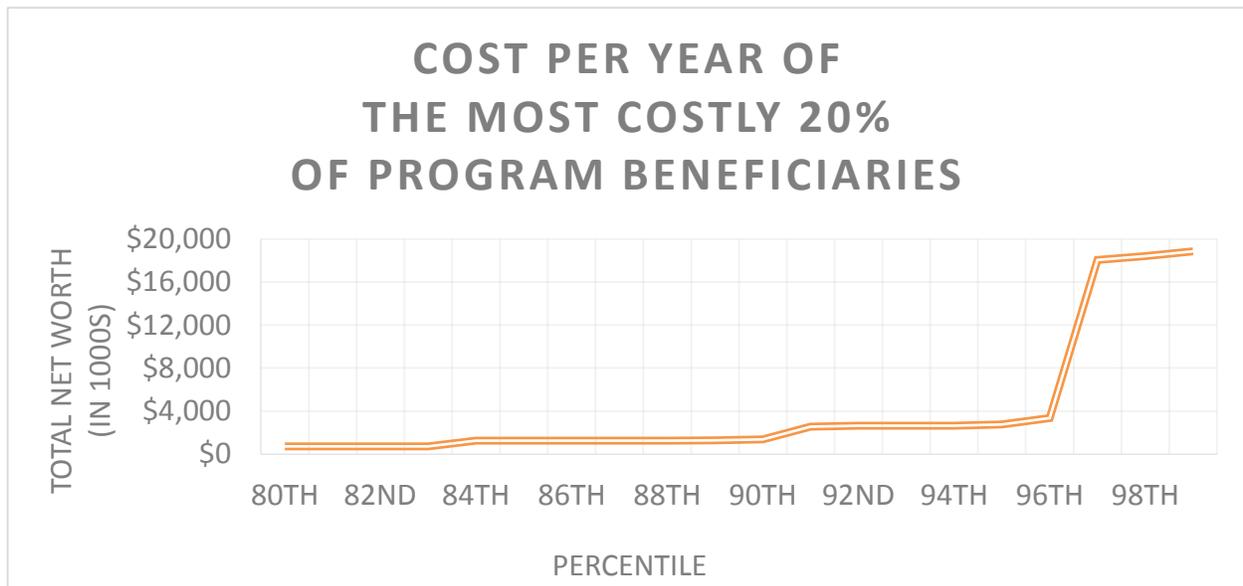
[10] Income was calculated in two ways depending on program eligibility requirements. When assets tests are present, income was equal to the projected social security benefit. When asset tests are not required, income equals the projected social security benefit plus the guaranteed payment from annuitizing all liquid assets. Annuity terms were for a fictitious 30-year 5%-yield fixed annuity.

[11] Most Utahns qualify for the retired person tax credit even at very high income levels.

Total Program Outlays through 2030 (in Millions)

All Retirees	$3,782
Bottom One-Third	$2,747
Bottom One-Quarter	$2,529
Bottom 10%	$2,065
Bottom 5%	$1,677

The least prepared new retirees cost the government the most in program benefits. The bottom 5% of retirees—in terms of retirement preparedness—cost the government an average of more than $9,000 per year—the very least prepared topping $18,000 per year in costs to the government.

total government outlays—just over $2.7 billion. 44% of outlays will be spent on just 5% of retirees at the very bottom of the accumulated assets spectrum. Increasing savings rates among the very bottom would have the largest impact on government outlays.

Through 2030, new retirees entering program eligibility will be eligible for $3.7 billion in program benefits. The one-third least prepared retirees receive 73% of

The one-third least prepared retirees receive 73% of total government outlays.

CUMULATIVE GOVERNMENT OUTLAYS

All Retirees
$3.7 Billion

One-third least prepared
$2.7 Billion
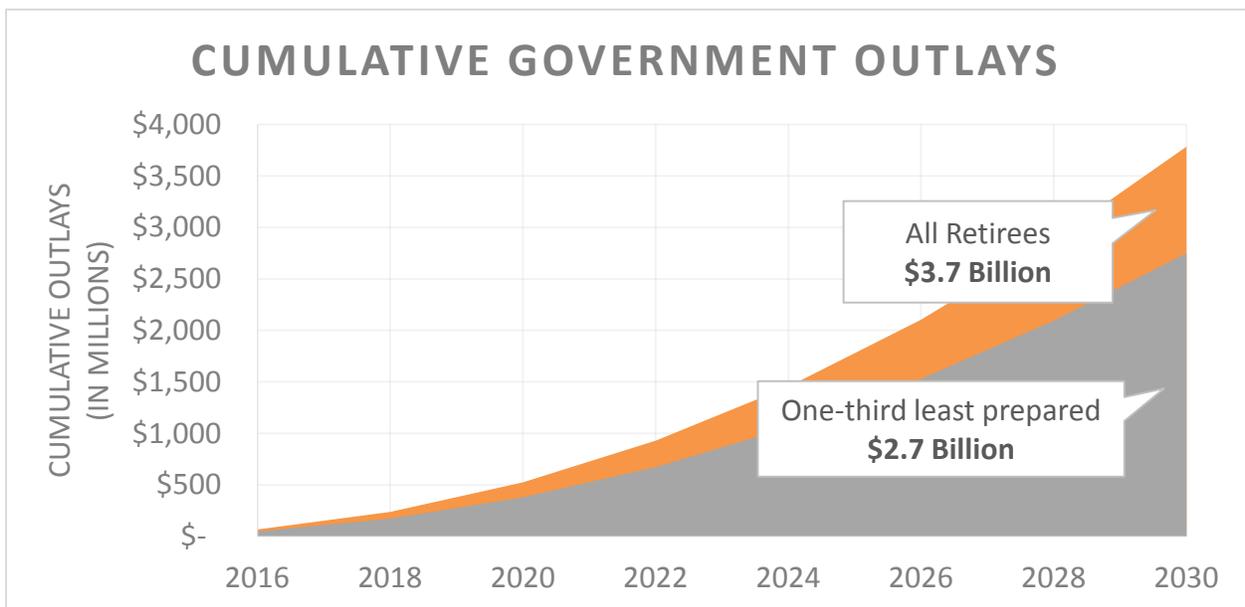
SECTION 4 – DISCUSSION

An increase in net worth among the bottom one-third of retirees by just 10% over those workers' careers would decrease expected government outlays by more than $194 million over the next 15 years. For these individuals, savings increases of that size would be very small— at most, just over $14,000 over their career. Modest increases in net worth have substantive impacts on government spending.

It is likely that total government outlays estimated in this report are much lower than actual government expenditures will be. Two factors contribute to this observation.

First, our analysis takes a conservative approach to estimating income and net worth. Annuitized liquid assets are likely to get lower returns than assumed in this analysis. Similarly, Social Security benefits are likely not well represented by the final year of income alone. A fuller picture of an individual's total career path would show smaller average income. Income is therefore overestimated, reducing eligibility and therefore expected program costs.

Second, our analysis focuses on a narrow set of possible government expenditures and it does not include the total cost of operating these programs. Administrative costs for certain programs can be a substantial addition above direct expenditures for beneficiaries.

Even with these modest estimates, it is clear that Utah will experience sustained growth in the retired population over the next 15 years. Expected shortfalls in household net worth will translate into substantial increases in costs associated with existing public programs. Lastly, modest corrections in savings for the largest recipients can yield substantial savings to public programs.