Medicaid and the Housing and Asset Decisions of the Elderly: Evidence from Estate Recovery Programs

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In 2000, $71 billion was spent on long-term care services for the elderly. Of that, the private long-term care insurance market paid out $300 million in long-term care expenditures, while Medicaid paid out $31 billion for nursing home expenditures, making Medicaid by far the most important provider of long-term care insurance. A key feature of Medicaid, which is a federally mandated program, is that eligibility is means-tested. Specifically, to be eligible, unmarried elderly individuals must have assets and income below their state’s eligibility levels. Persons with assets greater than this limit must pay for nursing home care out of pocket and, hence, spend down their wealth. However, owner-occupied housing (and primary vehicle) assets are exempt from these rules. In addition, Medicaid traditionally did not go after housing assets when a recipient died, making housing a particularly attractive asset to hold for those elderly with a bequest motive. This has led to a great deal of interest among economists and policy makers on the extent to which Medicaid distorts the housing, portfolio, and bequest decisions of the elderly by creating a subsidy for holding owner-occupied housing. This is particularly important because owner-occupied housing is the largest non-pension asset for the elderly. In particular, Social Security income makes up 48% of the wealth holdings, private pensions make up 24.2%, and the house makes up 16.7% (Munnell and Soto, 2005).

Unfortunately, there is relatively little empirical evidence from the public and urban economics literatures on the impact of Medicaid means-testing on elderly housing behavior. Moreover, a fundamental problem with the few studies that exist is that the estimates of Medicaid’s impact on housing have relied on cross-state variation in policies and might have been confounded by other factors that vary across states and also affect elderly housing behavior.

In this paper, I attempt to circumvent some of the difficulties that have plagued previous
studies on the impact of Medicaid on elderly housing and wealth decisions by using recent state-
by-calendar-year level variation in the Medicaid treatment of owner-occupied housing assets
from the adoption of Medicaid estate recovery programs. Under these programs, states have the
right to reclaim the value of Medicaid expenditures on nursing home care after the death of the
individual by placing liens on the homes of Medicaid beneficiaries. In particular, the Omnibus
Budget Reconciliation Act of 1993 (OBRA93) mandated that all states adopt estate recovery
programs to recoup assets from the estates of Medicaid recipients. This law had important
implications for the housing assets: prior to the adoption of estate recovery programs, the house
was deemed a safe asset; after the adoption, it was subject to recovery by the government to
repay states for benefits received, once the recipient was deemed permanently institutionalized.

In other words, prior to adoption of estate recovery programs, Medicaid imposed a 100% implicit
tax on holding financial assets above $2000, while at the same time Medicaid exempted
owner-occupied housing assets from the Medicaid eligibility decision. This resulted in a lower
implicit tax on holding owner-occupied housing assets rooted from Medicaid’s differential
treatment of assets, as the house could serve as both a residence and a store of wealth that can be
bequeathed. After adoption of estate recovery programs, Medicaid still imposed a 100% implicit
tax on holding financial assets above $2000, but now there was a higher implicit tax associated
with the holding of owner-occupied housing assets.

The adoption of an estate recovery program makes housing a less attractive asset in the
portfolio of the elderly for two reasons. First, while housing assets are still exempt from the
Medicaid eligibility decision, the state now can recover the value of Medicaid expenditures by
going after the house, most often with a lien, resulting in bequests being less likely to be made
through the house. Second, homeownership (and the holding of home equity) in the portfolio
are less attractive overall, as the implicit tax on housing assets under Medicaid has risen. Overall, if the elderly are responsive to Medicaid rules in their housing, portfolio, and wealth decisions, then the timing of the adoption of estate recovery programs across states should have affected the holdings of home equity and the frequency of homeownership and housing-related bequests among the elderly.

While Medicaid spend-down laws create a differential treatment of assets, Medicaid estate recovery programs also create differential incentives by marital status. Estate recovery programs cannot recover against any assets in an estate when there is a surviving spouse. This results in unmarried elderly having an incentive to spend down their home equity or sell their house, while the married elderly do not face any incentives to change their housing behavior.

While twenty-six states had estate recovery programs prior to 1993, most of the remaining states began to adopt such programs after OBRA93. In fact, by 2004, forty-seven states had estate recovery programs. However, because states had a vast amount of control over the type and size of their estate recovery programs, there has been wide variability in the structure of programs across states. By far, the most popular component is known as a TEFRA lien, which is placed on the home while the owner is living, enabled in the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982. In 1993, five states allowed for TEFRA liens; by 2004, nineteen allowed for such liens. Overall, because different states adopted both their estate recovery programs and TEFRA lien features in different calendar years, respectively, there is substantial state-by-time variation in Medicaid’s treatment of owner-occupied housing assets, since 1993.

I use detailed panel data on elderly housing, portfolio, and bequest behavior from the Health and Retirement Study (HRS), to provide new evidence on the impact of Medicaid and
means-testing on asset and portfolio decisions and to perform, what is to the best of my knowledge, the first empirical evidence on the impact of estate recovery programs on elderly behavior. I also capitalize on the so-called “exit” interviews done by the HRS, which consist of information gathered on the value and asset composition of estates and bequests from next of kin after an HRS respondent dies (“exits”). These unique and previously unused data provide detailed information on end-of-life decisions.

There are four primary findings. First, state adoption of ERPs (or TEFRA liens) induces the elderly to decrease their homeownership rate by 33% when their state adopts a TEFRA lien or ERP. Second, I find suggestive evidence that trusts are used as substitutes to housing to carry out bequest motives, as state adoption of ERP or TEFRA liens results in an increase of 58% in the trust participation rate at death. Third, state adoption of an ERP or TEFRA lien results in a decrease in home equity of about $28,000. The mean home equity for the sample is $119,124, which results in a decrease of home equity of about 23%. However, it is unclear whether this decrease in home equity results in a decrease in total wealth or a shift in portfolio assets. As a result, I test the impact of state adoption of an ERP or TEFRA lien on the housing share of the wealth portfolio. I find that adoption of these programs results in a decrease in the proportion of the total wealth portfolio that is made up of primary housing assets, which is consistent with the past literature.

References