

Estimating health care costs in retirement



By Amy E. Buttell

Rising medical expenses means that no retirement plan is complete without some kind of provision for health care needs. Here are some guidelines and resources for estimating what health care could cost during retirement.

Health care costs are rapidly emerging as a major expense both before and during retirement.

With lifetime employment a relic of the past and longevity on the rise, it is a top-priority to include health care expenses and planning as part of the financial and retirement planning you do with your financial advisor.

There are a number of issues surrounding health care costs including the impact of current health status, pre-retirement issues, preparation for health care in retirement, and continuing adjustments that may need to be made in terms of planning and managing your health care spending during retirement.

Health status

There is one aspect of health care and health care costs that is controllable amid many that are not: your current state of health. Retirees and near retirees need to consider decisions about health care in terms of how it will impact current and future costs.

If you maintain good health, you will have the ability to spend more of your money on things like travel in retirement. On the other hand, poor health means you will have to spend more on doctor's bills, perhaps at the expense of major purchases and travel. Previously, there wasn't a lot of good information on the impact of health care spending on your wallet. Now there is.

Associating costs with good, fair, or poor health can make potential future expenses more real. A website called

MedicareNewsWatch.com defines three states of health — good, fair, or poor — in terms of number of doctors' visits per year, number of hospital admissions, and number of prescriptions.

The website outlines costs by city and state and shows the impact of health status on expenses in retirement. The table below provides an example of the average annual out-of-pocket costs for Medicare Advantage plans based on the lowest-cost health plan in different cities. These costs include Part D (drug benefit) costs.

Reviewing these numbers could be motivation enough to get serious about your health status. Of course, there are circumstances in which you have little control over health issues, such as a cancer diagnosis, but recognizing the potential cost of treatment can make a difference in saving and how you and your advisor prepare and execute the financial plan.

Impact of healthcare reform

Healthcare reform will have a mixed impact in terms of improved availability of care and potential costs. If you have a pre-existing condition that makes it difficult or impossible to find health insurance, the new Affordable Care Act will make coverage available, although it could be pretty expensive. Other changes will make it easier for you to get coverage if you are self-employed, work for a small employer who doesn't provide health care coverage, or you're retiring early and want an individual plan.

In terms of Medicare, healthcare reform is supposed to eventually eliminate the prescription drug gap and also bring down overall health care costs by slowing the rate of growth of payments to health care providers and improving program efficiency.

Table 1: Good, Fair, and Poor Health: Needs at Each Level		
Health Status: Good Requiring occasional routine care	Health Status: Fair Requiring episodic care for nonchronic conditions	Health Status: Poor Requiring chronic disease care and management
Low annual utilization: <ul style="list-style-type: none"> • 4 Doctor office visits (in network) • 1 Urgent care visit (out of area) • 0 Inpatient admissions • 0 Home health visits • 6 Prescriptions (30-day supply) • 1 Vision, hearing exam • 1 Dental prevention visit 	Low annual utilization: <ul style="list-style-type: none"> • 12 Doctor office visits (in network) • 1 Emergency room visit • 1 Inpatient admission • 4 Home health visits • 24 Prescriptions (2 per month) • 1 Vision, hearing exam • 1 Dental prevention visit 	Low annual utilization: <ul style="list-style-type: none"> • 24 Doctor office visits (in network) • 2 Emergency room visits • 3 Inpatient admissions • 12 Home health visits • 72 Prescriptions (6 per month) • 1 Vision, hearing exam • 1 Dental prevention visit

Source: MedicareNewsWatch.com

If you have children who are unemployed or don't have or can't get health insurance on their own and you are insured through a plan that offers dependent coverage, your children can be covered through age 26, regardless of whether you claim them as a dependent on your taxes, they are employed, or even married.

In terms of Medicare, healthcare reform is supposed to eventually eliminate the prescription drug gap and also bring down overall health care costs by slowing the rate of growth of payments to health care providers and improving program efficiency. Medicare and non-Medicare beneficiaries will now receive certain preventive health care screenings for free, including mammograms, yearly wellness visits, prostate and colon cancer screenings, diabetes and depression screenings, and bone mass measurements.

Health insurance plans offered in the individual and small group markets will be required to offer a comprehensive package of items and services known as essential health benefits, which include emergency services, hospitalization, maternity and newborn coverage, lab services, rehabilitation services, prescription drugs and preventive and wellness services.

In terms of paying for health care reform, high income tax payers will see higher taxes, which include:

- **Higher Part A tax on wages:** Starting in 2013, the Medicare Part A tax rate rises by 0.9% to 2.35% from 1.45% on wages more than \$200,000 for single individuals and \$250,000 for married couples filing jointly.
- **A 3.8% surtax on unearned income:** Also starting Jan. 1, 2013, a 3.8% will be imposed on unearned income over \$200,000 for single individuals and \$250,000 for married couples filing jointly. The surtax applies to investment income – including interest, dividends, capital gains, annuities, rents, and royalties – or the amount of modified adjusted gross income above \$200,000/\$250,000, whichever is less. Investment income does not include distributions from IRAs and qualified plans, but such distributions would naturally be included in AGI.
- **Freezing of income tiers for higher Medicare premiums.** Medicare beneficiaries with MAGI over a certain threshold must pay an income related adjustment amount on their Part B and Part D premiums.

As people age, health care costs typically continue to increase beyond even inflation, mostly because declining health requires more hospital visits, medications, and assisted care.

Issues to consider before retirement

It used to be that pre-retirement health care costs were pretty negligible. With generous employer-based health care coverage, out-of-pocket costs weren't much of a concern. But that's changed. Now, employers are dropping health plans, switching to more expensive high deductible plans, or changing health insurance coverage frequently and increasing premiums and co-pays.

Here are some issues to consider when you're nearing retirement from Goodcare Consulting, a nationwide independent consulting company that specializes in the economics of health care.

- **Out-of-pocket health care costs.** Start tracking your out-of-pocket costs. It can be as simple as using a spreadsheet or just keeping all your bills in one place for future review.
- **Individual health care insurance policies.** If you are considering early retirement, worried about getting laid off, or thinking about starting your own business, be aware of the health insurance implications. If you're healthy, the individual health insurance market provides decent options. If you aren't healthy or have a pre-existing condition, health care coverage could become a serious issue.
- **Navigating COBRA.** If you've been fired or laid off, COBRA can provide continuing health care coverage while you look for another job. However, COBRA can be quite expensive, especially for family coverage. You can keep COBRA coverage for as long as 18 months or 36 months in a divorce.

- **High-deductible health insurance and health savings accounts.** More employers are offering high-deductible health insurance plans along with health savings accounts. These plans can be good, but they require you to take more responsibility for your health care choices and spending.

While it's a good idea to increase your awareness of retiree health care issues and Medicare in your 40s, 50s, and early 60s, you need to get really focused and project costs by age 63. Prior to that, it's difficult to get a handle on the specific costs that are likely to be incurred.

For married people, health care costs will be doubled—there are no health care discounts for couples. It's also a good idea to review costs directly related to Medicare, including premiums and co-pays, out-of-pocket costs Medicare doesn't cover, and costs for unexpected events, like a major health crisis such as cancer.

In retirement

Fidelity, which has estimated healthcare costs for retirees for the past decade, found that the cost for a couple retiring in 2012 – the most recent figures available – were \$240,000, an increase of 4% from 2011. Since 2002, health care costs have risen an average of 6% a year, and could continue to rise in the long run.

The Employee Benefit Research Institute (EBRI) estimated in late 2012 that the average 65-year-old man would need \$70,000 in savings and that the average 65-year-old woman would need \$93,000 in savings to have a 50% chance of having enough money saved to cover health care expenses in retirement. This doesn't include long-term health care costs.

Table 2: Average Annual Out-of-Pocket Costs for Medicare Advantage Plans (2013)

City	Good	Fair	Poor
St. Louis, Mo.	\$513	\$2,555	\$5,912
San Francisco, Calif.	\$1,063	\$2,678	\$6,713
Chicago, Ill.	\$682	\$2,548	\$6,711
Atlanta, Ga.	\$418	\$2,605	\$6,968
Austin, Texas	\$848	\$3,144	\$7,060
Philadelphia, Pa.	\$1,484	\$3,452	\$7,735

Source: MedicareNewsWatch.com

Because Medicare plans vary based on geography, the type of plan selected plays an important role in how high expenses will be in retirement.

According to Fidelity, the average individual spends a minimum of \$6,900 a year (couples spend a minimum of \$13,800) in out-of-pocket health care costs – which should also be adjusted annually for health care inflation. Of course, those are just averages, but it's a good starting point for estimating costs.

As people age, health care costs typically continue to increase beyond even inflation, mostly because declining health requires more hospital visits, medications, and assisted care. Statistically, health care costs skyrocket in the last few months of life.

Variables such as long-term care insurance and comprehensive living wills can help keep those costs in check to a degree. But because everyone's situation varies, carefully consider the current health status of you and your spouse, your family history, and any employer-based health benefits that will be available to you in retirement. All this information plays into longevity calculations and what may be required to meet your future medical expenses.

Here are some expenses to consider:

- **Insurance premiums.** Include premiums for Medicare Part B, Part C (Advantage Plans) Medigap insurance, and any corporate retirement health plan coverage.
- **Deductibles and co-pays.** Include deductibles for Medicare Part A (hospitalization) and co-pays for Medicare Part D (prescription drug benefit).
- **Prescription drugs.** Any additional out-of-pocket costs for prescription drugs including the doughnut hole.
- **Dental, vision, and hearing expenses.** These are non-covered expenses. Most plans don't offer any hearing aid coverage. Many don't cover dental or vision.
- **Long-term care.** This includes premiums for long-term care coverage and out-of-pocket costs for long-term care. Medicare does not offer nursing home coverage.

Medicare plan selection vital

Because Medicare plans vary based on geography, the type of plan selected plays an important role in how high expenses will be in retirement. Medicare is confusing and selecting the wrong type of plan can have unforeseen consequences down the road, foreclosing certain options. Here's a brief rundown on the various component costs of Medicare:

- **Medicare Part A.** The hospitalization benefit is free to all beneficiaries, except for a deductible. It doesn't include fees for doctors or procedures.
- **Medicare Part B.** This is the premium funded benefit that pays for doctors, procedures, and other medical services. Many use this in concert with Medigap policies.
- **Medicare Part C.** Another name for these are Medicare Advantage Plans, which are paid through Part B premiums. Most are PPOs or HMOs.
- **Medicare Part D.** This is the prescription drug benefit.

As life spans increase and regulations become more complex, it's vital to know exactly where to go to get help in estimating your costs. Here are some useful tools:

- **Fidelity Retirement Health Care Cost Calculator.** (<https://powertools.fidelity.com/healthcost/personalInfo.do>) makes a comprehensive assessment of how much retirees are likely to spend on health care in retirement based on their age, financial resources, and insurance status.
- **AARP Doughnut Hole Calculator** (<http://doughnuthole.aarp.org/>) allows users to input information about medications and dosages to figure out how to avoid the dreaded donut hole.
- **My Medicare Matters** (<http://www.mymedicarematters.org/>) gives assistance in reviewing plan choices and guidance through the maze of Medicare options.

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- **Medicare Interactive** (<http://www.medicareinteractive.org/index.php>) offers answers to specific Medicare questions and in-depth information about virtually every aspect of Medicare. It's run by the nonprofit Medicare Rights Center.
- **Medicare** (<http://www.medicare.gov/>) provides an official government site full of resources, including information about the various parts of Medicare.

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