Successful retirement planning must consider health-care factors

Investors typically focus on inflation and taxes as leading factors that can erode retirement savings. There is another factor, however, that has outpaced inflation and wages for many years, and may be overlooked: health-care costs.

Adding to the planning challenge is that health expenses are largely unpredictable. People are living longer and are more likely to need more health-care services in the future. Consequently, it is critical to include health-care costs when planning for retirement income.

Health-care costs have outpaced earnings and inflation since 1999, and the trend is projected to continue.

Several factors influence health costs for households

Health can play a surprising role in long-term costs

Healthy retirees actually may face higher health costs, simply by living longer. Americans on average have longer life expectancies. The Centers for Disease Control found that life expectancy rose to 78.6 in 2016. Women typically live longer than men, with an average life expectancy of 81.1 years compared with 76.1 years for men.

Consider the projected expenses of a healthy individual compared with someone with a chronic illness. According to HealthView Services, a healthy 55-year-old male can expect about $223,434 in lifetime health-care costs, compared with $116,275 for a diabetic 55-year-old male — an increase of over 90%.

Fewer employers offer retiree health benefits

In 1990, the federal government announced an accounting change that required companies to modify the way they report retiree health benefits, including future claims, on their corporate financial statements. In response, many private sector companies began significantly revamping their retiree health programs by reducing or eliminating these benefits. As a result, retired employees will have to rely more on personal resources to cope with health-care costs.

Health-care spending increases with age.

Health-care costs increase in absolute dollars as well as a share of total household expenses.

Paying for health-care shifts to retirees as company or employer benefits continue to fall.


Trend among large firms limiting retiree health coverage exceeds two decades

The future of Medicare is uncertain

With fewer retirees receiving employer health-care benefits, more will rely on Medicare in the future. With increasing longevity, baby boomers retiring, and existing federal government debt, there will be pressure in the future to address spending for government entitlement programs, including Medicare. This could result in higher taxes, reduced benefits, or both.

Key Medicare facts

<table>
<thead>
<tr>
<th>Year</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>2008</td>
<td>Benefit spending begins to outpace payroll tax revenue</td>
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<tr>
<td>2015</td>
<td>55 million people enrolled in Medicare</td>
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<tr>
<td>2010–2015</td>
<td>Health insurance expenditures increased by 2.4% annually</td>
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<tr>
<td>2016–2021</td>
<td>Health insurance expenditures projected to increase by 5.6% annually</td>
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<tr>
<td>2028</td>
<td>The Trust Fund will be exhausted, and 82 million people will be enrolled in Medicare (projected)</td>
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Long-term care costs can be staggering

Research from the Kaiser Family Foundation notes that about 70% of seniors 65 and older will need long-term care services and support. People age 85 and older — which is the fastest growing segment of the population — are four times more likely to need long-term care than younger seniors.

Additionally, long-term care costs can vary widely from state to state, from a high of almost $300,000 annually in Alaska to just over $63,000 annually in Oklahoma. In fact, there are 21 states where long-term care costs average more than $100,000 annually, according to the 2016 Genworth Cost of Care Survey.

But nursing home care does not always mean permanent residency. An increasing number of people use nursing homes for a relatively short length of stay for rehabilitation services. Among seniors, the average length of stay for a man is roughly 10 months and 1½ years for a woman.

Long-term care costs may exceed what families can afford.

Median annual care costs

Source: Genworth, Genworth 2017 Cost of Care Survey (Richmond, VA: Genworth Financial, Inc.), June 2017. Nursing facility assumes private room.
Health care is a critical component of retirement planning

Demographics and longevity are key factors driving health-care costs for individuals. The demand for health-care services continues to increase as more baby boomers retire and are living longer.

Paying for health care has also been evolving. As fewer companies offer retiree health benefits and government-funded programs such as Medicare come under pressure from tightening federal resources, the additional burden of paying for health care will increasingly fall on individuals. Retirees in the future will likely rely more on personal savings to meet those expenses and fill in the gaps.

Like other expenses in retirement, planning ahead can make a difference

Consider tax-smart strategies

Maximizing the potential of tax-smart financial planning is an important element when planning for the future. Tax efficiency may mitigate the impact of taxes and help ensure that retirement assets will last longer in the future.

Managing income level may help to avoid larger Medicare premiums. Investors may want to consider using Roth IRA strategies to create tax-free income in retirement. Also, consider establishing a Health Savings Account (HSA) while still working to take advantage of the tax benefit.

Factor in health-care expenses when planning for income in retirement

Health-care costs also influence retirement income planning. As investors establish a sustainable withdrawal rate for retirement, the impact of rising health-care costs should be a priority consideration.

Part of the planning should include matching up income streams, including guaranteed income, to fund recurring health-care expenses such as premiums. Investors may also plan on maintaining an emergency health-savings fund for non-recurring health expenses. Also, delaying the claim for Social Security can create a larger monthly benefit.

Long-term care insurance can be a complex decision

In addition to strengthening personal retirement savings, there are insurance-related options, such as long-term care insurance, that may be explored in advance of retirement. As the need for long-term care is uncertain and may involve substantial additional cost, long-term care insurance is an important topic to discuss with a financial advisor. The use of advanced estate planning strategies, such as trusts, may also help protect assets from being used to cover long-term care. A professional advisor can explain the pros and cons of long-term care insurance, trusts, and other advanced planning strategies.