Planning for Future Health Care Costs

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–Elaine Floyd, CFP®

The usual method for estimating spending needs in retirement is to take your post-retirement household budget and tack on an inflation rate, such as 3%. Not so for health expenses.

Some expenses increase at a faster rate than the inflation rate you use, others at a slower rate, but overall, expenses such as housing, utilities, food, and so on, should rise with the general rate of inflation.

Health expenses are an exception. Projecting future health care costs in retirement can be tricky because there are several factors influencing the amount you will pay for health care in the future.

Inflation

Since 1960 the annual inflation rate for health care expenditures has averaged 9.9%. This rate of growth is unsustainable. If the current trend were to be extrapolated out, it would produce an implausible result, with almost the entire GDP going to health care. So how much will health care spending rise in the future? Medicare trustees project that health care expenditures will increase at an average annual rate of 5.6% through 2025.

Although no one knows for sure how fast health care costs will rise, it seems reasonable to build a higher inflation rate into this portion of your budget and assume that your health care expenses might go up by 5% to 6% per year.

Your individual health care experience

General health care expenditures notwithstanding, you and your spouse will have your own individual health care experience during retirement. As the years go by, the odds of contracting a serious illness or chronic condition increase. Even with supplemental insurance, you could be forced to allocate a higher portion of your budget to out-of-pocket expenses such as copayments on drugs and doctor visits.

The Kaiser Family Foundation found that out-of-pocket spending for premiums and health care services totaled $4,020 for people ages 65-74, rising to $5,245 for ages 75-84, and reaching $8,191 for people over 85. You may not know exactly how much you'll have to pay for health care when you're 75 or 80 or 85, but you can be reasonably sure it will be more than you are paying now.

Longevity

The mere possibility of a long life results in higher-than-average health care expenditures. Even if you are lucky enough to stay healthy all your life and drop dead of natural causes at age 100 or 105, you still will have paid 35 or 40 years' worth of premiums.

Adding these up, starting at $375 per month for Medicare, Part D, and Medigap premiums and rising by 5% per year, a 65-year-old who lives another 35 years would end up paying over $400,000 in premiums alone – even if he or she never enters a doctor's office. With longer life expectancy comes a greater likelihood of the need for long-term care. Even in the absence of illness, the frailties of aging inhibit elders' ability to care for themselves.

The issue of longevity creates an unfortunate paradox. You should prioritize your health and strive to live well, and for a long time. But you should also understand that doing so will not necessarily save you money.

Potential loss of retiree health benefits

As health care costs continue to rise, employers are responding by reducing or eliminating retiree health coverage for new hires and requiring current retirees to pay more for the coverage they have.

Only 25% of large firms (over 200 employees) now offer retiree health insurance, down from 66% in 1988, according to the 2017 Employer Health Benefits Survey by Kaiser Family Foundation/Health Research & Educational Trust.

If you are counting on generous retiree coverage from your former employer, you may want to consider the possibility that such coverage may be reduced or eliminated in the future, requiring you to go into the open market to purchase supplemental insurance. Of course, there's no guarantee you'll run into a problem with your original coverage, but it's better to prepare.

How much will you need?

The most widely cited source of the amount needed to fund health care costs in retirement is Fidelity's annual survey. In March 2017 Fidelity announced that the average 65-year-old couple would spend $275,000 to pay for medical expenses throughout retirement, not including long-term care or annual out-of-pocket expenses such as dental care.

But there is danger in basing your individual financial plan on statistical averages. The spending patterns and life expectancies of large groups of people are essentially predictable. But there is no guarantee you, or any other individual, will encounter the "average" situation. In fact, you may have some specific reasons to believe you won't.

In the report "Funding Savings Needed for Health Expenses for Persons Eligible for Medicare," the Employee Benefit Research Institute (EBRI) says that determining how much money an individual or couple needs in retirement to cover health care expenses is a complicated process. The amount will depend on, among other factors:

- The age at which he or she retires
- Length of life after retirement
- The availability of health insurance coverage after retirement to supplement Medicare and the source of that coverage
- Health status and out-of-pocket expenses
- The rate at which health care costs will increase
- Interest rates and other rates of return on investments

The EBRI ran 100,000 simulations to allow for the various uncertainties and computed the present value of the savings needed at age 65 to cover health insurance premiums and out-of-pocket expenses in retirement. It found that in order to have 90% certainty of being able to cover health care expenses in retirement, a man would need $124,000, a woman would need $140,000, and a couple would need

$392,000. Like the Fidelity study, this one did not include long-term care.

Remember, the EBRI study looks at the approximate amount of funds one needs to be sure of retirement healthcare security, while the Fidelity study looks at average healthcare expenditures--$392,000 is an estimate of the amount you'd need to be almost totally secure; $260,000 is the statistical average retirement healthcare expenditure per couple. These numbers should inform, but not dictate, your plans.

Right now, the best thing for you to do is to get used to the idea of health care costs becoming more expensive in retirement. Coordinate with both your doctors and your financial planners to develop a plan that works well for you.

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