



Health Care Costs in Retirement

Understanding your options can help you better plan for future expenses.

Calculating projected living expenses is an important first step in planning for retirement. These costs include housing, food, travel, and recreation as well as health care. But predicting how much health care costs will total over the course of a retirement can be tricky.

Health conditions, costs of health care insurance, and out-of-pocket medical expenses are different for everyone, so preretirees can only estimate a range of likely expenses.

KEY POINTS

- Preretirees often are urged to engage in financial planning for their retirement, and a good first step is to get a firm handle on projected living expenses.
- The trouble is, for many, calculating one of the biggest expenses they may face—their health care costs—can be something of a wild card.
- At best, a range of likely costs can only be estimated.

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“Although the complexity can be daunting, understanding health insurance and medical costs can help you make financial plans with greater confidence,” says Roger Young, CFP®, a senior financial planner with T. Rowe Price. (See “A Wide Range of Expenses.”)

Even for individuals in good health, total expenses will vary due to the income-related differences in Medicare Part B premiums. People with higher incomes—in 2018, those with annual incomes above \$85,000—pay higher premiums. (See “Medicare Part B 2018 Premiums” on page 3.) While less than 5% of Medicare enrollees fall under this category,¹ it can be an important consideration.

Premiums for Medicare Part D, covering drug expenses, can vary by location as well as by income. The estimated national average annual premium is \$650,² and income-related adjustments can total as much as \$898 per year. Even with Part D coverage, many individuals face additional out-of-pocket expenses, such as copayments and coinsurance.

While 80% of Medicare participants do not opt for Medigap policies,³ those with the means to purchase them should strongly consider doing so. As the name suggests, these policies fill gaps in Medicare coverage. Annual Medigap premiums average about \$2,400 a year,⁴ though they differ by plan type, location, and other factors.

Out-of-pocket expenses in retirement also vary widely. Counterintuitively, people with additional private insurance, such as a Medigap policy, tend to spend a little more out of pocket than those relying on Medicare alone—perhaps because their health care needs are greater. Median annual out-of-pocket payments for those age 65 and older (excluding long-term care) were \$741 in 2014, but almost 20% of individuals spent at least \$2,000.⁵

Note that the full array of options for health care insurance in retirement is not addressed here, such as Medicare Advantage plans, Medicaid, employer-based retiree coverage, or the many exceptions to general rules around Medicare.

What you can expect to pay

“After totaling the cost of coverage and expenses, the bottom line is that many retirees easily could end up spending between \$5,500 and \$11,000 a year in 2018 dollars on their health care,” says Young. “This means that a couple might spend \$11,000 to \$22,000 a year.” (See “Potential Health Care Costs in Retirement” on page 4.)

A Wide Range of Expenses

Projecting health care costs in retirement starts with Medicare. These and other expenses generally are as follows:

- Medicare Part A for hospital expenses. Free for most.
- Medicare Part B medical insurance. Premiums change with income.
- Medicare Part D for drug expenses. Premiums vary with location and income.
- Medicare Supplemental Insurance (private Medigap policies) for some expenses not covered by Medicare. Premiums differ by plan type and other factors.
- Out-of-pocket expenses not covered by any insurance.
- Long-term care expenses.

¹Social Security Administration, January 2017. ²Jester Financial Technologies. ³Henry J. Kaiser Family Foundation, September 2016.

⁴Jester Financial Technologies. ⁵U.S. Agency for Healthcare Research and Quality, 2014.

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–ROGER YOUNG, CFP®, A
 SENIOR FINANCIAL PLANNER
 WITH T. ROWE PRICE

Remember that these are rough estimates with a wide range of possibilities. For example, Medicare Advantage plans, not included in this discussion, combine Medicare Part B, Medigap, and sometimes Medicare Part D expenses and often can be cheaper than buying the components separately. In preparing for retirement, you should consider many factors—among them, where you live, your overall health, your family medical history, your prescription drug requirements, and any medical specialists you might need to consult. To reduce your potential health care costs, consider preventive measures. Staying active through regular exercise and adopting a health-conscious diet, along with getting regular checkups, may help you stay healthier during your retirement years.

The high cost of medical expenses in retirement often comes as a surprise to people after they stop working. If you find that you may not be saving enough, consider increasing investments in your individual retirement account (IRA) or workplace savings plan. Health savings accounts (HSAs) offer another potential savings vehicle. “Available to individuals enrolled in high-deductible health plans, HSAs have become increasingly popular due to their tax benefits,” says Young. Since each of these options is subject to separate sets of tax, distribution, and estate rules, finding the right mix of savings vehicles requires careful planning.

Consider long-term care

In addition to the health care costs outlined, it’s important to plan for the possibility of long-term care, which encompasses in-home assistance, assisted living environments, and full nursing home care. Some individuals may never need long-term care. However, others may require multiple years of extensive and costly nursing care. This is a major financial risk, since most long-term care costs are not covered by Medicare, and Medicaid only comes into play after most of a person’s resources are exhausted.

Medicare Part B 2018 Premiums*

Based on modified adjusted gross income (MAGI) in 2016.

Individual MAGI	Married filing jointly MAGI	Annual Part B Premium (per Person)
\$85,000 or Less	\$170,000 or Less	\$1,608
Above \$85,000; Up to \$107,000	Above \$170,000; Up to \$214,000	\$2,250
Above \$107,000; Up to \$133,500	Above \$214,000; Up to \$267,000	\$3,215
Above \$133,500; Up to \$160,000	Above \$267,000; Up to \$320,000	\$4,180
Above \$160,000	Above \$320,000	\$5,143

*These rates apply to many people, but rates can be lower for those in the lowest income range whose premiums are deducted from Social Security due to a cap based on cost-of-living adjustments. The average annual premium in that case is \$1,308.

Source: medicare.gov.

Purchasing long-term care insurance is one way to shift this potential expense to an insurer. However, people at the low end of the wealth spectrum often can't justify the expense of a long-term care policy, and high-net-worth individuals may be able to successfully self-insure. As a result, those with middle-class incomes are most likely to consider buying long-term care insurance. Additionally, long-term care insurance premiums have risen sharply, and many insurers have retreated from the business. So it's best to exercise caution before purchasing this type of coverage.

Know your choices

Choosing the options that work for you requires an investment of time. But familiarizing yourself with your choices and assessing your own health care needs can go a long way toward making the costs of health care a manageable aspect of your retirement planning. "Whether you choose to manage all these financial risks through insurance, an investment portfolio, or some combination, it's important to make sure you're armed with knowledge of the health care expense landscape," says Young. ■

Potential Health Care Costs in Retirement*

Per person in 2018 dollars, excluding long-term care.

	Lower Earners, Median OOP	Middle of Five Income Ranges, Median OOP	Highest Earners, Top-Quintile OOP
Medicare Parts B and D Premiums	\$2,250	\$4,250	\$6,700
+ Out of Pocket (OOP)	\$750	\$750	\$2,000
+ Medigap Premium (Estimated Median)	\$2,400	\$2,400	\$2,400
= Total, Excluding Long-Term Care	\$5,400	\$7,400	\$11,100

*These are rough estimates with a wide range of possibilities as determined by a variety of factors.
Source: T. Rowe Price.

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