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INTO THE GREAT UNKNOWN: RETIREMENT HEALTH-CARE COSTS

KEY POINTS

- Calculating one of the biggest expenses for many retirees is something of a wild card, given unpredictable changes in health and health-care insurance over potentially decades of retirement.
- Starting with Medicare costs, T. Rowe Price roughly estimates retirees could end up spending between $5,500 and $11,000 a year each.
- That estimate does not include the cost of long-term care or long-term care insurance. Caution is in order before purchasing this insurance.

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.

Big medical cost unknowns, of course, stem from unpredictable changes in health and health-care insurance over potentially decades of retirement. As a result, out-of-pocket medical expenses—those not covered by insurance, as well as long-term care expenses—can vary widely among retirees.

Although the complexity can be daunting, understanding health insurance and medical expenses can help preretirees make financial plans with greater confidence.

COSTS

Projecting medical costs in retirement starts with Medicare costs, for which eligibility begins at age 65. Potential costs are generally as follows:

- Medicare Part A, for hospital expenses. Free for most.
- Medicare Part B, medical insurance. Premiums vary 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 vary widely by plan type and other factors.
- Out-of-pocket expenses not covered by any insurance.
- Long-term care expenses.

Even for those in good health, total expenses largely vary as a result of the income-related differences in Medicare Part B premiums. Those with higher incomes—in 2018, individuals with annual incomes above $85,000—pay higher premiums (Figure 1). While this affects less than 5% of Medicare enrollees,[1] it can be an important consideration.

Figure 1: Annual Standard Medicare Part B Premiums, 2018*

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.

Premiums for Medicare Part D, covering drug expenses, also can vary by location as well as income. The estimated national average annual premium is $650,[2] and income-related adjustments can be up to $898 per year. Even with Part D coverage, there typically are 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 certainly 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 can 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 people spent at least $2,000.[5]

(Note that the full range 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.)

[1]Social Security Administration, January 2017.
[2]Jester Financial Technologies.
[3]Henry J. Kaiser Family Foundation, September 2016.
[4]Jester Financial Technologies.
[5]U.S. Agency for Healthcare Research and Quality, 2014.

ESTIMATED TOTAL

Totaling the cost of coverage and expenses above, the bottom line is that many retirees could easily end up spending between $5,500 and $11,000 a year in 2018 dollars on their health care (Figure 2). For a couple, then, that could be from about $11,000 to about $22,000 a year.

(Medicare Advantage plans, not included in this discussion, combine Medicare Part B, Medigap, and sometimes Medicare Part D expenses and often can be cheaper.)

Figure 2: Potential Annual 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.

Remember that these are rough estimates with a wide range of possibilities. In preparing for retirement, individuals should consider many factors—among them, where they live, their overall health, their family medical history, their prescription drug requirements, and medical specialists needed.

Other estimates of retirement medical expenses from sources other than T. Rowe Price generally are in line with these estimated expenses; although they, too, can differ widely depending on the assumptions employed in their calculations.

Even before considering the potential for wide variances, the magnitude of estimated medical expenses in retirement often comes as a surprise to people after they stop working. Preretirees may find it's easier to focus on their housing, food, and transportation expenses more readily, even though it's possible that their health-care expenses may exceed one or more of those costs.

In any case, getting a clearer picture, however generalized, of potential health-care costs can be a big step forward in planning for a financially successful retirement—as it may lead preretirees to save more to cover health-care costs.

Accounts to invest that higher level of savings include individual retirement accounts (IRAs), Roth IRAs, workplace savings plans such as 401(k)s, and, particularly, health savings accounts (HSAs). Available to individuals enrolled in high-deductible health plans, HSAs have been increasingly popular due to their tax benefits.

As each of these options is subject to separate sets of tax, distribution, and estate rules, finding the right mix of savings vehicles requires planning as well.

LONG-TERM CARE

All of this is even before taking into account potential long-term care expenses, which have been excluded from the analysis outlined in Figure 2.

Long-term care can range across in-home assistance, assisted living environments, and full nursing home care. In general, most of these costs are not covered by Medicare, and Medicaid only comes into play after most of a person's resources are exhausted.

Some may never need long-term care. However, some may require multiple years of extensive and costly nursing care, which is a major financial risk.

Purchasing long-term care insurance is a possible way to shift this potential expense to an insurer, and there is a segment of relatively affluent retirees who theoretically could benefit from that. People at the low end of wealth typically can't justify or afford the expense, and high-net-worth individuals may be able to successfully self-insure—leaving people in the middle as those most likely to consider buying long-term care insurance.

At the same time, long-term care insurance premiums have risen sharply, and many insurers have retreated from the business. So caution is in order before purchasing this insurance.

Whether preretirees choose to manage all these financial risks through insurance, an investment portfolio, or some combination, it's important for them to make sure they're armed with knowledge of the health-care expense landscape.

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