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Adding Potential Long-Term Care Costs to Retirement Planning

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Ideally, seniors will have meticulously planned their finances to ensure a comfortable and secure retirement. Even in the best of plans, though, one risk that may be overlooked is the escalating cost of long-term care (LTC) among the elderly.

LTC generally refers to custodial rather than medical care. As individuals go through retirement, they may need more assistance with what has come to be known as activities of daily living (ADLs): eating, bathing, dressing, moving around, etc. The help that's delivered may be described as LTC, which can go on for years at a staggering expense.

As life expectancy continues to rise, the reality is that 7 out of 10 people will require LTC during their lifetimes.[1] The costs associated with such care can be substantial, destabilizing a carefully planned retirement budget. Six-figure annual outlays are not unknown, as explained below.

States stepping up

The concern over the need for such care has given rise to many federal and state initiatives to promote the purchase of LTC insurance. Washington state was the first to formally adopt a payroll tax (0.58%) to support the WA Cares Fund, beginning July 2023, to help cover future needs for workers who qualify.[2] Thirteen other states are contemplating a similar tax to help offset LTC costs in those states.[3]

The duration and level (and cost!) of LTC varies with the individual, rising as people grow older. Among those requiring LTC, women will need assistance longer than men: 3.7 years vs. 2.2 years, on average. What's more, 20% of individuals requiring LTC will need it for longer than 5 years.[4] Without proper planning, even the best-laid plans for a successful transition to retirement can be upended. The sooner proper preparation is in place, the better this risk may be hedged.

Costly care

LTC refers to a comprehensive range of services designed to assist individuals who, due to physical or mental impairments, are unable to carry out their ADLs satisfactorily. Although most LTC is not considered medical care, many individuals have the mistaken assumption that such care is covered by their health insurance plan. Usually, that's not the case.

Instead, LTC often involves paying for service providers in a variety of settings, including home health aides, community-based facilities such as adult day care, assisted living facilities, and nursing homes. These services can be quite costly, depending on factors such as care needs, age, and health condition. According to the recent data, the annual median cost of long-term care in 2023 is:[5]

Private Room in a Nursing Home: $111,600

Semi-Private Room in a Nursing Home: $96,000

Private Room in an Assisted Living Facility: $57,288

Home Health Aide: $55,650

Preparing well in advance of a need for LTC can help avoid both financial stress and the emotional strain of getting the necessary care.

Probable Causes

Predicting a need for LTC can be challenging, as it depends on various factors. These can include:[6]

1. **Age:** The risk of needing LTC generally increases as people get older.
2. **Gender:** Women are at higher risk than men, primarily because they often live longer.
3. **Marital status:** Single people are more likely than married ones to need care from a paid provider.
4. **Lifestyle:** Poor diet and exercise habits can escalate a person's risk.
5. **Health and family history:** These factors also significantly affect LTC risk.

As the above list indicates, many people will need some LTC, perhaps incurring substantial expenses. Another common misconception is that Medicare, the federal health insurance program for seniors (and some younger individuals with a disability), will cover LTC costs. However, Medicare typically does not cover LTC expenses such as assisted living or extended nursing home care. It's true that Medicare will pay for some skilled nursing care but the program doesn't pay for LTC costs associated with non-skilled custodial care that results from difficulty performing ADLs, as previously discussed.

Medicare generally will cover the cost of medically necessary skilled care, either in a nursing home or at home, on a short-term basis. On the other hand, Medicare will not cover the cost of a home health aide who is providing only personal care.[7] Therefore, it's important to thoroughly understand existing insurance coverage and explore all available options before making any decisions about LTC.

Climbing Costs

For years, the cost of LTC has steadily increased, along with the costs of goods and services faced by seniors such as food, gas, and housing. For instance, according to the latest Genworth Cost of Care Survey, the median cost of assisted living increased an average of 4.4% annually, from 2015 to 2021. This increase was faster than the growth in the median cost for nursing home care, which increased an average of 3.25% annually over the same period.[8]

As the costs of long-term care continue to rise, it's crucial for individuals and families to plan ahead. Although Medicare doesn't pay for the considerable cost of LTC in a nursing home or other facility, there may be other options to help cover those expenses. This might involve utilizing government assistance programs including Veterans benefits, if applicable; setting aside savings specifically for long-term care; investing in LTC insurance; or exploring other strategies to cover these potential costs.

Potential options include:

Government Assistance Programs

Among government assistance programs, Medicaid is a federal program administered by each state. Medicaid provides coverage for medical expenses and LTC costs for individuals with low income and limited assets. However, to qualify for Medicaid coverage, someone must meet strict financial requirements, often requiring spending down assets.[9] Although Medicaid can be a safety net for those with limited resources, it may not be suitable for those who want to choose where they receive care or who want to leave a legacy for loved ones or support a charity.

Note that some people with assets and income enter into certain strategies in order to qualify for Medicaid-paid LTC, especially nursing home care. Such plans may or not succeed in reducing exposure to steep outlays. Working with a competent, experienced financial professional and an elder law attorney is the key to possibly reaching a worthwhile outcome.

Another government program that may provide LTC assistance is the Veterans Health Administration's plan for qualifying veterans and their eligible dependents.[10] Veterans may be able to get assisted living, residential (live-in), or home health care coverage. Additionally, some states offer their own assistance programs for LTC.

Do-It-Yourself

Some retirees may depend on personal savings to cover LTC expenses. They could tap savings accounts, retirement funds, income from investments, proceeds from selling a home, or home equity via a reverse mortgage to pay some bills for custodial care. This approach might offer flexibility and control over personal finances as well as a broader array of choices for care, without having to pay premiums for LTC insurance that might never be needed. However, the high costs of LTC can rapidly drain lifelong asset accumulation, making it necessary to explore other financing alternatives.

Therefore, it is crucial for retirees and near-retirees to assess whether their future financial plans are designed to meet potential LTC costs. Considering the time that's left for saving, will personal assets be sufficient to cover those expenses? Moreover, relying solely on personal savings may not provide the same level of protection as adequate insurance coverage.

Seniors who decide to use retirement accounts such as 401(k)s or IRAs to cover LTC expenses should be aware of the potential tax ramifications of withdrawals. Consult with a financial or tax professional to understand the implications.

Unpaid Family Caregivers

According to a recent AARP study Valuing the Invaluable 2023, approximately 38 million unpaid caregivers, or 11.5% of the total population, will be caring for loved ones in 2023. The value of that care is nearly $600 billion and equates to 36 billion hours dedicated to the care of loved ones.[11] Much of that responsibility has fallen to those often referred to as the "sandwich generation", or those who find themselves caring for both their children and aging parents. These individuals are effectively "sandwiched" between the needs of two generations, often feeling the weight of caregiving responsibilities on their shoulders while juggling their own personal and financial obligations.

Relying on familial caregivers can be equally emotionally stressful to both the caregiver and the one needing the care. Financially, caregivers may be ill-equipped to take on the additional costs associated with caring for loved ones, and, without adequate savings, the parent requiring care may feel like a burden. To avoid such emotional and financial tolls, having alternative options for a potential long-term care need and speaking openly to family members is crucial.

Insuring for LTC

The LTC insurance market has changed significantly since its introduction in the 1960s. Standalone long-term care insurance policies are designed to cover services typically not covered by health insurance or Medicare. The premiums depend on factors such as age, gender, health, location, and more. The policies accumulate no cash value, meaning that if no LTC care event occurs, the premiums paid are simply lost. The premiums are required lifelong and will likely increase over time as rates are not guaranteed.

Initially, insurance companies offering such standalone policies charged premiums that turned out to be too low. Many insurers left the market because the number of consumers exercising the policies increased, resulting in higher-than-anticipated payouts. Newer standalone policies more accurately reflect the cost of covering the risk of LTC, which both significantly increases premiums (reducing the number of consumers who can afford them) and shrinks the pool of insurers in the standalone market.[12]

Nevertheless, a standalone LTC insurance policy could be an option to cover those expenses by paying premiums each year towards possible future costs. This coverage can be a good fit for people who can afford both today's premiums and potential future rate hikes.

The downside to standalone LTC coverage is paying annual premiums for a policy that might never be needed. Conceptually, this is similar to the home and auto policies many people purchase. Someone who stops paying premiums and lets the policy lapse is not likely to get a payback in return should an LTC event occur. Additionally, a standalone LTC policy may not cover 100% of the costs incurred, even though it can significantly reduce them.

Hybrid LTC Policies

Hybrid LTC insurance offers an alternative approach to standalone coverage by combining life insurance or annuity benefits with possible LTC needs. The hybrid policies provide more flexibility and options for policyholders. They allow policyholders to manage risks by eliminating future premium increases. A hybrid policy essentially serves multiple purposes, combining retirement income from an annuity or a life insurance death benefit with an option to pay for LTC, if necessary. A hybrid policy may also have less stringent underwriting requirements than a standalone policy, making it easier to qualify for the LTC benefit.

- **Hybrid life insurance and LTC policy.** If LTC is required, policyholders can access the death benefit to pay for covered expenses. If some lifetime benefits are paid for LTC, beneficiaries are likely to receive a reduced death benefit eventually.

  These hybrids come in several varieties. Some are linked-benefit policies, with a stated death benefit and a capped LTC benefit. Various formats are available, but the basic idea is that the use of the LTC benefit will reduce the eventual death benefit, but an accelerated death benefit comes when it is most needed.

  A slightly different arrangement is a life insurance policy with an LTC rider. This may be suitable for someone whose prime purpose is buying life insurance, with the rider offering some LTC coverage if the need arises. With either model, the life insurance involved is a permanent rather than a term policy.

- **Long-term care annuity.** This product combines long-term care insurance with an investment account that can provide some retirement cash flow. The annuity grows tax-deferred; if it's accessed for LTC expenses, the gains generally will be received income tax-free. Alternatively, if LTC is not needed, the annuity can either provide a source of income in retirement or can be left to loved ones named as beneficiaries.

Hybrid policies can be an efficient way to insure against potential LTC expenses while maintaining the potential for a death benefit or retirement income. Interested consumers should carefully review the terms and conditions of these policies and consider the financial stability of the insurance company offering them.

Planning Points

Retirees and near-retirees evaluating the different options for paying LTC expenses should consider the following factors:

- **Cost:** Review the premiums or other costs associated with each option to cover a future potential LTC need. Compare the expected outlays with the expected retirement budget and financial resources.
- **Coverage:** Assess the extent of coverage provided by each option, including the type of care included as LTC and the benefits payable.
- **Eligibility:** Determine the eligibility requirements for each option, such as income and asset limits for government assistance programs, or health conditions for insurance policies.
- **Flexibility:** Weigh the flexibility and control you have over your finances with each option, as well as any limitations or restrictions.
- **Risk:** Evaluate the risks associated with each option, such as potential premium increases, investment performance, or the possibility of not needing LTC.
- **Discuss future needs with family:** Be open with family members about the potential impact a long-term care need might have on the family and plan strategies to mitigate the risk of relying too heavily on one or more family members for care.

Choosing the right option for paying LTC expenses requires a thoughtful examination of personal and financial circumstances. For retirees and those soon to leave the workforce, it's advisable to consult with a financial professional who specializes in retirement planning and long-term care options, to help navigate the complexities and make an informed decision. An experienced professional can assess individual situations, analyze the costs and benefits of each option, and provide personalized recommendations based on expressed goals and preferences.

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