Retirement Planning With Health Care Expenses in Mind

It is only wise to consider what Medicare won't cover in the future.

Provided by *Benedict A. Mitchell Jr.*

As you save for retirement, you also recognize the possibility of having to pay major health care costs in the future. Is there some way to plan for these expenses years in advance?

Just how great might those expenses be? There's no rote answer, of course, but recent surveys from AARP and Fidelity Investments reveal that too many baby boomers might be taking this subject too lightly.

For the last eight years, Fidelity has projected average retirement health care expenses for a couple (assuming that retirement begins at age 65 and that one spouse or partner lives about seven years longer than the other). In 2013, Fidelity estimated that a couple retiring at age 65 would require about $220,000 to absorb those future costs.[1]

When it asked Americans aged 55-64 how much money they thought they would spend on health care in retirement, 48% of the respondents figured they would need about $50,000 apiece, or about $100,000 per couple. That pales next to Fidelity's projection and it also falls short of the estimates made back in 2010 by the Employee Benefit Research Institute. EBRI figured that a couple with median prescription drug expenses would pay $151,000 of their own retirement health care costs.[1]

AARP posed this question to Americans aged 50-64 in the fall of 2013. The results: 16% of those polled thought their out-of-pocket retirement health care expenses would run less than $50,000 and 42% figured needing less than $100,000. Another 15% admitted they had no idea how much they might eventually spend for health care. Unsurprisingly, just 52% of those surveyed felt confident that they could financially handle such expenses.[1]

Prescription drugs may be your #1 cost. In fact, EBRI currently says that a 65-year-old couple with median drug costs would need $227,000 to have a 75% probability of paying off 100% of their medical bills in retirement. That figure is in line with Fidelity's big-picture estimate.[2]

What might happen if you don't save enough for these expenses? As Medicare premiums come out of Social Security benefits, your monthly Social Security payments could grow smaller. The greater your reliance on Social Security, the bigger the ensuing financial strain.[2]

A positive note: EBRI and Fidelity both reduced their estimates of total average retirement health care expenses from 2012 to 2013. (Who knows, maybe they will do so again this year.)[1]

The main message: save more, save now. Do you have about $200,000 (after tax) saved up for the future? If you don't, you have another compelling reason to save more money for retirement.

Medicare, after all, will not pay for everything. In 2010, EBRI analyzed how much it did pay for, and it found that Medicare covered about 62% of retiree health care expenses. While private insurance picked up another 13% and military benefits or similar programs another 13%, that still left retirees on the hook for 12% out of pocket.[1]

Consider what Medicare doesn't cover, and budget accordingly. Medicare pays for much, but it doesn't cover things like glasses and contacts, dentures and hearing aids – and it certainly doesn't pay for extended long term care.[2]

Medicare's yearly Part B deductible is $147 for 2014. Once you exceed it, you will have to pick up 20% of the Medicare-approved amount for most medical services. That's a good argument for a Medigap or Medicare Advantage plan, even considering the potentially high premiums. The standard monthly Part B premium is at $104.90 this year, which comes out of your Social Security. If you are retired and earn income of more than $85,000, your monthly Part B premium will be larger (the threshold for a couple is $170,000). Part D premiums (drug coverage) can also vary greatly; the greater your income, the larger they get. Reviewing your Part D coverage vis-à-vis your premiums is only wise each year.[2,3]

Underlying message: stay healthy. It may save you a good deal of money. EBRI projects that someone retiring from an $80,000 job in poor health may need to live on as much as 96% of that end salary annually, or roughly $76,800. If that retiree is in excellent health instead, EBRI estimates that he or she may need only 77% of that end salary – about $61,600 – to cover 100% of annual retirement expenses.[1]

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Citations.

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