Health-Care Costs Could Eat Up Retirement Funds, Forecast Shows

A new estimate may convince you to work forever—if you can.

Suzanne Woolley | Aug 24, 2017 BLOOMBERG

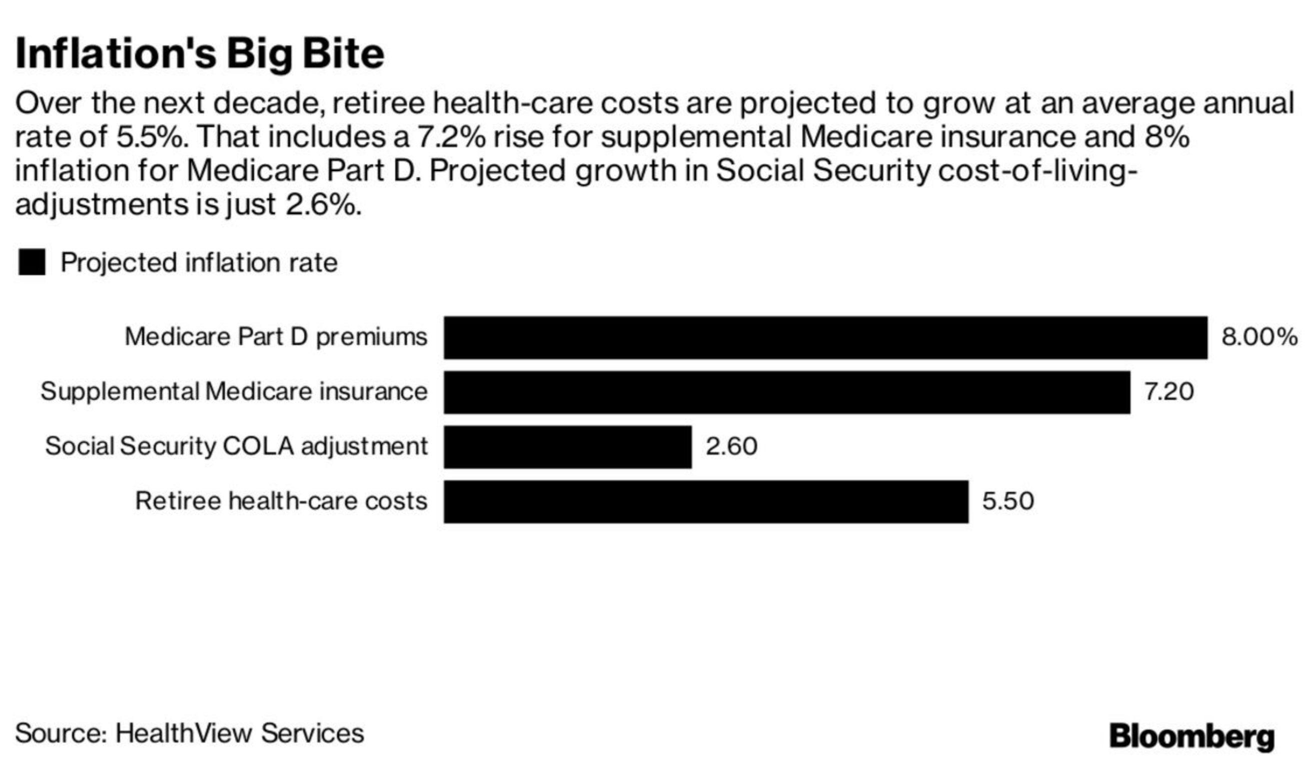
In a perfect world, the largest expenses in retirement would be for fun things like travel and entertainment. In the real world, retiree health-care costs can take an unconscionably big bite out of savings. A 65-year-old couple retiring this year will need $275,000 to cover health-care costs throughout retirement, Fidelity Investments said in its annual cost estimate, out this morning. That stunning number is about 6 percent higher than it was last year. Costs would be about half that amount for a single person, though women would pay a bit more than men since they live longer. You might think that number looks high. At 65, you're eligible for Medicare, after all. But monthly Medicare premiums for Part B (which covers doctor's visits, surgeries, and more) and Part D (drug coverage) make up 35 percent of Fidelity's estimate. The other 65 percent is the cost-sharing, in and out of Medicare, in co-payments and deductibles, as well as out-of-pocket payments for prescription drugs.

And that doesn't include dental care—or nursing-home and long-term care costs.

Retirees can buy supplemental, or Medigap, insurance to cover some of the things Medicare doesn't, but those premiums would lead back to the same basic estimate, said Adam Stavisky, senior vice president for Fidelity Benefits Consulting. The 6 percent jump in Fidelity's estimate mirrors the average annual 5.5 percent inflation rate for medical care that Health View Services, which makes health-care cost projection software, estimates for the next decade. A recent report from the company drilled into which health-care costs will grow the fastest.

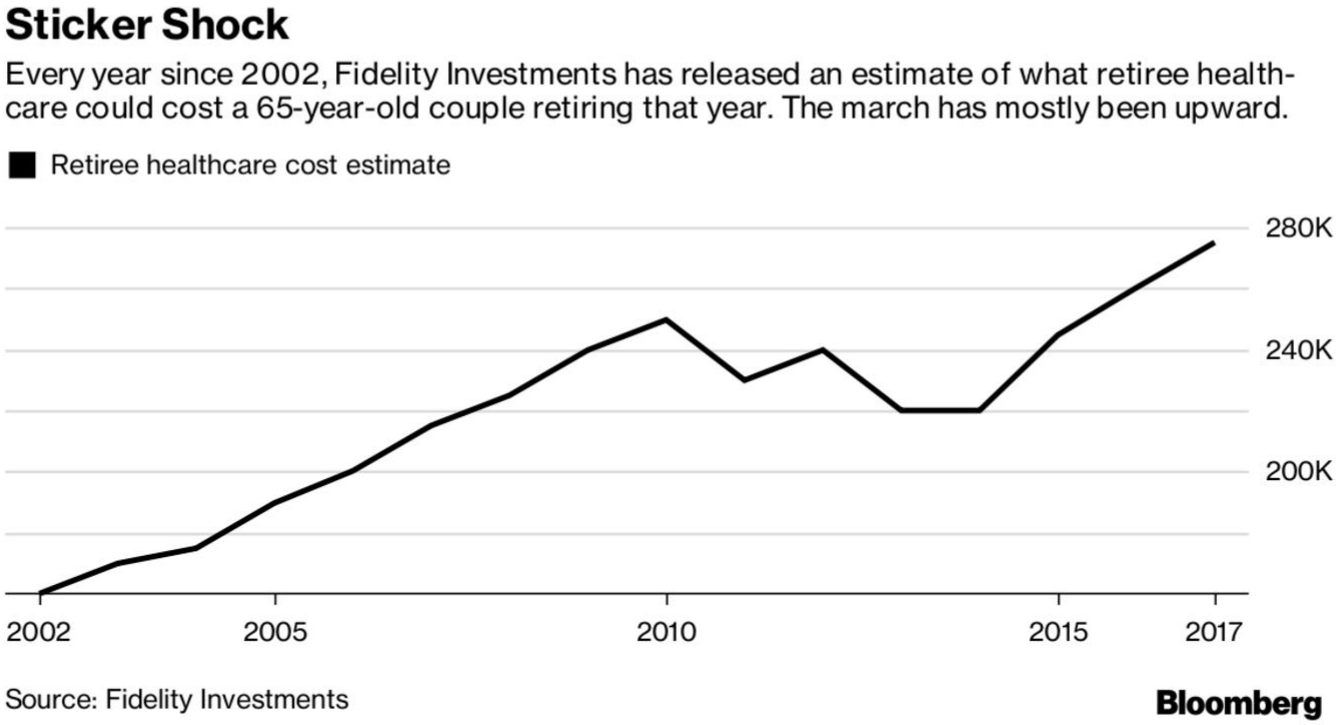
It estimates a long-term inflation rate of 7.2 percent for Medigap premiums and 8 percent for Medicare Part D. For out-of-pocket costs, the company estimates inflation rates of 3.7 percent for prescription drugs, 5 percent in dental, hearing, and vision services, 3 percent for hospitals, and 3.4 percent for doctor's visits and tests.

Cost-of-living-adjustments on Social Security payments, meanwhile, are expected to grow by 2.6 percent, according to the HealthView Services report.



What's really sobering is the impact of inflation on Fidelity's retiree health-care cost estimates over the years. From 2002, when Fidelity first did an estimate, to its latest projection, the number is up 70 percent.

"It's the power of compounding," Stavisky said. "It's great for investing and brutal for health-care costs."



In its 2017 statement, Fidelity brings up a fairly hot topic in health-care circles—health savings accounts, or HSAs—as a way employers are helping workers manage costs. (Others might describe the plans as shifting more of the rapidly rising costs of health care onto employees.) HSAs are tax-advantaged accounts to which employees can contribute a certain amount of pre-tax dollars each year to use for medical costs. Employers usually kick in some money, too. The 2017 contribution limit for singles is $3,400, and $6,750 for a person with a family. HSAs usually accompany high-deductible health plans, which are becoming far more common. (For a good comparison of health-care savings account providers, see Morningstar's 2017 Health Savings Account Landscape.) In return for low premiums, employees have high deductibles to cover before insurance kicks in. In 2017, annual deductibles are at least $1,300 for a single person, with a maximum out-of-pocket expense of $6,550. For a family, the minimum deductible is $2,600, with an out-of-pocket cap of $13,100.

Part of the logic behind HSAs is that employees will be better health-care consumers under such plans. And they might, if being an informed, effective consumer weren't extremely difficult and time-consuming in the murky world of American health-care pricing.

On the bright side, financial planners love that HSAs are "triple tax-advantaged." Money goes in pre-tax, earnings on that money aren't taxed, and the money can be used, without being taxed, for qualified medical expenses. If people have the means to pay for health-care costs out of pocket and leave the HSA money growing tax-free, it can be another tax-advantaged way to save for retirement. Health-care costs will likely keep climbing, so one of the best investments anyone can make is to work at staying healthy, if possible. For a sense of how much health care could cost you in retirement, and how staying healthy can lower those costs, try AARP's health-care costs calculator. It provides a rough cost estimate based on your height, weight, gender, and state. Users can add in various health conditions to see how much they might add to projected health-care costs in retirement, or subtract from them if, for instance, an overweight person slimmed down.

Whether you're 60 or 25 or somewhere in between, the prospect of retirement should be more inspiring—cities to visit, languages to learn, books to read, or to write —than the anxious business of war-gaming what your health will be like 10 or 20 or 30 years out. But if paying closer attention to your body and mind now means more money for travel and growth and relaxation after a long hard working life, it's not a bad trade-off.

And it's not available to everyone. In the real world, high costs and steep deductibles discourage many people from using the health care they've bought, starting a cascade of ills. Staying healthy can be expensive. Have personal finance questions or lessons to share? Join Money Talks, the new Facebook community from Bloomberg News.

To contact the author of this story: Suzanne Woolley in New York at swoolley2@bloomberg.net To contact the editor responsible for this story: Peter Jeffrey at pjeffrey@bloomberg.net