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The other big retirement threat

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Special to The Star

Aside from another market crash, health-care cost is perhaps the greatest threat to a secure retirement.

While most retirees believe that Medicare will cover their health care expenses after retirement, the Employee Benefit Research Institutes sites that Medicare only pays about 60 percent of current retirees' medial costs.

HealthView Services (HVS), which provides U.S. financial advisors with tools and information to address clients' concerns about Medicare costs and retirement, estimates that a 65-year-old healthy male will incur medical expenses between $4,100–$4,700 in 2013. HVS also reports that medical expenses increase with each year of age and as medical inflation costs rise in terms of co-pays, premiums and deductibles. Medicare, however, doesn't cover hearing, dental, vision or long-term care cost.

I recently completed a retirement plan for a couple, both 64, who I have worked with for more than 20 years. This retirement plan separates fixed costs such as homeowner taxes, insurance premiums, utilities and living expenses from medical costs, vacations, future car purchases and home improvements.

I want clients to see the expense items separately, so they can understand what the expenditures cost, when they occur and what inflation rates are attached to each expense. It also allows us to give each cost a priority rating. If cash flow is tight, then maybe a car purchase or a vacation is delayed in order to satisfy higher stated goals such as fixed costs and medical expenses.

When I started their data collection process, I asked them what dollar amount they wanted to use for out of pocket health-care costs when they entered the Medicare system. With limited knowledge of the cost of health care after retirement, they asked my opinion. I suggested around $5,000 per person, unless known health issues would warrant a higher annual figure, and my clients were surprised that their health-care expenses would be that high.

Fidelity Investments recently estimated that a 65-year-old couple retiring in 2012 will need $240,000 to cover medical expenses throughout retirement, a 4 percent increase from last year. The estimate has increased an average of 6 percent annually since Fidelity's initial calculation of $160,000 in 2002.

Fidelity also states that many retirees are overly dependent on their Social Security benefits, and the Boston-based company recently reported that Social Security's average cost-of-living adjustment is 2.3 percent. Here in lies the big retirement threat — Social Security income increases at an average rate of 2.3 percent, while health-care costs increase a little short of three times as much.

Fidelity also reports that today's 65-year-old couple will spend nearly 35 percent of their Social Security benefit on health-care expenses, and that the percentage will grow to 61 percent of the benefit by 2027.

It is no secret that the Medicare system is not financially healthy, and it would not surprise many of us if the premiums are increased or the benefits are reduced. Either action means more out-of-pocket expenses for the retirees described above.

While my clients had saved substantial dollars in their retirement plans and in their personal taxable accounts, had little debt and were within three years of paying off their home mortgage, the long-term impact of health-care costs to their retirement lifestyle surprised them.

Just like my clients, who identified a significant obstacle to a healthy retirement plan, it's never too soon to evaluate retirement expenses and to start setting aside savings to pay for future health-care costs. A detailed retirement plan that includes all of these moving parts will produce fewer surprises in your retirement.

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