HealthView Services:

2016 RETIREMENT HEALTH CARE COSTS DATA REPORT©

HealthView INSIGHTS

SECTION 1: INTRODUCTION

HealthView Services' 2016 Retirement Health Care Costs Data Report explores emerging trends and provides detailed projections of health care expenses in retirement.

The paper will address the impact of rising in-retirement health care inflation, the elimination of Social Security filing strategies, and adjustments to Medicare-surcharge brackets on future health care costs.

The Report also outlines costs related to state of residence, years to retirement, extent of coverage, gender, health status, and income: all of which must be considered by financial advisors when planning for future medical expenses at the individual level.

Finally, some time will be spent analyzing investment strategies, including personal time horizons (both before and during retirement) and the adjustment of income replacement ratios, to minimize the effect of rising health care on retirement budgets.

RETIREMENT HEALTH CARE COSTS: A NATIONAL ISSUE

Recent studies indicate that while Americans are becoming increasingly concerned about future health care costs, they have little knowledge of what truly lies ahead. A survey of over 4,000 individuals conducted by The Empower Institute and Brightwork Partners found that only 12% of working Americans have taken any steps toward addressing medical expenses in retirement, and more than half admitted to knowing virtually nothing about costs related to Medicare.[1] The issue has finally begun to generate considerable interest across the financial-planning spectrum, and, as the third section of this paper shows, a few investment adjustments and a sufficient time horizon can help Americans prepare for this growing retirement expenditure.

Primary cost drivers continue to be retirement health care inflation and expenses related to attained age. Looking ahead, for someone who has entered retirement in May of 2016, HealthView projects health care inflation to average slightly over 5.1% annually for next 20 years. Since supplemental insurance premiums are age-based, future retirees could face an additional annual 4.5% increase (or more) for supplemental plan coverage.

As health care costs continue their upward trajectory, recent legislative changes will also place an additional strain on many current and future retirees. The elimination of Social Security filing strategies, a zero cost-of-living adjustment (COLA) in 2016, a double-digit increase in Medicare Part B premiums, and an adjustment in supplemental insurance (Plan F) coverage beginning in 2020 follow an ongoing trend of placing more health care accountability on retiring Americans – many of whom will be living on fixed budgets.

2016 HIGHLIGHTS AND YEAR-OVER-YEAR COMPARISON

1. Total projected health care premiums (Parts B, D, and supplemental insurance) for a healthy 65-year-old couple retiring this year are expected to be $288,400 in today's dollars ($435,472 in future dollars). If out-of-pockets such as deductibles, copays, hearing, vision, and dental are included in the calculation, expenses in today's dollars are expected to be $377,412 in today's dollars ($567,903 in future dollars).

1. Lifetime Income Score V: Optimism and Opportunity, Empower Institute, 2015.

2. Monthly Medicare Part B premiums rose over 16% in one year – from $104.90 in 2015 to $121.80 in 2016.

3. Social Security COLA was 1.7% in 2015 and 0% in 2016. COLAs are projected to rise by 3.1% in 2017 and 2.7% annually thereafter. With no COLA increase in 2016, the hold harmless provision of the Social Security Act meant that approximately 70% of recipients were not required to pay the extra $16.90 per month in Part B premiums. Unfortunately, all retirees in 2016 and beyond will have to absorb this additional expense.

4. The Retirement Health Care Cost Index® – the percentage of Social Security required to cover total retirement health care costs – declined slightly as a result of higher than projected Social Security COLAs. (The 2015 Report forecasted COLAs would rise at 2% a year.) For a 66-year-old couple retiring in the second half of 2016, the Index fell from 67% to 57%. For a 55-year-old couple retiring at 66, the Index decreased from 90% to 88%. This decline shows that the impact of higher projected COLAs only slightly outweighs the benefits of filing options (that are no longer available). The Index continues to evidence that health care costs are still expected to consume a very significant portion of Social Security benefits.

5. The choice to File and Suspend at full retirement age (FRA), which allowed a spouse to collect a percentage of his/her partner's Social Security benefits, is now very limited and will no longer provide retirees with any measurable financial benefit. File Restricted is no longer an option for individuals who did not turn 62 by the end of 2015. Effectively, eliminating these strategies reduces potential Social Security income for many future retirees.

6. Medicare means-testing thresholds were lowered for the top three brackets. As a result, more affluent retirees will be propelled into higher MAGI thresholds and face greater income-based surcharges.

7. New to the 2016 report is a section on income replacement ratios (IRRs), a topic that was explored in a HealthView Insights paper last year. To summarize, health care costs in retirement are not directly comparable to those in pre-retirement. The majority of retirees will not only have to pay for Medicare premiums, but also supplemental insurance and other out-of-pocket costs as well. Also, current IRRs fail to incorporate true health care inflation into their calculations.

8. While the task may seem daunting, the right mix of investment products, additional contributions to existing plans (such as a traditional 401(k), Roth 401(k), or an HSA) and an adequate time horizon can help Americans afford quality health care in retirement.

SECTION 2: HEALTH CARE COST ANALYSIS

HEALTHVIEW DATA AND ASSUMPTIONS

HealthView Services 2016 Retirement Health Care Costs Report leverages data derived from over 50 million health care cases, and the firm's rigorous bottom-up approach integrates a number of specific variables that will drive future health care costs, including health status, age, gender, income, and state of residence. This methodology provides unique insight into how these cost components will impact various population groups. The final calculations draw upon, and are consistent with, government health care inflation forecasts.

Retirement health care cost projections include Medicare Parts B and D and supplemental insurance Plan F, the most widely used option. (It is assumed that most Americans paid Medicare taxes while employed and will not be responsible for Medicare Part A premiums). Total calculations include dental, vision, hearing, and other out-of-pocket expenses.

Unless otherwise indicated, the report relies on future dollar-cost estimates, which include inflation assumptions. When necessary, present-value dollar estimates are also used.

Long-term care expenses are not factored into cost estimates in this paper.

As with any aspect of retirement planning, actual costs for individuals may vary greatly from these averages.

HEALTH CARE INFLATION

A person retiring today could face more than $33,000 in total retirement health care costs than a person who retired a year ago because of health care inflation. The current projected rate of 5.1% for retirees greatly exceeds the annual U.S. inflation rate of 0.7% for 2015,[2] continuing the long-term trend of retirement health care inflation rising at a multiple of U.S. inflation.[3] (Note that inflation rose 7.3% from 2015 to 2016 primarily driven by the 16.1% increase in Medicare part B premiums.)

Also, there was no Social Security COLA in 2016, which means that tens of millions of Americans will have to absorb increased health care costs without the benefit of the hold harmless provision. On a slightly positive note, the hold harmless provision prevents Social Security income from declining year to year. Since there will be no increase in 2016 benefits (Table A on next page), current Medicare recipients in the first MAGI bracket will not have to pay the additional 16.1% for Part B premiums.

The sobering reality looking forward is that Social Security COLAs will not be enough to offset rising health care inflation.

2. http://usinflation.org/us-inflation-rate/
3. "Average Annual Percent Change in National Health Expenditures, 1960-2012". The Henry J. Kaiser Foundation: March 6, 2014.

TABLE A: SOCIAL SECURITY COLAS BY CALENDAR YEAR

Social Security Cost-Of-Living Adjustments (COLAS)					
Year	**COLA**	**Year**	**COLA**	**Year**	**COLA**
JULY 1975	**8.0%**	JAN 1989	**4.0%**	JAN 2003	**1.4%**
JULY 1976	**6.4%**	JAN 1990	**4.7%**	JAN 2004	**2.7%**
JULY 1977	**5.9%**	JAN 1991	**5.4%**	JAN 2005	**2.7%**
JULY 1978	**6.5%**	JAN 1992	**3.7%**	JAN 2006	**4.1%**
JULY 1979	**9.9%**	JAN 1993	**3.0%**	JAN 2007	**3.3%**
JULY 1980	**14.3%**	JAN 1994	**2.6%**	JAN 2008	**2.3%**
JULY 1981	**11.2%**	JAN 1995	**2.8%**	JAN 2009	**5.8%**
JULY 1982	**7.4%**	JAN 1996	**2.6%**	JAN 2010	**0.0%**
JULY 1983	**3.5%**	JAN 1997	**2.9%**	JAN 2011	**0.0%**
JULY 1984	**3.5%**	JAN 1998	**2.1%**	JAN 2012	**3.6%**
JAN 1985	**3.5%**	JAN 1999	**1.3%**	JAN 2013	**1.7%**
JAN 1986	**3.1%**	JAN 2000	**2.5%**	JAN 2014	**1.5%**
JAN 1987	**1.3%**	JAN 2001	**3.5%**	JAN 2015	**1.7%**
JAN 1988	**4.2%**	JAN 2002	**2.6%**	JAN 2016	**0.0%**

Despite an estimated 3.1% increase in 2017, total retirement health care cost inflation combined with age-related expenses (related to supplemental insurance) are expected to exceed COLAs by approximately 50% for the next decade. Because COLAs will fail to keep up, the compounding effect of this differential will squeeze retiree budgets.

HEALTH CARE COSTS AND THE AVERAGE AMERICAN COUPLE RETIRING TODAY

The following analysis (Table B) reviews future health care costs for a 65-year-old couple retiring this year, as well as a 55-year-old and 45-year-old couple retiring at age 65. These projections can be a valuable tool in preparing for future medical expenses. Given the significant cost variance by age, health status, gender, state of residence, and income, retirement health care budgets should be evaluated by individual circumstances and desired coverage, not the national average or an arbitrary number.

(All calculations are based on assumptions that the male and female have life expectancies of 87 and 89 respectively, and will have a combined modified adjusted gross income of under $170,000.)

TABLE B: COST PROJECTIONS FOR MEDICARE PARTS B, D, SUPPLEMENTAL INSURANCE PREMIUMS, AND OUT-OF-POCKET EXPENSES

	Premiums	Out-Of-Pocket	Total Costs (Present Value)	Total Costs (Future Value)
65-Year-Old Couple	$288,400	$89,012	$377,412	$567,903
55-Year-Old Couple	$368,474	$97,433	$465,907	$943,760
45-Year-Old Couple	$484,103	$108,172	$592,275	$1,614,712

Table C displays the monthly and annual health care premium costs in five-year increments for an average 65-year-old couple retiring in 2016.

TABLE C: COST PROJECTIONS FOR A 65-YEAR-OLD COUPLE (IN FUTURE DOLLARS) FOR MEDICARE PARTS B, D AND SUPPLEMENTAL INSURANCE

	Age 65	Age 70	Age 75	Age 80	Age 85	Overall Costs
Monthly Costs	$644	$884	$1,239	$1,724	$2,387	--
Annual Cost	$7,725	$10,608	$14,868	$20,688	$28,644	$435,472

As indicated, the couple can expect to spend $644 per month in premiums during their first year of retirement, approximately twice the amount they would have paid in an employer-sponsored plan. Monthly premiums alone will almost double by age 75 and increase by 270% by age 85.

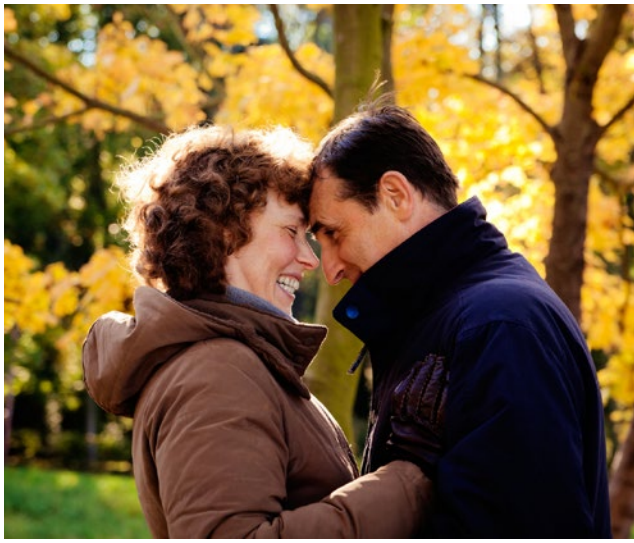
Now let's examine complete health care coverage (B, D, supplemental, and all out-of-pockets, including deductibles and copays) for the same couple throughout retirement.

Table D provides total cost projections in five-year intervals (up to age 85) and reveals the impact of this year's 7.3% retirement health care inflation rate.

TABLE D: TOTAL COST PROJECTIONS IN FIVE-YEAR INTERVALS

	Age 65	Age 70	Age 75	Age 80	Age 85
2015	$9,953.32	$13,917.02	$19,250.24	$26,368.22	$35,730.53
2016	$10,680.65	$14,594.75	$20,211.86	$27,701.63	$37,557.87
% Increase	7.3%	4.9%	5.0%	5.1%	5.1%

The primary cause of the substantial one-year jump can be traced to the 16.1% increase in Medicare Part B premiums, which will affect all new subscribers. As stated earlier, this rate does not apply to 2015 retirees who were protected by the hold harmless provision, which states that Medicare premiums will not increase more than Social Security COLAs (0% in 2016).



Because of the compounding effect of inflation, a couple that retires this year will be charged significantly more – both annually and over time – than a couple that retired in 2015. At age 70, 2015 retirees will spend $13,917.02, compared to $14,594.75 for those who retired in 2016 – a difference of $677.73. As the table illustrates, hundreds of dollars per year will lead to tens of thousands over two decades. This may dramatically impact those who live on fixed budgets and may not have prepared for this additional expense.

RETIREMENT HEALTH CARE COST COMPONENTS

Aside from cumulative projections, the following table provides anticipated inflation rates for Medicare Parts B, D, and supplemental insurance premiums.

TABLE E: COVERAGE INFLATION RATES

Service	Inflation from 2015 to 2016	Inflation from 2017 to 2024
Medicare Part B	16.1%	4.6%
Medicare Part D	5.0%	8.0%
Supplemental Insurance	3.8%	3.8%

At first glance, the Part B inflation rate for 2016 may seem disproportionate to what is projected until 2024. Last year, Medicare publicized Part B inflation projections for the next eight years (culminating with a $173.90 premium in 2024).[4] Part B Premiums rose 16.1% from 2015 to 2016 ($104.90 to 121.80). Because the 2024 forecast has not been adjusted, Part B premiums are expected to rise annually by an average of 4.6%

According to HealthView's most recent data, Part D will grow by 8% for the foreseeable future, which is more than 2.5 times the historical U.S. inflation rate of 3%. Part D plans charge a premium, but costs can vary based on type of coverage and state of residency. (There is also a coverage gap "donut hole," but that will be phased out by 2020.)

Also, aside from costs related to inflation, Medicare Parts B and D are subject to Medicare means testing (discussed in a later section), which can increase premiums by over 200%.

Supplemental insurance policies are influenced by two distinct variables: inflation and an inherent year-to-year cost-adjustment based on age.

The first factor in the calculation is the supplemental policy inflation rate, which is expected to grow by 3.8% per year. The second variable is that supplemental-plan premiums are "age-rated" and rise annually by an average of 4.5% to 5% (simply because a person is one year older). When the two figures are combined, the year-to-year increase (ranging from 8.3% to 8.8%) will be much higher than what the general public may anticipate.

Ultimately, the 3.8% rate for supplemental is somewhat misleading. In terms of actual price, if a person were paying $1,000 per year for supplemental, the following year, the policy will not go up $38; it will increase between $83 and $88 because premiums incorporate inflation and age rating.

HealthView anticipates out-of-pocket costs to grow by 3%-3.5% annually (Table F).

4. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/downloads/proj2014.pdf

TABLE F: PROJECTED COST-SHARING INFLATION RATE FROM 2016 TO 2017	
Service	**With Gap Insurance**
Hospitals	3.0%
Doctors and Tests	3.4%
Prescription Drugs	3.5%

Out-of-pocket inflation remains reasonably low and appears to be aligned with historic U.S. inflation rates.

IMPACT OF HEALTH STATUS AND LONGEVITY

According to HealthView's latest longevity data, a healthy 55-year-old couple is expected to live to age 87 (male) and 89 (female). Assuming they live two years beyond their average, (89 and 91 respectively), the couple could pay an additional $23,853 (in today's dollars) in Medicare Part B, D, and supplemental insurance premiums.

While annual costs may be lower for a healthy individual, that person's total lifetime costs will actually be higher than someone who suffers from a chronic health condition. In simple terms, living longer mean more years of paying for health care.

Table G summarizes the cost implications for a 55-year-old female who files for Medicare benefits at age 65.

TABLE G: IMPACT OF HEALTH CONDITIONS (FUTURE DOLLARS)				
Gender	**Age**	**Condition**	**Life Expectancy**	**Lifetime Costs (B, D, supplemental, and out-of-pockets)**
Female	55	Type II Diabetes	80	$267,878
Female	55	No Conditions	89	$523,737

A healthy 55-year-old female with a life expectancy of 89 can expect to pay $255,859 more than someone with type 2 diabetes and a life expectancy of 80.

For men, based on a ten-year difference in life expectancy, the cost variance between a diabetic and healthy male, both aged 55, will be $251,850.

The length of a person's life may be the single most determining factor in projecting total health care costs; therefore, expected longevity, which is largely based on individual health conditions, must be factored into all retirement plans.

IMPACT OF GENDER

Life-expectancy differences between genders range between two and four years (depending upon current age). Longer life expectancies, coupled with the effects of a compounding inflation rate, mean that women will, on average, spend more than males on retirement health care (Table H).

TABLE H: COST VARIANCES BY AGE AND GENDER (IN TODAY'S DOLLARS)

Gender	Age	Condition	Life Expectancy	Lifetime Costs (B, D, Supplemental, dental, and out-of-pockets
30	Female	91	2051	$548,098
30	Male	87	2051	$429,466

Table H shows a healthy 30-year-old woman is projected to spend $118,632 more in total health care costs than a healthy male of the same age. The variance is triggered by higher health care outlays directly related to the compounding effects of inflation in the final fours years of life.

IMPACT OF RESIDENCY

State of residency plays an important role in the variable cost of Medicare Part D (prescription drug coverage) and supplemental insurance premiums.

Private companies sell supplemental insurance, which can help defray the costs of some services not covered by Medicare. These can include, but are not limited to, additional hospital care, co-payments, and deductibles. Purchasing plans is not mandatory, but does provide additional piece of mind…at a price.

Prescription drug and supplemental insurance policies are regulated by state, which approves carriers, policies that can be sold, and associated pricing. Therefore, it is important to use state data, rather than national averages, when planning for retirement at an individual level.

There are currently 10 supplemental plans available. Because coverage and costs vary by state, retirees can face much higher expenses depending on where they choose to live. Based on the latest projections (taken from Plan F, currently the most popular supplemental plan), Table I reveals a 49% difference in supplemental premiums between Hawaii and Massachusetts.

TABLE I: SUPPLEMENTAL INSURANCE STATE-TO-STATE PREMIUM COST COMPARISON FOR 55 YEAR-OLD FEMALE IN FUTURE DOLLARS					
State	Age	Life Expectancy	Retirement Age	Coverage	Total Health Care Costs
HI	55	89	65	Supplemental Insurance (Policy F)	$116,790
MA	55	89	65	Supplemental Insurance (Policy F)	$173,583

While the cost of a supplemental policy may not be the deciding factor in this person's retirement destination, knowing that she may require an extra $57,000 for a supplemental plan in Massachusetts may change her savings strategies.

It is also worth noting that Plan F will be required to reduce benefits in 2020. The Plan's comprehensive coverage has triggered more frequent use of medical services by participants, and this adjustment is further evidence of ongoing efforts to manage costs at the federal level.

MEDICARE SURCHARGES

One of the most important (yet somewhat overlooked) developments during the last year was legislation to lower the top three modified adjusted gross income MAGI brackets that determine Medicare surcharges. (This begins in 2018.)

Since the passing of the Affordable Care and Modernization of Medicare Acts, Parts B and D are now means-tested. For subscribers, this means that higher incomes equal higher premiums. Medicare assesses surcharges by measuring MAGI, which comprises almost every potential source of income – including working in retirement, 50% of Social Security income, tax-deferred pensions, required minimum distributions, earned interest, and capital gains.

According to a 2014 report from The Urban Institute for the Kaiser Family Foundation, Medicare means testing will impact 25% of all Medicare subscribers by 2036.[5] While the new legislation may not necessarily affect the number of Americans who could be means tested, it will alter how much people who fall into the top three brackets will have to pay.

Table J below is a breakdown of the current Medicare MAGI brackets.

TABLE J: MEDICARE MEANS TESTING THRESHOLDS: NATIONAL AVERAGE FOR 65 YEAR-OLD MALE		
Income Level (Individuals)	Income Level (Married)	Total % Increase
$85,000 or less	Under $170,000	--
$85,001 - $107,000	$170,001-$214,000	37%
$107,001 - $160,000	$214,001-$320,000	93%
$160,001 - $214,000	$320,001-$428,000	150%
Above $214,000	Above $428,000	205%

5. Cubanski, Juliette, Neuman Tricia, Jacobson Gretchen, and Smith E. Karen. "Raising Medicare Premiums for Higher-Income Beneficiaries: Assessing the Implications. The Henry J. Kaiser Family Foundation. 29 Jan. 2014

The revised income tiers will place a larger number of affluent retirees into higher brackets. (See Table K.) Also, since the levels are not currently indexed to inflation, as salaries grow over time, many middle-class retirees may eventually fall into upper MAGI brackets and face even higher surcharges.

TABLE K: MEDICARE MEANS TESTING THRESHOLDS: NATIONAL AVERAGE FOR 65 YEAR-OLD MALE

Income Level (Individuals)	Income Level (Married)	Total % Increase
$85,000 or less	Under $170,000	--
$85,001 - $107,000	$170,001- $214,000	37%
$107,001 - $133,500	$214,001- $267,000	93%
$133,501 - $160,000	$267,001- $320,000	150%
Above $160,000	Above $320,000	205%

It is worth noting that the percentage range of means testing surcharges can vary slightly by state and age. For example, Alabama's metrics for their lowest and highest brackets are 36% and 196%, while New York's are 38% and 213%, respectively.

While the bracket adjustments take effect in 2018, the two-year look-back will measure income earned in 2016. This means that events such as the selling of a home or the death of a spouse (which can place the survivor into an over-$85,000 individual bracket) may lead to unanticipated surcharges in two years.

Aside from life-changing events, even the simple effect of rising wages over time can push an average worker over the first bracket.

Let's examine the potential impact of means testing on an individual by comparing two 40-year-old males: one earns an annual income of $40,000; the other earns $75,000, and (it is assumed) salaries increase by an average of 3% a year.

TABLE L: IMPACT OF MEANS TESTING ON TWO 40-YEAR-OLD MEN

Age	Salary	Annual Increase	Salary at Age 66	Income Bracket	Surcharge %	Medicare Part B and D Premiums	Medicare Part B and D Surcharges
40	$40,000	3%	$86,264	2nd ($85,000 to $107,000)	36%	$189,268	$68,148
40	$75,000	3%	$161,744	5th ($160,000 or more)	201%	$189,268	$380,754

Table L reveals that even a person with a modest annual income will initially enter the second means testing bracket, triggering a 36% surcharge. A 40-year-old earning $75,000 will be propelled into the fifth bracket and may face nearly $400,000 in surcharges. Once again, the data reveals that even average-earning Americans will face significantly higher lifetime health care costs because they have a longer time horizon until retirement.

These projections illustrate that means testing will be a critical issue for future retirees. However, with the right

mix of investment products, such as a Roth 401(k), HSA and life insurance (which do not count toward MAGI), costs can be managed. Proper planning at an early age could ultimately help save tens – or possibly even hundreds – of thousands of dollars in retirement.

HealthView Services' Insights paper, "Understanding the Impact of Modified Adjusted Gross Income on Retirement Health Care Costs: Strategies to Reduce Medicare Income Surcharges," [6] provides much greater detail on this topic, as well as strategies that detail how careful portfolio management can significantly reduce the risk of means testing.

RETIREMENT HEALTH CARE COST INDEX

In the spring of 2014, HealthView Services introduced its Retirement Health Care Cost Index®, a gauge that measures the percentage of Social Security required to cover total retirement health care costs.

Two major developments from this past year have affected previous projections.

The Index continues to assume that individuals will fully optimize Social Security at their full retirement age, but no longer have access to the File Restricted strategy. This change is a net-negative for the Index and means that a greater portion of Social Security will be required to cover health care costs.

The expectation that Social Security COLAs will rise at close to 3% going forward, compared to our previous projection of 2%, is a net-positive for the Index, since retirees will receive higher benefits than prior estimates.

In 2016, the average 66-year-old couple will require 57% of their lifetime pre-tax Social Security benefits to pay for health care costs, compared to 67% in 2015.* A 55-year-old couple will need 88%, and a 45-year-old couple, 116%.

In the event COLAs are lower than what has been forecast by the Social Security Trustees, the Index will rise and a greater portion of benefits will be needed for health care.

Table M examines a 66-year-old couple receiving average Social Security benefits based on a Primary Insurance Amount (PIA) of $26,544 per year. The chart reveals (in five-year increments) that Medicare premiums will consume, on average, 40% of the couple's total Social Security income at age 70 – and up to 75% per year by age 87.

**Note that these estimates do not include end-of-life costs for long-term care expenses.*

6. http://www.hvsfinancial.com/wp-content/uploads/2014/12/Means-Testing-White-Paper.pdf

TABLE M: ANNUAL PROJECTED COSTS VS. SOCIAL SECURITY COLAS (In Future Dollars Based on Social Security Trustee Projection for Annual COLA Increase)* Average 66-Year-Old Couple

	Annual Health Care Costs (in Future Dollars)	Social Security	Annual Difference	Percent of Social Security Dedicated to Health Care Costs
Age 70	$13,944	$34,464	$20,520	40%
Age 75	$19,291	$39,375	$20,084	49%
Age 80	$26,429	$44,986	$18,557	59%
Age 85	$35,808	$51,395	$15,587	70%
Age 87	$40,458	$54,208	$13,750	75%

**Data is based on this couple optimizing Social Security benefits at their full retirement age. 2016 COLA is 3.1%. All future COLAs are 2.7%.*

Let's place the findings from Table M into some context. Health care inflation is expected to outpace Social Security COLAs for the foreseeable future. This compounding effect of this differential means that over time, medical-related outlays may slowly exceed gross Social Security income. When this couple is 87 years old, health care costs will equate to approximately 75% of their gross Social Security benefits. This is certainly troubling for anyone near retirement age, but may have implications for workers in their forties and fifties because a longer time horizon creates a larger differential between health care inflation and COLAs.

Ultimately, if these projections are correct, in the coming decades, many retired Americans could eventually see their Social Security income completely absorbed by health-related expenditures.

SECTION 3: RETIREMENT PLANNING

The averages used in this report are a valuable metric for scaling future health care expenses. Given the significant difference in costs by age, health status, gender, state of residence, and income, it is important to base future health care expenses on individual circumstances.

Table N displays monthly savings needed to cover Medicare Part D premiums. It is assumed that Part B premiums will be deducted from Social Security payments. Required savings are based on a 6% return.

TABLE N: SAVINGS REQUIRED BY COUPLE TO FUND ORIGINAL MEDICARE PREMIUMS BY TIME HORIZON (IN FUTURE DOLLARS)**

Age	Life Exp.	Retirement Age	Coverage	Total Cost	Required Monthly Savings*
60	87/89	65	Medicare Part D	$159,763	$998
55	87/89	65	Medicare Part D	$234,745	$627
45	87/89	65	Medicare Part D	$506,797	$485

***Converting lump sums into monthly savings provides the proper context to illustrate long-term funding strategies.*

Once again, the most critical variable is age. Table N shows that a 45-year-old couple's Medicare Part D (prescription drug coverage) premium costs will be approximately $347,000 higher than a couple at age 60 because of the compounding effect of health care inflation. However, the younger couple's monthly savings requirements are actually less because they have a longer time horizon to prepare.

Every retiree should have enough money saved to cover Part D, but those who want to enjoy more inclusive coverage should not only start early, but also put away enough to afford a supplemental insurance. Policies can be very effective in addressing services not provided by Medicare, but monthly premiums are expensive and should be budgeted into retirement plans.

TABLE O: SAVINGS REQUIRED FOR COUPLE TO FUND BASIC MEDICARE AND SUPPLEMENTAL INSURANCE PREMIUMS BY TIME HORIZON (IN FUTURE DOLLARS)

Age	Life Exp.	Retirement Age	Coverage	Total Cost	Required Monthly Savings**
60	87/89	65	Part D and Supplemental	$394,257	$2,501
55	87/89	65	Part D and Supplemental	$517,309	$1,401
45	87/89	65	Part D and Supplemental	$917,087	$881

Table O replicates the previous projections and adds costs from purchasing a supplemental policy, which can significantly increase the necessary monthly savings. Once again, however, the earlier an individual begins to save, the lower the monthly amount needed.

INCOME REPLACEMENT RATIOS

Millions of Americans are already saving for retirement health care costs through income replacement ratios (IRRs).[7] As outlined in a HealthView Insights paper published at the end of last year, "Retirement Health Care Costs and Income Replacement Ratios," [8] IRRs incorporate a portion of retirement health care savings, but there is a considerable gap between what is included in IRRs and what they will actually need.

Since most Americans are only paying 25% of their health care costs when working, IRRs typically only include this portion in their calculations. IRRs also generally assume that household expenses in retirement can be projected forward using an average U.S. inflation rate of 2.5% to 3%, but fall short compared to the 5.1% expected for health care over the next several years. The compounding effect of this disparity will widen the gap between retiree savings and health-related expenditures.

An additional assumption built into IRRs is average longevity. Living longer will result in higher health care costs, and consequently, more savings will be needed to fund them. Lastly, Medicare surcharges are not factored into standard income replacement ratios.

7. http://www.gao.gov/assets/680/675526.pdf
8. http://www.hvsfinancial.com/wp-content/uploads/2015/11/Retirement-Health-Care-Costs-and-Income-Replacement-Ratios-Final.pdf

INCOME REPLACEMENT RATIOS: A CASE STUDY

JOHN AT 55

Let's examine a 55-year-old healthy male named John who is retiring at 65, will earn under $85,000 per year, and has a life expectancy of 86. In retirement, if he wants comprehensive coverage, he will need to save for Medicare Parts B, D, a Medicare supplemental plan, dental insurance, and all other out-of- pocket costs. (Totals are based on the national average and presented in real dollars.)

As Table P indicates, if John hadn't already partially saved through his IRR-based plan, he would need a lump-sum investment of $81,328 to pay for his health care in retirement.

TABLE P: SAVINGS NEEDED TO COVER HEALTH CARE WITHOUT AN IRR-BASED SAVINGS PLAN

Total Cost for Coverage	Lump Sum Investment at age 55 without IRR Retirement Plan Based on a 6% Return	Annual Savings for 10 Years starting at 55
$388,870	$81,328	$10,424

John's assumed that using an 80% IRR in his 401(k) would cover all of his health care, but as illustrated in Table Q, John must add $25,679 to reach that goal. A modest $3,291 annual investment, (or $274 per month) over ten years at a 6% return would also allow John to the close this gap.

TABLE Q: SAVINGS NEEDED TO COVER HEALTH CARE WITH AN IRR-BASED SAVINGS PLAN

Total Cost for Coverage	Lump Sum if Meeting IRR Requirements	Annual Investment
$388,870	$25,679	$3,291

If John decides to take action, he will need to increase his 401(k) contributions by $84 per pay period (assuming 26 pay periods in a year and a 50% employee match).

As mentioned earlier, it is also important to remember that Medicare surcharges are not included in standard IRRs. For example, if John's retirement MAGI income surpasses $85,000 annually, his premiums may be significantly higher because of means-testing surcharges.

SECTION 4: CONCLUSION

Driven by age, health care inflation (which continues to be a multiple of the U.S. inflation rate), and cost shifting, health care expenses are on a path to exceed Social Security benefits for many future retirees. This potential income loss underscores the need to build diversified retirement portfolios and maximize 401(k) and HSA contributions.

Another key takeaway is that a growing number of Americans will, over time, be affected by Medicare means testing. As shown, this is not an exclusive problem for the wealthy, but an emerging issue for future middle-class retirees. Managing MAGI through careful product selection can help minimize the impact and potentially save the next generation of retirees tens – and possibly even hundreds – of thousands of dollars.

When planning for health care, it is valuable to understand big-picture costs to frame the issue, but essential to plan at an individual level. Location, health condition, gender, coverage options, and income all have an impact. Factoring these variables is a starting point for making informed retirement investment decisions.

Lifetime health care expenses will be far higher than most imagine, but for those who start saving early or are already using IRR-based savings approaches, putting sufficient funds aside is within reach. In fact, when this data is shared with advisor clients and plan participants, many increase contributions to ensure health care is covered.

Several developments during the past year have changed the retirement landscape in a number of important ways, but the data continues to lead to one conclusion: health care costs are rising and need to be meaningfully addressed in the financial planning process.

ABOUT HEALTHVIEW SERVICES

Founded in 2008 by a team of seasoned financial professionals, health care industry executives, and expert physicians, HealthView Services is the nation's leading producer of health care cost-projection software. The firm's suite of tools is designed to prepares current and future retirees for the impact of retirement health care costs.

The company's signature service, HealthWealthLink, is an integrated retirement-planning platform that draws upon cost data from more than 50-million annual health care cases to create personalized estimates of retirement health care costs. The system also furnishes advisors with the necessary tools and information to implement financial strategies that can help clients offset this expense and achieve retirement goals. Health care cost-planning tools for individuals are also available through the company website.

HealthView has emerged as a respected thought leader in addressing the issue of affording quality health care in retirement, and the company has produced extensive educational content on the importance of integrating medical expenses into the planning process. The company has also released several white papers on topics ranging from health care cost-management strategies to income replacement ratios.

HealthView's unique approach to retirement planning and unparalleled expertise in health care cost projections has placed the firm at the forefront of this emerging domain.

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