4 Ways to Keep Long Term Care Costs from Devastating You and Your Family

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75% of Americans who reach the age of 65 will need long term care services at some point in their lifetimes, according to the U.S. Department of Health and Human Services. And every day, 10,000 more Baby Boomers turn 65. The size of the Baby Boomer generation, coupled with increased longevity, makes it likely that the percentage of older Americans needing LTC will go even higher.

Yet in spite of the likelihood of needing long term care – and the increasing cost of LTC services – less than 20 percent of Americans (fewer than 8 million) have long term care insurance, according to the American Association of Long-Term Care Insurance. And another study showed that 74 percent of Americans worry about being able to afford healthcare when they retire, but only 22 percent have factored it into their retirement plans. "The need for long term care continues to pose a significant, largely unprotected financial risk for Americans, especially generations nearer to retirement," says Michael Doughty, president of John Hancock Insurance.

Genworth, a leading provider of long term care voluntary plans, estimates the annual national median cost of LTC services to range from $43,536 for an assisted living facility to $92,376 for a private room in a nursing home. It can cost even more, depending on the state in which you live. (A private room in a nursing home in Massachusetts, for example, runs $144,175 per year, in Connecticut it's $160,600, and in Alaska, a whopping $292,000. And the costs are rising, with assisted living costs up two percent over the last five years and nursing homes up three percent.

In its 2016 Retirement Healthcare Costs Data Report, HealthView Services projects that the average healthy 65-year-old couple retiring this year will spend over $377,000 in their lifetimes on healthcare, including Medicare premiums, supplemental insurance and dental, vision and hearing coverage. (HealthView is a leading provider of healthcare cost tools and data to the financial and healthcare industries.) Add to that the cost of staying in a nursing home for a couple years and out-of-pocket medical expenses can quickly exceed half a million dollars.

Marguerita Cheng, a certified financial planner(tm) and CEO of Blue Ocean Global Wealth, says "everyone needs a plan for how they are going to handle long term care. They need to consider who will provide the care, who will receive it, and how they will pay for it."

Options for Funding Long Term Care

So why aren't more Americans planning for LTC services?

Part of the problem is that many people don't understand all the options available for funding long term care. Secondly, the options can be complicated – and costly. That said, planning for healthcare costs in general, and long term care in particular, is essential to a secure retirement. "It can be really confusing," says Cheng. "Not every option is going to be right for you…The key is to do what's most appropriate for your situation."

1) Self-Funding

One possibility is to self-fund long term care. Because of the high cost of LTC, self-funding is usually limited to higher income individuals and families, people who can comfortably set aside $200,000 or $300,000 in case they need it for LTC sometime in the future. If your assets are more modest, then self-funding becomes a riskier proposition. Conversely, if you do need LTC, the expense can quickly erode the nest egg you hoped to pass on to heirs. There's even the risk that your savings could be completely exhausted, leaving your family to deal with the LTC bill and causing additional family hardships.

Money set aside in a Health Savings Account can also be used to pay for LTC, even if you're 65 or over and can no longer contribute to an HSA. Another way to self-fund LTC without exhausting your assets is to purchase a deferred income annuity that would cover the costs of LTC at an advanced age.

One of the most attractive aspects of self-funding is that if you never need LTC services, the cost to you is zero. Another advantage of self-funding over insurance is that the money saved by not paying insurance premiums can be invested and allowed to grow. This could be especially beneficial to younger retirees and pre-retirees who are probably decades from needing LTC. By investing more and allowing those investments to grow, enough income could be generated to cover much, if not all, of your LTC expenses.

2) Medicaid

Many people who find themselves struggling financially, plan on using Medicaid to pay for their long term care. (Contrary to the belief of many, Medicare does not cover long term care services.) The problem with relying on Medicaid is that to qualify for coverage, all your other assets need to have been depleted. That means having little or no extra cash and no nest egg to leave to heirs. (Medicaid qualifications, including assets and medical need, vary widely by state.) According to Bill Good Marketing, another risk is that you may receive lower quality care because Medicaid's reimbursements to LTC facilities is often lower than the facility's costs.

Despite the drawbacks, Darin Shebesta, vice president at Jackson/Roskelley Wealth Advisors, still sees Medicaid (or a similar program) as the best option for some individuals. "With $300,000 or less in assets, spend that money down and go to a state-covered program because you may not have the ability to buy coverage," he says.

However, there is a strategy by which you can qualify for Medicaid and still preserve your assets. You can set up a "Medicaid-proof trust" that places your assets in an irrevocable trust to be passed on to your heirs. Medicaid-proof trusts are often used by people with average assets that want to plan for LTC but don't want to pay LTC insurance premiums or use their savings to pay for it. These kinds of trusts can be complex and should be written by a professional to ensure their enforceability. Medicaid-proof trusts also require forethought; assets going into the trust must be moved there at least five years prior to applying for Medicaid.

3) Private Insurance

LTC insurance is designed to cover the costs of long term care for a set period of time or up to a certain dollar threshold. Unfortunately, such insurance policies are expensive and can be confusing. Some policies preserve the right to increase premiums, making planning for them more difficult. And if you're lucky enough to never need LTC services, all the money you spent on premiums will have gotten you nothing -- other than very expensive peace of mind.

Long term care insurance has been in existence for 30 years but the market for LTC insurance policies has been declining. In the 1990s, over 100 insurers offered policies. "Today, the number of companies offering coverage is down to about a dozen," says Darla Mercado, a personal finance writer for CNBC. And if you compare today's policies to those written 25 years ago, "clients who buy coverage today generally are also paying more for less generous benefits," says Mercado. (One exception is that most of today's policies provide coverage for nursing homes or in-home care. In 1990, the majority of policies covered only nursing home care.)

Both traditional and hybrid policies come in a variety of flavors with a number of options from which to choose. When selecting a policy, Wade Pfau, Principal at McLain Asset Management, says there are four criteria to consider for every policy:

- How much time passes before benefits start,
- How much in benefits is provided per time period,
- How long benefits are provided, and
- The total benefit pool available to be used.

Waiting Period: One of the first criterion to consider is how long you'll have to reach into your own pocket to pay LTC costs before the policy kicks in. In some ways the waiting period is equivalent to the deductible you pay on other types of insurance. The waiting period is important for two reasons. First, it has a direct impact on the cost of the policy. All else being equal, the longer the waiting period, the less expensive the policy. Second, because many long term care situations last only a short time, having a very long waiting period may not make sense.

You should also keep in mind that Medicare or your private health insurance may pay for some of the initial costs, taking some of the sting out of the waiting period. And a longer waiting period may be advantageous if you have sufficient assets to pay for the first six to 12 months of LTC and are mostly concerned about protecting yourself against more catastrophic events.

Benefits Per Period: Pfau explains that "most benefits are defined in terms of a monthly or daily maximum payable benefit amount. Determining the appropriate level depends on the cost of care in your community and your ability to partially fund some expenses in other ways." Most policies pay benefits for a set period of time, usually one to five years. However, most will extend the period if the total pool of benefits has not been exhausted.

Benefit Pool: The benefit pool is the maximum dollar amount a policy will provide, regardless of the policy's original period of coverage. For example, let's use a policy that pays a maximum of $250,000 in LTC coverage and provides up to $200 per day for up to five years. At that rate, the benefit pool will be totally spent after 178 weeks ($200 X 7 X 178 = $249,200) and payments will stop.

Inflation Protection: Because you may not need benefits for 20 years or more after taking out a policy, it is almost certain that the cost of LTC will be significantly higher than when the policy is written. That's where inflation protection comes in. Although it adds to the cost of premiums, inflation protection can offset at least some of LTC's skyrocketing costs.

According to Pfau, "common options for inflation include no benefit growth, a simple growth rate, or a compounding growth rate." In general, available growth rates range from 3 to 5 percent. With no growth, the benefit amount remains the same regardless of how long the policy is in effect. The simple growth option adds a fixed amount to the initial benefit each year.

And with the compounding growth rate, a pre-determined percentage is added to the most recent benefit amount, not the initial amount.

Let's use Jason as an example. At 45-years-old, Jason takes out a LTC insurance policy in 2016 with a benefit of $5,000 per month. If Jason does not add inflation protection and has to go into a nursing home in 40 years, his maximum benefit will still be $5,000 per month. If Jason had gone with the 3 percent simple growth rate option, in 2056 his benefit would be $11,000 per month. And if the compounding growth rate of 3 percent had been selected, Jason's benefit would be $16,310.

Since there's no way to know when – or even if – you'll need LTC, there is no clear answer as to what the best option might be for you. Again, the determining factor may be cost. Simple growth will increase your premium, compounding growth will increase it more. And the higher the growth percentage, the higher the cost. If you can afford it, some sort of inflation protection seems prudent. And the younger you are, the more important the protection is.

4) Hybrid Insurance Plans

For many Americans, LTC insurance policies are cost-prohibitive. Others object to the use-it-or-lose-it nature of traditional policies. In response, some companies now offer **hybrid policies**. These plans combine LTC insurance with an annuity or a life insurance policy with a cash value.

Hybrid policies provide additional flexibility over conventional LTC policies. For example, whatever funds are not used for LTC can be left to heirs. Some policies even allow the funds to be tapped for *any* reason, once a certain amount of time has passed. And once that threshold has been reached (usually 7 to 10 years), you have the option of dropping the policy and getting back much of what you paid in premiums.

Another advantage of hybrid policies is that the premiums are fixed and the benefits are guaranteed. After a certain number of years (again, usually 7 to 10), as long as you are current on premiums, your amount of LTC coverage, your death benefit, and your policy's cash value will all be guaranteed. For traditional LTC policies, on the other hand, an insurer can petition its state's department of insurance to increase premiums or lower the benefits associated with existing premiums.

Because they do several things and because their premiums are often paid over a shorter time frame, hybrid policies are more expensive than their traditional counterparts, putting them out of reach of many families.

Looking Ahead

One of the biggest concerns of senior citizens is the high cost of medical care in retirement, including long term care. Healthcare costs are skyrocketing with little relief in sight. In fact, there's every reason to believe that the issue will get worse. As we age, the likelihood of needing medical care increases. And thanks to advances in medicine, we can expect to live longer than ever before.

So, what's the best way to plan for LTC coverage? For the ultra-wealthy, self-funding would usually work. For people at the other end of the financial spectrum, Medicaid is probably the best option. But for everyone in between – the vast majority of Americans – there is no clear cut answer.

Each option for funding LTC comes with advantages and disadvantages, many of which may not be immediately clear to the average consumer. LTC insurance policies can be especially difficult to understand. Given what's at stake, seeking the counsel of a financial advisor may be prudent. A financial advisor can look at your entire financial picture and goals and determine what the best course of action for you may be.

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- *Long term care is just one aspect of healthcare in retirement. For a broader perspective, check out our white paper, "How to Keep Healthcare Costs from Ruining Your Retirement."*

- *To get a second opinion on your retirement outlook and portfolio, visit www.theprovestperspective.com or call 800-277-0025.*

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