

Motley Fool's Rule Your Retirement Newsletter

The Annual Cost of Health Care in Retirement

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One of my side-of-desk roles here at The Motley Fool is to act as a financial sounding board to my fellow professional Fools. Recently, a colleague shared an elaborate spreadsheet he'd created that chronicled and categorized all his expenses for the past several years and projected how much he'd need in retirement. It was quite impressive.

Although a lot can change between now and when he retires — this savvy Fool is in his 30s — I think that if anyone can rely on a projection of future expenses, it's this fellow.

But there's one retirement expense that even he will have trouble predicting: health care.

Many factors determine how much someone will pay for health care in retirement:

- The Medicare plan(s) chosen by the retiree
- Changes to Medicare instituted by Congress or the U.S. Department of Health and Human Services
- The retiree's health status at retirement, and any conditions or accidents that occur over the course of retirement
- Whether the retiree will receive any health-care benefits from former employers, and any future changes to those benefits
- Where the retiree lives

Despite the challenges, several organizations have gamely attempted to estimate how much health care will cost in retirement. The most well-

known is [Fidelity's annually updated estimate](#), which currently says that the average retired couple (both age 65) will need \$280,000 saved just to cover medical costs. The [Employee Benefit Research Institute](#) estimates that a 65-year-old male needs \$131,000 saved and a 65-year-old female needs \$147,000.

Yet most people don't think in such lump-sum terms. And neither do most retirement-planning software applications or calculators. Rather, retirement finances are usually framed as lining up *annual* income with *annual* expenses and seeing whether the former will be enough to cover the latter.

So how much should a retiree expect to spend each year on health care? A recent [report](#) from Vanguard has some informative guidance.

Plan for Your Retirement OOPs

Vanguard teamed up with Mercer Health and Benefits to create realistic forecasts for out-of-pocket (OOP) health-care expenses in retirement. They started by classifying retirees into three risk categories: low, medium, and high. An individual's category is determined by tobacco use, frequency of doctor visits, and the presence of any of the 12 health conditions most associated with higher medical care:

- Hypertension
- Hyperlipidemia (high cholesterol)
- Rheumatoid arthritis, osteoarthritis
- Heart disease (ischemic heart disease, heart failure, acute myocardial infarction)
- Diabetes
- Chronic kidney disease
- Depression
- Alzheimer's disease, senile dementia, and related disorders
- Chronic obstructive pulmonary disease

- Cancer (colorectal, breast, prostate, lung)
- Asthma
- Osteoporosis

Those who fall in the highest 25% of health-care costs are considered high-risk, and typically smoke, frequently visit medical professionals, and have two or more of the aforementioned chronic conditions. Low-risk retirees, who tend to be non-smokers and are free of chronic conditions, fall into the bottom 25% of medical expenses. Medium-risk retirees, as you probably guessed, are in the middle 50%.

That said, most of the discussion in the report ignores the low-risk category, presumably because it's not prudent for retirees to base their forecasts on best-case scenarios.

The report also illustrates how the choice of Medicare plan can affect costs. The following table delineates the annual total health-care costs for a 65-year-old female in 2018, based on the medium- and high-risk categories, as well as a worst-case scenario of incurring expenses in the highest 10%. (Note: [This page](#) shows the differences among the supplemental, or Medigap, policies.)

	Medium-Risk	High-Risk	Worst-Case
Traditional Medicare	\$3,800	\$7,200	\$20,000
Supplemental F	\$5,200	\$6,500	\$10,900
Supplemental L	\$4,800	\$6,800	\$13,000

The Vanguard-Mercer report assumes that a Supplemental F policy with prescription-drug coverage is a good baseline policy and uses it to illustrate how age affects annual costs.

	Medium-Risk	High-Risk
Women Age 65	\$5,200	\$6,500
Women Age 75	\$7,900	\$10,300
Women Age 85	\$10,100	\$13,900

What Should You Assume?

If you're already retired, you already have a good idea of how much health care is costing you. The costs will rise every year, at a rate that exceeds overall inflation. Based on information in the 2017 Medicare Trustees report, the Vanguard-Mercer report assumes expenses for Medicare-eligible retirees grow at 5.6% a year. The growth rate will probably decline in the coming years, but for now, it's reasonable to assume your health-care costs will increase by that much each year.

The figures provided in the Vanguard report are also good guidelines. For additional opinions, try the cost-estimation tools from [AARP](#) and [Fidelity](#). The farther you are from retirement, the more you'll have to adjust estimates for inflation.

As illustrated in the Vanguard report, choosing the right Medicare policy for you is crucial. If you need help, consider getting assistance from [Medicare.gov](#), the [State Health Insurance Assistance Programs](#), or a professional expert (such as the folks at [GoodCare](#)).