HumbleDollar

Nursing Dollars

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LONG-TERM CARE is the elephant in the room that many of us try mightily to ignore. It's a potentially huge expense: A semi-private room in a nursing home costs an average $89,297 a year, according to Genworth Financial.

But what should we do about it? For answers, I turned to Christine Benz, director of personal finance at Chicago financial researchers Morningstar Inc., where she's worked for more than 25 years. Benz has written extensively on long-term care (LTC). She's also had personal experience: Together with her sisters, she helped oversee the care for her elderly parents.

How big is the risk? Half of folks turning age 65 will eventually need some form of long-term care, as Benz notes in her latest annual compendium of LTC statistics. But at any given time, the vast majority of those receiving care aren't in nursing homes. Instead, they remain at home, often receiving help from unpaid caregivers, such as their friends, spouse and adult children.

But as Benz can attest, the logistics of home-based care are daunting. "You really need a trusted adult child to help you make it all happen—the hiring of caregivers and the managing of caregivers and the maintenance of the home," she says. "There are all these things that swirl around staying in your home. You need to make sure your children are on board with that plan."

While most LTC takes place at home, half of those 65 and older will, at some point, find themselves in a nursing home, calculates Boston College's Center for Retirement Research. But 50% of the men and 39% of the women who spend time in a nursing home stay three months or less, which means Medicare likely paid at least part of the cost, assuming the nursing home stay followed a qualifying hospital stay.

Not everybody gets off so lightly. The U.S. Department of Health and Human Services estimates that 15% of those 65 and older will rack up long-term-care costs of $250,000 or more (and the tab would likely be far larger, if we put a dollar value on the unpaid help from friends and family). If you have few assets, much of this cost will be picked up by Medicaid. What if you don't? It could be coming out of your pocket.

Should you buy insurance? If you have less than, say, $300,000 in savings, you should probably skip LTC insurance. By the time you need nursing home care, you'll likely have depleted your savings—or close to it—and hence you will qualify for Medicaid, which pays some 60% of U.S. nursing home costs. One downside: You'll face limits on where you can receive care.

At the other end of the wealth spectrum, you might consider self-insuring (though Benz prefers the phrase "self-funding," noting that there's no risk pooling involved—a key component of any form of insurance). In the past, I've suggested that those with portfolios of $1 million and up can probably afford to pay LTC costs out of pocket. Between portfolio withdrawals and Social Security benefits, the cost should be manageable.

Benz sets the level even higher—at perhaps $1.5 to $2.5 million—and she may indeed be right. As she notes, the right number depends on a host of factors, including the cost of nursing homes in your area and whether you're married. Benz also points out that folks with a high spending rate early in retirement may not be left with enough to cover nursing home costs, even if they do quit the workforce with $2 million.

If you have a handle on local LTC costs, she says you might set aside enough to cover, say, 2½ years of nursing home expenses in a separate investment bucket—and perhaps twice that sum if you're married. Even then, be aware of what Benz calls a "fat-tail event"—the risk that you're among the 10% of nursing home residents who stay five years or more. How would you cope with that cost?

For those who plan to pay LTC costs out of pocket, Benz suggests saving traditional IRA assets for that moment. Yes, withdrawals will be taxable as ordinary income. But you'll likely have hefty tax-deductible health-care costs, and you can use the deduction to trim the tax hit on your IRA withdrawals.

What type of insurance should you buy? It's the middle group—those with between, say, $300,000 and $1.5 million—who should seriously consider buying LTC insurance. Problem is, the insurance industry hasn't exactly covered itself with glory. "It's hard to vouch for the long-term-care insurance market," Benz says.

Many policyholders have been hit with alarmingly large premium increases—sometimes so large that they can no longer afford their policy, forcing them to either drop the coverage or see if the insurer will allow them to continue paying their current premium in return for a reduced benefit.

Faced with this sorry history, folks have recently turned to hybrid policies that combine, say, life insurance with an LTC benefit or a tax-deferred fixed annuity with an LTC benefit. If you use the benefit, the eventual payout on the life insurance or fixed annuity is reduced.

Sound appealing? These hybrid policies offer a way to insure against LTC costs without the risk of big premium increases down the road. But as Benz points out, these products also involve a hefty opportunity cost: In return for the LTC benefit, you're giving up the chance to invest the money elsewhere—where it could be earning far higher returns.