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CSA Society of Certified Senior Advisors®

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Many retirees face the cost of long-term care when their financial situation is far from robust. These strategies can help older adults manage the added expense.

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The cost of long-term care has been steadily rising every year. While most people agree that receiving care in their own home would be preferential to receiving care in a nursing facility, few people are protected or prepared for the level of expenses associated with this care. It is important to be aware and understand the choices available and the impact they have on long-term financial security.

TYPE OF CARE	2010	2015	2020
Homemaker Services	$ 3,432	$ 3,718	$ 4,481
Home Health Aide	$ 3,623	$ 3,813	$ 4,576
Adult Day Health Care	$ 1,300	$ 1,492	$ 1,603
Assisted Living Facility	$ 3,185	$ 3,600	$ 4,300
Nursing home care – Semi-Private Room	$ 5,628	$ 6,692	$ 7,756
Nursing home care – Private Room	$ 6,266	$ 7,604	$ 8,821

Source: California Department of Insurance

The chart above shows the average monthly cost of long-term care in the United States in 2010, 2015, and 2020 according to studies done by Genworth Financial, Inc. (California Dept. of Insurance, n.d.).

Depending on where in the country a person lives, these rates can be higher or lower. These costs do not take into account many additional expenses older adults will most likely have, including medical insurance premiums and personal care such as haircuts, clothes, entertainment, newspapers, technology, medical co-pays and deductibles, telephone, and other expenses.

Although I have not found any real statistics outlining the history of premium increases on new issue long-term care insurance policies, the statistics on existing long-term care insurance premiums have been steadily increasing at amazing rates. A report by the California Department of Insurance (2018) illustrates how high these rate increases were in 2018 for existing long-term care insurance policies already in place. Three different companies in as many states hiked their rates from more than a third to nearly double the previous charge. The chart on the next page gives examples from the report.

How can anyone but the wealthiest individuals possibly manage the cost of long-term care, given these numbers? It's not easy. It depends on a careful combination of strategies to manage income, assets, and insurance to optimize each. When done correctly, these strategies can allow older adults to preserve the retirement nest egg they spent their life building so it can last longer for them and they can pass any remaining assets to their heirs in a tax-efficient way.

Many people choose to purchase a long-term care (LTC) insurance policy. The first decision when buying LTC insurance is to choose from among desired options, such as the waiting period, daily coverage amount, inflation option, number of years of coverage, and any others that may be offered. Then compare those options with each long-term care insurance provider being considered to be sure of making a like-kind comparison. Choose wisely and read the fine print; as noted above, rates can increase dramatically.

Case Study Illustrates Pitfalls

"Bonnie" was an 84-year-old widow living at Sunny Day, an assisted living facility, when she became my client. Her mind was pretty sharp, but her health was failing. She enjoyed participating in activities and being around people, especially her family. But after a bad fall a few years ago, she had trouble walking. She also had other medical issues, which is why she could no longer live alone. The assisted living facility where Bonnie lived provided entertainment almost daily, prepared all of her meals, drove her to medical appointments, and took care of other things Bonnie could no longer do herself. She wanted to stay there as long as possible and not go to a nursing center.

Bonnie had always lived comfortably, but not extravagantly. She had Social Security, a small pension from the company she worked for, and another small pension from her deceased husband. She also had a traditional individual retirement account (IRA), some non-retirement assets, and a cash reserve. She used the dividends and interest from her assets for income. She also had a long-term care insurance policy that had been purchased many years ago.

Bonnie had three major concerns:

1. She liked to keep her mind and body as active as she could. Quality of life was of utmost importance for Bonnie.
2. She was concerned about having enough money to pay for care she may need in the future and it was important to her to be able to support herself financially and not rely on others.
3. She wanted to preserve as much of an inheritance as possible for her children when she passes away.

INSURANCE COMPANY	STATE	INCREASE REQUESTED	INCREASE APPROVED	DATE INCREASE ISSUED
GE Capital Assurance	CT	41-72%	48.15%	7/30/2018
Bankers Life and Casualty	AL	35%	35%	6/10/2018
Transamerica Life Ins. Co.	CA	97%	30% - 90%	1/15/2018

Source: California Department of Insurance

Bonnie had been residing at Sunny Day Assisted Living for a few years, had made many friends and was comfortable there. Since quality of life was important for Bonnie, the goal was for her to stay there as long as possible and not be transferred to another facility, even if one could be found at a lower cost.

Following are some general guidelines on managing health costs, and how I applied them to Bonnie's situation.

If a client has long-term care insurance, use that first.

After six months, Bonnie became ill and needed hospital care. When released from the hospital a week later, she was transferred to a nursing center for rehabilitation before she could return to the assisted living facility. This is common for many older adults and many long-term care policies pay a different benefit amount when residing in a nursing home vs. an assisted living facility, and will pay no benefit when residing in the hospital. That is one reason applying early for benefits is so important. Bonnie had a LTC policy. If Bonnie had waited too long to apply, the delay would have caused the insurance company to need to verify where she had resided each day, and it would take a lot longer to receive benefits. Additionally, it is important to apply for benefits as soon as qualifying care is required so that premium payments will stop.

Improve the opportunity to receive the maximum benefits from long-term care insurance.

Long-term care insurance can be the most cost-effective way to cover the high cost of long-term care. That can be true whether care is at home, in an assisted living facility, or at a nursing center. Bonnie had a policy to help cover the cost of care but it would not fully cover all of her costs. Often, long-term care insurance benefits go unused. Here is one reason that can happen and how to overcome it.

It can be very helpful to have a knowledgeable person, such as an LTC expert, help the assisted living facility complete the paperwork to request policy benefits. Administrators sometimes do not know what to list on the form. For example, Bonnie was pretty independent. The first time she applied for benefits she had been denied. Later, a family member helped the administrator complete the form on Bonnie's behalf and she was approved. Some of the facts that should have been listed on the paperwork the first time had been omitted. For example, the administrator stated that they did not provide care for Bonnie since she had an aide living with her. That was not true. The aide assisted Bonnie with several things she could not do on her own, but she was not a nurse and was untrained and unable to provide several areas of care Bonnie required. The facility had a nurse who daily tended to Bonnie's open wounds that she often had due to a medication that thinned her skin. There were several other areas of care the facility provided that had not been listed initially.

Had the paperwork been completed correctly the first time, Bonnie would have qualified then. The family member requested the facility backdate the paperwork to the date originally submitted since her level of care had not changed and it was not Bonnie's fault that the facility completed it incorrectly. It worked, but it took over six months for Bonnie to receive all of the benefits her policy provided.

If there is no long-term care insurance in place or if it has been depleted, consider the following strategies to preserve what took a lifetime to build so it isn't lost in the last few years.

Health Reimbursement Account (HRA) and Health Savings Account (HSA)

Many long-term care expenses are qualified medical expenses. This means they are eligible for tax-free withdrawals from the member's Health Savings Account (HSA) or Health Reimbursement Account (HRA). It is important to check with a tax advisor and/or financial advisor to determine if the member's particular expenses qualify.

Federal guidelines state people can open and contribute to an HSA if they are covered under a qualifying high-deductible health plan that meets the minimum deductible and the maximum out-of-pocket threshold for the year. They must also not be covered by any other medical plan.

For an employee's HSA, the employee, the employee's employer, or both may contribute to the employee's HSA in the same year. For an HSA established by a self-employed (or unemployed) individual, the individual can contribute. HSA funds can be withdrawn tax-free and used for care.

Income Tax Offset

In 2020, the IRS allowed all taxpayers to deduct their total qualified unreimbursed medical care expenses that exceeded 7.5 percent of their adjusted gross income if the taxpayer used IRS Schedule A to itemize deductions. This provision can save clients a lot of money, as I illustrate with Bonnie's case.

The cost of care Bonnie was responsible to pay last year at Sunny Day was estimated at $4,300 per month, or $51,600 for the entire year. Bonnie's tax advisor stated that she had approximately $54,000 in tax-deductible medical expenses for the full tax year, which included the cost of the assisted living facility, medical co-pays, deductibles, prescriptions, and other miscellaneous health expenses.

Any money withdrawn from Bonnie's traditional IRA assets (contributed pre-tax) are taxable as regular income. Also, inherited IRA assets are fully taxable (although her heirs will have ten years to withdraw the money and pay the tax).

I suggested that Bonnie consider first withdrawing $54,000 (which included her required minimum distribution) of taxable IRA assets to pay for her care. The tax can be totally offset by the medical expense deduction. If additional money was needed, she could use non-qualified assets next. All cash not needed for immediate expenses would be allocated to a non-qualified secure cash position for future expenses.

This enabled Bonnie to pay no income tax on this withdrawal and also keeps her children from paying income tax if the money is left to them. The goal is to spend taxable assets that can be offset by Bonnie's medical and other expenses, so that neither Bonnie nor her heirs will be required to pay income tax on these assets.

Bonnie's monthly income:
$ 750 Bonnie's pension
$ 800 Pension from Bonnie's husband
$1,400 Social Security (partially taxed)
$1,250 Taxable dividend and interest income
$4,200 Total monthly income ($50,400/year)

$1,700 Cost of personal care, insurance, clothes, copay, prescriptions, dental, eyeglasses, newspapers, etc.

$2,500 Net income per month x 12 = $30,000 per year available for Bonnie's care

Allocation of annual cash withdrawn:
$51,600 Cost of care
$30,000 Available from current income
$21,600 Shortage in 2020

$54,000 Withdrawn from taxable IRA account
$21,600 Needed for care
$33,600 Excess cash withdrawn to allocate for future expenses

Income Tax Rates

Some of Bonnie's taxable income was offset by her personal exemption and a portion of her Social Security was not taxable. The chart below shows that Bonnie could have a total taxable income of up to $40,525 without increasing the rate at which her income is taxed. Since implementing the previous strategy should cause no taxable income, additional money could be withdrawn if needed without causing Bonnie to be taxed at an increased rate.

2021 FEDERAL INCOME TAX RATES FOR SINGLE INDIVIDUALS (IRS, 2020):	
10%	Up to $9,950
12%	$9,951 to $40,525
22%	$40,526 to $86,375
24%	$86,376 to $164,925
32%	$164,926 to $209,425
35%	$209,426 to $523,600
37%	$523,601 or more

Remove Market Fluctuation Concerns

A solid emergency fund is an important tool in developing and sustaining financial security. Although people often hear that the rule is to have six months of living expenses set aside for a cash reserve, everyone's situation is different. For some people, that amount may not be enough to feel comfortable. On the other hand, some people feel a six-month reserve is too high.

After Bonnie consulted with her financial advisor, Bonnie's cash reserve need was determined to be $45,000.

Once the amount of cash reserve to set aside was determined, her financial advisor must calculate a reasonable estimate of the amount that will be needed from assets each year to provide for any shortage to cover Bonnie's total expenses. Then multiply that amount by three years. Add to that number a cushion for inflation and the cash reserve. For Bonnie, the numbers looked like this:

Her current annual shortage is $21,600 per year. Increase that to $25,000 for inflation and the decrease in her dividend and interest income due to liquidating assets.

$75,000 Estimated annual expense shortage for three years

$45,000 Cash reserve Bonnie agreed would be comfortable

$120,000 Total

$120,000 is the amount that should not be invested in the market and should be held in guaranteed cash accounts. Even though the return may be extremely low, no return is better than potentially losing principle due to market fluctuations.

How to Allocate the Total Cash

$120,000 Total needed

$70,000 Cash reserve and twelve-month expense shortage invested in checking, savings, and money market

$50,000 Remaining balance to apply to laddered certificates of deposit (CDs)

Laddering CDs can be a simple way to help cash reserves work harder than many checking, savings, and money market accounts. Laddering requires dividing the money into several CDs with staggered maturity dates, so that some of the cash is available to use at regular intervals. Typically, the longer the term of the certificate, the higher rate of return.

An appropriate strategy for Bonnie can be as follows:

$25,000 Twelve-month certificate of deposit

$25,000 Twenty-four-month certificate of deposit

Also research other time periods that are twenty-four months or less. Often a special rate may be available for a different time period, for example seven months or thirteen months, which could be higher than the more common six months, twelve months, and twenty-four months. This strategy can help increase the return on cash assets while allowing access without a penalty when money is needed. As each certificate matures, transfer the proceeds to the checking, savings, or money market account.

Each year, calculate a reasonable estimate of the amount that will be needed from assets to cover any shortage of Bonnie's total expenses, and transfer that amount to the plan in place for the secure assets used to maintain three years of cash needs plus the cash reserve. Keep in mind that cash can be held securely in qualified or non-qualified plans.

Reverse Mortgage

Although this strategy did not apply to Bonnie since she was living in an assisted living facility, it may be an appropriate strategy for homeowners.

Older adults living in their home who own it outright or have a lot of equity and are at least sixty-two years old can consider a *reverse mortgage*. A reverse mortgage enables money to be taken out of the value of the home in a lump sum, monthly income payments, a line or credit, or a combination of all three, all in the form of a loan. The money can be used any way the homeowner likes, including to help pay for care. The homeowner is required to keep up with property taxes, maintenance, and insurance, and cannot move into a nursing home or assisted living facility for more than a year without selling the home. It can be especially helpful for retirees with limited income and few other assets. They keep the title and the lender places a lien (or mortgage) on the home. However, if they move or if the house is sold, the loan must be repaid out of the proceeds of the sale.

Before entering into a reverse mortgage agreement, it is important to review the written estimate of the total cost, as it can be very high and varies by company. Some of the costs include:

- document preparation,
- flood certification,
- HECM counseling fee,
- mortgage insurance premium,
- origination fee,
- settlement or closing fee,
- tax payment history,
- appraisal fee,
- credit report,
- title insurance,
- recording charges, and more.

A reverse mortgage can provide cash but it can be expensive and can also complicate matters if the homeowners plan on leaving their home to their heirs. An elder law or estate planning attorney, or financial advisor, can help determine if this is a good option. I suggest reviewing all options available before applying for a reverse mortgage.

Other Important Factors to Consider

There may be a *chronic illness, critical illness, or accelerated death benefit rider* on one or more life insurance policies that are in effect. Even if the rider was not in place at the time the life insurance policy was issued, some companies have added the rider to existing policies after they were issued. This rider can provide access to a payout of the death benefit while the insured is still living if he or she is suffering from a terminal illness. Policies may have different rules and requirements to qualify under this rider, so it is important to thoroughly understand the details of the policy provisions.

If Bonnie ever needs to sell a mutual fund, stock, or most any other investments that have appreciated and are not located in a qualified retirement plan, then she will need to know the *cost basis*. Cost basis is the amount paid for a security. At the time of the sale of an appreciated security, the owner only owes taxes on the difference between the amount paid for the investment plus all reinvested earnings and reinvested capital gains (cost basis) and the value received at the time it is sold. This will be less of an issue going forward, because companies have been required since 2011 for most investments (with others added over the next five years) to keep track of cost basis for clients (Horn, 2013). For investments purchased before the law went into effect, owners will need to have a record of the cost basis.

If clients do not have the cost basis for each security, a good place to start is to ask the company that holds the investment for it. Even though investment companies and banks were not required to keep track of cost basis, they still may be able to help. For a fee, some firms will offer to provide past statements so clients or their tax advisor can calculate the cost basis. This will allow advisors to determine which security will trigger the least tax when sold and allow clients to be prepared when required to provide the cost basis when filing their tax return. Consider selling securities with a high cost basis first. This strategy can lower taxes now and at death there is currently a step-up in basis to make these securities tax-free to heirs.

When withdrawing money to pay for care, consider leaving *Roth IRA* assets for last. They will continue to grow tax free for later use or to leave to heirs, also tax free. Of course, it is important to actively manage the assets held in IRAs and all investments keeping in mind time frame, risk level, fees, and other factors.

Medicaid typically provides benefits when there are few assets and little income. Medicaid eligibility and benefits can be different based on the state clients live in. Each state has a maximum amount of assets and income the ill and well spouse can retain to be eligible for benefits. There are many eligibility requirements including U.S. citizenship, age limits, level of health care needed, and more. Each state typically has a look-back period and penalty for assets that were transferred to someone else. It may be lengthy, for example, sixty months. Adults should check with their state and an elder law attorney for guidance.

Calculating how to spend assets while needing long-term care is not easy. Most older adults require the help of a financial professional to strategize for optimal use of varied investments and income. The best time to begin is before long-term care is needed. With current information and proper professional planning, older adults will have a much better chance of paying for the care they need, maintaining their quality of life, and even being able to pass assets to their heirs efficiently, if desired. The earlier the planning begins, the better the chance to be able to cover the cost of care and meet other important goals. •CSA

During her thirty-five plus year career as a Certified Financial Planner® and asset manager, **Nancy Butler** has worked with thousands of individuals, assisting them in the financial aspects of aging, including how to pay for the care they need and preserve the assets they spent their lives building. Today, Nancy is an international speaker, award-winning author and 3-year delegate to The United Nations for The Commission on the Status of Women. Nancy also teaches insurance classes in Connecticut.

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