The Hennepin County Aging Initiative

Research highlights: Retirement security, health care and late life

This synopsis of published research about aging, economic security and public finances was produced as part of Hennepin County's Aging Initiative. The Aging Initiative was created to help the county anticipate and understand the potential effects of changing age demographics for Hennepin County as an organization, and as a geographic and economic region, and to position the county to foster healthy aging for residents and clients through effective public policy.

More detailed discussion of retirement trends and their implications for the economy can be found in the Aging Initiative report on aging and the workforce.

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Top research findings

The following summary highlights key findings from the research about retirement security, health care and late life. A detailed discussion of the following nine items is included in the complete report attached to this summary.

1. Income decreases faster than consumption at retirement, by as much as 18 percent in Minnesota.
2. Consumption decreases slightly at retirement for the typical household, largely owed to declines in food-related spending. Consumption changes vary widely between households. Many wealthier households actually increase consumption at retirement whereas workers forced into early retirement see large declines.
3. Healthcare costs begin to accelerate around age 55, tripling by age 70. Medicare only covers about half of expenses as supplemental insurance and out-of-pocket costs increase faster than incomes.
4. Nearly a quarter of Hennepin County residents age 65 and older have trouble paying medical costs.
5. The risk for financial insecurity and poverty in retirement is not uniformly distributed. Single women, minorities, the late-career unemployed and those forced to retire early because of health issues are at increased risk of retirement insecurity.
6. Poverty rates for those age 65 and older may understate elder poverty. When medical costs, child care and non-cash benefits are accounted for, the poverty rate among seniors jumps from 8.9 to 16.1 percent.
7. Long-term care is a significant concern for future retirees. Current 65 year olds have a 70 percent change of needing long-term care and as many as a third of Baby Boomers have no plans to pay for it. Projected declines in care provided by a family member may increase dependence on public financing of long-term care.
8. Informal family care makes up the largest share of long term care services in Minnesota and is expected to decline rapidly as the Baby Boom generation ages, putting a higher burden on public provision of long term care.
9. Home healthcare subsidies cause families to substitute professional care for family care, improving health outcomes. It is unclear, however, whether these shifts and improved health outcomes result in any cost savings.

Introduction

The aging of the baby boom generation, Americans born between 1946 and 1964, will have a profound effect on Hennepin County's economy and government finances. Much of the literature on aging and retirement finances focuses on parts of a financial life-cycle with three stages:

I: Asset Accumulation
II: Retirement
III: Late-Life

Individuals accumulate assets during their working years, live off income from these assets in retirement and save the remainder for bequests or to pay for costs associated with late-life health declines. This report will focus on phases II and III – retirement and the late life spend-down of assets, including health care and long-term care.

When the oldest Baby Boomers turned 62 in 2008, the most common U.S. retirement age, Minnesota experienced a 30 percent jump in new retirees.[1] The increasing number of retirees will put substantial pressure on public finances at every level of government. Given these fiscal stressors, it is important to understand retirement, health care and asset liquidations patterns over the last periods of the life cycle and how they might affect Hennepin County as a governmental and socio-economic unit.

Many of the findings presented in this document come from studies of national data. For this reason it is important to note important differences between Hennepin County, the state of Minnesota, and the United States as a whole. Hennepin County has a lower unemployment rate than the national average (5.3 percent[2] vs. 8.3 percent[3]), higher median household income ($60,800[4] vs. $51,222[5]), and a lower percentage of residents below the poverty line (12.5 percent[6] vs. 14.4 percent[7]). As such, it is reasonable to expect that the economic security outlook for Hennepin County's retirees may be somewhat better than national averages predict. Furthermore, while Minnesota's business cycle closely follows fluctuations in the national economy, the regional economy is well-diversified, making it less vulnerable to market volatility and providing workers with a more stable environment in which to plan for retirement.[8]

Despite our region's relatively strong economic performance, it is important that national findings not be taken lightly. Hennepin County includes significant urban, suburban, and rural populations. This diversity makes Hennepin County a surprisingly apt microcosm of the state and country as a whole. Therefore, there is no reason to believe that national research findings will not be applicable to Hennepin County.

Retirement

Retirement is one of the most important events in a worker's financial life. The retirement decision is not made in a vacuum nor does it follow any predetermined rules – instead, it is the result of a complex relationship between a number of factors in work and life, including age, health, retirement wealth, potential future earnings and family considerations. For instance, the relationship between the retirement and retirement wealth works in two directions: accumulated savings influences the timing of the retirement decision and the circumstances of the retirement decision influence saving and dissaving near and in retirement.

Retirement and income

At retirement, the composition of income changes drastically. Social Security, pensions and income from retirement accounts replace earned income as retirees begin to live off the assets they accumulated during their work life.

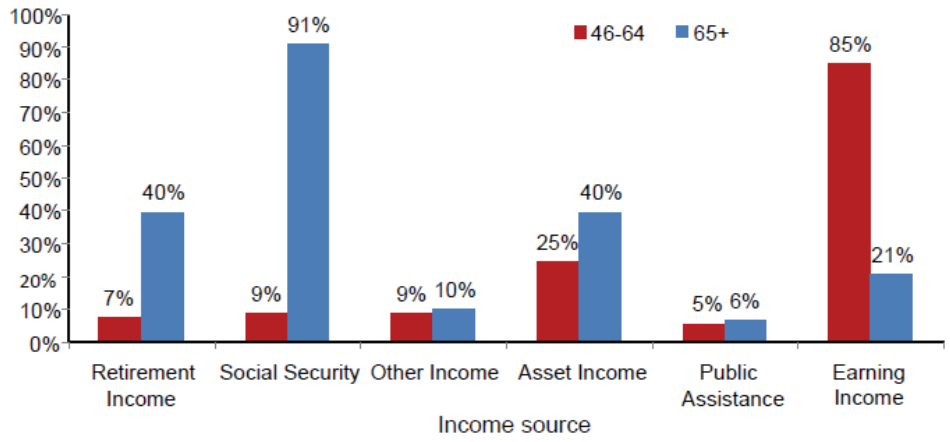
As with the rest of the nation, Social Security income is the most widespread source of retirement income in Hennepin County, with 91 percent of residents age 65 and older reporting Social Security income. Retirement income and asset income are the next most widespread at 40 percent of respondents.

In Minnesota, this transfer from earned income to Social Security, pensions, retirement fund income and assets is a major reason why income is 18 percent lower for 65-69 year old individuals than for 55-59 year olds.[9]

Retirement and consumption

Studies estimate that consumption drops around 2-3 percent at retirement for the median household, most of which results from about a 12 percent decline in food related expenditures.[10], [11] On average, however, consumption declines are closer to 15 percent. [12] This discrepancy occurs because some households experience particularly steep declines in consumption at retirement.

Figure 1. Hennepin 2010: Sources of income within age group: Comparing 46-64 and 65 and older – Multiple response



Data source: U.S. Census Bureau, 2010 American Community Survey, PUMS file

Note: Will not total 100 percent. This is a multiple response variable. Each respondent can give up to six responses. Respondents were asked about their income within the last 12 months

The literature is clear that retirees do not necessarily consume less at retirement, but rather spend less by making their own meals at home and taking care of the house themselves. At the same time, work-related spending, primarily on food, clothing, and transportation, decreases. While both median and average household consumption declines at retirement, only a little over half of all households actually experience a decline. In fact, some research estimates that those at the top of the income distribution typically increase their consumption in retirement. [13]

For other workers, the story is quite different. Workers who are forced to retire due to health limitations have been found to have a 67.5 percent chance of reporting declines in expenditure at retirement and declines are 114 percent higher than retirees for whom health was not an important factor in their retirement decision.[14]

Health Care

Health care costs rise sharply around retirement age. Nationally, health care spending doubles between ages 45-54 and 55-64, nearly tripling by age 75.

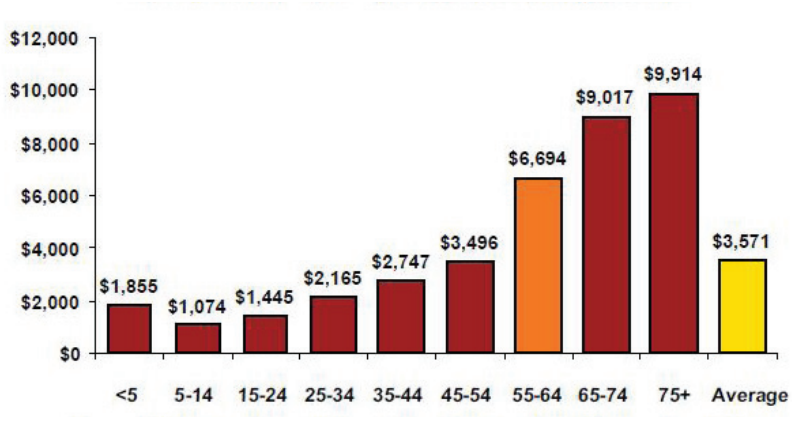
Medical costs have been rising faster than inflation over time, meaning that the natural increase in health costs due to age is compounded by an increase in the relative cost of medical care.

Since Social Security benefits form the main source of income for most retirees, increasing medical costs have major implications for the real value of retirement income over time. Inflation indices used for Social Security do not properly reflect price inflation in the average retiree's basket of goods. For example, premiums for Medicare Part B, in which most retirees participate, have risen much faster than Social Security benefits.[15] For men born in 1918 who began receiving benefits at age 65, increased medical costs decreased real purchasing power by almost 20 percent between 1983 and 2007. Women born in 1918 saw their average purchasing power decline by almost 27 percent.[16] Health care costs are expected to continue to rise faster than the rate of inflation for the foreseeable future, meaning that out-of-pocket expenditures for regular medical care will increasingly become a concern for the growing number of retirees.

Medicare provides health insurance for nearly every retired American over the age of 65. Nonetheless, Medicare covers a decreasing portion of late-life healthcare costs that must then be picked up by employer retirement plan (if the individual is still covered), Medicaid (if they qualify), private insurance or out-of-pocket payments. In 2002, Medicare covered about half of all medical costs for those age 65 and older.[17] Medicaid does a good job of filling in Medicare gaps for the poor, but only a small portion of retirees are eligible. For those above Medicaid income thresholds, out of pocket costs and supplementary medical coverage can be expensive.[18]

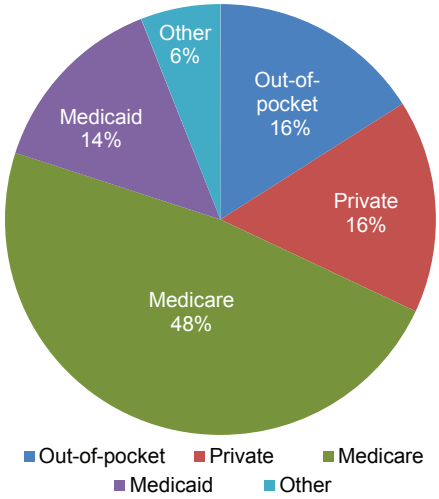
Out-of-pocket costs can be high for all cohorts with incomes above the Medicaid threshold. Retirees at age 65 with employer coverage face estimated lifetime out-of-pocket health care costs between $80,000 to $192,000, depending on the assumed rate of health insurance premium cost increases, rate of return on investments, the state in which the retiree lived and age at death. For those lacking this coverage, the bill can be very high, exceeding $500,000.[19]

Figure 2. Health care spending jumps after 55 . U.S. health care spending by age, 2004



Source: Agency for HealthCare Research and Quality. Medical Expenditure Panel Survey, data for per capita spending by age group in the Midwest. Excludes spending for long-term care institutions.

Figure 3. Composition of medical costs, age 65+



Source: U.S. Department of Health and Human Services

Note: Percentages as of 2002

As the population ages, the elderly live longer and medical costs continue to increase faster than inflation, it is reasonable to expect all sources of healthcare financing for the elderly to become increasingly strained, leading to increased out-of-pocket expenditures.

Risk of financial insecurity in retirement

An individual's risk of financial insecurity in retirement is largely based on the interplay between assets accumulated before retirement and circumstances in retirement.

The 2010 Employee Benefit Retirement Institute (EBRI) Retirement Readiness ratings estimated that 47.2 percent of Early Boomers (ages 56-65) and 43.7 percent of Late Boomers (ages 46-55) are at risk for being financially under-prepared for retirement. Importantly, retirement readiness improved overall since 2003, when 59 percent of leading-edge Baby Boomers were at risk. [20, 21]

Despite the availability of Social Security benefits for most retirees, a significant number of older Americans face the threat of poverty during retirement. Research estimates that almost half of Americans older than 60 will experience at least one year below 125 percent of poverty during retirement.[22]

Recent U.S. Census adjustments to measure poverty that account for medical expenses, child care and non-cash benefits including Medicare and food stamps, increase the 2009 poverty rate of Americans 65 years and older from 8.9 percent to 16.1 percent.[23] Out-of-pocket medical expenses account for the largest share of this increase. With the national alternative poverty rate for children at 18.0 percent and nonelderly adults at 14.8 percent, seniors are more impoverished than other adults and nearly as impoverished as children under 18.[24]

County-level data from Hennepin County's SHAPE survey indicates that medical costs strain the budgets of local retirees. In 2010, 24 percent of County residents age 65 and older reported at least some difficulty paying for insurance premiums, prescriptions or other medical costs during the past 12 months.[25]

The risk for financial insecurity and poverty in retirement is not uniformly distributed. Factors such as gender, race, marital status and the conditions of retirement can have a large impact on retirement security.

Race

Research indicates that elderly Black Americans are almost twice as likely as Whites to fall into poverty. Historically, African-Americans were between 2.3 and 2.8 times more likely to experience poverty in old age than White Americans.[26] During the next 35 years, it is predicted that 64.6 percent of African-Americans between the ages of 60 and 85 will be in poverty for at least one year compared to just 32.7 percent of Whites.[27] These elevated poverty rates are largely due to low levels of financial assets in minority communities, stemming in part from the cumulative impact of racial disadvantages. According to the Senior Financial Security Index (SFSI), 83 percent of African American and 90 percent of Latino seniors lack sufficient assets to pay for the rest of their expected retirement years, compared to 53 percent of white seniors.[28] Given the persistence of poverty and Hennepin County's increasing racial diversity, it is reasonable to expect that racial and ethnic minority populations will make up a disproportionate share of the elderly living below the poverty line.[29]

Gender and marital status

One-person households are more likely to experience poverty than two-person households. For unmarried Americans between 60 and 85, the percentage experiencing poverty was 51.2 percent compared with 24.9 percent for married Americans in the same age cohort.[30] The reasons for this trend are varied. Divorcees lose between 22 and 47 percent of their total wealth in divorce and women in particular have a hard time recovering this lost wealth.[31] Thus, female divorcees are particularly at risk. Likewise, because women earn less than their male counterparts, those that are continuously single accumulate fewer financial assets and receive fewer Social Security benefits.

Widows fare somewhat better than single women and divorcees, particularly if the death of a spouse occurs in later life. However, the financial demands of an illness or death of a spouse depletes the asset income of a widowed household compared to continuously married households.[32] The relative stability of widows' finances result from their access to survivor benefits through their spouses – Social Security in particular. Nonetheless, a widow's loss of income still results in an increased risk of financial insecurity in retirement.[33]

Conditions of retirement

Forced early retirement can put a retiree at increased risk for financial insecurity in retirement. These retirees are typically forced into early retirement for two reasons: late-career unemployment and poor health.

Despite experiencing relatively low rates of unemployment overall, older workers take significantly longer to find a new job once they become unemployed. Research estimates that Minnesota workers age 55 and older stay unemployed an average of five weeks longer than younger workers.[34] Studies of previous recessions estimate that the unemployment rate of displaced older workers (between 50 and 64 years) two years after a job loss is 25 percentage points higher than that of similar non-displaced workers. Those who do find new jobs tend to make a lot less money than before – as much as 20 percent less than similar workers who keep their jobs.[35]

For unemployed workers who have turned 62, applying for Social Security is often preferable to a prolonged search for work. Studies have shown that, generally speaking, a one percent increase in the unemployment rate increases the annual retirement rate by 1.8 percent even after accounting for financial incentives to delay retirement.[36] Accordingly, during the recession of 2007-2009, claims for Social Security benefits rose 9 percent, exceeding projections by 5 percent.[37], [38] The decision to retire is highly dependent upon income and education. Studies show that high school graduates are more likely to retire because of a weak labor market than more highly educated workers, whose retirement decisions appear less sensitive to the labor climate.[39] Even if employment rates trend toward full employment, it is estimated that 378,000 Americans will have opted for early retirement because of unemployment between 2009 and 2014.[40]

Those who retire early for health reasons may experience additional challenges. One study estimates that 29 percent of retirees listed health as an important factor in their retirement decision. Early retirees face a gap in health coverage before they become eligible for Medicare at age 65. Employer-sponsored retiree health benefits, which generally provide health insurance to retirees before Medicare begins at age 65, are disappearing, meaning that rising health costs associated with aging and poor health have to be paid through private insurance or out-of-pocket.[41]

This wave of unplanned early retirement due to the recession means that a large number of workers are retiring with fewer assets than originally planned. Those who find work will earn less than they would have if continuously employed, decreasing their retirement assets and Social Security income. Those who choose to retire early face unplanned reductions in their Social Security income due to retirement and a potential gap in medical coverage before age 65 that could force early retirees to withdraw retirement funds to pay for health care. Together, these factors put forced early retirees at greater risk for financial insecurity in retirement.

Health care and finances in late life

Drawdown of assets

Retirees typically save assets to pay for emergencies in later life, most often for a shock to their spouse's or their own health or as a bequest to their heirs. As mentioned earlier, real estate is the second most valuable asset for most households and is the main type of asset typically saved for these late-life emergencies.

Studies have shown that a spouse's death or declining health strongly predicts when a retired individual will cash out their equity and change their living arrangements.[42] This desire to hold on to housing assets into late life is so strong that 60 percent of participants in one study died before they could liquidate their real estate assets.[43] Although the housing market has been slow to recover and future price trends are difficult to predict, the tendency for retirees to save real estate equity for a late-life emergency or a bequest to heirs may prevent the retirement of the Baby Boom generation from having an immediate impact on the real estate market.

It appears that retirees are averse to spending down their other retirement assets for the same reason. Research estimates that 60-69 year olds withdraw just 2 percent from their 401(k) and IRA, a figure that only increases to 5 percent after age 70 ½ when regulations mandate minimum withdrawals.[44] Even at the upper levels of the wealth distribution where retirees are more likely to rely on stock-related income, there is little evidence of spending down assets during the first years of retirement.[45]

While some of this saving may be attributed to bequest motives, another major reason could be concern over the rising cost of long-term care.

Long-term care (LTC)

Medical technology will allow the Baby Boom cohort to live longer than their parents. Modern health care's ability to keep people alive may make long-term care an increasingly important part of late-life planning. However, adequate long-term care planning is not widespread among retirees, making financing long-term care a serious problem for the economic security of individual retirees and government finances.

In 2010, 65 year olds were estimated to have a 70 percent chance of needing some kind of long-term care during the remainder of their lives. Sixty percent will have to pay for a portion of their care themselves, spending an average of $48,000 with a 6 percent chance that LTC costs will exceed $100,000.[46] Even if advances in medicine and lower disability rates for retirees could delay entrance into nursing homes and other long-term care (LTC) arrangements, it is unlikely that the cost and demand for long-term care will abate.[a]

Even though most Minnesotan Baby Boomers will need LTC at some point, very few have made any plans to pay for it. In fact, a 2010 survey of Baby Boomers in Minnesota found that nearly a third of Minnesota boomers (32 percent) were unsure how they would cover the cost of long-term care.[b] Nearly a quarter (22 percent) planned to pay for LTC with their personal savings, 18 percent said they would utilize a government program, while roughly the same portion would rely on a LTC insurance product (16 percent).[47]

Together, these figures paint a dire picture for retirees' ability to pay for long-term care in late life. It is conceivable that a high proportion of the 32 percent of Baby Boomers with no plans to pay for LTC will end up on government assistance. Thus, long-term care could become a long-term drain on public finances as the Baby Boom generation reaches late life in the 2030s.

Paying for long-term care

There are a number of ways seniors can pay for long-term care.

Medicare covers some LTC costs for those age 65 and older. To receive long term care coverage under Medicare, you must have had a recent hospital stay of at least three days, be admitted to a Medicare-approved nursing home within 30 days of that hospital stay and need nursing home-level care. If these conditions are met, Medicare pays 100 percent

[a] For more information about projected disability rates for the Baby Boom generation, see the Aging Initiative Report on Aging and Health

[b] Because this DHS survey was delivered by phone and only to land-lines, older, white, and more affluent respondents may be overrepresented. In the case of the data cited here, it is reasonable to assume that the addition of younger, low-income individuals would only increase the number of respondents who would be uncertain about their LTC plans. This assumption would only serve to reinforce the overall point.

of costs for 20 days, up to $137.50 per day during days 21 to 100, for a total of 100 days of full or partial care.[48]

Medicaid covers supplementary medical insurance for eligible elderly individuals as part of Medicare Part B. In Minnesota, Medicaid, called Medical Assistance (MA), will cover nursing home care beyond 100 days, though program participants must first spend down most assets [c] in excess of $3,000, with limits on income.[49] If an individual can stay at home, however, income limits remain but there is no required spend down of assets. In Minnesota, Medicaid covered 40 percent of the LTC expenses for the elderly in 2004.[50] Nationally, LTC-related Medicaid funding for the retirement-aged individuals is projected to increase from $1.1 billion in 2010 to $5 billion in 2035, a nearly 500 percent increase.[51] Such an increase is not sustainable without large tax hikes or significant cutbacks in government services.

Employer benefits play only a small role in financing long-term care. At the beginning of 2004, fewer than 1 in 4 Medicare-eligible retirees had employer-subsidized coverage. This number is expected to decrease over time.[52]

Families have historically provided the largest volume of long-term care to retirees, supplying an estimated 92 percent of total care in 2005.[53] Baby Boomers, however, had higher divorce rates and fewer children than their parents and therefore will have fewer family members to care for them. The family care-giving rate is expected to decrease 50 percent in 2030.[54] It is estimated that a one percentage point drop in family care-giving results in a $30 million increase in public expenditures in Minnesota.[55] By this measure, the predicted 42 percentage point decrease in the rate of family care-giving would increase annual public expenditures by $1.26 billion in 2030.[56] Such an increase is unsustainable given current revenue and spending structures.

Out-of-Pocket payments financed 33 percent of Minnesota LTC costs in 2004, a rate that has continued to rise in recent years.[57] The amounts of these payments increase both with age and with income. A recent study estimates that annual LTC out-of-pocket medical expenditures rise from $1,100 at age 75 to $9,200 at age 95. While a 95-year-old in the bottom one-fifth of income will spend an average of $1,700 a year on long-term care, their counterparts in the top quintile will spend an average of $15,800.[58] This income-based differential reflects both an individual's ability to pay for care and their eligibility for government assistance such as Medicaid.

Long-term care insurance plays a relatively small role in paying for long-term care. It is estimated that only 10 percent of Minnesotans between the ages of 50 and 84 have LTC insurance.[59] This number may seem surprising given that 20 percent of Minnesotans over the age of 40 believe that they would use LTC insurance at some point in their life and 65 year olds actually have a 60 percent chance of incurring long-term care costs.[60] This gap between opinion and actual usage implies that there may remain some room for growth in LTC insurance participation.

Long-term care preferences

Future retirees will prefer to receive long-term care from family and friends at home. When Minnesota Baby Boomers were asked about what they would do if a health change compromised their ability to live independently, 41 percent of respondents would seek assistance in their home from family, friends and/or an agency, 27 percent indicated that they would move to an assisted living setting, and 27 percent were uncertain what they would do.[e, 61] Wealthier respondents regarded assisted living arrangements more favorably than other respondents and poorer respondents were the least likely to have thought about this option.[62] Long-term care preferences appear to be related to an individual's ability to pay for institutional care. If this relationship is true, then demand for assisted living facilities will be correlated with the relative affluence of retired Baby Boomers.

[c] Except primary residence, personal belongings, one motor vehicle, essential property, life insurance with value under $1,500, burial arrangements, and assets held in certain types of trusts.

[d] Because this DHS survey was delivered by phone and only to land-lines, older, white, and more affluent respondents may be overrepresented. In the case of the data cited here, it is reasonable to assume that the addition of younger, low-income, and minority individuals would only increase the number of respondents who would be uncertain about their LTC plans. This assumption would only serve to reinforce the overall point that this section is trying to make.

Nursing Homes

While 65 year olds have a 70 percent chance of needing some sort of LTC, they have just a 30 to 40 percent chance needing nursing home care, with an average stay of two years.[63], [64] Most of this group, however, will experience stays of less than one year, so Medicare payments will keep their out-of-pocket expenses relatively low.[65] Nonetheless, these averages hide significant variance in the duration of stay. Forty percent of all nursing home residents remain in nursing homes for more than one year, and as many as one-fifth stay for more than five years.[66] With so many nursing home residents staying well-beyond Medicare limits, the cost burden must fall on the wealth and assets of the resident, their family and Medicaid. In 2002, 37 percent of nursing home costs were paid out-of-pocket, 37 percent by Medicaid, 20 percent by Medicare, and just 6 percent by other forms of private payment such as LTC insurance and employer plans.[67] Given the relative size of the Baby Boom generation, the number of elderly residents requiring nursing home care may rise, incurring rapidly increasing costs on both the government and individuals.

Home health care

Public funding of home health care has been an increasing trend over the past 10 years. Advocates claim that home health care could significantly reduce the costs of LTC by replacing expensive institutional care with less expensive home care. The results, however, have been mixed.

Research generally agrees that publicly subsidized home healthcare causes substitution from informal family care to formal care and that the level of substitution is related to the generosity of the home healthcare program.[68] Other research goes further, finding not only that home healthcare programs improve health outcomes, but also substantially decrease usage of long-term care institutions such as nursing homes.[69] It is unclear, however, whether these factors could in fact lower the public cost of long-term care. In fact, some studies have found little to no overall cost savings in home health care.[70] These studies find that many home healthcare recipients either would never have entered the nursing home or that home healthcare did not reduce nursing home costs as much as expected. One study of VA participants showed that home health care recipients have higher health care costs overall than non-participants.[71] It is increasingly unclear whether publicly financed home health care could decrease spending on institutional elder care such as nursing homes.

Conclusion

Many retirees face the dual challenge of rising health care costs and a fixed income. Marital status, race, gender, employment and health can all compound this challenge by reducing the initial level of income still further, pushing many of these seniors closer to poverty. With the number of Hennepin County residents over age 65 doubling over the next 20 years, an increasing number of seniors may find themselves unable to finance the remainder of their retirement. By late life, rising health care costs and the unplanned-for expenses associated with long term care could increasingly outstrip remaining retirement assets, replacing the now prevalent resources such as savings and real estate with the remaining source of funding for long term care – the government.

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