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## ***Is your retirement “self-insured” or are you just gambling? October 2010***

Dave and Sue believe that they can self-insure the cost of long-term care in retirement. The reality is that despite a nest egg of \$1.4 million, they are not self-insured, but are gambling their lifestyle on the hope that neither will need significant long term care in retirement. Unfortunately they are up against long odds as 70% of retirees need some kind of long-term care in retirement.

Ignoring taxes (just for this discussion), let's assume that Dave and Sue have an income need in retirement of \$9,000 a month. They will receive \$2,000 and \$1,000 respectively from Social Security. Like many retirees, neither Dave nor Sue receives a pension. This leaves a gap of \$6,000 a month that is nicely covered, at a 4.5% distribution rate, from their \$1.4 million portfolio.

While we can be fairly precise with income numbers, calculating an accurate figure for long-term care risk is virtually impossible. Despite being misleading, averages give us a starting point. The average nursing home stay is 30 months at \$6,000 monthly for a total average cost of \$180,000. Keeping in mind that ½ of the population will exceed the average, a conservative scenario would be 60 months at \$8,000 monthly for a total of \$480,000 EACH.

From an asset standpoint, it would seem like Dave and Sue would be able to cover \$480,000 of medical expenses from their \$1.4 million dollar portfolio. However retirement planning is about income and not assets. Let me explain.

When Dave starts needing care at \$8,000 a month, Sue will still need to support her lifestyle. Let's assume that Sue can reduce her expenses by \$1,000 a month without cutting too drastically into her lifestyle (i.e. forcing the sale of their home). This still leaves a shortfall of \$7,000 a month for Dave's care. At first glance \$7,000 monthly may seem like a

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small amount relative to their \$1.4 million nest egg. However if Dave dies after five years of care, totaling \$480,000 Sue will find herself in a difficult situation.

Having withdrawn \$720,000 from her portfolio over the last five years (\$5,000 a month for her and \$7,000 a month for Dave's medical care), she is left with a portfolio of only \$980,000 (assuming 5% annual growth). Her reduced portfolio can now generate only \$4,600 of monthly income. This combined with a reduction of Social Security benefits, leaves Sue with just \$6,100 of income. A reduction of almost 30% in just 5 years. Add in the effects of trend line (3%) inflation and the real lifestyle cost comes closer to 40%.

As I hope you can see, Dave and Sue were not self-insured. Rather they have bet 40% of the survivor's lifestyle on the hope that neither will need long-term care in retirement.

This example is not intended to promote any type of financial product, including long-term care insurance. Without a comprehensive retirement income plan in place, long-term care insurance, or any other financial product, will do you little good. Don't gamble with your retirement income under the illusion that you are self-insured.