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Pensions and Intergenerational Equity

Preparing for the cost of residential care

M.Claire Dale and Susan St John

PIE Commentary 2022-13[1]

PIE highlights intergenerational equity issues around the rapid ageing of the population including the ageing of the old. By 2030 the baby boom generation will all be aged over 65, and the oldest baby-boomers will be entering the 85+group where the health costs are known to be high.

Life expectancy is increasing, however 20-30% of the years of life gained over last 25 years are lived in poor health. Long-term conditions include diabetes, obesity, cardiovascular disease, chronic obstructive pulmonary disease, cancer, asthma and other respiratory conditions, arthritis and musculoskeletal diseases, stroke, chronic pain, dementia, mental illness and addiction. Multimorbidity (two or more of these conditions) affects 1 in 4 older adults in New Zealand.[2]

Here, as often elsewhere, females have a higher life expectancy than males, but on average they spend more of their life in poor health: in 2013, females required assistance for 16.7 years of their life, compared with 14.3 years for men. In the 2019/2020 year, females were 59% of those assessed for home-care, and 65% of those assessed for Aged Residential Care (ARC).[3]

Few retirees are well-prepared for the costs of long-term care and many middle-income families will be impacted severely. They will see the assets of their older-aged relatives rapidly disappear as they are required to pay for their later-life care.

It is time to examine whether our system is suitably designed for the realities of the 21st century ageing population including their projected high costs of care and health services.

PIE was asked recently to clarify some aspects of paying for old age care. We republish this commentary by Mary Holm as a beginning of the needed debate around how society cares for the old with thanks to the New Zealand Herald.[4]

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[1] PIE Commentaries are opinion pieces published as contributions to public debate, and do not necessarily reflect the view of the Pensions and Intergenerational Equity Hub.

[2] See https://www.health.govt.nz/our-work/diseases-and-conditions/long-term-conditions/management-multimorbidity.

[3] See https://www.interrai.co.nz/assets/AR_interRAI_2020_FINAL-v2.pdf

[4] Published 29th October 2023, Mary Holm, NZ Herald. https://www.nzherald.co.nz/business/mary-holm-cash-for-grades-is-that-the-way-to-make-students-study/6R776RS54BB6RHPT7HGISIZJ7Q/

Question to Mary Holm from a reader:

> I refer to your recent response to the 67-year-old woman with savings of $440,000. You used the rough rule of thumb to suggest that she could spend $440 a week and still have a buffer.
>
> Unfortunately, the rule of thumb seems to ignore the potential risk of various aging health conditions that can completely throw asunder all of one's careful financial planning.
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> I know of a case where a man in his early 70s developed serious dementia and required 24/7 care. The care cost was about $80,000 per year, and his ten-year confinement before passing away cost the family more than $800,000. Your advice on how us oldies should allow for such very expensive costs in one's financial planning would be appreciated.

Reply from Mary Holm

The short – and stupid! - answer is: hope it doesn't happen to you.

At first glance, the odds seem good. "At 31 March 2020, of a population of around 790,000 aged 65-plus at that time, about 4.4 per cent were in Aged Residential Care (ARC)," says Claire Dale of the Pensions and Intergenerational Equity (PIE) research hub at the University of Auckland.

But she adds, "This small percentage disguises the reality that over the course of retirement, the probability of being in ARC is much higher, and around half the older aged population will use residential care at some point."

Still, not many stay for ten years, like your acquaintance.

"The average age of a person living in residential care is 85 years. However, there is significant variation in the entry age, and length of stay ranges from a few days to over ten years. Median length of stay in a rest home for someone receiving government funding is just 1.7 years," she says.

Residential care costs range from about $73,000 to $116,000 a year.[5]

Many people get help from the government with care costs. But is it enough help for enough people? Let's look at what's available.

If you are 65 or older, you are expected to sell your assets (and your partner's assets if you have a partner) to pay for your long-term care in a hospital or rest home until your asset total is reduced to a certain amount. After that, the government will help to pay. The amount varies, as follows:

- If you have a partner or dependent child who lives with you, and you own a home and car that the family wants to keep, the amount is $149,845.
- In other situations, it's $273,628. If you own a house or car, you are expected to sell them.

Other assets included in the total are cash, savings, shares and other investments including investment properties, boats, caravans and campervans and some types of life insurance policies.

Not included are your personal belongings, household items and any funds held in a recognised funeral plan.

[5] See How much does living in a residential care home cost? - New Zealand directory, older people, retirement, groups, rest homes, home help, elderly (eldernet.co.nz)

To stop people from getting around these rules, loans made to others, including family trusts, are included in your asset total.

And if you have gifted some of your assets over the years, their value may also be included. That depends on how much you have given, and how recently. More on this next week.

Nor can you get around the gifting rules by selling your assets at a low price to a friend or relative. "If you sold an asset, Work and Income will check whether the amount you sold it for was reasonable," says the Citizens Advice Bureau.

There's also an income test, which depends on the type of income. "There are no limits on the income that you can earn, but any income that a resident earns above the exempt income amount will go towards the cost of their care," says Te Whatu Ora.[6]

Where does all this leave us?

"While long term care at a very basic level is paid for by government if you have little by way of assets and income, and the rich can easily cover their own costs, it is a very expensive risk faced by many middle-income retirees who have only modest assets and income and don't qualify for a subsidy," says Susan St John of the Pensions and Intergenerational Equity (PIE) research hub.

"They will have no idea of the size of that risk nor of how to budget for it in retirement. Neither do insurers, so that it is no surprise to find you can't buy an insurance policy to protect yourself."

Change is needed, argues St John.

"Suppose at 65 you have a lump sum of $200,000. While there is some data that tells you how long a person lives on average, there is a huge spread of the age at death around that average. Outliving that lump sum is a real possibility.

"Moreover, it is not just that you don't know how long you will live, you don't know if you will need long-term care, nor whether such care will be for only a few weeks or more than ten years. Nor do you know the level of that care you will need or the costs of extras like dental care, hearing aids and specialist care or a superior room.

"With a looming tsunami of older baby boomers needing care, it is time we talked about ways to better share the costs of outliving savings. An insurance option suggested by PIE is a state-protected indexed annuity that can be bought at age 65, and that increases if long-term care is needed."

I like that idea. How about it, new government?

References

For a fuller discussion of aged care costs, see "Long term in-home and residential care for our ageing population" by M.Claire Dale and Susan St John (2022), And for LTC and annuity insurance ideas see St John and Dale (2019) Decumulation paper for the Retirement Commission 5th September.pdf

[6] For more information see Residential care subsidy / loan | Te Whatu Ora (seniorline.org.nz)