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Managing the Impact of Long-Term Care Needs and
Expense on Retirement Security Monograph

Home Equity and At-Need Annuities—A Dynamic Long-Term Care Funding Duo

By Steve Cooperstein

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Steve Cooperstein, FSA
Steve Cooperstein & Affiliates
http://www.InnovatingBeyondThe9Dots.com

Introduction

In the mid-'80s, when AIDS struck the gay community, viatical settlements were created enabling terminally ill life insurance policyholders to tap into the stored legacy value of their policies to pay for treatments or otherwise use these monies while they lived. In a somewhat similar vein, in the late '90s, "at-need" annuities were brought to market to mesh with the cost of long-term chronic care ("at-need" meaning when long-term care (LTC) cost needs have already commenced). Combined with the stored legacy value of home equity, these at-need annuities can be especially helpful in dealing with this other scourge—the potentially financially devastating, and all-too-frequent uninsured, cost of LTC.

Besides actually using this option "at-need," the possibility of being able to opt for it "at-need" could change how people address the spectrum of choices for funding potential LTC costs.

This paper describes the LTC funding problem, including weaknesses of reverse mortgages and Medicaid in these respects, and how this combination of an at-need annuity/home equity combination can offer "late-in-the-game" additional insurance leverage.

An extensive anecdotal example is provided describing how this option can be effectively used to maximize care outcomes by building on other funding. Cash flow analyses of alternatives are discussed, as well as sensitivities involved and the need to focus on risk/reward choices.

The potential and broader implications for practical layered funding of LTC costs, which this possibility facilitates, are also discussed.

The Cost of Long-Term Care

Chronic care by its very definition involves ongoing care. This can commence at younger ages, but for the most part onset occurs increasingly at older ages and generally progresses through stages of disability.[1] The saving grace in increasing onset at the older ages is that residual life expectancy is generally shorter.[2] In any case, the

[1] Eric Stallard, ASA, FCA, MAAA, "Estimates of the Incidence, Prevalence, Duration, Intensity and Cost of Chronic Disability among the U.S. Elderly," Living to 100 and Beyond, 2008.
[2] Ibid.

financial and emotional cost to the individuals, their families and society can be and are significant.[3]

Chronic care costs might progress along lines such as the following:

- Care at home:
  - Full primary caregiver help for a few years = $0, but increasing wear on the caregiver and often time away from work.
  - Home health care aide for four hours a day, three days a week, for two years, as reality sets in = $25,000.
- Care in an assisted living facility:
  - $4,000 a month for three years, as a further practical matter = $144,000.
- Care in a skilled nursing home:
  - $6,000 a month for three years, generally as medically necessary, but often if Medicaid financial assistance is needed = $144,000.

Duration, severity, whether coupled or not, and choice can drive these costs much higher (24/7 at home for 10 years @ "just" $20 an hour would be $1.75 million), though many people will not experience any of these costs in their lifetimes.

Funding Long-Term Care Costs

LTC cost is thus a major potential liability that no one really wants to anticipate, let alone budget for. As a result, compared to other potentially catastrophic financial risks, people have generally not taken direct action to provide for the high cost of long-term care should it arise in their lifetimes. Leveraged "pre-funding" through long-term care insurance (LTCI) has been weak, with penetration rates variously estimated to be less than10 percent to perhaps 15 percent of market potential.

A survey of recent retirees shows people have varied *intentions* about how they expect to pay for LTC.[4]

Plans to Pay for Long-Term Care	**All Retirees**
Personal savings	42%
Private LTC policy	32*****
Spend down investable assets and then be covered by Medicaid	21
Medicare would take care of it	16
Sell home and use proceeds	15
Access home equity line of credit	8
Expect family members to help pay expenses	2
Have not thought about it	15

[3] Ibid.

[4] "Will Retirement Assets Last a Lifetime?" page 71, Society of Actuaries' Committee on Post Retirement Needs and Risks, LIMRA, and the International Foundation for Retirement Education (InFRE): https://www.soa.org/research/research-projects/Aging/assets-lifetime.aspx.

*****This proportion is higher than found in the general retiree population due to the sample's higher net worth level.

At the low-net-worth end, people by definition have fewer assets to pay for LTC to protect them against its ravages, so they default to government assistance and often lower-grade care through Medicaid.

Some in the middle market buy LTCI. However, LTCI is perceived as so expensive that many middle-market people also default to Medicaid in one way or another. Under "Partnership" LTCI policies, for instance, the tail cost demurs to Medicaid generally after three years.

At the high end, many assume they will be able to fund chronic care costs entirely from assets if necessary, though this assumption is anecdotally known to have been sadly short-sighted.

In fact, only 33 percent of expenditures for LTC come from private spending, with Medicaid covering most of the rest.[5]

It is unclear where the Medicaid portion will head, given current financial pressures, longer-term projections, and considering states' efforts to make it more efficient and effective. Nonetheless, significant funding will continue to need to come from people privately paying from their assets. Increasing shortages of paid caregivers will also put a premium on private-pay services.

Home Equity as a Store of Value

Home equity is the major component of the net worth of most Americans.

Net Worth

Ages	**65 to 69**	**70 to 74**	**75 and older**
Median Net Worth	$114,050	$120,000	$100,100
Excluding Home Equity	$27,588	$31,400	$19,025

Source: U.S. Census Bureau, Current Population Reports, 65+ the United States: 2005, as reported by the MetLife Mature Market Institute: http://www.metlife.com/assets/cao/mmi/publications/studies/mmi-studies-65-profile-20041010.pdf.

Remarkably 80 percent of seniors, even those 75 and older, own their own home.[6] While some have a mortgage, almost half of those ages 55 to 74 have none.[7]

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[5] C.V. O'Shaughnessy. The Basics: National Spending for Long-Term Services and Supports 2012. Long-Term Care Expenditures by Source, FY 2010: http://www.thescanfoundation.org/sites/thescanfoundation.org/files/who_pays_for_ltc_us_jan_2013_fs.pdf.

[6] U.S. Census Bureau, Housing and Household Economic Statistics, Table 17, Homeownership Rates by Age of Householder and Family Status for the United States

[7] Housing: Centers for Disease Control and Prevention, National Vital Statistics Report, at http://www.metlife.com/assets/cao/mmi/publications/studies/mmi-studies-boomer-profile-2007.pdf.

As such, the disposition of one's home is a major element of retirement financial planning and management. The how and when of it, though, can be tricky.

A pre-retiree survey suggests a variety of intentions as to the use of home equity.

Plan to Tap Equity: Various Approaches

	Age			
Response	**50-54**	**55-59**	**60-65**	**All**
Downsizing	54	55	60	55
Home equity loan	6	14	20	11
Reverse mortgage	16	18	5	15
Not sure	25	13	15	18

Source: Boston College Survey reported at http://www.reverse-mortgage-information.org/534/reverse-mortgages-babyboomers.php

While some undoubtedly access home equity through regular and reverse mortgages, lines of credit, and by downsizing, the degree of continuing home ownership and the percent that are not mortgaged suggests that at least for current retirees, home equity remains a store of value for many late in life. Seemingly home equity hasn't been needed, at least partially perhaps because current retirees have benefited from pensions; others may be conservative and reluctant to use it, living on less to be able to access it for emergencies or leave it as a legacy

For many people home equity thus ends up, either planned or by default, as an available store of value to help pay for LTC costs. This is most fortuitous given the otherwise underfunding for LTC.

Accessing and Using Home Equity in Funding Long-Term Care

People are generally able to pay for modest LTC costs at the outset of the need for paid assistance, such as for a home care aide for a few hours a day a couple of days a week. This might initially be paid from excess income and by drawing on savings and investments. As costs persist and increase, it often becomes increasingly clear that home equity will need to be accessed to be able to pay for continuing care.

Many people turn to Medicaid as this point nears, as a home may be retained for a well spouse to live in and still be a non-counted asset for qualification for Medicaid. However, Medicaid will generally recover its outlays from the sale of the home after the spouse leaves it. As such the equity in the house will eventually pay for the cost of the LTC, and though later and perhaps not recovered in some states, the recovery is for a higher cost since Medicaid primarily forces more costly skilled nursing home confinement (though Medicaid does pay lower skilled nursing home rates than one would pay privately). The point here is that even those going the Medicaid route will use their home equity to pay for their LTC costs.

Many others choose to avoid the limitations of Medicaid (generally only semi-private care in nursing homes, and often less desirable ones) by opting to access home equity. Even people who bought LTCI may need to access home equity if the coverage they

purchased is only partial in one respect or another. And wealthy people may also need to access home equity to pay for LTC for, say, lengthy round-the-clock care at home.

The bottom line question is: How might people most effectively access the store of value in their home equity to pay for LTC should it arise? The answer, of course, depends on the particulars of the situation, which can be quite varied. It is instructive to look at the basic alternatives.

1. ***Sell the home*.** Clearly, one option is to sell the home, put the proceeds in appropriate investment or savings instruments, and withdraw monies from these funds to pay for LTC as needed. Other considerations, such as a spouse, wanting to keep the home for future generations, a weak market for selling, or the step-up tax basis, obviously also come into play.

2. ***Mortgage the home*.** A second option might be to access the equity through a new or increased mortgage, or a line of credit. A new or increased mortgage would of course require additional monthly mortgage payment outlays. It also involves incurring interest on the whole amount borrowed, whereas the LTC costs being financed are serial. Line-of-credit borrowing would be a better match, but, if available at all, they usually have lower borrowing limits and carry higher costs. As discussed below, accessing significant funds upfront provides the opportunity for leveraging.

3. ***Reverse mortgage.*** Reverse mortgages (line of credit or lump sum) feature no payments on the mortgage until the homeowner dies or vacates the home. The appeal here is that the deferral of payments "appears" to ease costs. "Appears" because, in fact, reverse mortgage interest is incurred on an ever-increasing mortgage. Further, reverse mortgage closing costs and interest rates are generally higher than a traditional mortgage, and interest is not tax-deductible until paid when the house is sold, so in fact incurred costs are much higher under a reverse mortgage! If taken out too early, it can seriously deplete the store of value of the home equity. Moreover, the limits on amounts that can be borrowed under a reverse mortgage limit their usefulness in funding substantial long-term care. And, of course, a reverse mortgage must be terminated when a single owner needs to move to a care facility.

Leveraging Home Equity's Store of Value with an At-Need Annuity

When a line of credit isn't sufficiently available or doesn't work as well, front-end net proceeds from home equity can be leveraged by an at-need impaired lifetime payout annuity to facilitate private payment of LTC costs for as long as the disabled person lives, sometimes enabling such lifetime payments that might not otherwise be possible.

At-need impaired lifetime payout annuities are basically immediate life annuities that recognize the shorter life expectancy of people needing LTC, and thusly offer higher lifetime annuity payments than would be paid to someone who is not longevity-impaired—hence providing the leverage for paying the high ongoing cost of LTC (as in

immediate annuities, leverage is created by all annuitants forgoing return of still unamortized purchase payments). Under these at-need annuities, applicants are individually underwritten based on mortality experience studies of cognitive and chronically disabled impairments as well as more acute ailments to determine their particular life expectancy, and then offered annuities with payout rates geared to these evaluations.

Depending on the person's age, gender, and type and degree of impairment, an annuity paying **20, 25, or even 30 cents on the dollar of purchase payment might be offered**. For example, $200,000 of mortgage or net proceeds from the sale of the home might thus generate $40,000+ a year for as long as the person lives, which may be used toward LTC and any other living costs (including the payment on a traditional mortgage if that is the desired approach). Optional "early" death benefit and increasing payout options are also available in at-need annuities and may be of value though they lower the payout-to-purchase-payment leverage ratio.

An Illustrative Example

The author's mother-in-law's LTC experience will illustrate how this combination's leverage can "pay off," as well as some of the curves that long-term care can entail.

My mother-in-law, a widow, living in her own mortgage-free home, was diagnosed with dementia with tendencies to wander on her 84th birthday. There was a power of attorney in place, but unfortunately in California, a power of attorney does not extend to placing a person in a secure facility, even a secure assisted living facility. So we were forced to seek conservatorship (which was finally granted after too much and likely too common trial and tribulation and money, but that is another story).

Under conservatorship, the courts must approve all financial arrangements, including disposition of the conservatee's home. Moreover, at least in the county involved with my mother-in-law, the courts were known to not be favorably inclined to annuities (perhaps as a result of attempts to sell high-commission/long-surrender-charge-period deferred annuities to conservators on the one hand, and the not uncommon reaction of people to lifetime annuities as being very risky if the annuitant died "prematurely" on the other hand).

Additional elements of my mother-in-law's situation, showing some of the many factors that come into play in LTC management, are:

- An LTCI policy, on which she had paid premiums for almost 20 years, was still in effect, but unfortunately was (thus) primarily a nursing-home-only policy with a maximum benefit of "only" $200,000.
- Medicaid wasn't an option since conservatorship requires that assets be used to provide the conservatee with the "least restrictive" care available.
- A reverse mortgage wasn't possible because my mother-in-law no longer resided in her house.

More specifically, my mother-in-law had sufficient cash to fund an assisted living facility consistent with her level of sophistication and appreciation of reasonably fine living—at least for a few years. We rented her home and she had Social Security income. But inflation in her living costs, and court, legal and conservatorship costs drained those funds to the point that by age 88 we had to either access the equity in her home or put her in a skilled nursing home that would be 80 percent paid by her LTCI policy for about three years. The courts would undoubtedly have gone along with the latter, but she was content in the assisted living facility, and even the best of the nursing homes did not seem right for her. Luckily, we found a lawyer who was willing to listen to how we saw the situation and present our thinking to the courts.

The presentation to the court was based on cash flow projections of her income and outgo, including options for using her home equity, together with, or not, an at-need annuity offered by an insurance company to pay *27.4 cents on the dollar* of purchase payment for as long as she lived.

Whereas selling the house would cover her projected costs to 93 (and leave an estate if she died before then), she would have no money left at 93 and would have to go on Medicaid and its potential for poorer care et al. Moreover, housing prices had already started to diminish. Selling might take some time, incur capital gains taxes, and the nature of her retirement community property suggested reasonable long-term value.

A mortgage on the house itself, i.e., without purchasing an at-need annuity, followed by the sale of the house at some point, projected deficit trouble even earlier. But mortgaging the house and buying the at-need annuity with the net proceeds produced leverage of 20 cents on the dollar (27.4 for the annuity less 7.4 cents for the mortgage), enabling her to continue to have the excellent care and comfort afforded by the assisted living facility for the rest of her life.

Convincing the court was accomplished not only by the projections, but educating them that, quoting from the petition:

> The income-generating annuity proposed by Petitioner will generate a guaranteed monthly income of [$XX,000], 27 cents per dollar of premium, to [the Conservatee] for the rest of her life. As established in this Petition, this income is necessary to provide [the Conservatee] with the money to cover her living expenses and allow her to remain at [the assisted living facility] or some equivalent facility for the rest of her life. If, as Petitioner hopes and expects, [the Conservatee] is likely to live many more years, an annuity is the only means through which this can be accomplished, since the payments are enhanced by its survivorship element and guaranteed for the life of the annuitant rather than for a

fixed period.

> A lifetime annuity might be thought of as a risky investment for a person of [the Conservatee's] age and dementia. The heirs of such an elderly person might protest since the potential estate might be diminished by the death of the annuitant before recovering the cost of the annuity through income payments. And while that is true, the whole purpose of the purchase of an income annuity is to mitigate the bigger risk of not being able to have sufficient income if the annuitant lives longer than the average expected of her age and health. However, in this case [the Conservatee's] heirs are Petitioner and her sister [____] and they are in agreement that the purchase of the annuity is necessary for their mother's lifelong health, safety, and happiness, and they believe that the purchase of the annuity is thus in [the Conservatee's] best interests. The fact that Petitioner and [_____] will inherit less money if [the Conservatee] should die before recouping the cost of the annuity is not as material to them as that [the Conservatee] be able to remain at [the assisted living facility] or an equivalent facility and obtain the best level of comfort and care for the rest of her life her resources can provide.

Of particular note in regard to the broad question of the purchase of an at-need annuity, my mother-in-law became gravely ill two months after the court approved the plan, the mortgage was obtained, and the life-only (no death benefit to maximize the leverage) at-need annuity was purchased. After a short while, her doctor recommended hospice because he judged, confirmed by the hospice and assisted living personnel in their experience, that she was in the process of dying. Interestingly, my wife and I separately felt OK about our decision because it removed the financial aspects of making the life-and-death decisions for her and assured her good care with her monies. Needless to say, my mother-in-law recovered, and lived reasonably well (given her age and condition) four-and-a-half more years till one month short of her 93rd birthday!

During that time, she broke her hip and we were able to put her in the head-over-heels best nursing home in our area and utilize most of the funds under her LTCI policy. When those benefits ran out, we sold the house for extra cash and because it too was becoming a cash drain. Moreover, because she no longer needed a confined assisted living facility, we were able to find her a terrific (and relatively affordable) convalescent home. Not only did she have first rate care throughout, the financial strains of a very expensive nine years were minimized, and she even left a reasonable legacy!

Summary Observations

Several observations are suggested:

1. Financing LTC need not (and probably should not) be fully pre-funded with only the “perfect fit” LTCI policy.

2. However, as is the case for the purchase of insurance for other potential catastrophic risks, the leverage afforded by the early purchase of some LTCI can become significantly valuable to those at risk.

3. Home equity is a store of value that can be useful for late-life financial needs; access to it should be approached with care.

4. At-need lifetime payout annuities can be very useful leveraging options in paying for LTC using home equity and/or other funds after the onset of long-term care. However, the options, pros and cons, and emotional issues involved need to be carefully explored with the parties involved.

5. Most broadly, the mere availability of at-need annuities represents a potentially significant dynamic in increasing the proportion of people privately paying for LTC.