Inflation Options

The cost of long-term care services is likely to continue to increase at a rate greater than the general rate of inflation. Historically the average rate of this increase has been between 5% and 6% per year. At 5% the cost of services will double approximately every 15 years. At 6% they will double every 12 years.

Most LTC policies offer 2 options for dealing with inflation, a simple inflation option and a compound inflation option. The are usually based on a 5% rate of growth. A 5% compound inflation option will double your benefits approximately every 15 years. A 5% Simple inflation option will double benefits every 20 years.

Since the cost of care can be expected to double every 12 to 15 years. The only option that has a reasonable chance of keeping up with the increasing cost of care is the compound inflation option. Unless you can be reasonably certain you will be dead within 15 years, the only option you should consider is compound. If you absolutely cannot afford compound, simple is better than nothing.

In my opinion, if you need to reduce benefits to make the premium affordable, you would be better off buying a shorter benefit period with the compound inflation option instead of choosing the simple inflation option.

Another approach worth considering is buying a smaller initial benefit maximum with a compound inflation option instead of a higher benefit with a simple inflation option.

Let's look at an example of how this could work out. With one of the leading carriers, a 65 year old could buy a policy with a $120 per day benefit and a simple inflation option (the "simple policy") for approximately the same premium as a $100 per day with a compound inflation option (The "compound policy").

Table 1 shows the policy benefits over the years with the simple inflation option compared to compound. Even though compound starts out lower, in 15 years they are equal and every year after that compound gets further and further ahead.

Year	5% Simple	5% Compound
0	120	100
5	150	130
10	180	160
15	210	210
20	240	260
25	300	430

One other approach to inflation found in some policies is the guaranteed purchase option. Instead of automatically increasing the benefit without increasing the premium as the simple and compound inflation options do, with this option you are periodically offered, (typically each year or once every three years), the opportunity to buy a certain amount of additional coverage, typically the same amount as you would have had if you had originally purchased a simple or compound inflation option, without having to prove you are still healthy. If you skip an opportunity to purchase the additional coverage that increase is lost forever and if you skip several options, (typically three), you also lose all future options. As a result, if you want your benefits to increase to keep up with inflation, you have to keep buying more coverage and your premium constantly increases. Because of this constantly increasing premium and because most of us do not have a constantly increasing ability to pay for more coverage you are likely to eventually find you can no longer afford to accept the offers to increase coverage. At that point your benefits stop increasing and begin to rapidly fall short of the cost of care.

To see the impact of this constantly increasing premium let's look at an example. To make a fair comparison, I will assume you are offered just enough additional coverage each your to keep your benefits exactly where they would have been if you had instead originally purchased a 5% compound inflation option. I'll assume the original purchase is made at age 65. The results are similar at both younger and older ages. I am using the rates for a carrier who is competitive at both younger and older ages (Table 2).

Table 2

Age	Benefit (at 5% compound)	GPO Needed	Cost of Addition	Premium GPO	Premium 5% Cmpd	Difference	Cummulative Difference
65	100	NA	$ 0	$ 680	$1,207	$ -527	$ - 527
66	105	5	37	717	1,207	-490	-1,017
67	110	5	40	757	1,207	-450	-1.467
68	116	6	54	811	1,207	-396	-1,863
69	122	6	59	870	1,207	-337	-2,200
70	128	6	66	936	1,207	-271	-2,471
71	134	6	72	1,008	1,207	-199	-2,670
72	141	7	93	1,101	1,207	-106	-2,776
73	148	7	104	1205	1,207	-2	-2,778
74	155	7	132	1337	1,207	+130	-2,648
75	163	8	148	1,485	1,207	278	-2,370
76	171	8	181	1,660	1,207	459	-1,911
77	180	9	201	1,867	1,207	660	-1,251
78	189	9	221	2,088	1,207	881	- 370
79	198	9	245	2,333	1,207	1.126	+ 756
80	208	10	298	2,631	1,207	1.424	2,180
81	218	10	329	2,960	1,207	1.753	3,933
82	229	11	396	3,356	1,207	2.149	6,082
83	241	12	476	3,832	1,207	2.625	8,707
84	253	12	523	4,355	1,207	3.148	11,855
85	265	12	576*	4,931	1,207	3.724	15,579
86	279	14	739*	5,670	1,207	4.463	20,042
87	293	14	813*	6,483	1,207	5.275	25,318
88	307	14	894*	7,377	1,207	6.170	31,488
89	323	16	1124*	8,501	1,207	7.294	38,782
90	339	16	1236*	9,737	1.207	8.539	47,321

*Estimated based on a linear increase in premium after age 84. Actual cost is likely to be higher.

One other approach to inflation that is sometimes recommended, particularly to those purchasing coverage late in life is to skip the inflation option entirely and instead buy a larger initial benefit. To analyze whether this is good advice, let's consider the amount of benefit that could be purchased for approximately the same premium and see what the benefits are as you get older.

At age 65 you could purchase a $100 per day benefit including the compound inflation option for about the same premium as a $180 per day policy with no inflation option.

Age	Benefit No COLA	Compound
65	180	100
66	180	105
67	180	110
68	180	116
69	180	122
70	180	128
71	180	134
72	180	141
73	180	148
74	180	155
75	180	163
76	180	171
77	180	180
78	180	189
79	180	198
80	180	208
		etc

As you can see, there are several different ways to deal with inflation. The only one that does a reasonable job of dealing with inflation is the compound option. Of course, it is also the most expensive. If you can afford it, the compound inflation option is the best one to choose.