HOW THE **FEDS** ARE GOING TO **HELP YOU** MAKE THIS

A RECORD YEAR

GROWING TOP LINE HVAC SALES REVENUE WITH TWO FEDERAL PROGRAMS

A white paper for contractors from Tracy Paul, Principal
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TELL ME QUICK!

Can't set aside a few minutes to carefully read this report? You'll probably miss out on a great opportunity to grow revenue despite the expected recession.

Washington wants homeowners to shift to electricity from other fuels ... and to replace lower-efficiency electric systems with today's best. So, they're preparing to pay as much as $14,000 for those upgrades. That means once these incentives are fully implemented, you'll be able to sell homeowners higher-efficiency equipment for less than what your basic systems cost them today – without sacrificing your margin!

Remember, when times get tough (like the 2023 economic forecasts suggest), consumers will begin to inherently look to short-term repair options for their equipment vs. long-term replacement. However, these two new and expanded federal programs give contractors a counter-balance to that short-term thinking and support new, and more affordable, replacement options to fuel top line growth for contractors who embrace electrification.

WASHINGTON GIVES HVAC CONTRACTORS A GIFT

HERE'S HOW YOU CAN USE THAT GIFT TO GROW TOP-LINE REVENUE

Most HVAC contractors have done well the past couple years. If you're among them, good for you! But it looks like maintaining the growth trend is going to get harder. I'm no economist, but it's pretty clear we're heading into a recession. I've run my business through three of them including 2008, and each time, I've watched my HVAC clients struggle with top-line growth from their replacement division, including stories about owners forgoing a paycheck or two so they could keep their people busy.

If you've been through a recession as an HVAC contractor, you know exactly what I mean. Consumers get stingy, opt for repair and just want you to keep their system running until they can afford a new one "next year." Understandably, economic uncertainty makes consumers hesitant to spend (or borrow) for replacement, and it will get harder for them to even get credit. I get the problem, you often have to squeeze on price to "make them deal" to hit your replacement goals at the expense of margin.

IT WASN'T JUST THE ECONOMY

Most contractors have done well over the past couple of years, and many give credit to the economy or their skill as businesspeople. They may or may not realize that chief among the many reasons for growth in the HVAC industry was the housing boom. Not the current boom, but the one that followed the Great Recession in 2008. As the economy recovered just over a decade ago, people invested in new homes … and the HVAC in those homes reached the end of its service life over the past few years. By the way, that business cycle is starting to dry up. So yes, contractors will have another shot at this unusually healthy replacement market … but not for another decade or so.

EXCEPT …

I came across a funny poll (there seems to be a poll for everything these days) to describe Congress in one word. While the top 10 included words like useless, incompetent, etc., our friends on Capitol Hill did manage to do our industry a huge favor. In 2022 Congress passed the Inflation Reduction Act. Tucked inside that act is a really generous gift to HVAC contractors. While it's there primarily to serve environmental goals, it also provides a way to dramatically increase your average sale and disrupt the normal replacement cycle.

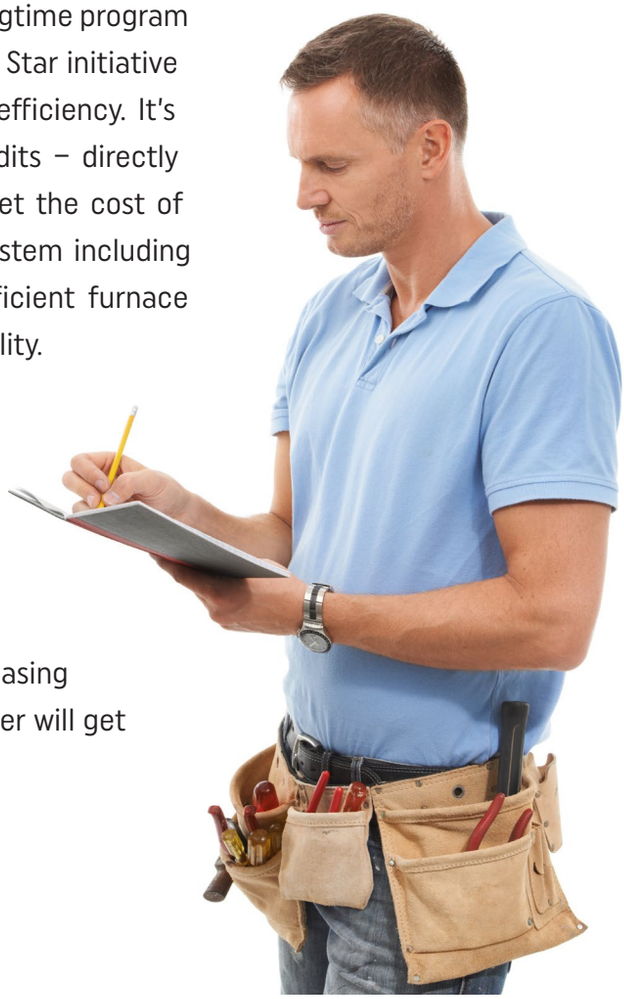
BENEFICIAL ELECTRIFICATION

Reducing carbon emissions is a high priority for the current administration. The rapid expansion of renewable power (wind, solar, etc.) and driving more power from electric power plants are by-products of a concept called "beneficial electrification." The goal of beneficial electrification is to replace major sources of carbon emissions with electric alternatives. The growth of electric vehicles is a great example in which the Feds see the use of electric energy as a cleaner alternative to gasoline and diesel fuel. It doesn't matter whether you agree with their philosophy. What matters is that they're using it to give you a golden opportunity to significantly grow your business.

Congress is providing incentives to encourage homeowners to replace less efficient appliances and those appliances that rely on gas and oil (including heating and air conditioning equipment) with modern alternatives. For the HVAC replacement market, those products are the split, non-ducted, and packaged air-sourced heat pumps. Yes, there are additional incentives for solar, geothermal, and others, but air-sourced heat pumps have broader opportunity for most contractors. And don't forget, the feds changed the efficiency calculation with "SEER2" in an attempt to better reflect field conditions of installed equipment. Manufacturers are scrambling to build and stock product that meets the new standard.

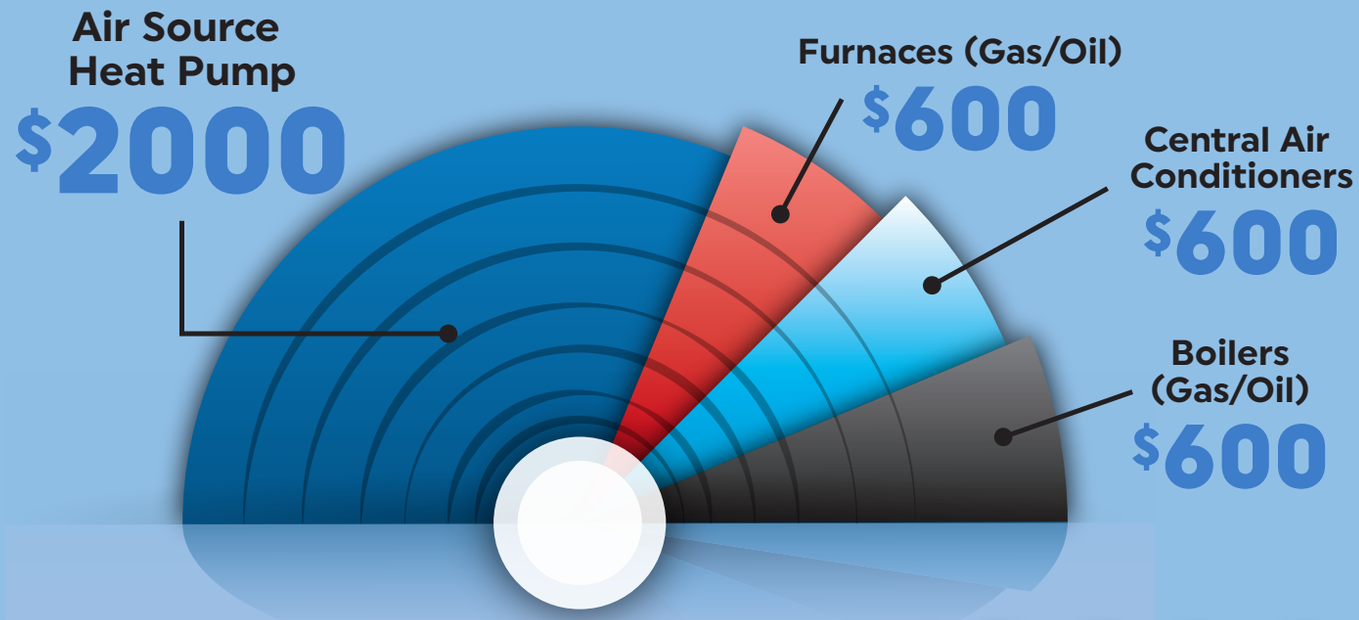
ONE FAMILIAR PROGRAM

What's known as the 25(C) federal tax credit refers to a longtime program handled by the Environmental Protection Agency's Energy Star initiative to encourage investment in residential renewables and efficiency. It's been expanded to offer up to $3,200 in federal tax credits – directly deducted from the homeowner's income taxes – to offset the cost of higher-efficiency equipment. For example, a dual-fuel system including a 16 SEER2 heat pump combined with a 97 percent efficient furnace qualifies for up to $2,600 off a homeowner's tax liability. Again, it's a direct credit off income taxes owed, not a reduction of taxable income. There are two other aspects of the tax credit worth noting. First, the $3,200 in federal tax credits are available year-over-year for homeowners continuing to make energy improvements. Second, many utility companies match, or exceed, the federal standard, significantly decreasing the cost of equipment to your customer. Yes, your customer will get better equipment for less money!



25(C) ENERGY STAR TAX CREDITS FOR 2023

UP TO 30% OF PROJECT COSTS



MAXIMUM ANNUAL CREDIT : **$3200**

ANOTHER WITH A FUNNY NAME

Congress always tries to give clever names to important legislation. Remember "Cash for Clunkers"? Well, they came up short on this one. It's called the High-Efficiency Electric Home Rebate Act, or, unfortunately, HEEHRA. That's pronounced like "hee-here-aw," by the way. Really rolls off the tongue, doesn't it?

Despite the lame name, it's a big opportunity. Would it be easier to sell 16+ SEER2 air sourced heat pumps if you could knock $14,000 off the price? In very simple terms, that's exactly what HEEHRA does... or will do once the feds and states identify how to distribute the money. They expect this program to provide incentives for the next decade. What's important is the money will be available to your customers as soon as they work out the details – so it's probably worthwhile to contact your state legislators and get involved. After all, it will make them look generous to their constituents.

HEEHRA REBATES FOR QUALIFIED PROJECTS

ITEM	MAXIMUM REBATE
Maximum consumer rebate	$14,000
HVAC heat pump	$8,000
Breaker box	$4,000
Electric wiring	$2,500
Heat pump water heater	$1,750
Weatherization	$1,600
Heat pump clothes dryer	$840
Electric stove/ cooktop	$840

Percent of costs covered (including installation):

- 100% for low-income homeowners (Below 80% of AMI)
- 50% for moderate-income homeowners (Between 80 and 150% of AMI)

HIGHER-QUALITY REPLACEMENTS BECOME MORE AFFORDABLE

With HEEHRA, your company can not only give a customer the replacement option they didn't think they could afford, but you can do it with equipment that will lower their utility bills for the next decade. Best of all, you sacrifice not one penny of margin. How much more will you clear on that 16+ SEER2 unit?

We've included a chart of the rebates available under HEEHRA. For examine, that 16 SEER heat pump qualifies for $8,000 on its own, but the program also throws in another $4,000 for a new breaker box and $2,500 for wiring – covering up to 100 percent of the project costs. Those rebates apply to homeowners who earn less than 80 percent of your area's median income (AMI). Smaller rebates covering up to half the cost are available for homeowners making less than 150 percent of AMI.

WILL PEOPLE REALLY QUALIFY?

The AMI for Cornerstone's hometown in an Indianapolis suburb is $91,900. That means homeowners earning less than $73,520 annually in our community qualify for the full rebates. Think about folks who are on a fixed income, such as the seniors in your market. They probably qualify. And homeowners making up to $137,850 can receive half the rebate amount -- $4,000 on a heat pump is still an impressive discount.

You can check for your community's AMI using Fannie Mae's free lookup tool. You'll probably be amazed at how many homeowners in your area qualify for these generous federal rebates.

https://ami-lookup-tool.fanniemae.com/amilookuptool/

BUILDING INCENTIVES INTO OFFERS

By combining the 25(C) and HEEHRA incentives with utility and manufacturer rebates, you can get consumers into better equipment (16 SEER2 heat pump and a 97% furnace) and increase your average order with less out-of-pocket than your current offer. Here's an example of how that could work. Instead of your bottom-tier package, you can now offer your customer a 16+ SEER2 heat pump and a 97% furnace that normally sells for between $15,000 and $17,500. Right off the bat, the homeowner qualifies for a $2,600 credit under the 25(C) program, as well as rebates of say $350 from the local gas company and $300 from the electric utility. Let's also say you'll build in roughly $1,000 in marketing funds, so the homeowner is saving $4,250.

Now let's add in the $4,000 heat pump HEEHRA rebate, which brings the total discount to consumer to a whopping $8,250! Put another way, for less than they'd pay for your "budget" option, homeowners can get significantly better equipment, lower utility bills and a superior level of comfort... while you gain average order and margin.

OKAY, YOU'RE HESITATING

Some contractors are reluctant to even consider making such a dramatic change to how and what they sell. Usually it comes down to one of two reasons. For some contractors, it's because heat pumps require more complicated installation and often demand upgrades to wiring and breaker boxes – but keep in mind HEEHRA offers up to a total of $6,500 for that electrical work.

The bigger reason is because it changes the way you sell. Typically, most contractors make their equipment recommendations based upon heating hours and cooling hours. If you're in the Indianapolis area, the split is about even. If you're in the northern tier of states – for example, in North Dakota – you think of yourself as being in a furnace market. Yes, it gets hot in the summer months, but that 14 SEER air conditioner handles the few months it's really needed. A good 90% furnace has been the right choice the rest of the year.

BUT HERE'S THE THING

The government's goal is minimizing energy that's produced through gas and oil appliances with electricity. Pure and simple (or as simple as anything in government ever gets), they want to increase the number of heating hours handled by electricity.

As long as the outdoor temperature stays above 40, that 16 SEER heat pump can keep the home comfortable. Instead of flipping the furnace on in October, we won't need it until late December. And then, only until March, instead of May. So the gas furnace only runs for a couple months instead of six. Every other heating hour is handled by the heat pump. Less carbon that way.

They want it to happen everywhere from Caribou, Maine to San Diego County. From the Northwoods to the sunniest corners of the sunbelt, savvy HVAC contractors will change the way they've been selling forever.

UPENDING THE CYCLE

Do you remember the Cash for Clunkers program that boosted sales of fuel-efficient autos by awarding vouchers to reduce the vehicles' cost? These incentives are quite similar. But while we can expect them to provide a short-term boost, they're actually likely to change the replacement cycle forever. You'll find your techs removing six- and seven-year-old equipment, replacing it just halfway through its expected service life.

It's possible this change in the cycle may lead to fewer peaks and valleys in the cycle for future installations, which could balance out year-to-year performance.

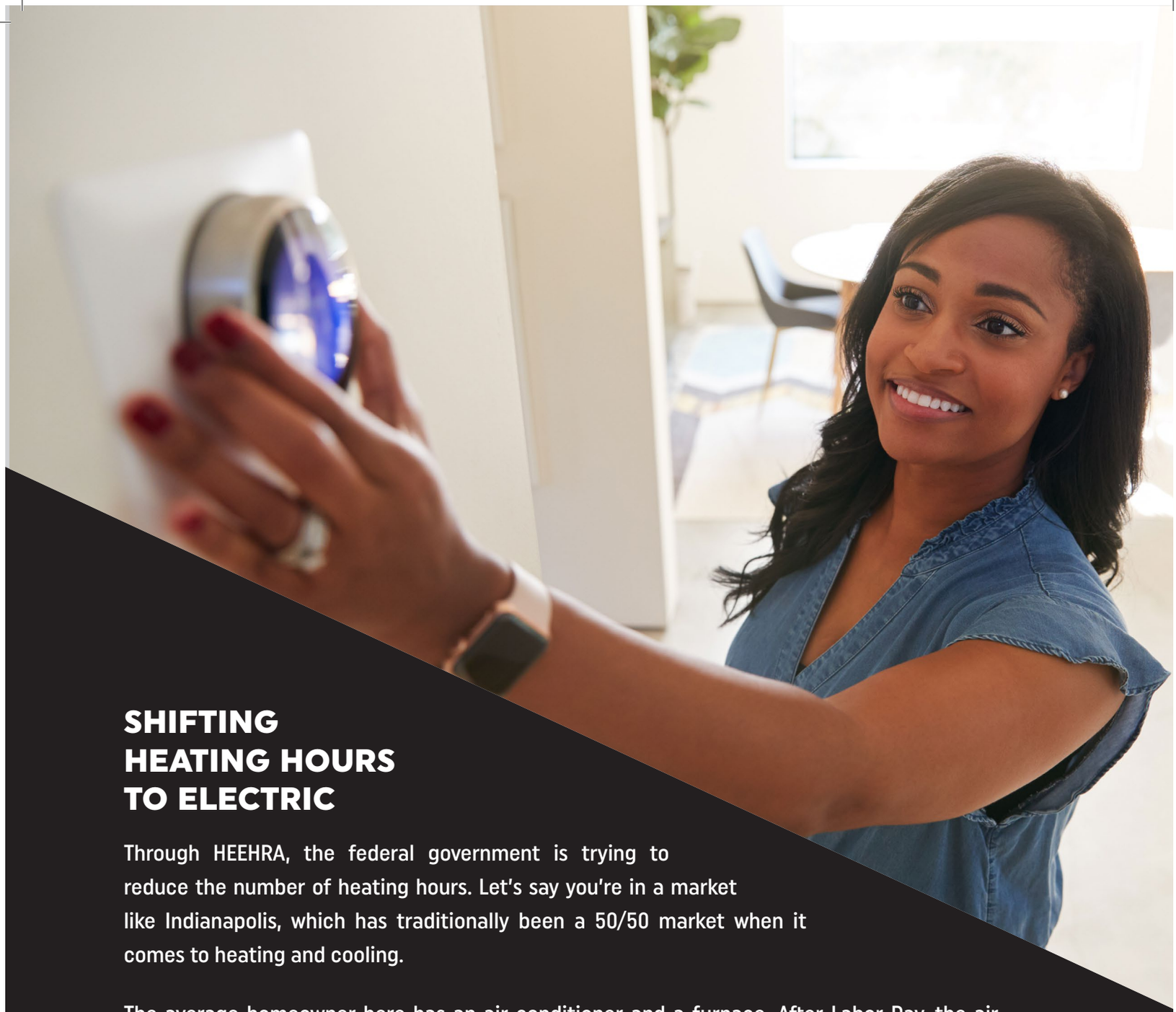
IS A RECESSION IMMINENT?

If you ask five economists what's going to happen with the economy, you'll get at least six different answers. Right now, most economic indicators seem to signal we're either in a recession or will be soon. The consensus I've seen is that it's not likely to be a prolonged slowdown, but even a short recession hurts HVAC businesses because it changes consumer behavior.

HVAC systems don't pay attention to the economy. They break down when they want to, whether the homeowner can afford a replacement or not. When it's 20 degrees outside and the furnace stops working, they can't wait. In the long run, replacement is nearly always a better option, but in the short run, money's tight. A $500 repair hurts, but not as badly as a $15,000 replacement.

Replacement business accounts for 75 to 80 percent of top-line revenue for the typical HVAC company, with the remaining 20 to 25 percent coming from service and maintenance. (Of course, if you have other service lines like electrical and plumbing, your percentages will be different.)

During a recession, more customers will choose repair over replacement, forcing you to settle for less revenue or making you turn up the pressure on your margins and sales team.



SHIFTING HEATING HOURS TO ELECTRIC

Through HEEHRA, the federal government is trying to reduce the number of heating hours. Let's say you're in a market like Indianapolis, which has traditionally been a 50/50 market when it comes to heating and cooling.

The average homeowner here has an air conditioner and a furnace. After Labor Day, the air conditioner isn't needed again until the Indy 500 approaches in May. The furnace takes over sometime in October and runs through March.

With these incentives, the homeowner can move to a high SEER heat pump that not only provides economical air conditioning, but can also generate heat until the outdoor temperature falls to 40 degrees. So now the heat pump takes the biggest share of heating until late December, and takes over again in early March. That means the furnace is the primary source of heat for just two months, instead of six. Efficient electrification covers the rest of the year.

Whether you're in a northern tier state, somewhere in the deep South, or anywhere in between, the switch to high-SEER heat pumps means more heating hours will be handled by electricity. That's the goal across the board.

If the only thing that has kept you from selling those high-SEER heat pumps is the idea that you couldn't make the money work for the homeowners you serve, you can thank the feds for rewriting all the equations. Between HEERHA and the 25(C) program, those heat pumps are now both affordable and practical, no matter where you do business.

THIS IS THE NEW NORMAL

If your people aren't comfortable handling heat pump installations, get them trained. Like everything from electric cars to smartphones, the consumer marketplace is changing. A decade ago, heat pumps were a tough sell; five years from now you'll wonder about any homeowner who insists upon a straight AC. Plus, you will never regret the investment you make in sending your techs to training now... as in right now. And you shouldn't have any trouble keeping them busy in a few months, so they'll need to be ready.

THE SOONER, THE BETTER

Given all the federal money flowing into the economy, coupled with stronger demand for higher SEER2 heat pumps, you shouldn't be surprised if the manufacturers start increasing prices. While the incentives should keep prices favorable for homeowners for a while, getting an early start will help you make the most of your margins.

So where do you start? While you wait for your state to implement the HEEHRA rebate program, you can prepare to get a jump on competitors by:

CREATING YOUR OFFER.
Compare all the available incentives to your product line and choose the right products to promote.

DEVELOPING YOUR PROCESS.
How will your sales and marketing teams promote your offer?

TRAINING YOUR TEAMS.
The techs need to be ready for heat pumps, and everyone needs to understand what makes them better.

GOOD LUCK. And if you need some help marketing this amazing opportunity, please give me a call.

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ABOUT THE AUTHOR

Tracy Paul is principal owner and founder of Cornerstone Advertising Inc., where he has helped HVAC and plumbing contractors of all sizes grow and become market-dominant companies in cities throughout North America for more than 25 years. Cornerstone is a full-service marketing firm that includes both traditional and digital advertising for the home service industry, and gives contractors access to a complete marketing department for less than it costs to hire a full-time marketing director, using proven strategies delivered through an account manager who treats their business like it was their own.

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