

Savvy home service companies adapting to meet new consumer needs

Since the early 1970's when they began to take root in California, home service contracts have emerged to become a key ingredient in the housing value chain. Today, as the housing sector starts to recover from a punishing recession, home warranty programs are not just an accepted industry practice, but are becoming an essential fuel for accelerating and sustaining the housing recovery.



The foundation of the value of a home warranty has always been: *home service contracts offer peace of mind.*

Historically, they have been providing protection for decades to real estate buyers and sellers, the industry's traditional customer base. But more recently the service contract industry has been evolving to meet a changing customer profile and a growing consumer demand—to make long-term home management easier.

Today, when many home appliances, device or major system comes with touch screens and computer controls, costs for repair or replacement can run into thousands of dollars. And the proportion of Americans who have no non-retirement savings whatsoever grew in 2012 to 39%, leaving millions more consumers unprepared for a large unanticipated expense.¹

Some home service companies have evolved their models and added products specifically to address consumer anxieties about large unplanned expenses. Cross Country Home Services (CCHS), for example, offers 20 different types of warranty products for consumers, and it also provides customizable service protection products for partners in the mortgage, banking, insurance, real estate and utility industries to help them provide that peace of mind that builds brand and customer loyalty.

CCHS President Sandra Finn summarizes her company's approach:

"We are constantly reviewing and incorporating feedback from our customers to improve our claims and other processes and to help us shape the kinds of products that will meet their home service needs. As one of the largest providers of home service contracts, we have the critical mass of customer data required to see how consumer needs are evolving and respond to those needs."

¹ 2012 Consumer Financial Literacy Survey, Harris Interactive

This discussion of warranty programs will review the fundamentals of home service contracts, the industry's changing customer profile, its current market position, some key challenges currently facing the industry, trends in product offerings, and new opportunities for consumers and industry partners.



UNDERSTANDING HOME SERVICE CONTRACT BENEFITS

"Home warranty" is a marketing term held over from the early history of the industry. In fact, a home warranty is not actually a warranty but a service contract. Generally, a home service contract provides service, repair or replacement on a home's major systems and appliances, usually for a term of one year.²

Basic and optional coverage varies from company to company with some regional variances. Home service contracts are specific and do not include everything in your house, and most do not cover home foundations, walls, structure or finish.

Typical systems that are covered include: interior plumbing, heating system, electrical system, water heater, ductwork, dishwasher, oven, range/cooktop, garbage disposal and garage door opener. Heating and air conditioning systems, refrigerators and washer/dryers may be part of a basic contract or may be options. Spa and pool equipment may also be part of optional coverage.³ A home service contract should not be considered a replacement for homeowner's insurance. Where homeowner's insurance protects the consumer from external forces like storms and fire and theft, home service contracts protect consumers from the unanticipated, and sometimes very expensive cost of normal wear and tear on systems and appliances in the home. In short, the industry's services "were born out of the need for household repair that was not in the scope of homeowner insurance."⁴

Repair needs for home appliances and service systems are actually quite predictable. According to the National Association of Realtors®, within the next 12 months, there is a 60 percent chance that a key system in your home, such as the furnace, air conditioner or major appliance will fail, and the cost of the repair will average \$900.⁵

Estimated Replacement Costs**



** The data above is based on TotalProtect's estimated ranges on retail costs for replacement of the listed systems and appliances. Includes data from national independent service contractors as of 2011. Pricing and benefits may vary by state.

² National Home Service Contract Association

³ National Home Service Contract Association

⁴ IBIS World Industry Report, 2/2012

⁵ Hendersonpress.com, 9/2/2011

Sometimes, it can be considerably more than that. For example, according to analysts, HVAC systems "are often some of the most expensive to repair and replace for homeowners and make up one of the primary draws for homeowners purchasing home warranty coverage."

A recent survey by the National Foundation for Credit Counseling showed that a majority of Americans (64 percent) did not have enough cash on hand to handle a \$1,000 emergency expense, much less one costing \$3,500.⁶

Service contracts are not intended to eliminate these household repair expenses but help mitigate them and make them easier to manage. By paying a budgeted annual fee of between \$350 and \$600, along with a service call charge that usually ranges from \$50 to \$100 (depending on the area of the country), consumers can avoid the potentially crippling cost of a major system failure. And they are assured access to local plumbers, electricians and other technicians who are licensed and qualified to make the repair.



CUSTOMER PROFILE

While home sellers historically have been the dominant purchasers of home warranty plans, the customer profile is changing and expanding, driven in no small measure by the consumer's desire to feel like they have more control in an increasingly complex world.

According to industry analysts, "buyers are becoming an increasingly important market," and "in particular, home warranty plans tend to be popular among first-time buyers" who have little experience with the costs of home maintenance and are looking for help.⁷ Experience shows they are also very attractive to experienced home owners who seek assistance in managing costs.

Across the industry, home service contracts are addressing the specialized needs of a variety of different customers:



- **Established homeowners** – Many homeowners used to depend on borrowing against their home's appreciated value as a way of managing unanticipated expenses when savings were depleted. That has become more challenging in today's volatile housing market, making customized home warranty programs a more valuable tool for protecting their savings against big ticket expenses.



- **First-time home buyers** – New homeowners often have little experience estimating what their household maintenance expenses will be and even less knowledge about who to call when repairs are needed. Service contracts reduce some of the anxiety of being a first-time homeowner by making household expenses more manageable and providing access to a trusted network of service providers.

⁶ National Foundation for Credit Counseling, 8/2011

⁷ IBIS World Industry Report, 2/2012



› **Home sellers, including home builders and real estate brokers** – Sellers often worry about receiving calls from their buyer months after the closing about an appliance that has stopped working. Service contracts provide after-sale protection for the seller and other parties to the transaction.



› **Services providers** – Home warranty companies provide a bridge to connect consumers to qualified repair and replacement professionals. They increase sales and service volume for those businesses, and increase their market visibility without increasing marketing costs. They also enable the service provider to establish a relationship with the customer that can extend beyond the term and scope of a home service contract.



› **Financial institutions** – Mortgage servicing companies and banks seek stable client relationships. Adding service contracts to their product mix helps financial institutions assist their customers to control expenses, and build client stability along with brand affinity.



› **Insurance companies** – Service contracts often complement homeowner's insurance, providing competitive differentiation for the insurer and filling in the gap areas not normally in the scope of a homeowner's policy.



› **Utilities** – Repair responsibility for the area between the street and the house can sometimes create a challenging divide for utility providers and homeowners. Service contracts that help homeowners repair or replace water, sewer, gas and electric lines can bridge that divide and enhance customer loyalty.



SNAPSHOT OF THE INDUSTRY

About 57 companies compete in the industry; most of these companies are small and compete on a regional basis. Cross Country Home Services (CCHS) is one of largest, servicing customers nationwide.⁸

The home warranty industry today is national in scope. The industry is governed by state rather than federal regulations, and typically, a state's regulatory profile, as well as population distribution and trends in existing home sales, determine demand for home warranty providers in a given area.

⁸ Warranty Week estimates, 2009

While existing home sales plunged from 5.65 million in 2007 to 4.19 million in 2010, recently home sales have begun to rebound. According to the latest information from the National Association of Realtors®, existing home sales rose 1.7% in 2011 to 4.26 million. The National Association of Home Builders was predicting a 19 percent increase in new single family housing starts for 2012, and through mid-year, the National Association of Realtors® was also reporting encouraging increases in resale activity, with figures for May at a two-year high.



Sellers find home warranty coverage particularly valuable when challenging selling conditions exist in the real estate market since there is greater competition for prospective buyers. The coverage afforded by a home warranty can provide sellers with a competitive edge.

About.com reported that sellers gravitate to the coverage as "another layer of protection." Writing about a dishwasher break-down after a sale, the writer suggested, "without a policy, buyers might ask the sellers to pay for repairs or even sue if they believe the dishwasher had a defect the sellers should have disclosed."⁹

In a recovering housing market, home service contracts have almost become an essential component for closing sales and assuring buyer comfort. This was their traditional role, and it has become virtually a given in many parts of the country. For example, in California where the industry began, 90% of the homes sold include a one-year home warranty, up from one in 10 in the seventies.¹⁰ Nationally in 2010, households bought about three million home warranty plans.¹¹

While the recession impacted demand for contracts linked to a real estate transaction, the industry continues to grow, in some cases, dramatically. Over the past five years, CCHS has more than doubled its revenue.

Market analysts who completed an analysis of the industry in February, 2012 for IBISWorld listed several critical requirements for service contract companies to succeed going forward. Among them:

- ▶ Home warranty providers must comply with state and federal legislation.
- ▶ Companies must establish contracts and solid relationships with repair contractors to perform repair and replacement work.
- ▶ Consumers demand for specialized coverage will increase and companies will need to develop an array of customized and flexible products to meet changing demands.



CHALLENGES ON THE HORIZON

While the housing industry is slowly coming back, it is expected to be several years before it completely recovers. Meanwhile, the service contract industry is again exhibiting healthy growth, but there are significant challenges the industry must address to sustain this momentum.

⁹ About.com, 8/26/2011

¹¹ National Home Service Contract Association

¹⁰ IBIS World Industry Report, 2/2012

Public education is one of them. The internet has had a dramatic effect in enabling consumers to research product purchases, but it has also created a challenging environment for consumers to sort out the good information from the bad. Online review forums suggest consumers often can have unreasonable expectations of what a service contract covers and does not cover. Increased customer satisfaction will depend on providing consumers with better information on how service contracts work, and which products in a growing portfolio will best suit their needs.

Understanding that the consumers most likely to post negative reviews to an online forum are those with unresolved complaints, CCHS is leveraging its customer service network to listen carefully, identify those consumers' concerns and address them before they make the decision to post. They are also working with their base of customers, the large majority of whom are very pleased with their warranty plans, to encourage them to take to social media to talk about their positive experience.

Kathleen Calligan, president and CEO of the Nashville Better Business Bureau, spoke enthusiastically recently about the value of service contracts. "Home warranties are almost as much a part of the real estate transaction as the home inspection," she said.¹² But she also tempered that support with a caution shared by those in the service contract industry. Continuing customer satisfaction requires that consumers carefully read the contracts before there is an emergency, and understand what they are getting, what the service fee is, who will choose the repair technician, and whether the contract coverage encompasses all the appliances and systems the consumer thought were covered.



CREATING NEW PRODUCTS & SOLUTIONS

Innovation in the service contract industry has helped strengthen larger warranty providers, and it has also helped their industry partners meet changing consumer expectations. A considerable advantage and opportunity for the larger players in the industry is their access to data about customer experience.

CCHS in particular, has invested aggressively in a customer-centric business model. It has grown and enhanced the sophistication of its 24/7 customer service database platform, allowing it to quickly connect a customer repair need with the right technician in a nationwide network of more than 40,000 pre-qualified contractors. The same platform provides, among other benefits, valuable data about customer satisfaction with the contractors, what types of repairs are the most common, what kinds of communication channels customers prefer and what types of coverage customers would like to have.

As an example, understanding customer needs helped the company to develop its line protection service programs. Very often, homeowners have no idea—until they hear a horror story from a neighbor or have their own repair nightmare—that they are responsible for the water, sewer, electrical and gas lines running from their homes to the street.

Line protection service programs address that need. In some cases, they are offered directly to consumers. Or they may be offered in partnership with the utility that consumers had presumed would be responsible for the repair. In looking at developing trends, industry analysts noted, "Utilities companies are increasingly selling water, sewer and wire protection plans as a bundled service offering with home warranty plans."¹³

¹² Nashville Tennessean, 1/8/2012

¹³ IBIS World Industry Report, 2/2012

Customer experience data has also prompted the industry, and CCHS, to work with other affinity partners to successfully address consumer concerns about other coverage gaps. By complimenting a homeowners insurance policy with a home service plan, for example, insurance companies can make sure that customers have broader protection and a more positive claims experience. If a faulty dishwasher floods the kitchen and ruins a customer's hardwood floors, typically homeowners insurance pays for the floor but not for the repair or replacement of the dishwasher. Bundling the coverage with a service contract allows the insurer to say "yes" to the dishwasher, improving the claims experience while building satisfaction and loyalty.

There have also been innovative approaches with mortgage lenders. Special programs for foreclosed homes are helping financial institutions mitigate the trepidation buyers have about purchasing a home that may have been abandoned due to foreclosure.

The risk for the lender, of course, occurs if the new homeowner encounters unanticipated expenses. Without a way to manage these expenses, he could abandon the property, and both local government, which wants a strong tax base, and the lender would be right back where they started.

"We wanted to make sure that when they got into the house, that they had the peace of mind to know that if an issue arose after closing, that it would be covered," said Michael Hammett, public information officer for the city of Phoenix, where they launched such a program. "With foreclosures at record highs, we wanted to make sure this program would be successful, meaning people would get into homes and stay in them."¹⁴

On a similar note, Freddie Mac, one of the nation's leading mortgage lending institutions, is now offering up to a \$500 home warranty credit to its homebuyers. The credit is available on owner-occupant offers for Freddie Mac homes and reinforces the value of providing another layer of comfort for consumers trying to navigate a volatile housing market.

CCHS clients in the mortgage and real estate industries already include companies such as Bank of America, CitiMortgage, Wells Fargo, Berkshire Hathaway/Home Services of America and Long & Foster; all of whom offer CCHS warranty products to their customers.

Customer data insights and 24/7 service capabilities are also enabling service contract companies like CCHS to provide emergency coverage plans, energy efficiency maintenance services and other options, including the development of service contract programs designed specifically for second home owners.

Integrating the voice of the customer throughout their operation has enabled CCHS to both improve consumer satisfaction with their claims process and enhance their product development efforts.

Good examples of this are CCHS's maintenance programs. CCHS was the first company to offer home maintenance bundled with home service contracts—a great benefit for those unfamiliar with the regular maintenance needs of major home systems and appliances. Proper maintenance is key, since under most warranty plans, a household system that has not been properly maintained may be ineligible for coverage.

Listening to consumers also led the company to leverage its buying power on behalf of its customers. As an alternative to having CCHS replace a covered appliance that is beyond repair, the company will provide home warranty customers with a credit that can be used to buy a new appliance at a heavily discounted price. The discounts sometimes can be up to 30% or more, and can give consumers the opportunity to upgrade if they wish.

¹⁴ Warranty Week, 12/09

Better yet, CCHS customers can use the Appliance Buyline® for member-only discounts even when there is no claim and, let's say, the customer just wants to update appliances as part of a kitchen makeover.

Such a commitment to innovation and a deep understanding of evolving customer needs is likely to become even more critical.

Market analysts predict that an ability to offer tailored solutions across a spectrum of customer segments will be a key success metric for the entire industry going forward, noting that home service companies that “offer a wide array of programs will most likely benefit the most during the recovery as there will be heightened demand for specialized coverage.”¹⁵

¹⁵ IBIS World Industry Report, 2/2012