

PUTTING A CAP ON YOUR MAINTENANCE COSTS

Should You Consider a Service Contract For Your Rental Property

by W. Michael Novotny, Designated Broker of Arrowpoint Realty, Inc

A typical service or maintenance contract for a rental home will cost anywhere from \$450 to \$600 or more annually. Generally it will cover such things such as the hot water heater, air conditioning system, appliances, plumbing, and pool or spa equipment. In most instances, if the covered item cannot be repaired, it will be replaced.

There are usually some important exclusions and/or limitations to these contracts, and nearly all of them provide for a “deductible” fee of \$35 to \$50 for each service call. Most companies offer a “basic” policy, with additional charges for expanding the coverage, such as for a second air conditioner for example. Nearly all policies state that they will not cover certain additional costs, such as EPA-mandated “disposal fees,” for old air conditioning units.

Service contracts are attractive to many investors because they offer something of a cap on annual repair and maintenance expenses, and particularly because they provide protection against major unexpected costs. Air conditioners last about 20 years and repairs or replacements can cost from \$100 to several thousand dollars. Hot water heaters are good for 8-10 years, and the cost of replacement and installation can run \$500 to \$1000.

There are some downsides to these service contracts. First, there is that typical deductible fee. The service contract usually specifies that this must be paid C.O.D, so it would likely fall on the tenant to at least initially pay the service person. The second problem is that some contracts specify that if the air conditioner or appliance is obsolete and parts are no longer available, the company is off the hook for repair or replacement.

But the biggest repair issue in Arizona is the nature of air conditioning repair and servicing. We run our air conditioners here at least eight months a year, and our heaters are used at least occasionally over the other four months. The summer of 2005 saw weeks of temperatures well over 110 degrees, and cooling systems were pushed to their max.

Service contract providers don't have their own employees, such as air conditioning technicians, but instead contract with local firms. Because of the volume of work they provide, and the guarantee of payment, they are able to negotiate extremely good pricing. Additionally, service contract companies usually do not permit their service providers from supplying major parts and making an additional profit from doing so. Instead, the service companies buy things such as compressors and fan motors directly from manufacturers, and then have those parts drop-shipped to the service location.

When the temperatures soar, repair requests from the service contract companies flood the local service providers, while those firms are also getting a larger volume of calls from their regular customers as well. Those non-contract calls generate a higher level of profit, both on the labor and parts, and so they may get priority treatment, while the contract work takes second priority.

Additionally, if a major replacement part is needed, it may be a week to 10 days before that part can be ordered and shipped, whereas the same part might be available immediately if purchased locally. The result is that repairs under a service contract, especially in times of high demand, may

take too long to get done, and cause a conflict with the requirements of the Landlord and Tenant Law.

When the response time on a repair gets too unmanageable, the warranty company may agree to “buy out” of the repair – that is, provide a certain amount of money to the owner to get the repair done by someone else. The two problems with this are that, first, the scheduled amount may not be adequate to actually fund the repair, and, second, some service companies will no longer continue coverage on an item that has been repaired or serviced by an outside vendor.

We neither encourage nor discourage our clients from obtaining service contracts on their rental homes, but we strongly urge you to read the fine print, making certain you understand what is covered and what is not, how much the deductible is, what is the response time, and what the policy says when landlords want to send in their own vendors if the response time is not acceptable.

There is a new twist to the service contract industry regarding air conditioners: Beginning in January of 2006, all new equipment will need to be rated at 13 seer. The seer rating is a level of efficiency, and currently, most air conditioning equipment comes in 10 and 12 seer levels. The more efficient the unit, the more expensive it is. Exactly how this new government-mandated standard is going to impact on repair and replacements done through a service contract is still being sorted out by that industry, but some of the warranty companies are already looking at raising prices, increasing deductibles, or charging an additional owner participation based on the replacement cost difference of the older units compared to the newer high-efficiency ones.