



UNITED STATES  
CONSUMER PRODUCT SAFETY COMMISSION  
WASHINGTON, DC 20207

**Memorandum**

**Date:** August 23, 2000

**To** : Ronald Jordan  
Engineer  
Directorate for Engineering Sciences

**Through** : Warren Prunella, AED, Directorate for Economic Analysis *W/P*

**From** : Robert Franklin *RF*  
Economist  
Directorate for Economic Analysis

**Subject** : Service Contracts for Residential Furnaces

You asked us to provide you with information about service contracts for residential furnaces. I have examined the literature in the trade press and articles in various newspapers and magazines. I also talked with two industry experts on the subject of service contracts. This memorandum summarizes the information that I collected.

**Services Covered by Service Contracts**

There are a number of different types of service contracts available to consumers.<sup>1</sup> Service contracts offered through heating, ventilation, and air conditioning (HVAC) contractors typically include an annual inspection and some routine maintenance, such as cleaning or filter changes. They also usually provide coverage for some repairs needed during the life of the contract. However, the extent of the coverage for repairs varies among plans. While some cover the full cost of most needed repairs, others may cover only labor or parts.

Many gas and electric utility companies offer service contracts for their customers' HVAC equipment. Generally, these contracts emphasize coverage for needed repairs. Annual inspections and preventive maintenance are usually not covered in the basic plan offered by utility companies, but may be offered as an extra-cost add-on.

Home warranty companies also offer service contracts for HVAC equipment. However, the service contracts offered by home warranty companies are comprehensive plans that cover virtually all repairs to the plumbing, electrical, HVAC systems and most major appliances in the home. Often, home warranties are included in the contracts for the sale of existing homes to

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<sup>1</sup> In this memo "service contract" is being used as a generic term for all plans that provide some form of pre-paid repair or maintenance service to homeowners. These plans are also referred to as "service agreements," "maintenance agreements," and "home warranties."

protect the buyer for the first year after an existing home is purchased. However, home warranty companies are increasingly promoting their service plans to homeowners in general and not just at the time an existing home is sold. While these are generally "repair only" plans and do not provide for annual inspections or preventive maintenance, some may require an initial inspection to ensure the equipment is in working order before the warranty goes into effect. Home warranty companies do not generally offer service contracts limited to HVAC equipment.

### Pricing of Service Contracts

I obtained some information on the pricing of the service contracts offered by utility companies. Basic "repair only" service contracts for a furnace ranged from about \$39.95 per year (\$3.33/month) to about \$132 per year (\$10.99/month). Some of these plans provide an annual inspection at additional cost. The additional cost for an annual inspection in one case was about \$100 annually (\$8.33/month). According to an informal survey conducted by a trade publication, the prices charged for an inspection and routine maintenance visit only (no repair coverage) by an HVAC contractor was similar: between \$70 and \$130.<sup>2</sup> Thus, the cost of a service contract for a furnace that covers annual inspections and routine maintenance in addition to needed repairs is likely to cost the homeowner around \$110 to \$260 annually.

The cost to homeowners of a comprehensive home warranty is typically \$300 to \$500 per year.<sup>3</sup> In addition to the annual fee, home warranties usually have a deductible for each service call. The deductible is usually between \$35 and \$100.<sup>4</sup>

### Prevalence of Service Contracts

According to a survey conducted for the Edison Electric Institute, only 23 percent of the households nationwide have any form of service contracts for HVAC equipment. This includes those that cover inspections and routine maintenance as well as those that only cover repairs. According the same survey, about two-thirds of all homeowners had not hired a company to conduct any repairs or service on their HVAC equipment during the previous 5 years.<sup>5</sup> A consultant for HVAC contractors that specializes in setting up and administering service contracts thought that the 23 percent figure was about right.<sup>6</sup> However, he pointed out that the

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<sup>2</sup> Some contractors offer a one-time "clean and inspect" for as low as \$19.97. However, the lower prices were generally "loss leaders" or specials. John R. Hall, "From 19.97 to \$131.21, Survey Draws Interesting Results," Air Conditioning, Heating, and Refrigeration News, 03 July 2000.

<sup>3</sup> Melissa Preddy, The Detroit News, "Home warranty can ease worries when purchasing an older dwelling," 02/21/2000 page b1.

<sup>4</sup> "Home: Old Home Can Carry Warranty No Costly Surprises for the New Owners," The Omaha World-Herald, page 1-F, Chris Olson, 03/20/1994.

<sup>5</sup> "Consumers want utility competition," Air Conditioning, Heating and Refrigeration News, B. Checket-Hanks, Feb 1, 1999 v. 206 i. 5 p. 1.

<sup>6</sup> Telephone conversation with Steve Howard, of The ACT Group, 16 May 2000.

percentage varies somewhat regionally with more households having service contracts on their heating equipment in the northeast where winters are more severe. However, since these estimates include all service contracts, including those that do not provide for annual inspections or routine maintenance, it is safe to say that the number of households with service contracts that provide for annual inspections and routine maintenance is less than the 23 percent estimated above.

Although the proportion of homes with service contracts on their HVAC equipment is low, there is evidence that it may be increasing. For example, more companies are offering service contracts. Whereas most service contracts were once offered by local (HVAC) contractors, they are now being offered by gas and electric utility companies and home warranty companies.

There is also evidence that sales of the different types of service contracts have increased. For example, data from the Texas Warranty Association (TWA), a newly formed trade association representing companies that provide home warranties in Texas, reports that 266,645 home warranties were sold in Texas in 1999, a 20 percent increase over 1998 and 70 percent increase over 1996.<sup>7</sup> Various news articles also provide evidence that the number of home warranties is increasing nationwide as well.<sup>8</sup>

Although the number of households with some form of service contract on their HVAC equipment is probably increasing, it is uncertain whether the number of households that have their equipment inspected annually is increasing. This is because the service contracts offered by utility companies and home warranty companies generally do not offer annual inspections as part of their basic services.

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<sup>7</sup> "Service Contract Association Formed to Fight Scams," The Air Conditioning Heating and Refrigeration News, May 1, 2000, p. 7.

<sup>8</sup> See the discussion in "Home: Old Home Can Carry Warranty No Costly Surprises for the New Owners," The Omaha World-Herald, page 1-F, Chris Olson, 03/20/1994. AND "Home: Old Home Can Carry Warranty No Costly Surprises for the New Owners," The Omaha World-Herald, page 1-F, Chris Olson, 03/20/1994. AND Melissa Preddy, The Detroit News, "Home warranty can ease worries when purchasing an older dwelling," 02/21/2000 page B-1. AND "Real Estate: The value of warranty service contracts," Mary Sit, The Boston Globe, 07/18/1993, p. A-1.