

# EQUIPMENT WARRANTY OPTIONS FOR RESIDENTIAL CONTRACTORS



**SHEET METAL & AIR CONDITIONING CONTRACTORS'  
NATIONAL ASSOCIATION**

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# **EQUIPMENT WARRANTY OPTIONS FOR RESIDENTIAL CONTRACTORS**

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## INTRODUCTION

Different types of warranties are available to customers when they purchase HVAC equipment. The types of warranties offered by contractors depends on the product sold and the policies of that contractor.

In addition, homeowners can purchase warranties on their HVAC equipment without an HVAC contractor's involvement through a third party. Maintenance, repairs, and replacement are then performed using that third-party warranty company's authorized HVAC contractors.

Standard contractor-sold warranties include one year, two-year, five-year, and up to 12-year parts and labor extended warranties. Many warranties are provided by the contractor as a part of equipment installation. Other types are sold by the contractor who submits the warranty to a manufacturer or third-party provider. These types of warranties are administered by that manufacturer or third party who pays the warranty claims to the contractor when repairs are made.

The purpose of this white paper is to provide an overview of the types of warranties available in the market place and know what is required for each type of warranty. It also describes the suggested contractor's warranty reserve which is an internal financial accounting of the warranty sale to the customer. Once these types of warranties and suggested reserves are identified, the contractor can make an informed choice about the type of warranty he wants to offer to customers.

## TYPES OF WARRANTIES

There are four major types of equipment warranties:

1. Contractor provided.
2. Manufacturer provided.
3. Third-party provided.
4. Customer provided.

With the exception of third-party and customer provided warranties, there are standard warranties that are provided by contractors and equipment manufacturers as part of the sale. Extended warranties can be sold to the customer and provided by the contractor (in some states), the manufacturer or a third-party designated by the manufacturer.

Each of these types of warranties will be discussed next.

### 1. Contractor Warranties

Contractor warranties can be divided into two types: standard warranties and extended warranties.

#### A. Standard One-year Warranty

The standard warranty on a new piece of residential HVAC equipment is usually one-year parts and labor. If a part fails within the first year, generally the replacement of that part is covered by the manufacturer but the labor to replace the part is provided by the contractor. The number of days to make a claim may vary based on the contractor – manufacturer relationship. There is no additional cost to the customer (as in the case of an extended warranty purchase). On purchased extended warranties, the contractor often can submit claims against the policy after the first 91 days.

#### B. Standard Two-year Warranty

Some contractors differentiate themselves in the sales process by providing a two-year standard labor warranty. They assume the risk for the second year of labor since manufacturers typically cover the parts portion of the warranty for more than one year, often up to five years.

#### C. Contractor Provided Extended Warranties

In some states (i.e. Florida and Arizona), the sales of contractor provided extended warranties are prohibited unless the contractor registers as an insurance company and provides the required bonds. As a result, most contractors in these states who sell extended warranties, do so through a manufacturer or third-party provider.

They do not want the expense of registering as an insurance company to provide their own extended warranties. Contractors should check with your state's insurance department to see if your company can provide extended warranties without registering as an insurance company.

In states which do not require an insurance license, some contractors choose to provide extended warranties internally. These are generally 5- or 10-year extended warranties, depending on what the competition is offering.

Contractors selling an in house extended warranty usually charge the customer what the manufacturers or third-party providers charge for the extended warranty. They put that money in a savings account. To offset some of their risk, these contractors purchase the 5- or 10-year parts warranty from the manufacturer (which is usually a fraction of the parts and labor warranty cost charged to the customer) and provide the labor themselves.

It is imperative that the money received for these warranties is put in a savings account and the warranty risk accounted for on the contractor's balance sheet as a liability. When this occurs, the contractor can see the total risk he is assuming for these types of warranty sales.

It is a good practice that the dollars in the savings account exceed the warranty reserve. Then, if the worst happens, the funds are available to cover the warranty expense.

Yearly maintenance is required as a part of keeping these warranties in effect. This maintenance is provided by the contractor who holds the extended warranty.

### ***D. Contractor Sold Extended Warranties – Manufacturer or Third-Party Provided***

If a customer is interested in an extended warranty, most contractors sell warranties provided by the manufacturer or third party. The manufacturer or third party tells the contractor how much the warranty cost is. It is up to the contractor to decide whether to mark up the cost to the customer. Most contractors use a 10% margin to calculate the price to the customer.

This additional cost covers the contractor's cost of warranty administration.

## **2. Manufacturer Warranties**

Manufacturer warranties can be divided into two types of warranties: standard warranties and extended warranties.

### **A. Standard Warranties**

Manufacturers generally provide a standard one-year parts and labor warranty with each piece of residential equipment installed by a licensed contractor (in states which require licensing) or a dealer of that type of equipment. Some manufacturers provide a standard 5-year parts warranty, or a 10-year parts warranty if the product is registered in the manufacturers database.

If there is a warranty claim, the manufacturer pays for the replacement part and gives the contractor a labor allowance.

There is no additional charge to the contractor for standard warranties.

### **B. Extended Warranties**

Manufacturers sell extended parts and labor warranties through their contractor dealers. With the rare exception of a manufacturer offering a 12-year extended parts and labor warranty on high efficiency equipment, most manufacturers offer either a 5- or 10-year extended parts and labor warranty.

Contractors offer these extended warranties as part of the sales process to the customers. The customer can choose to invest in an extended warranty or be satisfied with the standard warranty that comes with the equipment sale at no additional cost.

Manufacturers require that the warranty be registered within 60 days of the sale.

Manufacturers now state that the extended warranty can be voided when proof of maintenance is not provided when repairs are needed.

Manufacturers also provide the extended warranty only to the original homeowner (sold to the person,

not the home). Some allow transfers to subsequent homeowners if a transfer fee is paid within 60 days of the sale of the home.

### 3. Third-Party Warranties

Some manufacturers and equipment distributors may not want to administer extended warranties. As such, they sell the warranty to a third party which is called “white labeling”. The contractor never knows that the warranty was sold since the manufacturer’s name is still attached. That is, the contractor purchases a warranty from a supplier or manufacturer, and that supplier or manufacturer then sells the warranty to a third party who handles the administration of the warranty.

Certain third-party companies provide both residential and commercial (up to 25 tons) extended warranties sold directly to the contractor. This may apply when a contractor is not a dealer of a particular manufacturer’s equipment yet wants to sell the customer an extended warranty of that equipment.

Third-party warranty requirements generally follow manufacturer requirements: the equipment must be registered within 60 days of the equipment sale and the warranty may be voided if proof of yearly maintenance is not shown.

### 4. Customer Provided Warranties

Customer provided warranties are usually a part of a whole house warranty purchased when the home is sold. They are not sold by contractors.

There are many companies currently selling home warranties including AIG, Sears, American Home Shield, Choice Home Warranty, American Home Warranty, and Total Home Protection.

Contractors can sign up with these warranty companies to do the repairs. The home warranty company dictates the amount they will pay for a repair. All these companies require a deductible ranging from \$35 to \$65 each time a contractor comes to their home for a repair. None of them, except for Sears, cover maintenance related repairs.

There can be administrative and warranty application issues for the contractor such as long response time to authorize repairs and the warranty company may not cover many repairs because they deem them as “maintenance related”. This can lead to a dissatisfied customer who is angry at the contractor who is caught in the middle.

Currently, Sears has the only home warranty that covers maintenance. As part of their monthly fee, maintenance is performed twice a year by an authorized contractor. In addition, all repairs are deducted from the sale price of a new piece of equipment installed by a Sears authorized contractor.

Home warranty companies will not cover any repairs lacking proof of maintenance. They also won’t cover other items such as ductwork, drain related repairs, or repairs due to Acts of God (hurricanes, tornadoes, etc.).

## CONTRACTOR WARRANTY RESERVES

All contractors, whether they sell an extended warranty or include the standard warranty, should have a warranty reserve.

No manufacturer, third-party provided, or customer provided warranty company pays the true labor cost for a repair. Contractors can often negotiate a labor allowance and parts markup for the repairs. However, these markups rarely cover the total expense of a warranty repair.

Therefore, contractors must keep a warranty reserve to cover warranty issues.

Some contractors include a specific cost per ton, i.e. \$25 per ton, for each ton of equipment sold. Others use a percentage of equipment cost, usually 1% or 2%.

One suggested accounting best practice for a reserve is to start with 2% of equipment cost and include that cost in the price of the job. Then, when the equipment is sold and the customer pays, put that warranty amount in a separate savings account.

The corresponding amount is put on the balance sheet under current liabilities – warranty reserve. Then, as the warranty costs are incurred, the dollars in reserve get transferred to warranty sales on the profit and loss statement. At the end of the year, if the warranty reserve is negative, add another percent to equipment cost for the following year. If the warranty reserve is growing, a contractor might make the decision to decrease the warranty reserve to 1% for the next year.

If a contractor is providing his own 5- or 10-year extended warranty, this process is crucial to ensure the contractor's ability to cover repair costs during the lifetime of the warranty.

### FINANCIAL STABILITY OF EXTENDED WARRANTY PROVIDERS

Many of the companies who began offering extended warranties went bankrupt due to the number of warranty claims. One manufacturer, Nortek, exited the extended warranty business and now only covers 1 year's labor. This left contractors honoring the warranties at considerable expense for extended warranties that were previously sold on Maytag and other Nortek equipment.

All manufacturers have seen their warranty claims rise as the equipment ages. As a result, they are beginning to enforce the maintenance requirement to keep the warranty in effect before they will cover warranty claims. They are asking to see proof of maintenance before paying claims.

Some manufacturers are now exploring dropping their 10-year extended warranties and only offering 5-year parts and labor warranties.

If a contractor is considering a third-party extended warranty provider, it is best to research the financial health of that provider. Find out what their claims experience is and ensure that the company has a good history of selling extended warranties for more than 10 years.

### EXTENDED WARRANTIES IMPACT ON THE SALES PROCESS

Contractors have three options in the sales process: include the extended warranty cost in the sales price, show it as an option, or don't mention it.

Contractors need to determine and consider customer "needs and wants" during the sales process. For many high efficiency equipment sales, the cost of an extended warranty is included in the sales price. Many contractors offer an extended warranty as an option for lower efficiency equipment.

An extended warranty, in most cases, will not improve the closing ratios. If a customer wants an extended warranty, she may expect that the contractor will provide one as part of the sale.

When a contractor includes the extended warranty in the sales price and the customer objects that the price is "too high," the sales person can ask the customer whether she would like to remove the extended warranty to lower the price. This can help close sales.

If extended warranties are offered as options, then the salesperson must have the customer initial or sign "accepted" or "declined" on the proposal. Years later, when a customer has a system breakdown, that customer may assume she has purchased an extended warranty because it was discussed during the sales process.

The only way to prove that the warranty was purchased is by having the customer put his/her initials or signature on an extended warranty option accepted or declined line. This eliminates problems in future years if there is a needed repair.

During the sales process the sales person must explain to the customer exclusions of the warranty. For example, that an extended warranty can be voided if regular maintenance is not performed on their system, and that the warranty is voided if the home is sold (or a transfer fee must be paid within 60 days of the home sale). The sales person, at the end of the job, should again remind the customer of these exclusions.

## EXTENDED WARRANTIES IMPACT ON MAINTENANCE PLAN GROWTH

Most contractors include a one-year maintenance plan as part of the sale (then increase the maintenance plan price to recoup the cost of that plan). It is up to the customer to renew the plan after the one year expires. The delicate balance is how to sell maintenance agreements as a benefit and not a cost yet informing the customer of the requirement to keep the equipment maintained to avoid warranty issues.

In most cases, if a customer has an extended warranty, that customer must have a maintenance plan so that the warranty is not voided. During the maintenance plan renewal process the contractor reminds the customer about the benefits of a “clean system” along with the warranty requirement which results in most customers renewing their maintenance plans.

Therefore, as a contractor sells more equipment with extended warranties, the number of maintenance plans will grow. The contractor will be performing more maintenance checks as a result and building trust with the customer. When it is time to replace the equipment (after the extended warranty expires), the customer is likely to choose the contractor who has been maintaining the equipment during the lifetime of the extended warranty.

Some contractors, for the highest efficiency sales, include both the 10-year maintenance program and the extended warranty cost in the price to the customer. This locks in a customer for 10 years with no additional costs incurred by the customer. If the customer is financing the equipment, this adds very little to the monthly payment.

Selling extended warranties usually means more maintenance, less demand service, and more replacements in future years. If a contractor is focused on selling equipment rather than service, then extended warranties can help increase future equipment sales.

## WARRANTY SELLER BEWARE – KEY ISSUES TO CONSIDER

This section covers issues contractor needs to be aware of when selling extended warranties.

### A. Labor Rates and Repair Times Paid by Warranty Providers

Labor rates are negotiated with the contractors for providing the warranty repairs. In addition, many providers of extended warranties dictate how long the repair should take and only pay that number of hours, even if a situation occurs where the warranty repair takes longer than the provider says it should.

In addition, this labor rate rarely covers the total cost of labor and overhead. Contractors must be content with generating almost no profit, and usually a loss, on extended warranty repairs.

### B. Demand Service Decline

With extended warranties, contractors will experience more equipment replacements and more maintenance. Demand service will decline. In addition, the service provided under warranty will generate less revenues than non-extended warranty customers. A warranty reserve savings account is critical.

### C. Extended Warranty Requirements

Contractors must know the requirements for the extended warranties they sell to customers. Most require that the warranties be registered within 60 days of the replacement. Most require a negotiated labor rate. Many provide the part and do not allow for parts markups.

Many only cover the equipment for the original homeowner. If the extended warranty can be transferred, it must be transferred within 60 days of the home's sale to stay in effect.

## **D. How Extended Warranties Are Voided**

All extended warranty providers now state that the warranty can be voided when maintenance is not performed. This must be clearly stated to the customer when purchasing extended warranties. Unless the contractor is on monthly recurring billing, at renewal time, the customer must be reminded that to keep the warranty in effect, maintenance must be performed.

In addition, when the contractor submits the warranty claim without the proof of maintenance, the claim can be denied which forces the contractor to try to collect from the homeowner. In some cases, the homeowner may refuse to pay even though the warranty clearly states that it can be voided without the proof of maintenance.

## **E. Issues With Homeowner Purchased Extended Warranties**

If a contractor chooses to be a certified contractor for a home owner purchased warranty, be aware that these types of calls take a long time to complete, a long time on the telephone to get repairs approved, and they pay only a certain amount for each type of repair, usually well below normal service repair rates. Any maintenance related repair will not be covered and the customer will usually get mad at the contractor delivering the news rather than the warranty company.

## **SUMMARY**

Adequate and proper equipment warranty coverage, and the depth of that coverage, reflects the confidence in quality equipment, professional installation and high level of customer service a contractor should present to customers. Knowing and selecting the appropriate warranties contractors have available is important to gaining new customers, retaining current customers, and improving overall profitability.