

Seven Things to Know Before You Buy a Rental Property — Thing One: Utilities

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As a real estate lawyer for 25 years, I have watched many investors come and go, and some stay and prosper for the long haul. I have helped them with contracts, closings, evictions, contractor troubles and sales, among other things. Each time someone calls me for advice, they have some sort of problem which was either dropped on them, or created by what they did or didn't do. This, combined with my own experiences as a real estate investor, combine to give me a unique vantage point from which to observe real estate problems, and consider how to avoid the avoidable problems and situations, where an ounce of prevention is worth a pound of cure.

This is the first of a long series of articles on "Seven Things" about different aspects of real estate investing. Why seven things? It could just as easily be five or ten, but seven is a lucky number, and about seven makes a nice series of articles on each topic. So here we go;

1: KNOW YOUR UTILITIES.

Knowing your utilities means knowing which utilities are paid for by the tenants, and which are paid for by the landlord. A basic rule is that any utility paid for by the landlord will, on average, be consumed more generously by the tenants. I learned that rule the hard way when I had a twelve unit in Squirrel Hill, with central heat. I would drive by in the dead of winter, and the windows on the upper floors were wide open in ten degree weather, while the big old boiler chugged away and the gas meter spun like a blur. The gas bill was more than the mortgage, and it took me until June to break even on that building. By July, I had to start setting aside a reserve for the next year's heat, so the building wasn't worth it to operate.

A similar building with individual furnaces in each unit, and gas bills paid by the tenants, rented for only \$50.00 less per unit per month. Why? If the tenants pay their own gas bill, they don't usually leave the windows open in the winter, and even if they do, it doesn't affect your bottom line. For the extra \$50.00 per unit per month, I got \$7,200.00 per year, and paid over \$15,000.00 in gas bills for the heat, hot water and gas stoves, plus the electricity to run the pumps to keep the hot water heat circulating. Now I don't mess around with paying tenants' heat. If a building is worth owning, it is worth putting in separate gas meters and furnaces for each unit, and giving the tenants the bills for their own heat. For not much more, you can add central air and make your units easier to rent in the Spring and Summer.

Knowing your utilities also means making sure the separate utilities in the building are really separate, and tenants don't heat common areas or parts of other units on their own bills. If the furnace for unit 1 has just one duct in unit 2, or in the common entry or basement, and the Public Utility Commission or the individual utility receives a request for an audit of the utilities for that tenant, you will end up with that tenant's whole bill in your name. The worst case I saw of this problem was a tenant who was a clever law student. Note that law students are not a protected class. He had gas heat and a bill in his own name, but he was never available for the meter reader, and always called in his own readings for the gas meter for almost a year. He had very low bills, but when the meter reader did come in March, and gave the tenant a \$2,000.00 bill, he called the utility to do an audit, they found a duct in the basement had come (or been pulled?) apart, and the tenant's furnace was heating the common basement. The whole bill went into the landlord's name, and is still being litigated with the PUC two years later.

Further, a landlord is not allowed to take a common bill, like a water bill for a single meter on the whole building, and divide it among the tenants. If it isn't a real separate meter, you must pay the bill and price the rent high enough to cover the bill.

Knowing your utilities also means knowing which utilities are publicly provided, by a municipality or municipal authority, and therefore lienable against your property, regardless of whether the unpaid bill on which the lien is based is in the tenant's (or former tenant's) name, or in the landlord's name to begin with. An electric bill from PP&L or West Penn power is from a private company, and they don't have the right to lien or

charge you for the tenant's unpaid bill. But if the municipality where you have your property buys the electricity from the utility and resells it to your tenant, that same electric bill now comes from a municipal authority, and if the tenant doesn't pay, the unpaid bill attaches as a municipal lien against your property. The worst illustration I have seen of this is tiny Pitcairn, PA. There, the water and sewage, electricity, cable and internet are all provided through a municipal authority. If a tenant owes \$350.00 in rent, pays the rent, and doesn't pay his water, sewer, electric, cable (including services like HBO, cable modems, internet phones and pay per view movies), you could end up with a notice of unpaid bills for that month in excess of the rent you received and eventually a lien against you for that unpaid amount. I gave up my buildings in Pitcairn after getting a bunch of those notices. Knowing your utilities requires that you verify the information the seller provides on utility costs, too. Many sellers have a tendency to underestimate their seller paid utilities to make a building for sale look like it cash flows better than it really does. The various utility companies maintain actual records of usage, which you should check before you close on the building. Finding out the numbers are wrong before you buy gives you the opportunity to renegotiate the price or buy a different building with better cash flow. Finding out a year after you buy may give you a lawsuit against the seller for misrepresentation, but it won't change your cash flow right away, even if you eventually win the suit.

That is about all I have to say about utilities. Look for Part Two next month!
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