

# Deductibles: Who Pays?

By Brian Friel, CPIA

A member of your community came home from a recent vacation to find out that their hot water heater had decided to take an ill-timed vacation as well and there was a foot of water waiting for them in their living room when they arrived home.

Naturally our distressed homeowner contacts the community manager who in turn contacts the association's insurance agent and a claims representative is sent out to adjust the claim. The homeowner also contacts their personal insurance (HO-6) carrier and they send out their own representative to investigate the claim.

Generally speaking, in Pennsylvania, it is typical that the association's master policy provides "Original Specifications Coverage" which covers the unit as conveyed by the Declarant. Improvements and betterments made by unit owners after the initial settlement are covered by the HO-6 carrier along with the personal contents of the unit owner.

The association's carrier determines that the cost to repair the unit to "Original Specifications" will be \$25,000 and subtracts the association's deductible of \$5,000. Ultimately, a check is cut for \$20,000 made payable to the association and these funds are turned over to the homeowner so that they can have their unit restored to its "Original Specifications"

One of the most common questions we receive as community association insurance professionals is "Who pays the master policy deductible?" In our example, this deductible is \$5,000 but commonly \$10,000 and in some cases as high as \$25,000 if the association has a poor track record of frequent and

severe claims. These are not small amounts of money and deserve careful consideration and analysis in any insurance program.

There are essentially two main options. First, the association can pay the deductible out of reserves; however, this is not a desirable option since the association cannot predict how many claims they may have during a policy year and this practice could quickly wreak havoc on the association's reserve account. The second and most common option is that the deductible is passed on to the unit owner or owners affected by the claim.

This arrangement is often misunderstood by homeowners and their personal insurance agents. How is it that the homeowner gets left with the responsibility to pay the master policy deductible and how

do they insure against it so that the homeowner doesn't need to pay it out of pocket?

Some states have included in their condominium statutes specific wording dealing with the responsibility of the deductible in these cases. In Pennsylvania, Section 3312 states the following:

Recovery of deductibles.--If any insurance policy maintained by the association contains a deductible, then that portion of any loss or claim which is not covered by insurance due to the application of a deductible, as well as any claim or loss for which the association is self-insured, shall be levied by the executive board in accordance with section 3314(c) (relating to assessments for common expenses)

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And section 3314(c) goes on to say the following:

(c) Special allocations of expenses.--Except as provided by the declaration:

- (1) Any common expense associated with the maintenance, repair or replacement of a limited common element shall be assessed in equal shares against the units to which that limited common element was assigned at the time the expense was incurred.
- (2) Any common expense benefiting fewer than all of the units shall be assessed exclusively against the units benefited.
- (3) The costs of insurance shall be assessed in proportion to risk and the costs of utilities that are separately metered to each unit shall be assessed in proportion to usage.
- (4) If any common expense is caused by the negligence or misconduct of any unit owner,

the association may assess that expense exclusively against his unit.

While there is a lot of language here, the main point here under sub-heading (2) is that the statute gives the board the right to charge the deductible back to the unit owners affected by a loss.

Of course, we also need to examine the association's governing documents. In my experience, this issue is rarely discussed within the original governing documents and if it is discussed it is mainly just to state that there will be a deductible and it will not exceed a certain amount, usually \$10,000.

However, we have often recommended over the years that association's adopt an "Insurance Resolution" to the documents which expressly outlines the scope of coverage provided and specifies who has responsibility to pay the deductible. This "Insurance Resolution" provides a lot of clarity to a situation which desperately

needs it and is well worth the time the board will spend putting it in place.

Since we know that the association can and often does transfer responsibility of the deductible to the homeowner, we also need to know how they can insure this exposure under their personal HO-6 policy. While most carriers offering HO-6 policies can and do provide coverage for the master policy deductible, there are hundreds of carriers writing these types of policies in Pennsylvania alone so we often recommend that homeowners discuss this issue thoroughly with their personal agent. Some companies take the position that this coverage is afforded under the Dwelling (Coverage A) of the HO-6, others view it as a Loss Assessment (Coverage D).

Our main goal in this process is to assure that each homeowner understands what they need to insure prior to having a claim so that the master policy and the HO-6 policy work together in harmony. While it easy for those of us in the community association insurance business to understand and articulate these concepts to our managers and boards, all is lost if we cannot communicate these issues to the community at large. We often provide for our associations a "Homeowner Letter" which explains what the master policy provides and urges homeowners to speak with their personal agents about covering the master policy deductible and the other items which are their responsibility. After all, our duty to provide members of our community with timely and accurate information about the associations insurance program should never take an ill timed vacation!



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