

A GUIDE TO LATENT DEFECTS INSURANCE

This summary is a brief guide to Latent Defects Insurance. It does not describe all of the Policy in detail but it does list the key points.

Latent Defects Insurance

Latent Defects Insurance provides protection to building owners, occupiers and others with an interest in buildings against damage or the threat of collapse due to a defect in the structure of the building including the external walls and roofs (irrespective of whether these last two items are “structural” or not). The defects must be undiscovered at the date of practical completion of the building and occur during the period of up to 12 years after that date which is the maximum policy period. The cover is available for commercial and industrial buildings and large residential blocks.

The Benefits

- The insurance is non - cancellable over the policy period which can be either 10 or twelve years. Sums Insured can be index-linked to protect the Policyholder against inflation.
- There is no need to prove fault or liability on the part of third parties before insurers will respond to any claims.
- Burdensome and time consuming litigation does not take place before repairs are put in hand. Immediate funds are available to effect repairs for insured losses without borrowing or self-funding.
- Legal proceedings are costly and the outcome can never be predicted with certainty. Even if liability can be established, doubts will remain as to whether or to what extent the party or parties liable have the means to meet their liabilities, not forgetting that liability insurance for professionals is usually arranged on an annual claims made a basis with no guarantee that indemnity will be afforded for claims in the future.
- The policy is assignable to future owners and tenants of the building who are increasingly reluctant to assume the risks associated with building defects and will be attracted to a building where Latent Defects insurance has been arranged. The letting position of the developer is therefore stronger.
- The insurers' technical advisors will be involved on behalf of the insurers in finding a suitable solution once an insured defect manifests itself. The technical inspection assists quality.
- The insurers' technical advisors through their independent design and construction audit may detect defects prior to practical completion allowing them to be rectified before the owner or developer takes over responsibility for the building from the contracting parties.

The cover provided

The insurance covers destruction, damage or the threat of imminent collapse to the building due to a latent defect in the structure, the external walls and the roof. Resultant damage to other elements of the insured building including the cost of accessing the defect and reinstating such elements are included within the indemnifiable repair costs. Further, where the building requires some remedial work or strengthening to relieve the continuing effects of the latent defect then these costs are also met under the policy.

Also covered are the cost of debris removal, professional fees and changes in the method of repair required to satisfy Local Authorities or similar regulatory requirements.

The policy automatically covers weatherproofing defects in external walls and roofs and can be extended to cover waterproofing/seepage defects in basements. These additional levels of cover do not come into force until after an initial 12 month period from practical completion.

The time to arrange cover

Building projects should be proposed for insurance as early as possible and preferably before any work commences on the site. This enables sufficient time for the risk to be assessed and for the insurers' technical advisors to have a full and effective role. Proposals for insurance after the commencement of construction may be considered but the increased risk to insurers may be reflected in the scope of cover available and the cost of the insurance.

A proposal form is available detailing the information required in order to assess each risk and provide quotations for insurance.

The need for Technical Advisers

Before providing cover insurers require a technical audit. Whilst a technical audit cannot eliminate the risk to insurers it does provide a certain degree of confidence and enables them to identify the level of risk presented to them. This risk assessment is achieved through an independent Technical Inspection Service which is provided by leading consulting engineers who report to insurers verifying the level of risk. Their fees are paid by the proposer and when added to the insurance premium, the combined amount represents the overall cost of this insurance.

In simple terms, the scope of their services consist of:

- Preparation of an initial risk appraisal report
- An evaluation of specifications, drawings and calculations prior to the commencement of the contract.
- Visits to the construction site in order to check progress, adherence to design requirements, monitor quality control of supervisions, materials and workmanship.
- Producing periodical reports to insurers during the course of construction.

The technical audit is carried out in tandem with the design and construct process and should not cause delays on site.

The insured parties

The benefit of the policy is for building developers, owners, their founders and subsequent owners, tenants and other users of occupiers of the building. Requests to include the interests of the professional team and contracting parties are considered on a case by case basis. Where such interests are included the involvement of the insurers' technical advisors may be increased coupled with a consequent increase in the insurance terms.

The Sum Insured

The sum insured should represent the total rebuilding costs of the building at the date of inception of the policy including if required an item in respect of debris removal and professional fees. The estimated contract value is adopted at proposal stage for the purpose of calculating the deposit premium. A limit of indemnity may be sought and depending upon the level chosen a suitable reduction in premium level may be available. Whatever sum insured is selected it may be index linked throughout the period of insurance.

The cost

The cost of protection against latent defects comprises two elements, namely the technical inspection fee and the insurance premium. These costs vary considerably according to a

number of factors i.e. size of the project, nature of works, ground conditions, contractual relationships, experience of professional team, scope of cover, the level of deductible etc. The duration of the construction works has a direct bearing on the technical inspection fee.

Fee payments may be staggered over the course of the construction programme on lengthy contracts. Usually a 20% deposit premium is payable at proposal stage followed by the balance of premium at inception which will be adjusted to take account of the final sum insured.

Exclusions from cover

Full details of exclusions are contained in the policy but the principal exclusions are:

- Defects in non-structural works and equipment
- Defects due to lack of maintenance or misuse
- Defects due to structural alterations after inception (unless agreed by the insurers)
- Normal fire perils, war and kindred risks
- Defects known prior to inception
- Seepage (unless endorsed by the insurer)
- Consequential losses.

Extensions to cover

The basic cover may be readily extended subject to additional premium and certain conditions to include the following:

1. Waterproofing of basement levels including resultant damage to other parts of the insured premises due to such defects. However, the first 12 months of the policy period is excluded and cover may be subject to a post construction check by the insurer's technical advisors.
2. Where the new building works involve retained facades and the like these may be incorporated within the policy for resultant damage to them arising out of a latent defect.
3. Loss of rental income and removal/relocation expense may be insured following a claim under the 10 years material damage policy. Loss of rental income insurance is generally arranged on an annually renewable basis with an appropriate sum insured, indemnity period and time exclusion.
4. Waiver of subrogation rights against any member of the professional team.
5. Refurbishment contracts. In such cases cover would generally be limited to latent defects in the structural and weatherproofing elements of the new refurbishment works including resultant damage to other parts of the insured premises due to such defects.