Latent defects insurance (LDI) is a type of insurance that provides cover for the cost of remedying and rectifying damage arising out of latent or inherent defects.

Latent defects are normally defined as faults in the design, workmanship, materials, supervision, construction, installation or site preparation of a new building that remain undiscovered at the date of practical completion, but come to light afterwards by virtue of physical damage, and are of a type that could not reasonably have been revealed by the insured.
WHAT’S COVERED?

- Typical policy periods run between 10-12 years from the date of practical completion but should normally be sought prior to construction start, although some insurers will consider arranging cover on partially complete and recently completed structures.

- Cover is for:
  A) Structural defects
  B) Ingress of water (excluded for first 12 months)
  C) Subsidence landslip or heave
  D) Threat of imminent collapse requiring remedial works to prevent damage caused by a defect in design, workmanship or materials but not discovered before inception of cover

- Cover operates on a reinstatement basis, including professional fees, debris removal, costs to comply with public authority requirements, external walls or roof

- Resultant damage to non-structural elements

- The cover applies to owners, tenants, lenders and the policy is freely assignable

- Waivers of subrogation are available at cost if required in favour of contractors and design consultants.

WHY BUY LDI?

There are a number of advantages of LDI. Some of the key reasons why our clients arrange latent defects on their developments are summarised below:

Property Exclusion
Latent defects are normally partly or wholly excluded from standard property policies, and this product fills that gap in coverage for our clients.

Tenants
Tenants taking on long term leases (especially full repair and insure leases) are increasingly insisting on having a Latent Defects policy in place from which they can benefit. Therefore developers are making sure in this competitive environment that they tick all of the boxes they can for prospective tenants.

First Party Cover
A latent defect policy can mitigate the concerns and fears of owners, developers and tenants alike by providing them with a first party insurance solution that can be called upon to remedy a defect and minimise disruption. To claim, an insured party does not need to prove negligence under a LDI policy.

Assignment of Cover / Onward Saleability
The policy is also freely assignable to future tenants or purchasers. This can help to smooth the process of a sale or tenancy agreement.

Contractor Warranties
In the absence of LDI the developer would most likely be responsible for paying the reinstatement costs, and following damage due to a latent defect would need to pursue the contractor to recover their costs.

In many major projects, the owner will have the benefit of direct agreements with the original contractors and main sub-contractors and consultants, giving them the same contractual recourses as the original developer. These agreements are generally known as collateral warranties.

The main argument is that both collateral warranties and professional indemnity policies require the claimant to prove the fault / negligence of a third party.

Professional indemnity cover would also only cover the relevant contractor’s professional liability – for example negligence in designing the works, but would not cover their liability for inadequate workmanship or materials.

The associated time delays and legal costs in proving fault or negligence are removed by having a first party cover in the form of LDI.

WHO BUYS LDI?

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<th>Developer:</th>
<th>Main purchaser of LDI. Developer can pass costs onto the owner or tenant and cover is a useful marketing tool.</th>
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| Property Owner: | - May purchase in order to protect their own interests.  
| | - Useful if seeking tenant for buildings or selling on.  
| | - May purchase if contractor has gone into receivership or of poor financial standing. |
| Tenant: | May purchase cover for similar reasons as property owner. Useful if taking on full repairing lease and tenant is concerned about major defects. |
| Receiver: | May purchase in the event that contractor is in liquidation and there is no viable recourse route in the event of building defect. |
| Contractor: | Little demand for cover apart from when associated with the developer and/or property owner. |
| Private Finance Initiative/ Public Private Partnerships: | Have purchased primarily where existing structures have been involved and/or where purchase of such cover has eased financing or reduced borrowing costs. |
More importantly, if the contractor has become insolvent it will no longer be possible to pursue any rights of recourse against them, and the contractor’s professional indemnity insurance will no longer be in effect. This problem will have been compounded if the claim has not been notified during the period of insurance.

Certainty of Cost & Coverage

The policy is taken out at the start of the project and does not need to be renewed. It is therefore unaffected by the subsequent insolvency of any member of the construction team.

The cost are also agreed prior to the start of construction and the majority of the premium (90% -95%) is paid upon practical completion in one installment.

THE TECHNICAL AUDIT FUNCTION

A LDI policy is subject to a satisfactory technical audit throughout the construction process, hence the reason why the cover needs to be arranged prior to the start of any major works. Cover is not impossible to arrange after this date, but enhanced rates and / or restrictions on coverage may apply.

At practical completion, if the technical auditor considers the building or structure has been built to an appropriate standard and is in compliance with approved drawing and agreed specification, he or she will then issue the appropriate certificate of approval or acceptance and confirm to the insurer that the building is suitable for latent defects cover.

The developer will then need to provide the following before cover can incept and documents issued;

- Copy of practical completion certificate
- Gas & electrical certification
- Schedule of addresses (for residential developments)
- Reinstatement valuation may also be required to ensure sums insured are accurate

The insurers will then issue the relevant certificates of insurance (for all residential dwellings) including a formal policy document for the owner of the development.

COMMON CLAIMS

Examples of the types of claim:

- Defectively designed floor slabs allowing movement and consequent damage to floors and walls
- Omission of wind posts allowing damage to the walls
- Subsidence causing damage to the walls
- Defective cladding allowing water to penetrate
- Failure of basement tanking allowing water to penetrate
- Defective roofing allowing water to penetrate
- Failure to rain screen allowing water to penetrate
- Poorly fitting windows allowing water to penetrate

Claims Examples:

Waterloo Station Nickel Sulphide Inclusion – necessitating extensive glass replacement


MIXED USED DEVELOPMENTS

In recent years the number of developments which involve both commercial and residential facilities within one building has been steadily increasing. It is possible to arrange an insurance package that offers combined coverage for the standard structural defects and also the latent defects for the residential area of the building, which is fully compliant with the norms in the mortgage lending market.

This is of particular importance because residential and commercial properties of mixed use developments share the same foundation and structure; hence it is necessary for one policy to cover potential defects in the structural integrity of the whole development.

Mixed use developments often require further consideration, as clients generally go ahead with what they believe to be the correct method in relying on the NHBC cover from the contractor, and do not always consider insuring the remainder of the development i.e. the commercial areas.

Having cover for both residential and commercial areas, aside from the transfer or risk, can make selling a development in the future much easier. In cases where we have been asked to price for this cover post practical completion, it almost impossible unless completion of the development occurred within 12 / 24 months.

ADDITIONAL COVERS

The following types of cover can also be arranged for landlords or tenants of buildings and work alongside the structural cover:

- Loss of rent
- Loss of gross profit or revenue (business interruption arising out of an indemnifiable event)
- Increased cost of working from alternative premises
- Alternative accommodation
- Damage to mechanical & electrical services
- Mechanical / Component failure cover.

SUMMARY

Latent Defects cover is an area that has gained significant momentum over the last few years after a very slow start in the UK, and its use is by no means as universal as in France and some other areas of the world. There is still quite a limited market place but the product can provide valuable risk transfer and is a key commercial issue for many developments. This paper has attempted to highlight some of the many issues that can arise, but if any further clarifications are required further information can be obtained from the authors.
WHY JLT

We are able to advise on and arrange bespoke insurance packages, especially where developments involve “Mixed Use” within one building, i.e. mixed commercial and residential developments. We have previously arranged packages to cover both the standard structural defects alongside providing cover for latent defects for residential areas of the building.

We have also advised on cover for refurbishment projects, and in some instances where projects have already commenced, although insurers willing to participate in such risks are limited.

Key relationships with leading latent defects insurers, allow for us to access competitive Premiums and arrange robust tailored packages for our clients.

We will provide full support throughout the duration of the policy, including claims assistance should this be required.