

LATENT DEFECTS

CONSTRUCTION

Latent Defects insurance is a type of insurance that provides cover for the cost of remedying and rectifying damage arising out of Latent or inherent defects, whether it be in commercial, residential or mixed use developments. 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.

Latent defects can be extremely problematic, they can cause considerable disrepair and disruption to a variety of parties, and can be highly expensive to correct. A latent defects policy can reduce the concerns and fears of owners, developers and tenants alike by providing them with a first party insurance solution, for typically 10-12 years from the date of practical completion, that they can call upon to remedy a defect and minimise disruption. The policy can be freely assignable and can help to ease the process of a sale or tenancy agreement.

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 completed structures.

Cover is for:

- a) Structural defects
- b) Ingress of water (Excluded for first 12 months)
- c) Subsidence landslip or heave and
- 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, seepage below ground level.

Additional optional cover

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

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

Advantages of a Latent Defects Insurance Policy Contractor Insolvency & Collateral Warranties

In the current climate, the risk of contractor or consultant insolvency is significant. This may influence the view of collateral warranties held by funders and tenants, who are taking a more risk-averse position and are looking for secure long-term protection against defects. A well structured and bespoke Latent Defects Insurance programme could be the answer.

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, whereas professional indemnity insurance (which the construction team would

generally be required to maintain in terms of a collateral warranty) has to be renewed annually, and will provide no protection if it has not been renewed at the point a claim is made, Key points:

- No need to prove negligence or establish fault
- Time delays and costs associated with legal remedies are removed
- Allows for an easier sale of the building to another owner/tenant
- Immediate funds available to allow for repairs and minimise interruption
- Satisfies funder requirements, who will want to mitigate potential risk exposures and whose requirements are gaining increased importance on construction developments
- Third party insurances can be uncertain as the limits of indemnity may be inadequate or cover may no longer be available, due to non-renewal
- Cover is freely assignable and therefore can be passed on to future owners during the policy period which strengthens the position of the developer by allowing the new owner to have first party insurance protection
- Technical audit surveys provide design advice and monitor quality
- Waivers of Subrogation are available if required in favour of contractors and design consultants.

Alternative Solution

The key residential warranty players in the current market are NHBC and Premier Guarantee, and it is often the standard approach to use either of these warranties to cover the exposure of Latent Defects. However as an alternative to the above we can also provide bespoke insurance solutions in managing the risk of Latent Defects. With the NHBC and Premier Guarantee the key difference is that in the first 2 years after completion of the building, the building contractor or developer is liable to put right or repair any defect or damage, and pay for the necessary removal, storage and temporary accommodation.

In this instance NHBC would only pay for costs relating to any arbitration or court award for the failure of the building contractor to carry out any remediation works, any cost of work agreed through the resolution service but not carried out by the building contractor, or the full costs in the event of the building contractor's insolvency.

However the Latent Defects policies we can provide, ensure that the cost of putting right any defects in the structural works are covered from day one of completion, subject to normal policy terms and conditions. Therefore the developer is not reliant on the building contractor in the first 2 years. Ingress of Water is typically excluded in the first 12 months; however, this would generally be recoverable by the developer from the contractor under the Defects Liability Provisions of the build contract.

Role of the Technical Auditor

Before cover is formally offered, insurers will normally arrange for technical surveyors to carry out inspections on the site, with a view to monitoring the construction process. The surveyors will be experienced and competent structural engineers.

The purpose of this is to try to prevent damage from occurring by employing an additional resource and enhanced assessment function. Not only can this be beneficial with regards to saving on claims, but also in terms of quality assurance, and the comfort derived as a result.

The cost of the audit depends on a number of factors, but is rarely higher than 25% of the premium.

Examples of where the auditor's observations have been integral include:

- Unrestrained columns
- Inadequate reinforcement
- Cross bracing moved by architect
- Roof membrane laid incorrectly.

Contact

Naresh Dade

Tel: + 44 (0)20 7528 4776

Email: Naresh_Dade@jltgroup.com

Jaima Harrington

Tel: + 44 (0)20 7528 3998

Email: Jaima_Harrington@jltgroup.com

Paul Tubb

Tel: +44 (0) 207 528 4292

Email: Paul_Tubb@jltgroup.com

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 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.

JLT Specialty Limited

6 Crutched Friars
London EC3N 2PH
Tel +44 (0)20 7528 4000
Fax +44 (0)20 7528 4500
www.jltgroup.com

Lloyd's Broker. Authorised and Regulated by the Financial Services Authority. A member of the Jardine Lloyd Thompson Group. Registered Office: 6 Crutched Friars, London EC3N 2PH. Registered in England No. 01536540. VAT No. 244 2321 96.

© June 2011 263128

