

When cracks appear will you SINK or SWIM?

**An introduction to Latent Defects Insurance,
by Keith Hynds, Director of Willis & Company
(Insurance Brokers) Ltd**



The risk of latent defects in buildings has for too long soured relationships in the world of construction and property.

Could Latent Defects Insurance be a possible solution? This 9 point guide highlights why Latent Defects Insurance should be seriously considered...

1. What is the advantage of Latent Defects Insurance?

The cover is written on a material damage basis and therefore there is no need to rely on proof of negligence or liability, merely that the damage falls within the cover provided by the policy. As a result, there will be no need to pursue costly legal action in an attempt to recover the costs of remedial work. Immediate funds will be available to effect repairs for insured losses without the need to borrow or self fund.

2. But surely I can rely on collateral warranties backed up by Professional Indemnity insurance that are in place?

Many in the construction industry doubt the long term reliability of collateral warranties as a means of protecting building owners and occupiers. Reasons include:

- Collateral warranties are only of any value if the party who has given the warranty has the assets to support a claim or has professional indemnity or other insurance policy covering the claim.
- Professional Indemnity policies exist to protect the interests of the insured professional not the building owner.
- Claims under most collateral warranties depend upon establishing negligence and such claims are strenuously resisted. If backed up by professional indemnity insurance, compensation depends on the outcome of litigation - a slow, expensive and highly complicated process with no guarantee of success. Even if successful, the average time

span between the first notification of a claim and its payment is 4 years, which is 4 years of wasted management time.

iv) As Professional Indemnity policies are written on a claims made basis, collateral warranties are no more secure for the long term future than the policies of the parties who have given the warranties. Therefore even if Professional Indemnity cover was in force when the event took place, if cover is not in force when a claim is made, then no cover would be operative.

Unfortunately many firms in the construction sector have gone into receivership over recent years and in the current economic climate more could follow.

3. So how does Latent Defects cover work?

Following a technical audit, undertaken during the construction phase, for which a separate fee is charged, insurance cover commences at practical completion, for a chosen period of between 6-12 years. A one off premium is paid. There is in built indexation for the building sum insured during the policy period.

Cover is provided in respect of damage which has not been discovered at practical completion caused by any of the following events:

- errors in the design or construction of the insured elements of the property insured.
- defects in the materials used in their construction.
- ingress of water through external walls or roofing, including basements.
- collapse, subsidence, landslip or ground heave

'Insured elements' are those elements of the property insured intended to support and transmit the combined deadload, imposed load and windload, together with all enclosing elements which form the external envelope, which include:

- the external walls and cladding
- floors and stairs
- roofs and roof structures
- all other external and internal load-bearing elements essential to the stability

and integrity of the buildings including foundations, columns and beams.

Cover normally runs from practical completion and is triggered by damage caused by a defect in a load bearing element or in the envelope itself. For example, if a crack appears in a wall or floor because of a defect in the floor slab or foundations, the cost of rectifying the defect and repairing all the damage is met by Insurers. The envelope includes all the external elements - the cladding, basement and roof. Normally the minimum excess is £10,000 each and every claim.

4. What makes Latent Defects cover different and better?

- there is no need to prove responsibility in court or out. The claims procedure is triggered as soon as damage is detected.
- there is therefore less need to rely on collateral warranties, as cover is available for upto 12 years.
- the policy generally covers the owner or tenants of a building but cover can be extended to protect the contractor and professional team or those acquiring a financial interest in the building. This aspect can assist greatly in resolving an area that currently can introduce disharmony from the very start of many building contracts.
- policies are normally assignable.
- the uncertainties, expense and hassle associated with protracted litigation or negotiation are avoided altogether.
- the technical audit will be a kite mark that the building was designed and constructed to the standard that everybody had a right to expect.
- the developer benefits from the fact the building is made more attractive than competitor buildings because it is protected by a latent defects policy.
- contractors have insurance against poor workmanship.
- once in force a latent defects policy is non cancellable by Insurers which provides peace of mind and allays concerns as to whether the liable party will still be in existence at the time a problem arises.

5. What about cover for consequential losses?

Depending on the particular project cover can also be arranged to include loss of rent or loss of revenue on behalf of the building owners/users.

6. Which projects qualify for Latent Defects cover?

Insurers who provide latent defects cover generally specialise in buildings intended for commercial, industrial, public sector schemes or PPP projects.

On a project by project basis, Insurers will also consider cover for buildings partially or recently completed.

In addition, cover can be provided for major refurbishment contracts in addition to traditional new build.

7. What type of latent defects claims have been dealt with by Insurers?

These include defectively designed floor slabs, defective cladding, failure of basement tanking, defective roofing, failure of rainscreen, subsidence, poorly fitting windows and omission of wind posts.

8. So what is the cost of a Latent Defects policy?

Depending on the level and period of cover chosen with a contract value in excess of £750,000 the one-off premium could be anything from approximately 0.5% - 1% of the estimated rebuilding sum insured, plus the cost of the technical audit. So the one off premium on a new office building with a rebuilding sum insured of £10 million could cost as little as £60,000 + IPT, providing 10 years cover; (with technical audit fee in addition), which in certain circumstances could be charged back to the tenant.

9. Interested? How do I obtain further details including an indicative quotation?

Contact Keith Hynds at Willis & Company (Insurance Brokers) Ltd on 02890 329042 or email keithh@willisinsurance.co.uk



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