

LATENT DEFECTS INSURANCE



During the construction phase of a building, loss or damage is normally insured under an “all risks” contract works insurance policy. Following completion of construction, a property “all risks” policy is usually arranged; however, this policy does not provide protection for damage arising out of an inherent or latent defect in the building.

WHAT IS LATENT DEFECTS INSURANCE?

Latent defects insurance (LDI) provides cover in the event of an inherent defect in the design, workmanship, or materials becoming apparent in the structure or waterproofing envelope of a building resulting in physical loss or damage. It will indemnify you for the cost of the repairs to or replacement of damaged property and/or pay to prevent imminent further damage caused by a defect up to the total sum insured, typically the full reinstatement value. Cover can be arranged for new buildings and significant extensions to or conversions of existing buildings.

The policy is generally available for a period of 10 to 12 years from the date of issue of final certificate of practical completion. The insured can be any party who has an interest in the property (normally the owner or developer) and can be required by funders or incoming tenants with an obligation to repair under the terms of a lease agreement.

WHY IS IT IMPORTANT?

A property “all risks” policy on a completed building does not normally provide protection for damage arising out of an inherent or latent defect in the building. For this reason, serious consideration should be given to the procurement of a LDI policy.

Unless LDI is procured, reinstatement of any damage caused by an inherent defect in the structure or waterproofing envelope will fall to the owner’s balance sheet. The likely recourse may be against the contractor’s (or subcontractor’s or consultant’s) professional indemnity (PI) insurance policy if the defect is caused by professional negligence, not workmanship or materials. Further, there may be a liability cap under their engagement preventing full recovery. In addition, proving liability may not be straightforward, meaning a claim could take years to reach a resolution, especially if the courts are involved. If the contractor is no longer in business when the defect becomes apparent, there may be little or no recourse for the owner.

PROJECT TIMELINE – THE PROCESS OF OBTAINING LATENT DEFECTS INSURANCE



SCOPE OF COVER

- The policy will provide “full value” reinstatement cover with a built-in 5% per annum indexation to assist inflation over the policy period.
- Policy periods are usually 10-12 years from practical completion which corresponds to applicable statute of limitations.
- Covers for defects in design, workmanship, or materials. Policies can be extended to provide cover for mechanical and electrical defects, business interruption, and, if required, new home warranties to residential owners.
- Available for commercial, residential, and mixed-use developments.

A recent case has highlighted that disputes over latent defects can take up to six years to reach successful resolution through litigation.

BENEFITS

- First party policy – there is no requirement on the policyholder to establish fault, negligence, or liability of the party(ies) to the construction contract.
- Insurance can be called upon quickly if the insured property suffers physical loss or damage or there is a threat of imminent damage due to a latent defect, within the terms and limits of cover.
- Costly, burdensome, and time-consuming litigation does not need to take place before repairs can be carried out, which enables the building to be returned to use speedily.
- The policy is assignable to future owners and/or tenants of the building who, in current market conditions, are increasingly reluctant to assume the risks associated with building defects and will be more attracted to a building where LDI has been arranged as opposed to one where this protection does not exist.
- The technical audit process may identify defects prior to practical completion, allowing such defects to be rectified before the owner/developer takes over responsibility for the building from the contractor. This independent audit during the construction phase ensures not only quality but also compliance with plans and specifications, as well as the ultimate availability of insurance cover.
- Provides insurance protection to repair/replace damaged property even if contractors and/or professional team are no longer trading.
- Provides balance sheet protection.

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