

# LATENT (STRUCTURAL) DEFECTS INSURANCE

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## History

Latent Defects Insurance (sometimes referred to as Structural Defects) was introduced to this country by French insurers during the 1980s.

The main purpose of the cover is to allow the owner of a new building to rest assured that, should their investment suffer from damage caused by a defect in design, workmanship or materials, then they have in place a first party insurance to remedy that defect.

If the proposition is as straightforward as all that then why is this cover not very common in the UK?

The answer to this question is quite complex and one which has been exercising the minds of numerous people associated with the construction industry.

Historically, Contract Works Insurance (or Contractors All Risks) has provided an 'all party' cover in respect of new works, during the construction phase and the maintenance period, of a new building. After handover an owner would have to prove that any damage manifesting itself was the result of negligence on the part of one or more parties to the construction contract.

The options would then be to:

- negotiate a settlement directly with one or more of the parties to the construction contract
- sue them if they denied liability

Either way this is likely to be a protracted process with no guarantee of success but this, believe it or not, is what most developers rely on.

They choose to ignore the facts that :

- third party claims typically take 5-7 years to settle
- third party covers are arranged on an annual basis and may not be renewed
- third party limits of indemnity may be too low to provide adequate redress
- the third party may no longer be in existence.

The good news is that severe post construction building defects are rare so that the likelihood of suffering is comparatively remote but, unlike a serious fire, which is also a very remote occurrence, building defects are not visible and rarely receive much publicity.

From time to time items appear in newspapers illustrating defects in buildings, such as the design defects in Great Ormond Street Children's Hospital extension; the cladding failure on BP's building in London; the nickel sulphide inclusions causing shattering of overhead glass in the Eurostar terminal at Waterloo Station.

These are high profile examples and sell newspapers. But for each high profile example there are dozens which do not make the headlines.

There were few memorable examples of high alumina cement but many instances of its effects. Whereas its effects may not have been caused by negligence, because its use could be defended by the plea of state of knowledge within the industry being limited at that time, its effects would undoubtedly be covered, under a Latent Defects policy, as a defective material - with damage manifesting itself after the construction period.

No one knows when the next high alumina cement type product will occur!

## How Cover is Arranged

To obtain terms for a new building underwriters will want to know details of:

- a) the Insured
- b) the new building and
- c) the parties to the contract.

These form the physical rating features.

In addition the following factors affect the premium rating level :

- a) the period of cover required (the original French cover was for 10 years, hence the term 'decenniel', but 12 years is now far more common in UK - and costs just a little more)
- b) the level of deductible for which the Insured opts - £10,000 is the usual minimum for buildings up to £1m reinstatement value but for larger buildings anything up to £1m can be provided
- c) the method of maintaining an up to date sum insured over the period of cover - this can either be done by reviewing the sum insured at each anniversary and paying pro rata additional premiums or opting for a fixed rate increase e.g. 5% per annum compound and paying for that level of increase at the outset.

Simple proposal forms are available to collect all of this information

These factors all affect the rate charged which will typically fall between £5 and £10 per £1,000 sum insured - the sum insured being the reinstatement cost of the completed building - this should include an amount in respect of professional fees, debris removal and demolition costs.

### **The Technical Audit Function**

In addition to the above premium, underwriters are likely to require a deposit premium to cover the cost of an audit of the design and construction. The purpose of this audit is to try to prevent damage which may be detected by an extra pair of eyes employed specifically for that purpose.

It can happen that the original design team is too close to the action and can miss the obvious.

Examples which have been spotted by auditors have included:

- unrestrained columns
- poor reinforcement placement in a floor slab
- inadequate reinforcement specified
- absence of wall ties
- lack of movement joints
- cross bracing moved by architect
- gable end drainage channel omitted
- out of sequence work leading to inadequate flashing detail
- inadequate fixing of facade to structure
- roof membrane laid incorrectly

Not only have these saved insurers from potential claims but they have saved the building owner from considerable upheaval and discontent from their tenants - not to mention the deductible! Such errors can be put right by the builder prior to handover.

The team of engineers used for this purpose tend to be very experienced structural engineers who have been carrying out technical audits for a number of years.

The technical auditor's role is solely to try to prevent a claim occurring and not to cause disagreement. His function is to confirm to underwriters that to the best of his knowledge the building does not present any known defect in design or construction. If he is unhappy with any feature he will try and resolve the problem with the proposer's nominated representative on site.

If this is not possible the matter will be referred back to the underwriter to resolve with the proposer. This tends to be very rare because both the proposer and the underwriter have the same aim - a building with no known defects and if our technical auditor has identified a potential problem, the proposer will normally want it resolved, rather than run the risk of a defect, either in design or construction, which has been identified.

The cost of the audit varies from project to project and is affected by a number of factors. Except on small projects it is usually less than 25% of the premium.

## **The Policy**

Once the audit has been completed and practical completion has been achieved a formal offer of cover is made. This offer usually reiterates the terms indicated at the outset and gives the proposer 90 days to decide whether or not to proceed.

The policy, once issued, is then freely assignable to any party acquiring an insurable interest in the building, during the currency of the policy.

A full specimen policy wording is available on request but the main elements set out below.

The cover is for

- a) structural defects
- b) ingress of water
- c) subsidence landslip or heave
- d) threat of imminent collapse requiring immediate remedial works to prevent damage

caused by a defect in design workmanship or materials but not discovered before the inception of the cover

The main exclusions specific to Latent Defects Insurance are

- a) the deductible
- b) damage discovered outside the period of insurance
- c) anticipated or planned for movement, settlement, shrinkage or expansion
- d) abnormal use or overloading
- e) wear and tear or inadequate maintenance
- f) change in colour or ageing process
- g) the contractor's contractual obligations for snagging
- h) damage to paint and other surface coatings

The basis of settlement

The cover is intended to operate on a reinstatement basis including the cost of remedial work to prevent further damage.

It includes

- a) professional fees
- b) removal of debris
- c) dismantling, moving, removing, storing, returning and re-erecting property belonging to the Insured
- d) costs of compliance with public authority

## **Optional Covers**

### **Consequential Loss (Business Interruption) Covers**

Cover can be arranged for landlords or tenants of buildings for which a material damage latent defects cover is provided against:

- a) loss of rent receivable
- b) loss of gross profit or revenue
- c) increased cost of working from alternative premises

## Claims

Examples of the types of claim -

- |    |                                  |   |   |
|----|----------------------------------|---|---|
| a) | defectively designed floor slabs |   | allowing movement and consequent damage to floors and walls |
| b) | omission of windposts            |   | allowing damage to the walls                                |
| c) | subsidence                       |   | causing damage to the walls                                 |
| d) | defective cladding               | ) |   |
| e) | failure of basement tanking      | ) | All   |
| f) | defective roofing                | ) | allowing  |
| g) | failure of rainscreen            | ) | water   |
| h) | poorly fitting windows           | ) | to  |
|    |                                  | ) | enter   |
|    |                                  | ) | the   |
|    |                                  | ) | building  |

## How Rowlands & Hames can assist you

Rowlands & Hames can obtain no-obligation quotations from a number of insurers.

It is important that quotations are obtained prior to completion of any building, rather than once occupied, as any defects need to be resolved.

Please contact your usual Rowlands & Hames Account Director.

*Rowlands & Hames take this opportunity to thank Norwich Union for its assistance in preparing this bulletin. Not all policies offer equivalent coverage.*

**Please contact Rowlands & Hames for further information.**

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