



# Why you should consider latent defects insurance



Owners and developers generate huge amounts of paperwork and incur not insignificant fees negotiating fitness for purpose obligations and other rights of recourse against design and build contractors and other construction professionals relating to construction projects. Often this requires these obligations to be backed up with professional indemnity insurance. But will this provide them with the protection they need?

The demise of Carillion in early 2018 highlighted that even the largest and most reputable contractors can fail. When a contractor, sub-contractor or other design professional fails, any party with a new claim against the failed entity will join the list of creditors and potentially only be able to recover a fraction of its loss.

What's more, as professional indemnity insurance is usually purchased on an annual basis and always on a "claims made" basis, it is likely that the policy will lapse at the next renewal date after the demise of the relevant entity, meaning that there is no insurance pot available to meet future losses from building owners or other claimants. In addition, the recent significant hardening of the professional indemnity insurance market has meant that design and build contractors and other construction professionals are in many cases having to reduce the quality of the cover they are purchasing from renewal date, in turn making it more likely that they will not have the funds available to deal with future claims and fail.

## How can you ensure you are protected?



A potential solution is to purchase latent defects insurance. For those unfamiliar with the cover and how it is arranged, insurers (in return for a non-refundable deposit premium paid at the start of the construction phase), agree to provide protection for the cost of repairs following a structural defect manifesting itself during either a 10 or 12 year period after Practical Completion, provided that the Insured agrees to a monitoring process paid for out of the deposit premium during the construction phase and this reveals no undue concerns, and further provided that the Insured pays the balance of the premium at Practical Completion.

In addition, to cover against latent structural defects, the policy can be extended to provide protection against failure of the weather-proofing envelope, water ingress into basements and the cost of replacing mechanical and electrical equipment during the period of insurance. Insurers are also prepared to offer terms to cover loss of rent or other business interruption costs following latent structural defects.

Policies can be freely assigned to future owners of the building and/or tenants. As the policies are "first party" policies providing the insured (i.e. the owner or tenant with protection), all the insured has to do to receive the policy proceeds from insurers is to demonstrate that insured damage has occurred and quantify its loss, allowing the insurer to in turn try to establish whether it is able to exercise rights of recovery against the design and build contractor and/or any other party.

## How is latent defects insurance developing?



Although there has been a reduction in the total capacity available in the insurance market for this type of cover over the last 12 months, we have not seen the same very significant hardening of the insurance market, that has impacted professional indemnity terms for design and build contractors and other construction professionals.

Even prior to Carillion's liquidation and the recent hardening of the professional indemnity insurance, market contractors were increasingly arranging latent defects cover on large UK construction projects. We expect recent events will only serve to increase the demand for this cover

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