

Latent Defect Insurance or Collateral Indemnity



Would you purchase a new home or invest in a new commercial property unless there was some form of guarantee covering building defects that become apparent within 10 or 12 years of completion? Whenever a developer sells a new home they will guarantee the quality of their design, materials or workmanship by offering extended warranty backed by a specialist insurer, such as the National House Building Council (NHBC), who are possibly the best known. However, there are several other providers who cover the whole range of developments such as mixed usage, commercial, social and not just residential.

The comfort of knowing that a defect will be rectified, should it occur within 10 or 12 years of practical completion, is of appeal to the developer, financier, potential owner, occupier or leaseholders. Whether it be a minor or major integrity threatening defect, knowing it will be rectified provides comfort to all parties. In fact, having latent defects cover may be a condition of the purchase imposed by the financiers. In addition to repairing the structure, the purchasing of a warranty can also protect the developer and all professionals involved in the development against reputational damage.

Given the benefits to financiers, developers and future owners alike, the arrangement of latent defects cover can be a sound commercial decision.

There can be a tendency to rely on collateral warranties, but the first hurdle is to try to establish which party is responsible for the damage. It is often incredibly difficult to decide whether it is a faulty design, faulty workmanship or faulty materials, and in many cases, it can be a combination of any or all of these factors which may take a very long time to establish. Also, not all parties to a contract are included in the collateral warranties, and if a defect is found to be the responsibility of a subcontractor who has not been included within the warranties, there is no right of recourse against them, and therefore, the defect would need to be repaired at the owner's expense.

In a latent defect policy, there is no need to prove fault. It is property-specific cover, and you only need to establish that there is an inherent, structural defect rather than HOW the defect occurred.

Finally, and maybe the most important benefit of a latent defect policy is that a specified inherent defect is still protected even if the contractor or other party has become insolvent.

In layman's terms, and the best analogy we have heard is "a collateral warranty is third party cover whereas a latent defect policy offers a fully comprehensive policy". In addition, a latent defect policy will attach to the property itself rather than a specific owner, developer or contractor. Moreover, the policy benefit can be assigned to whichever party owns the property up to the time that the policy ceases which adds value to the asset owner as well as to the vendor and purchaser alike.

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So why purchase Latent Defects?

1. Financiers will more than likely insist on this cover as the loan is secured against the building. If an inherent defect becomes apparent, the property value may be prejudiced.
2. Rectifying a building defect is more straightforward as the cover is material damage based and you only need to evidence a specified inherent defect for the claimant to obtain benefit from the policy. You do not have to establish the cause of the defect or prove negligence.
3. By avoiding the need to establish negligence the repair process is more efficient, reducing the overall impact to the owner and maximising returns on asset.
4. Avoids the need to seek redress under a collateral warranty that can become a legal issue thus adding delay and costs with no guarantee that the action will be decided in the claimant's favour.
5. The policy is not tied to any contractor so if the original speculative developer has gone into liquidation then there is reassurance that the specified defect will be dealt with.
6. When a landlord lets a brand-new build under a standard 5year + commercial lease, the lease agreement may state that should the tenant have to vacate the premises due to a major building defect then the landlord may be liable for elements of financial loss suffered by the tenant. Also, the tenant may be able to either enforce a break clause or withhold rent till the defect is rectified. Therefore the landlord has a large potential to suffer a significant loss following a major building defect. By having latent defects cover the loss is mitigated as the repairs will take place much more quickly and rectification of the fault does not have to be pursued through the courts. The cover is assignable to a purchaser for a 10-or 12-year policy benefit period.
7. Latent defects is a blanket cover and covers specified inherent defects caused by parties who are not part of any collateral warranty agreement.
8. Cover is flexible and can be extended to include such things as Mechanical and Electricals, loss of income etc.
9. Cover can be extended to include mechanical and electrical installations which on new structures make up a greater percentage of the whole project cost.

When should I arrange cover?

As soon as possible in the build process. It is best to involve insurers at the planning stage as their input can be invaluable and does reduce the cost of the insurance. Post construction latent defects can be arranged, but this is a far more expensive option.

Contact us

Clear provides specialist insurance advice to the property sector. To learn about cover options visit: www.clearinsurancemanagement.com/business-types/residential-property-insurance/

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