



# Latent Defects Insurance



# Product overview

Whilst a building is being constructed, it will likely benefit from a Construction All Risks (CAR) policy put in place either by the contractor or the developer. Once the building has reached practical completion, this policy will fall away and be replaced by a property owners' or building insurance policy, similar to a home insurance policy.

Property policies do not provide cover for damage resulting from latent or inherent defects in the structure. This risk can be covered by a Latent Defect Insurance (LDI) policy, which is specifically designed to provide cover for damage caused by defective workmanship, materials, and design on a first-party basis, meaning there is no need for the client to pursue recourse against a contractor. The policy lasts for 10–12 years and is freely assignable during this period to a new owner of the building should the client decide to sell.

The policy can be extended to include cover for M&E damage, loss of rent, and alternative accommodation.

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

## Why is LDI important to consider?

- Without LDI, owners rely on collateral warranties given by contractors – to use these, they must have proof that the contractor was negligent.
- This can be a costly and lengthy process, with the effects of the defect left for the owner to bear.
- Cases can last for years with no guarantee of either legal or repair costs being paid, even if the court rules in the owner's favour.
- If the contractors have ceased trading, or it cannot be proven that they were at fault, the cost of repairs will fall on to the client's balance sheet.
- The contractor's own insurance might not be sufficient to meet the size of the claim.
- The cost of lost revenue if the building is unusable due to a defect will be left for the owner to bear.

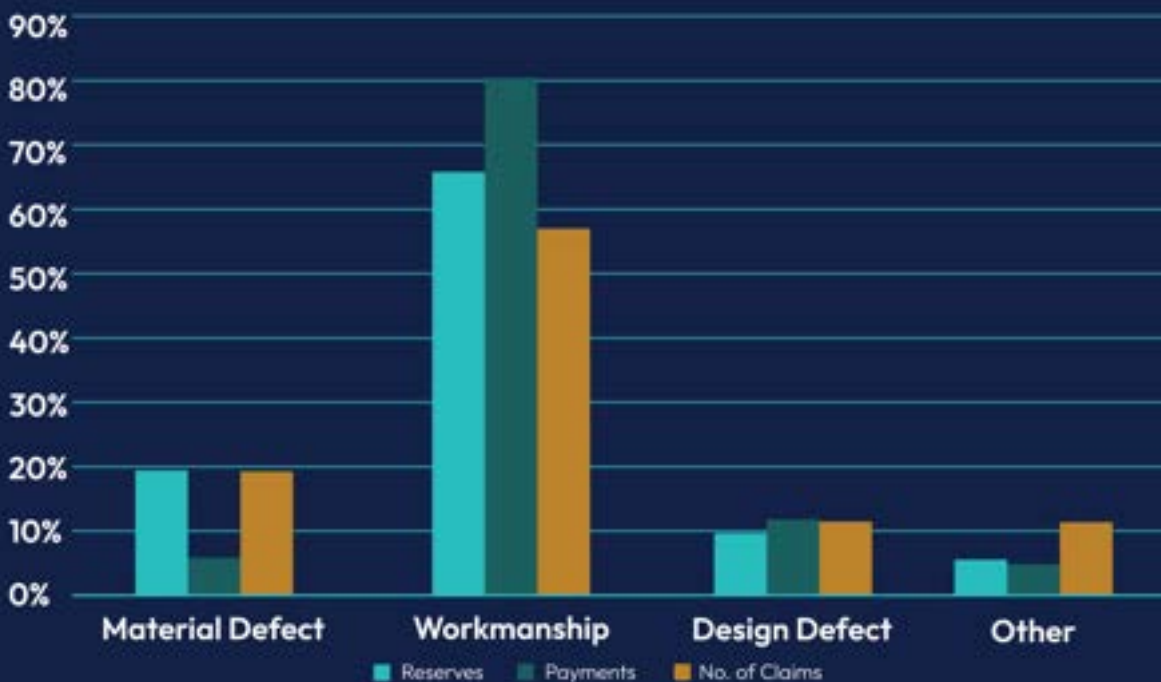


# Contractual risks

Once the defect period at the end of the construction phase, which is agreed with the contractor, has expired, the contractor is no longer obligated or required to rectify any defects they have not been made aware of. If there is no LDI policy in place, the owner may have the option to seek damages from the contractor for negligence or breach of contract. This would fall against the contractor's Professional Indemnity (PI) insurance, which is usually maintained for 12 years after Practical Completion; however, there are several potential risks to the owner:

- Whether the contractor or sub-contractor has adequate PI cover to meet the claim.
- Negligence must be proven for a claim to be successful.
- PI cover will not provide cover for defective materials or workmanship.
- The PI market, following the Grenfell disaster, has introduced many restrictions and limits to policies – thus limiting the scope against which a claim can be made.

With many projects operating under a construction management model, much of the risk previously borne by the main contractor under a design and build model – in respect of the financial strength of the sub-contractors – passes to the employer. This is important to note, as these sub-contractors will likely have lower PI limits and may therefore not be in a position to respond in full to a claim, even in the best case.



PI Insurance will not provide protection against defective workmanship or materials.



# Commercial latent defects insurance

An LDI policy removes the need for owners and developers to rely on collateral warranties provided by the contractor or contractors which, as discussed previously, can be hard to enforce when needed.

## What does the policy provide?

- A fully reinstated sum insured with indexation included to account for inflation
- A 10 or 12-year policy term from practical completion
- Covers defective design and workmanship as standard, with available additions of M&E cover and Loss of Rent

Residential LDI has been a very popular product for many years, as it protects homeowners and mortgage companies from the threat of damage that would affect both the value of the asset and the client's ability to service the loan. Commercial LDI is rapidly growing in popularity for the same reasons, a trend that has been catalysed by the weakening position of collateral warranties.

A commercial LDI policy provides cover for the structure of the building and its weatherproofing as standard, but as mentioned, it can be extended to include other highly worthwhile elements of cover. These additions can provide cover for the Mechanical and Electrical elements of the building, which are often overlooked as an area of risk.

A further addition can cover the financial loss consequent to such a loss, including loss of rent and alternative accommodation cover. This addition in particular has driven commercial LDI's rise in popularity, as it acts to protect the owner's revenue in cases where the asset cannot be fully utilised.



# Claims examples

## Example 1: Ground Floor Slab

Cracks appeared in the floor slabs and damage was caused to doors and cladding in a four-storey office block due to defective workmanship. This was covered under the LDI policy and the total cost of rectification amounted to over £6 million.

## Example 2: Water Damage

Ingress of water occurred at the basement of a three-storey building due to inadequate design of the drainage system, the materials used in construction, and poor installation of the system. The pipes had to be replaced and the paving slabs, surface water drainage system, and waterproof membranes had to be reformed, totalling costs of nearly £600,000. This was covered under the LDI policy.

## Example 3: Glazing

Glazing installed in an office building failed and fell to the ground as a result of nickel sulphide inclusions within the glass panels. All of these panels should have been heat-soaked, but approximately 35–40% were not. This resulted in a successful multi-million-pound claim under the latent defects policy.





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