

Inherent or Latent Defects Insurance

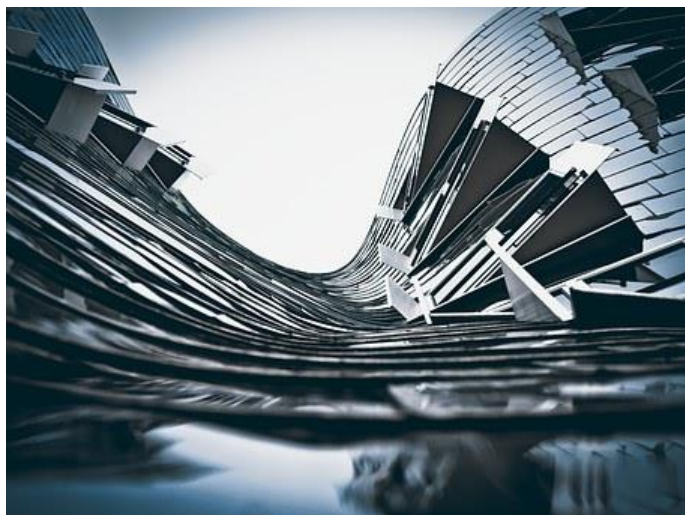
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Features of Inherent Defects Insurance

Inherent Defects Insurance (IDI) was first introduced to the UK in the late 1970's, having been available in France for many years before this. IDI provides protection against the cost of repairing, restoring or strengthening a property if damage occurs as a consequence of an inherent defect in the structural or non-structural elements of a building and / or in the mechanical or electrical services of the building.

The key features of IDI are that:

- Cover is usually provided for a policy period of 12 years;
- Cover is operative from the date of practical completion other than in respect of mechanical and electrical services where cover commences 12 months after the date of practical completion;
- Once incepted, cover is non-cancellable over the 12 year policy period;
- Cover is available for damage to both the structural and non-structural elements of a building and the mechanical and electrical services, as a result of faulty design, materials or workmanship. All of these elements can be provided for under a single policy;
- The premium is usually paid in full at the inception of the cover;
- It can provide protection and peace of mind for any combination of the following: commercial property owners, property developers, tenants and / or financiers;



- Cover operates in a similar manner to a conventional property policy and is on a “first party” basis. This means that in the event of insured damage, the policy will pay out and there is no requirement to prove that it arose as a result of negligence of a third party;
- Cover is usually available for newly constructed, partially completed and completed industrial and commercial property. It should be noted that it is considerably more difficult to obtain cover in respect of completed projects as insurers have been unable to carry out a technical audit during the construction phase and requests of this nature can be viewed as selecting against insurers;
- Cover is available for both property damage and loss of rent receivable;
- The benefits of the cover can be assigned to any party acquiring an insurable interest in the property during the policy period.

In the event that damage occurs as a consequence of an inherent defect, an IDI policy will provide cover in respect of:

- The cost of rebuilding, repairing, restoring or strengthening any part of the property;
- The cost of any remedial action required to prevent imminent damage;
- The cost of removing and disposing of debris, dismantling and / or demolishing and shoring up of the premises;
- The cost incurred to dismantle, remove, store and re-install any contents and / or fixtures in the building in order to facilitate reinstatement of the property;
- The cost of legal, professional or consultants’ fees;
- The additional costs incurred as a consequence of complying with any legislative or regulatory change brought about by the European Union, an Act of Parliament or the bye-laws of any local or municipal authority.





Inherent Defect

An inherent defect is one that is undiscovered at the date of practical completion or inception of the cover, but manifests itself at a later date and causes actual physical damage, but could not have been reasonably discovered at the time by the insured.

Sum Insured

The sum insured will be based upon the reinstatement cost of the property at the date of practical completion, plus an indexation allowance for inflation over the course of the 12 year policy period.

Underinsurance

Should the sum insured not adequately cater for the cost of reinstating the premises, then the amount of any claim will be proportionately reduced. It is therefore vital to ensure that sums insured are adequate at the outset and that inflation provisions are set at appropriate levels.

Rent

The sum insured provided for rent can remain unaltered throughout the period of insurance, however, the same underinsurance condition will apply and it is therefore vital that the correct sum insured is ascertained at the outset and amended as required.

Subrogation

In the event of a claim, insurers may wish to exercise their right to subrogate against negligent members of the professional or construction team. This may enable them to make a recovery of all or part of any outlay that they have suffered. It is possible that insurers may be willing to waive their rights of subrogation if asked to do so at the outset of the cover. Clearly, the terms put forward by insurers will be amended to reflect the request and the increased exposure that this will lead to.

Assignment

During the course of the policy period, it is possible to assign the policy to new owners or other interested parties who acquire an insurable interest in the property.

The Premium

The full premium for the policy period is due at the commencement of cover along with insurance premium tax. No other premiums are payable during the policy period unless the sum insured has to be increased.

In certain circumstances, it may be possible to pay the premium by instalments; however, this will usually be subject to a surcharge. It should be noted that in this situation, the whole of the insurance premium tax will be payable at inception as insurers have to account to the HMRC for the payment of this.

Excess

Insurers will expect that an excess will apply to each and every claim. It can often be agreed that a single excess will apply to damage discovered at different times but caused by the same defect. In respect of policies where cover has been provided for loss of rent, the excess may be stated as a number of days rather than as a monetary amount. If the sum insured is increased annually by an indexation percentage then the excess will be increased annually by the same amount.

The core cover

The cover provided by an IDI policy is aimed at catering for the majority of potentially serious defects that could cause damage to the property. These include the following:

Structural cover

This element of the cover provides protection against damage arising as a result of defects in the structural elements of the building being:

- Foundations, columns and beams;
- The external walls and any cladding;
- External doors and windows;
- Stairs and floors;
- Roof structures;



- Other external and internal load bearing elements that are essential to the stability of the premises.

Weatherproofing and Waterproofing

Damage caused by a defect in the weatherproofing or waterproofing cover is included. Cover operates as a consequence of damage arising from water entering the property due to a defect in the weatherproofing envelope of the building at or above ground level, and the waterproofing seal of basement areas. The areas covered include:

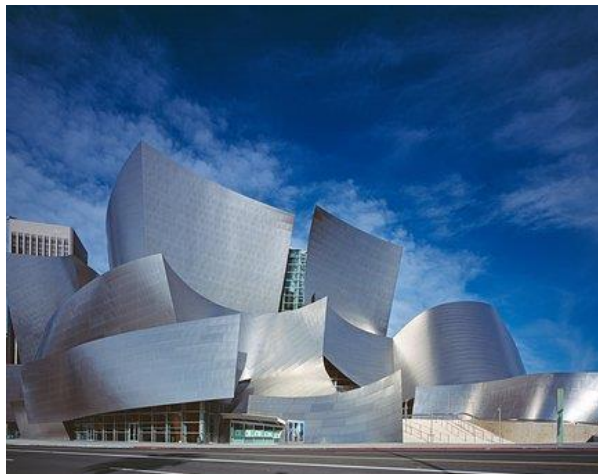
Weatherproofing

- Roof coverings;
- Skylights;
- External walls, cladding (including glazed curtain walls and similar non-load bearing facing) and fixtures;
- External windows and doors, however, moveable elements are excluded;
- The ground floor slab.

Waterproofing

- Waterproofing elements which form part of the building and are below ground level.

Cover is usually available for a 12 year period; however, it is usual for there to be a waiting period of 12 months from the date of practical completion before weatherproofing and waterproofing cover is operative.



Additional covers

There are a number of additional covers that can be purchased including:

- Damage caused by a defect in the non-structural parts of a building;
- Damage caused by a defect in the mechanical and electrical services;
- Loss of rent.

Non-structural parts

Cover can be arranged for damage caused as a consequence of an inherent defect in the non-structural parts of a property. This is regarded as being all other areas of the property not covered under the headings of structural and weather proofing but excluding the following:

- Protective coatings;
- Decorative finishes;
- Floor coverings.

Mechanical and electrical services

Cover can be provided for damage caused as a result of inherent defects in the following:

- Heating, ventilation and air conditioning systems including boilers and calorifiers;
- Fresh and waste water systems;
- Lifts and escalators;
- Window cleaning equipment;
- Electrical distribution systems;
- Building management and environmental systems;
- Building security systems.

In addition to the above, component failure cover can be purchased as an extension of the mechanical and electrical cover or merely as an extension to the IDI cover. The cover provides protection for certain non-load bearing elements without the need for physical damage.

It should be noted that cover is not provided for any external services.



Occupier's business interruption

It is possible for the occupier to purchase an annual business interruption policy. This provides cover for loss of profits or rent or additional cost of working and would sit alongside the IDI policy.

Technical audits

Technical audits form an integral part of IDI and are usually carried out by an independent consulting engineer, known as the Technical Agent. Their role is to monitor the project throughout the design and construction phases on behalf of insurers. They will issue reports to insurers as the work progresses and will confirm that the property has been constructed in accordance with normal standards and in line with good building practices.

The Technical Agent's role will include:

- Monitoring of the design and construction methods;
- Checking that communication between members of the project team is effective and that responsibilities are clear;
- Regular site visits;
- The issuance of a certificate of approval to insurers at practical completion;
- The issuance of further certification regarding weatherproofing / waterproofing cover, 12 months after practical completion and following a further inspection;
- Carrying out triennial audits and health checks in respect of mechanical and electrical services only.

You will be informed immediately should the Technical Agent encounter any difficulties or problems in order that they can be resolved quickly and effectively.

Technical Agent's fees

All audit fees are paid by the Insured directly to the Technical Agent in order to assist with the recovery of VAT and to ensure that Insurance Premium Tax does not become applicable. The fees will be invoiced during the construction phase of the project.

Benefits of the technical audit process

The principal objective of the technical audit is to ensure that the property is designed, constructed and installed in accordance with normal building standards. In the event that there are any issues arising out of the technical audit, the Technical Agent will inform insurers. However, many issues are resolved amicably at the time of the audit and are never actually reported to insurers. The active involvement of the Technical Agent can highlight problems or areas of concern at an early stage. This can mean that the issues can be resolved in an efficient and effective manner and ensure that costly amendments and delays can be avoided.

Principal exclusions

The principal exclusions relating to the cover include the following:

- Any works which are outstanding at the time of practical completion;
- The use of any property for any purposes other than for which it was designed;
- Load or the application of pressure in excess of the design load or pressure;
- Inherent defects discovered during the defects liability period;
- Wear, tear and gradual deterioration;
- Fire, lightning, explosion, earthquake, storm, tempest, flood, frost, bursting or overflowing of water tanks, pipes or other apparatus, discharge or leaking from an automatic sprinkler installation, pressure waves caused by aircraft or other aerial devices flying at sonic or supersonic speeds or the impact of aircraft or other aerial devices or articles dropped or falling therefrom or the impact of any other vehicle whether licensed or not;
- Pollution and contamination;
- War and other hostilities including acts of terrorism;
- Wilful acts or omissions by the insured;
- Computer hardware, programmes, electronic data and codes, software and data storage materials;
- Operator error.

In addition to the above, the following applies to the cover provided for mechanical and electrical services only:

- Any testing and intentional overloading of the mechanical or electrical services, unless it is undertaken in accordance with the manufacturer's or supplier's instructions.

The process

In order to obtain a quotation we will require the following:

- A completed proposal form;
- Copies of plans, specifications and elevations;
- Soil reports.

This will then enable us to obtain quotations which will include details of the Technical Agent and their fees. If the quotation is acceptable to you, we will ask for your written confirmation of the appointment of the Technical Agent. Insurers will issue a Certificate of Intention to Insure which will outline the cover to be provided at practical completion.

During the course of construction, the Technical Agent will monitor the progress of the project and issue regular reports and updates to insurers. It is the aim of the Technical Agent and insurers to work in conjunction with each other to ensure that a policy is issued in accordance the original intentions of all parties concerned with the project.

When practical completion has been achieved, a copy of the certificate of practical completion should be sent to insurers. The Technical Agent will issue a final report and provided that there are no final issues to resolve a policy will be issued and the premium will be due.

In the event that weatherproofing and / or waterproofing cover has been taken out, the Technical Agent will carry out a further site visit after 12 months to check upon these elements of the building. Providing that there are no outstanding matters, cover will be incepted.

If the cover includes mechanical and electrical services, triennial health checks will be undertaken. This is to ensure that ongoing maintenance of plant and equipment is being undertaken as necessary. The checks will encompass inspection of the following:

- Maintenance and statutory inspection records;
- A general overview of plant and equipment using thermographic imaging.

The benefits of IDI

The principal benefits of an IDI policy are that:

- The cover is provided on a “first party” material damage basis so there is no requirement to prove that there was negligence or fault on the part of a member of the professional team. All that is necessary is to show that there is an inherent defect or that damage has been caused as defined within the policy. As a result, the policyholder should receive funds to rectify the damage quicker and regardless of blame than would be the case if they had to prove that a member of the professional team was negligent. As a consequence, disruption is minimised;
- As long as the sum insured is adequate, the insured will be able to make a full recovery. This may not always be the case if the negligent consultant or contractor does not have sufficient professional indemnity insurance or assets to enable a full recovery to be made;
- It does not rely on the continued solvency of the professional team;
- The cover can be used as a further marketing tool or differentiator by property owners and developers when negotiating the sale or letting of a property;
- The cover is assignable to future tenants and owners if required;
- Cover is non-cancellable once it has been incepted;
- It can reduce the need to rely on collateral warranties, guarantees and professional indemnity insurance, although it should be noted that IDI cover is not a substitute for any of these;
- It provides peace of mind to property developers, property owners, funders and future tenants and owners.

Please note that the above has been prepared as a general guide only and no responsibility for loss or damage arising from the advice provided can be accepted by Realty Insurances Limited.