

Refurbishing existing buildings: Increased interest for latent defects insurance (LDI)

As construction increases in inner cities, a lack of development space means that owners and developers are looking to repurpose existing buildings. Net-zero targets are helping to drive this development in the built environment. As a result, interest in latent defects insurance (LDI) for projects involving the refurbishment of existing structures is growing, adding complexity to an already niche aspect of construction insurance.

LDI provides first-party protection for inherent defects in buildings when they occur post-completion of construction works. It runs alongside property cover, where defects are commonly excluded. Under a LDI policy, works are monitored by an insurer-appointed surveyor or engineer, ideally from commencement of the project right through to its practical completion.

Traditionally, developers and owners have used LDI for new builds. However, the increase in refurbishments has resulted in more enquiries relating to this type of project. Many UK owners and developers purchase LDI cover for all their projects but have struggled to understand what cover is necessary involving existing structures.

This factsheet seeks to address questions raised about LDI and outlines some of the information that will be required by insurers.



CAPACITY

What is the state of the LDI market?

The LDI market is small. It is also split between direct insurers, offering cover on commercial projects, and residential LDI or “new home warranty” providers acting as managing general agents (MGAs).

What is the market appetite for developments, including existing structures?

Not all insurers will offer coverage on existing structures, further limiting the already small market. The insurer’s appetite will also be dependent on the condition of the existing structure, its age, and whether it is listed.



COVERAGE

What are the specific risks relating to the existing structure and issues covered by the insurance policy and common policy limits, deductibles, and exclusions?

Insurers willing to offer coverage for existing structures will do so based on the existing structure. This means that if a defect arises from the new works that impacts the existing structure, there is cover, but not the other way around. Some insurers are moving to offering full cover on existing structures or considering loss limits rather than just excluding the existing structure. Deductibles may be slightly higher on commercial projects or common areas as these tend to have a much higher value than individual residential units. Deductibles can be higher on commercial policies or common areas and can vary from £10,000 to £1 million.



STANDALONE MECHANICAL AND ELECTRICAL (M&E) WORKS COVER

Where little structural works are being conducted but high values of M&E works are being installed, would M&E cover be more suitable?

Marsh sees many projects with a large existing structure, where little structural works are being undertaken, but high values of M&E are being installed. Standalone defects cover solely for the M&E works can sometimes be more appropriate and cost effective. Increased demand for standalone M&E cover is also often driven by prospective tenants.



EXISTING BUILDING AGE

How does the age of a building affect the opportunity for LDI cover?

Buildings constructed before the 1980s can be deemed riskier due to the materials used and the regulations imposed at that time. Buildings built after this time are slightly more well-known entities and are more likely to be considered by insurers. Having a well-documented record of architectural plans and drawings will be beneficial.



INSPECTION REQUIREMENTS

We are often asked what the requirements are for inspections and assessments of a project before cover can be granted.

As with LDI on a new build project, inspections will need to be conducted throughout the full-build period. When there are differences in existing structure projects, ideally, a feasibility study and audit of the current structure will be carried out before new works commence to assess its condition and structural integrity. It may be possible to engage insurers early and invite their auditor to conduct a site investigation. This engagement can help build confidence in a refurbishment project.



CLAIMS PROCESS

What is the process for making a claim under a policy? How are claims evaluated and resolved?

As cover for the existing structure is often written on a consequential loss basis, the insured needs to prove that the primary cause of the loss arose from a defect in the new works. It's often very difficult to differentiate between the new and the existing structure when a project is complete, which supports the need for early and full engagement during the technical audit, to provide a well-documented risk.





PREMIUMS

How are premiums calculated for this type of insurance and what factors might affect the cost?

On a new build project, a premium rate is applied just to the value of the new works. When there is an existing structure, a premium rate is also applied to the reinstatement value of that. For these types of undertakings, premium rates tend to be higher for both the new works and existing structures, as these projects are deemed to be higher risk. However, rates depend on the amount and condition of the existing structures in play. It's also common for some low-value existing structures such as facades or retained walls to feature in projects but these will have less of an impact on the overall premium as long as the values are relatively low.



RISK MANAGEMENT

What steps can developers take to manage risk?

Developers should engage with the LDI insurance market early on in the lifecycle of a project to ensure maximum cover is available at the most affordable premium. Some developers engage with insurers too late, when a project has already started, and face more restrictive cover at heavily inflated premium rates to compensate for the insurers' missed inspections. Sometimes, they are not offered cover, particularly for high-risk projects with existing structures.

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FUTURE DEVELOPMENTS

In the past, first-party LDI cover could be procured on existing structures. Due to the tightening construction insurance market and questions surrounding existing structures, this has become more restrictive in recent years, to the extent that only consequential loss cover is offered in many cases.

There is also the question of whether the increase in refurbishment projects will lead the market to shift to include full cover for existing structures. The answer is that some insurers are broadening their terms to offer this rather than just consequential loss cover. However, it is not being offered for all projects.

Complete, clear, and good-quality information is required to obtain the best response from insurers. Early engagement with your construction insurance broker is vital to collate the information needed by insurers to cover this type of project and to gain optimum terms.

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