POST-PROJECT PITFALLS IN SHANGHAI: WHO PAYS?
INHERENT DEFECT INSURANCE

BACKGROUND

China’s booming residential property development has provided fertile ground for mushrooming ‘project companies’ – companies that are formed for a specific residential housing project and dissolved immediately after its completion. Sprouting alongside these appearing and disappearing entities is concern about who is obligated to pay for faulty construction discovered after a project’s completion.

To comply with Shanghai Residential Property Management Regulation Article 19 (established in 2004 by the Shanghai local authority), the developer of residential properties must pay a maintenance security deposit to a special account before final registration.

Shanghai Residential Property Maintenance Security Deposit Management Provisional Regulations, issued by the Shanghai Municipal Housing Security and Housing Administration Bureau in 2011, required the deposit be equal to 3% of the final contract value and be refundable after 10 years. So, if a project contract is valued at USD1,00,000,000, the required security deposit is USD3,000,000.

This security deposit can now be replaced by Inherent Defect Insurance (IDI).

Shanghai is the first city in China to accept IDI as an alternative to the deposit. Other cities will likely follow suit.

INSURERS

After the latest regulation was released at the end of 2011, local insurers developed policy wording, rating and insuring procedures. There now exists a co-insurance panel led by China Pacific Property Insurance Company Ltd. (CPIC) and supported by PICC, Ping An and AAIC. The panel has issued IDI policies that have been accepted by the Shanghai Municipal Housing Security and Housing Administration Bureau. The first policy was issued in November 2012.
COVERAGES

Inherent Defect Insurance covers costs to correct defects and the consequences of such defects after the construction is completed. Coverage includes:

- Foundation and main structure – 10 years***
- Insulation and waterproofing – 5 years
- Doors and windows – 2 years
- Plaster – 2 years
- Insulation – 2 years
- Fit-out work – 2 years
- Heating and cooling systems – 2 seasons

*** Project company is liable from the end of 10 years to the end of the project design life (ranges 50-70 years).

As part of the insurance, underwriters will hire a third party inspection service (TIS). The TIS will review the design documentation and construction plans. They will monitor construction and make recommendations for improvements. Policies cannot go into effect until a TIS does this review.

COST OF INSURANCE

The cost of the insurance should be less than 2% of the contract value, and the insured has no further liabilities. In other words, with IDI where there is a covered loss, the insurance will pay the loss up to the full contract value. If IDI is not purchased, the project companies can be held responsible for paying losses above the deposit up to the full value of the contract.

CONCLUSION

While this is a relatively new product in China, risk managers of residential projects in Shanghai are urged to consider IDI coverage as an alternative to paying a maintenance security deposit.

CONTACT

For more information contact your Willis Client Advocate® or

Christian Cui
China Construction Practice
+86 021 50818580
cuic@willis.com

If you would like information on other international issues, or to view past Alerts, please visit our website.

The observations, comments and suggestions in this publication are advisory and are not intended nor should they be taken as legal or financial advice. Please contact your own legal or financial adviser for an analysis of your specific facts and circumstances.