

Insuring exceptional buildings: a Portuguese case study

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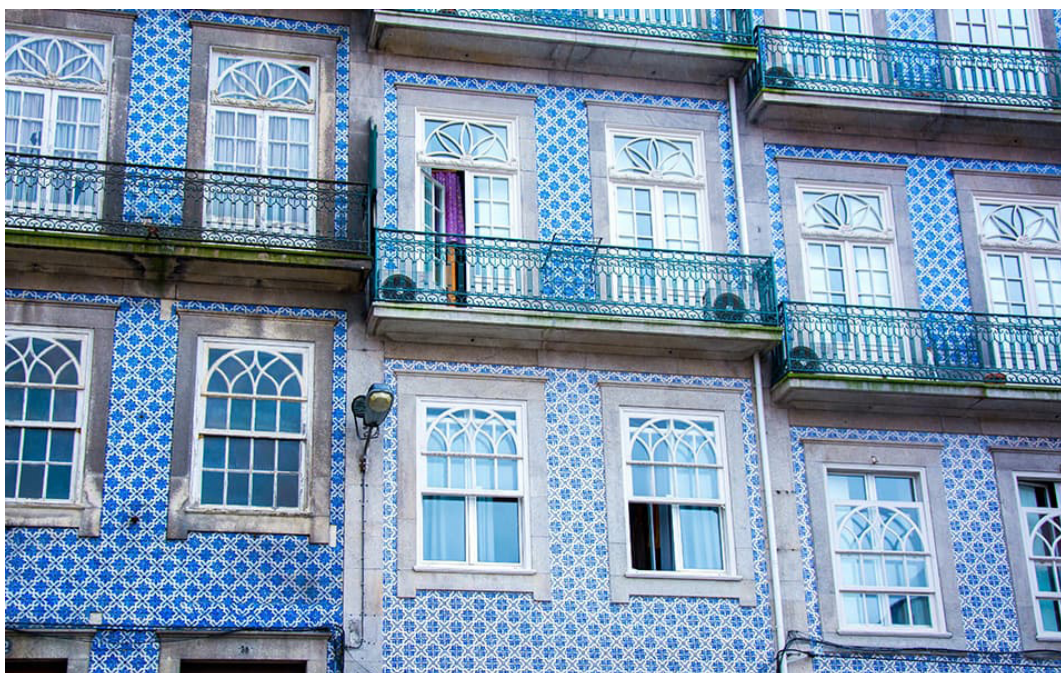
Introduction

Exceptional buildings are key features in every city, a small number of heritage buildings that live alongside modern architecture, adding personality to the urban landscape. Their value as emblems of the history of civilisation is incalculable. Most of us will agree that they are entitled to special consideration in terms of both conservation and insurance.

Replacing murals, tiles, craft materials, and architectural elements in the building's interior that have been damaged can be challenging and quite costly. Insurance makes it possible to restore and repair the damaged asset to the same level of quality using the same techniques to maintain their historical integrity. To do this, the same materials, or their modern equivalents, will be used, in combination with the most advanced methods available at the time of the loss.

Fidelidade has a highly specialised team capable of handling the most complicated loss events. In addition, in special cases we also work with independent adjustment firms with in-house capabilities that enable them to handle specific types of loss expeditiously. Specialist adjusters are assigned to the insured from the outset and are named in the policy.

When a loss occurs, the insured must fulfil the duty of salvage and take all available steps to minimise the damage and preserve the historical value of the buildings and their contents. Having a mitigation and contingency plan in place is another aspect that will have a positive impact when a loss occurs.



These conditions offer the insured the peace of mind of knowing that their properties are protected in case of damage or loss. In the current context, it is more and more common to see exceptional buildings being reconverted into spaces in the service of the community and opening their doors to different activities, such as workshops, day care centres, and fair or festival venues. Other times these historical assets are owned by private groups that recondition them for use in holding events with catering services for large numbers of people to earn extra income. These activities increase the risk of suffering mishaps.

What's the definition of an exceptional building? Museums, hotels, theatres, churches, and government buildings make up a long list of these architectural works of art.

It should be noted that, generally speaking, these buildings are more vulnerable to perils like fire because of how they were built. In addition, they are often targets of vandalism and terrorist acts.

Putting together suitable insurance

Taking out insurance of this kind can be somewhat complicated, so here at Fidelidade we advise our insured to work with insurance brokers who are experienced in these sorts of risks and have access to networks of specialists to ensure full-service advice throughout the entire process.

Customers should have a clear idea of what their obligations and responsibilities are, whether as owner, concession holder, landlord, or tenant of the building. These obligations stem from a private contract entered into by the parties concerned or are laid down in the legislation on historical buildings and monuments. These may or may not be transferred by means of insurance as an essential part of the customer's risk management strategy.

Risk assessment and scope of coverage

Valuation of the insurable interest

At Fidelidade, when putting together insurance packages for exceptional buildings, the main challenge is calculating the replacement value of the asset and the cost of reconstructing buildings of this kind. It is also necessary to ascertain in advance whether materials and repair methods are commercially available. This assessment is performed by third parties who are specialists in the field, who also evaluate the condition of the artworks and their exposure to such natural phenomena as humidity, heat, light, and so forth. A photographic record is extremely important in these cases, to serve as evidence in case of damage.

Valuations of this kind need to be carried out periodically, ideally every two years, and need to take account of changes in prices, especially in inflationary periods like the present.

Risk audit

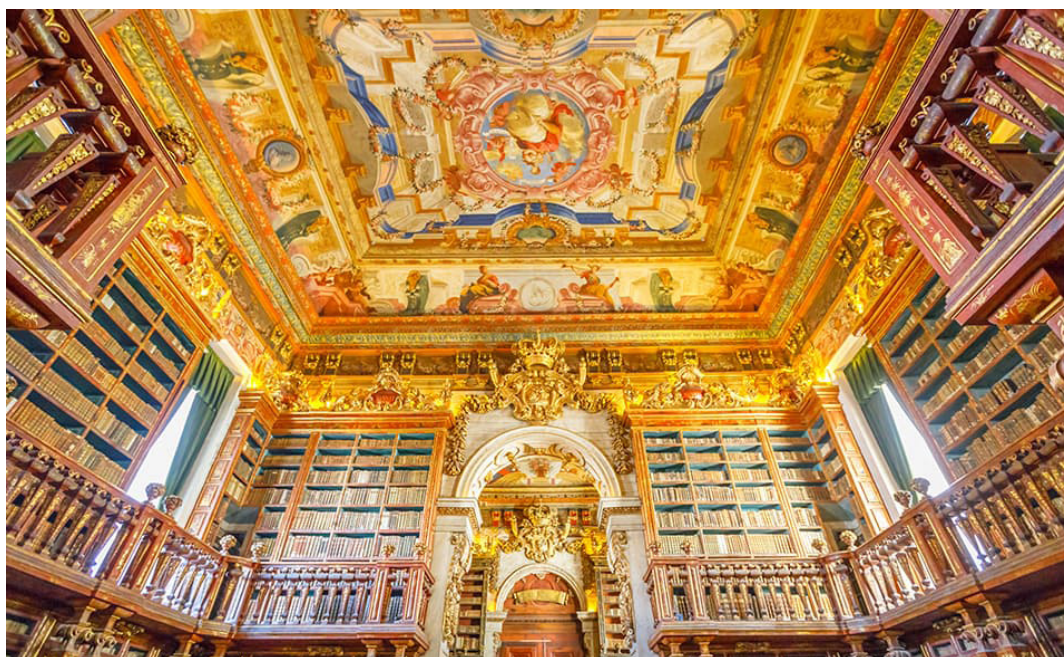
In addition to the valuation, it is crucially important to ascertain the state of repair of the building and the measures to protect against fires and outside attack. In many instances the buildings simply cannot support sprinkler systems, given that contact with water would cause irreparable harm to the buildings' contents, so this may not be a viable solution.

In these cases, preventive and predictive maintenance play an overriding role. The care and maintenance of critical equipment like boilers and electrical cabinets and installations is therefore essential. Putting in place a network of

specialised experts who are capable of identifying these sources of potential incidents and who can propose ways of mitigating them is thus a fundamental component of insurance of this kind.

The specialised technicians in charge of auditing the risks will also be involved in the restoration and engineering work continually in progress in these types of buildings, which can suffer losses for a variety of reasons: work on heating systems, handling of inflammable materials like paints and solvents, use of readily degradable insulating materials like plastics that can come apart in wind and rain. Cleanliness and neatness are fundamental aspects to be relied on in projects of this kind.

A record of risk improvement recommendations with execution times, sums invested, and personnel in charge should be made and kept up to date. This has many benefits for both the insurer and the insured and should be drawn up at the end of each audit.



Damage covers

Multi-risk insurance is the most commonly used type of cover for damage, providing coverage for damage of all kinds caused by risks named in the policy, e.g., fire, explosion, smoke, water, vandalism or natural events. Where required by the insured, coverage can be extended to include the breakdown of machinery and electrical damage. Multi-risk insurance is adequate for buildings of this type, and for that reason all risk insurance coverage is less commonly used.

All risk property damage insurance covers all property damage that occurs unless it is caused by a peril expressly excluded by the policy. These types of insurance generally provide levels of coverage for both partial and total losses.

Fidelidade does not usually insure exceptional buildings under other modalities such as first risk insurance. It also does not usually insure the cost of demolition of, improvements to, or expansions to buildings.

As mentioned above, buildings are repaired with available materials that have the same characteristics using the same building methods. Where not available, the most similar commercially available solution will be used. Mention

should again be made of the complexity of reconstructing buildings of this kind. Many of them have outdated structures and foundations that can heighten the risk of damage during rebuilding. This leads to scenarios in which total indemnities are paid for damage affecting 50% or 60% of the building, with covers for the cost of debris removal and lot clearing, among others.

The insurance premium and coverage are specified taking all the above-mentioned aspects into account. Since the cost of rebuilding is assumed to be higher than the cost for a modern building, the cost of insurance also tends to be higher. However, where a policy makes provision for standard rebuilding methods, this will impact repair costs and hence possibly premiums. In certain cases part of a building can be insured at the historical value and another part insured for rebuilding with equivalent but modern materials. This alternative is commonly used where it is known that the original building method is no longer available, either because the materials or qualified labour are unavailable or because the insured prefers an intermediate cost-benefit solution.

Lost profits

There are any number of hotels throughout Portugal operating out of historical buildings for which the insured have extended coverage to include the consequential damages of loss of income resulting from a loss covered by the policy.

In determining the scope of this cover, loss scenarios need to take seasonality into account, since expected occupancy levels at the time of the loss will have a direct bearing on the sum insured. Where the client does not have a detailed weekly or monthly occupancy forecast, common practice is to limit the monthly indemnity to 120% of the average yearly occupancy¹.

Another factor to bear in mind is that many of these buildings are rented out to associations, clubs, and the like, and in these cases the policyholder usually seeks to transfer the risk of lost rents and other associated costs onto the insurer.

Other risks

There are other forms of covering the different interests of the policyholder and insured besides multi-risk property damage insurance. The most common forms in Portugal are contents only, terrorism risk, machinery breakdown, and third-party liability policies.

Contents insurance

This type of insurance is common in cases where the customer wants a policy that covers only certain works of art owned by the insured or owned by third parties and in the custody, care, or control of the insured. Common examples are art collections, sculptures, and church altars. These policies do not cover the building itself, either because it is not the policyholder's responsibility or because it could not be rebuilt in case of loss. If requested, theft can also be covered under an appropriate sublimit.

Just as for buildings, it is important to have the works appraised by a third party. Security and conservation measures for the works at the insured venue also need to be taken into account.

This is an agreed sum policy that uses a special Lloyd's clause.

¹ By way of example, if the insured has declared lost profits of 1,000,000 for the 12-month compensation period, the monthly limit payable by the insurer would be $1,000,000/12 \times 120\% = 100,000$.

Terrorism risk insurance

Property damage policies ordinarily exclude terrorism risk cover, making it necessary to purchase a special policy with an excess and limits commensurate with risk exposure. Unlike other European countries where acts of terrorism are covered by special insurance funds set up for that purpose, this alternative does not exist in Portugal. Exceptional buildings may have higher exposure because they can be targeted by different terrorist groups on account of the crowds that gather there or for geopolitical or religious reasons. Capacity limits need to be taken into account as a risk aggravating factor from both a local and an international perspective.

Machinery and equipment insurance

Occasionally a building might not be insured, but its internal equipment is. This cover can encompass machinery of all sorts: lifts, service lifts, transformers, generators, boilers, and all manner of electronic equipment, such as telephone switchboards and data processing centres or networks, to mention just a few.

When purchasing this type of insurance, the customer must submit a set list of machinery with its replacement value. The insurance pays the replacement cost in case of a total loss and the cost of repair in case of a partial loss, as long as the repair cost is not the same as the actual cost of the equipment. There must be a maintenance contract in force, and the manufacturer's recommendations must be followed. It is common practice to limit the age of insurable equipment to ten years.

Third-party liability insurance

When underwriting a third-party liability policy, special attention must be paid to the personal injury excess, for two main reasons:

- These buildings have many visitors and can generate large crowds of tourists.
- The characteristics of the building are not the same as those of modern buildings, which are designed with the user in mind and taking all the most modern safety measures into account. These buildings often have more slippery floors, low ceilings, abrupt changes in levels, and poor lighting and signage and lack other safety measures that are in common use today.

All these factors make these buildings more susceptible to minor accidents like falls, bumps, and knocks, a frequent source of claims that can increase administrative costs, to the detriment of the bottom line if excesses are not calculated carefully.

In the event of a loss

The loss adjustment and underwriting team is the third fundamental pillar and as mentioned above plays a basic role in offering the insured top-level service. Fidelidade has a highly specialised team capable of handling the most complicated loss events. In addition, in special cases we also work with independent adjustment firms with in-house capabilities that enable them to handle specific types of loss expeditiously. Specialist adjusters are assigned to the insured from the outset and are named in the policy.

When a loss occurs, the insured must fulfil the duty of salvage and take all available steps to minimise the damage and preserve the historical value of the buildings and their contents. Having a mitigation and contingency plan in place is another aspect that will have a positive impact when a loss occurs.

Ascertaining the condition of the insured asset prior to the loss is another complex and critical task in the insurance process. It is therefore important to keep files up to date with reports, videos, and recent photographs of artworks.

Conclusion

Insurance is an essential factor for managing the risk inherent to all properties. This principle is even more important in the case of exceptional or historical buildings. These buildings have a higher risk exposure because of the complexity of their building components and other factors. It is therefore vitally important to have up-to-date information in relation to assets of this type, e.g., repair costs, state of repair, and safety measures.

Furthermore, because of the potential historical and social impact of a loss, it is essential to have mitigation and prevention measures in place to lessen the risk of damage that can be irreparable to these heritage sites of our society.