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## **Report on the Bermuda Commercial Property Market**

### **Introduction**

The re-insurance and fund administration industries in Bermuda have seen significant growth since 2000 until the turbulence of the markets in 2008/09. This translated into increased demand for commercial property and in turn this has fuelled significant new office development. The economic downturn heralded by the sub prime problems in the USA and subsequent "credit crunch" has impacted on the world economy leading to an incipient world recession. The impact on the Bermuda re-insurance sector has been severe and together with regulatory changes in the USA Bermuda is likely to see a contraction of growth in the re-insurance and financial services sector. The expansion in the supply of office space with new construction since 2006 when coupled with the likely contraction of office space requirements of insurance companies will impact on future rents and values for commercial property.

### **Insurance market**

Bermuda in 2006 boasted over 41 insurance companies with over \$500.00 million in shareholders equity. According to the 2005 edition of Standard & Poor's Global Reinsurance Highlights, 14 of the top 40 re-insurance companies or some 40% of the worlds biggest reinsurance companies are now based in Bermuda. The Island is now ranked 4<sup>th</sup> re-insurance domicile after Germany, USA and Switzerland.

The Bermuda market remains strong from 2006 onwards. This is reinforced and demonstrated by Bermuda insurers and re-insurers paying nearly 26% of the insured losses arising from the 2005 US hurricane season. The payout of \$12 billion compares with an estimated \$7.1 billion losses for US re-insurers. In response to the lost capital and the expectation of high returns from a hardening market in 2006 approximately \$18 billion in new capital flowed into the Bermuda market. Hedge funds saw the Bermuda reinsurance market as an investment opportunity. Approximately \$8.0 billion was invested in 9 new start up companies and sidecars to form "the class of 2005".

The number of Bermuda captives has increased steadily since 2000 with the capitalisation expressed in dollar volume significantly up in the period. The introduction of segregated account companies in 2005 saw a further surge in interest in captives using Bermuda's market. The umbrella company with separate cells for separate interests resulted in further incorporations of new companies and has proven to be a growth area for captives by reducing and sharing costs between captives. Bermuda in 2005 had some 987 captive insurance companies and a further 83 protected cell companies containing a further 6,200 cells. In 2008 Bermuda has seen a reduction with the emergence of competition. Bermuda is still the world's leading captive domicile ahead of the Cayman Islands, the British Virgin Islands, Guernsey, Dublin and the Isle of Man.

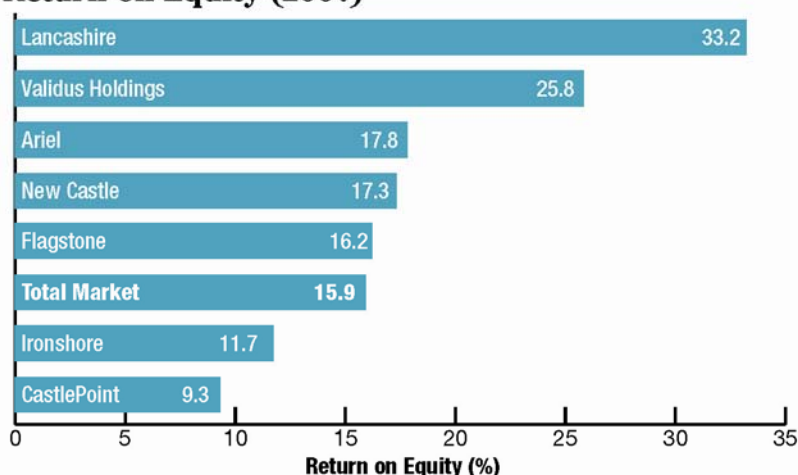
The non-captive sector of the Bermuda insurance industry grew out of the US liability insurance capacity crisis of the mid-1980s and was started by pioneering excess liability companies, ACE Ltd. and XL Capital Ltd. Finite risk insurance was added in 1986 with the formation of Centre Re. Then in 1992, on the heels of Hurricane Andrew, Bermuda attracted its first property catastrophe re-insurer, Mid Ocean Re. A further seven "cats" followed in 1993 and with them came a \$4.5 billion influx of new capital being formed within 100 days.

After 9/11 in 2000 a total of 10 new major companies with \$15.00 billion of new capital were incorporated and moved the local market to a new plateau. These Class 4 Insurance companies include such entities as AWAC, RamRe, Endeavour, Axis.

After Hurricane Katrina and the 2005 hurricane season twelve new companies with a combined capitalization of \$8.00 billion were incorporated. These companies include Arrow Capital; Amlin; Ariel Re; Ascendent Re; Cyrus Re; Flagstone Re; Flatiron Re; Harbour Point; Hiscox (Bermuda); Lancashire; Newcastle and Validus Re. An additional \$10.00 billion in new capital was raised for existing Bermuda re-insurers and sidecars to replace lost capital and re-gear for the increased premium income anticipated in 2006. Paris re is the new addition to the latest “class of 2006” showing that Europe is not immune to the siren song of Bermuda. Paris Re is an offshoot of the French giant AXA Re with an initial capitalisation of \$1.5 billion.

- “Class of 2006”
- Aeolus Re (capital \$500.00 million)
  - Castlepoint Holdings (capital \$265.00 million)
  - Security Capital Assurance (\$1.2 billion capital)
  - Wind River Insurance(owners: Bermuda’s River Capital Group and Aon’s segregated accounts co)
  - White Rock (SAC)Bermuda)
  - Ironshore Insurance (\$1.0 billion)

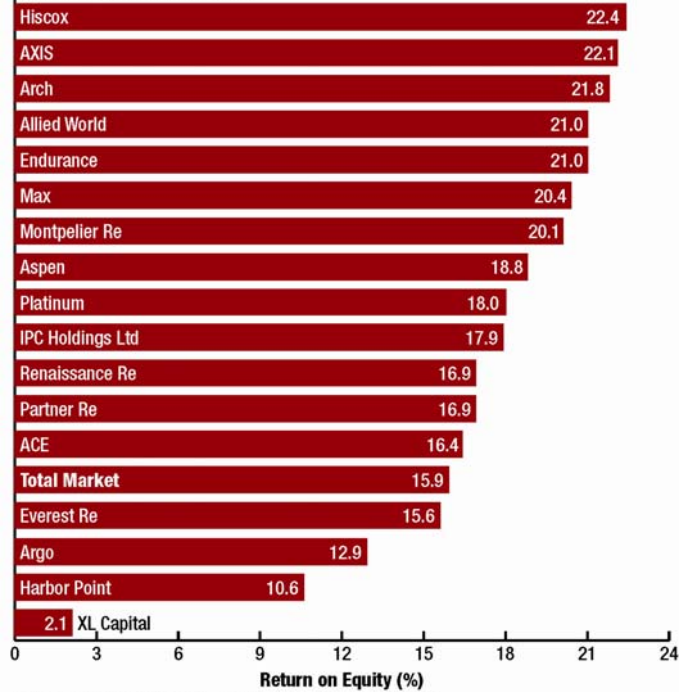
**Exhibit 3  
Bermuda Start-Up Insurers/Reinsurers —  
Return on Equity (2007)**



Note: Total equity is the total reported equity of the company.  
Source: A.M. Best Co.

ACE and XL are local giants with combined shareholder equity in 2006 of over \$21.00 billion. The top 20 Bermuda companies in 2006 reportedly have a combined total in assets of over \$278.00 billion. The epic storms of 2005, whilst confirming the Bermuda’s market ability to meet the claims from Hurricanes Katrina, Rita, Wilma and other storms, resulted in 2006 in half a dozen Bermuda companies being taken down including Alea Group Holdings, Olympus Re, PXRE, Quanta Capital, Rosemont Re, sEnergy Insurance and Western General Insurance. Their demise shows the dynamic nature of the Bermuda market with the defaulting companies being acquired or put into run off.

**Exhibit 4**  
**Bermuda Insurers/Reinsurers —**  
**Return on Equity (2007)**  
 Excluding Class of 2005.



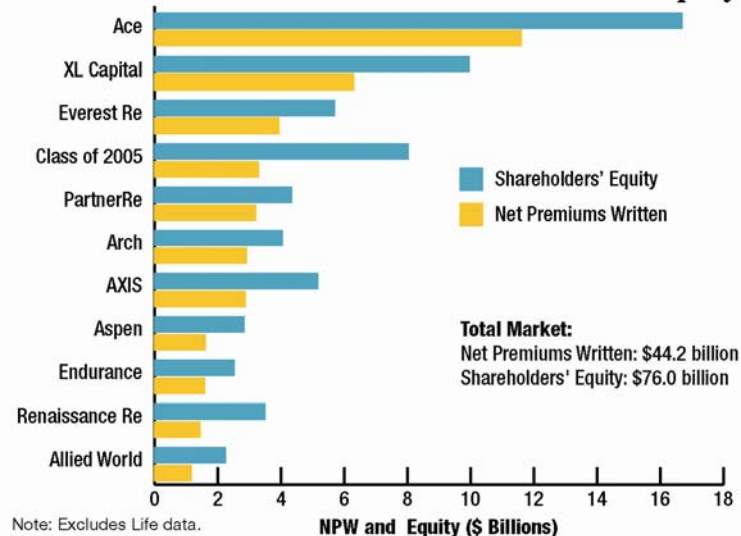
Note: Total equity is the total reported equity of the company.  
 Source: A.M. Best Co.

The impact of the credit crunch has seen the shrinkage of the US economy occasioned by the restructuring of Wall Street that has seen the demise of AIG and Lehman Bros, together with the changed role of investment banks such as Goldman Sachs, Morgan Stanley. The bail out of US Banks has forced US government intervention on an unprecedented scale.

The perceived risk of taxation changes occasioned by the election of President O'Bara with a Democratic Congress led ACE, Paris Re, Flagstone Re and Partner Re to redomicile their Corporate operations in 2008. Although the precise declared reasons in each companies case differed the end result saw significant capital removed from the Bermuda market.

These changes will see a reduction in demand of office rental space. Already XL are shrinking their local operation from July 2009 into 1 of the 2 towers in their HQ building on Bermudiana Road. Some 76,000 sq.ft. is now available for rent.

**Exhibit 5**  
**Bermuda Insurers/Reinsurers —**  
**2007 Net Premiums Written and Shareholders' Equity**



Note: Excludes Life data.  
 Source: A.M. Best Co.

## Office market

The completion of the Waterfront complex Phase 2 on Pitts Bay Road, additions to the Bacardi building , the Ace / XL and other projects added approximately 476,000 sq.ft bringing the total office space in Pembroke to 1,000,000 sq.ft. The combined office floorspace for the Hamilton area therefore totals some **4,000,000 sq.ft.** in 2007.

Below are the projected additions to Hamilton office floorspace. The supply of office space has increased by 10% since 2007. The completion of the current developments will see some **25%** new office floor space added. This will hasten a segmentation of the market with older vacated space being upgraded to sustain existing rental values or experiencing reduced rents. Some of the new space has been pre-let or is for the internal growth of existing companies.

Demand for new prime office space from re-insurance companies and fund administration companies has been primary drivers for demand for new office space since 2000. This demand has been impacted as a result of the financial downturn and the anticipated impact of President O'Bama changes to the tax regulations of companies doing business with the USA. The virtual nationalisation of AIG will potentially result in the closure of Bermuda operations to be repatriated onshore to the USA. The collapse of XL share value and the re-organisation of the company once a Bermuda powerhouse could in the next year be sold or merged , while ACE has been re-domiciled to Switzerland with an operation HQ relocated to New York from Bermuda. This has created extra new office space in 3 prestige buildings resulting in some 80,000 sq.ft. being immediately available to compete with buildings being built within the past 10 years to prestige standards .

The focus of most new building has a distinct western bias in the City toward ACE, XL, AIG buildings and the Waterfront complex on Pitts Bay Road to be reinforced by the Belvedere & Waterloo House projects as they are built. Other properties with outstanding permission for potential development (with planning permission in principle) or under discussion are also listed below. A number of these projects will undoubtedly not be built due to the 2008 recession. Currently some **300,000 sq.ft.** of space is available for rent in new projects and this will increase as schemes under construction are completed .

The first construction project to cease building operation has occurred at Church Street #31 as a result of the downturn in demand. The site crane will be dismantled and the structural steel has been fabricated at the manufacturer will have to be stockpiled in USA unless extra financing is obtained by the owner. The Belvedere project on the Bermuda Bakery site on Pitts Bay Road will ultimately comprising some 153,000 sq.ft. has now been phased to allow demand to revive. The Waterloo House project for 143,000 sq.ft. is likely to await an upturn.

## New Buildings Completed since 2006

AIG expansion, Richmond Road (Sept'06)	120,000 sq.ft
Waterfront Complex Phase 3 (Nov'06)	100,000 sq.ft.
AS Cooper ( Retail/Offices) Front Street (Dec'06)	65,000 sq.ft.
Par-la-Ville Rd./ Bda. Commercial Bank (Sept'06)	45,000 sq.ft.
Pearman Building-Brunswick Street (Jul'07)	10,000 sq.ft.
St. Andrews Church, Church Street (Nov'07)	45,000 sq.ft.
HWP Front Street (Nov'07)	65,000 sq.ft.
East Broadway waterfront (Jul'08)	25,000 sq.ft.
Argus Insurance ,Wesley St. (Sept'08)	96,000 sq.ft.
Purvis, Victoria Street/Brunswick Street (Sept'08)	110,000 sq.ft.
Victoria street (June'08)	50,000 sq.ft.
Harbourfront (Sept'09)	35,000 sq.ft
Par-laVille Rd #55(Apr'09)	<u>40,000 sq.ft.</u>
<b>Total</b>	<b>806,000 sq.ft.</b>

## New buildings currently under construction

Washington Properties –Church Street (Jan 2010)	100,000 sq.ft
Trimingham, Front Street (June 2010)	120,000 sq.ft.
Par-la-Ville Rd ( Mar'10)	35,000 sq.ft.
Par-la-Ville Rd (Sept'09)PowerHouse	50,000 sq.ft.
Parliament Street (June 2010)	17,500 sq.ft.
Court Street #65 ( June 2010)	17,500 sq.ft.
Bermuda General Bakery, Pitts Bay Ph 1 July 2010	100,000 sq.ft.
East Broadway (Sir John Swan – June'10)	<u>100,000 sq.ft.</u>
<b>Total</b>	<b>540,000sq.ft.</b>

## Other schemes planned or in discussion

Church Street (Dec'10) ?	74,000 sq.ft.
Vera P Card redevelopment Front Street	50,000 sq.ft.
Commercial Properties Par-la-Ville Rd	50,000 sq.ft.
Wesley Street #4	50,000 sq.ft
Ritz Carlton Hotel	120,000 sq.ft.
Stonehaven, Reid Street/Court Street	125,000 sq.ft
CD&P Par-la-Ville Road / Trott Road	90,000 sq.ft.
ACE Phase 2	<u>70,000 sq.ft.</u>
<b>Total</b>	<b>629,000 sq.ft.</b>

## **Office Rental Values**

Demand for new prime office space from re-insurance companies and fund administration companies have been primary drivers for demand for new office space. Now with ACE, XL and AIG downsizing office space is available within their buildings for the first time. The prime rent for good quality office space in newly completed buildings still exceeds \$65.00 per sq.ft. with graduated rents towards the upper floors and penthouses reaching over \$70.00 per sq.ft. How long these rents will be sustained for large floor plates is dependant on demand with already indications that rental levels are negotiable or being reduced.

The focus of most new building has a distinct western bias in the City toward ACE, XL, AIG buildings and the Waterfront complex on Pitts Bay Road. The proposal for a new Ritz Carlton Hotel on Par – la – Ville car park demonstrates this bias and if the scheme is completed will provide a business hotel with 100 rooms with 15 shops, 60 residences and 20,000 sq.ft. convention centre to support the Hamilton market. The Belvedere proposal for the Bermuda Bakery site on Pitts Bay Road will see a new complex with 105,000 sq.ft. of offices, 40,000 sq.ft. of residential space and 8,000 sq.ft. of retail space combined with underground parking for 215 cars. Sir John Swan's new development at Seon Place on East Broadway is an exception to the western trend will rise to 10 floors with underground parking.

## **Projects for rent**

East Broadway waterfront Windward Place – 25,000 sq.ft. new building on waterfront with limited parking and off the track location. Rents of between \$75.00 and \$80.00 per sq.ft. asking figures.

141 Front Street – Sir John Swan - 107,000 sq.ft. 10 storey signature building on eastern gateway to City of Hamilton quoting rental rates from \$65.00 to \$70.00 per sq.ft. Available Spring 2010

Argus Building, Wesley Street – 96,000 sq.ft. available March 2009 \$45.00 to \$55.00 per sq.ft.

Washington Properties – Church Street – New planned development of 100,000 sq.ft. office, residential and retail development. Commencing 2008 completion Jan'2010 rental rates \$65/\$75.00 per sq.ft..

Stonehaven, Reid Street / Court Street – No progress on proposal for 125,000 sq.ft. retail/office scheme with permission now being altered to a mixed use scheme with 39 apartments and offices/retail / restaurants. Development Funding will be difficult to secure.

Triminghams, Front Street – 120,000 sq.ft for occupation by HSBC Global Trust administration and other departments of HSBC. Commencing Jan'2007 and completion Jan' 2010

Belvedere Bld., Pitts Bay Road – New project to construct 153,000 sq.ft. around existing 1960's office building on 5 floors with underground car parking. Now to be phased as a result of downturn in the market with 1<sup>st</sup> phase completed 2010 will comprise the car park alone on 2 floors with foundations for the new offices.

XL Bermudiana Road – 76,000 sq.ft. available from July 2009 on 6 floors in the North Tower with quoting rents of \$80.00 per sq.ft. plus a service charge of \$25.00 per sq.ft. to allow for cleaning, taxes and common areas maintenance & lighting.

## **Commercial Site values**

The purchase by the Bermuda Monetary Authority of the Commercial Bank Building on Victoria Street for \$28.60 million in December 2004 represented a new plateau for the Hamilton office market and has fuelled an increase in the values of commercial property. The addition of 24% of new floor space within the next 18 – 24 months will pact on future capital values. Future rental growth may be moderated should the existing level of demand remain the same.

Questions are being asked about Bermuda's environmental capacity and infrastructure. In anticipation of these concerns some existing and new companies are altering their business model to allow for overseas satellite operations in Halifax, Dublin and Scotland. Active discussion is underway concerning modifications to planning regulations. This may see changes such in the new Bermuda Development Plan as increased height allowances for Hamilton buildings.

The completion of the new HSBC Front Street building on the old Trimmingham site will see some 120,000 sq.ft. of new office allow the Bank to consolidate its operational spread across 8 different properties in Hamilton. It is reported that 2 properties and buildings are to be sold to allow consolidation of their ownership and operations from March 2010.

The make up of the Bermuda market could swing towards an increased British presence as further Lloyds Agencies diversify or re-domicile their operations with Bermuda still attracting interest. Increasingly Bermuda reinsurers have been securing a presence in London by merging or acquiring Lloyds syndicates. Some market consolidation through the merger or acquisition of companies is already in evidence with the Partner Re /Paris Re merger and the bidding for IPC Re by Flagstone Re, Validus Re and Max Re could strengthen remaining individual companies. The term limits on employees has impacted negatively on the retention of senior professional staff with their families. This has deflated the residential housing market with rents falling and a greater choice of accommodation available as many of the new condominium units are completed. The balance of Bermuda collective fates is increasingly tied to the success of the insurance sector that dwarfs all other economic activity on the Island with all the indicators showing that the insurance and fund management sectors have contracted.