The Impact of Crossrail on Property Performance
2018

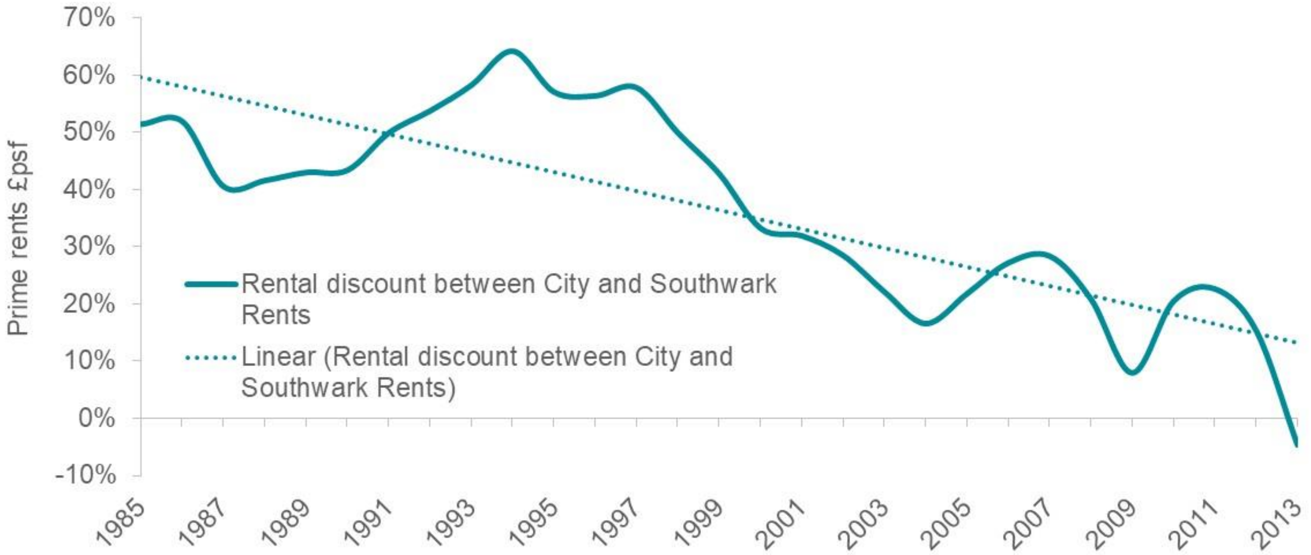
2018 is proving to be an exciting time for the UK economy as London's largest infrastructure project, Crossrail is scheduled for completion. The high-speed rail project, which will be officially known as the Elizabeth line, will improve connectivity across London, reduce journey times into the capital and is forecast to increase passenger capacity by 10%. Crossrail will revolutionise the commercial property market through the re-development of locations along its key transport nodes.

Crossrail will provide a direct connection between London's key business districts (West End, City and Canary Wharf), reinforcing the strength of London's established office markets. It will also unlock value at key interchange stations such as Farringdon, which is positioned between the City and West End and provides passengers with easy access to other transport networks (Thameslink), making it strategically placed to re-emerge as an office location.

Review of previous projects and impact on commercial property. A review of previous infrastructure projects enables us to evaluate the impact of new transport links on the commercial property market. Notable projects such as the completion of the Eurotunnel (1994), the opening of the Heathrow Express Link (1998), and the completion of the Jubilee line extension (1999) all resulted in a boost to rental and capital values in previously underdeveloped London markets. A similar effect has been seen with road infrastructure projects. Perhaps one of the earliest and most prominent examples to consider is the opening of the M25 motorway in 1986. The orbital motorway transformed the south-east economy, providing easier access in and around London. Its effect on the commercial and residential property markets was extreme: a mass of redevelopment for the industrial market during the late 1970s and early 1980s; new office parks emerged alongside the outskirts of the M25 and residential values across the commuter belt rose significantly (reportedly by up to 400% in areas of West London).

A key example of a location which benefitted extensively from recent infrastructure improvements is the Southwark office market. Figure 1 shows the rental discount between Southwark and City rents and pinpoints key points in time when new transport improvements completed. The opening of the Eurostar terminal at Waterloo station in 1994 coincided with prime rents in Southwark's office market increasing significantly. The same was apparent upon completion of the Jubilee line extension in 1999. Both projects contributed to a sharp narrowing of the Southwark to City rental discount.

Figure 1 – Southwark to City prime rental discount



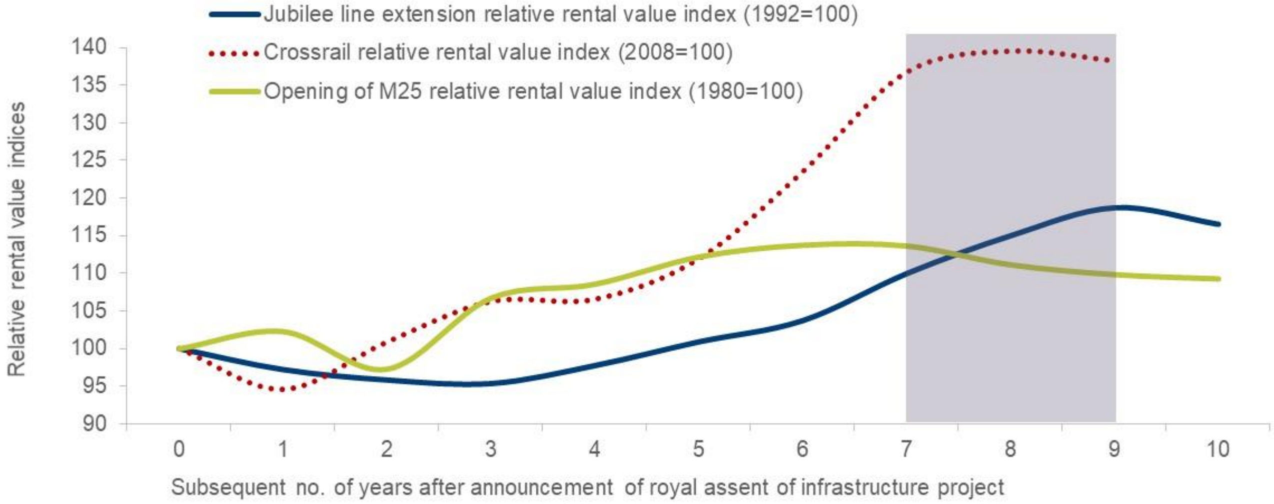
Source: Cushman and Wakefield

Impact of Crossrail on performance so far. So how much of an impact can we expect to see from Crossrail related development? To date, the swathes of new development activity coupled with increased investor demand for stock in and around Crossrail's links has already had a knock-on effect on commercial property performance. The western fringe office locations such as Farringdon and Clerkenwell have seen average rental values recorded by IPD increase by 29% since the beginning of 2008. Retail rental values in the North of Oxford Street area have already witnessed an increase of 60% over the same period, according to IPD. Investor demand has also followed suit and data on recent transactional deals show that a number of transactions are completing at keener yields as investors price in the development potential and the value-creation from the Crossrail effect. A review of initial yield movements across the same markets since 2008 show inward yield movement of 128bps for the Western Fringe office market. Given that IPD tracks the performance in average yields and rental values, it is more than likely that the figures for prime stock are above this.

Figure 2 assesses the impact of Crossrail on relative rental values since royal assent was granted for the scheme in 2008. The chart tracks the index in rental values for those markets set to benefit from Crossrail relative to All Property (further details on the composition of the indices are described below). The same methodology was also applied for the Jubilee line extension and the opening of the M25 motorway. While not a direct comparison, it does provide a reference as to how much further scope in rental value growth we can expect to see. As shown by the chart, a decade after royal assent was granted, areas benefiting from the Jubilee line extension had rental value increases c. 20% in excess of the IPD UK Office average. A similar trend was apparent with the opening of the M25 motorway with relative rents on industrial stock close to the M25 increasing by 13% by the late 1980s. Nine years since the announcement of Crossrail, relative rental values have already increased by 38%, outpacing the growth seen from previous infrastructure projects.

Given each of these previous infrastructure projects' relative rental values have peaked between seven and nine years after royal assent, we believe the uplift from Crossrail locations has now been factored in. The premium pricing on stock may make accessing the market at this stage a problem for investors, especially given current strong demand for investments.

Figure 2 – The effect of infrastructure projects on relative rental values



Source: MSCI

The Jubilee line extension relative rental value index is calculated from the average annual rental value growth of Southwark and Westminster offices relative to IPD All Office rental value growth. The Crossrail relative rental value index comprises the average annual retail and office rental value growth for North of Oxford Street and Western Fringe markets in London (and includes Clerkenwell and Farringdon), relative to IPD All Property rental value growth. The M25 relative rental value index comprises the prime annual rental value growth for Heathrow Industrial and average rental value growth for Bracknell, Croydon, Reading, Slough and Watford industrials relative to All Industrial rental value growth.

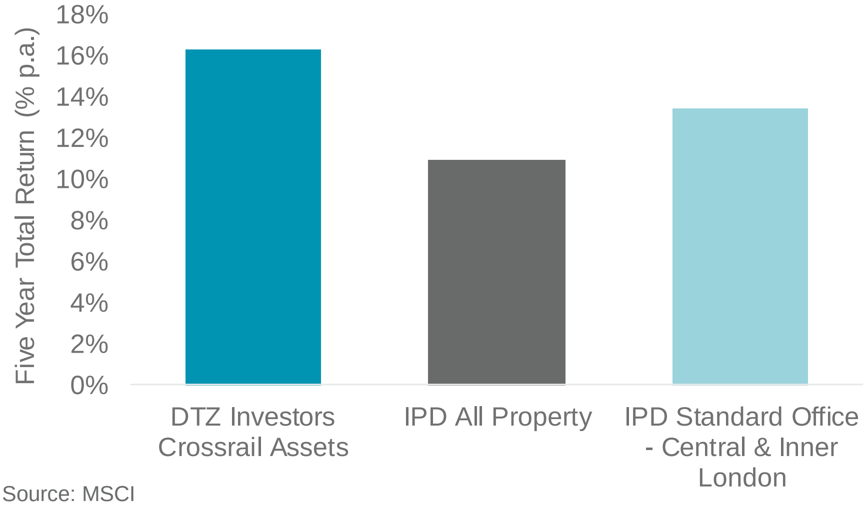
DTZ Investors' track record demonstrates our ability to select property which can deliver outperformance and our assets located in close proximity to Crossrail stations have benefitted from strong capital value growth. Over the past five years, these assets have outperformed the IPD All Property total return by 4.9% p.a. and IPD Central London Offices by 2.6% p.a. (Figure 3).

So what's next? Implications for investors and strategic outlook. There are several new infrastructure developments on the horizon that have the potential to enhance the value of commercial property in close proximity. Due to complete in 2020, the Northern Line extension to Battersea will further support the regeneration of Battersea and Nine Elms. The completion of the Thameslink programme will also provide improved access through the City, through the newly redeveloped Blackfriars and London Bridge stations. Upgrade plans for 23 stations on the London Overground could support growth in other fringe locations within Greater London, whilst the proposed c. £14bn third runway at Heathrow Airport would provide a further boost for the capital, upon its completion in 2026.

Moreover, if Crossrail proves to be a success then this will inevitably provide the impetus to push-start more ambitious large-scale projects such as Crossrail 2 and High Speed 2 (HS2). The Crossrail 2 project will adjoin north and south London submarkets as well as providing better links across the southern counties, while the HS2 project is set to provide convenient high-speed rail connections cross-country.

DTZ Investors believes that the impact of new infrastructure development on commercial property value improvement is compelling. A review of both past and existing projects points to increased economic activity by enhancing tired and previously underdeveloped areas into higher-value, exciting new locations. By closely monitoring the progress of upcoming infrastructure projects, investors can gain insight into the next best place to invest. Investors that are proactive and seek to target well-located property prior to the completion of infrastructure improvements will ultimately benefit the most.

Figure 3 – Total Return Performance (2013-17 % p.a.)



Source: MSCI

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About DTZ Investors

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