Australian Commercial Real Estate Markets – Q4 2024

SPOTLIGHT
Savills Research

Spotlight on 2025

A brighter outlook • Capital markets new growth cycle • Sector trends & top investment picks

Brighter outlook

Rate cut expectations pared back

Rate relief, higher yields
Despite the shift to looser monetary policy from major central banks, government bond yields have risen since mid-September as investors see less scope for interest rate cuts in 2025 than previously anticipated.

Resilient economic growth, expansionary fiscal policy, and expectations of a higher growth and inflation outlook under Trump's plan for tax cuts and tariff hikes have led to a paring back of rate cut expectations.

Sweet spot?
The economic outlook is brighter with ongoing disinflation in 2025 coupled with relatively stable growth. According to the IMF, the global economy will expand by 3.2% in 2025, while advanced economies are expected to record 1.8% growth, the same pace as 2024. Headline inflation is forecast to decline to 2.0% in 2025, from 2.6% in 2024.

Australian economy turning a corner
Economic growth is expected to accelerate in Australia, driven by a recovery in consumer spending as wage growth outpaces inflation, and strong government spending growth. The IMF expects the Australian economy to grow by 2.1% in 2025, up from 1.2% in 2024.

Less restrictive RBA an outlier
The RBA, which has a less restrictive policy rate than some major central banks, remains on hold, highlighting the upside risks to inflation.

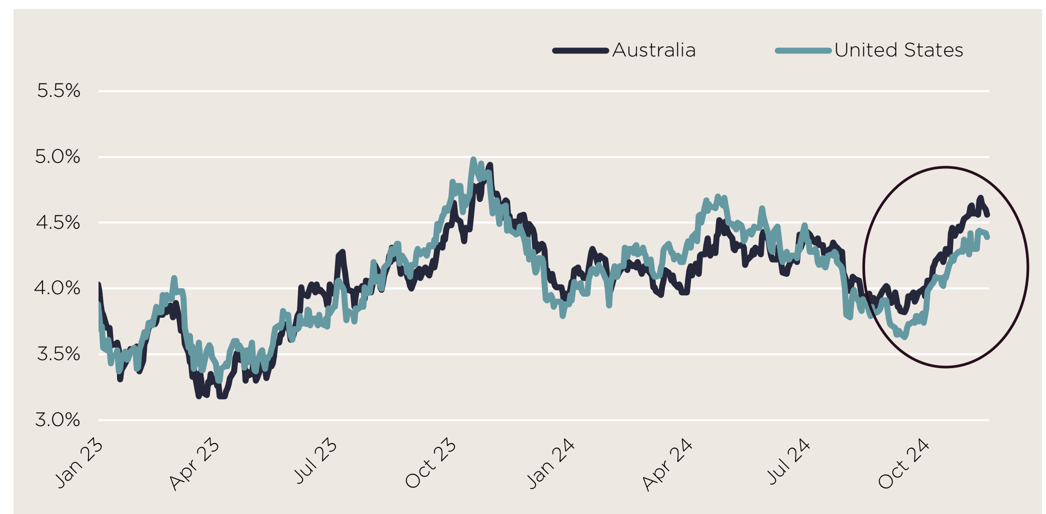
The timing of interest rate cuts has been progressively pushed out, with the central bank saying that inflation will take longer than previously expected to return to target.

However, the RBA is expected to join its counterparts and begin easing monetary policy around mid-year. The median expectation among market economists is for 75bps of cuts, while financial markets are pricing in around 50bps.

Debt and deficit
How bond markets react to large fiscal deficits in some major economies will be crucial to the investment outlook.

Large increases in government debt – particularly in the US and China, where public debt-to-GDP ratios are expected to reach 134% and 111%, respectively, by 2029 – could exacerbate volatility in bond markets and place upward pressure on bond yields over time as investors worry about the long-term sustainability of government debt burdens.

Scaling back rate cut outlook
Daily rate of 10-year bond yields in Australia and the US, per cent



Source Savills Research using Macrobond (bond yields as at 19 November 2024)

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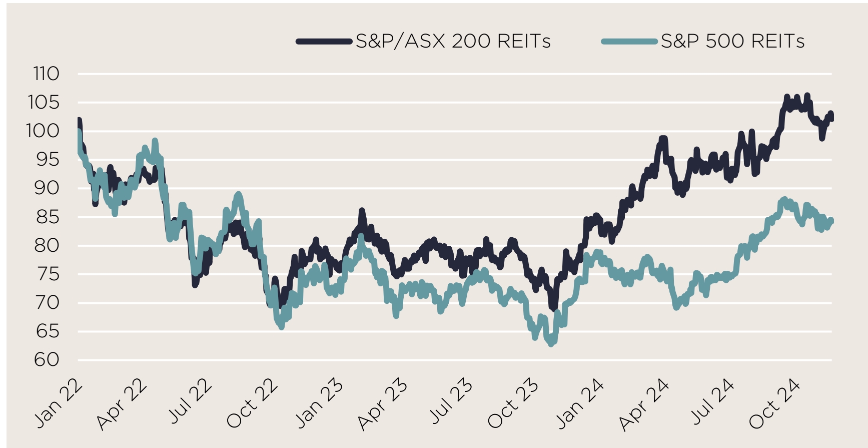
Capital markets impacts

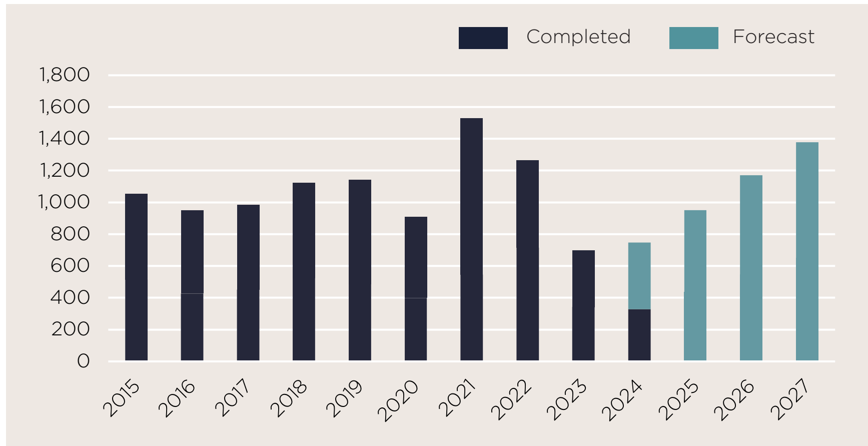
New growth cycle

REITs' share prices point to property market recovery
ASX 200 and S&P 500 REITs indices, January 2022 = 100



Source Savills Research using Macrobond (share prices as at 20 November 2024)

Capital market liquidity to rebound
Global commercial property investment volume annual, US$bn*



* Deals US$10m plus. Includes US, Canada, France, Germany, Italy, Netherlands, Spain, Sweden, UK, Australia, China, Hong Kong, India, Japan, Singapore, and South Korea – over 90% of global CRE investment
Source Savills Research using MSCI RCA, Macrobond and Oxford Economics

Investment market recovery coming to fruition
Despite the recent volatility in bond markets, the outlook is conducive to a recovery in investment markets with stronger than expected economic growth supporting occupier market conditions. Meanwhile, slowing inflation and the prospect of rate cuts in 2025 are improving sentiment.

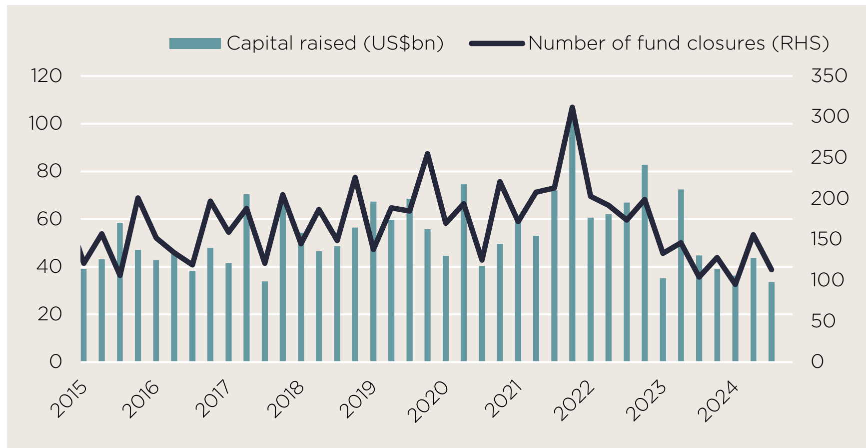
Reflecting the improving outlook for commercial property markets, REITs share prices have increased steadily in 2024. The S&P/ASX 200 REITs index has risen more than 30% from October 2023, recovering all the losses since the beginning of the rate tightening cycle in 2022.

Return to capital growth in 2025
Commercial property markets are reaching a cyclical bottom in the asset price cycle, with declines in capital values easing across the major sectors. Office capital values fell by 1.6% in Q3 to be 12.9% lower the year to Q3 2024, up from -13.6% growth over the year to Q2. The industrial, retail, and hotel sectors recorded only slight declines in capital values, with annual capital growth improving albeit still negative. The stabilisation of asset values will help drive a recovery in investment markets, and we expect a return to capital growth in 2025.

Liquidity will continue to improve amid growing pressure to deploy
Asset repricing and the prospect of a new growth cycle are helping to unlock transaction activity, with 2024 activity YTD now well above the lows seen in 2023. Globally, deal activity is turning a corner - 2024 volumes are expected to be slightly higher than 2023, with further improvement in 2025 and beyond.

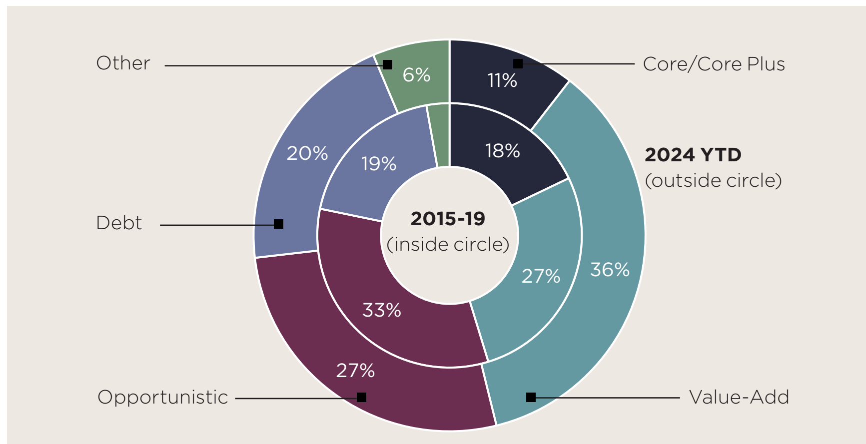
Dry powder remains well above average, and pressure to deploy capital as we near the bottom of the cycle will grow. According to RealfinX, around US$750 billion in unallocated capital is sitting in global closed-ended funds targeting real estate. While this is 2% below 2023 levels, dry powder remains well above the 10-year historical average of c.US$430 billion.

Fundraising still in the doldrums
Capital raised, US$bn (LHS), number of fund closures (RHS)



Source Savills Research using RealfinX

Investors focused on value-add strategies
Share of fundraising by strategy, per cent



Source Savills Research using RealfinX

Curb your enthusiasm

While liquidity is slowly increasing, the ongoing slide in fundraising activity points to only a gradual improvement in capital markets.

According to RealfinX, closed-ended real estate funds raised US$113.6 billion of capital in the nine months to September, down 25.4% from the same period in 2023.

Despite this overall decline, fundraising for value-add strategies increased over the same period. Funds raised for value-add strategies rose by 18% in the nine months to September, and value-add strategies have accounted for 36% of fundraising YTD, up from an average of 27% between 2015 and 2019.

The shift towards value-add comes primarily at the expense of Core/Core+ strategies (where fundraising has fallen 63% YTD). Funds raised for opportunistic strategies have also declined YTD, but these strategies still account for the second largest share of capital raised at 27%.

Super-sized funds to reshape capital markets

Superannuation and pension funds are set to play an increasing role in commercial property capital markets both domestically and overseas.

Pension fund activity is being underpinned by rapid growth in assets under management and portfolio repositioning towards assets benefitting from long-term structural tailwinds such as data centres, industrial & logistics, and residential.

AustralianSuper invested $2.2 billion into US data centre company DataBank in 2024 and acquired a minority stake in Vantage Data Centers EMEA in 2023 for $2.5 billion. Meanwhile, the Canada Pension Plan Investment Board (CPP Investments) has teamed up with Blackstone to buy AirTrunk and its portfolio of data centres in Australia and across APAC.

The industrial & logistics sector has also been a key focus recently, with Aware Super and REST Super involved in separate joint venture acquisitions in the sector in Australia.

Sector trends to watch in 2025

Amid a more favourable macroeconomic backdrop, and the potential pivot to rate cuts, the balance of risk will shift in favour of deploying capital.

Returns. Investors are in the process of recalibrating risk-return expectations, a strategic move that is being carried out with a heightened focus on deploying capital to drive returns through targeted income growth strategies, with greater resilience in 'beds' (residential and select hospitality), 'sheds' (industrial), 'tech' (data centres), retail and centrally located prime offices.

A pivot in central bank policy will bring some stability to pricing. But some pressures will remain. This will keep competition in the market for select asset classes and create buying opportunities for value-add and opportunistic investors.

Liquidity or strategic positioning. An increase in motivated sellers and capital recycling is expected to boost market liquidity, enabling redeployment opportunities for investors with renewed or increased allocation targets.

Performance recovery. Institutional investors are expected to adjust sector commitment targets in 2025. Buoyed by demographic and technology tailwinds, expect higher allocation to industrial, residential, select retail and hospitality, alongside niche subsectors, such as data centres, cold storage, and student housing.

Prime (office) optimism. Rising development costs in recent years have prompted more investors to shift strategies. The supply squeeze is leading to supply constraints in certain sectors and locations (industrial, residential, retail and prime offices) – this is likely to trigger new rental growth cycle and attract investors keen to capitalise on these dynamics.

The rise of super fund capital. An increase in risk-on activity is anticipated for superannuation and pension fund investors as they engage more actively with the market on land acquisitions for data centre, last mile industrial and land lease communities. But don't rule out well-located Prime CBD offices. Early indicators suggest that some super and pension funds are positioned to capitalise on the anticipated growth cycle in core CBD markets where there is low supply and tenant demand is accelerating.

Target and scale. Demand for premium central office spaces is being further intensified by tenants' "flight to quality," which is reducing premium vacancies and driving this growth cycle. More investors will look to target and scale prime office assets in 2025.

Land bet. While some caution may persist in the near term, there will be a growing focus on land acquisitions to position longer-play development pipelines across sectors such as industrial (logistics, last mile and data centres), residential (including multifamily, student, land lease communities), childcare, and life sciences.

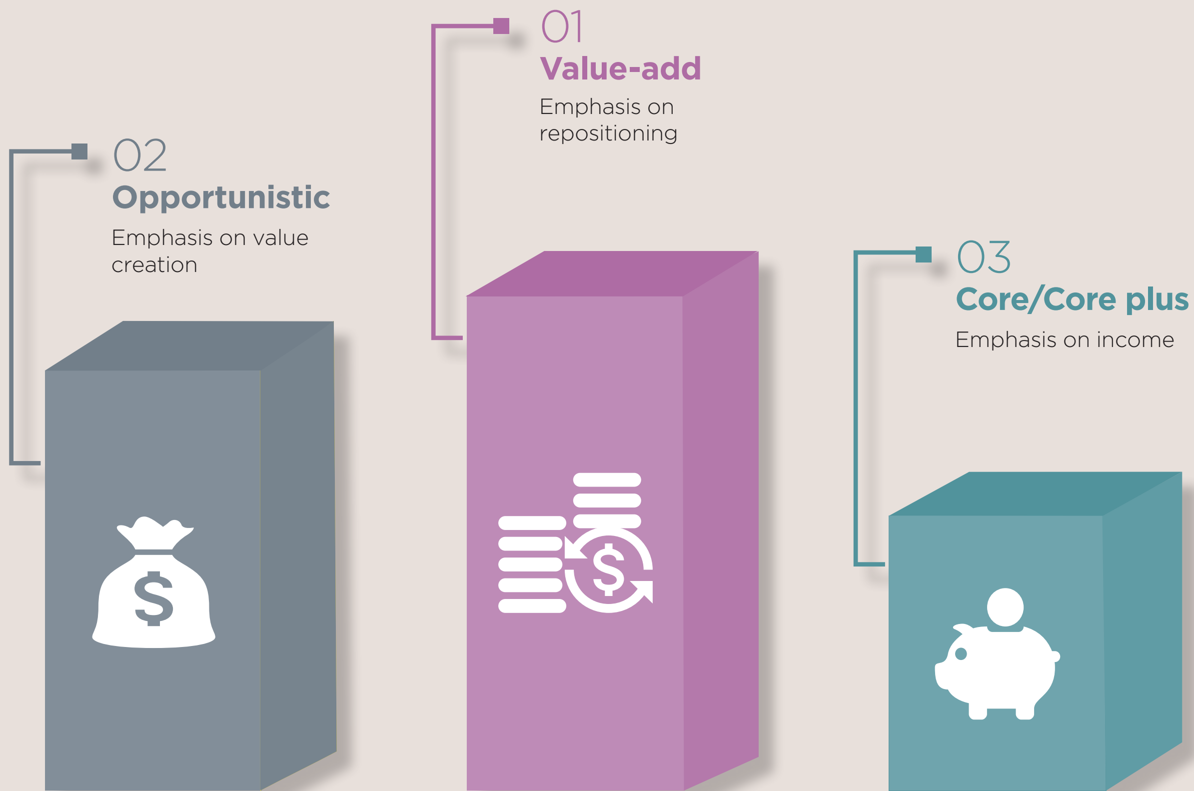
Increasing allocations to industrial will be ongoing. A strategic recalibration is underway as investors deploy capital to develop or reposition properties in high-demand, growth-oriented markets, aiming to expand sector exposure and enhance returns.

Power play. Expect increased investment in the data centre pipeline (and land), with competition against traditional industrial users set to rise. This demand will heighten pressure on renewable energy goals due to their substantial power requirements, and present significant opportunity for growth.

Data centre FOMO. AI growth is set to accelerate through 2025, intensifying demand for power and grid infrastructure. This shift will put the spotlight on how the market navigates land and power constraints amid surging data centre demand. The rapid expansion of data centres will also prompt more investors to raise capital or seek out new equity sources for these investments.

Top investment picks

A new cycle begins: Expect increased risk-on activity, and heightened competition as more transactions move forward and capital markets price in future growth.



02 Opportunistic

Industrial: Secondary or older stock with development upside; includes development land, infill sites, and data centre locations.

Residential: Land for multifamily, build-to-rent or student accommodation development in high-demand, undersupplied urban areas.

Retail: Assets with mixed-use or development upside, suitable for refurbishment.

Office: Secondary office in gateway locations with potential for hotel or residential conversion.

Signs of Distress: Assets with indications of financial or operational distress, presenting potential acquisition opportunities.

01 Value-add

Industrial: Secondary or older stock with redevelopment potential in high-demand, growth-oriented markets; development land, infill sites, and data centre locations.

Residential: Secondary stock in markets with low vacancy and limited supply, offering reversionary or repositioning potential within existing structures.

Retail: Low-occupancy, well-located shopping centres with opportunities for mixed-use redevelopment or modernisation.

Office: Secondary assets in core locations with low premium vacancy rates and strong transport links.

03 Core/Core plus

Industrial: Prime (stabilised) assets in core and infill areas benefiting from structural and demographic growth trends.

Residential: Centrally located branded residences, established multi-family, and student accommodation near top-tier universities, with appreciating home values and low vacancy.

Retail: Established grocery-anchored and premium retail centres in infill (and last mile) locations with modern facilities.

Office: High-quality, centrally located assets with high occupancy, ESG credentials, and superior transport and amenity links.

Hotels: Assets in CBD and gateway locations.

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