

## Real Estate Strategic Outlook: Australia

### Foreign capital increases as pricing stabilises

#### Interest rate cuts likely over the first half of 2025

The Reserve Bank of Australia (RBA) has left the cash rate unchanged at 4.35% over the past twelve months; inflation figures continue to trend lower, with interest rate cuts on the horizon. Australia's headline inflation rate has seen a sharp decline to 2.8% (Sep 24), however, the RBA has cautioned that the underlying inflation rate remains marginally higher at 3.5% (Sep 24), attributable to sticky services inflation and a challenged housing market. Economists and major banks have since pushed out their forecasts to a first rate cut in the first half of 2025. The RBA remains optimistic that the underlying inflation rate can reach the target band of 2-3% by mid-2025, though remain vigilant to geopolitical risks. Nonetheless, a period of falling interest rates and declining inflation should support a rebound in economic growth 2025+.

#### Price certainty becoming more evident across most sectors

A stabilisation in the cash rate and expectation of interest rate cuts has led to an acceleration in transaction volumes accelerated over the second half of 2024, now sitting above 2023 levels, buoyed by demand from foreign capital. Transaction yields have largely stabilised across most sectors, however for the office market, there is greater certainty within newer prime grade assets in core locations. Lending conditions remain favorable, despite short term volatility in swap rates with a preference towards the Industrial and Residential sectors. Declines in the cash rate and subsequently 10yr gov bond yields over 2025 should further support liquidity and a moderate decline in property yields.

#### Residential: Supply-demand imbalance continues

Residential supply remains constrained. Dwelling approvals have improved, however completions remain subdued, more challenged in apartment product. Vacancy rates remains tight sub 2%. Rental growth has moderated from record highs, though elevated on historical levels. Build-To-Rent remains in its infancy, with demand driven by declining purchase affordability, weaker in Sydney & overseas migration. Capacity constraints within the construction sector and high build costs are likely to see vacancy remain lower which bodes well for rent growth prospects.

#### Logistics: Rental gap to widen in favour of 'Infill'

The industrial market continues to normalise, with differing performance at a precinct level. Weaker household consumption continues to weigh on leasing markets as businesses right size space requirements. Elevated levels of supply and increased sub-lease availability has seen vacancy rise, with infill locations proving more resilient. Capital values have been protected by continued growth in face rents, however at the expense of higher incentives. The outlook for supply has improved with tighter lending conditions for speculative development and higher construction costs seeing a pivot towards pre-commitment. However, supply remains heavily concentrated in 'greenfield' locations which will see greater competition. We expect the rental gap to widen in favour of infill markets close to population catchments & key infrastructure.

#### Office: Potentially attractive buying opportunity for the right location

Office fundamentals continue to improve, however location and grade remain key. The return to office thematic has gathered pace with office 'utilisation' rates now sitting above 80% of pre-covid levels. Sub-leasing volumes have steadily declined as larger occupiers re-absorb space, signalling that the right sizing cycle may be coming to an end. There continues to be a divergence in leasing performance with a preference towards newer prime grade assets in core locations, influencing vacancy and incentives at a sub-market level. Limited upcoming new supply should further support vacancy, incentives, and ultimately effective growth. Large discounts to book values amid improving occupier fundamentals are more favourable in the Sydney office market, which may present an attractive buying opportunity over the next 6-12 months.

#### Total Return Forecast in Australia, 2025-2029f, p.a.



Source DWS, December 2024.

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