Commercial Property Market Update

June 2025

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Contents

Executive summary

The downturn in the Australian commercial property market has appeared to have made a U-turn, with two out of three key sectors now recording positive returns. The office sector returns remain negative but has appeared to have bottomed out. KPMG maintain a degree of optimism about the long-term demand for commercial property.

Office sector

- The office sector has been affected the most by a combination of challenges: the shift to remote and flexible work, uncertain business conditions with rising unemployment and, most of all, expanding implied capitalisation rates that have sent office values tumbling.
- However, investor sentiment towards Australia's office sector is turning, with national vacancy rates starting to show some downward movement, along with evidence of underlying face rental growth in most core markets, noting that this movement remains subject to considerable volatility, which is typical when the sector is at a turning point. Capitalisation rates have remained steady over the half year.
- The market's growing anticipation of a moderate to potentially aggressive interest rate cutting cycle is expected to lend further support to pricing and investor confidence.

Retail sector

- Income returns are at their highest since mid-2016. The stable increase in income returns are delivering total returns for the sector ahead of those in office and logistics.
- Total returns for the retail sector remains low at 3.7% as a result of an extended period of expanding capitalisation rates, however capitalisation rates have remained steady over the half year.
- There is a growing weight of capital that is seeking quality retail assets that are either underpinned by strong non-discretionary based fundamentals or those that provide future mixed-use potential. There is notable confidence in the neighbourhood sector.

Industrial sector

- Total sector returns are currently at 3.3%, marking two consecutive positive quarters, following four consecutive quarters of negative growth.
- The income side of industrial property has played a crucial role in offsetting capital losses.
- While vacancy rates have inched upwards over the past 12 months, they remain among some of the lowest globally, reinforcing the sector's resilience in Australia.
- Prolonged continued unsatisfied occupier demand has resulted in a strong increase in supply as well as strategic reallocations of space to other states to optimise operational efficiency and cost-effectiveness.

KPMG Commercial Property Uncertainty Index

- The index has fallen for all individual sectors between the December quarter 2024 and the March quarter 2025, which provides another positive indicator for the commercial real estate sector.
- Uncertainty in the office sector remains the highest but the latest uncertainty read shows that uncertainty is falling sharply in the sector and confidence is returning.

Economic considerations

- Recent global economic development is expected to weigh on the domestic growth outlook in 2025. Despite this, economic growth in 2025 looks to be a notable improvement compared to 2024.
- The triple ongoing boosts of strong population, resilient job market and real wages will be pivotal for the recovery of the commercial property sector. Population growth continues to grow stronger than budget forecasts, due to strong net overseas migration. Unemployment rate remains in the low 4%, while wages growth has finally caught up to the cost of living.
- The interest rates cuts cycle has begun and is key to further market improvement. Lower borrowing and financing costs can finally pave the way for developments that previously stalled.
- While the ongoing trade war presents a significant risk to economic activity and the property sector, as shown by historical evidence, this time it might be different. The recent downgrade of the US credit rating further adds to Australia's appeal, potentially leading to a reallocation of capital with investors seeking safer and more stable markets.

Economic forecasts	Current	2025 (f)	2026 (f)
Real GDP growth	1.3%	1.8%	2.0%
Unemployment rate	4.1%	4.3%	4.4%
Inflation	2.4%	2.6%	2.5%
RBA cash rate	3.85%	3.10%	2.85%
Population growth	1.7%	1.3%	1.2%

Executive summary (continued)

Commercial property outlook

Industrial:

- Above-trend rent growth, experienced over an extended period, is waning. Despite the current low vacancy rates, recent increases in new and proposed supply will lead to a stabilisation in rental growth and further elevate vacancy rates towards more normalised levels.
- It is possible that some of the momentum from the demand side will continue to meet the strong increase in supply, mainly due to lower inflation, lower interest rates and steady population growth. However, the extent to which this momentum can be sustained is highly dependent on the ongoing trade war, significantly impacting both consumer and business confidence.

Office:

- Office values are showing signs of stabilisation in early 2025, particularly for high-quality assets as businesses seek well-located and modern workspaces as seen in Sydney CBD already.
- This demand will be further encouraged by the anticipated series of rate cuts this year that will look to lower the risk premium of the office sector.
- Return-to-office momentum continues to build with vacancy rates trending down, slightly supported by improving leasing inquiry and conversion. Supply remains constrained, and barriers-to-entry for new developments are significant, and often not feasible. Notwithstanding, capital markets are showing ongoing signs of recovery and increased levels of trade.

Retail:

- Despite higher cost of living, visitation to shopping centres has been climbing steadily, supported by the return of tourists, students and office workers. This trend has led to steady year-on-year increases in income and trade for the retail sector. The outlook for retail sales continues to improve as some of the pressures on household budgets start to ease as a result of ongoing wage and job growth.
- We continue to expect greater demand for well-located, resilient retail centres that cater to the daily needs of the community. The neighbourhood sector shows signs of particular strength, in comparison to larger assets.
- Improved financial conditions have resulted in more transactions and this will likely continue next year with the anticipated rate cuts.

		Current (Q1-25)	Next 12 months
Office	Vacancy rate	14.1%	Down
	Cap rate	6.0%	Steady
	Returns	-4.6%	Up
Retail	Vacancy rate	5.4%	Steady
	Cap rate	5.8%	Steady
	Returns	3.7%	Up
Industrial	Vacancy rate	2.7%	Slightly up
	Cap rate	5.4%	Steady
	Returns	3.3%	Steady

Key economic events and market conditions

Tariff uncertainty is weighing on the growth outlook

The economy grew by 0.2% in the March quarter 2025, much weaker than expected, which shows that the recovery of the Australian economy remains fragile. Importantly, GDP per capita, effectively living standards, has again gone backwards, falling by 0.2% over the March quarter.

Notably, public spending, which has been propping up GDP growth in recent months, recorded the most significant fall since the September quarter 2017. In the private sector, investment picked up a little, though from a low base.

Retail sales figures struggled to maintain momentum

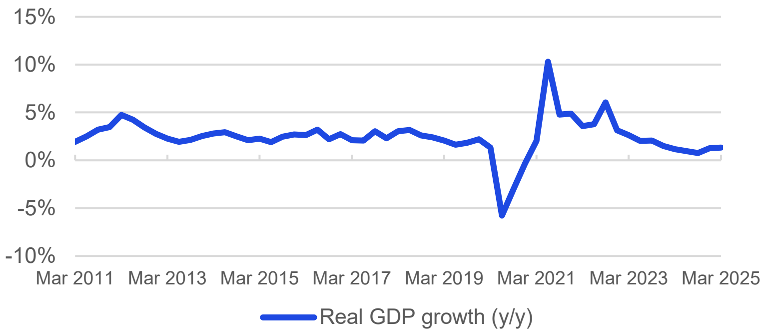
Quarterly retail sales volumes barely grew in the March quarter 2025 after recording strong growth in the second half of 2024, when volumes rose by 0.8% q/q and 0.5% q/q in the December quarter and September quarter 2024 respectively. Over the year, retail volumes still increased 1%, maintaining the same growth as the previous quarter. Retail spending per capita also experienced a slight decline after two consecutive quarters of growth.

Inflation is now sustainably within the RBA's target range

The latest inflation figure for the March 2025 quarter shows that headline inflation remained at 2.4%. Trimmed mean inflation – the RBA's preferred measure – notably fell to 2.9% from the previous quarter's 3.3%. This is the first time since 2021 that core inflation has come back to within the RBA's target band of 2-3%. The direction of inflation is expected to allow the RBA to continue lowering the cash rate for the second time in May 2025, following its first rate cut after four years in February 2025.

Building costs have also been moderating, with the growth in building cost slowing to 3.9% in the March quarter of 2025 from 4.9% in the previous quarter. This was due to easing supply chain pressures and significant declines in key construction input prices, such as energy and metal commodities.

Chart 1: GDP growth

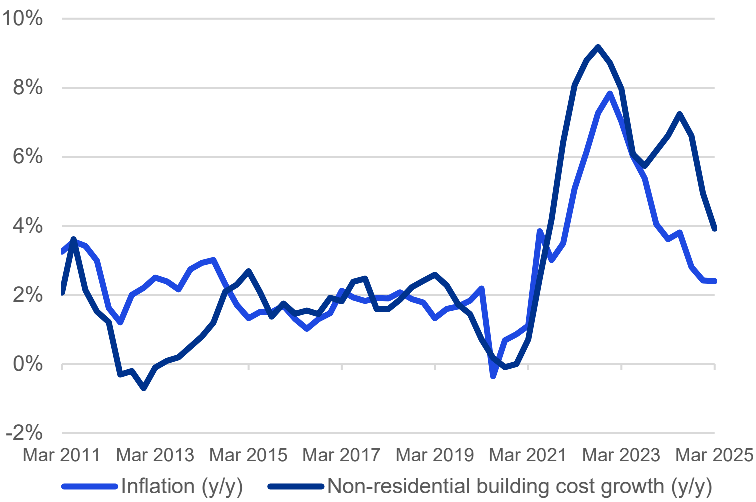


Source: KPMG, ABS, Haver

Chart 2: Retail turnover

Source: KPMG, ABS, Haver

Chart 3: Inflation and building costs



Source: KPMG, ABS, Haver

Strong government spending has kept the unemployment rate low

The labour market since the new year commenced remains tight, with the unemployment rate remaining in the low 4%. However, there are signs of cooling in the labour market, with employment growing modestly compared to strong gains recorded last year when jobs were driven by strong government spending. Forward-looking measures such as the number of job ads or job vacancies suggest that unemployment will continue to rise, albeit at a more gradual level.

Wages growth rose 0.9% in the March quarter 2025 and 3.4% annually, driven by wages growth in the public sector with the new state-based enterprise agreements. Wages growth in the construction sector, previously falling in-line with national wages growth last year, has outpaced aggregate growth in the past two quarters.

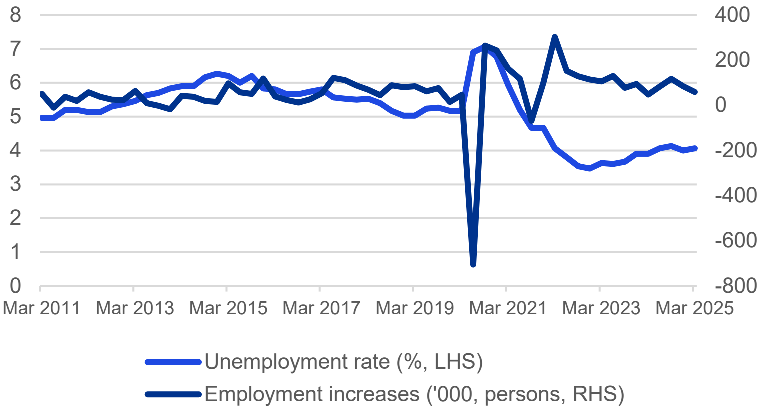
Completions yet to catch up with large backlogs

The declining trend in the number of approvals observed over the past three years appears to have reversed, according to the partial data for FY25. The number of approvals in the first two quarters of FY25 grew by 17% compared to the corresponding quarters in FY24. This growth comes after the number of approvals in FY24 declined, to be only a quarter of the rate recorded in FY23.

Market feedback suggests that some developers and investors remain optimistic about the long-term demand for commercial property, anticipating that current challenges will eventually subside, and the market will continue recover.

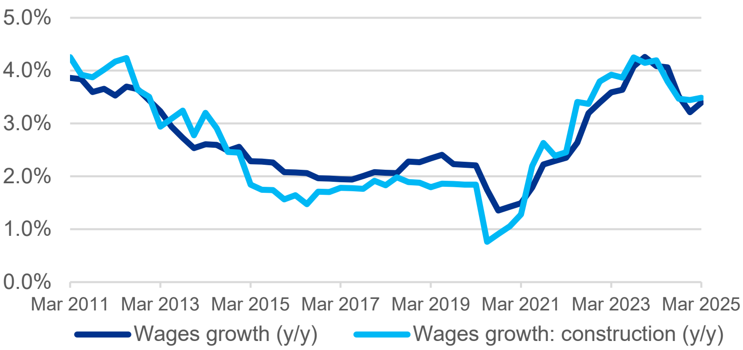
Completions have been growing since FY24. The number of completions in FY24 increased by 21%, with a corresponding rise in the value of work completed by 16%. This positive trend has continued into the first two quarters of FY25, with a significant increase (of 95%) in the number of completions, albeit with a modest rise in the value of work completed. Consequently, the number of works under construction decreased by 41%, indicating that the backlog is starting to clear up for the first time in two years.

Chart 4: Labour market



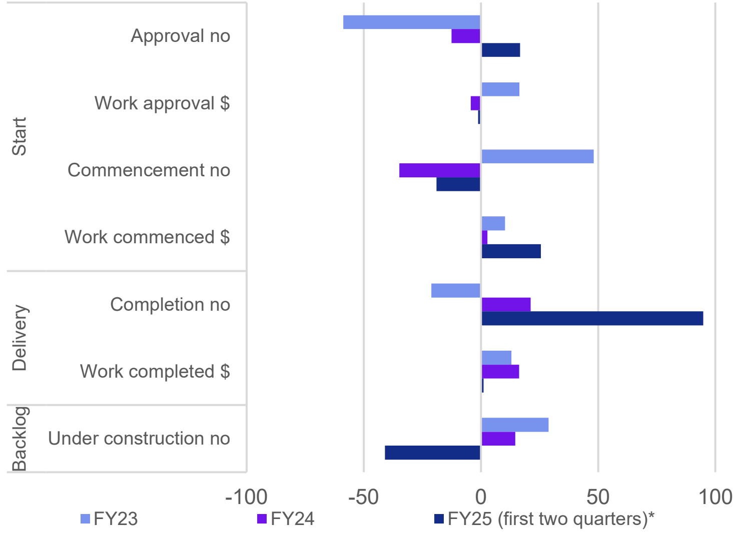
Source: KPMG, ABS, Haver

Chart 5: Wages growth



Source: KPMG, ABS, Haver

Chart 6: Non-residential construction activity by stages (annual growth)



Source: KPMG, ABS, Haver
*FY25 only includes the data for the first two quarters and represents the growth relative to the first two quarters of FY24.

New lending statistics 'well above' pre-pandemic levels despite elevated interest rates

Commercial property lending remains above the levels observed pre-pandemic, driven by continued demand for industrial property and a slight recovery for retail property. The latest data for the December quarter of 2024 reveals that commercial property exposures increased by 5.7% y/y but remained relatively unchanged as a share of total assets over the past 12 months. While the finance sector still has a willingness to provide and maintain funding support to commercial property investors, this is coming with tighter lending criteria.

Financial stress stable at low-levels, reflecting conservative lending practices

The share of non-performing commercial real estate loans from banks has remained stable compared to the same time last year. Overall, non-performing rates on commercial property have remained steady and still far below the levels seen during the GFC, in part reflecting conservative lending practices among banks operating in Australia.

Corporate insolvencies have increased significantly in early 2025, with the Australian Securities and Investments Commission (ASIC) reporting a surge in companies entering external administration and controller appointments. Over the past four quarters, approximately 850 construction companies have entered insolvency in each quarter, which is significantly higher than the pre-COVID levels. However, as a proportion, construction sector insolvencies now represent about 24% of total insolvencies, which is lower than the peak of approximately 30% in 2023 but still above the pre-COVID share of below 20%.

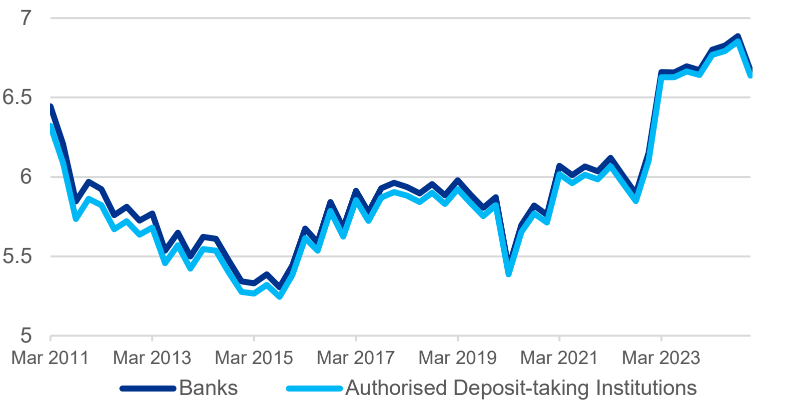
Lender appetites are changing after a prolonged period of shifting away from offices

The share of office exposures in total commercial property exposures has continued to decline over the past 12 months, falling to 26.8% in December 2024 from 27.5% in December 2023 according to the latest APRA statistics. However, the rate of decline has slowed down significantly, suggesting the appetites from lenders toward offices are changing.

Industrial assets are still being viewed by lenders as safer investments, increasing from 17.4% to 19.0% over the year in the December quarter 2024.

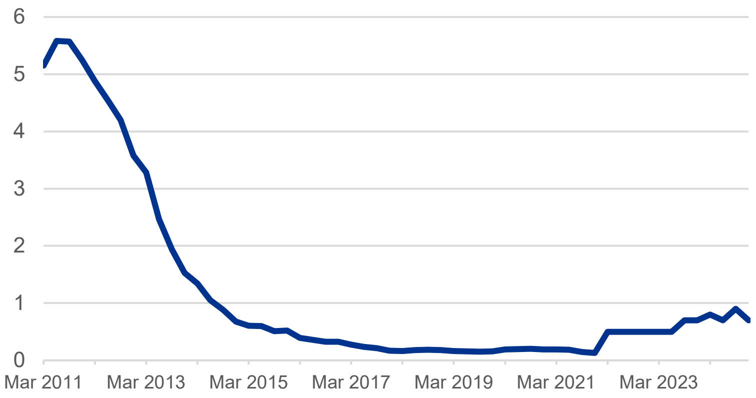
Despite the weakness in retail conditions throughout much of 2024, retail properties remain in demand. The share of retail exposures increased to 24.8% in the December quarter 2024 from 24.5% a year ago, though this increase is modest compared to industrial properties.

Chart 7: Bank loan exposures to commercial property (share of total assets)



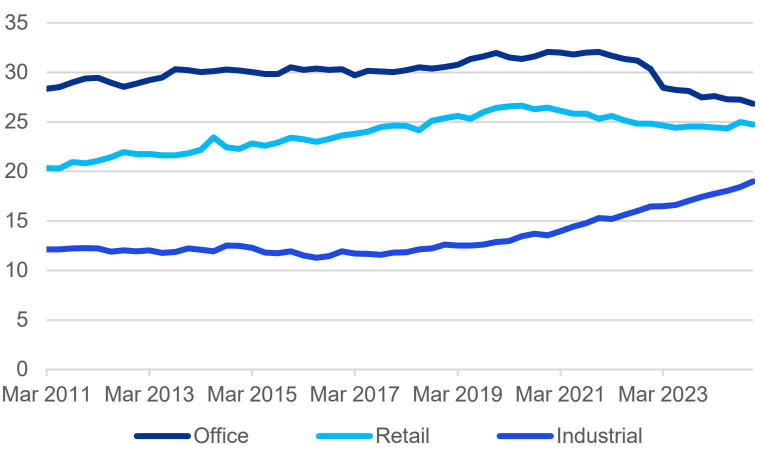
Source: KPMG, APRA, Haver

Chart 8: Non-performing rate* (share of banks' commercial property exposures)



Source: KPMG, APRA, Haver
Note: *Data reported as impairment rate prior to 2022

Chart 9: Exposures of different commercial property segments (share of total commercial property exposures)



Source: KPMG, APRA, Haver

Foreign investor demand for commercial real estate yet to recover from FY22 levels

The value of commercial investment proposals approved increased to $186.9 billion in FY24 from $173.1 billion in FY23. While demand has improved, it's far from the levels achieved in FY22.

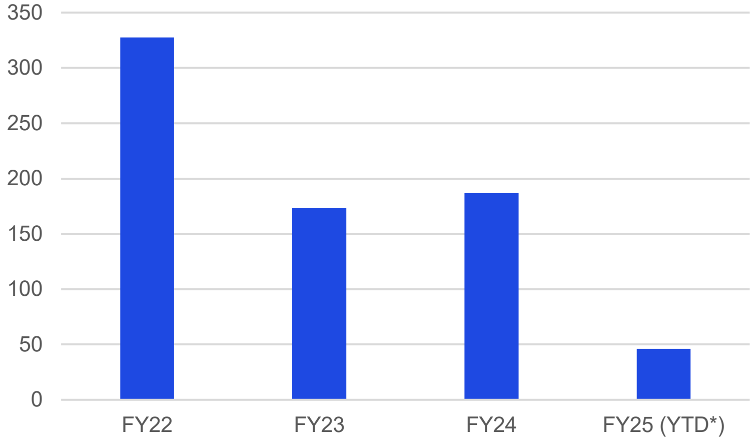
The United States remains the largest source country for approved commercial investment proposals, with investment from the US more than doubling the figures recorded in FY23.

We're seeing significant offloading of assets from countries facing their own economic headwinds as well as small capital allocations because of liquidity reasons. Investors from China and Singapore have traditionally injected the most funds into Australian real estate. However, FY24 saw the re-emergence of Japan as a powerful investment force, particularly in the build-to-rent sector. French investors in FY24 became the third largest source of international capital.

Improvement in the flow of international capital into Australia in FY25 is uncertain amidst ongoing trade war gyrations and US domestic policy changes including a potential lowering of the corporate tax rate.

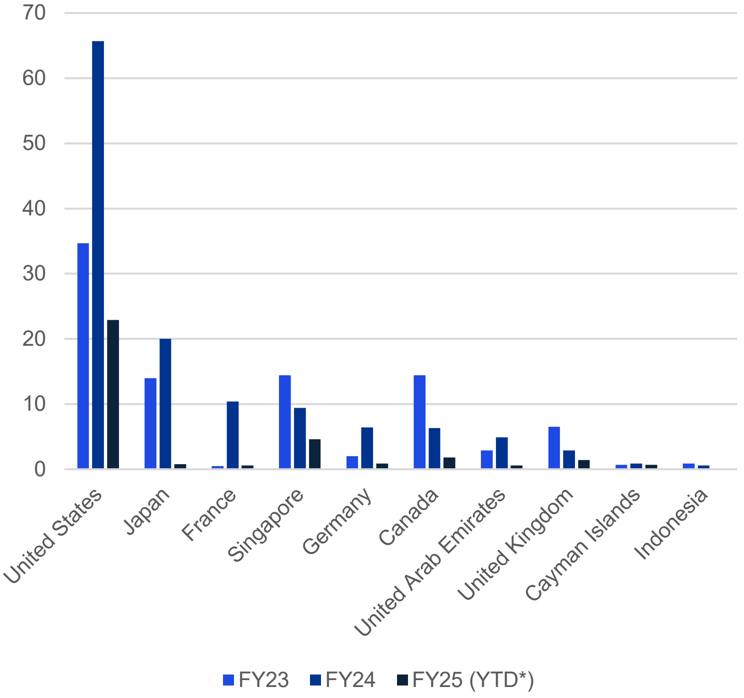
The latest data for the first quarter of FY25 shows a quarterly fall in foreign investment to $46.6 billion from $58.7 in the last quarter of FY24.

Chart 10: Value of foreign investment proposals for commercial real estate ($ billion)



Source: KPMG, Commonwealth Treasury
Note: *The YTD figure for FY25 only includes data for the first quarter.

Chart 11: Sources of foreign investment proposals for commercial real estate ($ billion)



Note: *The YTD figure for FY25 only includes data for the first quarter.

The KPMG Commercial Property Uncertainty Index

Introduction

The KPMG Commercial Property Uncertainty Index provides insights into the unpredictability and potential risks associated with investing in office, industrial and retail property.

An asset that produces consistently fair returns should generate a stable, low uncertainty index. Where an index spikes, it signals investors are expecting, or are reacting to, significant changes in market conditions.

Chart 12 presents the KPMG Commercial Property Uncertainty Index for the industrial, office, and retail sectors between Q2 2008 and Q1 2025.

Historical performance

During the Global Financial Crisis (2008-2010), all three commercial property sectors in Australia experienced sharp spikes in uncertainty due to volatile economic conditions, tighter and costlier financing, and weakened investor sentiment. As markets stabilised, uncertainty levels remained relatively steady from 2010 to 2020.

A new wave of uncertainty emerged with the onset of the COVID-19 pandemic in 2020, though its impact varied across sectors. The retail sector saw an immediate spike due to lockdowns and a rapid shift to online shopping. Recovery followed as restrictions eased, supported by government stimulus and consumer demand.

The industrial sector, particularly logistics and warehousing, initially benefited from the e-commerce boom. However, ongoing supply chain disruptions and global trade shifts contributed to rising uncertainty in 2021.

In contrast, the office sector experienced a delayed spike. The widespread adoption of remote work led businesses to reassess their need for physical office space, creating long-term uncertainty around future demand.

Recent performance

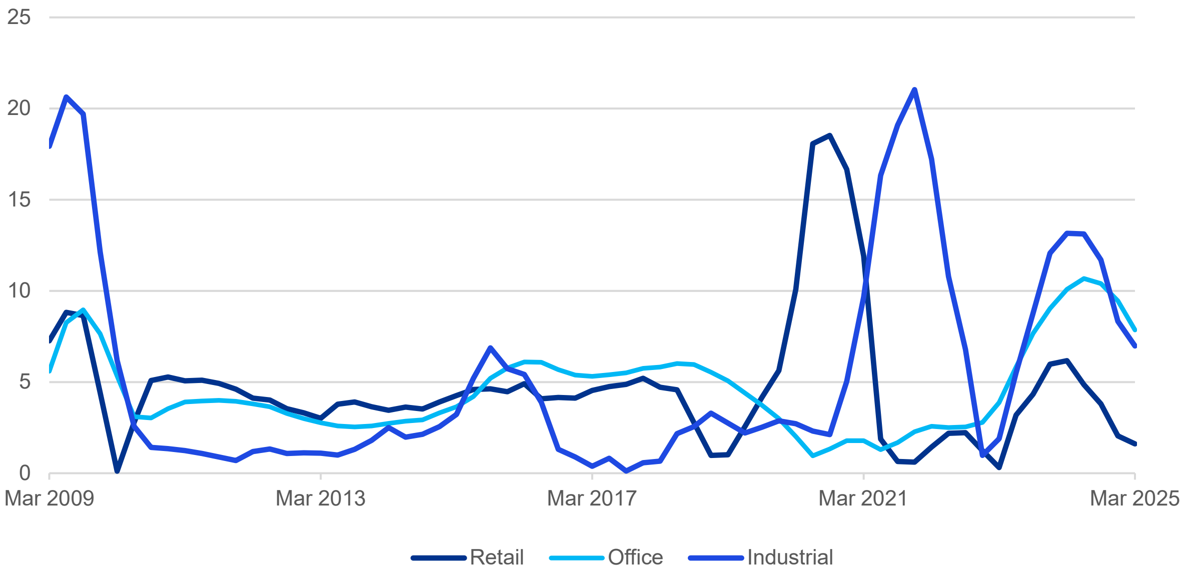
The KPMG Commercial Property Uncertainty Index has fallen for all individual sectors between the December quarter 2024 and the March quarter 2025.

Uncertainty in the office sector remains the highest. However, uncertainty is likely to have peaked in June 2024, and the latest uncertainty read shows that it has been falling sharply in the office sector.

Following the corrections in industrial property, uncertainty in the sector has stabilised considerably, recording the biggest fall over the year across the three sectors.

After having peaked in the June quarter 2024, the retail sector has continued to record consecutive falls in uncertainty, with the index sitting at 1.61 index points in the March quarter 2025, indicating a low level of uncertainty compared to its long-run average.

Chart 12: KPMG Commercial Property Uncertainty Index



Retail property sector

Space conditions

The retail sector headed into 2025 with some caution regarding uncertainty in the global trade policy. The vacancy rate edged up to 5.4% in the March quarter 2025, representing a 0.4 pt increase relative to the December quarter 2024.

Despite that, trading conditions have seen a noticeable improvement since the second half of 2024, with the vacancy rate falling from 7.9% in the June quarter 2024. Prime, super prime and major regional centres have experienced lower vacancy compared to 12 months ago, suggesting a good demand for these properties amidst a recovery in economic conditions. By contrast, secondary retail's vacancy remains mostly unchanged from levels observed 12 months ago.

Asset pricing

Capitalisation rates have stabilised across the sector over the half-year. In the March quarter 2025, the capitalisation rate for the sector is currently siting at 5.7%, a 13 basis-point increase compared to the March quarter 2024. There has been some instances of minor cap rate compression in the more liquid neighbourhood sectors (including in some regional locations), indicating solid demand from the investor cohort, seeking stable asset class fundamentals underpinned by non-discretionary cash flows.

Overall, market feedback suggests a shift in investor sentiment reflecting improving domestic economic conditions, and a more positive outlook for inflation and interest rates.

Chart 13: Vacancy rates across retail property subsectors (%)

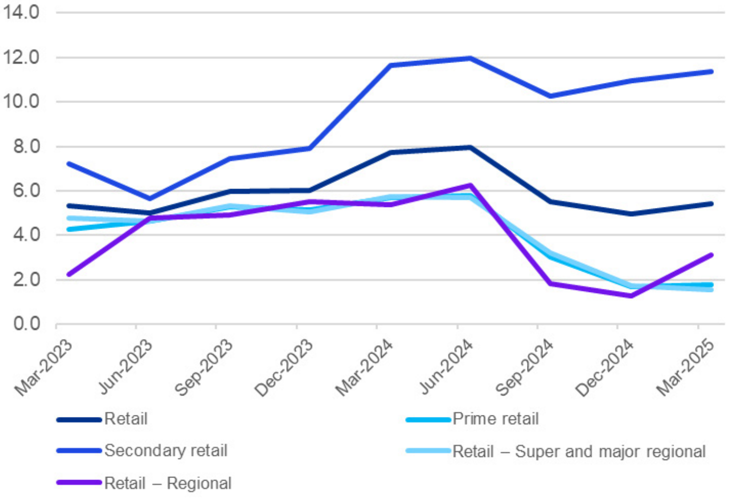
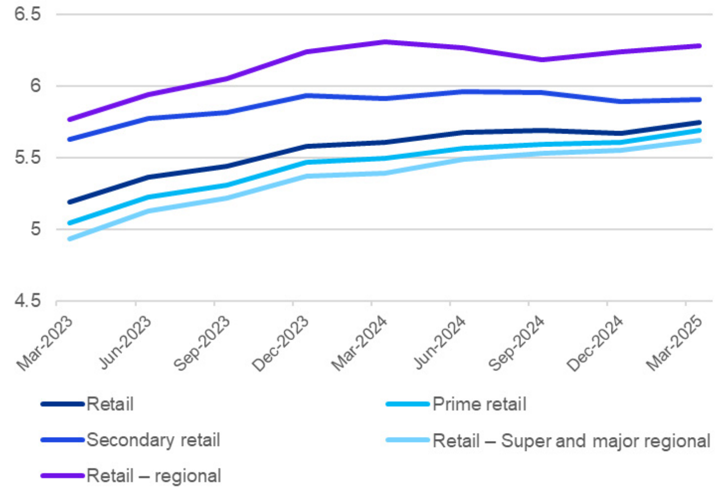


Chart 14: Capitalisation rates across retail property subsectors (%)



Source: KPMG, MSCI/PCA

Retail property sector (continued)

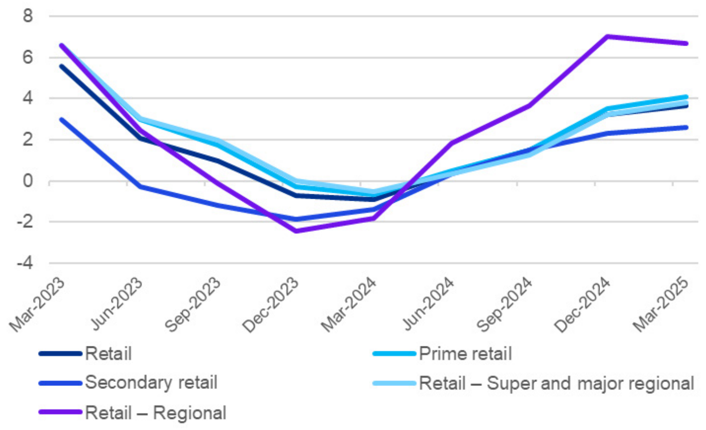
Investment performance

Investment performance has improved in recent quarters. Total returns for the retail sector as a whole were at 3.7% in the March quarter 2025, marking the fourth consecutive quarter of positive returns after the sector experienced negative returns in late 2023 and early 2024.

The turnaround in total returns happened because of the strong fundamentals of retail property, supported by extraordinary population growth and strong employment growth. Limited supply for retail property has also played a key role in supporting the recent performance.

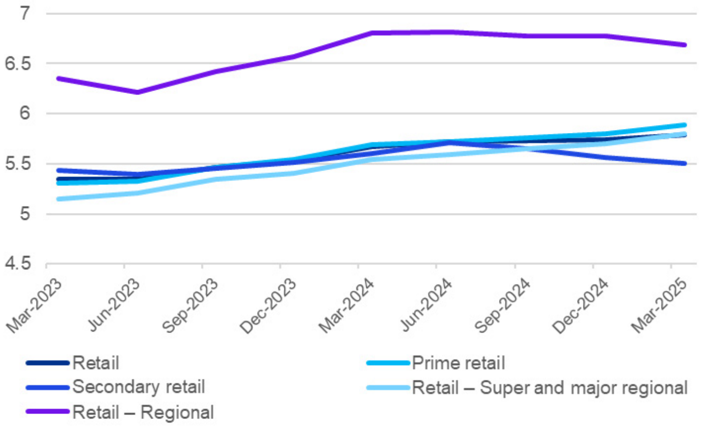
Despite the resilient income returns, capital growth for the sector remains negative. Nevertheless, capital growth is showing signs of improvement, currently at -2%, a significant recovery from -6.2% at the same time last year.

Chart 15: Total returns across retail property subsectors (%)



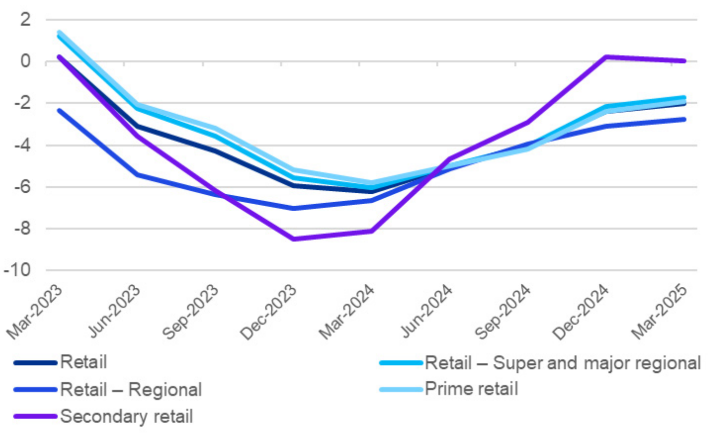
Source: KPMG, MSCI/PCA

Chart 16: Income returns across retail property subsectors (%)



Source: KPMG, MSCI/PCA

Chart 17: Capital returns across retail property subsectors (%)



Source: KPMG, MSCI/PCA

Office property sector

Space conditions

The University of Sydney's Transport Opinion Survey (TOPS) for March 2025 revealed a stabilisation in remote working time among Australian workers, with the average working from home (WFH) rate remaining at 22% over the past 12 months.

For the first time since December 2022, vacancy rates for the office sector recorded a fall, albeit slightly, with vacancy rates falling to 14.1% in the March quarter 2025 from 14.0% in the December quarter 2024.

Sydney CBD recorded large absorption, with vacancy rates decreasing by approximately 60 basis points over the quarter to 12.8%. Melbourne CBD offices also recorded a moderate decrease in vacancy, with vacancy rates falling by 50 basis points to 17.7%. Brisbane CBD offices recorded negative absorption and an uptick in vacancy rates, sitting at 10.3% respectively.

Asset pricing

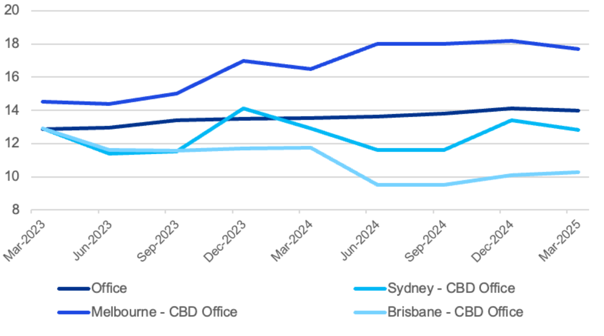
Since June 2022, capitalisation rates for the office sector have consistently expanded, however have remained generally steady over the half year, reflective of the renewed sentiment for the sector.

Effective rent growth is visible for the core CBD markets of Sydney, Brisbane and Perth, however, is notably negative for Melbourne.

The overall outlook for investment sentiment in the core office sectors is cautiously optimistic. Clear visibility on ESG credentials and opportunities remain front-of-mind for landlords, purchasers and occupants alike.

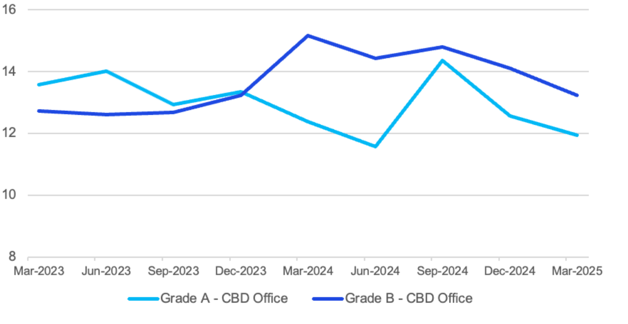
There are early signs of potential cap rate compression in some core markets, however deal flow remains below historic averages, making it difficult to predict when core values will begin to recover post the recent period of acute correction.

Chart 18: Vacancy rates across office property by location (%)



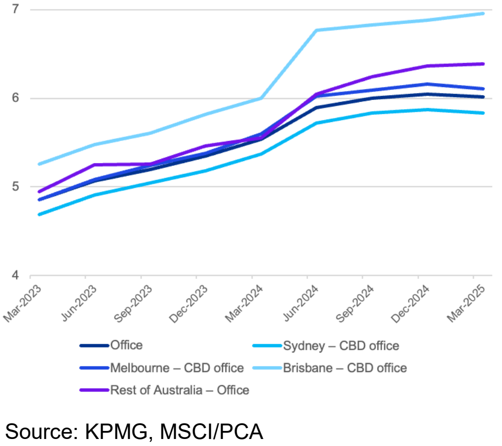
Source: KPMG

Chart 19: Vacancy rates across office property by quality (%)



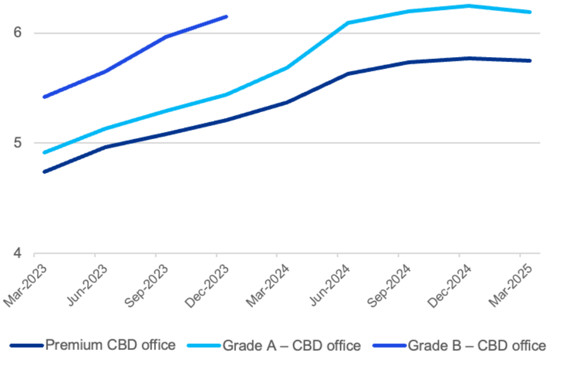
Note: The data represents the average rates collected across Sydney, Melbourne, and Brisbane.
Source: KPMG

Chart 20: Capitalisation rates across office property by location (%)



Source: KPMG, MSCI/PCA

Chart 21: Capitalisation rates across office property by quality (%)



Note: The data for Grade B – CBD Office is not reported since December 2023.
Source: KPMG, MSCI/PCA

Office property sector (continued)

Investment performance

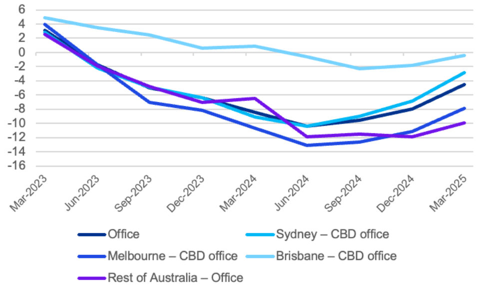
Total returns for office property across multiple CBDs have remained negative since June 2023, except for Brisbane CBD which has recorded losses since June 2024.

Despite Brisbane's relatively higher income returns, which are 50 basis points above those in Sydney and Melbourne, they are still not enough to offset the broader downturn in capital values for office properties. Superior income returns for Brisbane CBD office properties, driven by dominant demand from large corporations and government entities and a scarcity of available space, are insufficient to counteract the decline in capital values, a common force affecting offices across Australia.

Lease incentive profiles remain high, across all sectors, and there is general market acceptance that incentives will remain higher for longer. However, there are early signs of easing, albeit slightly, in some core CBD markets.

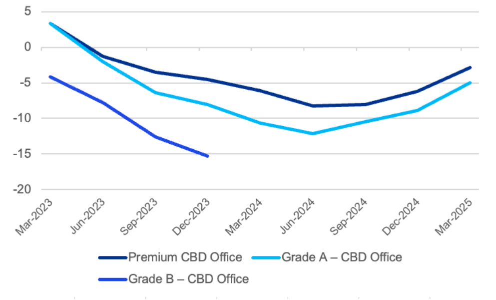
Office quality and ESG credentials remain a key differentiator for asset performance, which include the potential for material capex considerations over the investment horizon.

Chart 22: Total returns across office property by location (%)



Source: KPMG, MSCI/PCA

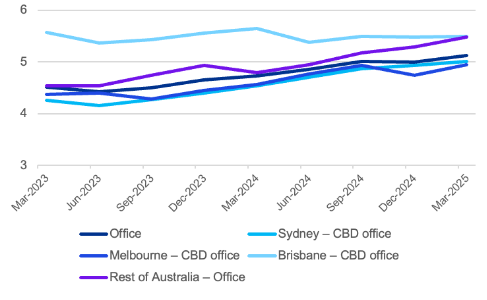
Chart 23: Total returns across office property by quality (%)



Note: The data for Grade B – CBD Office is not reported since December 2023

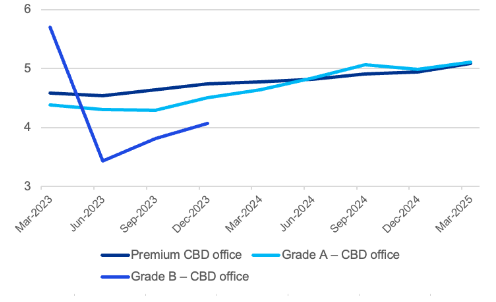
Source: KPMG, MSCI/PCA

Chart 24: Income returns across office property by location (%)



Source: KPMG, MSCI/PCA

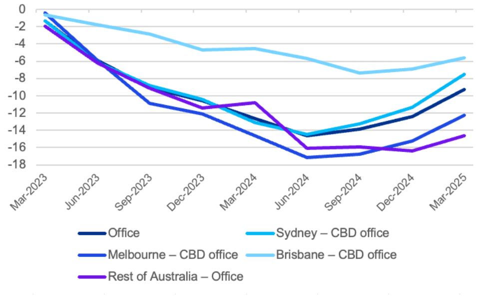
Chart 25: Income returns across office property by quality (%)



Note: The data for Grade B – CBD Office is not reported since December 2023

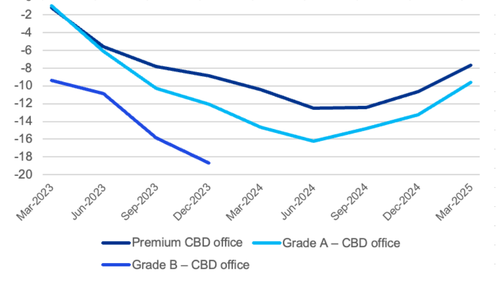
Source: KPMG, MSCI/PCA

Chart 26: Capital returns across office property by location (%)



Source: KPMG, MSCI/PCA

Chart 27: Capital returns across office property by quality (%)



Note: The data for Grade B – CBD Office is not reported since December 2023

Source: KPMG, MSCI/PCA

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Industrial property sector

Space conditions

After a protracted period of supply constrained markets contributing to below long-term trend vacancy, the national industrial property markets across all surveyed locations is currently sitting at 2.7% and has been stabilising in the three most recent quarters, to a more normalised level of sector vacancy.

The particularly constrained supply cycle in New South Wales in the past has eased materially, with a mix of both committed and speculative developments contributing to easing supply concerns.

From an occupancy perspective, this increase in available supply has facilitated examples of strategic reallocations of resources to alternate east coast states to optimise operational efficiency and cost-effectiveness. This has resulted in a more balanced distribution of absorption across the eastern seaboard, with state-based vacancy rates in all surveyed locations indicating more normalised supply conditions now, and for the foreseeable future.

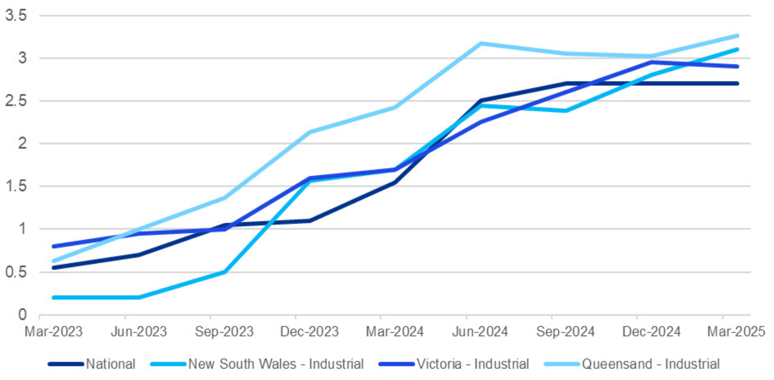
Whilst we are witnessing effective rental growth in the east coast markets (along with marginal increases in lease incentives), the veracity of rental growth has subsided considerably from 2022/2023 levels.

Asset pricing

Capitalisation rates have consistently decompressed for industrial properties since September 2022 and currently reflect 5.4% for March 2025, post recent acute correction, rising by only 20 basis points from 12 months ago. However, capitalisation rates have notably stabilised over the last three quarters.

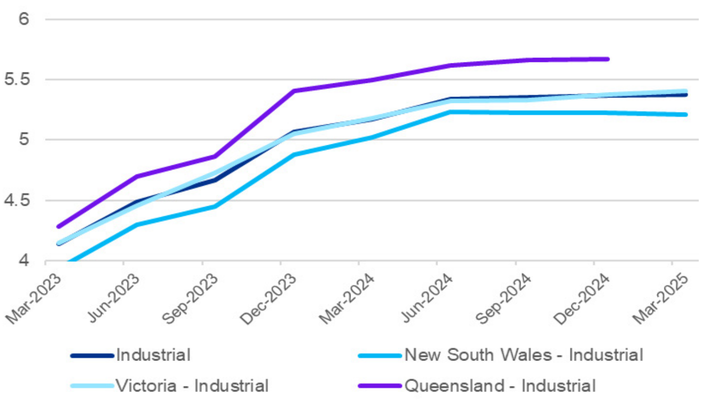
Across the three state-based primary east coast markets, capitalisation rates have increased the most for Queensland properties, rising by 80 basis points over the past 12 months to sit at approximately 5.7%.

Chart 28: Vacancy rates across industrial property by location (%)



Source: KPMG

Chart 29: Capitalisation rates across industrial property by location (%)



Note: QLD data is not reported for Mar 25
Source: KPMG, MSCI/PCA

Industrial property sector (continued)

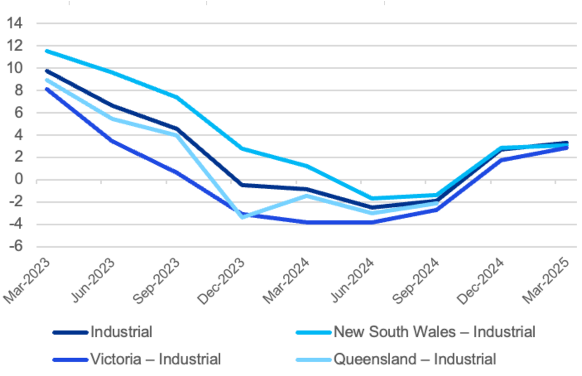
Investment performance

Total returns across all industrial sectors by location are back to positive for two consecutive quarters, currently at 3.3% in the March quarter 2025 after enduring four consecutive quarter of corrections.

New South Wales appears to be more resilient than other sub-markets, with total returns being the highest. Additionally, the losses during market corrections were not as large as those recorded in Victoria and Queensland.

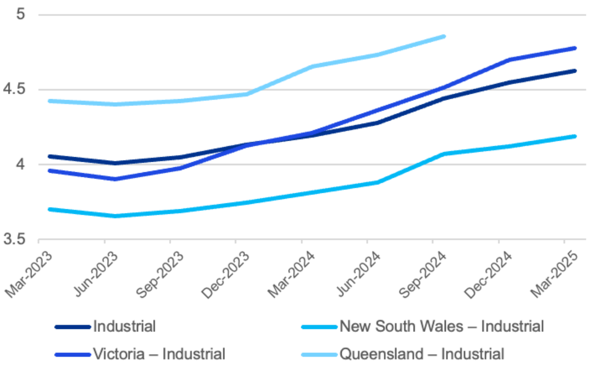
Despite the capital losses, the income side of industrial property continues to appeal to the investor market, with income returns consistently increasing on a quarterly basis. Steady population growth, the ongoing growth in e-commerce and the push to automation will grow demand, while supply will be comparatively constrained by high construction costs and limited access to appropriately zoned and serviced land.

Chart 30: Total returns across industrial property by location (%)



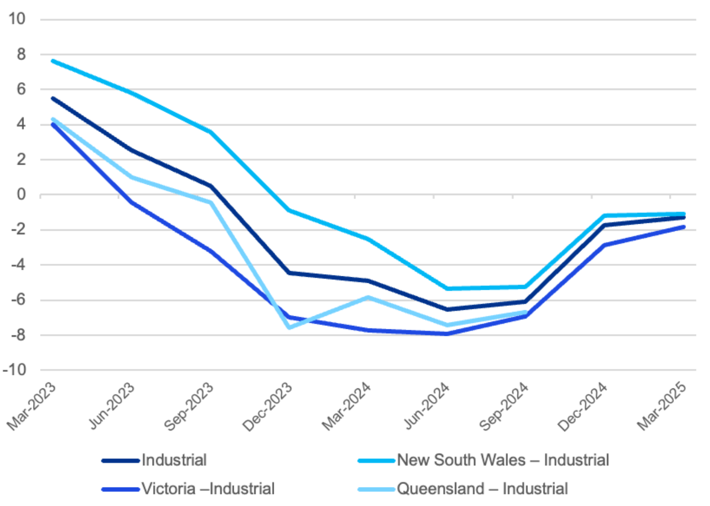
Source: KPMG, MSCI/PCA

Chart 31: Income returns across industrial property by location (%)



Note: QLD data is not reported for Mar 25
Source: KPMG, MSCI/PCA

Chart 32: Capital returns across industrial property by location (%)



Source: KPMG, MSCI/PCA

Recent developments in the build-to-rent sector

The build-to-rent sector (BTR) has taken off in Australia, but it will take time to mature

Unaffordable housing is a key concern for Australians. The issue was a central issue in the recent federal election, prompting targeted policies aimed at easing the crisis. Among various strategies, BTR development emerged as a potential solution to increase the supply of rental housing.

Early BTR projects catered to high-end tenants. However, affordable BTR projects are now emerging within Australia, primarily as components of larger scale developments that balance a proportion of affordable rental units.

Nevertheless, the BTR sector in Australia is still in its infancy, with just under 3,800 BTR units currently completed in the Sydney, Melbourne and Brisbane markets according to the Real Estate Institute of Australia. By contrast, the number of BTR completions in the UK, where the sector is more mature, has exceeded 100,000 units since the UK government first began the initiatives in 2016.

Projections suggest an expansion of the BTR pipeline in Australia in the coming years. There are 44,139 units at various stages, with 29% under construction, a further 24% having planning approval, and 42% in the process of seeking planning approval.

Legislative change to stimulate Australia's BTR sector

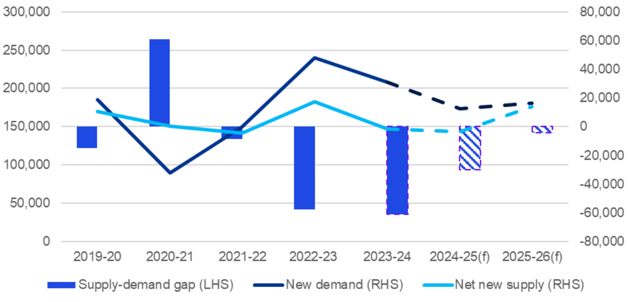
Shortly before the federal election, new income tax concessions in the BTR sector came into force that look to incentivise investment and construction in the BTR sector. The legislation was first announced as part of the FY24 Federal Budget, with the final amending legislation receiving Royal Ascent in December 2024.

The legislation has three key elements:

- an increase to the capital works deduction rate from 2.5% to 4%, where construction has commenced on or after 9 May 2023
- a reduction to the final withholding tax rate on eligible fund payments from managed investment trust (MIT) investments from 30% to 15% where such payments are made on or after 1 July 2024
- the introduction of a potential claw back mechanism via a so-called 'misuse tax'.

The regulations in the legislation also require BTR projects to offer five-year rental terms, prohibit no-fault evictions and ensure that 10% of each project is leased as affordable housing managed by a not-for-profit community housing organisation.

Chart 33: Housing supply – Housing demand imbalance



Source: KPMG's calculation, Housing Australia

State governments have also shown initiatives to support BTR developments. The BTR land tax and duty concessions vary between the states, however in the eastern states, eligible BTR properties and developments can receive concessions, noting each have slightly different eligibility requirements and timing considerations, but include:

- a 50% reduction in the land value for the purposes of calculating land tax (reducing the overall land tax liability)
- an exemption (or refund) for foreign purchaser duty and foreign land tax surcharges.

Japanese buyers take the lead as Australia's dominant offshore investors

While 84% of BTR sites are owned by domestic investors, Japanese investors appear to be the most active, supported by Japan's low interest rates. Many of these companies are collaborating through joint ventures with Australian firms to leverage local expertise and resources. Recent key projects include:

- Lendlease with Japan's Daiwa House Nippon Steel, to develop a $650 and $500 million BTR tower on the edge of the Melbourne CBD and Docklands.
- Mitsubishi Estate's $1.8 billion investment in Mirvac's BTR venture.
- Cedar Pacific joining forces with Japanese timber, housing, and building materials giant Sumitomo Forestry to develop a $1.2 billion portfolio of BTR apartments, with a strong focus on sustainability.

Data centre sector

Australia is a key strategic location for data centre (DC) operators

Australia's DC market is steadily evolving, and is experiencing notable capital activity, including greenfield land acquisitions, while facing barriers to entry such as high development costs (impacting all sectors), and protracted approval processes amongst other regulatory complexities.

The market is expected to see significant growth, driven by increasing demand for digital services, artificial intelligence and cloud computing. Industry projections suggest that deployable data centre capacity could more than double over the next five years in Australia.

The sector is evolving into a maturing asset class, driven by a much broader investor base and improving demand fundamentals. Transactions, once rare, are increasingly featuring direct investments and platform transactions or listings, highlighting the market's growing appeal, and activity. However, when compared against traditional investment sectors, the volume of comparable transactions remains relatively subdued.

Challenges facing the DC market in Australia

The rapid increase in data consumption and energy demands is making DCs crucial to modern infrastructure. This surge has placed immense pressure on energy resources and sustainability efforts. Some recent developments include:

- The recently reported 'prohibition' of new DCs at Macquarie Park in Sydney, which could represent a significant regulatory challenge. According to the media articles, governments and regulators are reportedly attempting to manage the sector's runaway growth, turbocharged by the rise of AI applications and its heavy demand on energy and water supply. This could highlight the 'balancing act' required to support sector growth while addressing environmental and resource concerns.
- The Australian Energy Market Operator (AEMO) has reportedly raised concerns about grid stability. They have warned that the stability of the country's electricity grid could be threatened unless the power consumption of DCs is managed effectively.

Despite increased investment, investor confidence in DCs is expected to strengthen over the remainder of the decade. However, persistent challenges (such as power supply, construction costs and supply chain constraints) could continue to hinder DC development. Moreover, some degree of investor uncertainty persists, regarding the potentially redundant nature of DC assets. The continued advancement in technologies (such as chip architectures and liquid cooling), may compel investors to adopt a more measured approach.

Recent investment activities in Australia and New Zealand

Despite the challenges, the DC market in Australia and New Zealand is witnessing significant capital activities. Here are some key developments from late Q1 and Q2 2025:

- STACK Infrastructure has reportedly mandated a prominent capital advisor to raise AU$1.3 billion in debt. This funding is intended to finance the expansion of existing DCs and the construction of new ones.
- Spark New Zealand has reportedly engaged an investment bank to run an auction to find a partner for its data centre platform. The portfolio includes 22 MW in operational capacity and more than 118 MW in capacity under development. Spark NZ is offering around a 50% stake in the platform, with several potential bidders reportedly expressing interest.
- Blackstone Group has reportedly appointed two major investment banks to review AirTrunk's portfolio and has considered selling two DCs located in Sydney and Melbourne, potentially worth around AU$4 billion.
- Partners Group (Switzerland-based private equity firm) have reportedly acquired GreenSquareDC for AU$1.2 billion.
- Goodman Group has raised AU$4 billion that will be used to partly fuel its data centre build-out across the globe.

Valuations point of view

Valuing a DC asset is a sophisticated process that can extend beyond traditional real estate practices, demanding a comprehensive understanding of operational intricacies, market trends and factors (such as energy and water supply) that influence a DC asset's long-term performance. Pricing is now a more nuanced exercise, taking into account individual asset characteristics and specific circumstances.

While conventional valuation approaches, methods and techniques provide a foundation, the unique valuation considerations (such as lease profiles and operational models) of a DC asset require a bespoke approach from a valuer, particularly when factoring in global market dynamics and the evolving demands of the sector.

Technical appendix

What is uncertainty?

Uncertainty in a financial asset and from an investment return perspective is defined as the conditional volatility of a disturbance that is unforecastable from the perspective of economic agents, which include investors.

An economic disturbance is an event or action that reduces the predictability of the future net cash flows from income producing assets, like commercial property.

If an economic disturbance alters the perception an investor has of an asset's ability to earn a predictable return in the future (usually, in some context, to the return it has earned in the past) then the value an investor places on that asset will change; and where that information is not fully transparent across all participants in the market, there is likely to be an increased variance in (investor) valuations.

There can be a wide variety of shocks that alter investor expectations, but where changes occur rapidly (i.e. more volatility) the record of the past necessarily contributes less to predictions about future income. Volatility, which is a well-known indicator for measuring asset price risk, is conventionally measured as the standard deviation of asset returns.

Increases in uncertainty can depress hiring, investment, or consumption if households or investors are subject to fixed costs, are risk averse, and/or if financial constraints tighten in response to higher uncertainty.

What does the KPMG Commercial Property Uncertainty Index measure?

The KPMG Commercial Property Uncertainty Index tracks the variability of total returns from real estate properties. These returns are calculated based on the Morgan Stanley Capital International (MSCI) and Property Council of Australia Property Index (MSCI/PCA Property Index). This MSCI/PCA Index reflects the overall returns from direct real estate investments that are not leveraged, taken from one property valuation to the next, and considers only those properties that are completed and available to rent.

The KPMG uncertainty index does not break down how much of the uncertainty in the market is due to changes in property values (capital returns) versus rental income (income returns). Instead, it provides a measure of the overall level of uncertainty linked with the total returns from property investments.

Properties that yield steady and reasonable returns are typically associated with a lower score on the uncertainty index, indicating a stable market environment. Conversely, a spike in the index suggests that investors are either anticipating, or responding to, significant shifts in the market. An increase in the index value is an indicator of rising uncertainty in the investment environment, while a decrease suggests the opposite.

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Technical appendix (continued)

How is the KPMG Commercial Property Uncertainty Index calculated?

The KPMG Commercial Property Uncertainty Index has been constructed using total returns within a stochastic volatility model framework; an approach similar to that applied to measure stock market volatility. The stochastic volatility model treats volatility as a random process that evolves over time as opposed to treating it as constant or deterministic.

The uncertainty index value calculated using a stochastic volatility model tells users whether total returns of commercial property is more volatile in the current period, compared with previous periods (i.e. the index value is higher in period t than in period t-1) or less volatile (i.e. the index value is lower in period t than in period t-1).

A consistently low index number would indicate that the returns from the property market are stable and less variable. This stability could be due to a robust underlying demand for property or economic stability. In such a case, investors might lower their hurdle rates, as the risk associated with investing is perceived to be lower, and hence, they can accept lower returns for the reduced risk.

A moderate or high index number indicates a more volatile investment performance. In a volatile and uncertain investment environment, adopting a 'wait and see' approach can be advantageous. Volatility can lead to rapid and unpredictable changes in investment values. By waiting, investors can avoid making decisions that might result in significant losses due to unforeseen market movements. Uncertainty often implies a lack of information or the presence of conflicting information. Delaying investment decisions allows for the collection and analysis of additional data, leading to more informed decision-making. Alternatively, investors might also want to adjust their hurdle rates higher in such scenarios to compensate for the increased risk.

How is the stochastic volatility formula applied in the KPMG Commercial Property Uncertainty Index?

The key idea behind stochastic volatility models is that the latent volatility cannot be directly observed; instead, it must be inferred from the returns data. To achieve this, we firstly estimate the square of total returns, y_t, using a conditional mean equation:

$$\mathrm{y_t} = \mu + \sigma_t \epsilon_t \text{ (1)}$$

We then model the evolution of the variance term, σ_t^2, over time using a standard stochastic volatility process (see Harvey et al, 1994):

$$\log(\sigma_t^2) = \alpha + \beta \log(\sigma_t^2) + \omega \eta_t \text{ (2)}$$

where ϵ_t and η_t are iid $N(0{,}1)$ random variables.

The stochastic volatility parameters α, β and ω are then estimated by casting (1) and (2) into a state-space form using a Kalman Filter.

We then define the measure of uncertainty as:

$$\mathrm{U_t} = \sqrt{E(\sigma_t^2)}$$

References

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