

Wealth matters

Behind the façade – navigating divergence across commercial real estate

Australian commercial property is increasingly a tale of two markets, with performance diverging between premium assets and the rest of the market. In this environment, asset selection – rather than broad exposure – is the primary driver of returns.

More persistent inflation has led to renewed monetary policy tightening by the RBA, reshaping the investment outlook. Higher interest rates lift return hurdles through an increased cost of capital, contributing to valuation uncertainty. At the same time, global supply-chain volatility is driving higher energy and freight costs, with second-order effects to flow through to construction. This raises development costs and the threshold for viable new supply, placing upward pressure on required rents or potentially delaying projects.

This Wealth matters article explores the evolving dynamics and diverging performance within Australia's commercial property sectors. While the economic backdrop remains uncertain, Mutual Trust continues to source attractive opportunities, with recent investments in Brisbane, Adelaide and Sydney.

Our approach focuses on lower-risk assets in prime or central locations where structural trends – including population growth, infrastructure investment and limited new supply – underpin long-term demand for well-located space. Income resilience, defined leasing pathways and manageable capital expenditure (capex) requirements are essential. Our current sector positioning reflects these principles:

Office

Prime assets in core precincts with constrained supply

Industrial

Infill assets and modern logistics facilities

Retail

Regional and sub-regional sized centres, and large-format retail

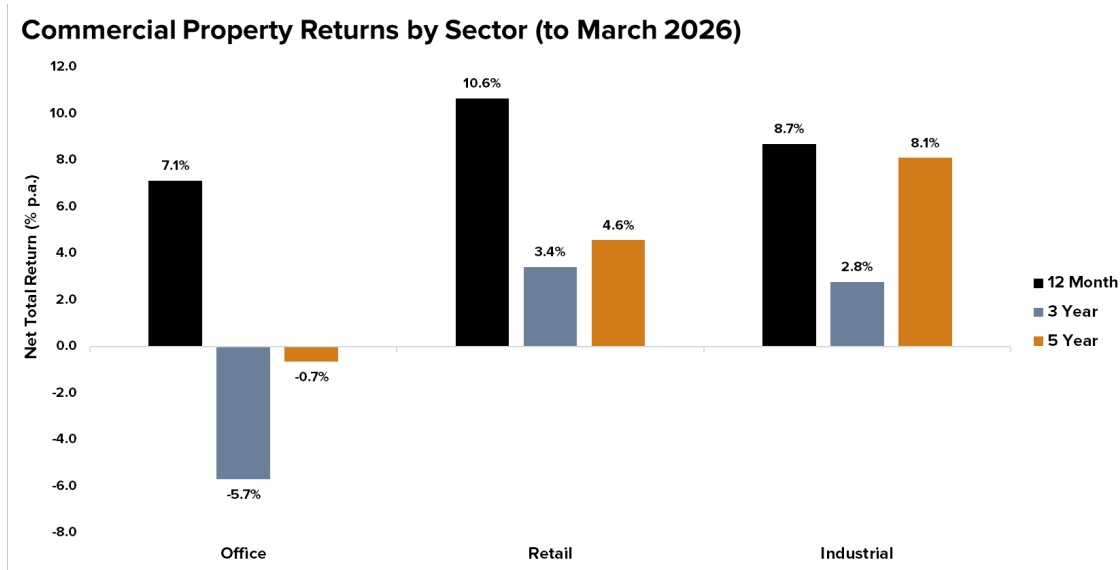
Real assets, such as real estate and infrastructure, play an important role in portfolio construction, supporting income resilience and preserving purchasing power in a higher inflation environment. However, asset selection, rigorous due diligence and disciplined acquisition pricing remain critical to managing risk and optimising returns. Mutual Trust's approach is grounded in over a decade's experience investing in these sectors, supported by trusted partnerships with specialist investment managers.

Uneven performance across commercial property sectors

The latest MSCI data (to end-March 2026) shows positive returns over the past 12 months across retail, industrial and office sectors (based on unlisted wholesale property funds):

- **Retail:** the clear leader over the one and three-year periods.
- **Industrial:** delivered the strongest five-year annualised performance.
- **Office:** lagged retail and industrial.

Sub-sectors and locations are experiencing varied conditions, with a mix of headwinds and tailwinds – including higher financing and construction costs alongside limited new supply and strong demand for high-quality assets – shaping market dynamics and individual asset performance.



Source: MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index

Capital is increasingly being directed toward quality assets offering defensible income, rental growth potential and manageable capex. In contrast, lower-quality assets are facing headwinds from shifting tenant preferences, rising operating costs and tighter financing conditions.

The Australian Budget 2026-2027 announced the curtailment of negative gearing for residential property – but unchanged for commercial property – potentially driving a gradual reallocation of capital towards commercial assets.

Office – performance determined by asset grade, location and ability to reposition

The office market recovery is selective and asset dependent. The most attractive risk-adjusted opportunities are in prime-grade assets in core precincts, supported by strong tenant demand. We are cautious on secondary assets, suburban locations and assets with higher capex requirements.

Australia’s office sector is transitioning from a valuation-led downturn to an early-cycle, quality-led recovery, with performance increasingly determined by asset grade, location and repositioning potential. The recovery is concentrated in prime-grade assets, which benefit from better amenities (e.g. end-of-trip facilities and shared spaces), connectivity (proximity to transport), and sustainability credentials, enhancing their ability to attract and retain tenants.

In contrast, secondary assets (older or lower-quality buildings in less desirable locations) face a longer and more volatile adjustment.

This divergence is reinforced by widening gaps between market pricing and replacement economics. ‘Economic rents’ (the rent required to justify new development) for premium offices have increased by more than 60% between 2020 and 2025, according to CBRE’s Pacific Real Estate Market Outlook. In most markets, economic rents are higher than market rents, driven by higher construction costs, elevated incentives and increased financing costs – therefore increasing the all-in cost of delivering new space and

limiting new projects. The practical consequence is a constrained development pipeline.

CBRE data shows Australia’s CBD office supply over the next five years is projected to fall to roughly one-third of the volume delivered in the prior five-year period, implying a materially tighter development pipeline. Sydney is expected to have no new supply in three of the next five years, while Adelaide, Brisbane, Melbourne and Perth are each projected to have no new supply in four of the next five years under current forecasts.

This supports the medium-term outlook for well-positioned, prime buildings backed by ‘flight to quality’ demand and illustrated by divergence in vacancy rates:

- **Location matters:** The Property Council of Australia reported CBD vacancy at 14.8% in January 2026, versus non-CBD markets much higher at 18.5% (national office vacancy was 15.9%)
- **Quality matters:** JLL data from September 2025 showed overall vacancy for premium-grade buildings much lower than the rest of the market at 11.1%. This compares to 16.6% for secondary-grade buildings.

Recent office investment example: Quality CBD assets in Brisbane and Adelaide

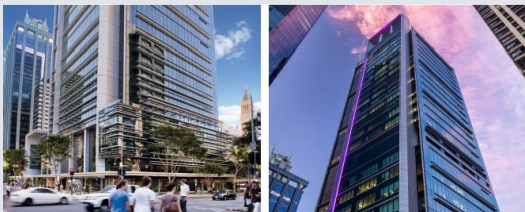
Within office, a recent co-investment opportunity was in two prime-grade CBD office properties in Brisbane and Adelaide, offered to Mutual Trust via one of our trusted investment managers.

The strategy was to invest in these assets at an attractive point in the cycle and grow value over time through rental growth.

Given the age of the properties (average age less than 12 years) and prior capex, there is limited need for a major capex program over the holding period.

The assets are underpinned by premium tenants and a diversified leasing profile. At entry, key metrics included an approximate 35% discount to replacement cost, weighted average lease expiry of ~5 years and occupancy of 99%.

In addition, both assets rate highly on ESG (environmental, social and governance) credentials, supporting both tenant and investor sustainability requirements.



Recent industrial investment example: Infill logistics asset in Western Sydney

Through one of our trusted investment managers, Mutual Trust clients recently invested in a diversified portfolio of assets including an investment in a freestanding warehouse and showroom located in Western Sydney.

The strategy was to acquire a well-located infill industrial asset in a tightly held market with limited land supply, underpinned by secure income and medium-term rental upside. The Fund targets a net IRR of ~12% and distributions of ~5% p.a.



The property was acquired via a sale-and-leaseback, providing an income stream with a weighted average lease expiry of ~4.5 years. At acquisition, the investment reflected a capitalisation rate of ~5.7% offering an attractive entry point relative to comparable Western Sydney assets.

This investment benefits from a strong incumbent tenant, along with a strategic location where industrial supply is constrained and future development activity is concentrated in larger-scale logistics precincts.

We see elevated risks for secondary assets, suburban locations and assets with higher capex needs.

Tenant preferences for buildings in central locations have left suburban markets challenged, while secondary assets face higher vacancy, higher incentives and a tougher leasing task. Refurbishing floor space and amenities and upgrading the sustainability credentials of buildings is becoming essential to attract and retain higher quality tenants. However, capacity to fund these works can be limited in instances where higher vacancy and higher cost of debt have impacted cash flows and stretched loan-to-value ratios

(LVRs), limiting balance sheet capacity.

Industrial – structural drivers underpin outlook, including logistics and data centre demand

The next phase for industrial property is likely to reward a selective approach. Mutual Trust's recent investments have focused on infill assets in major capital cities offering defensive qualities – land scarcity restricts new builds, while demand from last-mile logistics operators remains strong.

The industrial sector has experienced strong growth post-COVID, supported by durable, structural tailwinds. While demand remains solid, tenants are more price-sensitive and selective relative to the previous five-year period.

Gross take-up (total leasing activity, including new leases and renewals) was robust in 2025 as elevated incentives supported new lease transactions. National vacancy is approximately 3.5%, compared to pre-COVID levels above 5%, reinforcing tight market conditions despite a sustained development cycle.

Low vacancy and tighter financial conditions reduce the risk of oversupply. However, risks are elevated for older, lower-spec industrial facilities where deferred maintenance and specification gaps weigh on competitiveness and require higher capex.

Growing e-commerce continues to have an impact on Industrial property.

The structural expansion of online retail continues to support demand for warehousing and distribution space. Australia Post's eCommerce Report notes that online retail sales increased by 14% in 2025, materially outpacing household spending growth of circa 5%. Online retail accounts for approximately 12% to 13% of total retail turnover (ABS estimates). This highlights the ongoing shift in consumer behaviour, supporting a favourable outlook for logistics assets.

Rapid growth of data centres – reshaping industrial property markets

Data Centre operators are increasingly outbidding traditional industrial users for suitably serviced land in Melbourne and Sydney, pushing industrial land values higher and intensifying competition for well-located, infrastructure-ready sites.

Land scarcity and energy availability are emerging as key constraints. While not all industrial land is suitable for data centres, the widening demand imbalance highlights the race for space, driving aggressive land acquisition activity and reshaping market dynamics. As reported in the AFR, global hyperscalers and major local operators have, in some cases, paid material premium versus prevailing industrial benchmarks to secure land with the required attributes.

The expansion of data centres is expected to tighten effective industrial land supply in core markets, with flow-on effects for industrial rents, land use and development feasibility.

Mutual Trust portfolios have exposure across the AI-value chain, including data centres, through various asset classes including commercial property.

Retail – near-term outlook remains constructive but is format and location dependent

Leasing conditions are supportive across key retail formats, with low vacancy and limited new supply underpinning occupancy and rental growth for well-located, well-managed assets. Our preference is for regional and sub-regional sized centres in large cities, and prime large format retail in established corridors. In contrast, risks are elevated for non-core centres with location disadvantages, where leasing activity is weak.

Australia's retail property market delivered returns of 10.6% over the 12-months to March 2026 (MSCI). CBRE's recent retail update indicated rents increased across all tracked categories in the first quarter of 2026. The strongest growth was recorded in CBD assets (~2.2% quarter-on-quarter), reflecting tenant

appetite for higher-performing locations and limited availability.

Development feasibility remains challenged by rising costs, creating barriers to new supply – with the development pipeline skewed towards neighbourhood and large format retail in high population growth corridors, limiting competitive pressure for established regional assets.

Retail occupier demand is being supported by modest growth in real consumption. However, consumer sentiment fell sharply in April, and the higher interest rate backdrop is expected to further weigh on confidence. The latest Westpac-DataX Card Tracker points to a mixed backdrop, with signs of slowing in discretionary categories beginning to emerge, albeit volatile – creating potential headwinds for the sector.

The most compelling opportunities are in well-located assets where strong leasing demand and limited new supply are driving lower vacancy, supporting landlord pricing power and rent growth.

Brick-by-brick – Constructing a direct property allocation

Within our portfolio allocation to direct property, we blend more defensive exposures (such as healthcare assets), with attractive opportunities across office, retail and industrial sectors. Our portfolios are well diversified regionally, with recent investments made in Brisbane, Adelaide and Sydney.

Real assets, such as real estate and infrastructure, play an important role in portfolio construction by preserving purchasing power in a higher inflation environment, supporting income resilience, and lowering portfolio volatility.

When allocating capital towards direct property, Mutual Trust's approach prioritises asset selection over broad asset class allocation – we remain highly selective. This is supported by trusted partnerships we have built over the past decade with specialist investment managers, who have demonstrated expertise in selecting, managing and enhancing the value of direct property investments over the long-term.

Looking ahead, the performance divergence between premium and secondary assets is expected to widen further. Therefore, we are focused on high-quality assets where structural trends (i.e. strong population growth, significant infrastructure investment, and elevated construction costs limiting new supply) should underpin demand for well-located space over the long-term. The Federal Budget 2026-2027 included a further \$2 billion investment in infrastructure enabling new housing supply, potentially supporting demand for industrial and retail assets located in new or expanding residential corridors.

We prefer assets acquired at a discount, often below replacement cost, and those with strong sustainability credentials (or a clear strategy to improve) as an avenue to attract and retain tenants. Income resilience, defined leasing pathways and manageable capital requirements are essential.

Please call or email your Mutual Trust Advisor if you have any questions, or for more details regarding Mutual Trust's direct property approach.



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