Australian Capital View

Knight Frank

May 2026

Geopolitical uncertainty has dampened investor sentiment following a promising start to 2026, though the long-run fundamentals underpinning investment activity remain supportive.

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Key insights

The Middle East conflict has increased uncertainty, tempering investor sentiment and the outlook for 2026 following a promising start. However, looking through the immediate volatility, the long-run fundamentals underpinning investment remain highly supportive.




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RESEARCH & CONSULTING

$7.3b

Investment volume in Q1 2026

Total investment volumes in Q1 2026 fell to $7.3 billion, with volumes seasonally lower in Q1 each year.

75 bps

Change in interest rates

The cash rate has risen by 75 bps in 2026 to 4.35%, with markets pricing in 1-2 further hikes in 2026.

42%

Institutional capital most active

Cross-border investors have been the most active, accounting for 42% of total acquisitions in Q1 2026.

6.7%

National prime office yield

The weighted Australian prime office yield remained stable at 6.7% in Q1 2026.

5.7%

Eastern Seaboard prime industrial yield

The average prime industrial yield across the Eastern Seaboard rose slightly to 5.7% in Q1 2026.

5.6%

National retail yield

The weighted Australian average prime retail yield held steady at 5.6% in Q1 2026.

Property markets to be more resilient to rate rises

A renewed series of interest rate rises is unwelcome news for investors. However, the wider market context is very different to that of 2023-24 and will allow property to be more resilient.

Conflict to exacerbate supply constraints

Meeting feasibility targets was already challenging, and higher oil prices are now feeding through to raise costs further across a range of materials which will further complicate the equation for developers.

Outlook for office rent growth to attract investors

The renewed rate hiking cycle confirms that rental growth will be needed to drive performance in the near term. A tight supply pipeline will add further impetus to prime rents in CBD office markets, but naturally this will play out at different speeds.

Superfunds returning to direct acquisitions

Looking beyond the recent headwinds, an interesting dynamic in capital markets has been the return of superannuation funds to making direct acquisitions, particularly for build-to-rent and affordable housing.

Interest rates rise

CONFLICT RE-IGNITES INFLATIONARY PRESSURES

The Iran conflict has introduced immediate headwinds for both the global and Australian economy. Although business conditions remained solid in March, the forward-looking measure of business confidence fell significantly. This divergence suggests that the economy had healthy momentum going into this shock, and that while it is is too early to see the impact on activity, businesses expect a sharp escalation in cost pressures.

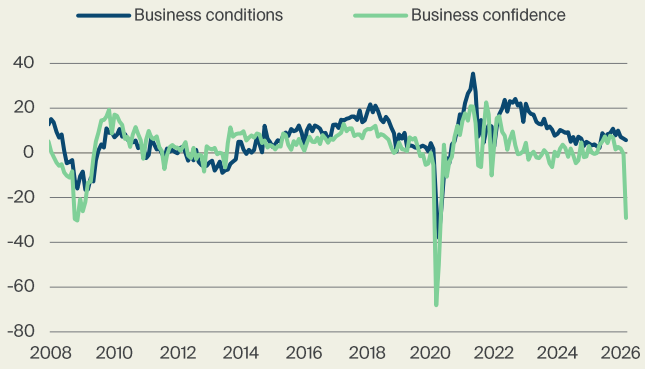
The effective closure of the Strait of Hormuz by Iran has led to a sharp rise in the price of oil, and oil derivatives such as diesel and plastics. This has directly flowed through to a sharp rise in annual headline inflation which rose to 4.0% in Q1, with the trimmed mean rising to 3.5%. The key risk for the RBA is the second-round effects of higher transport and material costs being passed through to other prices, as well as keeping longer-term inflation expectations anchored. There are early signs of this in the construction industry with several suppliers of materials such as pipes, cement, concrete and timber raising prices and citing higher oil and transport costs.

MORE INTEREST RATE HIKES EXPECTED IN 2026

This positive inflation shock comes at a time when inflation was already above the RBA target. As a result, the RBA raised interest rates by 25bps for a third time in May to 4.35% – in line with the recent high in 2024. Market pricing has risen sharply, with one to two more rate hikes priced in during 2026. However, uncertainty remains over the number of hikes expected in 2026 with forecasters holding divergent views.

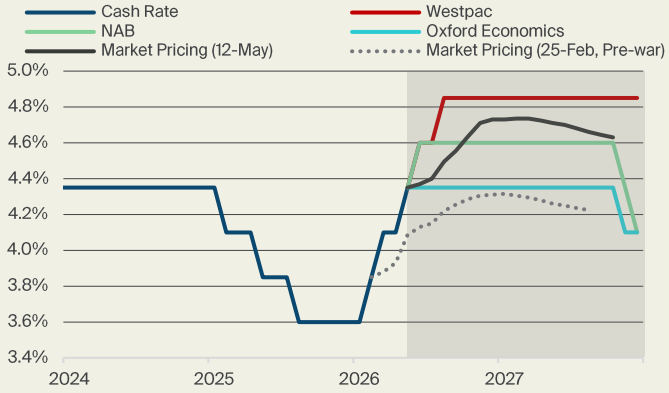
Geopolitical uncertainty has introduced near-term headwinds for the property sector, with inflation concerns and the prospect of further rate increases feeding through to higher borrowing costs. Key measures of long-term rates, including the 5-year swap rate and 10-year bond yield, have crept over 5% — the highest level since 2011 — and remain elevated because of heightened uncertainty over the outlook for inflation and short-term rates. Higher borrowing costs may weigh on transaction activity over the coming months as buyers reassess return hurdles and debt serviceability assumptions.

Conflict lowers business confidence
NAB survey, balance of positive and negative responses



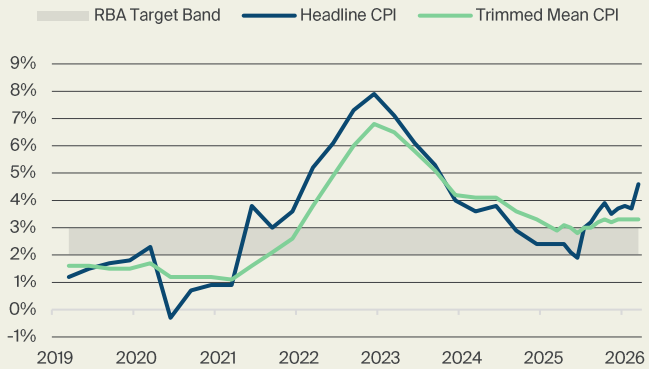
Source: Knight Frank Research, NAB, Macrobond

Uncertainty over path of interest rates
Cash rate - historical, market pricing and forecasts by source (%)



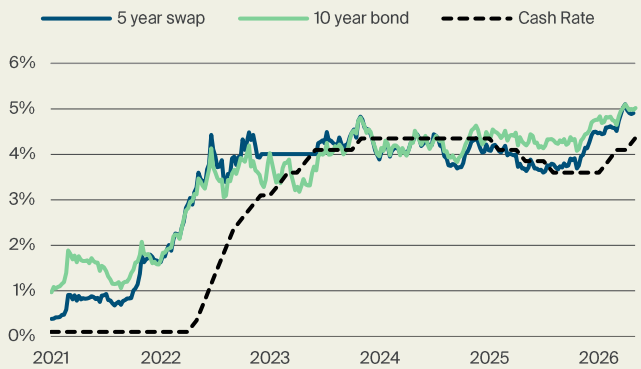
Source: Knight Frank Research, ASX, RBA, NAB, Oxford Economics, Westpac

Inflation remains above the RBA target
Annual growth in headline and trimmed mean inflation (y/y %)



Source: Knight Frank Research, ABS
Note: Data transitions from quarterly to monthly in April 2025.

Australian borrowing costs have risen
Yield by swap duration (%)



Source: Knight Frank Research, Macrobond

Investment activity slows

IRAN CONFLICT WEIGHS ON ACTIVITY IN MARCH

The escalation of the Iran conflict at the end of February proved to be a material inflection point for capital markets activity during the quarter, with robust early deal flow — underpinned by several large retail transactions — giving way to a marked softening through March as geopolitical uncertainty prompted many investors to adopt a cautious, wait-and-see stance. Concerns over a higher interest rate environment and broader macroeconomic headwinds are likely to temper near-term activity, however structural supply constraints across most asset classes continue to underpin a compelling medium-to-long-term investment case.

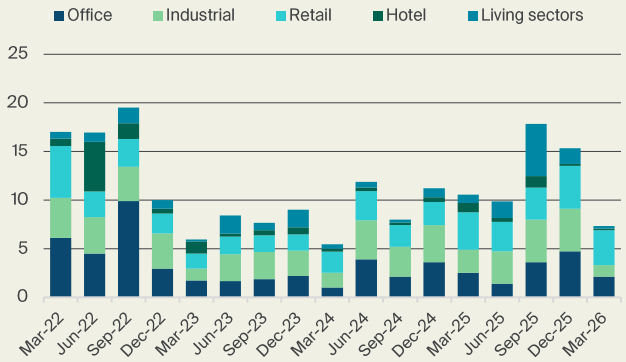
Total closed Australian transaction volumes fell to $7.3 billion in Q1 2026. This fall largely reflects that Q1 is seasonally a weak quarter for transaction activity. The strength of transactions in the retail sector continued with retail ($3.6 billion) the most traded asset class in Q1, followed by office ($2.1 billion), and industrial ($1.2 billion). It is estimated that $2.1 billion of transactions remain under contract for Q1.

SEVERAL SIGNIFICANT TRANSACTIONS IN Q1

Significant transactions in Q1 were concentrated in the retail and office sectors. For retail this included Fawkner Property buying Erina Fair for $895 million from Lendlease and NPS, and Australian Retirement Trust buying a 20% stake in Westfield Sydney for $864 million from Scentre Group. In offices, Investa JV BGO bought 100 Mount St in North Sydney for $558 million from Dexus, a 20% stake in Salesforce tower was bought by OUE REIT from Mitsubishi Estate for $357.2 million, a 50% stake in the O'Connell St Precinct was sold for c$530 million to Charter Hall.

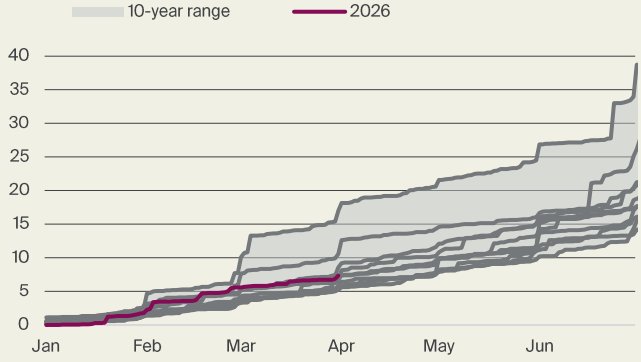
Rolling annual investment volumes in NSW and QLD have maintained an upward trajectory, sustaining levels above their long-term averages and reflecting broadening investor appetite across these markets. Retail and industrial assets saw transaction momentum continue to grow in Q1, with rolling annual volumes remaining above long-term averages in both sectors. The office market, while showing early signs of recovery, continues to lag with activity remaining subdued.

Investment volumes slow
Quarterly investment volumes by sector (AUD billions)



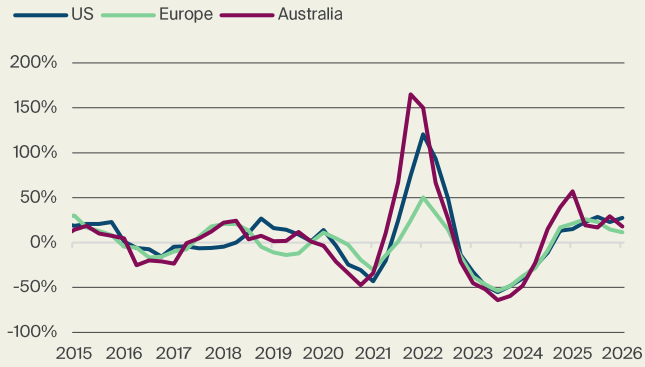
Source: Knight Frank Research, RCA

National cumulative transactions
Daily cumulative transaction volume by year, total (AUD billions)



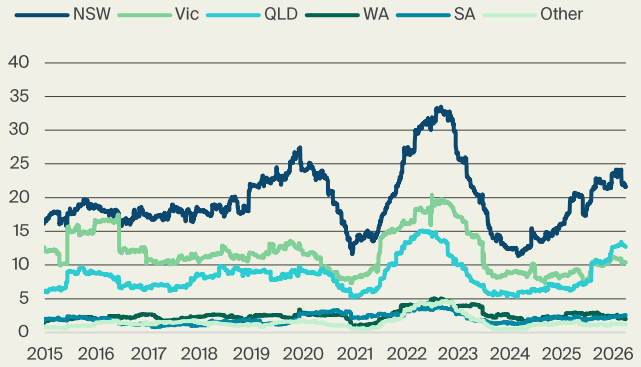
Source: Knight Frank Research, RCA

Global investment volumes robust in Q1
Annual growth in investmnt volumes by region (US billions)



Source: Knight Frank Research, RCA

NSW and QLD drive rise in transaction activity
12-month rolling total transaction volume by sector (AUD billions)



Source: Knight Frank Research, RCA

Institutions lead activity

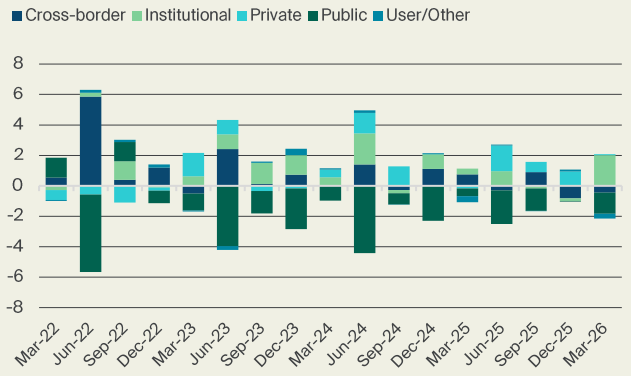
INSTITUTIONAL CAPITAL DRIVES ACTIVITY IN Q1

Institutional capital led purchasing activity in Q1 2026, accounting for $2.6 billion in transactions (42% of total activity), followed by public capital at $1.4 billion (23%), cross-border and private capital at $1.0 billion each (16%), and user/other capital at $0.2 billion. This composition reflects growing institutional confidence in market fundamentals — most notably across the retail and office sectors — underpinning the outlook for medium-term investor returns.

REIT activity, however, faces near-term headwinds, with declining equity valuations driven by a higher-for-longer interest rate outlook that may constrain acquisitions in the coming quarters. As rate expectations stabilise and equity valuations recover, REITs are well-positioned to re-emerge as a more significant source of buying activity across the market. Notably, this has not dampened broader institutional appetite for retail assets — GPT's recent $610 million capital raise for its Wholesale Shopping Centre Fund, which was oversubscribed and attracted an equal split of domestic and offshore capital, is a strong signal of enduring conviction in the sector.

Institutions drive activity

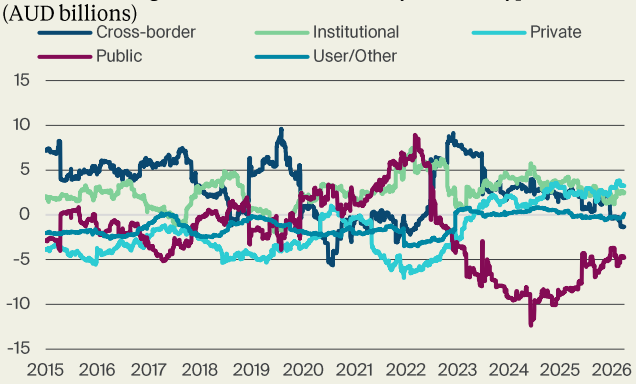
Net investment volumes by investor (AUD billions)



Source: Knight Frank Research, RCA

National annual rolling transaction volume

12-month rolling net transaction volume by investor type (AUD billions)



Source: Knight Frank Research, RCA

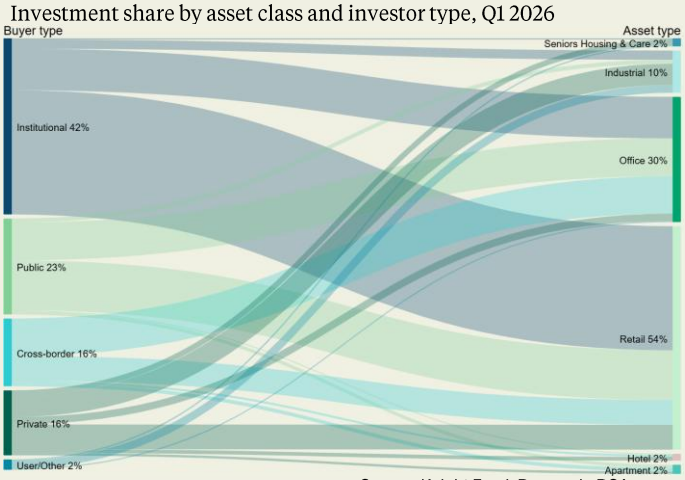
CROSS-BORDER INVESTMENT SOFTENS

Cross-border investment softened to $1.0 billion in Q1 2026, a figure likely understates underlying demand given that Q1 is seasonally the weakest quarter for offshore capital deployment. The quarter's most significant transaction was Taiwan's Forest Endeavour acquiring a portfolio of 10 neighbourhood shopping centres from Woolworths for over $500 million — a deal that also reflects the continued offshore conviction in Australian convenience retail. Cross-border activity was also evident in the office sector, with Singapore's OUE REIT acquiring a 20% stake in Salesforce Tower for $357.2 million and Germany's DWS Group purchasing 32–36 York St for $156.2 million.

Asian capital continues to demonstrate strong and broadening appetite for Australian assets, a trend expected to persist throughout 2026. Australia's relative appeal is underpinned by several structural factors including a stable, transparent investment environment, and an increasingly compelling entry point as domestic property values recover from their cyclical trough.

Cross-border capital deployment is diversified

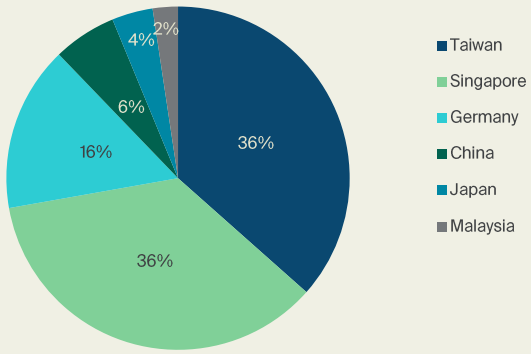
Investment share by asset class and investor type, Q1 2026



Source: Knight Frank Research, RCA

Strong investment from Asia

Proportion of cross-border transaction volume, Q1 2026 (%)



Source: Knight Frank Research, RCA

Yield outlook has shifted

INCREASED UNCERTAINTY OVER YIELDS IN 2026

Industrial yields told a mixed story in Q1, remaining flat in Sydney, Perth and Adelaide while rising in Melbourne and Brisbane for the first time in almost two years, likely reflecting growing uncertainty around the sector's sensitivity to elevated oil prices and supply chain cost pressures stemming from the Iran conflict. Retail yields remained steady at 5.6% in Q1 2026, supported by easing interest rates, improving financing conditions and strong household spending before the conflict. Regional and sub-regional centres have recorded the largest moves in recent quarters as investor confidence returns to these previously out-of-favour segments.

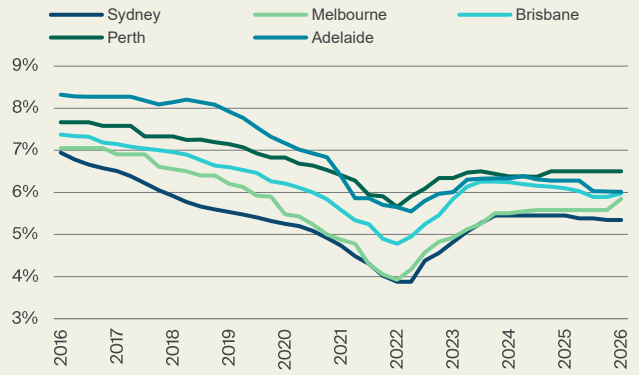
Looking ahead, the shift to a higher interest rate outlook in Q1 may delay the yield compression that was previously expected to occur in 2026. Renewed cost-of-living pressures and business margin squeeze — driven by elevated oil prices and a potential return of inflation — may weigh on both retail and industrial demand for the remainder of the year, while higher borrowing rates could soften demand among investors.

OFFICE MARKET REMAINS DIVERGENT

In the office sector, average prime CBD yields were largely unchanged across most markets in Q1 2026, confirming that core asset values have largely stabilised. The outlook for higher interest rates following the conflict in the Middle East has increased uncertainty and will likely see investors take a wait-and-see approach in the medium term. Yields for best-in-class assets in core CBD locations are expected to remain well supported through this period of uncertainty. However, yields in less favourable precincts and in suburban areas may face some upward pressure as higher rates encourage a more cautious approach among investors.

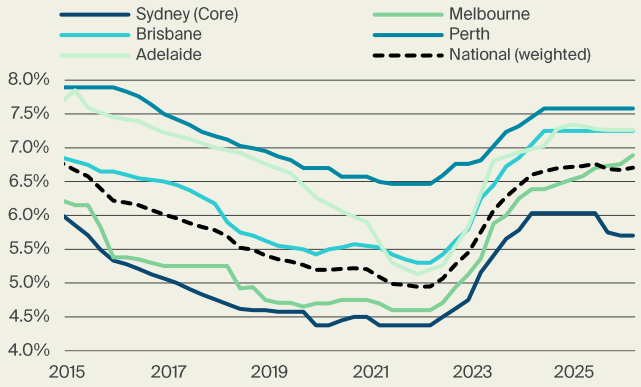
Occupier demand remains heavily weighted towards the best CBD precincts, including the Core in Sydney CBD and the East in Melbourne CBD. These precincts have significantly outperformed the rest-of-CBD precincts with 14.3% and 16.1% net effective rent growth over the past year, respectively. This has created a large gap between rents in core precincts and other locations, with core rents 54% higher in Sydney and 93% higher in Melbourne.

Industrial prime yields
Average prime industrial yield, 5,000 sqm assets & 5 yr WALE (%)



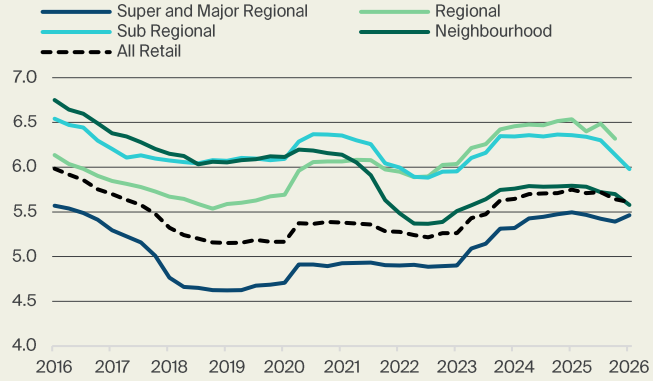
Source: Knight Frank Research

Prime office yields mostly steady in Q1
Prime office yields by CBD (%)



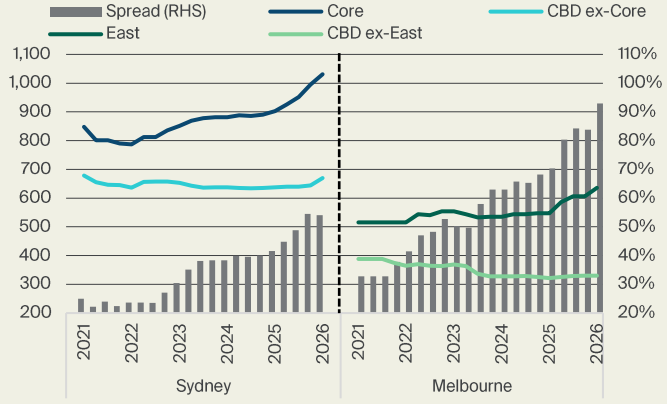
Source: Knight Frank Research

Retail yields fall in Q1
Yields by retail type (%)



Source: Knight Frank Research, MSCI

Core precinct rents continue to pull away
Average CBD net effective rents by precinct ($/sqm) and spread (%)



Source: Knight Frank Research

Market outlook

New challenges for property markets, but investor demand still solid

RENEWED RATE RISES, BUT A VERY DIFFERENT SITUATION TO 2023

A renewed series of interest rate rises is unwelcome news for investors, with the experience of rate rises in 2022-23 still fresh in the memory. However, the wider market context is very different and will allow property to be more resilient this time around.

Firstly, valuations are at a different level having already adjusted to the higher rate environment. A recovery was commencing throughout 2025, but had yet to gather pace and broaden beyond core locations, so pricing is less vulnerable than at that time. Secondly, occupier markets are generally looking far healthier, particularly in the office and retail sectors.

CONFLICT TO RAISE ECONOMIC RENTS AND EXACERBATE SUPPLY CONSTRAINTS

Occupier markets are looking healthier in large part because of diminishing new supply. Office markets in particular are starting to see the benefit of a constrained supply pipeline, as evidenced by strong prime rental growth in the Brisbane, Sydney and Adelaide CBDs.

Meeting feasibility targets was already challenging, and higher oil prices are now feeding through to raise costs further across a range of materials, including PVC piping, concrete and glass, which will further complicate the equation for developers.

Our modelling indicates that a 10% rise in construction costs for a new premium office tower increases the required economic rent by around 5%. For industrial sites, a 10% rise in total construction costs for a new prime industrial development increases economic rents by around 4%.

BUDGET TAX CHANGES INCREASE ATTRACTIVENESS OF COMMERCIAL PROPERTY

In the Government's 2026-27 Budget, it announced a change to Australia's Capital Gains Tax (CGT). This change will likely encourage more private investors to invest in commercial property because of their higher yields compared to residential property. Commercial investment returns are typically driven to a much greater extent by income returns rather than capital growth, and the new method for calculating CGT liability favours this type of investment over other investments offering lower income but the potential for higher capital growth. Commercial investments also remain eligible for negative gearing, although this tends to be less commonly used.

INVESTOR DEMAND FOR PRIME OFFICES STILL SOLID DUE TO OUTLOOK FOR FURTHER RENT GROWTH

The renewed rate hiking cycle confirms that rental growth will be needed to drive performance in the near term. As noted above, the likelihood of a constrained supply pipeline will add further impetus to prime rents in CBD office markets, although naturally this will play out at different speeds.

Higher funding costs and global uncertainty may impact trading activity in coming months, but there is still significant demand for quality assets given improving prospects for rental uplift. We expect that most investors will continue with their plans to deploy capital, rather than step back from the office market as we saw in 2023.

RISKS TO THE RETAIL RECOVERY AS DISCRETIONARY SPENDING SLOWS

Retail saw a stronger recovery in 2025, recording the strongest average total return among the sectors at 9.9% over the year to Q1 2026. However, recent developments present a clear headwind for the sector. The key transmission channel runs from energy prices through to inflation, higher interest rates, lower real incomes and ultimately weaker household consumption.

The extent to which spending will slow remains to be seen, but the impact will be to put renewed pressure on retailer margins, particularly for discretionary categories, and by extension, rental income.

SUPER FUNDS RETURNING TO DIRECT ACQUISITIONS

Looking beyond the recent headwinds, an interesting dynamic in capital markets has been the return of superannuation funds to making direct acquisitions. In recent years, most major funds have been circumspect, preferring to maintain rather than expand their holdings during 2022-24 and making relatively few large-scale acquisitions during this time.

However, over the past 12 months, many funds have opted to deploy capital directly, acquiring large assets across all sectors. Living sectors have been a favoured target, with Australian Super, HESTA, Australian Retirement Trust and Aware Super all making significant acquisitions which demonstrate the funds desire to grow their holdings of build-to-rent and affordable housing. This has also helped to demonstrate liquidity for large schemes, offering an exit to the domestic developers and offshore groups who commenced the development process.

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