Market Outlook 2025

MaxCap Group Research – December 2024

The year ahead

More interesting times ahead. Market conditions are still challenging, as multiple wars rage on abroad, and global trade conflicts heat up rapidly. Australia and New Zealand remain islands of relative stability, as local growth firms, inflation fades, and asset values bounce in 2025.

Scope for more stimulus. While rate cuts have started in New Zealand, Australia is very late to the stimulus party. Dashed expectations for 2024 rate cuts have delayed this recovery. We see modest rate cuts in 2025 as the catalyst for a firmer upswing ahead.

Capital choices. Investors are still voting with their feet, pushing further into private credit, to enhance portfolio returns and diversification. Meanwhile, a private equity real estate turning point is unfolding, as more investors return with greater confidence, looking for value.

Credit holds strong. Despite modest rate cuts ahead, we are still in a prime window for commercial real estate debt. The outlook is well supported by persistent housing undersupply, the improving construction outlook and an enviable blend of risk-adjusted returns.

Equity into recovery. Meanwhile commercial real estate markets are moving into a more durable cyclical turning point, even ahead of meaningful declines in borrowing costs. The pace of recovery will likely differ across markets, driving a clear need for astute sector selection.

Key themes for 2025. We expect a firmer upswing to take hold in 2025. Investors need to prepare for this upswing with the right strategies and the right sector exposures. In a world with more capital than opportunities, disciplined deployment will be the key to success.

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A new set of challenges

The global **economic backdrop** still looks challenging for investors in 2025, albeit for slightly different reasons compared to prior years.

- **What is persisting** is the patchy outlook for growth and geo-politics. Wars continue to rage on in Europe and the Middle East. Deglobalisation is driving the world into more fractured blocs that is impeding the cross-border flows of people, goods and capital.
- **What is changing** is the rapid escalation of trade tensions – between China, the US and the rest of the world – that looks set to sharply lift tariff barriers, reduce commerce and push up tradeable inflation. The global growth outlook is now weaker and more volatile than before.

Australia and New Zealand present good opportunities in **stable markets**, far removed from global troubled hotspots, but there are local nuances.

- **Population growth** is starting to slow, which means the big boom for housing demand is winding back a little, although we are still tracking to a sizeable undersupply of housing for several years to come.
- **Lower rates** are set to drive the next cyclical upswing. While the timing varies – sooner in New Zealand and later in Australia – lower rates are expected to accelerate the cyclical recovery from 2025.
- The **commercial cycle** is finally turning. Already, there are some initial signs of pricing recovery across all sectors, as investors finally see better prospects for tenancy demand and value at today's cap rate.

In a challenging world, there are still **growing regions**, **rising sectors** and **resilient strategies** that continues to deliver on returns for investors.

"MaxCap is very well positioned for the year ahead, with a robust institutional platform progressively enhanced over 18 years. Across the cycle, we are there alongside our borrowers, and we are there delivering strongly for our investors."

Wayne Lasky Executive Chairman

The concerns of yesteryear are fading, particularly the risks of higher rates and lower values. However, geo-political and trade risks are rising, while other fundamentals drivers remain supportive.

2024: Survive 'til 2025

- **High rates, with risks of more hikes**
- **A massive population boom**
- **An urgent shortage of housing**
- **Ongoing price falls in office and retail**
- **The big pivot to private credit**

2025: Restart your engines

- **Heading towards Goldilocks rates**
- **Moderating population growth**
- **A persistent housing shortage**
- **Commercial values turning higher**
- **More investor choices on the menu**

Source: MaxCap Group (December 2024)

The next wave of capital

Capital markets are set to strengthen in 2025, as investors become more confident about deployment and look to adjust their portfolios to this rapidly-changing market landscape.

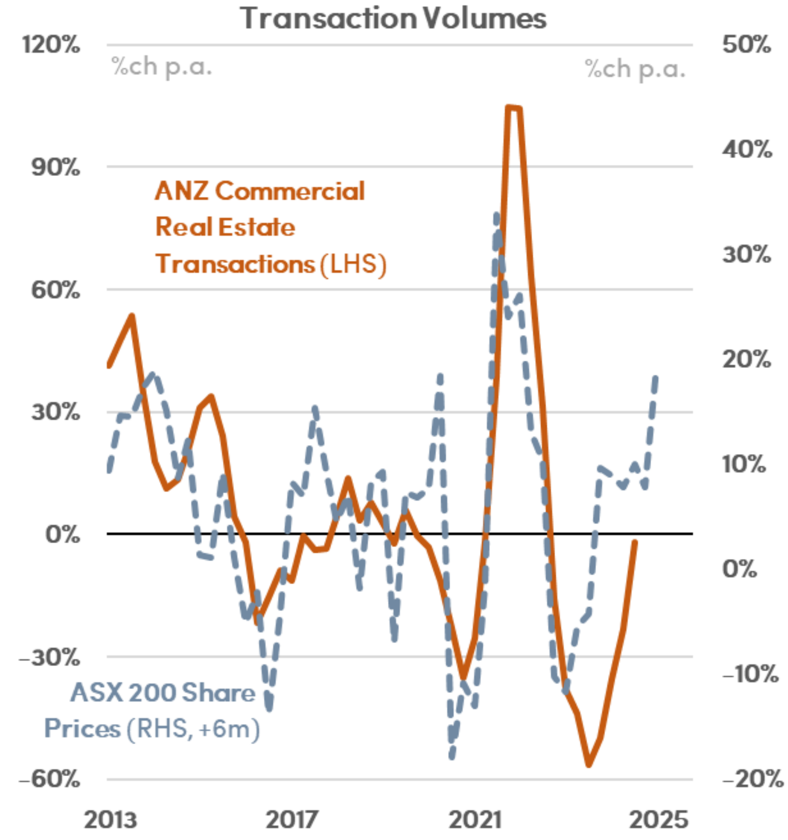
- Perhaps the best gauge of sentiment can be seen with **global equity markets**, where lower offshore rates are driving stronger local share prices. The gains in equities are consistent with a broader turnaround in real estate deal volumes, which is set to grow again in early 2025.
- The nascent recovery in **commercial asset values** is a key factor behind the turning point in investor sentiment. Less concerned about catching a falling knife (or falling values), potential buyers are shifting from fear to greed, and from loss aversion to a search for profits.
- The push into **private markets** are still reshaping allocations. More investors are realising that public markets carry risks unrelated to real estate assets, but more linked to banks and credit cycles. Mostly, investors are moving to private markets for better risk-adjusted returns.
- Australia and New Zealand are still **prime targets** for cross-border capital, as the list of global investible markets shortens further. In a world with more fractured lines of geo-political division, these markets are still highly transparent, very accessible and open for business.

In 2025, we expect more capital in the financial system, particularly into private markets. In this context, **manager selection** becomes more vital, as we expect a widening performance gap between under-resourced novice managers, and more established and experienced managers, who are able to deliver resilient returns even in difficult markets.

"With more sophisticated capital flows into private markets, disciplined deployment is now a top investor priority. The key to success is to find a best-in-class partner, with a deep high-quality pipeline and a strong long-term track record."

Robert Hattersley Group Head of Capital

The broadening recovery in equity markets adds greatly to investor confidence (and reduce the denominator constraint in portfolios). Real estate deal flows are set to recover from here.



Source: Real Capital Analytics, MSCI, MaxCap Group (December 2024)

A resilient performer

For several years, we have seen **a golden age** for private credit unfold in this part of the world, particularly for commercial real estate debt.

- **Elevated interest rates** have provided a boon for commercial real estate debt investors, as lenders pivoted from fixed- to floating-rate facilities. As other asset classes faltered with higher rates, private credit offered investors a good safe haven, with strong resilient returns.
- This **robust performance** in Australian commercial real estate debt has not been repeated in many other markets. Similar credit strategies have not fared as well abroad, given deeper asset price corrections and more market distress in parts of North America, Europe and Asia.

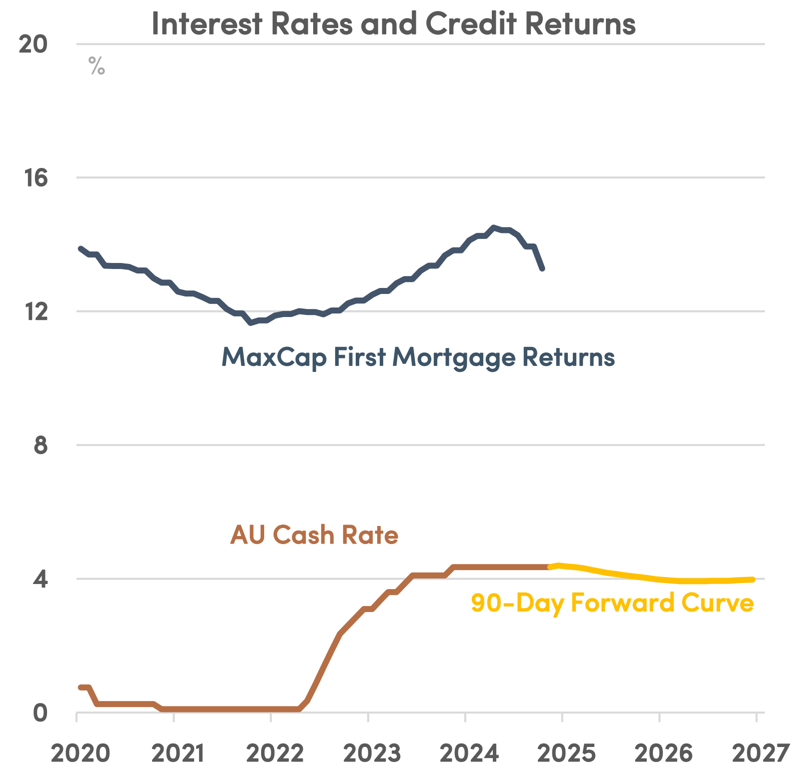
With an outlook of firmer growth, lower rates and more capital inflows into this segment, **is this market performance sustainable** in 2025?

- Certainly, there is **more capital** competing for deals. Increasingly, we are seeing new start-ups looking to write their first deal or managers branching out into private credit for the first time, all without the skillset or support needed to appropriately price a deal or manage the risks.
- In this market, **deep origination capacity** is vital. With a deeper transaction pipeline, established managers can afford to be more selective on deals, pricing, sectors and sponsors, which allow them to be far more patient and disciplined on deployment.
- **Lower interest rates** ahead are less of a concern, as more lenders implement rate floors into their loans. At the same time, lower rates will also spur on more borrowers and more activity as feasibility improves.

"With more capital chasing deals in private credit, origination capacity becomes absolutely vital. For this reason, we run big sourcing teams to build deep pipelines, so that we can be selective on sponsors and price loans according to their risks."

Bill McWilliams *Chief Investment Officer*

Australian commercial real estate debt has delivered consistent returns over a very long timeframe, through multiple economic cycles, and periods of low and high interest rates.



Source: Bloomberg, MaxCap Group (December 2024)
Past returns are not a guarantee of future performance.
Gross returns are reported before fees.

A better vintage

The equity side of **commercial real estate** has seen challenging times in recent years, not so much with the pandemic and lockdown, but more so with higher interest rates.

- Certainly, we are starting to see **a cyclical turning point** in commercial real estate markets taking hold in late 2024, partly with the end of the rate tightening cycle in early 2024 and partly with the expected start of the rate easing cycle in mid 2025.
- At the same time, we are starting to see **shifts in structural demand**. The work-from-home phenomenon is unwinding, with diminishing drag to office demand. Similarly, the shift to online shopping is slowing, as online and in-store sales growth start to converge more consistently.
- Meanwhile, there is still considerable momentum behind the **living and logistics** sector. Robust population growth continues to outpace housing construction, driving persistent undersupply. Logistics demand remains firm, spurred on by the need for faster distribution networks.

Altogether, we are looking at **a stronger set of market conditions** for real estate equity strategies in 2025 and beyond.

- With asset prices lifting again, we are past the trough of the cycle. And judging from prior market cycles in Australia, 2025 is shaping up to be **a much better vintage** for commercial real estate investors.
- Meanwhile, equity investors have **more options** on the table, given a broadening cyclical turnaround. Certainly, we continue to expect living sectors to run ahead of other sectors, with office trailing in its recovery.

"It is the right time to be moving from defence, back into offence. Whilst our core focus remains in the living and logistics sectors, we are seeing more opportunities to generate strong yields from dislocations in alternative sectors."

Simon Hulett Head of Direct Investment

With each downturn, slower demand drives weaker returns (seen as the red patches). What follows are better vintages with firmer demand and stronger returns (shown here as the green patches).

Annualised Returns for Commercial Real Estate: Australia

Entry year	1Y	2Y	3Y	4Y	5Y	Entry year	1Y	2Y	3Y	4Y	5Y
1985	15					2005	14	13	12	11	11
1986	18	16				2006	19	16	15	13	13
1987	23	20	19			2007	17	18	17	15	14
1988	24	24	22	20		2008	0	8	12	12	12
1989	12	18	20	19	18	2009	-2	-1	5	8	9
1990	0	6	12	14	15	2010	9	3	2	6	8
1991	-8	-4	1	6	9	2011	10	10	6	4	7
1992	-4	-6	-4	0	4	2012	9	10	10	6	5
1993	2	-1	-3	-3	0	2013	9	9	10	9	7
1994	11	6	3	0	0	2014	10	10	10	10	10
1995	7	9	7	4	1	2015	14	12	11	11	11
1996	8	7	9	7	5	2016	12	13	12	11	11
1997	9	9	8	9	7	2017	12	12	13	12	11
1998	9	9	9	8	9	2018	10	11	11	12	12
1999	8	9	9	9	8	2019	7	9	10	10	11
2000	10	9	9	9	9	2020	1	4	6	7	8
2001	9	9	9	9	9	2021	12	6	7	7	8
2002	9	9	9	9	9	2022	7	9	6	7	7
2003	10	9	9	9	9	2023	-3	2	5	4	5
2004	11	10	10	10	10	2024	-3	-3	0	3	3

Source: MSCI, MaxCap Group (December 2024)
Past returns are not a guarantee of future performance.

Tips for navigating 2025

Prepare for a cyclical restart

In 2025, we expect to see a small step down in rates, but a big step up in sentiment, which should support the economy as it lifts from its nadir. This is your typical cyclical restart.

In real estate, private credit remains in good shape, while private equity is expected to see a firmer recovery ahead, as asset prices start to lift again. This is the right time to reset your portfolio, reassess your equity strategies and affirm your sector selection.

Sector selection is still king

As with prior years, we continue to see a persistent performance gap across sectors, even if the gap is narrowing a little in 2025.

In our view, living sectors are expected to maintain the lead, supported by more supply-side policy changes to encourage homebuilding. Commercial real estate sectors are coming back into frame, likely with industrial and retail slightly ahead and suburban office trailing behind this cycle.

Be disciplined in deployment

As rates fall and equities become expensive, we expect more capital to hit private markets. In a volatile, fragmented global economy, we expect more capital allocated to our shores.

The challenge in 2025 is not capital, but deployment. Finding the right manager, with the right skillset, a deep pipeline and a long track record, is the key to success. A hasty push to deploy at lower margins is a sure-fire way to realise higher risks and lower returns.

Sources: MaxCap Group (December 2024)

Additional Information

Senior Lender of the Year, Asia Pacific | MaxCap Group | Private Debt Investor AWARDS 2023

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