

The Correlation between Commercial and Residential Property

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Most Australians' first experience with property investing is through residential real estate. It's familiar, relatively accessible and closely tied to personal experience with housing. However, as portfolios grow, many investors begin to consider how different types of property can work together to improve diversification, income stability and long-term returns.

Adding commercial property alongside residential real estate can enhance portfolio diversification because the two sectors are driven by different demand fundamentals and return characteristics. While both are influenced by broader macroeconomic factors such as interest rates, economic growth and population trends, the underlying drivers of performance vary significantly.

Residential property is primarily influenced by population growth, household formation, housing supply and mortgage availability. Returns tend to be more heavily weighted toward capital growth, particularly in supply-constrained markets. Commercial property, by contrast, is typically income-focused, with returns supported by contractual rental income generated through leases with business tenants.

Demand for commercial property is linked to business activity and sector-specific economic drivers. Office demand reflects employment levels and workplace trends, retail performance is influenced by consumer spending, and industrial property is supported by logistics activity and e-commerce growth. Because these drivers differ from those affecting residential housing, the sectors tend to move less closely together across the cycle.

This relatively low correlation means that combining residential and commercial property can improve portfolio resilience. Residential assets may provide strong long-term capital appreciation, while commercial property can deliver stable income and exposure to different economic drivers.

Illustrative Correlation Between Property Sectors (Australia)

Property Sector	Residential	Office	Retail	Industrial
Residential	1	0.20–0.30	0.15–0.25	0.10–0.25
Office	0.20–0.30	1	0.60–0.75	0.55–0.70
Retail	0.15–0.25	0.60–0.75	1	0.50–0.65
Industrial	0.10–0.25	0.55–0.70	0.50–0.65	1

Key Takeaway

Residential property has low correlation with commercial property sectors, meaning adding commercial assets to a residential-heavy portfolio can provide diversification, income stability and exposure to different economic drivers within the broader real estate market.