Sydney CBD economic rents reach their peak

Q4 2025

Estimates of the economic rent for a premium office tower in Sydney CBD are significantly above current and forecast rent levels. This indicates the severe constraints on development feasibility, which are leading to a drought of new office supply over the coming years.

Click here to subscribe

Key insights

Economic rents have surged since 2021 as a mix of rising costs and market pressures put the brakes on new office development. The resulting supply drought will be a defining feature that will shape the Sydney CBD office market for years to come.

ALISTAIR READ
SENIOR ECONOMIST, RESEARCH & CONSULTING

$2,130

Current economic rent

Economic rents are estimated to be at $2,130/sqm. This is the rent required on construction completion in Q3 2028 to make a new premium office tower feasible in Sydney CBD.

$1,690

Current forecast rent

Forecast rents are estimated at $1,690/sqm. This is the forecast premium Sydney CBD rent expected on construction completion in Q3 2028 if rents grow at 3% per annum.

26%

Gap between economic and forecast rent

Current economic rents are 26% above forecast rents if construction commenced in Q3 2025.

Economic rents have risen sharply

Current Sydney CBD economic rents for a new premium office tower are estimated at $2,130/sqm (net face rent), an 89% increase since Q1 2021. This is the rent required in Q3 2028 for viable development.

Economic rents are above forecast rents

Economic rents are estimated to be 26% above the forecast level of rent upon development completion – assuming construction starts in Q3 2025.

Several factors driving higher development costs

Elevated economic rents are being driven by a combination of higher construction costs, elevated interest rates, a softening in yields (and the resulting fall in asset valuations) and increased incentives.

Development pipeline has thinned out

The development pipeline has thinned out as developers find it difficult to meet feasibility criteria. There is no new supply under construction that is expected to be complete beyond 2027.

Economic rents are forecast to fall

Yields are forecast to continue to compress throughout 2026 and 2027, driving a fall in economic rents. Economic rents are expected to fall to $1,900/sqm in late 2026 and remain stable in 2027.

Development forecast to be viable in 2028

Economic rents are projected to fall below forecast rents in 2028 – meaning that new developments will be feasible. This implies that a new premium office tower would not complete construction until 2031.

Economic rents have surged

A STEEP RISE SINCE 2021

Economic rents – the level of rent at which the construction of a new development becomes feasible – have risen sharply since 2021 due to a significant rise in construction costs, interest rates, yields, and incentives.

In Q3 2025, for a new premium office tower in Sydney CBD – starting construction this quarter with a three-year construction period – we estimate that the economic rent required upon completion is $2,130/sqm (net face rent). That is, a developer would need to receive an average rent of $2,130/sqm across the building in the first year of leases (starting in Q3 2028) for the development to be deemed feasible – defined as the owner receiving a 10% project IRR.

In modelling economic rents, we assume that premium Sydney CBD office yields remain steady throughout the construction period at their current level. The completed building is assumed to sell at 25bps below the current average yield for premium assets in the core (5.25%) to reflect a new building premium (see page 5 for more detail on the methodology).

ECONOMIC RENTS NOW WELL ABOVE FORECAST RENTS

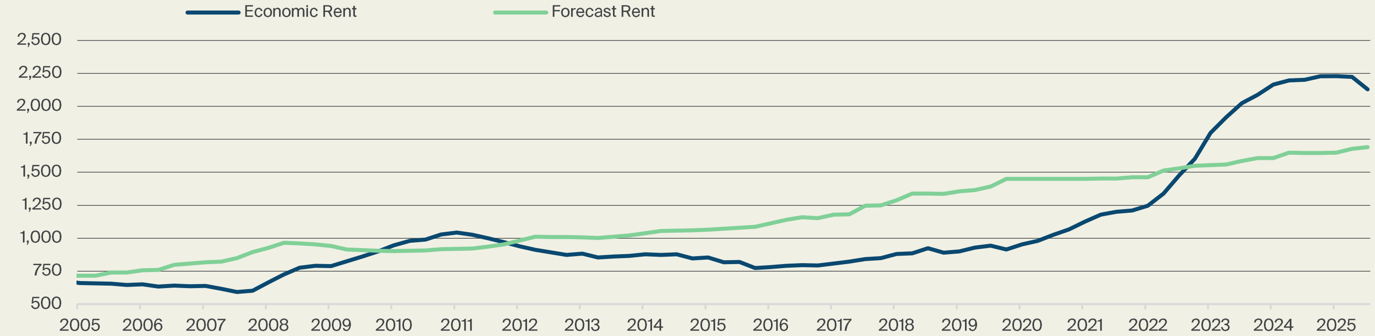
Economic rent growth in Sydney's CBD has far outpaced premium office rent growth in recent years. Since Q1 2021, economic rents have surged by 89%, compared to just 17% for premium rents. As of Q3 2025, the average premium office rent stood at $1,547/sqm. Looking ahead, a forecast that assumes 3% annual growth has premium rents reaching $1,690/sqm by development completion in Q3 2028, well below the economic rent required for viability.

This implies that both current and forecast premium rents are well below our estimated economic rents. In Q3 2025, economic rents were 26% higher than the forecast rent upon completion and 38% above current premium rents.

This historically wide gap between economic and forecast rents underscores the challenge of achieving financial feasibility for new office developments in the current market environment. As a result, the pipeline for new office supply in the CBD has diminished substantially, with very few developments expected to proceed until the gap narrows later this decade.

Sydney CBD economic rent rises sharply

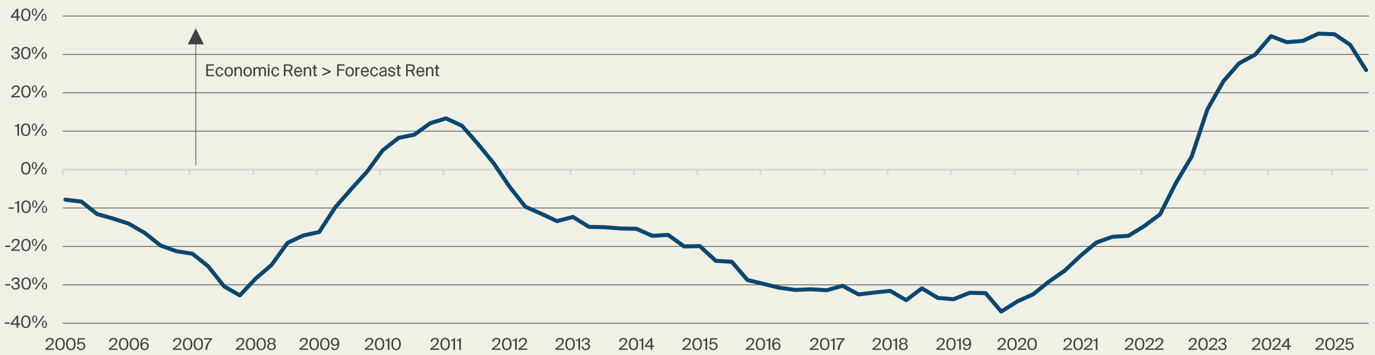
Estimate of economic rent required at project completion for a Sydney CBD premium development versus forecast rent [current market rent plus 3% p.a. growth over 3 years] ($/sqm, net face rent)



Source: Knight Frank Research

Economic rent is well above forecast rent

Difference between economic and forecast rent (%, economic rent divided by forecast rent)



Source: Knight Frank Research

Drivers of high economic rents

HIGHER CONSTRUCTION PRICES INCREASE COSTS

Since 2021, Australia has seen a sharp increase in construction costs, driven by a combination of global and domestic supply-side pressures. Construction costs for a new premium tower in Sydney have risen by 50% from $6,587/sqm (gross floor area) in Q1 2021 to $9,877/sqm in Q3 2025. The rise in costs has occurred across both materials and labour costs. Some material prices rising by over 70% since Q1 2021, and the wages of construction workers have risen by 17% over the same period. Since construction is one of the largest costs of development, this has been a significant factor limiting new development feasibility.

HIGHER YIELDS REDUCE CAPITAL VALUES

Yields – through their impact on capital values – are a crucial factor in determining the feasibility of new development, with lower yields driving up completed project values and higher yields reducing values.

Yields rose substantially during 2022-24 as higher interest rates and funding costs reduced investor appetite, with average Sydney CBD prime office yields rising from 4.4% in 2021 to 6.00% in 2024. Yields have started to edge downward as the market recovers, but remain around 140 bps above their levels in Q1 2021.

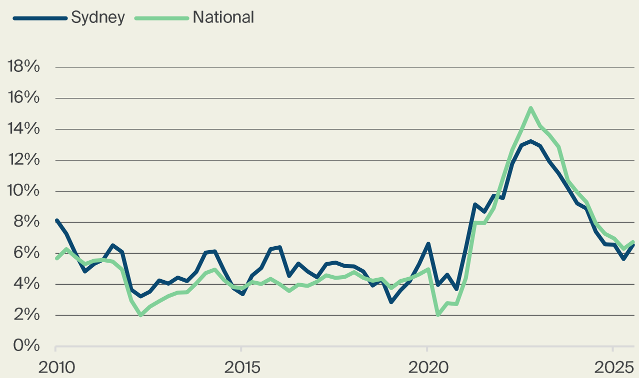
INTEREST RATES RISE TO CONTROL INFLATION, RAISING BORROWING COSTS

Starting in 2022, the Reserve Bank of Australia (RBA) implemented the largest and fastest interest rate increases in decades to rein in inflation as the economy emerged from the pandemic. From Q1 2021 to Q4 2023, the cash rate rose by 425 bps and 2-year swap rates rose by 380 bps, significantly lifting funding costs for owners/developers. For new office tower projects, higher borrowing costs have raised hurdle rates and tightened feasibility. Interest rates have since fallen, but they remain elevated compared to the cash rate over the last decade.

SUBDUED LEASING DEMAND HAS WEIGHED ON RENTAL GROWTH AND INCREASED INCENTIVES

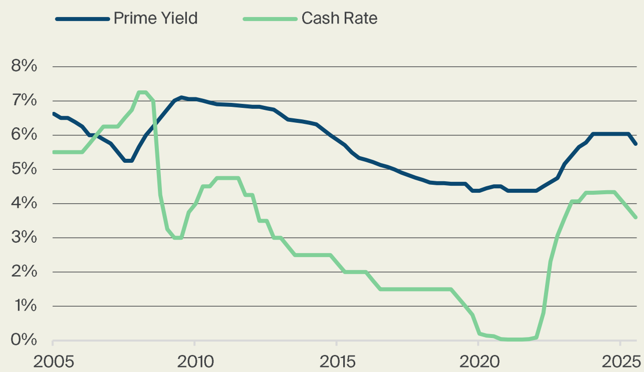
Since 2020, landlords defended face rents by lifting incentives, which became the main lever to secure tenants. Rising construction costs also pushed tenants to favour landlord-funded fit-outs through incentives rather than paying upfront. Prime incentives have doubled from 18% (gross) in Q2 2019 to 36% in Q3 2025, weighing heavily on net effective rents. Net effective rents have barely moved, increasing just 3.0% (0.5% p.a.) since Q1 2021 and remain 14% below their 2019 peak.

Sharp rise in construction costs
Annual growth in the building cost index (%)



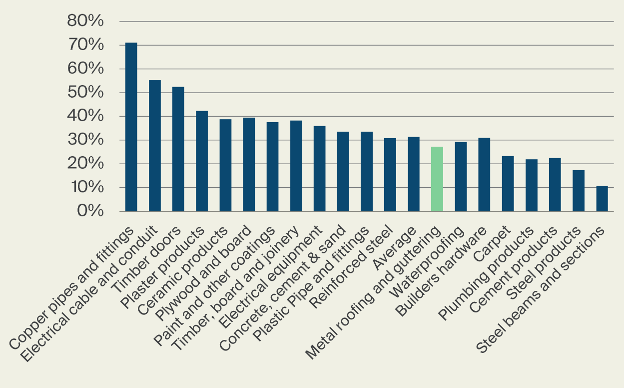
Source: Knight Frank Research, Rawlinsons

Sharp increase in yields and interest rates
Sydney CBD prime yield and RBA cash rate (%)



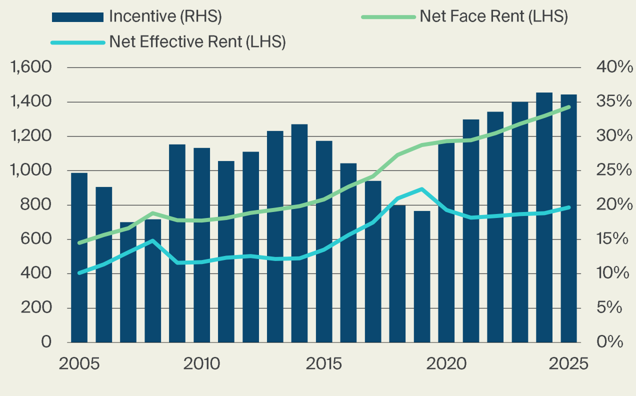
Source: Knight Frank Research, RBA

Construction material costs rapidly escalate
Inflation in construction costs, Q1 2021 - Q3 2025 (% y/y)



Source: Knight Frank Research, ABS

Sydney CBD rents weighed down by incentives
Sydney CBD prime office rents ($/sqm) and incentives (%, gross)



Source: Knight Frank Research

Estimating economic rents

METHODOLOGY

Economic rent is defined as the level of rent at which the construction of a new development allows the developer to receive a 10% IRR at each point in time, accounting for the variation in a multitude of factors including construction costs. This estimate uses a discounted cash flow (DCF) model for building a new premium office tower to solve for the economic rent required. The model uses a 10-year cashflow, augmented so that the current period is the start of year four. The model assumes that the developer:

- Purchased a site three years ago (a secondary building) and has received rental income during that period.
- Has received all approvals required to commence the construction of their proposed building.
- Decides that they will pull the trigger and commence construction in the current period.
- Takes three years to construct the new premium office tower (50,000 sqm NLA).
- Has the building 92% leased upon completion (based on average leasing rates for new premium assets completed in recent years)
- Holds the building for four years, then sells the whole building at 97% occupancy (also based on recent leasing data for new premium buildings).

The model assumes that future market conditions will be the same as current conditions, meaning that we hold market yields, incentives and interest rates constant from commencement to completion. The building sells at a 25bps premium to the current premium yield reflecting its status as a new asset. Net face rents are forecast to grow at 3% p.a. The model allows for other costs including stamp duty, land tax, leasing agent fees, sale agent fees, and professional fees.

INTERPRETATION OF ECONOMIC AND FORECAST RENTS

The **economic rent** ($/sqm, net face rent) at each period is an estimate of the rent that the building owner needs to receive when the building is completed for the project to be viable – defined as the owner receiving a 10% IRR . This rent level refers to the average rent needed across the whole building in the first-year leases which start in three years time.

The **forecast rent** ($/sqm, net face rent) at each period is the rent level that an owner can expect to receive upon completion if they assume that the current market rent grows at 3% p.a. over the construction period.

The economic rent estimates are intended to reflect an average across the market and will not accurately reflect the circumstances of each office development. Individual project viability will ultimately depend on many different factors. For example, projects where the land was acquired at low rates many years ago (compared to three years ago as assumed in the model) are likely to be closer to meeting the feasibility criteria than these estimates suggest.

FORECASTING ECONOMIC RENTS

To generate forecast economic rents, we append Knight Frank's forecasts to the historical office rent series – for example, projected net face rent growth of 5.5% p.a. to 2030. This expanded dataset is then run through the same 10-year DCF model used for the back-history, with unchanged inputs assumptions such as 3% p.a. rent growth during the construction period. The result is a consistent estimate of future economic rent and forecast market rents.

Model Assumptions

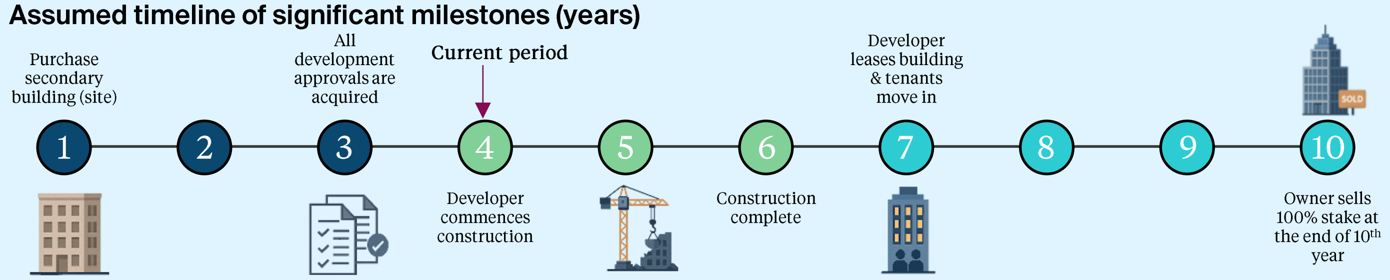
Variable	Assumption
Premium NFR rent growth (during both construction and during the hold period)	3.0% p.a.
Construction cost (Q1 2025)	$9,500/sqm (GFA)
Construction cost growth	3.0% p.a.
Project cost funded by debt	60%
IRR target (project/unlevered)	10%
CPI growth	2.5% p.a.
Lease term (for calculating incentive payment)	5 years
Difference between new office tower yield and average premium office yield	-0.25%
Occupancy rate on completion	92%
Occupancy rate when asset is sold	97%

Assumptions to forecast economic rent outlook

Variable	Assumption
Premium NFR rent growth* (average over forecast period)	5.5% p.a.
Outgoings	2.5% p.a.
Construction cost growth	4.0% p.a.
CPI growth	2.5% p.a.
Premium incentive*	-2.2%
Interest rate on construction loan*	-0.6%
Premium and secondary yield*	-0.5%

*(Q3-25 to Q4-30)

Assumed timeline of significant milestones (years)



Supply pipeline has thinned out

OFFICE SUPPLY PIPELINE WILL REMAIN CONSTRAINED

With economic rents well above forecast levels, the development pipeline has thinned, as many wait on the sidelines for conditions to improve. We are now seeing this clearly with new Sydney CBD office supply forecast to average around 52,000 sqm per year over the next five years – almost a third of the average seen over the past decade. Importantly, there are no new schemes currently under construction which will be complete beyond 2027.

The current level of supply additions over the next 3 years as a percentage of total stock at its lowest level on record (1.6%) and is forecast to trend towards zero if no schemes progress for 2028 and 2029.

There are only three buildings currently under construction, all scheduled to complete in 2027. Charter Hall is well underway with its Chifley South (42,000sqm) premium development, which has approximately 50% commitment and with strong tenant enquiry. Meanwhile, Mirvac and Mitsui Fudosan are developing 55 Pitt Street (63,000sqm) and have already achieved over a 40% commitment rate. In the Southern precinct, the Dexus developed Atlassian Central (58,000sqm) is on track for completion by 2027.

HALO TOWER EXPECTED TO BE THE NEXT DEVELOPMENT TO COMMENCE CONSTRUCTION

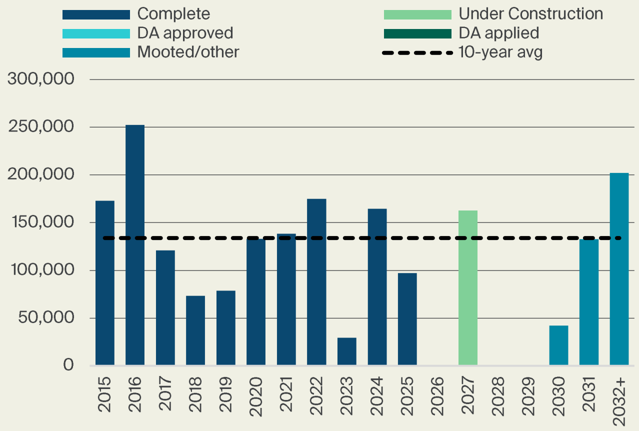
The next new construction premium office tower that is expected to commence construction in the Sydney CBD is the Halo Tower (42,000 sqm). It is expected that construction may begin in late 2026, with completion in 2030.

The Halo tower will likely be a relatively unique tower, with smaller floor plates compared to many other premium developments. As a result, it is more likely to look towards smaller tenants and suite fit-outs. Combined with the favourable location in the core, there is expected to be strong demand and rents for this asset. This increases the likelihood of meeting feasibility criteria and lowers the leasing risk profile compared to other potential developments in the supply pipeline with large floorplates and less favoured locations.

After the Halo Tower, we expect that the next developments will be the Hunter East Tower and Hunter West Tower, driven by the development of the new Sydney Metro West line under these sites. This extended drought of new supply for the next five years is likely to reshape the Sydney CBD office market for years to come.

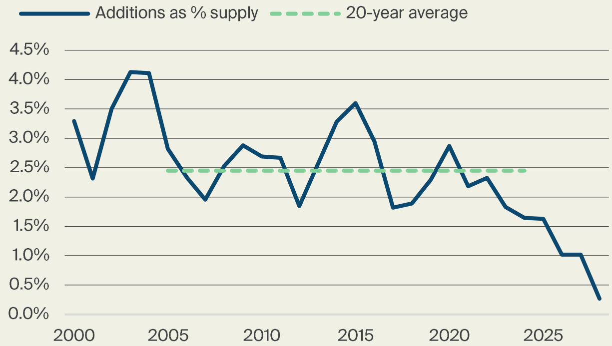
Sydney CBD development completions

Sydney CBD development pipoeline by development status (sqm)



Supply continues to trend down

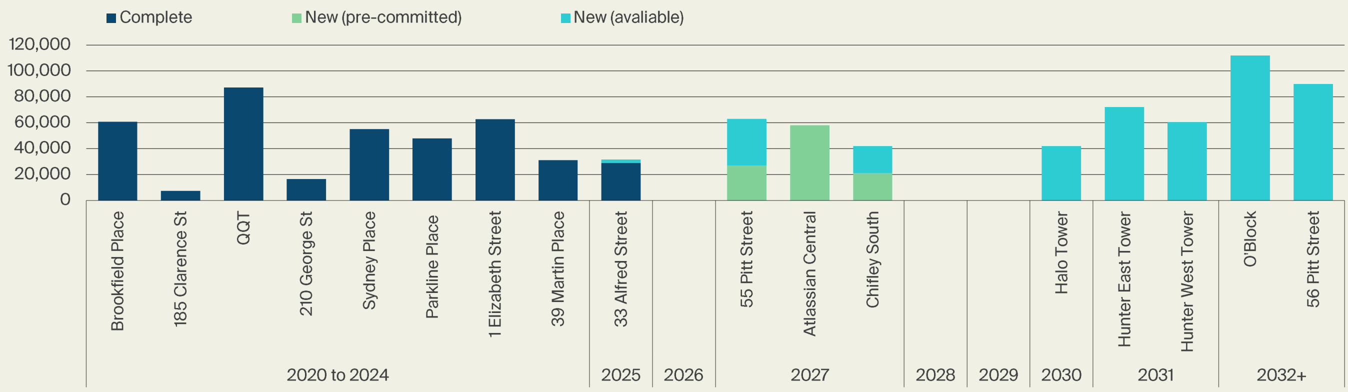
Sydney CBD supply as % of office stock, 3-year forward rolling average (%)



Source: Knight Frank Research, PCA

Sydney CBD premium office development pipeline

New premium office space by completion status and precommitment level (sqm)



Source: Knight Frank Research

Low supply will drive the market

LIMITED SUPPLY WILL UNDERPIN STRONGER RENT PERFORMANCE

Dwindling new supply will drive an acceleration in rental growth, although this will proceed at different speeds. In the first instance, rent agreed on a pre-commitment basis for the new towers coming through will start to rise. The growing scarcity of new product will then drive improvements in occupancy and rental performance for existing premium & A-grade assets, starting in core locations and then extending to adjacent precincts.

This significant supply–demand imbalance is likely to drive the leasing market for new premium-grade stock over the coming years. Only 57,000 sqm – or 1% of total market stock – of new premium space is available for lease until 2027. With no other developments slated for delivery in 2028 and 2029 at this stage, the supply pipeline is approaching historically low levels.

Tenant mobility will likely slow as occupiers opt to renew existing leases rather than absorb the cost and disruption of moving. This stickiness will anchor demand in existing premium stock, and as the supply shortage begins to bite, bargaining power will shift decisively towards landlords. In this environment, leasing incentives are also likely to compress as tenants lose leverage and owners become more confident in holding firm on terms.

Net effective rents for Sydney CBD premium offices are forecast to grow at an average rate of 6.6% p.a. from Q4 2025 to Q4 2030. This is well-above the 10-year average to Q3 2025 of 4.1% p.a.

DEVELOPERS WILL FOCUS ON SYDNEY CBD CORE

To stand the best chance of proceeding, prospective developments will need to be in core CBD locations where rents are higher, and yields are tighter. Suburban markets and CBD precincts such as southern CBD are likely to face a longer hiatus of new supply given lower prevailing rents and higher yields.

OWNERS MAY LOOK TOWARDS REFURBISHING EXISTING SPACE

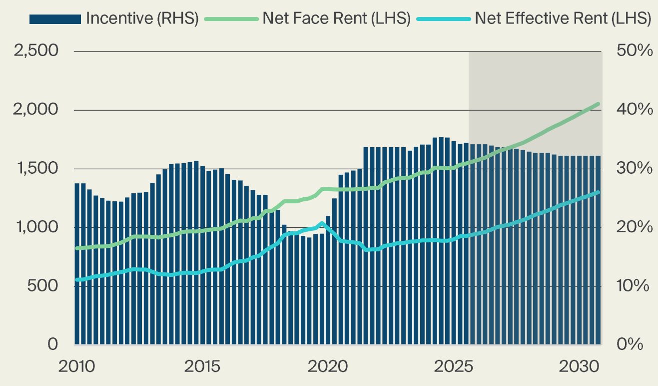
Developers may look at alternative paths to provide new-look options for tenants at the top end of the market, including comprehensive refurbishments which economise on overall project cost compared to entirely new developments.

SHIFT IN INVESTOR FOCUS TOWARDS STABILISED ASSETS

Investors that have traditionally sought to deploy capital via development will find this challenging in the current environment. As a result, we expect many to shift their focus to acquiring stabilised assets and core-plus investments requiring less costly CAPEX.

Rents forecast to rise while incentive fall

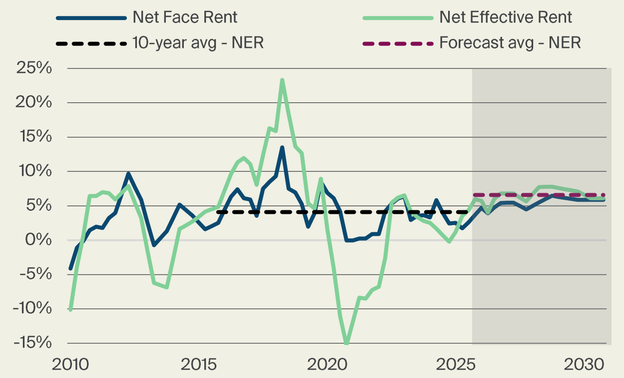
Premium office rents and incentives (gross) in Sydney CBD (%)



Source: Knight Frank Research

Rent growth forecast to be above average

Annual growth in premium office rents in Sydney CBD (%)



Source: Knight Frank Research

Outlook for economic rents

ECONOMIC RENTS HAVE LIKELY PEAKED

After years of upward pressure, Sydney CBD economic rents now appear to have peaked – at $2,230/sqm in Q1 2025 – and are set to ease through 2026. They fell in both Q2 and Q3 2025 – the first back-to-back declines since late 2012. The sharp Q3 drop was driven largely by a 25 bp tightening in core Sydney CBD yields. It's an encouraging shift that points to improving feasibility, but the gap remains wide.

THE GAP WILL NARROW AS YIELDS EDGE INWARD AND FORECAST RENTS RISE

Over the next few years, economic rents are expected to fall further to around $1,900/sqm in late 2026 before stabilising. The sharp decline modelled through 2026 to 2028 largely reflects how changing yields impact both sides of the feasibility equation: forecast yield compression raises the expected sale value of a new asset, meanwhile rising yields three years ago (in 2023 and 2024) lower the capital values of secondary assets and reduce site acquisition costs. Together, both factors work to drive economic rents down.

At the same time, market rents are forecast to rise as the supply of premium office space tightens, driving increased rent growth. Premium net face rents are forecast to rise by 5.4% in 2026 and 4.5% in 2027, closing the gap to economic rents.

NEW DEVELOPMENT PROJECTED TO BE VIABLE IN 2028, IMPLYING COMPLETION IN 2031

Economic rents are projected to remain above forecast rents – indicating it is not feasible to commence construction on a new development – until 2028. Given the assumed three-year construction period, this projection implies new premium office towers may not be completed in the Sydney CBD until 2031. This is broadly in line with the forecast pipeline for new supply in Sydney CBD.

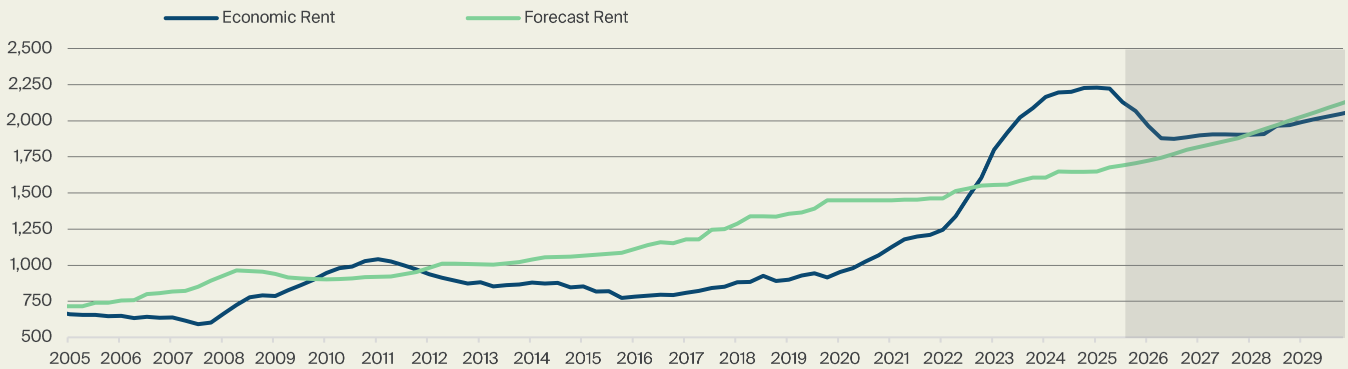
FALLING ECONOMIC RENTS ARE DEPENDENT ON YIELD COMPRESSION

This downward trajectory, however, hinges on yield compression materialising. It is the single most important driver of the projected fall in economic rents; lower yields increase the exit value of a project and reduce the level of rent growth required for viability. The forecast assumes yields for both premium and secondary assets fall by a cumulative 75 bps by Q1 2028 – 50 bps from today's levels following the 25 bps tightening already seen in Q3 2025.

If yields compress more slowly, or by a smaller amount, the gap between economic rents and achievable market rents will persist for longer, delaying the point at which new development becomes feasible. And without meaningful yield compression, that gap remains elevated for years, continuing to constrain the supply pipeline.

Yield compression to drive fall in economic rent

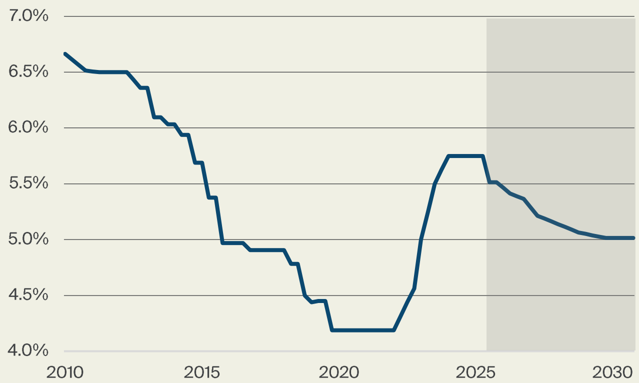
Estimate of economic rent required at project completion for a Sydney CBD premium development versus forecast rent [current market rent plus 3% p.a. growth over 3 years] ($/sqm, net face rent)



Source: Knight Frank Research

Yields are forecast to fall

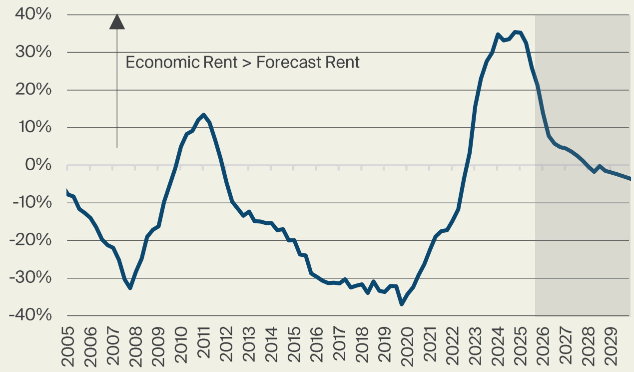
Premium office yield in Sydney CBD core (%)



Source: Knight Frank Research

New development projected to be feasible in 2028

Difference between economic and forecast rent (%, economic rent divided by forecast rent)



Source: Knight Frank Research

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

You can also click here to subscribe to our research.

Research & Consulting
Alistair Read
+61 450 831 899
Alistair.Read@au.knightfrank.com

Research & Consulting
Ben Burston
+61 452 661 682
Ben.Burston@au.knightfrank.com

Capital Markets
Michael Kwok
+61 2 9036 6620
Michael.Kwok@au.knightfrank.com

Office Leasing
Andrea Roberts
+61 410 628 024
Andrea.Roberts@au.knightfrank.com

Occupier Services
Katherine Moss
+61 2 9036 6647
Katherine.Moss@au.knightfrank.com

Valuations
James Marks
+61 422 520 110
James.Marks@au.knightfrank.com

Institutional Sales
Rob Sewell
+61 2 9036 6847
Rob.Sewell@au.knightfrank.com

Recent Research

Australian Horizon Report 2026

Sydney CBD Office State of the Market Q3 2025

Australian Office Indicators Q3 2025

Australian Capital View Q3 2025

Dwindling new supply to drive rents

Is now the time to develop?

Knight Frank