

# Melbourne CBD - economic rent to moderate supply



Q1 2026

Estimates of the economic rent for a premium office tower in Melbourne CBD are significantly above current and forecast rental levels. This indicates a constraint on development feasibility which will lead to continued office supply restraint over the coming years.

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# Key insights

The development pipeline is slowing markedly, in part due to a surge in economic rents. Higher construction costs and other market movements are making most new developments unfeasible at the present time; but this sets the scene for future strong rental growth.



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## \$1,348

Economic rent in Q4 2025

Economic rents are estimated to be at \$1,348/sqm. This is the rent required in Q4 2028 to make a new premium office tower feasible to commence now in Melbourne CBD.

## \$951

Forecast rent in Q4 2025

Forecast rents are estimated at \$951/sqm. This is the forecast premium Melbourne CBD rent expected in Q4 2028 if rents grow at 4% per annum.

## 42%

Gap between economic and forecast rent

Difference between economic rent and the forecast rent if construction commenced in Q4 2025.

## Economic rents have risen sharply

Melbourne CBD economic rents for a new premium office tower are estimated at \$1,348/sqm (net face rent) in Q4 2025, a 135% increase since Q1 2021.

## Economic rents are above forecast rents

Economic rents are estimated to be 42% above the forecast level of rent upon development completion – assuming construction starts in Q4 2025.

## Multiple 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. Post-2026 there is a greatly diminished supply pipeline for Melbourne.

## Development delivery not viable until near 2031

Economic rents are projected to be relatively close to forecast rents in Q3 2029. If realised, this implies further new developments would not be delivered until at least Q4 2033.

## Viability different in key precincts and projects

Due to bifurcation in the Melbourne CBD market certain precincts (especially the Eastern Core) become viable much quicker. Certain projects will still see the numbers add up.

# Economic rents have risen

## ECONOMIC RENTS HAVE RISEN SHARPLY

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 Q4 2025, for a new premium office tower in Melbourne CBD – starting construction this quarter with a three-year construction period – we estimate that the economic rent required upon completion is \$1,348/sqm (net face rent). That is, the developer needs to receive an average rent of \$1,348/sqm across the building in the first year of leases (starting in Q4 2028) for the development to be deemed feasible – defined as the owner receiving a 10% projected IRR.

Economic rental growth in Melbourne’s CBD has far outpaced premium office rental growth in recent years. Since Q1 2021, economic rents have surged by 135%, compared to just 16% for premium rents. As of Q4 2025, the average premium office rent stood at \$845/sqm. Looking ahead, using a forecast that assumes 4% annual growth, this has premium rents reaching \$951/sqm by development completion in Q4 2028.

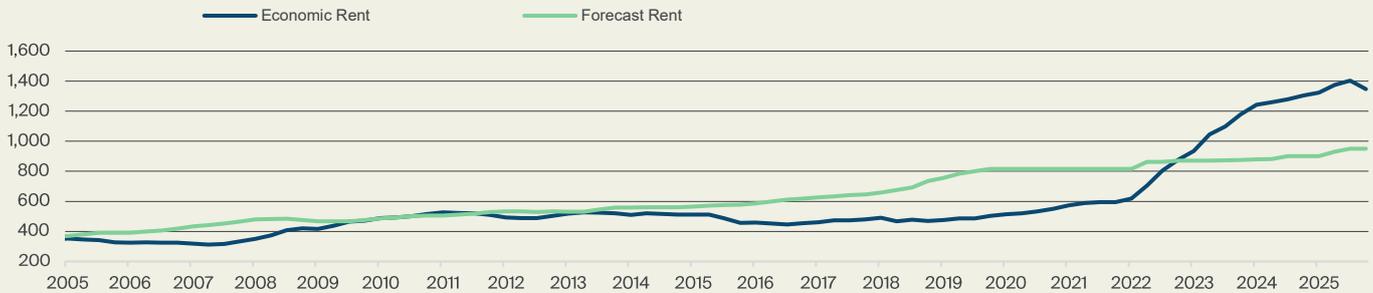
## ECONOMIC RENTS ARE ABOVE FORECAST RENTS

Both current and forecast premium rents remain well below economic rent levels. In Q4 2025, economic rents were 42% higher than the estimated rent at development completion and 60% 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 thinned out with several projects that had previously stated start dates being deferred or moved to mooted after failing to meet feasibility criteria. There is little committed new supply beyond 2028. This extended drought of new supply is likely to reshape the Melbourne CBD office market for years to come.

### Melbourne CBD economic rent has risen sharply

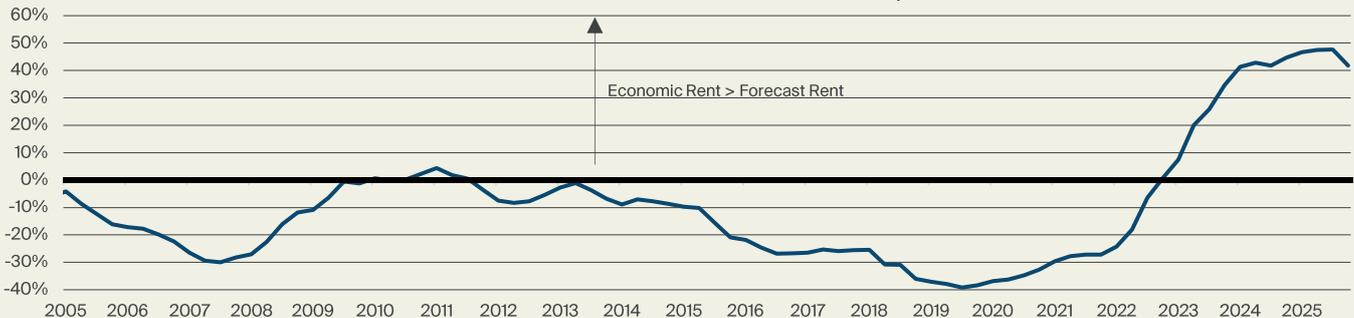
Estimate of economic rent required at project completion for a Melbourne CBD premium development versus forecast rent [current market rent plus 4% p.a. growth over 3 years] (\$/sqm, net face rent)



Source: Knight Frank Research

### Economic rent is well above forecast rent

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



Source: Knight Frank Research

# Supply pipeline has fallen

## 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 Melbourne CBD office supply forecast to average around 56,400sqm per year over the next five years just 42% of the average seen over the last twenty years. Of this new supply, 57% is being delivered in 2026, namely the premium builds of 435 Bourke St (60,000 sqm) and 51 Flinders Ln (29,000 sqm) together with 7 Spencer St (44,000 sqm) and the refurbishment of 720 Bourke St (27,000 sqm).

## LIMITED NEW SUPPLY POST 2026

Post 2026 there is very little expected to be delivered, and only one premium building projected to be completed and that is not until 2029-30 (600 Collins St offering 60,000 sqm). This can be seen as due to a combination of effects. The two main factors are the rising vacancy rate (currently 19% in the CBD) which provides uncertainty concerning getting buildings occupied, The consequence of this is a rise in incentives and a stalling in some precincts of rental growth.

This has been combined with higher construction costs. Add to that the raised interest rates, increasing the cost of debt

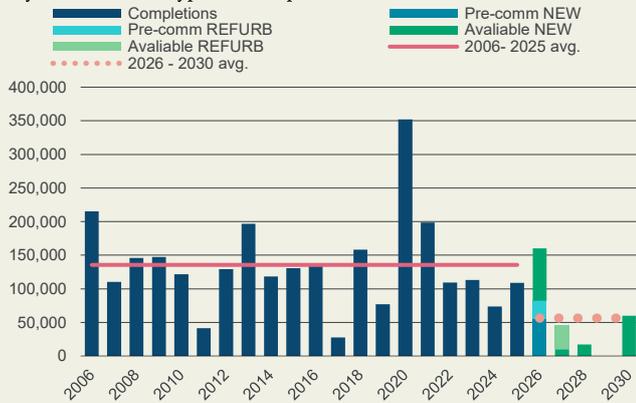
and it is no wonder that developers have stepped away from committing to new builds or major refurbishments going forward. This is precisely the pricing conundrum that the economic rents are highlighting.

## NEW SUPPLY TO BE SQUEEZED WELL INTO THE EARLY 2030'S

The impact this is going to have on the Melbourne CBD is stark. We are expecting to see a prolonged squeeze on new supply going well into the early 2030's. New supply is going to fall to below 1% of actual stock and remain there well into the 2030's. This compares to the average increase in stock of 3% over the previous 20 years. Supply is not expected to be turned back on again until the numbers clearly add up. Developers will remain cautious about breaking ground on projects whilst the numeric remains this stark.

### Melbourne CBD development completions

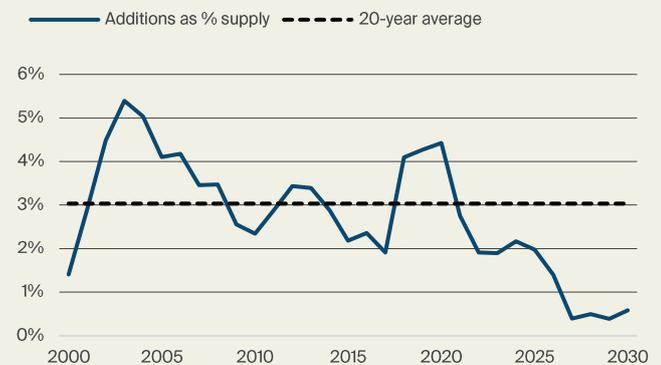
By commitment type 000's sqm



Source: Knight Frank Research, PCA

### Supply squeeze will be felt into the 2030's

Melbourne CBD supply as % of office stock, 3-yr forward rolling



Source: Knight Frank Research, PCA

### Melbourne CBD premium office development pipeline

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



Source: Knight Frank Research

# But not all developments are equal

## ECONOMIC RENTS HAVE LIKELY PEAKED

After years of upward pressure, Melbourne CBD economic rents are now likely to have peaked, having already fallen back in Q4 2025. However, they remain over 40% higher than our forecast rents. We are forecasting economic rents to now consistently fall through to 2029. 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 \$1,200 in late 2028 before stabilising. The shape 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, 2024 and 2025) lower the capital values of secondary assets and so 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 rental growth. Premium net face rents are forecast to rise by 3.4% in 2026 and 3.7% in 2027 before accelerating from 2028 with limited new supply, closing the gap on economic rents.

## GENERIC NEW DEVELOPMENTS EXPECTED TO BE ON HOLD UNTIL EARLY 2030S

Economic rents are projected to remain above forecast rents – indicating it is not feasible to commence construction on a new development – until Q3 2030. However, it will be well into 2031 before the positive gap is a more comfortable >5%.

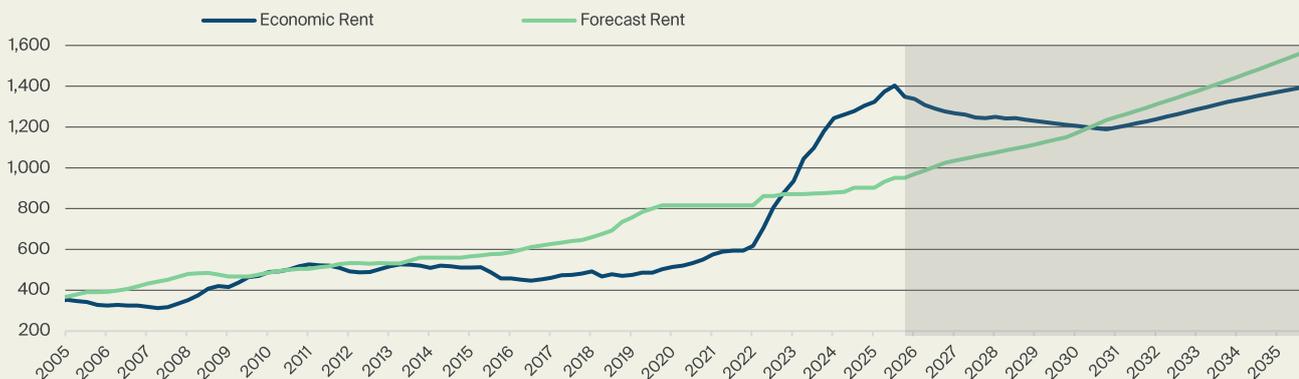
## NOT ALL PRECINCTS AND PROJECTS ARE CREATED EQUAL

Melbourne's bifurcation is both well known and rather extreme, with average Eastern Core net face rents 34% higher than the average CBD. Consequently, whilst the CBD is missing the cut by over 40%, the Eastern core is within spitting distance, if a suitable site can be found. Conversely, the North Eastern precinct needs rents over 100% higher than forecast at present to commence development, with Flagstaff even further out. This highlights the fact that certain developments may become move viable earlier, whilst others have a long wait.

High value projects in choice locations, projects where historic site costs are cheaper or already a sunken cost to the developer will all stack up earlier. For those projects, commencement will be viable much earlier in this latest development cycle.

### Melbourne CBD economic and forecast rent going forward

Estimate of economic rent required at project completion for a Melbourne CBD premium development versus forecast rent [current market rent plus 4% p.a. growth over 3 years] (\$/sqm, net face rent)



Source: Knight Frank Research

### Economic rent is well above forecast rents

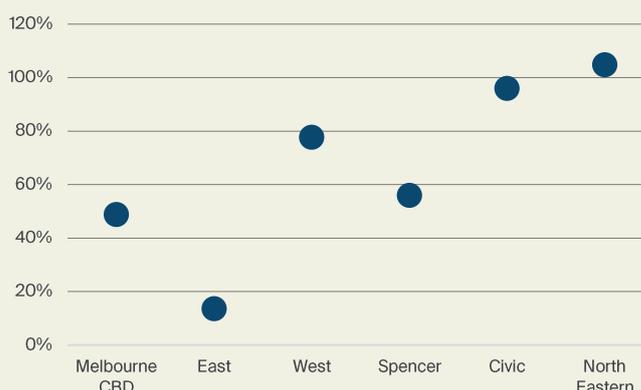
Difference between forecast and economic rent (%)



Source: Knight Frank Research

### But not all precincts are equal

Difference between forecast and economic rent (%) as at Q4 2025



Source: Knight Frank Research

# Methodology

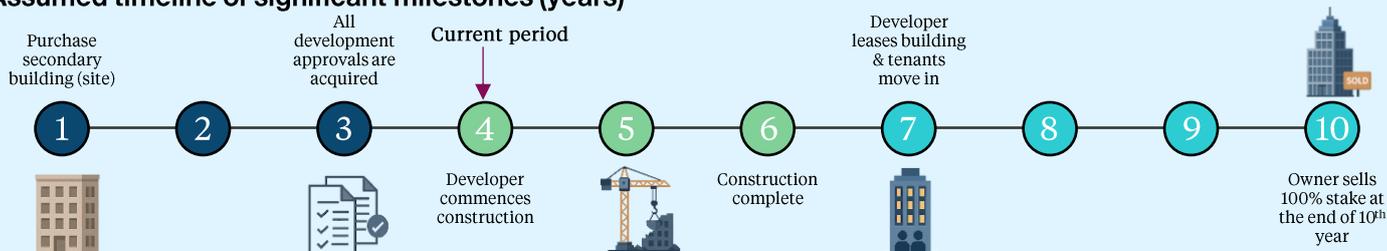
## METHODOLOGY

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 constructing a new premium office tower. The model uses a 10-year cashflow that is augmented so that the current period is three years into the cash flow period. The model assumes that the owner/developer:

- Has purchased a secondary office building three years ago and received rental income during that period.
- During the past three years owner/developer has received all approvals required to commence the construction of their proposed building.
- In the current period, owner/developer decides that they will pull the trigger and commence construction.
- Assuming they pull the trigger and commence construction today, demolishing the secondary building and constructing the new premium office tower (50,000 sqm NLA) takes three years.
- The owner/developer has the building mostly (92%) leased on completion, holds the building for four years, then sells the whole building.

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 model also includes numerous other costs including stamp duty, land tax, leasing agent fees, sale agent fees, and professional fees.

### Assumed timeline of significant milestones (years)



### Model Assumptions

Variable	Assumption
Premium NFR rent growth (during both construction and during the hold period)	4.0% p.a.
Construction cost (Q1 2025)	\$7,000/sqm
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)	7 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	100%

## 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 from the tenant 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 4% p.a. over the construction period.

The economic rent estimates represent an average across the Melbourne CBD and do 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 a decade ago (compared to three years ago as assumed in the model) are likely to be closer to meeting the feasibility criteria than these economic rent estimates suggest.

### FORECASTING ECONOMIC RENTS

To forecast the future path of economic rents, we extend the historical office data using Knight Frank's forecasts. The same 10-year DCF model used on the historical estimates is then used to forecast the future level of economic and forecast rents.

### Assumptions to forecast economic rent outlook

The below assumptions are used to forecast economic rents. These forecasts broadly align with Knight Frank's Melbourne CBD office forecasts.

Variable	Assumption
Premium NFR rent growth (average over forecast period)	4.5% p.a.
Secondary NFR rent growth	2.5% p.a.
Outgoings	2.5% p.a.
Construction cost growth	4.0% p.a.
CPI growth	2.5% p.a.
Premium Incentive*	-5.4%
Interest rate on construction loan*	0.0%
Premium yield*	-0.7%
Secondary yield*	-0.7%

\*(Q4-25 to Q4-30)

# Drivers of the economic rent gap

## PRICING OF DEVELOPMENTS

### 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. Melbourne construction costs have risen 54% from \$4,708/sqm in Q1 2021 to \$7,314/sqm in 2025. The rise in construction costs has occurred across both materials and labour costs. Some material prices have risen 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.

### INTEREST RATES RISE, 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 around 4.3% and 2-year swap rates rose by 3.8%, 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 from their highs, but they remain elevated compared to the cash rate over the last decade.

## VERSUS INCOME & CAPITAL VALUE

### HIGHER YIELDS REDUCE CAPITAL VALUES

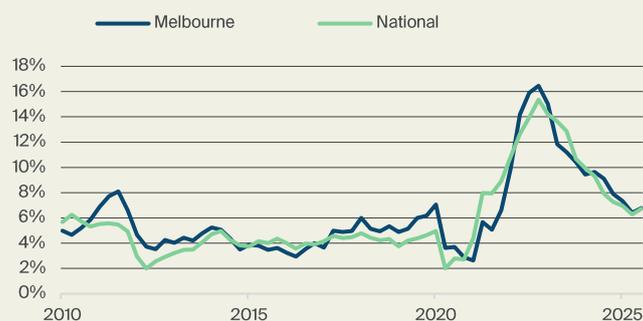
Melbourne CBD prime office yields have continued to rise in 2025 and are around 200 bps above their level in Q1 2021 while prime capital values are 19% lower.

Yields have risen as higher interest rates and funding costs reduced investor appetite, while elevated vacancy, high incentives, and uncertainty around tenant demand have further undermined confidence in income growth. Yields – through their impact on capital values – are a crucial factor in determining the feasibility of new development.

### SUBDUED LEASING DEMAND HAS WEIGHED ON RENTAL GROWTH AND INCREASED INCENTIVES

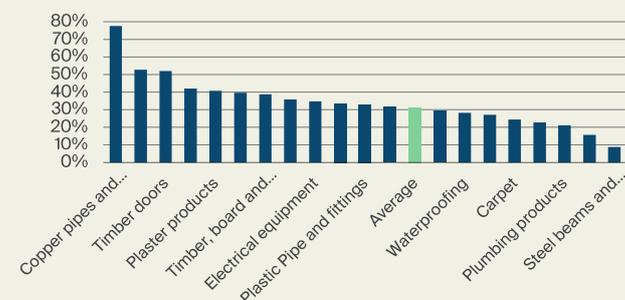
Since 2020, landlords defended face rents by lifting incentives, which became the main lever to secure tenants. Rising construction costs also pushed tenants to favour landlord-funded fit-outs through incentives rather than paying upfront. Prime incentives have nearly doubled from 25% (net) in Q1 2019 to 48% in Q4 2025, weighing heavily on net effective rents. Net effective rents have fallen by 5% (-1.1% p.a.) since Q1 2021 and remain 16% below their peak in 2020.

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



Source: Knight Frank Research, Rawlinsons

**Construction material costs rapidly escalate**  
Inflation in construction costs, Q1 2021 - Q4 2025 (% y/y)



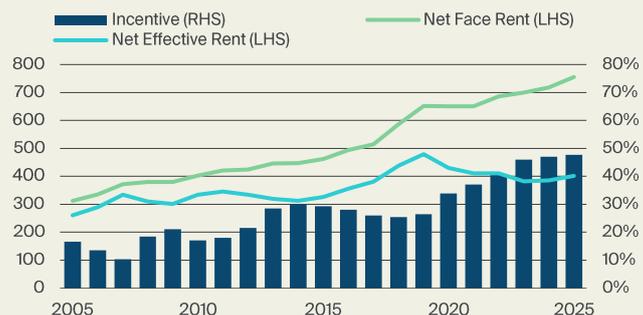
Source: Knight Frank Research, ABS

**Yields and interest rates rise**  
Melbourne CBD prime yield and RBA cash rate (%)



Source: Knight Frank Research, RBA

**Melbourne CBD rents remain subdued**  
Melbourne CBD prime office rents (\$/sqm) and incentives (% net)



Source: Knight Frank Research

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Dwindling new supply to drive  
rents



Is now the time to develop?



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