Intelligent Investment

Buy vs. Build: Analysing Office Economic Rents in Asia Pacific

VIEWPOINT

Elevated construction costs, increasing land values and changing capital values have significantly altered underlying assumptions for new office developments. This Viewpoint explains why these factors are affecting rental assumptions and how this will impact the Asia Pacific office demand-supply balance in the coming years.

CBRE RESEARCH
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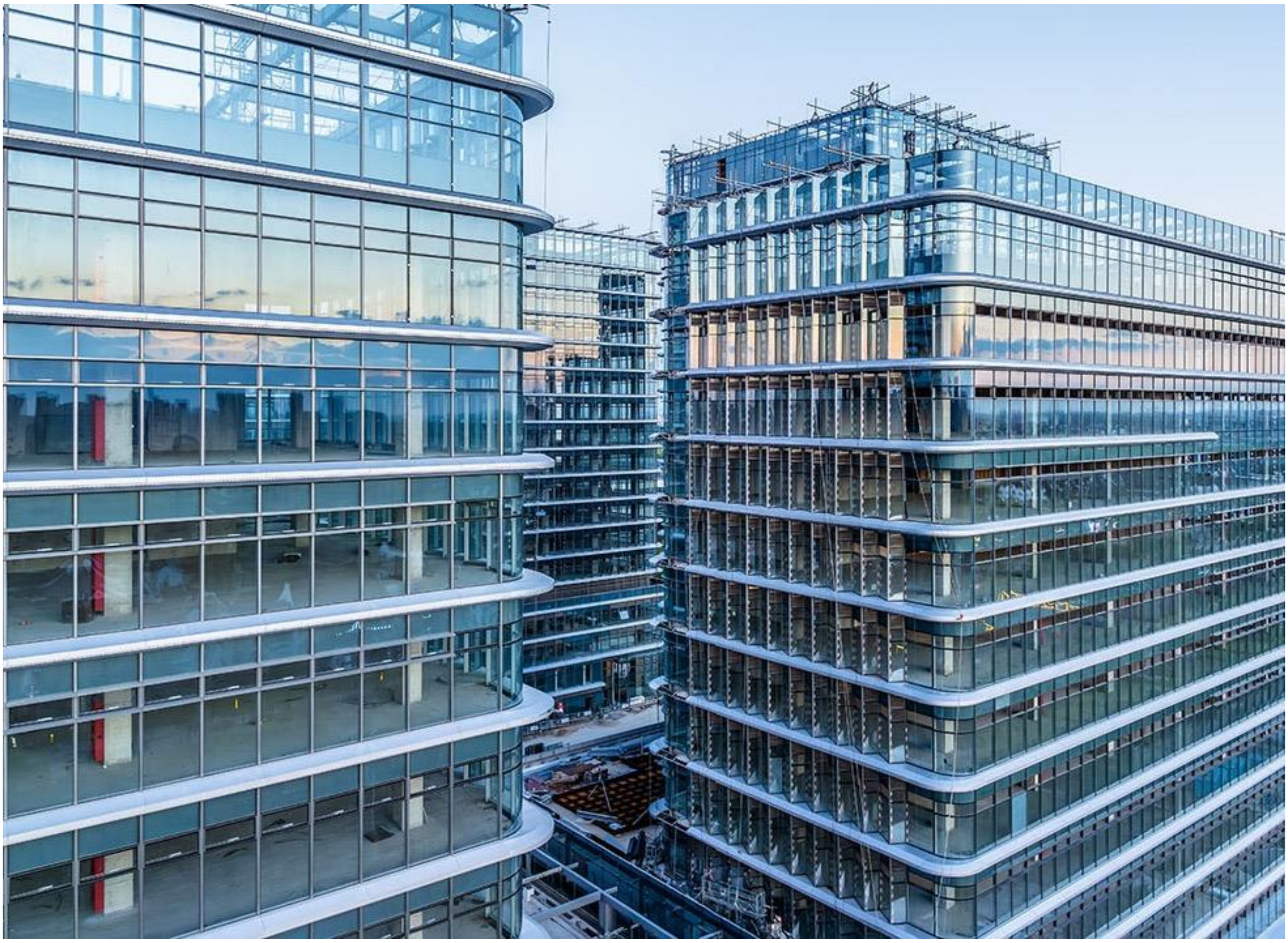


Introduction

With the Asia Pacific commercial real estate market continuing to experience elevated construction costs and asset repricing, office developments are being impacted by rising economic rents. Most markets in the region have reported significant growth in this metric over the past five years.

Increasing construction costs, rising land values and changing asset pricing are leading investors to more closely scrutinise theoretical rents when planning new office developments. Investors calculate the so-called “economic rent” by taking the estimated property yield they require in the current market and applying it to the development cost. Along with other factors, comparing the economic rent with the market rent enables investors to assess whether a proposed development project is justifiable in the current investment market.

Between 2020 and 2025, Australia reported the strongest increase in Grade A office economic rents in Asia Pacific, with a combination of increasing construction costs, decompressing yields and rising land values driving economic rental growth of more than 70% apiece in Sydney and Melbourne.

While increases in construction costs in mainland China have been modest, asset repricing has driven increases in economic rents. In Hong Kong SAR, while repricing and construction cost increases have impacted economic rents, land values fell by 25% to 30% between 2020 and 2025 in Central district.

In Singapore, Japan and Korea, land values have risen but limited asset repricing has helped mitigate pressure on economic rents.

CBRE expects Asia Pacific office developments will continue to be postponed as investors find it difficult to justify commencing work on new schemes. This will constrain the supply pipeline in the medium term. As a result, the region’s office markets will adjust to the tighter supply-demand imbalance, which will help rental growth align with the change in construction and land costs.

With the office outlook improving and pricing at top of the cycle in most Asia Pacific markets, investors will continue to target acquisitions of existing stock. Markets with strong rental prospects such as Australia, Japan, India, and Korea, will attract investment demand in H2 2025.

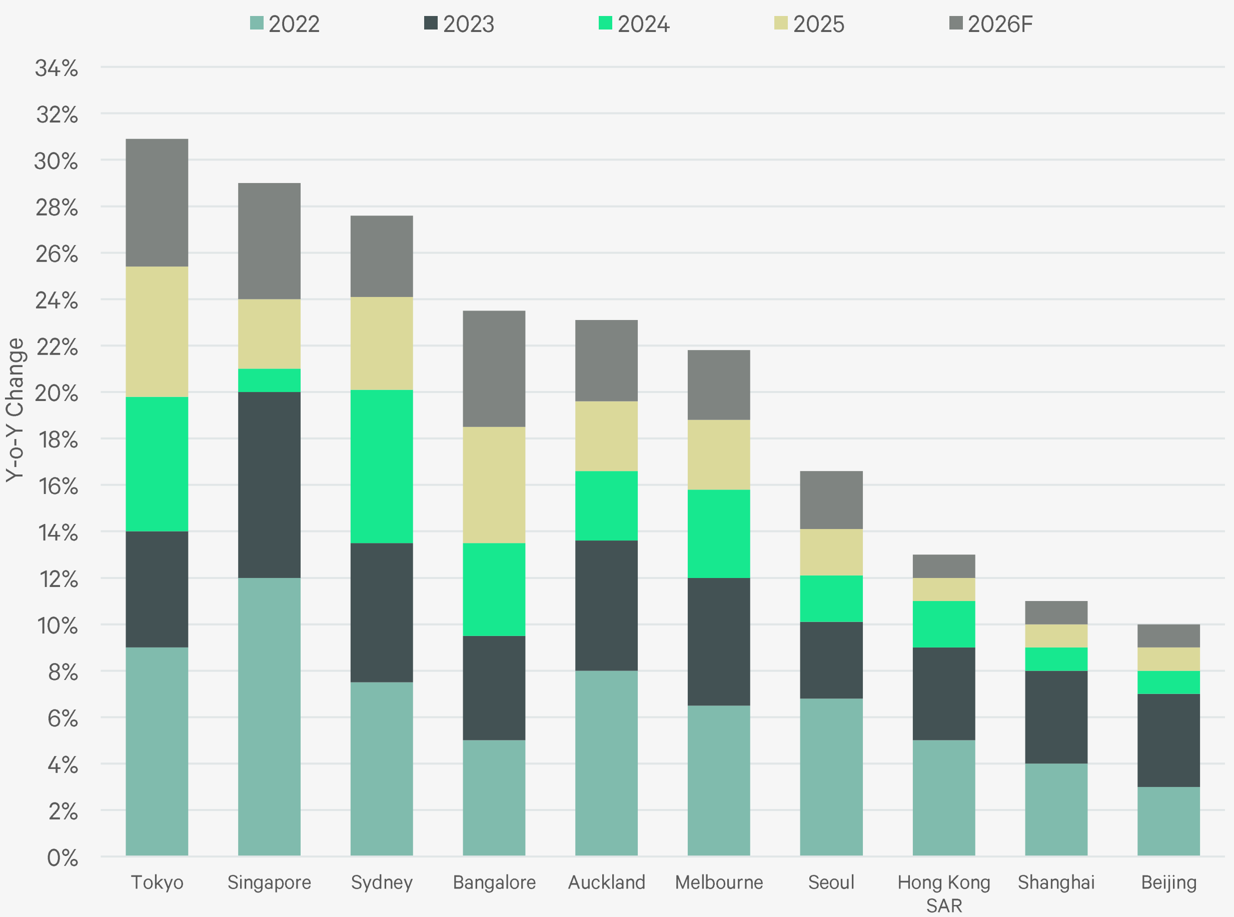
Construction costs are expected to remain elevated despite softening inflation

Between 2022 and 2024, supply chain issues and inflationary pressures saw cumulative construction costs for most markets in Asia Pacific increase by at least 10%, with Singapore, Tokyo and the Pacific most affected.

While expectations are that such costs should see more modest growth in 2025, the introduction of tariffs on imported goods into the U.S., has added a layer of uncertainty. CBRE's Q1 2025 Cap Rate Survey[1] found that over 76% of responses indicated that investors are at least somewhat concerned about tariffs, with worries most pronounced in mainland China, Hong Kong SAR and Singapore.

Tariff-related uncertainty has led to weaker consumer demand and softer inflation across the region (ex. Japan). While this is yet to translate into observable change to construction costs, the easing of inflationary pressure may help ease construction costs in some markets.

Figure 1: Baseline Construction Cost Growth for Key Asia Pacific Markets (% Growth y-o-y)



Source: Turner & Townsend, CBRE Research, Q2 2025.

[1]CBRE Asia Pacific Cap Rate Survey Q1 2025

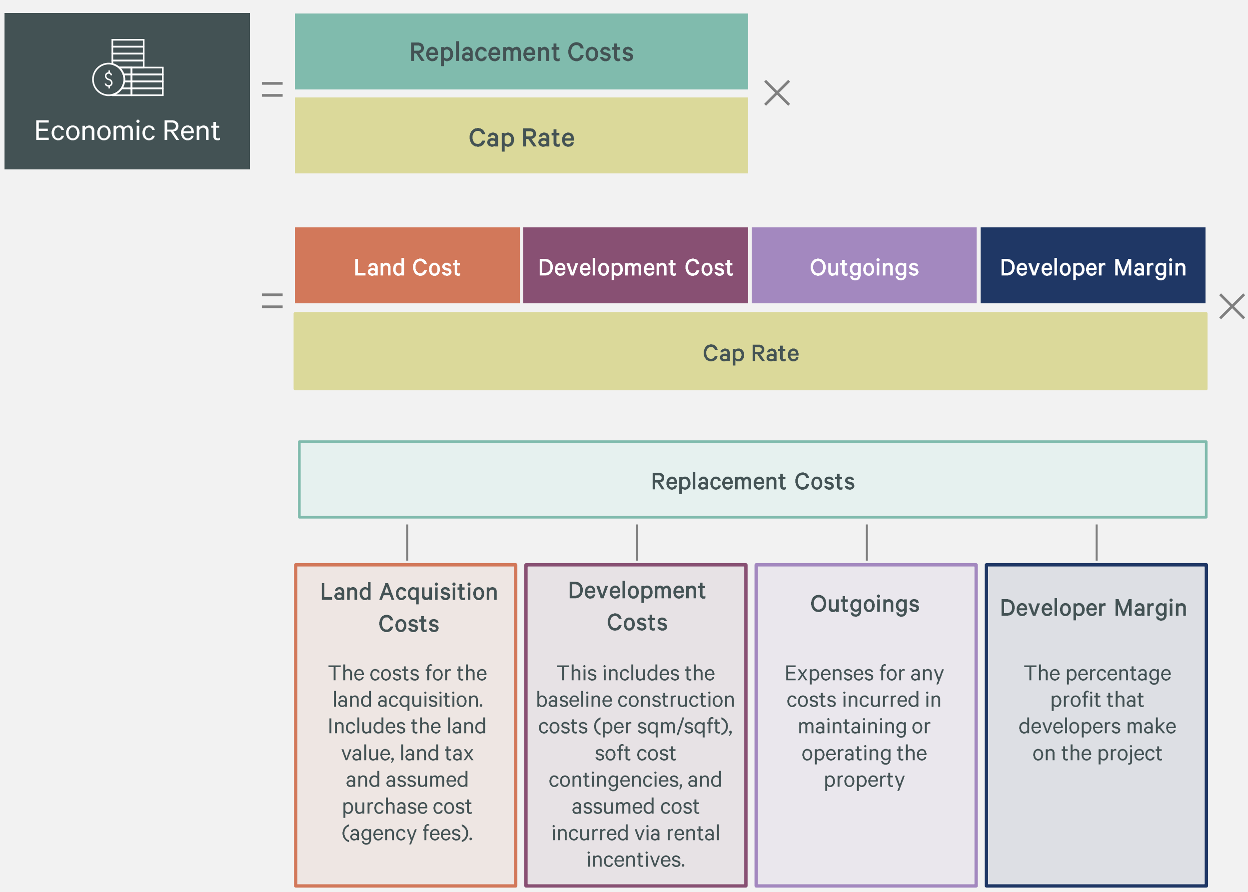
How is this affecting rental assumptions for new office developments?

The phenomena outlined on the previous page are compelling investors to look more closely at the cost approach to valuation when it comes to new developments.

The cost approach to real estate valuation compares current development costs, including land, construction, and estimated property operations, with how the current market would value the property once it is completed.

This is achieved by taking the cap rate (or range of cap rates) prevalent in the current market and applying it to the development cost to derive the economic rent. The economic rent is the rent that is used to justify the development cost based on the current market value.

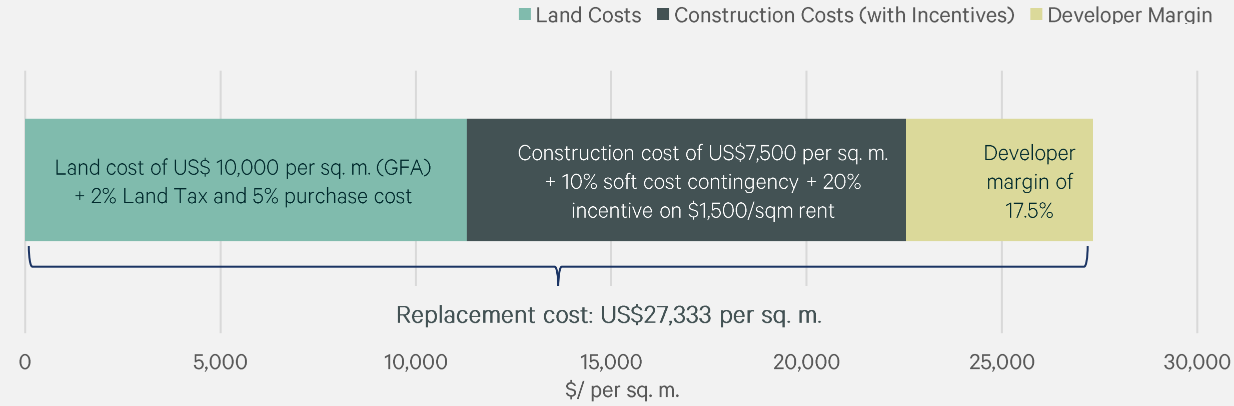
Figure 2: Example of How Economic Rents are Derived from Market Value and Development Assumptions



Example of replacement cost and economic rent calculation

To further understand the economic rent analysis, CBRE's replacement cost methodology shown in Figure 3 uses the example of an analysis of an office asset with the following assumptions. Land acquisition costs are US$10,000 per sq. m. (GFA), construction costs are US$7,500 per sq. m., face rents are US$7,500 per sq. m., incentives are 20% on the first years' rent and the developer's margin is 17.5%.

Figure 3: Replacement Cost of Office Asset (example)

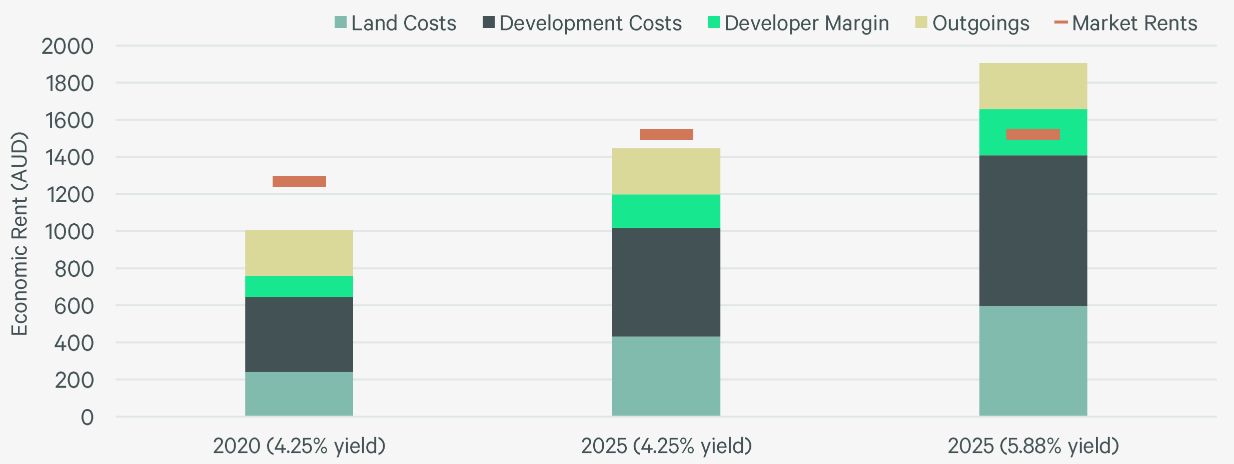


Source: CBRE Research, Q2 2025.

Based on the assumptions listed above, the all-in development value of the asset is calculated to be US$27,333 per sq. m.. Using this calculation and applying the capitalisation rate of the asset, the economic rents needed to justify the development can be calculated.

With some office markets in Asia Pacific having experienced a period of asset repricing, the change in yields has also impacted economic rent valuations. This can be seen in Figure 4, which uses a Grade A office asset in the Sydney CBD as an example. With estimated yields increasing from 4.25% to 5.88% between 2020 and 2025, this repricing has also had a significant impact on the change in economic rents.

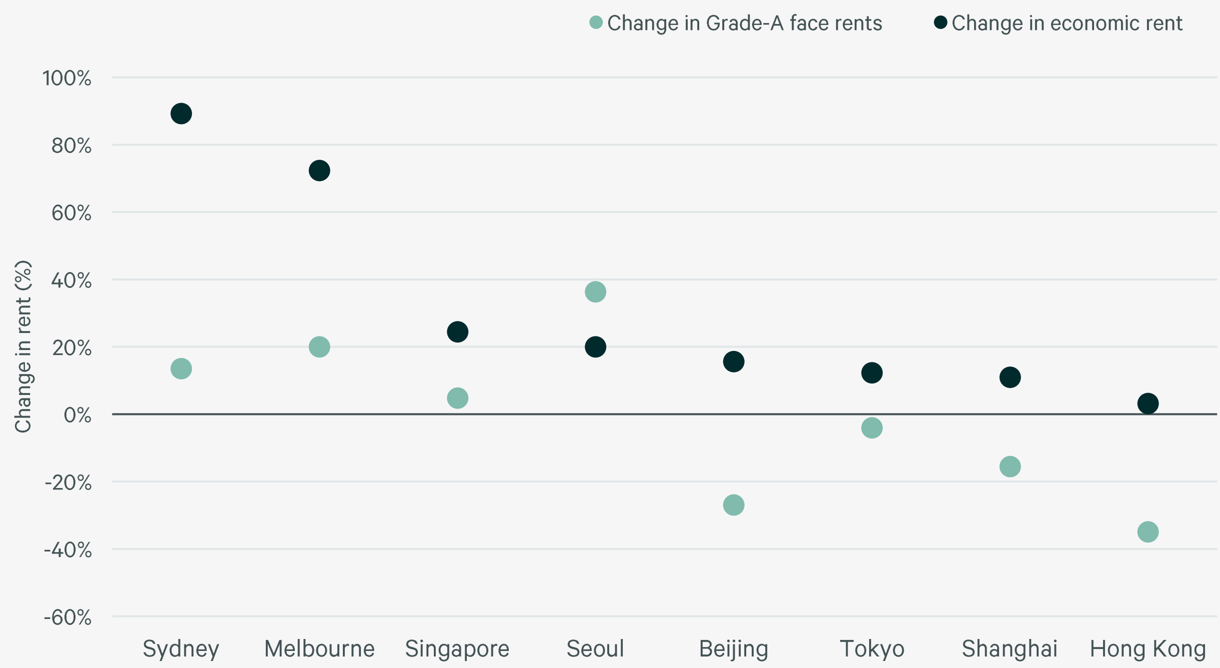
Figure 4: Economic Rent of Sydney CBD Office Asset (example)



Source: CBRE Research, Q2 2025.

Economic rents have grown across most Asia Pacific office markets between 2020 and 2025

Figure 5: Change in Economic and Grade A Rents Between Q1 2020 and Q1 2025 (Grade A CBD Office)



Note: Limited values for Beijing and Shanghai are assumed as unchanged due to limited transaction evidence between Q1 2020 and Q1 2025.
Source: CBRE Research, Q2 2025.

From an economic rent perspective, Australia was the most affected office market during the recent period of inflationary pressure, interest rate hikes and rising construction costs. Commercial land values have increased significantly in Sydney over the past five years, growing by almost 80%, according to Valuer General. Land in Melbourne has also appreciated. Together with significant changes to yields and tenant incentives, this has seen economic rents for Australia's two biggest office markets increase by over 50% over the past five years.

While construction costs have increased in Singapore and Seoul, limited asset repricing and changes in tenant incentives have seen growth in economic rents lag those in Australia and Greater China. In the case of Tokyo, which has also witnessed changes to construction costs, economic rents have slightly fallen following mild yield compression between 2020 and 2025. However, changes to land values remain the biggest influence on economic rents in these three markets, with each city experiencing different degrees of land value growth over the past five years.

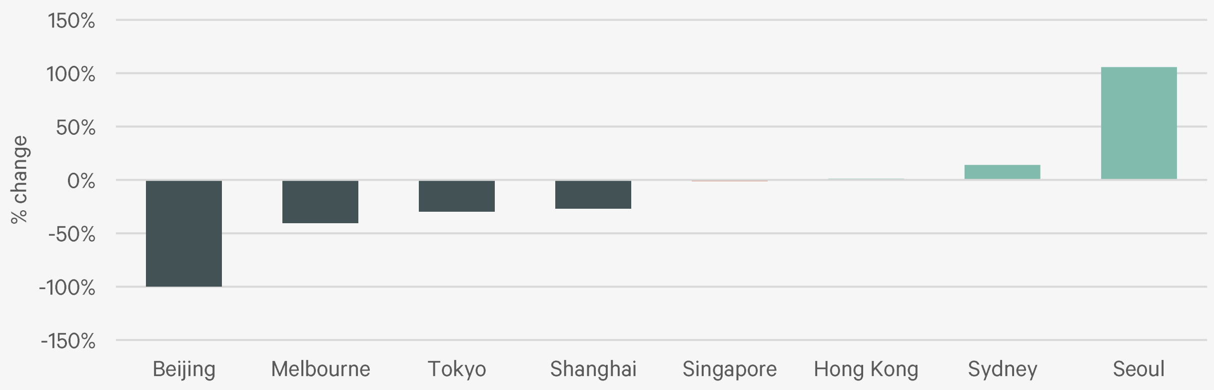
Mainland China has experienced a similar trend to Australia, albeit to a lesser degree. While construction cost increases have been somewhat modest compared to other markets, increases in incentives and yield expansion have occurred following a period of weak occupier demand. In Hong Kong SAR, construction cost growth and asset repricing has been offset by a significant decline in land values, with CBRE estimating a decline in land values of 25% to 30% for core Hong Kong SAR land locations between 2020 and 2025.

The development pipeline will continue to be impacted as economic rents maintain their spread against market rents

The combination of high construction costs and softer cap rates will ensure the feasibility of new projects across Asia Pacific continues to come under close scrutiny. Market-level dynamics are also at play, with financing pressures continuing to impact developments in Singapore, Korea, Australia and mainland China, although recent months have seen signs of easing.

Figure 6 shows that completed supply for most CBD office markets in Asia Pacific lags forecasts made two years ago, with Beijing, Melbourne and Tokyo seeing the greatest change in forecasted vs. actual completions in that period.

Figure 6: Change in Forecast CBD Office Supply vs. Completions in 2024 (forecast as of Q1 2022)



Source: CBRE Research, Q2 2025.

CBRE expects Asia Pacific office developments will continue to be postponed as investors find it difficult to justify commencing work on new schemes. This will constrain the supply pipeline in the medium term. As a result, the region's office markets will adjust to the tighter supply-demand imbalance, which will help rental growth align with the change in construction and land costs.

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