The Economic Slide Abates but Uncertainty Abounds

By James W. Hughes and Joseph J. Seneca

New Jersey ended the second quarter of 2002 on a positive economic note. In June, employment increased for the first time since January 2002. Although the gain amounted to only 1,000 jobs, it stood as a positive shift from the pattern of recent declines. Especially noteworthy was the surprisingly strong growth of 5,300 jobs in the services sector. Nonetheless, over the past year (June 2001 to June 2002), the New Jersey economy lost 25,500 jobs, as shown in Table A (page 2). Manufacturing continued to be the leading edge of decline, losing 27,500 jobs. The approximately 900,000 manufacturing jobs once housed in the state in 1969 (33 percent of total employment) have now been reduced to only 424,000 (less than 11 percent of total employment).

New Jersey’s economic performance in the first half of 2002 (December 2001 to June 2002) generally mirrored that of the nation (Table B, page 2)—both had modest job declines. However, during the preceding three years, New Jersey had outperformed the United States in employment growth. So far in 2002, New Jersey has slightly underperformed the U.S., but not by a significant amount. Thus, New Jersey is marching in economic lockstep with the nation and (continued, next page)

Somerset County: A Tale of Two Markets

Office and Industrial Market Overview

By Matthew J. Dolly

The Somerset County commercial real estate market has been one of the most active in New Jersey. This market consists of nearly 17 million square feet of office space and roughly 35 million square feet of industrial/warehouse space. Whereas both the office and industrial markets enjoyed success during the mid to late 1990s, recently the two markets have headed in somewhat different directions.

With an office vacancy rate of 16.6 percent, Somerset County reports the highest percentage of available inventory in the eleven-county northern and central New Jersey office market. The rate reached as high as 17.2 percent during the first quarter of 2002. In addition, Somerset County also has the third highest amount of available office sublease space on the market, approximately 1.9 million square feet, an amazing amount considering that just two years ago, there were only 178,000 square feet of sublease space available in Somerset County. When adding the available sublease space to the new and relet space already listed on the market, Somerset County’s office vacancy rate jumps to 27.9 percent. The addition of new office building inventory has also increased the flood of office space available in the county. So far this year, eight buildings totaling 1,255,800 square feet were added to the inventory. The two largest buildings, 200 and (continued, p. 7)
New Jersey is marching in economic lockstep with the nation and continues to reflect the economic condition of the country as a whole.

Two areas where the state has unique economic concentrations—finance and pharmaceuticals—were sources of strength during the boom years. However, both now reflect a new level of uncertainty.

The Financial Sector

The emergence of Trans-Hudson Manhattan—the shift of “Wall Street” to New Jersey—has been a major growth factor in the state’s economy for two decades. In fact, the Jersey City, Weehawken, and Hoboken waterfront can be considered the low-cost place of doing business in Manhattan. In addition, the financial sector has been a particular source of sharp employment change because of the terrorist attacks of September 11. In June 2002, “Wall Street-type” employment (a financial subsector labeled “other finance” by the New Jersey Department of Labor, a subsector that includes security and commodity services, nondepository credit institutions, and holding and other investment offices) stood at 81,900 jobs in New Jersey, down 5,900 jobs from the start of the year (Table C).

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### TABLE A: New Jersey’s Employment Change June 2001 to June 2002
*(Numbers in thousands)*

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>4,034.3</td>
<td>4,008.8</td>
<td>(25.5) -0.6%</td>
</tr>
<tr>
<td>TOTAL PRIVATE SECTOR</td>
<td>3,432.7</td>
<td>3,399.5</td>
<td>(32.2) -1.0%</td>
</tr>
<tr>
<td>GOODS PRODUCING</td>
<td>614.1</td>
<td>587.5</td>
<td>(26.6) -4.3%</td>
</tr>
<tr>
<td>Mining</td>
<td>1.6</td>
<td>1.8</td>
<td>0.2 12.5%</td>
</tr>
<tr>
<td>Construction</td>
<td>161.0</td>
<td>161.7</td>
<td>0.7 0.4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>451.5</td>
<td>424.0</td>
<td>(27.5) -6.1%</td>
</tr>
<tr>
<td>SERVICE PRODUCING</td>
<td>2,818.6</td>
<td>2,812.0</td>
<td>(6.6) -0.2%</td>
</tr>
<tr>
<td>Transportation/public utilities</td>
<td>272.9</td>
<td>262.3</td>
<td>(10.6) -3.9%</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>280.0</td>
<td>274.7</td>
<td>(5.3) -1.9%</td>
</tr>
<tr>
<td>Retail trade</td>
<td>651.4</td>
<td>651.9</td>
<td>0.5 0.1%</td>
</tr>
<tr>
<td>Finance/insurance/real estate</td>
<td>269.0</td>
<td>273.3</td>
<td>4.3 1.6%</td>
</tr>
<tr>
<td>Services</td>
<td>1,345.3</td>
<td>1,349.8</td>
<td>4.5 0.3%</td>
</tr>
<tr>
<td>GOVERNMENT</td>
<td>601.6</td>
<td>609.3</td>
<td>7.7 1.3%</td>
</tr>
</tbody>
</table>

Source: New Jersey Department of Labor

### TABLE B: Nonfarm Payroll Employment Change New Jersey vs. the U.S., 1998 to 2002
*(Numbers in thousands)*

<table>
<thead>
<tr>
<th></th>
<th>N.J. Number</th>
<th>Percent</th>
<th>U.S. Number</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999: December 1998 – December 1999</td>
<td>105.5</td>
<td>2.7%</td>
<td>3,109.0</td>
<td>2.4%</td>
</tr>
<tr>
<td>2000: December 1999 – December 2000</td>
<td>79.6</td>
<td>2.0%</td>
<td>1,913.0</td>
<td>1.5%</td>
</tr>
<tr>
<td>2001: December 2000 – December 2001</td>
<td>(1.3)</td>
<td>(0.0)</td>
<td>(1,429.0)</td>
<td>(1.1)</td>
</tr>
<tr>
<td>2002: December 2001 – June 2002</td>
<td>(14.5)</td>
<td>(0.4)</td>
<td>(150.0)</td>
<td>(0.1)</td>
</tr>
</tbody>
</table>

Source: New Jersey Department of Labor
U.S. Department of Labor, Bureau of Labor Statistics

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The Financial Sector

The emergence of Trans-Hudson Manhattan—the shift of “Wall Street” to New Jersey—has been a major growth factor in the state’s economy for two decades. In fact, the Jersey City, Weehawken, and Hoboken waterfront can be considered the low-cost place of doing business in Manhattan. In addition, the financial sector has been a particular source of sharp employment change because of the terrorist attacks of September 11. In June 2002, “Wall Street-type” employment (a financial subsector labeled “other finance” by the New Jersey Department of Labor, a subsector that includes security and commodity services, nondepository credit institutions, and holding and other investment offices) stood at 81,900 jobs in New Jersey, down 5,900 jobs from the start of the year (Table C).
These losses reflect both the continued return to Manhattan of some immediate post-September 11 employment shifts . . . and broader bear market and recession contractions in the industry at large.

Nevertheless, the state’s employment in the “other finance” category is still greater (81,900 jobs) than that just prior to September 11 (81,300 jobs). A brief history tells an interesting tale.

In April 1982, the beginning of the boom years of the 1980s, there were only 14,700 jobs in “other finance” in New Jersey (Table C). By the time that potent expansion came to an end 83 months later (March 1989), employment had nearly tripled to 38,700 jobs. During the recession that followed (March 1989 to May 1992), Wall Street hemorrhaged jobs as it desperately tried to cut costs. However, New Jersey’s “Wall Street-type” employment kept growing and actually reached 43,700 jobs by May 1992. It appears that major finance and brokerage firms controlled costs not only by personnel reductions, but also by moving jobs to lower cost locations, i.e., New Jersey.

This growth trajectory accelerated through the balance of the decade. When the great 109-month transmillennial expansion ended in June 2001 in New Jersey, the state had 81,500 jobs in “other finance,” a near-doubling of the employment total (43,700 jobs) at the start of the recovery in May 1992 (14,700 jobs), and a more than six-fold increase from the total at the start of the boom years of the 1980s.

When the state’s employment base started to contract during the first months of the current downturn (June 2001 to September 2001), only 200 “other finance” jobs were lost. But one month later (October 2001), following the terrorist attacks, “Wall-Street-type” employment jumped by nearly 10,000 jobs in New Jersey to a record high total of 91,100 jobs. As the year came to a close, however, a significant share of these gains started to disappear. Employment fell to 87,800 jobs by December 2001, a pattern of decline that continued through June 2002 (to 81,900 jobs). Still, employment remains slightly higher than pre-September 11 levels, a performance that was achieved despite a widespread downsizing taking place in the broader New (continued, p. 4)
York financial world. But given Wall Street and stock market travails, this sector does not appear ready to resume its role as economic engine anytime soon. A similar conclusion can be drawn for the state’s pharmaceutical industry.

The Pharmaceutical Industry

The recent acquisition of the Pharmacia Corporation by Pfizer Inc. highlights another extraordinarily important segment of the New Jersey economy. As of June 2002, the pharmaceutical industry accounted for 50,000 jobs in New Jersey, an increase of 300 jobs from May. While the 50,000 pharmaceutical jobs represent only 1.2 percent of the state’s current total employment base (4 million jobs), it should be realized that pharmaceutical positions are predominantly high-paying, high tech, and scientific. Thus, they account for a share of total state personal income far higher than their proportion of total employment.

Moreover, New Jersey has long had an inordinately high share of the national pharmaceutical industry. As of June 2002, the state accounted for barely 3 percent of the nation’s total employment base (4.0 million jobs out of 130.7 million). However, New Jersey accounted for fully 15.3 percent of the nation’s total employment in pharmaceuticals (50,000 out of 326,600). This share is five times greater than that expected based on the state’s overall proportion of national employment (15.3 percent versus 3.0 percent). It is no wonder that New Jersey has been called “the nation’s medicine chest.”

While this status is unlikely to be threatened anytime soon, New Jersey’s total pharmaceutical employment today (50,000 jobs) is virtually the same as it was 10 years ago (June 1992), the nadir of the 1989–1992 recession. In terms of employment, it stands as a long-term, no-growth industry. Moreover, New Jersey’s share of total national pharmaceutical employment fell from 19.3 percent to 15.3 percent during that same 10-year period. This should raise some level of concern in today’s uncertain environment of pharmaceutical mergers, increasing pressures on drug prices throughout global markets, the slowing pace of new drug introductions, and patent expirations.

It is highly probable that some of this loss is simply demographically driven. The state has been a demographic laggard for decades, with the nation’s population growing much faster than New Jersey’s. Between the 1990 and 2000 censuses, New Jersey’s population grew by 8.9 percent (ranked 33rd among the states) compared to 13.2 percent for the nation as a whole. Consequently, pharmaceutical sales and distribution employment, for example, would tend to grow faster in high demographic growth areas, i.e., outside of New Jersey. These, however, would tend to be lower-paying pharmaceutical jobs. At the same time, New Jersey’s unique concentration of professional, technical, and managerial employment in pharmaceuticals reflects the state’s dominance in headquarters and research functions. Nonetheless, the loss in overall pharmaceutical employment share should evoke significant public policy concern. This is a crown jewel of the New Jersey economy that other states covet enormously. Taking it for granted could be hazardous to the state’s economic health. The same conclusion applies to the financial sector.

The national economy is struggling with a still profitless and jobless recovery. Although there are encouraging signs of economic revival (industrial production and housing), the grizzly bear market combined with financial fraud on a large scale has shaken consumer and investor confidence badly. Interest rates are at all-time lows and the federal budget surplus has moved into deficit, giving little discretion for additional monetary and fiscal stimulus. Thus, the concern is that consumers, who in the 1990s increasingly became equity holders and whose spending now accounts for over 69 percent of GDP, will reduce their rate of buying at a critical time for the recovery of the economy. Nevertheless, the second quarter GDP should be the low point of the year, with gradual and very modest improvements occurring nationally for the rest of 2002. New Jersey should follow this same pattern.
New Jersey’s Office Market is
Anyone’s Ballgame
By Matthew J. Dolly

“Get your free rent here!” During this baseball season, landlords in the New Jersey office market are beginning to sound a lot like vendors at a sports event by offering a variety of incentives to lure tenants to lease their space. This approach, which was unheard of not too long ago, almost seems imperative as landlords are not only competing with other landlords, but are also competing with tenants trying to sublease their own oversupply of space. The New Jersey market, like most others in the nation, is struggling from corporate consolidation and a recession. The difference in New Jersey is the impact of September 11, 2001, which caused many companies to offer for sublease any of their unused space in an effort to cut their losses while assisting World Trade Center tenants in their space needs. Unfortunately for these New Jersey tenants, leasing activity from WTC and other New York companies was either minimal or temporary, leaving large blocks of office space available in a market already flooded with a surplus of sublease space.

The good news is that there is reason to believe that the market may be headed for recovery. Less construction is planned for the immediate future, causing prospective tenants to look to existing buildings for their space needs. Examples of this recovery include recent subleasing of three Hudson County buildings. The Harborside Financial Center was originally built solely for the use of The Charles Schwab Corporation. However, in an attempt to cut costs, the company ended up putting the entire 594,000 square feet of Plaza 10 on the market for sublease even before construction.

(continued, p. 6)
was completed this June. Since then, Mizuho Corporate Bank and Instinet subleased 107,000 square feet and 140,000 square feet respectively at Plaza 10. In addition, John Wiley & Sons and JP Morgan Chase and Company preleased a combined 883,000 square feet of office space in two other buildings on the Hudson Waterfront. These three transactions—Schwab, John Wiley, and JP Morgan—result in inflated absorption statistics for Hudson County. Other transactions spurring hope for a recovering market include leases signed by two large tenants in Essex County during the quarter. Dun and Bradstreet leased 123,000 square feet on John F. Kennedy Parkway in Short Hills, and Wolff and Samson P.A. signed for 61,000 square feet at the Offices at Crystal Lake in West Orange. In Passaic County, Synavant, a marketing consultant for biopharmaceutical companies, signed a lease for the Wayne-McBride Office and Research Park in Wayne. Additional transactions in central New Jersey also encouraged talks of a market in recovery. In the largest sublease during the quarter, Avaya signed on for 352,000 square feet in the former AT&T Research and Development facility in Middletown, Monmouth County. Another communications company, Verizon, has preleased a 95,000 square-foot call center built for them in Hamilton Township, Mercer County. In addition, in Somerset County, Medpointe moved into 70,000 square feet on Davidson Avenue in Franklin Township.

When adding the large, preleased Hudson Waterfront buildings to the inventory and accounting for the lease activity during the quarter, the vacancy rate for new and relet space actually decreased from 12.4 percent to 11.7 percent.
Office Market, continued

12.4 percent to 11.7 percent. In fact, seven of the eleven counties in the region reported decreases in vacancy rates, giving hope to the industry. More importantly, perhaps, is the fact that the amount of sublease space on the market remained virtually unchanged during the quarter, after increasing by only eight percent during the first quarter of 2002. This result is a vast improvement over 2001, when the amount of sublease space added to the market increased by at least 22 percent to as much as 38 percent during each quarter.

Average asking rents for the eleven-county region remained steady, decreasing just 20 cents to $24.61 per square foot during the past three months. Eight of the eleven counties experienced decreases in asking rents, albeit none substantial. Overall, commercial real estate firms are continuing to have more opportunities to list space than to show space, but tenant activity is slowly increasing. An improving economy will go a long way in getting the commercial real estate market on firm footing once again. The market should continue to improve slowly in the short term, but more rapidly in the fall months. Maybe companies and investors will feel a bit safer when a year has gone by since the September attacks on America. But for now, landlords will continue to offer tenants free or discounted rents, long-term leases, and increased workletters. For tenants, at this point, the market for office space is anyone's ballgame.

Somerset, continued

400 Crossing Boulevard at Bridgewater Crossing, are each approximately 300,000 square feet. Aventis Pharmaceuticals preleased the majority of space in these two facilities. In addition, six other buildings totaling 660,000 square feet were added in Bridgewater, Bernards, and Warren. The largest lease in these buildings was signed in December 2001 when Affinity Federal Credit Union leased 106,000 square feet. Nearly half of the new inventory in Somerset County is still available for lease. There are twenty units of office space 100,000 square feet or greater available (new, relet, and sublet) in the county.

The average asking rent for Somerset County office space is $26.72 per square foot—the highest in the eleven-county region. Top quality, class “A” office building rent is also the highest in the region, as landlords are asking $28.11 per square foot. Normally, rents go down as demand slows down, but much of the office space available in the county is listed in newly constructed buildings with higher asking rents, increasing the average.

Sales activity has been picking up in Somerset County, as seen by the $200 million Pharmacia purchase of AT&T’s headquarters facility in Basking Ridge. The property is located on 140 acres, consisting of 1.3 million square feet of office space and a conference center. Also in Basking Ridge, UBS Realty Advisors acquired 131 Morristown Road for $50.3 million. The 211,000 square foot office building is fully leased to United Healthcare.

The Somerset County industrial market has not been quite as active as the office market. Unlike its office counterpart, the county’s industrial vacancy rate is one of the lowest in the state. At six percent, this represents 2.2 million square feet of available industrial space. Also, Somerset County’s warehouse market has only 350,000 square feet of available sublease space. In comparison, Hudson and Middlesex County each report more than 2.3 million square feet of available warehouse sublease space. However, Somerset County does have eight blocks of space consisting of 100,000 square (continued, p. 8)
feet or more available, and many have been on the market for over a year, indicating a weak market for leasing activity. In addition, 141,211 square feet of negative net absorption has been reported for the Somerset County industrial market so far in 2002. Gross absorption has also been sluggish, as only 445,000 square feet of leasing activity has been reported through July 2002. This follows at least one million square feet of leasing activity during each year from 1999 to 2001. Not since 2000 has there been a lease signed for more than 100,000 square feet of warehouse space, when Ortho-McNeil and R.P. Scherer each leased space. The majority of warehouse leases signed in Somerset County during the past three years have been for less than 50,000 square feet.

Industrial building sales activity is gaining momentum in Somerset County. Thus far in 2002, five buildings larger than 40,000 square feet have been sold. Five buildings in that size range were also sold during 2001, and three more were sold in 2000. Average asking rents range from $5.00 to $5.50 per square foot for warehouse space in Somerset County.

In today’s market it is very difficult to find tenants searching for large blocks of space. One example can be identified at the Bridgewater Technology Campus on Route 202 in Bridgewater. This former Olivetti site consists of a 245,000 square foot office/warehouse facility. Plans for the site were promising when the project started, as the developer wanted to redevelop the site into a 500,000 square foot pharmaceutical headquarters. Although the property is strategically located along New Jersey’s pharmaceutical corridor, the demand for a transaction of this magnitude has decreased. Furthermore, while companies such as Lucent and AT&T continue to announce layoffs, it is difficult to predict when the market for large blocks of space will increase. The investment market, however, provides optimism, as sales activity in both the office and industrial sectors has been on the rise. Many Wall Street investors as well as individual buyers believe that real estate is the safest investment during this period of economic volatility, especially when buildings with lower occupancy rates are offered at a discounted price.