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Regional Report

James W. Hughes and Joseph J. Seneca, editors

Recovery Gains Traction But Manufacturing Hemorrhages

By James W. Hughes and Joseph J. Seneca

On July 17, 2003, the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) determined that the trough in business activity occurred in the U.S. economy in November 2001—fully 20 months ago—and that this trough marks the end of the recession that began in March 2001 and the beginning of an expansion. (Interestingly, the Dating Committee first announced in November 2001 that a recession had begun in March 2001. Thus, the eight-month-long recession was over by the time the Committee first declared when it had started!) Unfortunately, national labor markets deteriorated significantly after November 2001, as payrolls subsequently contracted by approximately one-million jobs, and the unemployment rate jumped

from 5.6 percent to 6.4 percent. This occurred despite the substantial rise in real GDP, which NBER considers as the single best measure of economic activity. Thus, aggregate economic activity in the U.S. has actually been increasing for 20 months, leading to the phenomenon of jobless economic growth.

In this context, the New Jersey economic recovery finally appears to be gaining traction. As recoveries take hold, the following question arises without fail: what will be the engines of economic growth that will power us through the coming expansion? Unfortunately, economists and industry observers have a less-than-stellar track record in making such predictions. The experience of the 1990s in particular reveals the *(continued, next page)*

Jersey Shore Shines

By Linda Tanaka

Amidst the economic and meteorological doldrums New Jersey has been experiencing, the Jersey Shore is practically glowing with promise.

Recent data reveals that the Monmouth-Ocean metropolitan area was one of the top ten areas for job growth in the nation. The two counties added 7,100 jobs in 2002. Much of this gain was in the educational and health services areas. Other growth industries included financial services and retail. Also, the defense industry's Fort Monmouth in Eatontown as well as related industries such as engineering have also added to the area's prosperity. For example, Northrop Grumman and CACI recently signed new leases, while CSC continues to seek space. This job growth has helped support the positive state of the

region's commercial real estate. Monmouth County has the lowest direct vacancy rate and one of the lowest total vacancy rates in the state. Ocean County, with more industrial space and less office inventory than Monmouth County understandably did not experience the same wave of activity.

Elsewhere in New Jersey the picture was not as bright, with job losses in Middlesex, Somerset, Hunterdon, Bergen, and Passaic Counties. This dampened economic environment was reflected in the record high vacancy rates reported for these counties (see "Commercial Space Confined by Challenging Times" on page 5 of this report).

Construction of office and research facilities within Monmouth County has been on the rise, another indication that the area's *(continued, p. 8)*

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difficulties of forecasting the specific forces of future economic growth.

In 1992, when the great trans-millennial 120-month economic expansion began, there was not a forecaster alive who predicted that the Internet would be a locomotive driving the prosperity of the U.S. in the second half of the decade. In fact, most forecasters had only a vague notion of the concept of “information superhighway” at that time—perhaps because Al Gore had not yet invented it! But it was the Internet, information technology, and the high-technology business capital investment boom that ultimately powered the U.S. economy during the mid-to-late 1990s—and the conventional economic wisdom failed to foresee it in the early years of the decade.

In addition, most forecasters did not envision the sustained housing boom of the 1998–2003 period. The conventional wisdom in the early 1990s was that housing’s role in the coming expansion would be modest compared to its extraordinary role in the 1980s expansion. A conservative “post-housing-bubble” mentality widely prevailed following the severe home-price correction in the 1989–1992 period. But “future shelter reality” obviously turned out quite differently, as housing ultimately served as a potent economic savior following the business capital investment bust. Housing continued to support the economy during the most recent recession and the subsequent period of jobless economic growth.

An earlier example of forecasting prowess also proves sobering. In 1982—at the start of the great boom of the 1980s—the widespread conventional economic wisdom was that high technology manufacturing, energy investment, and services would be the leading growth locomotives of the decade. What subsequently happened? Two of these three “engines” expired within the next year! High technology manufacturing and energy investment cratered, while only services soared. Although a batting average of .333 in baseball is quite good, a record of .333 in economic forecasting is a direct route to an enforced holiday known as unemployment.

Considering this poor historical forecasting record, there will be no grand proclamation in this report of the specific growth sectors of the current expansion. What we will proclaim is that the expansion has arrived and that it has started to gain traction. During the first half of 2003, measured from December 2002 to June 2003, the New Jersey economy had a net gain of 39,200 jobs, or 1.0 percent (Table A). Total employment in the state reached 4,023,800 jobs in June, the second highest monthly total ever. The state is thus destined to set a new all-time employment peak during the third quarter of 2003.

This performance stands in sharp contrast to that of the nation (Table A). In the first half of 2003, the United States lost 236,000 jobs (-0.2 percent). With the exception of financial activities, New Jersey outpaced the nation in every employment category. The leading sectors in the state were professional and business services (+10,100 jobs), construction (+8,100 jobs), public sector (+6,000 jobs), education and health services (+5,500 jobs), and leisure and hospitality (+5,300 jobs). Thus, growth was widely spread throughout the New Jersey economy, with the exception of the information sector (-400 jobs) and manufacturing (-5,400 jobs).

Offices and Manufacturing

It has been that “old economy” sector—manufacturing—that has again borne the brunt of the first new economy recession and it is manufacturing that remains a drag on the first new economy recovery. As a result of the faltering of manufacturing, the dynamic core economic competency of New Jersey is increasingly centered in the activities sheltered in the state’s office inventory. Analysis of the new NAICS (North America Industrial Classification System) data, first described in the last issue of this report, reveals that this is even more true than originally thought.

Manufacturing is one of the new NAICS “supersectors” that is now defined differently (effective March 2003). Previously, a manufacturing headquarters was classified under SIC (Standard

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Industrial Classification) in manufacturing; in NAICS, it is now classified under management of companies and enterprises, a NAICS service-producing sector. Thus, simply by this redefinition change, manufacturing represents a smaller share of the economy under NAICS than it did under SIC. Moreover, the new classifications show that manufacturing job losses have been even more substantial than previous analyses have shown.

Between 1990 and 2002, total manufacturing employment in New Jersey declined by nearly one-third (-30.3 percent), with a loss of 160,700 jobs in this 12-year period (Table B). In 1990, manufacturing (529,500 jobs) accounted for 14.6 percent of the total employment in the state (3,635,100 jobs). By 2002, its share had fallen to 9.2 percent, accounting for only 368,800 jobs out of a state total of 3,993,800 jobs. By June 2003, manufacturing employment had further declined to 356,700 jobs (an 8.8 percent share). Thus, severe, absolute, and relative decline has been the fate of this once-storied economic (*continued, p. 4*)

**TABLE A: Employment Change
December 2002 to June 2003**
(Numbers in thousands)

New Jersey	December 2002	June 2003	Change: 2002–2003	
			Number	Percent
NONFARM EMPLOYMENT	3,984.6	4,023.8	39.2	1.0%
TOTAL PRIVATE SECTOR	3,366.4	3,399.6	33.2	1.0
GOODS PRODUCING	522.8	525.5	2.7	0.5
Natural Resources and Mining	1.5	1.5	—	0.0
Construction	159.2	167.3	8.1	5.1
Manufacturing	362.1	356.7	(5.4)	-1.5
PRIVATE SERVICE PRODUCING	2,843.6	2,874.1	30.5	1.1
Trade, Transportation, and Utilities	883.3	886.8	3.5	0.4
Information	110.5	110.1	(0.4)	-0.4
Financial Activities	276.6	278.6	2.0	0.7
Professional and Business Services	579.7	589.8	10.1	1.7
Education and Health Services	534.3	539.8	5.5	1.0
Leisure and Hospitality	309.5	314.8	5.3	1.7
Other Services	149.7	154.2	4.5	3.0
PUBLIC SECTOR	618.2	624.2	6.0	1.0

United States	December 2002	June 2003	Change: 2002–2003	
			Number	Percent
NONFARM EMPLOYMENT	130,198	129,962	(236)	-0.2%
TOTAL PRIVATE SECTOR	108,642	108,473	(169)	-0.2
GOODS PRODUCING	22,323	22,063	(260)	-1.2
Natural Resources and Mining	572	567	(5)	-0.9
Construction	6,731	6,801	70	1.0
Manufacturing	15,020	14,695	(325)	-2.2
PRIVATE SERVICE PRODUCING	86,319	86,410	91	0.1
Trade, Transportation, and Utilities	25,378	25,260	(118)	-0.5
Information	3,353	3,284	(69)	-2.1
Financial Activities	7,889	7,981	92	1.2
Professional and Business Services	15,972	15,984	12	0.1
Education and Health Services	16,373	16,533	160	1.0
Leisure and Hospitality	12,019	12,048	29	0.2
Other Services	5,335	5,320	(15)	-0.3
PUBLIC SECTOR	21,556	21,489	(67)	-0.3

Sources: New Jersey Department of Labor, United States Bureau of Labor Statistics
Note: National June 2003 data is preliminary.

... the new classifications show that manufacturing job losses have been even more substantial than previous analyses have shown.

4 Recovery, *continued*

The fundamental transformation of the state's economy could not be more dramatically revealed by these new data and employment classifications.

sector in New Jersey. Nationally, the same pattern prevailed, with the U.S. losing nearly 2.5 million manufacturing jobs since 1990, as manufacturing's share of total employment fell from 16.1 percent to 11.7 percent.

Moreover, these declines occurred during the longest economic expansion in the nation's history (120 months) and the second longest expansion in the state's history (109 months). Nonetheless, every single manufacturing sector in New Jersey showed double-digit rates of decline, with the exception of the pharmaceutical and medicine subsector (-4.8 percent). While the growth in headquarters jobs in pharmaceuticals previously obscured the employment losses accruing in the actual production area, this is no longer the case.

The production losses have been extraordinarily severe in a number of other sectors and subsectors.

For example, communications equipment (-71.9 percent), paper manufacturing (-60.3 percent), electrical equipment, appliance and components (-48.5 percent), machinery (-46.7 percent), computer and electronics products (-43.5 percent), and basic chemical manufacturing (-42.4 percent) all experienced traumatic employment contractions. While the gleaming headquarters and research operations linked to manufacturing operations—particularly in pharmaceuticals—may actually be expanding or at least holding their own, the number of jobs in the actual production of goods has been in virtual free-fall. The fundamental transformation of the state's economy could not be more dramatically revealed by these new data and employment classifications. The increasing centrality of our office inventory to our “new” core knowledge-based, information-age economy is even more emphatically underscored. ■

TABLE B: New Jersey Manufacturing Employment Data
Annual Averages, 1990 and 2002
(Numbers in thousands)

	1990	2002	Change:	
			Number	Percent
MANUFACTURING	529.5	368.8	(160.7)	-30.3%
DURABLE GOODS	244.7	163.1	(81.6)	-33.3
Nonmetallic Mineral Product	20.2	15.0	(5.2)	-25.7
Fabricated Metal Product	40.5	30.2	(10.3)	-25.4
Machinery Manufacturing	37.5	20.0	(17.5)	-46.7
Computer and Electronic Products	61.1	34.5	(26.6)	-43.5
Communications Equipment	13.9	3.9	(10.0)	-71.9
Navig., Meas., Electromedical and Control Instr.	26.1	16.7	(9.4)	-36.0
Electrical Equipment, Appliance and Components	16.3	8.4	(7.9)	-48.5
Transportation Equipment Manufacturing	13.1	9.7	(3.4)	-26.0
Miscellaneous Manufacturing	27.9	23.5	(4.4)	-15.8
NON-DURABLE GOODS	284.9	205.7	(79.2)	-27.8
Food Manufacturing	39.2	32.1	(7.1)	-18.1
Apparel Manufacturing	24.2	9.6	(14.6)	-60.3
Paper Manufacturing	27.5	17.8	(9.7)	-35.3
Converted Paper Product	25.0	15.9	(9.1)	-36.4
Printing and Related Support	33.4	26.9	(6.5)	-19.5
Chemical Manufacturing	98.7	76.4	(22.3)	-22.6
Basic Chemical Manufacturing	19.1	11.0	(8.1)	-42.4
Pharmaceutical and Medicine	41.9	39.9	(2.0)	-4.8
Soap, Cleaning Comp., and Toilet Prep.	20.6	13.9	(6.7)	-32.5
Plastics and Rubber Products	28.5	23.7	(4.8)	-16.8
Plastics Product Manufacturing	26.1	21.7	(4.4)	-16.9

Source: New Jersey Department of Labor

Commercial Space Confined by Challenging Times

By Linda Tanaka and Gregg Nowell

The New Jersey Commercial Office market ended the first half of 2003 trapped between a prolonged soft patch and the impending expiration of leases covering a substantial amount of space. Within the commercial real estate industry, investors seeking positive returns have kept sales healthy. However, owners may begin to face cash flow problems as leasing activity falls even further, reaching record-high levels of vacancy.

Over the past three months, the Northern/Central New Jersey region saw vacancy rates climb nearly one-fifth to 16.1 percent and total vacancy rates (direct plus sublet) rise nearly one-quarter to reach 22.7 percent. Asking rents averaged \$25.58 for the area. Net absorption remained strongly negative. Since January of this year, space added to and taken off the market resulted in 1.7 million additional square feet. Vacancy rates for large blocks of space

(i.e., 100,000 square feet or greater) are running between 6.0 percent and 43.5 percent within the eleven counties studied. This is attributed to the scarcity of the single, large, credit tenant who would ordinarily occupy such space.

Class A space is faring slightly worse. Total vacancies are running 27.4 percent, up more than 31 percent from March of this year, with asking rents of \$28.03. Here, too, net absorption was strongly negative, standing at -1,764,552.

Somerset County sustained its downward slump as well as its status of least desirable vacancy rates. Nearly three million square feet of direct and sublet space were added to this market. Total available space topped eight million square feet for a total vacancy rate of 41.9 percent. Space directly available increased by more than half over the past three months, adding nearly two million (*continued, p. 6*)

... owners may begin to face cash flow problems as leasing activity falls even further, reaching record-high levels of vacancy.

Northern and Central New Jersey Total Office Market Second Quarter 2003

County	Buildings	Total Inventory	Direct		Total (Direct + Sublet)		Average Asking Rent	2nd Qtr. Net Absorption	2003 YTD Net Absorption
			Available Space	Vacancy Rate	Available Space	Vacancy Rate			
Bergen	545	28,895,626	4,174,890	14.4%	5,675,180	19.6%	\$25.98	(151,113)	(62,389)
Essex	376	28,441,431	4,574,425	16.1%	5,222,533	18.4%	\$25.69	(34,334)	(25,944)
Hudson	159	23,240,061	2,808,722	12.1%	4,678,244	20.1%	\$28.21	(164,045)	(240,538)
Hunterdon	40	1,113,976	85,975	7.7%	94,963	8.5%	\$21.77	15,600	2,235
Mercer	332	15,992,963	1,559,513	9.8%	2,300,959	14.4%	\$24.58	(18,417)	34,909
Middlesex	405	24,954,475	4,364,118	17.5%	6,722,551	26.9%	\$24.63	10,875	4,157
Monmouth	362	13,557,028	1,183,805	8.7%	1,738,587	12.8%	\$24.17	(37,181)	(402,045)
Morris	396	27,032,686	5,616,338	20.8%	7,896,207	29.2%	\$25.86	(109,518)	(730,910)
Passaic	146	5,997,570	704,951	11.8%	750,495	12.5%	\$22.62	(5,428)	27,371
Somerset	252	19,257,522	5,401,998	28.1%	8,064,075	41.9%	\$26.41	(1,353,940)	(243,303)
Union	287	10,492,317	1,584,407	15.1%	1,963,128	18.7%	\$23.27	(20,572)	(22,617)
TOTAL	3,300	198,975,655	32,059,142	16.1%	45,106,922	22.7%	\$25.58	(1,868,073)	(1,659,074)
Central NJ	1,638	84,254,305	14,093,841	16.7%	20,789,300	24.7%	\$25.12	(1,419,235)	(628,899)
Northern NJ	1,662	114,721,350	17,965,301	15.7%	24,317,622	21.2%	\$25.94	(448,838)	(1,030,175)

*Includes all office buildings, 10,000 square feet and greater. Does not include owner-occupied facilities.

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square feet for a total of 5.4 million square feet. Only Morris County with 5.6 million square feet exceeds the amount of space directly available.

It will require a considerable upswing in the economy to realign supply and demand in this trading area. There are currently 61 properties in Somerset County representing 12.2 million square feet in large blocks of space. Nearly half of this space is vacant. The former AT&T headquarters building in Basking Ridge adds more than one million square feet of space to the market and new owner, Pfizer, has no interest in occupying the site. Quarterly net absorption is down 1.3 million square feet due to lack of demand.

Bergen and Hudson Counties also experienced a deepening of difficult times over the last quarter as evidenced by large increases in total vacancy rates, although the rates themselves are less severe than in

other counties. The total vacancy rate increased by about one-third to reach 19.6 percent in Bergen County and 20.1 percent in Hudson County. Rents remain strong in both counties, with Bergen asking rents averaging \$25.98 and Hudson asking rents averaging \$28.21.

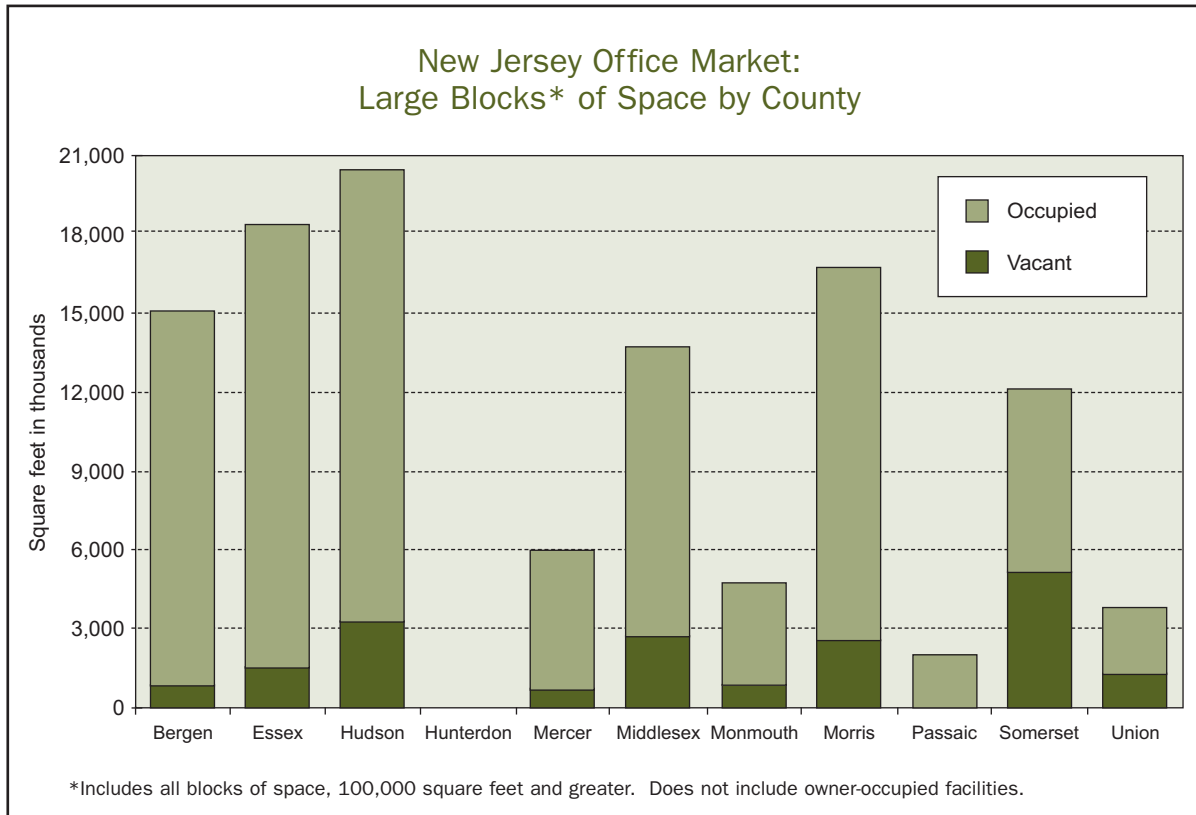
Hudson County's 20.4 million square feet in large blocks of office space should make it extremely vulnerable. However, Hudson County's admirable position as a desirable alternative to, or back office space provider for, companies based in New York, as well as Governor McGreevey's renewed Business Employment Incentive Program (BEIP), have helped to maintain its relatively healthy position. These factors have already helped win Moody's Investors Service, which will relocate 130 jobs from Manhattan to Jersey City, as well as Lord Abbett and United States Trust Company. As a result, the vacancy rate

It will require a considerable upswing in the economy to realign supply and demand in this trading area.

Northern and Central New Jersey Class "A" Office Market Second Quarter 2003

County	Buildings	Total Inventory	Direct		Total (Direct+Sublet)		Average Asking Rent	2nd Qtr. Net Absorption	2003 YTD Net Absorption
			Available Space	Vacancy Rate	Available Space	Vacancy Rate			
Bergen	99	15,837,229	2,386,091	15.1%	3,570,585	22.5%	\$29.10	(112,793)	(80,340)
Essex	63	15,341,018	2,091,715	13.6%	2,658,552	17.3%	\$29.31	47,154	(304,450)
Hudson	54	18,230,355	1,832,810	10.1%	3,623,041	19.9%	\$29.99	(136,951)	(284,702)
Hunterdon	6	387,791	33,002	8.5%	33,002	8.5%	\$27.59	—	(3,800)
Mercer	67	6,903,726	499,818	7.2%	1,115,139	16.2%	\$29.67	5,762	80,476
Middlesex	110	15,516,894	3,075,126	19.8%	4,827,539	31.1%	\$26.33	(22,118)	(17,958)
Monmouth	50	5,732,653	600,845	10.5%	1,084,818	18.9%	\$27.46	5,947	(431,509)
Morris	121	17,925,426	4,559,084	25.4%	6,653,386	37.1%	\$27.42	(87,011)	(603,357)
Passaic	21	2,396,069	270,950	11.3%	308,294	12.9%	\$27.06	(2,308)	5,475
Somerset	101	14,335,360	4,497,557	31.4%	7,028,611	49.0%	\$28.37	(1,402,065)	(247,095)
Union	28	3,572,573	599,999	16.8%	961,244	26.9%	\$27.58	(60,169)	(81,030)
TOTAL	720	116,179,094	20,446,997	17.6%	31,864,211	27.4%	\$28.03	(1,764,552)	(1,968,290)
Central NJ	356	46,061,206	9,273,345	20.1%	15,017,351	32.6%	\$27.65	(1,472,643)	(697,116)
Northern NJ	364	70,117,888	11,173,652	15.9%	16,846,860	24.0%	\$28.34	(291,909)	(1,271,174)

*Includes all office buildings, 10,000 square feet and greater. Does not include owner-occupied facilities.



Although Somerset County is still feeling the brunt of this slowdown, Monmouth County is poised for what may be the start of a rebound.

for large blocks of space is comparatively small at 16.1 percent.

The total vacancy rate for Class A space in these counties increased by about half to 22.5 percent in Bergen and 19.9 percent in Hudson.

While the change from the previous quarter is less dramatic, Morris (29.2 percent) and Middlesex (26.9 percent) Counties are also exhibiting record-high total vacancy rates. Asking rents averaged \$25.86 and \$24.63, respectively.

Middlesex County also shows substantial vacancy rates in its large blocks of space as vacant. The county has 13.8 million square feet in large spaces. However, 2.8 million square feet, or 20.5 percent, are vacant.

Approximately one-third of the Class A commercial space in Morris and Middlesex Counties is vacant. Owners are asking \$26.33 and \$27.42 per square foot, respectively.

Monmouth County's signs of improvement persist. This is due to a humming local economy and demand

from the growing defense industry and several engineering firms that have recently signed leases. Since March 2003, the total vacancy rate decreased by 11 percent to 12.8 percent as did net absorption, improving 92 percent over this time period to a low negative 37,181. Average asking rents are \$24.17.

Class A office property demonstrated a total vacancy rate of 18.9 percent and asking rents of \$27.46.

Although Somerset County is still feeling the brunt of this slowdown, Monmouth County is poised for what may be the start of a rebound. Hopes remain hinged on a national economic rebound and the Governor's renewed Business Employment Incentive Program to kick-start the economy and ultimately, New Jersey's commercial real estate market.

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commercial market is warming up. According to the Monmouth County Department of Economic Development and Tourism, the county saw a 24 percent increase in permits, expanding from \$6,377,507 in December 2002 to \$7,906,266 in March 2003. Much of this growth is attributed to additions, renovations, and smaller projects (under 10,000 square feet). However, a few larger endeavors are also in the works—a 200,000 square-foot building in Wall for Horizon Blue Cross Blue Shield, an 89,200 square-foot building in Colts Neck, a 28,000 square-foot project in West Long Branch, a 25,000 square-foot structure in Howell, a 23,672 square-foot building in Freehold Township, and a 22,000 square-foot project in Eatontown.

Offering further proof that Monmouth County's economic downturn may be "all washed up," the summer months, typically slow for the commercial office industry, have been uncharacteristically busy. Many of the firms keeping brokers active this

summer are already located in the area and are in search of larger space to accommodate expansion. Monmouth County prides itself on such internal growth, with most of its progress attributed to the success and expansion of local businesses rather than the relocation of large Fortune 100 companies. One River Center, a 482,000 square-foot corporate office park in Middletown, is replacing some telecommunications space with area businesses in the admirable position of outgrowing their existing offices. Other expanding firms include Kato Foods (76,000 square feet); HealthNet (75,000 square feet); Booz-Allen & Hamilton (25,000 square feet); Shore Health Group (20,000 square feet); Titan Health Corp (10,000 square feet); KMJ Accounting (8,000 square feet); and Knight Trading (5,000 square feet).

However, as word of the area's prosperity spreads, the larger firms based elsewhere may begin to pursue moving to the Jersey Shore. While still not a "day at the beach," the climate is steadily improving. ■

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