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James W. Hughes and Joseph J. Seneca, editors

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Short-Term Questions and Long-Term Concerns

By James W. Hughes and Joseph J. Seneca

Three things are certain in life: death, taxes, and endemic economic concerns. No matter how strong an economy has been growing, there has never been a time when there wasn't some concern about the hazards ahead. So it is with the United States and New Jersey economies of today. Both are now moving deep into the second half of 2006. New Jersey fully retains its powerful core of leading-edge, knowledge-based economic activities. However, going forward, it has two major concerns. The first is *short term*. Even though the state's economy continued to expand in 2006, employment growth has slowed substantially, particularly in the private sector. This loss of economic momentum comes at a time when the national economic expansion is maturing. Currently (August 2006), the expansion is 57 months old. The average length of the nine postwar national expansions, excluding the current one, is 59 months. That average will be reached this October. Thus, America's current expansion will achieve above-average-length status in November. Since we have yet to invent an economic expansion that lasts forever, the maturing of the current one raises questions about its eventual demise and the impact on New Jersey.

Moreover, the stresses of higher interest rates and sharply rising energy costs are causing national economic growth to slow measurably. Inevitably, a weakening national economy and a maturing economic cycle will filter down into New Jersey. This makes for a modest short-term outlook for the balance of the year, particularly given the state's 2006 employment downshift. *(continued, next page)*

Exodus from Manhattan to New Jersey?

By Sachiyo Asakawa

Manhattan is running out of office space. Employment is robust, and companies want to be located in Manhattan. In the second quarter of 2006, the vacancy rate for "class A" space in Manhattan was 8.9 percent, with an average asking rent of $56.51 per square foot. In the most prestigious Midtown market, roughly bounded by 40th Street to the south and Central Park to the north, average asking rent has climbed to $85 per square foot. The asking rent for the General Motors building at 767 Fifth Avenue reached $175 a square foot. With increasing demand and falling office construction, many landlords and brokers expect that asking rent will pushed to a record high, and the vacancy rate will drop below 3 percent by 2009.

This scenario bodes well for New Jersey. Much like the exodus to New Jersey after 9/11, companies are seeking New Jersey office locations. *(continued, p. 5)*

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The region's once unique advantage in knowledge-based workers is fading under the stress of its high-cost environment.

The *long-term* concern is the impact of globalization on New Jersey and its peer states of the Northeast, all of which have significant employment concentrations in knowledge-based industries and are high-cost places of doing business. The impact of globalization appears to be twofold. First, new worldwide knowledge-based competitors have cost structures that are significantly below those of the United States. Accordingly, some of the high-end economic growth of New Jersey and other northeastern states is leaking to these new global competitors. Second, this same cost differential places the Northeast at a disadvantage within the United States, as corporate America must continually and aggressively cut costs to remain competitive under unrelenting global pressures. The region's once unique advantage in knowledge-based workers is fading under the stress of its high-cost environment. Labor, like capital, is mobile, and high value-added service sector economic activity can successfully occur in lower-cost, more affordable states of the Sunbelt. Employment data indicate that this is already occurring, with a short-term impact on New Jersey and implications for the state's future economic competitiveness.

New Jersey's 2006 Economic Slowdown

The downshift in New Jersey's employment growth in the first half of 2006 raises questions about the direction of the state's economy for the balance of the year as the national economy slows in response to the steady increase in interest rates engineered by the Federal Reserve. The scale of the state's economic downshift can be gauged by comparing employment growth in the first six months of 2006 to the equivalent six months of 2005. Total nonfarm payroll employment in New Jersey grew by 17,700 jobs in the first half of 2006 (table 1). This was 39 percent below the 29,000 jobs added in the first half of 2005. Some reduction was to be expected due to a slowdown in the nation's job growth, but not to this extent. Nationally, employment growth slowed by 13 percent, from a 981,000 job increase in the first half of 2005 to an 854,000 job increase in the first half of 2006. Thus, New Jersey's job growth slowdown was three times greater than that of the nation (39 percent versus 13 percent).

New Jersey's downshift into a slower economic gear began in the second half of 2005. To put the state's current growth into a broader perspective, during the last two expansions (1982–1989 and 1992–2000) the state's average monthly employment gain was 6,452 jobs. During the first half of 2006, New Jersey gained 2,950 jobs per month, less than one-half the average monthly gain experienced in the last two expansions.

Moreover, employment growth in the first half of 2006 was bolstered by a more than doubling of government employment growth compared to 2005. In the first half of 2005, the state added 3,000 government jobs. In the equivalent period of 2006, New Jersey added 6,400 government jobs. This public-sector employment growth partially masked a severe reduction in private-sector employment growth, which declined from a 26,000 job increase in the first six months of 2005 to an 11,300 job increase in the first six months of 2006, a 57 percent decline in job growth.

The situation in the private service-providing sector was essentially the same, with growth in the first six months of the year falling from 31,100 jobs in 2005 to 13,600 jobs in 2006, a 56 percent decline. Significant downshifts occurred in trade, transportation and utilities (+6,300 jobs to +300 jobs), professional and business services (+8,200 jobs to +3,600 jobs), information (+100 jobs to –2,800 jobs), and financial activities (+1,300 jobs to +100 jobs). These are the higher-paying sectors of the New Jersey economy. Concurrently, two of the three lower-paying private-service-providing sectors also experienced growth reductions: leisure and hospitality (+5,800 jobs to +4,500 jobs) and other services (+4,400 jobs to +2,000 jobs). In contrast, the education and health services sector was able to accelerate its seemingly relentless expansion (+5,000 jobs to +5,900 jobs). Surprisingly, the state was able to reduce its losses in the goods-producing sector, one of the few positive developments in 2006. This was all due to manufacturing, whose losses fell from –6,100 jobs in the first half of 2005 to –3,200 jobs in 2006.

TABLE 1
New Jersey Nonfarm Payroll Employment
Absolute Change
December 2004–June 2005 vs. December 2005–June 2006
(Seasonally adjusted; numbers in thousands)

	Dec. 2004-June 2005	Dec. 2005-June 2006
Total Nonfarm	29.0	17.7
Total Private Sector	26.0	11.3
Goods-Producing	–5.1	–2.3
Natural Resources and Mining	0.1	0.0
Construction	0.9	0.9
Manufacturing	–6.1	–3.2
Private Service-Providing	31.1	13.6
Trade, Transportation, and Utilities	6.3	0.3
Information	0.1	–2.8
Financial Activities	1.3	0.1
Professional and Business Services	8.2	3.6
Educational and Health Services	5.0	5.9
Leisure and Hospitality	5.8	4.5
Other Services	4.4	2.0
Government	3.0	6.4

Note: North American Industry Classification System (NAICS) employment sectors.
Source: New Jersey Department of Labor.

Economic Cost Competitiveness

In the August 2005 *Sitar–Rutgers Regional Report*, it was first reported that there were precious few net new employment additions to the state's knowledge-based economic core in the post–2000 period. These are the white-collar office jobs in financial activities, information, and professional and business services that are of key importance to the state's office markets.[1] The leveling off in the employment growth in these sectors is not unique to New Jersey but is shared with its advanced-economy peers in the Northeast Region of the United States—New York in the Middle Atlantic Division of the Northeast, and Connecticut and Massachusetts in the New England Division. This stands in marked contrast to the emerging peer states in the Sunbelt.

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Table 2 lists the growth in *combined* employment in information, professional and business services, and financial activities by geographic region, division, and selected states for the 2000–2005 period. The broad pattern is that national growth in these three sectors combined slowed dramatically in the nation as a whole. However, the Northeast and Midwest slipped into actual decline, while growth was concentrated in the South and West, except for California, which reflected the pattern of the Northeast and Midwest.

While the Northeast lost 204,000 jobs in information, professional and business services, and financial activities, the South gained 409,300 jobs. Similarly, while the Middle Atlantic Division of the Northeast lost 126,000 jobs, the South Atlantic Division of the South gained 302,400 jobs. At the state level, Connecticut, Massachusetts, New Jersey, and New York were losers, while Florida, Maryland, North Carolina, and Virginia were ***(continued, next page)***

[1] Professional and business services include management of companies and enterprises (corporate headquarters), scientific and technical services, legal services, accounting services, engineering services, research and development services, and computer systems design and services, among others. Financial activities include finance, banking, securities investment and brokerage, and insurance, as well as others. Key components of the information sector are telecommunications and Internet-related activities. All of these employment categories are measured by the North American Industry Classification System (NAICS).

winners. A significant positive sign for New Jersey was that it had the smallest absolute decline in the Northeast and the lowest rate of decline.

New Jersey is enmeshed in a broader dynamic of declining competitiveness of the more mature developed parts of the nation.

A similar differential is evident within the West Region. The Mountain Division, led by Arizona and Nevada, had the fastest growth (7.0 percent, or 128,100 jobs) of any division, but the Pacific Division slipped into decline (–0.5 percent). This was all due to California's loss of 61,400 jobs (–1.7 percent) in the three sectors. Perhaps California could be considered the budding "Northeast" of the West!

Some of this pattern can be linked to differentials in population growth, but certainly not a majority of it. Expansion in these economic sectors is increasingly sensitive to differentials in the cost of doing business as new investment avoids more expensive places and concentrates instead in faster-growing, less-expensive locations. Consequently, employment shares in the Northeast in these high-end service-providing sectors are slipping. For example, New Jersey accounted for 4.0 percent of the nation's total employment in information, professional and business services, and financial activities in 1990. By 2005, its share had fallen to 3.5 percent. Similarly, New York's share fell from 9.6 percent to 7.3 percent, Connecticut's share fell from 1.8 percent to 1.4 percent, and Massachusetts's share fell from 3.2 percent to 2.7 percent. Thus, New Jersey is enmeshed in a broader dynamic of declining competitiveness of the more mature developed parts of the nation.

TABLE 2
Information, Professional and Business Services, and Financial Activities By Region, Division, and Selected States[a] 2000–2005

Region/Division/State	Change: 2000–2005 Absolute	Change: 2000–2005 Percentage
United States	209.3	0.7
Northeast	–204.0	–3.5
New England	*–78.0*	*–5.0*
Connecticut	–25.1	–6.2
Massachusetts	–63.4	–7.6
Middle Atlantic	*–126.0*	*–3.0*
New Jersey	–21.9	–2.2
New York	–120.2	–5.5
Midwest	–101.2	–1.6
East North Central	*–90.0*	*–2.1*
West North Central	*–11.2*	*–0.6*
South	409.3	4.3
South Atlantic	*302.4*	*5.5*
Florida	231.7	13.0
Georgia	–14.1	–1.6
Maryland	24.7	4.4
North Carolina	14.9	2.1
Virginia	27.3	3.2
East South Central	*46.1*	*3.7*
West South Central	*60.8*	*2.2*
Texas	49.1	2.5
West	105.2	1.6
Mountain	*128.1*	*7.0*
Arizona	56.4	10.6
Nevada	42.6	23.4
Pacific	*–22.9*	*–0.5*
California	–61.4	–1.7

Note: a. Employment totals for each division include all the division's states, some of which are not shown. The sum of employment for selected states will not add to division totals.

Source: U.S. Bureau of Labor Statistics.

What Is To Be Done?

The problems facing New Jersey obviously require the state to pay direct and sustained attention to its economic development policies and its business environment if it wants to recapture its former comparative advantages. Fortunately, this is now occurring in Trenton, and Governor Corzine, who has made economic growth a top priority, is devising new economic strategies and initiatives. These will be reported in detail in the November 2006 *Sitar–Rutgers Regional Report*. ■

As the Midtown office market becomes increasingly competitive, companies that need to expand have nowhere to go. One viable option for them is to come to the other side of the river, where asking rent for prime "class A" space is about $30 per square foot. Citco Fund Services, the largest hedge fund administrator in the world, moved its employees from cramped quarters in Midtown to 70,000 square feet of never-before-occupied space at 10 Harborside Plaza in Jersey City. This move lowered the vacancy rate of the Hudson Waterfront Market to 13.4 percent, down from an average 17 percent vacancy rate, where it had stagnated. Citigroup, following suit, is negotiating a lease for 370,000 square feet of office space at Newport in Jersey City, a move that will relocate 1,500 employees from their current downtown Manhattan office.

Whereas most New York-based firms tend to seek out New Jersey locations for back-office functions, Citco moved its entire headquarters to Jersey City. New Jersey, historically a locus for back-office space, welcomes this trend. *(continued, next page)*

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Northern and Central New Jersey Total Office Market
Second Quarter 2006

County	Buildings	Total Inventory	DIRECT Space Available	DIRECT Vacancy Rate	TOTAL (Direct and Sublet) Space Available	TOTAL (Direct and Sublet) Vacancy Rate	Average Asking Rent	QTD Net Absorption	2006 YTD Net Absorption
Bergen	534	29,604,117	3,576,285	12.1%	4,492,132	15.2%	$25.96	86,508	134,892
Essex	396	28,884,243	2,914,462	10.1%	3,119,677	10.8%	$25.02	29,550	142,775
Hudson	165	24,259,595	2,497,060	10.3%	3,501,604	14.4%	$26.74	98,706	1,034,560
Hunterdon	52	1,770,854	323,369	18.3%	383,084	21.6%	$23.00	(13,986)	(20,319)
Mercer	336	16,032,558	1,997,443	12.5%	2,186,048	13.6%	$24.58	(111,692)	(270,934)
Middlesex	456	26,727,004	4,663,324	17.4%	5,221,188	19.5%	$24.05	312,493	137,251
Monmouth	414	15,566,634	1,623,898	10.4%	1,801,255	11.6%	$22.06	(76,133)	(5,915)
Morris	436	29,601,651	5,699,737	19.3%	6,061,155	20.5%	$26.78	(125,083)	169,798
Passaic	160	6,659,545	1,014,646	15.2%	1,056,203	15.9%	$23.83	4,470	(33,329)
Somerset	271	19,846,099	3,255,129	16.4%	4,248,656	21.4%	$23.72	21,385	37,741
Union	308	11,193,494	1,038,226	9.3%	1,291,712	11.5%	$24.46	46,489	147,096
Total	**3,528**	**210,145,794**	**29,876,753**	**14.2%**	**33,362,714**	**15.9%**	**$25.06**	**272,707**	**1,473,616**
Central NJ	1,785	89,365,789	12,578,020	14.1%	14,748,859	16.5%	$23.77	192,542	45,239
Northern NJ	1,743	120,780,005	17,298,733	14.3%	18,613,855	15.4%	$25.22	80,165	1,428,377

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

Northern and Central New Jersey “Class A” Office Market
Second Quarter 2006

County	Buildings	Total Inventory	DIRECT Space Available	DIRECT Vacancy Rate	TOTAL (Direct and Sublet) Space Available	TOTAL (Direct and Sublet) Vacancy Rate	Average Asking Rent	QTD Net Absorption	2006 YTD Net Absorption
Bergen	78	12,800,918	1,792,729	14.0%	2,470,927	19.3%	$28.57	(14,170)	(112,634)
Essex	61	15,143,571	1,393,424	9.2%	1,562,859	10.3%	$27.33	18,878	162,506
Hudson	49	19,180,692	1,687,752	8.8%	2,665,442	13.9%	$30.86	89,552	1,002,696
Hunterdon	6	762,030	207,608	27.2%	255,335	33.5%	$24.28	12,058	10,839
Mercer	68	7,033,448	1,033,443	14.7%	1,172,886	16.7%	$26.86	(229,952)	(356,705)
Middlesex	114	15,847,576	3,155,266	19.9%	3,570,222	22.5%	$25.58	397,833	253,006
Monmouth	55	6,386,016	509,296	8.0%	609,928	9.6%	$26.63	(14,616)	(850)
Morris	127	18,888,299	4,479,499	23.7%	4,807,117	25.5%	$27.81	(74,962)	101,570
Passaic	16	2,040,351	573,473	28.1%	585,483	28.7%	$25.90	(39,401)	(104,301)
Somerset	100	14,407,892	2,496,095	17.3%	3,463,370	24.0%	$24.12	54,815	82,638
Union	30	3,836,174	426,873	11.1%	671,472	17.5%	$28.38	18,603	192,739
Total	**704**	**116,326,967**	**17,755,458**	**15.3%**	**21,835,041**	**18.8%**	**$26.53**	**218,638**	**1,231,504**
Central NJ	367	47,511,106	7,620,973	16.0%	9,487,878	20.0%	$26.31	226,683	170,828
Northern NJ	337	68,815,861	10,134,485	14.7%	12,347,163	17.9%	$27.46	(8,045)	1,060,676

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

Although Jersey City has attractive new inventory of office space with state-of-the-art facilities, there is a perceived stigma attached to locating offices in New Jersey. Jersey City is simply not Manhattan, and companies want to be in Manhattan to boast a prestigious New York City address. Firms also seek proximity to competitors in the industry cluster. Still, the headquarters move of the world’s largest financial group, Citco Fund Services, may draw other financial companies to Jersey City and correct the perception that a New Jersey address is not a plus for business locational decisions.

While we applaud major moves to Jersey City, we must note that office spaces in the Jersey City market will eventually be fully leased. Most buildable parcels in the area are likely to be targeted for residential development unless the housing market slowdown accelerates. ■

A Summer of Some Discontent

by Sachiyo Asakawa; Greg Nowell, Senior Vice President; and Christopher Santoro, Assistant Vice President

As many industry professionals predicted, the northern New Jersey office market continued to be stable through the second quarter of 2006. The total vacancy rate dropped slightly to 15.9 percent, a 0.4 percent decrease from 16.3 percent in the previous quarter. The sign of a healthy market was also seen in the rise of average asking rent from $24.93 per square foot to $25.06, the highest in the past four quarters.

The largest lease transaction in the second quarter of 2006 was Washington Group International's renewal of 234,000 square feet at 510 Carnegie Center in Princeton, encompassing the first to sixth floors. The most notable transaction, also the second largest in size, was a 93,190-square-foot lease of 1 Gateway Center in Newark to the law firm of Gibbons, Del Deo, Dolan, Griffinger & Vecchione. This single transaction marks an important turning point for the Newark office market. The vacancy rate for the Newark office market dropped to a record-low 14.0 percent while the average asking rent was pushed to $25.60, a record high, at the end of this year's second quarter. Compared with the same quarter two years ago, when the average rental rate was $23.50 and the vacancy rate was 16 percent, this quarter was a great achievement for the Newark office market. With newly elected Mayor Cory A. Booker taking office, the city of Newark is optimistic about the outlook for its office market.

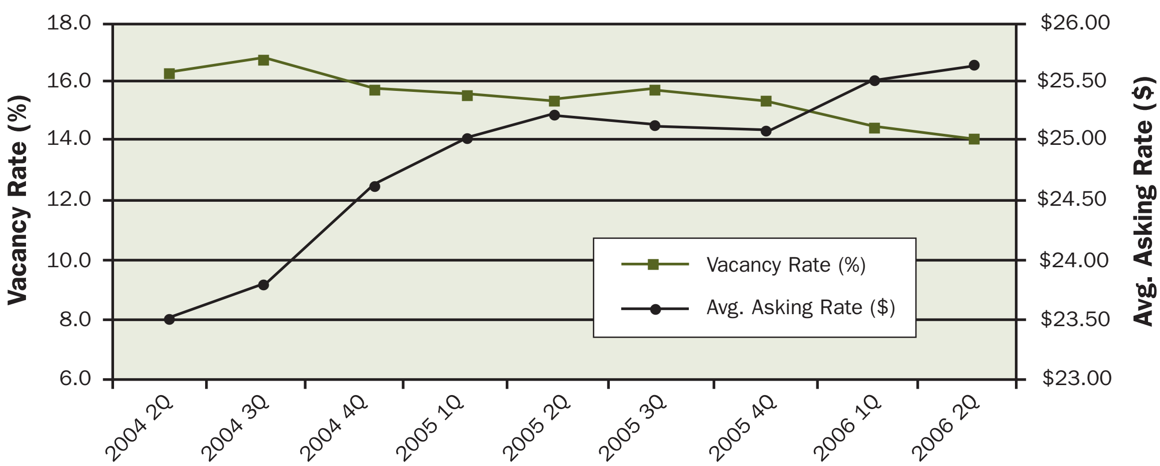
The city of Newark is optimistic about the outlook for its office market.

As contrast to the awakening Newark market, the Monmouth office market slowed during the second quarter after consecutive robust quarters during the last six months of 2005 and the first quarter of 2006. Monmouth's total vacancy rate climbed to 11.6 percent from 9.9 percent in the previous quarter, and asking rent dropped to $22.06 per square foot from $22.66.

Historically, activity during the summer months is noticeably slower, and we believe this holds true for the summer of 2006. Industry professionals have noticed numerous transactions—both sale and lease—to be moving slowly or put on hold. Many large-space users are reluctant to make commitments in view of broader economic concerns and the ever-increasing costs of oil and energy. Further, we have noticed many of our clients slowing down the hiring of new employees and the postponement of expansion into new markets and territories.

Escalating gas prices and the current state of global affairs are key influences that will likely affect the northern New Jersey office market this summer. These forces may lead the market in unpredicted directions, the results of which will be seen in the next quarter. ■

Average Asking Rate and Total Vacancy Rate, Newark Office Market



China and New Jersey: Perfect Together

By Joseph Nitti, President—Industrial Division

China—now the major manufacturing site for furniture, household appliances, garments, and toys, as well as telecommunications equipment and personal computers—has become the epicenter for international logistics. With mergers such as Lenovo with IBM's PC unit, China will produce more than three-fifths of the world's personal computers. Home furniture made in China now accounts for 50 percent of the U.S. home furniture market. Well-known Fortune 500 internationals like Microsoft, Motorola, General Motors, General Electric, Dupont, Proctor and Gamble, and Siemens have long been in China, and it is estimated that one out of every four full containers exported in Shenzhen in 2004 was purchased by Wal-Mart.

China's major comparative advantage as a global manufacturing sector is its seemingly unlimited work force, composed of former farm workers who have migrated to the cities. Labor costs remain low and, consequently, low-paid labor enables prices for goods and services to be low. Global sourcing strategies drive multinational companies to outsource in China, providing opportunities for the country to establish networks with the rest of the world. With this move toward outsourcing of manufacturing, increased demand has arisen for international logistics. Logistics systems have became more sophisticated and efficient than ever. UPS now goes not only from door to door in the United States but from China to your door.

With China's emerging role as an epicenter of manufacturing and logistics, the United States must assess its place in a changing global economy. New Jersey is unique because it is home to the major sea and air cargo port system on the East Coast; its port ranks third largest in the nation. China's manufacturing power, combined with the new "All Water Route" that moves products to the New York metropolitan market, has strengthened the demand for warehouse and distribution centers here. If New Jersey's industrial market can keep pace with the challenges posed by the new global logistics, the state should be able to enjoy a strong future in this economic sector. ■

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William Sitar, President, Sitar Company • ONCOR International

Sachiyo Asakawa, Director of Research, Sitar Company • ONCOR International

James W. Hughes, Dean, Edward J. Bloustein School of Planning and Public Policy

Joseph J. Seneca, University Professor, Rutgers, The State University of New Jersey

Production: **Larry Brown, Will Irving, and Arlene Pashman**

Sitar Company • ONCOR International
1481 Oak Tree Road
Iselin, NJ 08830
732/283-9000
www.sitarcompany.com

Edward J. Bloustein School of Planning and Public Policy
Rutgers, The State University of New Jersey
33 Livingston Avenue, Suite 300
New Brunswick, New Jersey 08901-1981
www.policy.rutgers.edu