

# Sitar–Rutgers

## Regional Report

James W. Hughes and Joseph J. Seneca, editors

### 2002: A Turnaround Year

By James W. Hughes and Joseph J. Seneca

**T**he opening of year 2002 finds New Jersey and the United States still enmeshed in a recession which “officially” began in the first quarter of 2001. The recession stemmed from a fundamental cyclical adjustment—characterized both by plummeting business investment and plunging business inventories—exacerbated by the effects of the September 11 terrorist attacks. But this year New Jersey and the United States will begin recovery. The key questions are exactly when and how strong will it be.

#### It’s Official: The First Recession of the New Millennium

According to the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER):

A recession is a significant decline in economic activity spread across the economy,

lasting more than a few months, visible in industrial production, employment, real income, and wholesale-retail trade. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough.

On November 26, 2001, the Committee released its determination that the national economy had reached a peak of activity during the month of March 2001 and then began to decline. So, the Great Trans-Millennial Expansion, which began in March 1991, was finally put to bed after a full 10-year duration (or 120 months)—the longest economic expansion in history. The first recession of the new millennium—and the first new-economy recession—therefore began in March 2001, and employment began a sustained decline. Subsequently, in the third quarter of 2001, *(continued, p. 2)*

### Real Estate Recovery . . . Around the Corner?

By Richard Heilmann, SIOR

**A**lan Greenspan, Fortune 500 companies, Market Gurus, real estate developers. . . they are all stating that economic recovery is coming, that the U.S. economy and real estate markets have hit bottom, and that there is evidence that we are heading out of the recession.

While we hope the experts are accurate in their forecasts, the commercial real estate market enters the first quarter of 2002 with doubts and concerns. There are tremendous office vacancies throughout central and northern New Jersey, and the “big box” distribution market in central New Jersey is experiencing the slowest activity and highest vacancy rate in five years. This is a remarkable turnaround from the first quarter of 2000, just 24 months ago. At that time there were two office tenant prospects for every one space of availability.

There were bidding wars for prime office space. Office rents peaked at \$43.00 per square foot for Class A space. In the industrial market, rents for large distribution space in the Meadowlands area reached \$7.50 per square foot.

Heading into the first quarter of 2002, rents are down, vacancies are up. How long will this last?

Upon surveying many of our customers—which includes corporations from a broad spectrum of industries—there is consensus that business will improve by the end of the third quarter of 2002 and continue into the fourth quarter. Most of our customers maintain a business plan for growth in 2002 and believe the worst will be over soon. It is predicted that the industry leaders of economic recovery will be defense contractors; engineering; *(continued, p. 7)*

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Campus at New Brunswick

Annual Change in Employment  
New Jersey vs. the U.S. 1993–2001  
(Numbers in thousands)

			NJ		U.S.	
			Number	Percent	Number	Percent
1993:	December 1992	December 1993	45.9	1.3	2,768.0	2.5
1994:	December 1993	December 1994	73.3	2.1	3,884.0	3.5
1995:	December 1994	December 1995	21.9	0.6	2,200.0	1.9
1996:	December 1995	December 1996	67.8	1.9	2,795.0	2.3
1997:	December 1996	December 1997	92.5	2.5	3,356.0	2.8
1998:	December 1997	December 1998	74.4	2.0	3,017.0	2.4
1999:	December 1998	December 1999	107.3	2.8	2,752.0	2.2
2000:	December 1999	December 2000	80.6	2.0	2,329.0	1.8
2001:	December 2000	December 2001	(14.5)	(0.4)	(1,080)	(0.8)
1998–2000: Annual average			87.4	--	--	--
Post World War II: Annual average			50.0	--	--	--
Source: New Jersey Department of Labor U.S. Department of Labor, Bureau of Labor Statistics						

*Thus, a job-creating economy succumbed to a job-devouring economy.*

the Gross Domestic Product (GDP) of the United States declined by 1.3 percent. National economic swagger was replaced by economic stagger.

### The New Jersey Downturn

So, too, recession came to New Jersey. Employment peaked in the state in February 2001, indicating that the state slipped into recession virtually at

the same time as the nation. Between February 2001 and September 2001—just prior to September 11—about 20,000 jobs were lost in New Jersey, according to revised figures. If the February-to-September trend had continued through the end of the year, New Jersey was on course to lose 30,000 jobs in 2001. Thus, a job-creating economy succumbed to a job-devouring economy.

But the terrorist attack on lower Manhattan rendered 30 million square feet of office space unavailable and displaced at least 100,000 jobs. A number of these dislocated jobs immediately shifted to New Jersey, overriding and obscuring the continuing underlying economic deterioration. As a result, in October, the state experienced a net gain of 14,800 jobs—the product of job transfers from lower Manhattan superimposed on the state’s trend of job losses. But net employment contraction quickly returned in November and December. Nonetheless, New Jersey had a net gain of 5,600 jobs in the fourth quarter of 2001 (October, November, and December). For the year, there was a net loss of 14,500 jobs in New Jersey during 2001, measured from December 2000 to December 2001. While this is quite modest for a recessionary year, it represents a major swing from the previous three years, where annual employment growth in the state averaged 87,000 jobs.

By December 2001, the unemployment rate in the state had reached 4.9 percent, up from an average of only 3.8 percent for all of 2000. While New Jersey’s current rate stands nearly a full percentage point lower than the December 2001 national rate (5.8 percent), the state’s unemployment did increase dramatically at the end of 2001. So, New Jersey started off 2002 deep in the economic trough, with the prospects for rising unemployment and job losses extending into the second quarter of the year.

Nonetheless, during 2001, New Jersey’s downturn was generally milder than that of the nation. Employment in the United States declined by 0.8 percent between December 2000 and December 2001. During the same time frame, employment in New Jersey declined by 0.4 percent, one-half of the national rate. The nation has experienced a net loss of over one-million jobs in the past year, compared to a loss of only 14,500 in New Jersey. Obviously, dislocated economic activity from lower Manhattan to the state has played a significant role in buffering the state’s overall employment picture. Otherwise, the state would be tracking the overall national decline much more closely.

## Shifting Tides

But we should not forget that we have yet to invent a recession that lasts forever. At some point in 2002, the economic tides will shift, if only based on historical averages. The average post-World War II national recession is eleven months long. Since the national downturn started in March 2001, then an “average” recession would be finished by February 2002. The longest post-war recession was 16 months. Replicating that experience would see the current recession end in July 2002. So based on post-war history, the recession should end sometime between February 2002 and July 2002. However, there is a historical aspect of the business cycle which may portend a longer downturn.

*... we have yet to invent a recession that lasts forever.*

## New Slowdown Type

Since 1946, every downturn in the U.S. has been driven by rising interest rates, consumer spending declines, and a slump in housing activity. These trends characterized the last eight recessions. Rising interest rates were caused by Federal Reserve tightening in the face of inflation. Consumers then cut back on spending, with housing and automobile purchases most drastically affected. After that impact was felt, industrial production declined, yielding recession.

The current slowdown, however, before September 11, was a backward one. It was led by a decline in business capital investment—particularly in high technology and information technology—following the incredible capital investment boom of the second half of the 1990s. It was consumer spending and housing that had kept the economy afloat. So, this is a unique situation in our modern era.

However, investment-led slowdowns were common before World War II. Their downside is that they take much longer to recover. For example, between 1854 and 1945, the average recession lasted for 21 months. The present economic cycle—a business investment-led recession—may have more in common with those that took place before World War II than with those that took place after it. That would suggest a recession ending in December. So 2002 is (*continued, p. 4*)

destined to see recovery. The question is whether it will take place at the beginning, middle, or end of the year—not quite a precision forecast!

### Recent Barometer Readings

According to NBER, a recession ends after a trough of economic activity occurs. While this has not yet happened, there were a number of national indicators released in January 2002 that point to a national bottoming out: GDP (advance estimate) grew by 0.2 percent during the fourth quarter of 2001, the number of workers filling new claims for unemployment benefits fell to the lowest level in six months, annual new home sales and existing home resales both set new national record highs in 2001, consumer confidence levels rose quite strongly for two straight months, and the Index of Leading Economic Indicators increased for three straight months bringing the index level above the pre-recession peak. It's no wonder that Federal Reserve Chairman Alan Greenspan, in testimony before the U.S. Senate's Committee on the Budget on January 24, 2002, stated that the nation is poised between an economic contraction and a resumption of economic growth. And on January 29, 2002, the Federal Reserve did not raise interest rates, keeping its target for the federal funds rate unchanged at 1.75 percent. In addition, large amounts of new federal spending were beginning to occur.

Despite this somewhat positive outlook, there is, nonetheless, another factor that adds uncertainty. While this does not spell doom, it does suggest a potential growth inhibitor in 2002.

### Not Quite a Doomsday Scenario

While we have discussed alternative alphabet recoveries before, early 2002 may see a new economic twist: overlapping alphabets. Two simultaneous recoveries may be underway—a quick V-shaped recovery and a much slower unfolding U-shaped recovery. The V-shaped recovery represents the sharp bounce-back from the terrorist attack of September 11. That attack caused an immediate direct loss of economic output, as a result of massive disruption and

dislocation. Subsequently, the economy immediately suffered an extraordinary demand jolt, derailing the consumer spending locomotive. But the vast shock effect of September 11 has started to fade, evidenced by the upturn in the economic indicators cited above.

The U-shaped recovery is the much more gradual comeback from the inventory overhang and the capital investment collapse. Bloated inventories already have been slashed at a record pace. But while inventory rebuilding will soon begin, we are still some time from an upturn in capital spending because of low levels of capacity utilization. The combination may well yield a “half-speed ahead” economy through 2002.

The worst case scenario, although unlikely, is the possibility of a double-dip recession, with the V-shaped rebound petering out before the U-shaped recovery gathers significant momentum. This could conceivably play out with negative GDP growth in the first quarter of 2002 following the surprising positive (+0.2 percent) GDP growth in the fourth quarter of 2001. Whether or not a double dip occurs, it is probable that instead of a full-fledged recovery and expansion, we may see a “half-fledged” recovery and expansion in 2002, a possibility underlaid by several other factors.

### A Half-Fledged Expansion

Whatever the exact starting date of the expansion in 2002, it is likely that there will not be a return to the level of growth that characterized the second half of the 1990s. Nationally, that spectacular growth was the result of an extraordinary set of circumstances:

- a long-term process of globalization and deregulation,
- a shift of resources from the public sector to the private sector as a result of the end of the cold war,
- huge federal budget surpluses,
- the emergence of the stock market as a national sport,
- huge capital overinvestment in high technology and telecommunications, and
- a new information age economy where the sustained removal of frictions from the economic system spurred productivity gains. (*continued, p. 8*)

*Two simultaneous recoveries may be underway—a quick V-shaped recovery and a much slower unfolding U-shaped recovery.*

# Tenants Gaining Upper Hand

By Matthew J. Dolly

**W**hile the fourth quarter of 2000 closed out a very successful year in the northern and central New Jersey office market, the end of 2001 is not so promising. During the year, the market experienced everything from a national tragedy to a sluggish economy, both of which in turn forced many large companies to lay off several thousand employees and put large quantities of sublease space on the market. As of year-end 2001, a total of nearly 32 million square feet of office space remained available, with roughly one-third of the total being sublease space. Although only 11.5 percent of the total inventory remained vacant, the rate climbs to 17.7 percent when factoring in available sublease space. When comparing this number to one year ago, a substantial increase in available space is recognized considering that only 12 percent of the total space (including sublease space) was available at the close of 2000.

Nearly two-thirds of the total available office space is listed in class "A" buildings. Amazingly, of the 19.7 million square feet of available class "A" inventory, 9 million square feet consists of sublease space. Furthermore, in the five counties that make up central New Jersey, class "A" buildings report more sublease space available than new and relet space—remarkable considering all of the new construction that has taken place since 1995. AT&T and Lucent Technologies are responsible for the three largest blocks of sublease space in central New Jersey, returning to the market three units of more than 300,000 square feet in Warren, Franklin Township, and Middletown. In the northern New Jersey counties, the largest contributors to the five million square feet of sublease space on the market are Lucent, Tycom, Telcordia, and Nabisco.

Average asking rents remained at about the same level as they were during the third *(continued, p. 6)*

*During the year, the market experienced everything from a national tragedy to a sluggish economy.*

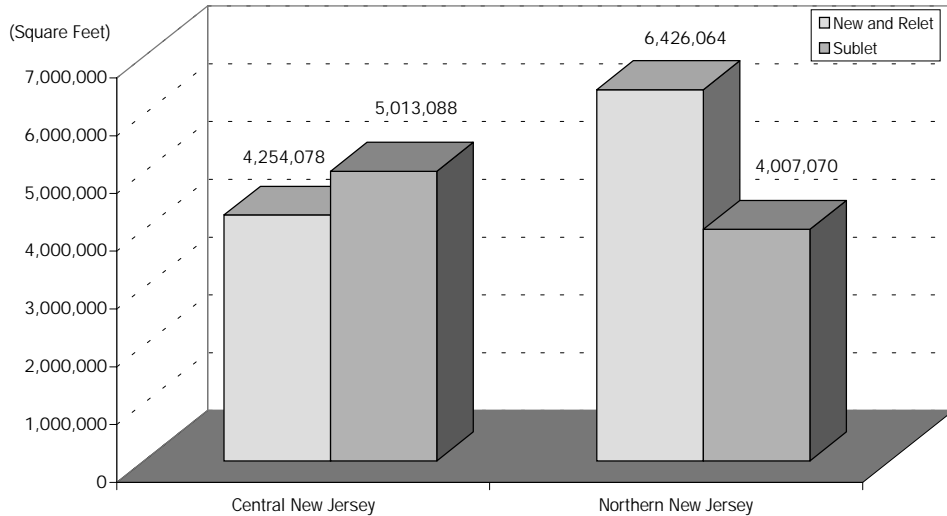
Northern and Central New Jersey Total Office Market  
Fourth Quarter 2001

County	Buildings	Total Inventory	Available Space	Vacancy Rate	Sublet Available	Average Asking Rent	4th Qtr. Net Absorption	2001 YTD Net Absorption
Bergen	528	28,467,018	2,909,732	10.2%	1,002,586	\$25.67	478,279	209,068
Essex	344	28,445,139	4,487,240	15.8%	424,280	\$23.63	639,418	503,338
Hudson	140	18,702,447	1,178,514	6.3%	672,624	\$28.90	281,888	1,690,669
Hunterdon	42	1,186,777	111,503	9.4%	---	\$21.74	49,687	(48,337)
Mercer	307	15,198,201	2,016,998	13.3%	588,600	\$23.63	(34,360)	33,903
Middlesex	377	24,919,466	2,313,568	9.3%	2,687,134	\$23.57	1,017,285	974,905
Monmouth	305	12,307,054	823,495	6.7%	606,525	\$21.73	3,853	240,866
Morris	375	25,654,298	3,530,457	13.8%	2,492,588	\$26.39	1,093,846	1,721,547
Passaic	136	5,648,289	524,278	9.3%	666,318	\$19.70	32,226	(6,240)
Somerset	223	15,905,104	2,408,853	15.1%	1,977,819	\$25.51	229,322	701,107
Union	270	9,566,993	1,154,128	12.1%	402,347	\$22.24	(437,875)	(17,017)
<b>TOTAL</b>	<b>3,047</b>	<b>186,000,786</b>	<b>21,458,766</b>	<b>11.5%</b>	<b>11,520,821</b>	<b>\$24.65</b>	<b>3,353,569</b>	<b>6,003,809</b>
Central NJ	1,482	77,896,818	8,717,042	11.2%	6,262,425	\$23.77	778,225	1,933,764
Northern NJ	1,565	108,103,968	12,741,724	11.8%	5,258,396	\$25.17	2,575,344	4,070,045

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

## 6 Tenants, *continued*

New Jersey Office Market  
New and Relet vs. Sublet Availability  
Class "A" Buildings Only



Central New Jersey: Mercer, Middlesex, Monmouth, Somerset, and Union Counties  
Northern New Jersey: Bergen, Essex, Hudson, Hunterdon, Morris, and Passaic Counties

Northern and Central New Jersey Class "A" Office Market  
Fourth Quarter 2001

County	Buildings	Total Inventory	Occupied Space	Available Space	Vacancy Rate	Sublet Available	Average Asking Rent	4th Qtr. Net Absorption	2001 Net Absorption
Bergen	130	18,077,859	16,284,345	1,793,514	9.9%	678,842	\$27.47	364,120	318,232
Essex	68	13,768,798	12,396,228	1,372,570	10.0%	307,796	\$26.55	609,472	631,512
Hudson	46	14,604,143	14,222,402	381,741	2.6%	635,591	\$32.48	399,267	1,663,175
Hunterdon	7	406,957	363,471	43,486	10.7%	---	\$25.68	(1,000)	(40,320)
Mercer	64	6,419,328	5,809,842	609,486	9.5%	447,473	\$25.77	(110,745)	(39,936)
Middlesex	101	14,398,119	13,069,624	1,328,495	9.2%	1,930,661	\$24.93	910,333	1,116,060
Monmouth	40	5,369,102	5,137,511	231,591	4.3%	497,020	\$24.93	24,612	215,105
Morris	143	18,503,629	15,755,707	2,747,922	14.9%	2,246,588	\$27.03	1,073,113	2,015,080
Passaic	22	2,362,478	2,275,647	86,831	3.7%	138,253	\$21.07	(100,402)	(2,500)
Somerset	95	12,048,541	10,203,576	1,844,965	15.3%	1,763,598	\$27.62	184,478	722,932
Union	25	3,026,560	2,787,019	239,541	7.9%	374,336	\$24.44	(77,677)	394,594
<b>TOTAL</b>	<b>741</b>	<b>108,985,514</b>	<b>98,305,372</b>	<b>10,680,142</b>	<b>9.8%</b>	<b>9,020,158</b>	<b>\$26.66</b>	<b>3,275,571</b>	<b>6,993,934</b>
Central NJ	325	41,261,650	37,007,572	4,254,078	10.3%	5,013,088	\$26.19	931,001	2,408,755
Northern NJ	416	67,723,864	61,297,800	6,426,064	9.5%	4,007,070	\$27.28	2,344,570	4,585,179

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

... in central New Jersey, class "A" buildings report more sublease space available than new and relet space.

quarter of 2001. Asking rents are not spiraling downward because the average is based on new and relet space, which has not become available at nearly the same velocity as has sublease space. One thing that has become available are landlord concessions, which had disappeared for about three years. Tenants have begun to gain the upper hand on the market, especially since the sublease space available offers flexibility in lease terms. Another advantage of leasing sublease space is that often enough furniture and technology are left behind, so that even if the lease rates remain higher because of the quality of space, tenants are saving money on their overhead costs. This certainly is an attraction for tenants who were displaced during the World Trade Center Disaster.

While large blocks of sublease space continue to saturate the market, several large tenants took occupancy during the fourth quarter of 2001, providing for somewhat of a silver lining to a cloudy market. Novartis moved into their new facility in Parsippany, leasing 143,000 square feet. Also, Chubb and Son moved into a new 100,000 square-foot facility in December. Other

companies taking occupancy late in 2001 include Globespan, Pfizer, Atlantic Health Systems, Fidelity Corporate Real Estate, and Lehman Brothers, who leased 153,000 square feet of sublease space from Datek at 70 Hudson Street in Jersey City, shortly after the September 11 tragedy.

In summary, there may never be another year like 2001. Certainly, the market has experienced its ebbs and flows in the past, but they were never quite like this. Because so much of the space on the market is in the form of subleases, landlords are still getting paid their rents while tenants try to get subtenants to help them recover from a recession. Economists predict that the recession may be nearing an end, while the tech market is trying to make a comeback. Landlords and developers hope both happen sooner rather than later, with 13 million square feet of new construction slated for 2002 and only sixty percent of it preleased. My careful prediction for 2002 is that events will not be as unpredictable as 2001, and that tenants enter 2002 with the upper hand on the commercial real estate market. ■

*... tenants enter 2002 with the upper hand on the commercial real estate market.*

## Real Estate, *continued*

architecture and construction management; and biotechnology and pharmaceuticals. The economic expansion of the 1990s in New Jersey was led by the pharmaceutical, telecommunication, and financial service sectors. The predicted 2002 recovery will include pharmaceuticals; however, we do not believe the initial upswing will have pharmaceuticals as the recovery leader.

The \$13 billion school construction referendum will be of benefit to engineering, architecture, and construction management. We believe this industry group will expand. New Jersey's biotechnology industry is a national force, and companies relocate to and expand in New Jersey due to our highly educated labor market.

For office and industrial tenants, the first half of 2002 might be the best time to acquire space or to renegotiate renewal terms for leases that may expire in the next 12 to 24 months. Landlords do not want to

lose any tenants, and several landlords have indicated that 2002 is a year to focus on retaining tenants and "doing what we have to do" in order to renew and extend leases.

Do not expect an overnight return to the overheated markets of 1999 and 2000. The office vacancy rate for all space is 18 percent and will take quite a while to return to an equilibrium of 12 percent. We expect there will be continued downsizing from New Jersey's traditional business powerhouses. In addition, a noticeable trend will occur. Office buildings that are now vacant but that had been occupied by tenants in blocks of space greater than 100,000 square feet are expected to be filled by multiple tenancies averaging 15,000 to 40,000 square feet in size. A prime example of the market change would be a class "A" modern office building in the Morris County market totaling 150,000 square feet. During the (*continued, p. 8*)

Each of these circumstances was underpinned by exceptional levels of consumer and business confidence—a new economy optimism.

But the tombstone was set in place last March marking the end of a remarkable period, with September 11 and the Enron debacle further changing the world since then:

- re-regulation in a number of economic sectors potential returning to the norm,
- resources shifting back to the public sector from the private sector,
- fewer budget surpluses and a more realistic stock market, reflecting slower profit growth,
- information technology investment on the back burner for several years, with the capital investment locomotive transformed into the capital investment caboose, and
- the added costs of safety and security adding necessary frictions to the economy, reducing new economy efficiencies and constraining productivity gains.

These changes are tempered further by lower levels of business and consumer confidence—new economy skepticism.

Thus, there is a reasonable probability that there will be a post-recession world of much more modest national long-term growth because of these shifts. And this will be true in New Jersey as well, with the boom years of 1998–2000 rendered a fond memory. ■

late 1990s, the building was occupied by a Fortune 500 firm. Due to layoffs, consolidation, and the recession, the building became vacant at the end of 2001. As 2002 commenced the developer is negotiating with prospects for 25,000 or 30,000 square feet. What had been a single occupant building will ultimately become a multi-tenanted, business diverse, fully leased building by the end of 2002. The tenants will receive competitive terms, and the developer will have stabilized the income on the building for the next 5 to 7 years.

The warehouse and distribution markets will rebound; however, the market may not reach an equilibrium until the middle of 2003. Rental rates, which have been reduced by over ten percent, will stabilize. We do not predict a dramatic increase in industrial rents.

In the deep recession of the early 1990s, landlords, developers, and investors coined the phrase “stay alive until '95.” Perhaps the motto for economic rebound will be “concessions for you in 2002 and recession free in 2003!”

*Richard Heilmann is Senior Vice President of the Sitar Company•ONCOR International.* ■

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