

Sitar–Rutgers

Regional Report

James W. Hughes and Joseph J. Seneca, editors

Halting and Uncertain Economic Progress

By James W. Hughes and Joseph J. Seneca

During 2002, the nation's Gross Domestic Product (GDP) grew by 2.4 percent, rebounding from an anemic 0.3 percent expansion in 2001. However, by the end of 2002, growth began to falter, and then, with mounting global instability and the specter of war in Iraq, the economy seemingly went to bed in the first quarter of 2003. GDP (advance estimate) grew by only 1.6 percent, and 465,000 jobs were lost nationally in February and March, threatening a double-dip recession. A "chicken little" economy—commentators rushing around telling us the economic

sky is falling—again reared its head. From March 2001 (the start of the United States recession) to March 2003, the nation lost a total of 2,053,000 jobs, a loss of 1.5 percent.

But the national economy may soon get out of bed rather than fall out of bed. A modest rebound should occur in the second quarter of 2003, assuming increasing stability in Iraq. As economic momentum slowly builds, growth should accelerate by the end of the year. Nonetheless, weak business investment remains an impediment to a more robust expansion. High debt levels, excess *(continued, next page)*

Defending New Jersey's Office Market

By Linda Tanaka and Gregg Nowell

Defense spending may be the "boom" industry for which the New Jersey office market has been looking. The defense industry in this sense includes more than the traditional manufacturers of weapons, aircraft, and tanks traditionally thought of as falling under the "defense" umbrella. The ripple effects of defense spending are far reaching. New Jersey businesses ranging from catering services to technology are benefiting from the increased spending as a result of the war and increased Homeland Security measures. In total, 1,534 New Jersey companies were awarded contracts

worth \$3.5 billion by the Department of Defense for the fiscal year ended September 2002.

In fact, New Jersey ranks 14th in defense spending. New Jersey is seeing greater growth in defense spending than many other states, increasing by 21 percent in the previous fiscal year versus the average increase of 17 percent. This is due in large part to New Jersey's strong electronics and communications industries. These industries earned \$1.1 billion in government contracts, placing New Jersey in the number four spot for defense spending in technology. Burlington *(continued, p. 11)*

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2 Halting, *continued*

Despite net gains in employment since August 2002, the post-recession period does not yet give evidence of a strong recovery trajectory.

capacity in many sectors, and increased corporate oversight all serve as inhibitors to risk taking and investment. Consequently, a jobless economic recovery continues to be our short term destiny, a repeat of the pattern of the early post-recession 1990s.

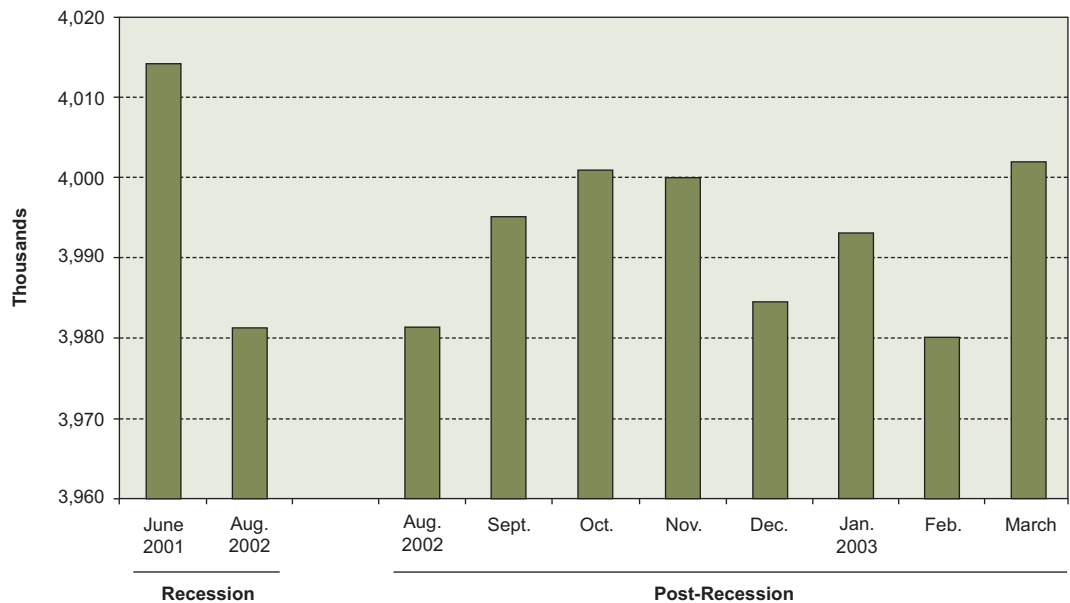
New Jersey's Post-Recession Period

In this context, New Jersey's economy has clearly outperformed the nation's economy. Between June 2001 and August 2002, our current working definition of the state's recession, 33,100 jobs were lost, or -0.8 percent—approximately one half of the national rate of decline (-1.5 percent). The state's employment loss period was only 15 months as compared to the 25 month (and counting) stretch of

national employment decline. Between August 2002 and March 2003, which we have tentatively labeled the "post-recession" period instead of a full-scale recovery period, New Jersey gained 20,600 jobs. Thus, as of March, the state had already recaptured 62 percent (20,600 out of 33,100) of its recessionary job losses. It will take a further gain of only 12,500 jobs to match the historic New Jersey employment peak of June 2001 (4,014,400 jobs).

However, caution is necessary in drawing any firm conclusion that the state's employment recession is over since there has been sharp volatility in the monthly employment data. Despite net gains in employment since August 2002, the post-recession period does not yet give evidence of a strong recovery trajectory. Table A shows that the monthly nonfarm

TABLE A: New Jersey Total Nonfarm Employment



Source: New Jersey Department of Labor

TABLE B
Payroll Employment Loss
New Jersey vs. New York City Job Loss
(Numbers in thousands)

	Start of Downturn	End of Downturn	Employment Loss	
			Number	Percent
	June 2001	August 2002		
New Jersey	4,014.4	3,981.3	-33.1	-0.8%
	December 2000	February 2003*		
New York City	3,761.2	3,535.1	-226.1	-6.0%

* Note: Employment still declining as of February 2003.
 Source: New Jersey Department of Labor, New York City Comptroller's Office

With New Jersey's employment level approaching the peak of the last expansion, a basic question is why the state's economy doesn't "feel better."

employment totals have exhibited a sawtooth pattern of advances and retreats since August 2002. Part of this is due to seasonal adjustment problems in retail employment in December and January, distorting employment totals in both months. A second factor that may have produced volatility is the new industry classification system that was deployed in New Jersey in March 2003 and is described in the accompanying article on page 4 of this report. In any case, the pattern of economic advance since August 2002 is fraught with uncertainty, and differs from any other post recession period since World War II.

The New York City Setback

With New Jersey's employment level approaching the peak of the last expansion, a basic question is why the state's economy doesn't "feel better." One

reason is the very significant regional labor market and income impacts that have accompanied New York City's traumatic downturn. As detailed in Table B, New York City's recession started in December 2000, six months earlier than the downturn in New Jersey. A full 26 months later, the city was still experiencing employment declines, with cumulative losses totaling 226,100 jobs (-6.0 percent) during the period from December 2000 to February 2003. This total is almost seven times greater than the employment losses (-33,100 jobs or -0.8 percent) suffered by New Jersey through its much shorter employment downturn (June 2001 to August 2002). Moreover, as noted earlier, New Jersey has already recaptured 62 percent of these losses.

The scale of New York City's losses rivals that experienced during the severe (*continued, p.11*)

Measuring the New Economy

By James W. Hughes, Nancy H. Mantell, and Joseph J. Seneca

... NAICS was developed on the principle that "producing units that use similar production processes should be grouped together."

Since the 1930s, industrial data on employment, output, or wages and other types of income have been organized by Standard Industrial Classification (SIC) codes. These codes performed admirably in measuring the old manufacturing economy of the mid-twentieth century, but were not up to the task of monitoring the twenty-first century service oriented, information dominated, knowledge based economy.

In 1997, the federal government began to put a new classification system into operation. The new system, the North American Industry Classification System (NAICS)—pronounced “nakes”—has several advantages over the SIC system. It is a common system now in use by the United States, Canada and Mexico, making the economies of these three major trading partners directly comparable. It also is more compatible with the International Standard Industrial Classification (ISIC) of the United Nations. According to the U.S. Office of Management and Budget, NAICS was developed on the principle that "producing units that use similar production processes should be grouped together."

The new system helps analysts understand what is really happening in the economy. NAICS has added many industries and sectors that simply did not exist at the time the SIC system was developed and these industries were, therefore, difficult to track and quantify. Among the new industries are software publishing (in the new Information sector) and computer and electronic product manufacturing in the Manufacturing sector. In addition to adding sectors and industries, NAICS has also removed industries, primarily in the Manufacturing sector, and moved some industries or parts of industries from their SIC sectors to different NAICS sectors. The system will be updated and revised on a five-year cycle. The first revision was completed in 2002.

NAICS has twenty major sectors, compared to nine in the old SIC system. Sectors that were not in the SIC system as either sectors or industries

include Information; Professional, Scientific and Technical Services; Management of Companies and Enterprises; Administrative and Support Services; and Waste Management and Remediation Services. As a result, there will be changes in the way analysts view the size of various industries. For example, New Jersey has an extremely large pharmaceutical industry. However, a significant number of these jobs are located at corporate headquarters or at research, development, and testing facilities where no actual manufacturing is done. Under NAICS, jobs at corporate headquarters are placed in the new Management of Companies sector, while R&D facilities are recorded in the Professional, Scientific, and Technical Services sector. Thus, the pharmaceutical industry, and the Manufacturing sector in general, in New Jersey now appear smaller than they did using the SIC industry definitions. For example, NAICS shows about 40,000 jobs in Pharmaceuticals and Medicine, compared to approximately 50,000 pharmaceutical jobs in the SIC system. Total manufacturing under NAICS stands at about 360,000 jobs compared to 420,000 jobs counted under SIC. On the other hand, some sectors, like Construction, will show almost no change between the two systems.

The table shows the March 2003 employment profile for New Jersey in terms of the NAICS supersector categories. Manufacturing, which one-half century ago accounted for one-half of New Jersey's job base, now accounts for only 9.0 percent, far less than professional and business services (14.5 percent), and significantly below the public sector share (15.5 percent). The state's manufacturing share is also well below the nation's manufacturing share (12.5 percent). Private service producing employment (71.3 percent) increasingly dominates the New Jersey economy, reinforcing the central position of the state's office markets for our economic future. ■

New Jersey Employment Profile
March 2003
(Numbers in thousands)

	March 2003	
	Number	Percent
NONFARM EMPLOYMENT	4,001.9	100.0%
TOTAL PRIVATE SECTOR	3,382.3	84.5
GOODS PRODUCING	527.0	13.2
Natural Resources and Mining	1.3	0.0
Construction	165.7	4.1
Manufacturing	360.0	9.0
PRIVATE SERVICE PRODUCING	2,855.3	71.3
Trade, Transportation, and Utilities	885.8	22.1
Information	111.5	2.8
Financial Activities	278.9	7.0
Professional and Business Services	582.1	14.5
Education and Health Services	539.5	13.5
Leisure and Hospitality	309.1	7.7
Other Services	148.4	3.7
PUBLIC SECTOR	619.6	15.5

Source: New Jersey Department of Labor

Manufacturing, which one-half century ago accounted for one-half of New Jersey's job base, now accounts for only 9.0 percent . . .

Rutgers Economic Advisory Service Forecast for New Jersey, Spring 2003

By Nancy H. Mantell

The recovery in 2003 will strengthen at the end of the year, exerting some upward pressure on prices in New Jersey that will continue into early 2004.

Between 2002 and 2008, the state will add jobs at an average rate of 1 percent (or 40,600 jobs) a year. Over the rest of the forecast period through 2022, job growth will average 1.1 percent, or 50,000 jobs, per year (see table). For the full forecast period—2003 to 2022—employment growth will be nearly identical to that over the past two decades.

The Rutgers Economic Advisory Service (R/ECON™) forecast for New Jersey looks for growth in real output of 4.4 percent this year, as the economy finally emerges from the recession. The inflation rate of 2.0 percent matches last year's rate, even with the rapid rise in oil prices early in the year. Output growth will weaken in 2004, with growth of 2.8 percent, and remain moderate over the next few years. It will pick up in the longer term, with

growth averaging 4.1 percent a year from 2008 to 2022.

The recovery in 2003 will strengthen at the end of the year, exerting some upward pressure on prices in New Jersey that will continue into early 2004. Thereafter, the mild growth expected will provide little impetus for rapid inflation. Consumer price inflation will average 2.7 percent from 2004 to 2008, and 2.6 percent from 2006 to 2022.

The state's population rose 0.9 percent a year between 2000 and 2002. It will increase by 0.6 percent a year between 2002 and 2008, and 0.8 percent a year for the rest of the forecast period. At those rates, New Jersey will add 1.37 million residents between 2002 and 2022. The population will rise from 8.59 million in 2002 to 9.96 million in 2022. *(continued, p.12)*

Summary of New Jersey Economic Forecast 2002 to 2022

	2002	2003	2004	2004 to 2008	2008 to 2022
Annual Percentage Growth					
Nonagricultural Employment	-0.1%	1.0%	1.6%	0.8%	1.1%
Real Gross State Product	0.9	4.4	2.8	2.4	4.1
Personal Income	3.1	4.2	5.2	5.3	5.6
Population	0.9	0.8	0.6	0.6	0.8
Consumer Prices	2.0	2.0	3.3	2.7	2.6
Percentage					
Unemployment Rate (average)	5.8%	6.0%	5.7%	5.8%	5.8%

Source: R/ECON™

Note: Data for 2002 and the forecast period have been adjusted since the forecast was produced to take into account the most recent data releases for employment, the unemployment rate, and personal income.

Stagnant Market, But Hope Springs Eternal

7

By Linda Tanaka and Gregg Nowell

With over 3,200 buildings and nearly 200 million square feet of office space, New Jersey continues to rank among the top ten office markets in the nation.

As the economy has remained stagnant, so has the office market. Overall, the market shows little change from the previous quarter in terms of inventory, vacancies, and rents, with vacancies remaining at historically high levels.

Available space for the region climbed to 26,770,673 square feet or 13.7 percent of total

inventory. Somerset County maintains the highest vacancy rate at 19.6 percent. The Route 287 corridor continues to struggle with over 12 large blocks (100,000 square feet or more) of Class A space available.

Five counties saw significant increases in vacancy rates over the past quarter. While the vacancy rates for both Monmouth and Hudson Counties remain moderate at 9.8 percent and 9.5 percent, respectively, the rate at which space has been coming on the market over the past quarter has (*continued, p.8*)

Overall, the market shows little change from the previous quarter in terms of inventory, vacancies, and rents, with vacancies remaining at historically high levels.

Northern and Central New Jersey Total Office Market First Quarter 2003

County	Buildings	Total Inventory	Direct		Total (Direct + Sublet)		Average Asking Rent	1st Qtr. Net Absorption
			Available Space	Vacancy Rate	Available Space	Vacancy Rate		
Bergen	541	28,904,301	3,191,052	11.0%	4,123,189	14.3%	\$25.48	(161,582)
Essex	366	28,260,179	4,389,469	15.5%	5,075,834	18.0%	\$24.26	(356,705)
Hudson	158	23,504,561	2,237,624	9.5%	3,523,959	15.0%	\$24.88	(191,572)
Hunterdon	41	1,131,499	93,243	8.2%	105,071	9.3%	\$15.64	(13,150)
Mercer	316	15,553,154	1,653,464	10.6%	2,177,345	14.0%	\$23.70	(284,654)
Middlesex	396	24,696,484	3,985,065	16.1%	5,687,424	23.0%	\$22.79	(8,491)
Monmouth	352	13,409,488	1,315,419	9.8%	1,559,435	11.6%	\$23.28	(463,163)
Morris	379	26,614,415	4,370,317	16.4%	6,266,868	23.5%	\$25.32	(333,180)
Passaic	137	5,710,481	544,004	9.5%	605,685	10.6%	\$21.69	14,009
Somerset	241	17,624,025	3,461,460	19.6%	5,145,300	29.2%	\$25.27	(33,904)
Union	282	10,292,352	1,529,556	14.9%	1,845,415	17.9%	\$24.98	(88,920)
TOTAL	3,209	195,700,939	26,770,673	13.7%	36,115,705	18.5%	\$24.46	(1,921,312)
Central NJ	1,587	81,575,503	11,944,964	14.6%	16,414,919	20.1%	\$23.97	(879,132)
Northern NJ	1,622	114,125,436	14,825,709	13.0%	19,700,786	17.3%	\$24.86	(1,042,180)

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

8 Stagnant, *continued*

Sublease space has more than tripled over the past two years and now adds over 9 million square feet to the regional market.

proven to be exceptional. Monmouth County added nearly two-thirds more direct space to the market and Hudson County added almost 50 percent, reaching 1.3 million and 2.2 million directly available square feet, respectively. In addition, vacancies in Morris County increased by more than one-quarter to 16.4 percent; and Middlesex and Union Counties saw increases in direct vacancies of approximately 20 percent with a rise to 16.1 percent and 14.9 percent, respectively.

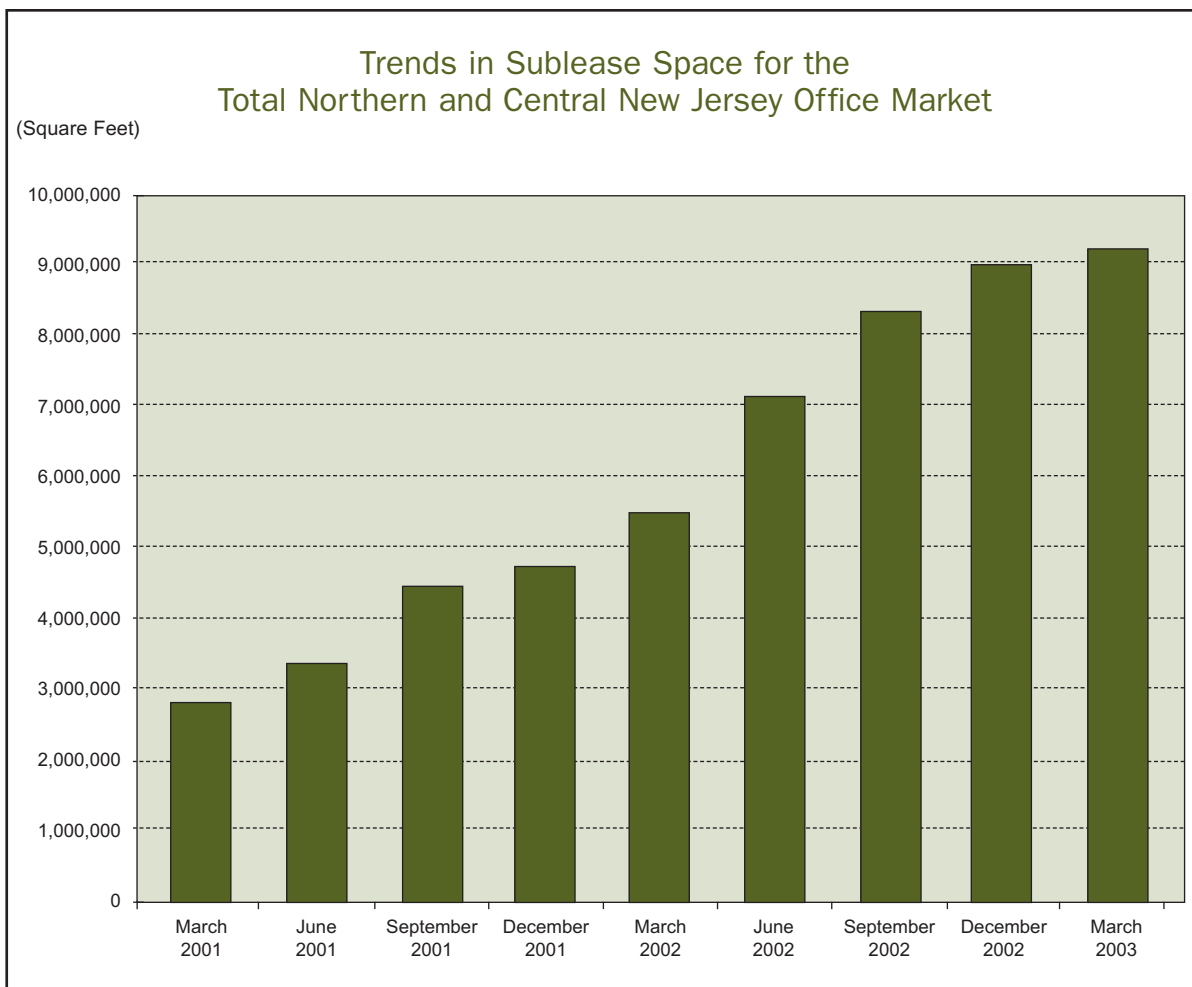
However, Monmouth County is showing some signs of promise. The county has seen a great deal of recent leasing activity, with approximately 250,000 square feet of leases out for signatures. The defense industry is displaying signs of growth, as are several other prominent users. This could be the beginning of a turnaround for this commercial region.

Sublease space has more than tripled over the past two years and now adds over 9 million square feet to the regional market. Many recent transactions have

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

County	Buildings	Total Inventory	Direct		Total (Direct+ Sublet)		Average Asking Rent	1st Qtr. Net Absorption
			Available Space	Vacancy Rate	Available Space	Vacancy Rate		
Bergen	100	15,939,809	1,765,053	11.1%	2,364,163	14.8%	\$27.00	(116,100)
Essex	63	15,331,653	2,058,563	13.4%	2,544,069	16.6%	\$25.99	(378,062)
Hudson	50	17,828,935	1,082,753	6.1%	2,312,497	13.0%	\$25.68	(138,194)
Hunterdon	7	403,791	18,752	4.6%	18,752	4.6%	\$24.00	—
Mercer	65	6,580,582	477,970	7.3%	932,867	14.2%	\$26.49	(12,681)
Middlesex	104	15,085,326	2,712,945	18.0%	3,974,181	26.3%	\$23.85	33,792
Monmouth	51	5,762,803	802,001	13.9%	961,708	16.7%	\$24.59	(470,120)
Morris	114	17,096,824	3,447,153	20.2%	5,079,578	29.7%	\$26.87	(171,850)
Passaic	20	2,215,270	124,321	5.6%	177,982	8.0%	\$24.12	2,636
Somerset	102	13,453,925	2,744,630	20.4%	4,334,554	32.2%	\$26.24	11,118
Union	26	3,460,870	593,105	17.1%	887,681	25.6%	\$27.50	(66,919)
TOTAL	702	113,159,788	15,827,246	14.0%	23,588,032	20.8%	\$25.99	(1,306,380)
Central NJ	348	44,343,506	7,330,651	16.5%	11,090,991	25.0%	\$25.29	(504,810)
Northern NJ	354	68,816,282	8,496,595	12.3%	12,497,041	18.2%	\$26.59	(801,570)

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



... space continues to be put on the sublease market as fast, or faster, than it can be absorbed.

been subleases, but space continues to be put on the sublease market as fast, or faster, than it can be absorbed.

With a total vacancy (direct plus sublet) rate of 18.5 percent, nearly one in five square feet is currently vacant. Somerset County continues to get hit hard with three in ten feet (29.2%) now vacant either directly or via sublease.

In addition, Morris County (23.5%) and Middlesex County (23.0%) show record high total vacancy rates. However, within Middlesex County, Metropark remains a very strong submarket. Hudson

County, while lower than some other counties, shows a steady increase in total vacancy rate, rising to 15.0 percent at the end of March 2003.

On the whole, average asking rents have remained relatively stable and now stand at \$24.46. Hunterdon County took the biggest hit in average asking rental rates since the last quarter, dropping 15 percent to a low of \$15.64. Bergen County maintains the highest rents at \$25.48 on average. Close behind are Morris County (\$25.32) and, unexpectedly, Somerset County (\$25.27). Not surprisingly, the New Jersey market showed significant negative (*continued, p.10*)

10 Stagnant, *continued*

Despite the increase in total available space, landlords have managed to stave off, and in some cases reverse, any significant decreases in average asking rents.

absorption for the first quarter of 2003, weighing in at -1,921,312, a large turnaround from the small, but positive absorption recorded at the end of 2002.

Driving this were Monmouth (-463,163), Essex (-356,705), Morris (-333,180), and Mercer (-284,654) Counties, each exhibiting large, negative absorption. Only Bergen and Passaic Counties saw absorption move in a positive direction over the past three months. Bergen County saw absorption of -455,197 in December 2002 and now stands at -161,582. In Passaic County, absorption shifted to 14,009 from -74,774 at the end of the last quarter. Interestingly, Monmouth County may move in to positive territory next quarter as 700,000 square feet is about to be taken out of the market. Demolition of the CECOM building in Tinton Falls may be a reality in the near future, at which time the zoning will change and residential units will be built. With 58 percent of the region's office space categorized as Class A, these trends are also the major drivers for the overall office market.

Bergen County saw the largest change in Class A space, dropping one-quarter of the Class A buildings, bringing the total inventory down to nearly 16 million square feet of space within only 100 buildings. Morris County followed closely behind, losing 22 percent or 33 Class A buildings, leaving 17.1 million square feet.

The overall vacancy rate for Class A space in the region stands at a high 14.0 percent. Somerset (20.4%), Morris (20.2%), Middlesex (18.0%), and Union (17.1%) counties continue to show the uppermost rates of availability. In addition, the vacancy rate for Class A space in Monmouth County

has increased substantially since year end 2002, tripling to 13.9 percent. On the other hand, Mercer County is showing signs of improvement with the Class A vacancy rate declining significantly to 7.3 percent.

The picture for total vacancy, which includes both direct and sublet space available, looks even bleaker. The total vacancy rate for Class A space in the area topped in at a whopping 20.8 percent. Demand is virtually non-existent in most markets and larger tenants with good credit are hard to find.

Again, Somerset (32.2%), Morris (29.7%), Middlesex (26.3%), and Union (25.6%) Counties are experiencing the worst total vacancy rates.

Despite the increase in total available space, landlords have managed to stave off, and in some cases reverse, any significant decreases in average asking rents. The average asking rent for Class A space in the region is currently at \$25.99. In fact, Hunterdon County, with its especially low total vacancy rate, has even shown a significant increase in class A rents, rising 30 percent to \$24.00.

Absorption among Class A properties demonstrated a large and significant reversal over the past quarter, moving from a positive 400,243 square feet to an extremely large negative 1,306,380 square feet.

There are signs of improvement in the telecommunications, pharmaceutical, finance, and defense industries. With the lag between an economic turnaround and the impact on the office market several months long, the depressed market of the past several years may indeed have an end in sight. ■

1989–1992 recession. During that downturn, both New Jersey and New York City had employment declines in excess of 250,000 jobs. Thus, the city is experiencing a distressing economic setback that is spilling over into New Jersey, negatively impacting the state's labor markets and incomes. This follows a period (1998–2000) when New York City's near record pace of job growth spilled positively into New Jersey, bolstering the state's prosperity.

In addition, New Jersey's economy has been hurt by the collapse of the stock market bubble and the severe contraction of Wall Street employment.

Consumer spending in the 1997–2001 period was enhanced significantly by the capital gains extracted from that bubble, as well as by year-end Wall Street bonuses. Both have been effectively removed from the economic table, invoking economic pain in the state not revealed by simple employment statistics. ■

Thus, the city is experiencing a distressing economic setback that is spilling over into New Jersey, negatively impacting the state's labor markets and incomes.

Defending, *continued*

(\$1.1 billion) and Monmouth (\$920 million) Counties have reaped the majority of the defense contract benefits due to the large number of military bases and contractors located there.

All of this growth and spending results in increased or new space requirements. Lockheed Martin's Burlington County plant is the second largest employer in the county. In Monmouth County, Lockheed just received new and renewed contracts and, as a result, is looking for expansion space in and around exits 105 through 109 of the Garden State Parkway.

Fort Monmouth in Eatontown is Monmouth County's largest employer with a staff of 5,380. It supports over 30 major defense-related companies as well as numerous subcontractors within the county.

Northrop Grumman recently signed a long-term lease at 17 Christopher Way in Eatontown. This two-year-old, single-story flex building was developed by the Donato Group, one of Monmouth County's oldest and most respected developers, and is

typical of the hi-tech facility for which many defense-related companies are looking.

CACI International leased two new facilities on Hope Road in Eatontown off exit 105 of the Garden State parkway to primarily serve defense-related contracts.

Other well-known companies in the area that are benefiting from increased spending include L-3 Communications, Computer Sciences Company, Booz Allen Hamilton, Oracle, Telos Corporation, and Delphi Petroleum. Furthermore, subcontractors to the major defense players are becoming prominent tenants and employers throughout New Jersey. Often, these subcontractors are smaller companies awarded short-term assignments of one, two, or three years. As a result, these subcontractors are fine candidates for the abundant sublease space available as well as Class B and C properties.

Linda Tanaka is Director of Research of the Sitar Company • ONCOR International.

Gregg Nowell is Senior Vice President of the Sitar Company • ONCOR International. ■

12 Rutgers, *continued*

The state unemployment rate will average 6 percent this year, up from 5.8 percent in 2002. The rate will decrease slightly in 2004, but average 5.8 percent over the rest of the forecast period.

The recession kept personal income growth to only 3.1 percent in 2002. With the end of the recession, personal income should rise 4.2 percent this year and 5.2 percent in 2004. Personal income growth will average 5.5 percent a year during the rest of the forecast period. Income growth will be sustained over the forecast period by relatively rapid growth in proprietors income. Transfer payments will also sustain the income stream, particularly after 2010 as the baby boomers begin to draw down their retirement benefits.

Nancy H. Mantell is Director of the Rutgers Economic Advisory Service. ■

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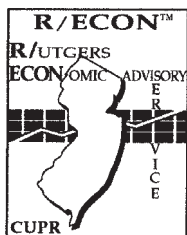
Linda Tanaka, Director of Research, Sitar Company • ONCOR International

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

Joseph J. Seneca, University Vice President for Academic Affairs

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E-mail RECON@rci.rutgers.edu ■ Web site www.policy.rutgers.edu/cupr/recon.htm

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