

The Kiplinger California Letter

TRENDS IN BUSINESS, GOVERNMENT AND REAL ESTATE • Vol. 45, No. 14

Dear Client:

July 22, 2009

After the state budget furor winds down...
The legislature will turn to water problems
that have been building steadily for decades.

WATER

The drought is adding to economic troubles.
Calif. agricultural losses will reach \$2 billion this year, and farm counties have high jobless rates: Imperial, 27%; Stanislaus, 16%; Fresno, 16%; Tulare, 14%; Madera, 14%; and Kern, 14%.

It's increasing the urgency of the debate,
though it will take years for any solution to work.

Lawmakers will probably OK a bond issue
of some kind to be considered by voters next year. Legislators want to show some accomplishments after the big fight to close a \$26-billion budget deficit.

They're working on a \$10-billion package
that would pay for a variety of water projects.

Chances are it will be slimmed down
and changed dramatically before passage.

Republicans want dams and reservoirs.

They're proposing a new dam at Temperance Flat in the San Joaquin Valley, a new one in Colusa County north of Sacramento and an increase in the height of Los Vaqueros Reservoir dam northeast of Livermore.

Most Democrats disagree, preferring underground storage and conservation. They also want local water agencies, rather than the state, to bear most of the costs.

The state Senate has appointed a special committee to work out differences. Water is such a big issue that senators are competing to get appointed to the panel.

Look for the same kind of intransigence that marked the budget debate.

Gov. Schwarzenegger, who has veto power, agrees with GOP lawmakers on the need for aboveground storage. Democrats, backed by green groups, won't yield easily.

Figure on a dam or reservoir being part of the agreement to satisfy the GOP. But voters may be wary of taking on more debt after this year's troubles.

Even a bond issue will be just a partial answer to Calif.'s water troubles.

Water flow through the Sacramento-San Joaquin Delta will be reduced
from already low levels to protect endangered fish. A new plan ordered by a court will cut water by 20% to 30% in normal years and up to 50% in very dry years.

Don't count on more water being sent from the north to the drier south.
Voters defeated an effort to build a peripheral canal around the delta in 1982.

Meanwhile, local areas are finding their own solutions as the state dawdles. San Diego agencies are spending \$568 million to raise the San Vicente Dam's height. And work begins soon on a desalination plant expected to be operational in 2012.

Localities are also counting on Mother Nature for a short-term fix. An El Niño in the Pacific Ocean is likely to bring more rain and snow in the winter.

STATE ECONOMIC FORECASTS

	2009	2010
Job growth (Nonfarm employment)	-3.7%	-0.2%
Building permits (Residential, in thousands)	49	91
Growth in taxable sales (Current dollars)	-3.5%	0.2%
Growth in personal income (Current dollars)	-1%	1.7%
Population growth	1.1%	1.1%
Average unemployment rate	11.5%	12.2%

SOUTHERN CALIF.

Unions are making a big push to organize warehouse/distribution workers in Riverside and San Bernardino counties. Their efforts are getting support from Change to Win, the coalition of unions that have broken off from the AFL-CIO. Labor groups are aiming at a big target...the 113,000 workers employed at 2,900 warehouse and distribution centers that each take up at least 50,000 sq. ft. Expect numerous demonstrations that'll disrupt work and block traffic, similar to the janitors' protests several years ago. Already, union protesters have blocked a Wal-Mart warehouse entrance, organized a sit-in and picket line at a temp agency and jammed an Ontario intersection used by several warehouses.

Plans are still alive for a big San Diego development across the street from Petco Park. Padres Chairman John Moores will probably get extra time to build a convention center/hotel beyond the June 2011 deadline set by the city in 2006. The effort was set back when Marriott dropped out of the project last Aug. Figure on an office, housing or retail project for Anaheim RV Village, which has been sold for \$10 million. The 293-acre site at Ball Road and Harbor Blvd. is prime for development as Orange County RV and mobile home parks move inland. Continental Tire North America will lease distribution space in Redlands. The company will occupy 480,000 sq. ft. in a new facility owned by ProLogis.

A cruise terminal is in the cards for Long Beach/Los Angeles ports. L.A. will become one of the nation's fastest growing and most lucrative ports of call for cruise ships, according to researchers. Passenger growth could reach 3% to 4% per year in the area, spurring plans by L.A. officials for a \$1-billion terminal. Hollywood Park will be replaced by a housing and retail development to include condominiums, townhouses, shops, theaters and 25 acres of parks. The Inglewood City Council has approved the \$2.1-billion, 238-acre project, with work to start in late 2010 or 2011. Horse racing will continue until then.

Santa Barbara County developers will get more time to finish projects, starting in Aug. Prompted by the recession, the board of supervisors will grant a two-year extension on a building permit in exchange for a \$300 fee and evidence of economic hardship. Construction has been delayed by tight credit and few sales. Lompoc is getting a resort and wine center. A hotel, shopping center, spa and wine tasting room will be built at North 12th Street and Highway 46.

NORTHERN CALIF.

San Francisco's chain store restrictions are keeping out many retailers that don't want to go through the regulatory hassles required.

Big-box stores and smaller restaurants have walked away from talks with malls rather than get needed conditional use permits, leaving many buildings vacant.

Pfizer is withdrawing plans to open a San Francisco research center, dealing a setback to Mission Bay's emergence as a major biotech hub.

The company will probably keep its workers at a facility in South San Francisco.

San Ramon will get a boost from Bank of the West, which signed a lease for 240,000 sq. ft. of space to consolidate seven of its East Bay lending operations.

Concord is getting two Asian grocery stores this fall. Seafood City plans a 63,000-sq.-ft. shopping center. 99 Ranch Market, a 30,000-sq.-ft. store.

Sierra Army Depot in Lassen County will hire more civilian workers as trucks, tanks and other equipment return for servicing amid troop reductions in Iraq. Up to 300 jobs are likely in a county with an unemployment rate of 12.3%. The military depot is located about 45 miles southeast of Susanville.

Chances are improving for a mixed-use project at Clovis' former city hall. Granville Homes is negotiating with city officials to build space for businesses on the ground floor and 60 apartments or condos on the second and third floors.



STATE
FINANCEFirms dependent on local governments will be hurt by state budget cuts

agreed to by legislative leaders and Gov. Schwarzenegger in mid-July.

Localities absorbed more than \$5 billion in reductions during last-minute talks.

Redevelopment projects will be stalled, idling builders, surveyors, architecture firms and their workers. Among those threatened by the reductions: The railyard project in Sacramento. San Pedro Square and the renovation of the convention center in San Jose. And work on the Reseda Shopping Center, the Westlake Theatre mixed-use project and Hollywood and Western housing in Los Angeles. Affordable housing projects across the state are in jeopardy.

Road maintenance is going to be delayed by a budget provision diverting cities' and counties' share of the highway users tax to the state.

Figure on fewer police and firefighters because of the state's decision to declare an emergency and borrow property tax revenue from localities.

A court battle is coming as cities and counties challenge the state's right to take the money. But only an injunction will stall the switch in funds.

Further business impact: The state will collect money earlier in the fiscal year by speeding up collection of income and corporate taxes. And chances of oil drilling off the coast are increased by a budget provision including revenue to be paid in advance by a Texas oil exploration firm.

AG

A midsummer assessment of the wine grape crop is all positive:

Ideal weather, an adequate labor supply, not many insects or diseases and a crop size that's not so large that it will depress prices this fall.

The recession gives Central Valley growers an edge over those in areas such as the Napa Valley and Sonoma County, which produce more expensive wines. Cash-short consumers are turning more to wines that retail for \$7 a bottle or less.

BUSINESS
COSTSCalifornia cities are still among the most expensive for doing business, according to the *Kosmont-Rose Institute Cost of Doing Business Survey*.

L.A., Oakland, S.F. and Santa Monica received "very high cost" ratings, and 11 cities in L.A. County are among the 50 most expensive cities in the U.S.

The 10 most costly U.S. cities, in alphabetical order: Akron, Ohio.

Chicago. Jersey City, N.J. Los Angeles. Newark, N.J. New York. Philadelphia. Phoenix. San Francisco. And Tucson, Ariz. The survey ranks U.S. cities according to taxes on sales, utilities, property, income and local businesses.

Workers' comp rates will keep going up, despite a state agency's refusal to approve any increases for the rest of the year. An insurers group had requested a 23.7% increase. That was rejected by the insurance commissioner, Steve Poizner, who is seeking the Republican nomination for governor next year. His ruling is advisory only, and most insurers are raising rates between 5% and 15%.

REGS

Cal/OSHA rules to protect health care workers take effect on Aug. 5.

The first airborne disease measure in the nation covers hospitals, clinics, prisons, nursing homes and other places where diseases are easily transmitted. Firms need to train workers in hygiene, decontamination and avoidance methods to prevent TB, flu, measles and other ailments spread by coughing and sneezing.

Tougher state green building codes are coming. Beginning Aug. 1, new buildings and renovations must be 15% to 20% more energy efficient than they were under 2005 rules and more than 20% above federal standards. Roofs will have to be painted white or alternative colors that reflect sunlight.



**REAL
ESTATE**

Leasing opportunities abound for firms confident in their future prospects. Office and industrial landlords are slashing rates, offering a year's free rent and extra space plus paying for furniture, moving costs and telecom connections. Yet many businesses are wary, closing only short-term deals in a shaky economy.

Healthy firms are signing long-term contracts at bargain prices.

Some are moving to higher-class neighborhoods than before, locking in low rates.

There are too many office buildings in most cities after a mid-decade surge in construction. Vacancy rates are in double digits everywhere...21% in Sacramento. Companies aren't hiring, and that means they don't need as many cubicles.

A renter's market will continue for a long time in most parts of the state.

Conditions will begin tilting in landlords' favor late next year in L.A. and S.F., but it will take other areas a year or so longer to get supply and demand in balance.

San Diego. Rental rates will drop and new space will be available in a city with a vacancy rate of 20%. Asking rents are already down 6% over 12 months. Highest vacancy rates: South San Diego, 42%, and Rancho Bernardo/Poway, 34%.

Orange County. Office demand won't return to 2006 levels until 2014.

The county is still reeling from the collapse of financial services companies, hit hard by the subprime market collapse. Two bright spots: Private education and health.

Los Angeles. Downsizing companies have been subleasing lots of space, pushing vacancy rates up near 15%. But L.A. will recover faster than most areas because it isn't as overbuilt. A landlord's market will return in late 2010 or 2011.

San Francisco/Oakland. Biotech and a recovery in the finance industry will lead to an upturn in S.F. about a year and a half from now. Until then, rents will drop, as they did in the second quarter...down 6% from the first quarter. The East Bay will be slower to recover as businesses hesitate to staff up.

San Jose. Recent Silicon Valley layoffs are going to increase vacancies and cause rents to stay low until 2011, when a high-tech upturn will help matters. A construction wave a few years ago has left a glut of office and R&D space.

Sacramento. A wave of office foreclosures is coming, unlike in other areas. State government cutbacks are going to add to the distressed market in the capital.

The industrial market will remain soft as well. Warehouses are idle in much of the Inland Empire, the Central Valley and other areas as trade with foreign countries declines and consumers pinch pennies at home. A lot depends on the recovery in foreign countries...which depends on a U.S. rebound as well.

Construction is sure to lag, too. The sounds of bulldozers and jackhammers won't be heard as long as building owners are struggling to fill their space.

Some good news in Calif. real estate: Housing prices are on the way up.

The median price in the Bay Area was \$352,000 in June, up 3.1% from May but still down 27.4% from June 2008, according to MDA DataQuick, a research firm. The Southern Calif. median price was \$265,000, up 6.4% from May but down 26.4% from June 2008. Foreclosures are becoming a smaller factor in home sales, and mortgage financing isn't as difficult to get as it was in the fall and winter.

Home sales appear to be on the mend, increasing steadily over 10 months. Buyers are returning with the belief that the bargains won't get any better.

Yours very truly,

The Kiplinger Editors
THE KIPLINGER EDITORS

July 22, 2009