ALERT

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CalChamber
CALIFORNIA CHAMBER OF COMMERCE

CalChamber Supports Special Election Measures

Props. Provide Framework for Fiscal Responsibility

The California Chamber of Commerce Board of Directors has voted to **support Propositions 1A–1F**, the special election measures to be considered by voters on May 19.

"Together, these measures will help California get back on track with short- and long-term solutions to solve the current budget deficit and help avoid a similar crisis in the future," said Allan Zaremberg, CalChamber president and chief executive officer.

Propositions 1A-1F will restrict state spending in the future, force the state to put money into a rainy day account for future economic downturns, modernize the lottery so the state can get more revenue from it, transfer unspent funds in several special accounts so the money can be used now, require that schools and community colleges get paid back amounts recently cut from their budgets when the economy improves and prohibit elected officials from getting salary increases when the state has a deficit.

"These measures provide an important framework for fiscal responsibility, including limiting spending and creation of a rainy day reserve while still ensuring education, transportation projects and other vital programs will be funded," said Zaremberg. "CalChamber urges voters to pass these six measures to reform the budget process and provide us with the solutions needed to protect us against the types of deficits we faced this year."

Federal Bills Renew Effort to Eliminate Secret Ballot Elections for Choosing Unions

Leading members of the U.S. Senate and U.S. House of Representatives introduced legislation on March 10 that will abolish employees' right to secret ballot elections during union organizing drives and replace it with a "card check" scheme.

The California Chamber of Commerce is **opposing** the so-called "Employee Free Choice Act," which abolishes private, secret ballot elections during union organizing drives and allows the federal government to gain more control over private sector employees and employers through government arbitrators deciding the terms of labor-management agreements.

This act will hurt U.S. businesses by driving up costs and forcing employers to be less competitive in a global market.

The bills, **S. 560 and H.R. 1409,** are authored by U.S. Senator Edward Kennedy (D-MA) and California Congressman George Miller (D-Martinez), respectively.

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Companies Urge Repeal of Unfair Tax Penalty; Lawsuit Filed

The California Chamber of Commerce and a coalition of business organizations and companies are urging the state Legislature to repeal an onerous, retroactive tax penalty law adopted without public hearing by majority vote as part of the October 2008 state budget package.

If the law is not repealed immediately, many law-abiding companies already under the weight of the recession will be forced to make a large, new and unexpected tax payment, possibly in the multimillions of dollars, by May 31, 2009.

SBX1 28 (Committee on the Budget) created a new, nationally unprecedented strict liability penalty—on top of significant existing penalties for underpayments and inaccuracies—for California companies that the Franchise Tax Board (FTB) determines have underreported taxes in excess of $1 million.

The penalty applies regardless of whether the company has any culpability and provides no appeal right. The penalty is 20 percent of the understatement amount.

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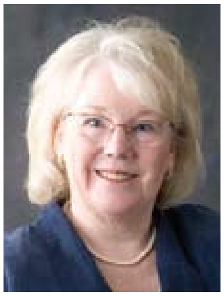
Inside

Labor Law Corner

Employers Have Discretion to Adjust Work Schedules to Avoid Layoffs



Barbara Wilber
Labor Law Consultant

We want to reduce our schedule from five eight-hour days per week to four eight-hour days for all hourly employees. What are the guidelines?

Nothing in the law prevents an employer from setting or changing a work schedule for hourly employees. In fact, reducing hours is a valid alternative to layoffs during economic hard times.

Determining how and when to schedule hourly employees, including reducing the hours and number of days worked, is at the employer's discretion. Having said that, there are several considerations of which employers should be aware.

Considerations

Before making the decision to reduce hours, ascertain whether contractual or union agreements limit your ability to make unilateral changes in scheduling. Unless the reduction affects all employees in a department, unit or classification, use objective criteria when choosing specific individuals.

Assess how a reduction in hours will affect existing sick leave, vacation, paid time off and health insurance policies. An employee's eligibility often is based on whether employment is full-time or part-time and a reduction in hours may cause a loss of eligibility.

If you choose to continue offering these benefits, update your policy to reflect any changes and contact your health insurance provider.

Employees whose hours are reduced below full-time because of lack of work may be eligible for unemployment insurance benefits. The California Employment Development Department provides a work sharing program available to employers who are considering a reduction in hours as an alternative to layoffs.

For more information, visit ***www.edd.ca.gov***.

Alternative Workweek

Employers may not reduce the established hours and days of an alternative workweek schedule. Employers may, however, unilaterally repeal the schedule with reasonable notice to employees. Another option is to propose a different alternative schedule and hold a new election.

Reducing the salary of an exempt administrative, executive or professional employee in connection with a reduction in hours and days may invalidate the exempt status of the employee. The Labor Commissioner addresses the issue in an opinion letter dated March 12, 2002.

Impact on Employees, Customers

It is important to develop a strategy and evaluate how the reduction will affect your employees and your customers. Recognize that a domino effect may occur. As employee morale suffers, productivity may decrease, which may, in turn, affect customer service.

Try to lessen the impact by advising employees that there will be reductions in hours and explain the reasons it is necessary.

The Labor Law Helpline is a service to California Chamber of Commerce preferred and executive members. For expert explanations of labor laws and Cal/OSHA regulations, not legal counsel for specific situations, call (800) 348-2262 or submit your question at www.hrcalifornia.com.

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CalChamber-Sponsored Seminars/Trade Shows

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Business Resources

Pandemic Threats and Natural Disaster Preparedness. San Diego North Chamber of Commerce. March 24, San Diego. (858) 487-1767.

International Trade

U.N. Peacebuilding Symposium. Rotary Club of San Francisco. March 15, San Francisco.

17th Convergence India. Exhibitions India Pvt. Ltd. March 18–20, Pragati Maidan, New Delhi, India. (650) 740-6064.

Global Technology Symposium. San Francisco Global Trade Council and U.S. Polish Trade Council. March 26-27, Stanford.

Labor Law

Payroll Deductions Overview. Free Live Web Seminar. CalBizCentral. March 18. (800) 331-8877.

FMLA 101. Live Web Seminar. CalBizCentral. March 31. (800) 331-8877.

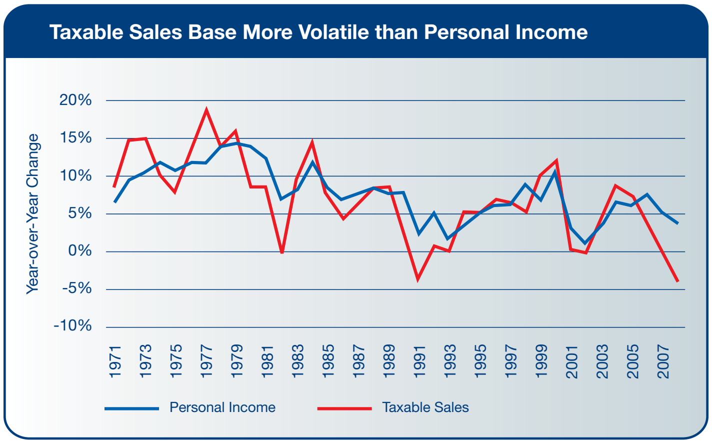
Prop. 1A Will Stabilize State Budget, Foundation Tells Tax Commission

Volatility of state revenues can be addressed without changing the tax system, the California Foundation for Commerce and Education advised the Commission on the 21st Century Economy this week.

In written testimony to the commission, created by executive order of the Governor to examine and make recommendations on the state's tax systems, Foundation President Loren Kaye called Proposition 1A on the May special election ballot the most practical solution to tax volatility.

The approach endorsed by the Governor and Legislature and to be presented to the public for approval, manages volatility rather than seeking to abolish it, Kaye notes. Proposition 1A will lead to "smoothing" revenues by requiring that "peaks" be saved to be spent during "troughs," he pointed out.

"It seems logical that this option be tried and tested before considering more radical options," Kaye said.



Not Practical

Other suggested solutions don't pencil out, Kaye said.

● **Modifying the personal income tax (PIT).** Volatility of the PIT could be reduced by flattening its progressivity or de-emphasizing its dependence on capital gains, stock options or other income that is highly correlated with economic cycles, Kaye observed. "While this could work in theory, it would likely over the long term produce less overall revenues for the State. It also would reverse the historic principle of progressivity in the income tax system."

● **Diluting the personal income tax.** The PIT now constitutes about 55 percent of General Fund revenues. Fifteen years ago it was 46 percent; 30 years ago it was 34 percent. Increasing other, less volatile, revenue sources would reduce the impact of PIT volatility, but those sources would have to be substantially increased to make a difference, Kaye concludes. "To reduce the influence of the PIT from 55 percent to, say, just 50 percent of General Fund revenues would require either raising other taxes by about $10 billion or replacing $5 billion in PIT taxes with $5 billion in other, new taxes," he said.

Over the last 35 years, the taxable sales base has been more volatile than personal income, Kaye added (see chart). PIT revenues have been more volatile because of capital gains and stock options, but both major revenue bases react to the economy. "There is no such thing as a countercyclical revenue source," Kaye commented.

Fallout from Tax on Services

The Foundation also took a close look at the "trendy notion" to broaden the sales tax base to include services, which has been much discussed by the commission. The Foundation concluded:

● **A services tax is not needed to change the responsiveness of the sales tax to the economy.** The current taxable sales base is already very sensitive to the economy, and adding services would not materially change that.

● **Taxing services** that would most likely be added to the sales tax base **would provide only minimal opportunity to reduce sales tax rates in a revenue-neutral manner.** "Increasing the price of a haircut by 9 percent in return for a ¼ percent or ½ percent reduction in the price of a shirt seems to be an odd trade without much economic gain," Kaye said.

● **"Increasing taxes on selected** (and likely the most politically vulnerable) **services would be unfair, discriminatory and economically harmful**," he said.

● **Imposing a services tax**, he concludes, would "increase the cost of labor, which sends the wrong signal when the economy needs to produce jobs."

Reducing Burden

Kaye recommended to the commission that, to the extent major changes are contemplated, they should aim to reduce the burden on job-creating income and investment:

● **Reduce and rationalize the corporate income tax.** California's corporate income tax is the highest in the Western United States. Nearby competitor states like Nevada, Washington and Texas have no corporate income tax. The state should also recognize the importance of our high-value innovation industries by providing them with a competitive advantage by gradually conforming the state's research and development tax credit to the federal credit. Finally, lawmakers should repeal the ill-considered understatement penalty adopted in 2008 as part of the then-budget solution.

● **Reduce the personal income tax rate.** California's tax rate is the highest in the nation, and it is also one of the most progressive. Several of California's strongest competitor states for economic development have no income tax, such as Texas, Florida and Washington.

● **Rationalize the sales tax by gradually eliminating the tax on investments in tangible property.** Few states, other than California, allow the taxation of business inputs. This places California manufacturers and other businesses at a substantial competitive disadvantage.

The commission has held monthly hearings starting in January. It is expected to report its findings to the Governor and Legislature by early summer.

The Foundation's policy paper, "A Tax System for the 21st Century," is available at ***www.cfcepolicy.org***.

Contact: Loren Kaye

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Lost Protections

The CalChamber believes that only a secret ballot system protects employees from both unions and employers. The current secret ballot system overseen by the National Labor Relations Board (NLRB) would cease to exist under this act, opening the door for an environment of intimidation and coercion.

Because of the public nature of the proposed system, employees could experience immense outside pressure. This would undermine employees' democratic rights and the protections of a fair and secret election to determine whether to have union representation.

Federal Intervention

The act also allows a federal arbitrator to write the labor agreement if the parties do not reach agreement within 120 days—an extraordinarily short time for negotiating first contracts.

This short deadline provides an incentive for union negotiators to make sure the process lasts long enough to get the matter into arbitration and eliminates any incentive to negotiate in good faith.

The contract would be imposed with no ability for either employers or employees to challenge it.

In 2007, "card check" legislation passed the U.S. House of Representatives, but fell just nine votes short of passage in the U.S. Senate.

Action Needed

The CalChamber urges members to contact their representatives in Congress and ask them to **oppose S. 560** and **H.R. 1409**.

For a sample letter, visit ***www.calchambervotes.com***.

Staff Contact: Marti Fisher

Companies Urge Repeal of Unfair Tax Penalty; Lawsuit Filed

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Lawsuit Filed to Stop New Law

In addition to seeking legislation to repeal the new penalty, the business community is challenging the new law in court on the grounds that it violates constitutional due process rights, among other arguments (*California Taxpayers' Association v. Franchise Tax Board*).

The lawsuit, filed on February 17, seeks a temporary restraining order to prevent enforcement of the new law while the litigation is pending.

Slows Economic Recovery

The new penalty means that expansive amounts of capital which ultimately will have to be refunded may be tied up with FTB rather than being invested in the economy. The penalty's $1.4 billion in projected revenues is achieved by in essence forcing companies to overpay their taxes by May 31, 2009, in order to avoid any risk of a penalty. This requires companies to guess the outcome of pending reasonable disputes with FTB and to speculate over a multitude of unforeseeable issues that commonly arise after the fact with complex tax filings. This may mean paying two to three or more times the potential understatement amount.

Hits Even Tax-Compliant

For companies with large, complex tax returns, $1 million or more can easily and reasonably be in dispute. For example, a company that owes $100 million in taxes would have to be 99 percent accurate or be penalized.

A $1 million understatement could result from circumstances outside the company's control. For example, companies that sell products internationally are sometimes in the middle of pricing disputes between the IRS and other countries. The dispute resolution can significantly change the company's federal and state tax liability after the fact. Normally, these complexities are resolved between companies and FTB over time.

Overpayments must eventually be refunded, but meanwhile, cash-strapped companies are being forced to make a loan at below-market interest rates to the state of California. In addition, the need to defensively overpay will mean expensive new administrative burdens and additional tax filings.

FTB still is processing refunds of defensive payments made in the 2005 state amnesty program, which contained a similar penalty structure.

Affects Many Companies

Companies of all types and sizes that have a significant business presence in California may be harmed by the new penalty. California's largest job-creating companies and investors—such as multistate or multinational companies—will have less capital for jobs, research and development, and economic sustainment and recovery.

Smaller companies, such as subcontractors that provide goods and services to these larger companies, may suffer from less business.

Retroactive, Permanent Penalty

The penalty retroactively applies to tax years going back to 2003. Because the penalty is permanent, tying up multimillions with FTB may be something companies will have to deal with every year on an ongoing basis.

Action Needed

The California Chamber of Commerce is actively seeking repeal of this measure and is asking concerned CalChamber member companies to join the effort.

Concerned readers should contact Kyla Christoffersen as soon as possible at *kyla.christoffersen@calchamber.com*.

Staff Contact: Kyla Christoffersen

U.S., State Economic Picture Still Grim; Capital Market, Housing Concerns Remain

U.S. Economic Downturn Steepens

Economic statistics for the nation deteriorated severely during the last several months. Reflecting the underlying trends, the government's initial estimate of gross domestic product (GDP) came in at a -3.8 percent annual rate in the fourth quarter, well below the -0.5 percent pace registered in the third quarter.

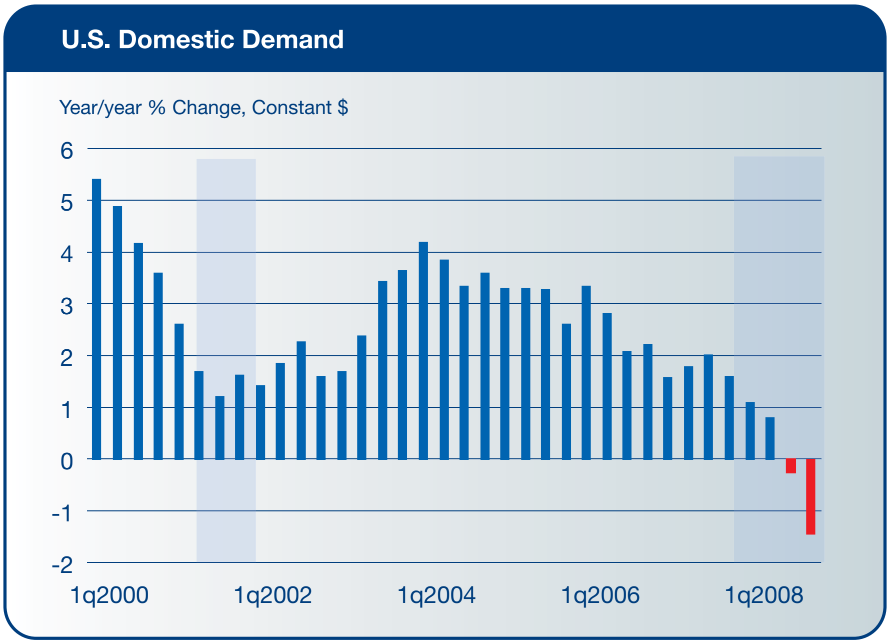
A plunge in business spending for new equipment and software, plus falling consumer spending for durable and non-durable goods, were the main reasons the economy fell so sharply last quarter. Together, they sliced -5.4 percentage points from quarterly growth.

Also on the downside, residential investment spending reduced growth by –0.8 percentage points, the 11th quarter of negative performance.

An unexpected increase in business inventories provided the biggest positive contribution to last quarter's economy, adding +1.3 percentage points to the economy's overall growth rate. Also, rising federal government spending contributed +0.4 percentage points to fourth quarter growth.

Net exports (gross exports minus gross imports) added just +0.1 percentage point to quarterly growth. That figure, however, conceals the spreading weakness in foreign trade. Plunging exports drained -2.8 percentage points from growth during the fourth quarter, while falling imports (which enter GDP with a minus sign) added +2.9 percentage points.

As shown in the chart, final domestic demand, which excludes both changes in inventories and net exports, fell by -1.5 percent last quarter compared with fourth quarter 2007, continuing the downward trend in place since summer 2007 and the slowest quarter since the sharp 1980 recession.



Other news also has been downbeat. Non-farm payroll employment has declined every month since December 2007, and the cumulative loss through January 2009 was nearly 3.6 million workers. Job counts are falling especially fast in construction, manufacturing, transportation, retail trade and the financial and real estate sectors. Worse yet, employment declines have spread to most other industries, reflecting employers' extreme uncertainty about the outlook and cautious attitudes toward hiring.

Meanwhile, the nation's unemployment rate moved up from 4.6 percent in June 2007 to 5.0 percent in December and 5.5 percent in June, and then soared to 7.7 percent in January 2009. Consumer sentiment is hovering near the record lows of 1980. Weak consumer confidence reflects current labor market conditions and anxiety about the impact of the ongoing crisis in financial markets.

In a bit of positive news, recent trends on the inflation front are generally favorable. Energy prices hit new highs in late June/early July 2008, with crude oil briefly testing the territory north of $155 per barrel and regular gasoline prices in California nearing the $4.60 per gallon mark.

Both have dropped dramatically, however, with crude below $40 per barrel and gasoline around $2.25 per gallon by mid February. Lower transportation fuel costs provide a welcome boost to the purchasing power of both households and businesses in a weakening economy.

Concerns about the deepening recession have grown markedly in recent months. Most economic forecasters have marked down their economic projections for 2009, and a significant proportion now expect a serious downturn similar to that of 1981-82 (in GDP terms), the nation's last deep recession.

The Economic Advisory Council shares these concerns. The economic data reported for November, December and January revealed steep declines in employment and sales that usually appear during deep recessions. Very few industries are adding any new workers.

Interest Rates and Financial Markets

The Federal Open Market Committee (FOMC) dropped the fed funds target rate to a range of 0 percent to 0.25 percent at its December 15-16, 2008 meeting, about as far as interest rate policy can go. The Fed's main concern was the weaker economy, evidenced by steep declines in industrial production, housing and foreign trade.

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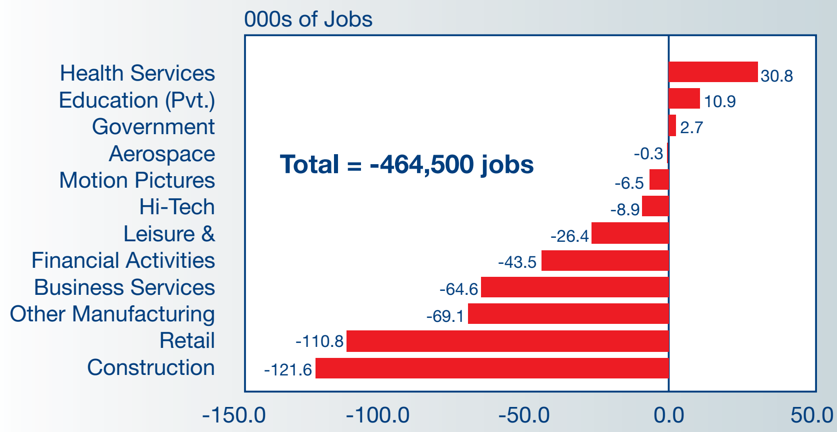
While conditions in some credit markets have improved, "credit conditions for households and business firms remain extremely tight." Thus, the Fed plans to use its balance sheet to "support the functioning of financial markets and stimulate the economy through open market and other measures likely to keep … [its] balance sheet at a high level."

In response, there has been some improvement in domestic and foreign capital markets. Corporate spreads have narrowed somewhat. Highly rated companies are now able to issue commercial paper without federal guarantees. January saw record issuance of longer-term corporate bonds. Other leading central banks are following similar policies to increase market liquidity, ease interest costs, and stem the downward economic momentum in their nations.

Most households and firms, however, still face constraints when they try to obtain mortgages and business loans. The Council's prognosis: the situation is improving but the battle is not yet won.

Job Change by Industry—California (January 2008–January 2009)



Source: California Employment Development Department

California Economy Flags

Like the nation, California's economy turned down sharply toward year end 2008. For example, the state lost about -257,000 non-farm jobs between December 2007 and December 2008. Of these, 70 percent (or nearly -180,000 jobs) disappeared during the fourth quarter alone.

For the year, through December 2008, the state's unemployment rate increased by 3.4 percentage points (to 9.3 percent). Of this, the fourth quarter increase was 1.6 percentage points.

Other broad-based indicators also paint a darkening picture. Personal income earned in California increased by 3.2 percent during third quarter 2008 compared to third quarter 2007 (latest data available). A year earlier, that figure was 5.2 percent.

Problems in the state's construction, manufacturing, retail trade and finance sectors accounted for much of the drag in the state's earnings growth. Taxable sales growth dropped into negative territory during the last two quarters of 2007. By third quarter 2008, estimated year-to-year declines had swelled to -5.0 percent. Sales declines have been most severe for California's motor vehicle dealers, followed by building materials dealers and household furniture and appliance stores.

With personal incomes, corporate profits and taxable sales lagging, declining tax revenues have generated a huge operating deficit in the state's General Fund. The need to close this deficit reduces the state's ability to support the economy.

Employment performance among the state's industries was mostly negative over the 12 months up to December 2008. On the plus side, the only major industries with higher job counts were health care and social assistance; (private) educational services; professional, scientific and technical services; government; and the farm sector. Job counts fell in all other major sectors.

Employment declined the most in California's construction, retail trade, manufacturing, finance and insurance, and employment services sectors. Together, firms in these five industries reduced payrolls by nearly -262,000 workers, while other sectors reported smaller declines.

Exports of goods made in California have provided a much-needed boost to the state's economy. Total state exports grew by 7.8 percent during 2008. The largest category of exports—high tech manufactures (computers, peripherals and so forth) declined by -4.5 percent in dollar terms, while non-electrical machinery exports fell by -7.8 percent. Exports of transportation equipment, however, jumped by 17.8 percent.

And exports of other important California-made products also grew rapidly, like chemicals (up by 16.1 percent), miscellaneous manufactures (+21.8 percent), and agribusiness products (farm produce, livestock, fish, processed food products, and beverages and tobacco), which increased by a healthy 20.2 percent.

Comparing the state's major metro areas, regional employment performance worsened as the year progressed. By December, only one area, Bakersfield, reported any gain in non-farm employment, and it was a modest +0.3 percent. Areas with relatively moderate job losses (-0.9 percent to -1.4 percent) through December 2008 included San Francisco, Los Angeles, Fresno, San Jose and San Diego.

At the other end of the scale, employment declines have been most severe (-2.6 percent to -3.0 percent) in Alameda-Contra Costa, Riverside-San Bernardino, Ventura County, Orange County, Stockton and the Sacramento area.

Although employment is now falling, the San Francisco area continues to

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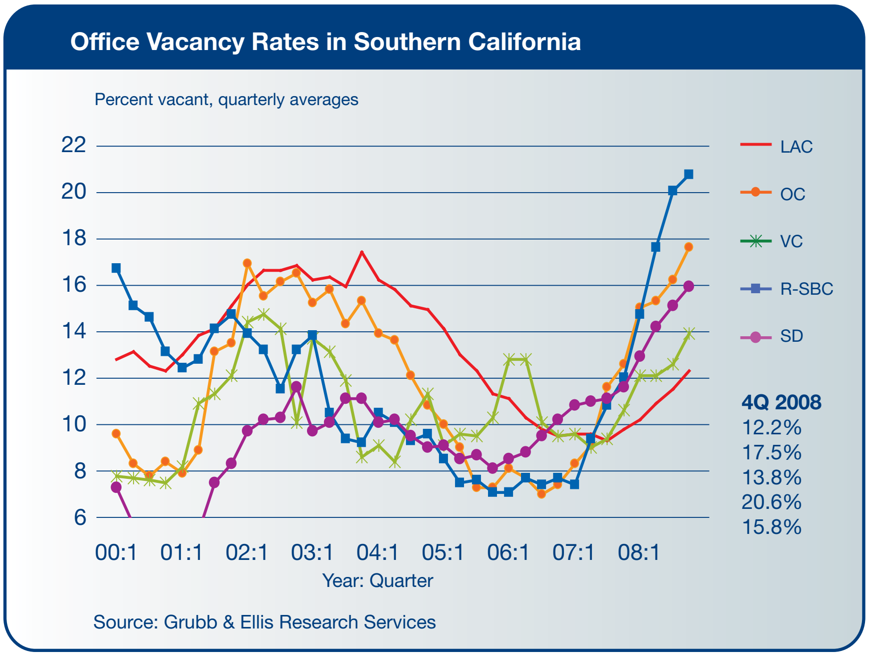
outperform most other regions of the state. In large part, this reflects the strength of the Bay Area's high tech services sector, where employment is rising (for now), and the biotech sector, which continues to develop nicely. The same two industries have also helped San Jose.

Tourism-related activities turned down during the fourth quarter, and there are growing concerns about the months to come. Retail trade losses are mounting fast and many finance jobs have disappeared, especially in Oakland and San Francisco. In addition, construction job losses play an important role in the Oakland/Contra Costa metro area.



Office Vacancy Rates in Southern California

Source: Grubb & Ellis Research Services

In Southern California, the motion picture industry faced numerous challenges in 2008. Although the writers' strike ended early in the year, negotiations with the Screen Actors Guild have not been settled. Shooting of major studio feature films and commercials dropped sharply.

Although television productions increased, much of the improvement came in TV reality shows, which have relatively low budgets, and cable network dramas. The industry is trimming production and employment in the face of lower advertising and broadcasting revenues.

Elsewhere in Los Angeles, the stronger industries are health care, private education and some professional services (accounting and architecture and engineering). Retail trade and residential construction continue to weaken throughout the region, especially in the Inland Empire.

Orange County has taken substantial hits to its mortgage banking industry, and tourism is sluggish. San Diego's economy is experiencing a relatively moderate decline, with growth in biotech, education and health care, plus a welcome stability in defense-related activities offsetting—but only partially—declines in construction, retail trade and financial activities.

Agriculture and Resources

On the surface, 2008 appeared to be a pretty good year for California's agriculture sector. Prices were high for many products and exports grew strongly. Livestock and dairy prices, however, weakened as the year progressed and turned down sharply toward year end. Prices for stone fruit and some nuts also fell. Export markets softened in the fourth quarter. While feed costs also declined, there are concerns about prospects for 2009.

Demand for many premium California-grown products is expected to soften at home and abroad, as recession-weary consumers economize. And drought restrictions (see below) have become a reality, forcing many California farms to make hard decisions about which products to produce and which to reduce or eliminate. Trees as well as crops are at risk.

Indeed, there is great concern about water supply across the state. The recent string of dry years—including projections for 2008-2009—has left water storage at very low levels in the California systems and the Colorado River area. Both the California State Water Project and the Central Valley Project restricted deliveries in 2008, and even bigger cutbacks are anticipated for 2009.

Worse, it appears severe cutbacks are likely for water that must transit the Delta. While the outcome depends on a new Delta fish plan still being developed by the U.S. Fish and Wildlife Service, water allocations to parts of the Bay Area, Southern California and the San Joaquin Valley are all likely to be reduced significantly in the plan.

The supply of electricity in California should be adequate in the near-term as industrial demand weakens. Electricity prices, however, will be sharply higher in 2009, reflecting the utilities' higher costs associated with mandated investments to reduce their environmental footprint and to increase their distribution networks.

Real Estate and Construction

The downturn in housing continued over the last three months, but some interesting changes have been taking place. Here are some interesting statistics for the state's resale home market:

● Existing single-family home sales in California increased by nearly +85 percent over the year to December 2008, while condo sales were up by +45.9 percent.

● Prices continued to fall, with the median price of single-family homes sold in December 2008 (at $281,100) down by -41.5 percent compared to December 2007.

● The number of homes available for sale represented just 5.6 months supply (at December's sales rate) compared to

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13.4 months a year earlier.

December's healthy sales increase partly reflected the weakness of December 2007, when the credit crunch was near its worst. There have also been fundamental geographical and market changes in the "mix" of homes sold, however. In particular, sales have soared in the inland areas of California that experienced high foreclosure rates and where large numbers of lender-owned, real estate-owned homes are on the market.

"Distressed" sales, i.e., at low, "distressed" prices, have accounted for a high and growing fraction of home sales, which has pushed down the state's median price. In addition, California buyers were able to take advantage of higher conforming loan limits (up to $729,750) available in the second half of 2008. The limit has fallen to $625,500 for 2009, a possible concern.

While healthy, December's home sales were still -20 percent below the peak sales pace of 2005. Significant further improvement seems unlikely in the near-term, as most primary mortgage lenders have tightened the credit quality standards borrowers are required to meet.

Residential construction activity continued at very low levels across the state during the fourth quarter, although a bit higher than the previous quarter.

Total housing permits were issued at an annual rate of 68,000 units during first quarter 2008 and 75,000 during the second quarter. Permit issuance, however, sank to just 58,000 units (annual rate) during the third quarter. Only 60,000 permits were issued during the last quarter, a drastic decline of -72 percent from peak construction levels of 2004.

Single-family homes were the most affected. The fourth quarter pace was -83 percent below the 2004 years, while multi-family permits were off by "only" -44 percent.

New home builders still have sizable inventories of unsold homes and lots. Construction of new homes has dropped fast and effective selling prices are falling, so the unsold inventories are beginning to decline, especially single-family units.

Inventories of attached housing units, however, are swelling as large projects are completed. Finding buyers for these units likely will take a while.

Industry observers do not expect any significant improvement in new home construction before 2010, with some areas not reaching bottom until a year later.

Cracks are also showing in California's commercial real estate markets. Specifically, availability rates have risen markedly in 2008. The situation is most problematic for retail and office space. Retail sales are declining, and retailers' access to financing has been limited by the credit crunch. Several chains have declared bankruptcy or closed down altogether, and this trend is expected to worsen in the near-term.

With most lenders unwilling to lend for commercial real estate development, construction of new retail space is slowing fast. Nevertheless, vacancies are surging and rents are on the decline because of all the stores closing down.

Most areas in California are experiencing higher retail vacancies. The biggest problems appear to be in Riverside-San Bernardino and areas where large amounts of retail construction took place in recent years.

As for office space, demand has declined, reflecting employment trends in office-based industries, especially finance and insurance. Many firms are cutting back and vacating or subleasing space.

Vacancies are high and rising in the Inland Empire (20.6 percent), Sacramento (17.7 percent), Orange County (17.5 percent) and San Diego (15.8 percent). Considerable new product is coming into Sacramento and several other markets, suggesting rents will be weaker there than elsewhere. Statewide, the value of new office construction permits declined by -40.8 percent in 2008, which means the office construction pipeline will shrink eventually, although not before vacancies rise further.

Industrial real estate markets have been steadier than retail or office, but vacancy rates are rising in this sector as well even though new construction is slowing. Demand for warehouse and distribution space has slackened, reflecting the more somber outlook for retail sales across the United States. Demand for high tech and biotech space,

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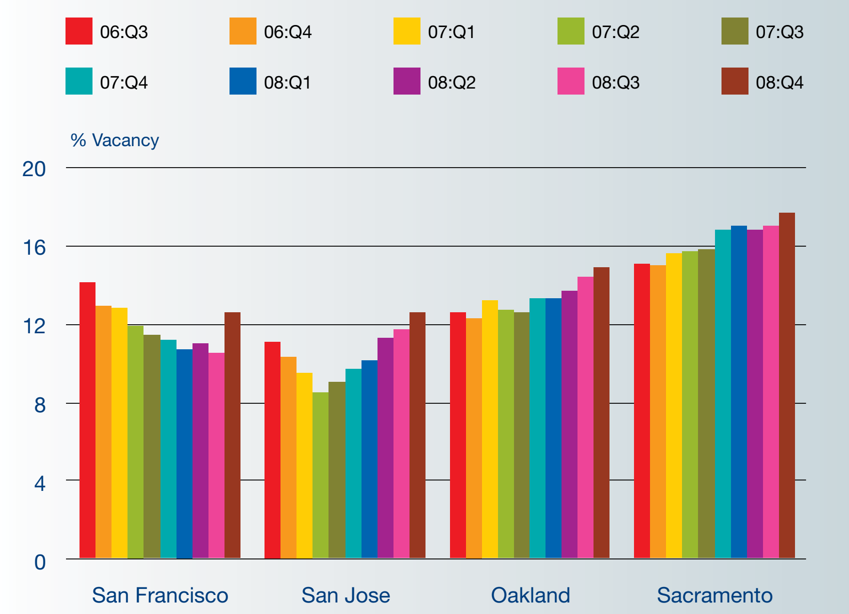
Office Vacancy Rates in Northern California



Source: Grubb & Ellis

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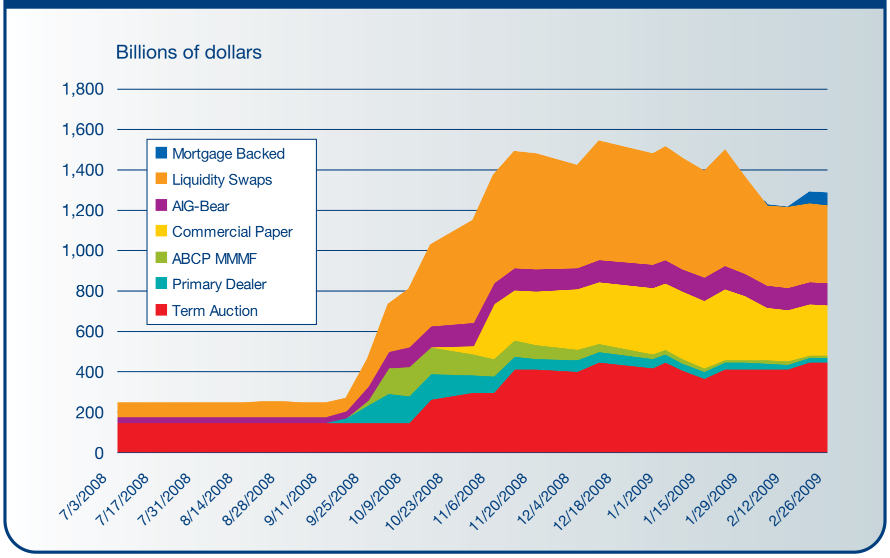
which had been growing nicely, appears to have flattened out.

Although up a bit (to 2.2 percent in fourth quarter 2008), vacancy rates remain extremely low in Los Angeles County. Vacancy rates are highest in Sacramento (11.2 percent), San Jose (10.6 percent), and the Inland Empire (9.9 percent). Vacancies are surging in the latter area, where substantial new construction is under way even though demand for distribution space has fallen.

The Financial Rescue 1: Federal Reserve Actions



The value of non-residential construction permits declined by -34.9 percent in California during 2008 compared with 2007. Permit activity increased most in Contra Costa County (+244.9 percent), Kern County (+183.7 percent), Los Angeles County (+23.7 percent) and Sacramento (+11.9 percent). The biggest declines in permit activity occurred in Orange County (-72.7 percent) and Riverside-San Bernardino (down by -69.6 percent).

Financing has become extremely difficult to obtain for most types of new commercial real estate projects, so permit values are expected to fall more in 2009. Thus, the construction pipeline will empty out, limiting the amount of new supply coming into already-slowing markets.

Risks

Risks are mostly to the downside in this environment. The economy is in the midst of what looks to be a serious recession, and we cannot tell how deep the recession will be nor how long.

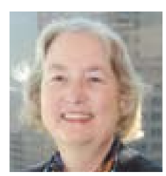
One key risk is continued volatility in global capital markets. Central banks and governments around the world are pouring trillions of dollars into their financial industries and various industries. There are tentative signs of easing, but the financial industry's problems are complex and likely to worsen along with the general economy.

Considerable time and still more public support likely will be required before the most important issues can be resolved. If nothing else, capital market volatility limits financial institutions' ability and willingness to take on more debt and to engage in ordinary business and consumer lending, thereby worsening the current credit crunch. The result: Business and household spending could slow even more than now seems likely.

A second risk is that rising joblessness and a tightening of credit conditions could worsen the current troubles in the state's housing markets, taking sales volumes back down again. California housing can't begin to approach normal until unsold inventories are reduced significantly. That process was beginning to unfold in the months leading up to December. The progress made so far, however, could be derailed if the credit crunch were to relapse.

On the other hand, several large banks have started special programs to work with borrowers to limit future delinquencies and foreclosures. If the new programs succeed, the decline in home prices could be slowed.

Staff Contact: Dave Kilby



The California Chamber of Commerce Economic Advisory Council, made up of leading economists from the private and public sectors, presents a report each quarter to the CalChamber Board of Directors. The council is chaired by Nancy D. Sidhu, vice president and chief economist for the Los Angeles Economic Development Corporation.

Publication of this report is a project of the California Foundation for Commerce and Education.

CFCE California Foundation for Commerce & Education

Lawsuit Contends Feds Ignored Science in Restricting Water Pumping in Delta

The State Water Contractors, an association of 27 public water agencies and utilities that purchase water from the State Water Project (SWP), filed suit on March 3 against several federal government entities to challenge new regulatory restrictions on state water operations.

The restrictions stem from a biological opinion developed by the U.S. Fish and Wildlife Service for the Delta smelt, an endangered species of fish that lives in the Sacramento-San Joaquin Delta. Other federal agencies named in the lawsuit include the U.S. Department of the Interior and the U.S. Bureau of Reclamation.

The water contractors are asking the court to stop the federal agencies from restricting higher volumes of pumping for the SWP and also to compel the Fish and Wildlife Service to revise the 2008 biological opinion to consider all available science and data.

The new regulatory restrictions, adopted in December 2008, are a response to U.S. District Court action dating to May 2007, when Judge Oliver W. Wanger of the California Eastern District cut allocations from the SWP to protect the Delta smelt.

In April 2008, the judge found that the biological opinion for the Delta smelt was flawed based on the conclusion of the National Marine Fisheries Services that water diversions for the SWP were killing the smelt. The judge ordered that the biological opinion be rewritten.

The December 2008 guidelines severely reduce the ability of the SWP and federal Central Valley Project (CVP) to deliver water to the 25 million Californians and 3 million acres of farmland that they normally serve.

Late last month, the U.S. Bureau of Reclamation announced that Central Valley farms will receive none of their normal allocation of water from the CVP due to serious drought conditions and the bureau's regulatory guidelines that prioritize allocation of water for the CVP.

Scientific Data Missing

The lawsuit argues that the Fish and Wildlife Service failed to make use of the best science and data available when drawing up the biological opinion. The water contractors contend that the service was aware of other factors contributing to the decline of the Delta smelt population, such as invasive species, toxic runoff from pesticides and waste treatment plants, and non-native predator fish introduced for sport fishing, but did not explore these factors while developing the biological opinion.

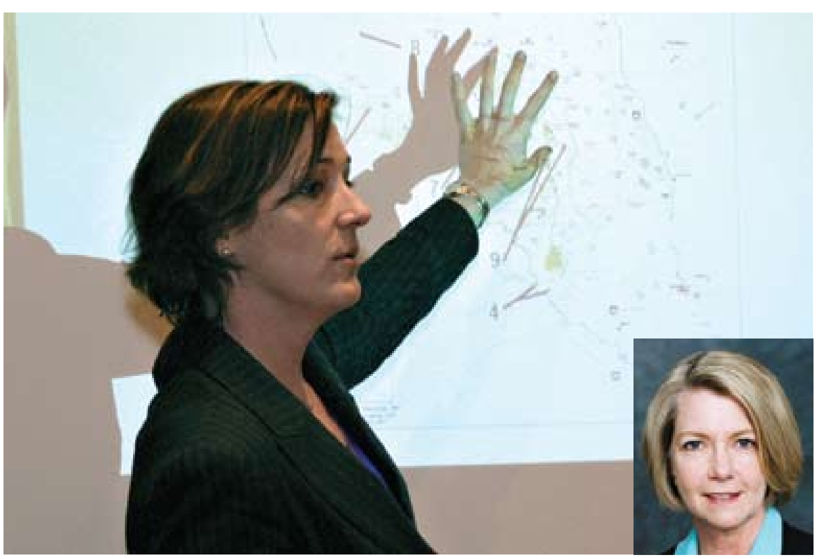
The lawsuit states that while "project pumps do take some Delta smelt, the best available scientific data show that this take, and other project effects, do not have population level effects on the Delta smelt."

Instead, the lawsuit contends, these factors were dismissed in favor of a biological opinion model that attributes the declining Delta smelt population to SWP pumping alone.

If the court grants an injunction, SWP pumping operations could continue pending a revision to the 2008 Delta smelt biological opinion.

Staff Contact: Valerie Nera

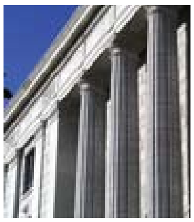
Water Outlook Focus of CalChamber Committee, Board of Directors



Speaking at the March 5 CalChamber Water Committee meeting are Karla Nemeth, California Resources Agency, discussing the Bay-Delta Conservation Plan, and Maureen Stapleton (inset), general manager of the San Diego County Water Authority, explaining actions her agency has taken to diversify its water sources.

Lester Snow, director of the California Department of Water Resources, outlines for the CalChamber Board of Directors the severe water shortage due to drought and court rulings reserving water flow for environmental purposes.

Court Upholds Workers' Comp Reform



A California court of appeal has confirmed the expanded protections for employers intended by the Legislature when it passed the California Chamber of Commerce-supported workers' compensation reforms of 2004.

In the case *Benson v. Workers' Comp Appeals Board* 170 Cal. App. 4th 1535 (2009), the court held that if an employee suffers from a specific injury and a cumulative injury, regardless of when the injury occurred, they are entitled to two separate awards—one for each injury. The worker is not entitled to a combined award with a longer payout period as this is contrary to the legislative intent, the court ruled.

Case Background

Diane Benson worked as a file clerk for Permanente Medical Group beginning April 1992; the job required her to stand almost all day and perform repetitive neck and upper extremity motion. On June 3, 2003, she injured her neck while reaching up over her head and pulling out a plastic bin to file a chart. Her initial diagnosis was neck strain and she was put on light duty. On July 15, 2003, she was put on temporary total disability and never returned to work. On September 26, 2003, her disability was deemed permanent and stationary.

The agreed medical examiner (AME), Dr. Izzo, found Benson had suffered two separate injuries to her neck—the specific injury on June 3, 2003, and a cumulative trauma injury through June 3, 2003. Dr. Izzo apportioned half of Benson's permanent disability to cumulative trauma and the other half to the specific injury.

The entire panel of the Workers' Compensation Appeals Board overturned an administrative law judge's (ALJ) holding and found that, because the AME found that there were two different injuries and both were equally responsible for the disability, Benson is entitled to receive a 31 percent award for each injury in the amount of $24,605 per injury. Each award is payable at $185 per week for 133 weeks.

The ALJ's award combined the two injuries into a 62 percent award, for a total of $67,016.25, payable at $185 per week for 362.25 weeks.

The difference between the amount of time found by the ALJ and the Board is caused by the non-linear benefit schedule, which more generously compensates more severe disabilities. As such, because a 62 percent award indicates a more severe injury, the award should last longer to greater compensate the injured employee.

Benson argued the ALJ was right as the decision was consistent with a California Supreme Court decision that held the same (*Wilkinson v. Workers' Comp Appeals Board* 19 Cal. 3d 491 (1977)).

Permanente claimed that workers' compensation reforms contained in SB 899 (Poochigian; R-Fresno, Chapter 34, Statutes of 2004) dictated the board's holding.

The court of appeal agreed with the board because the SB 899 reforms changed the apportionment discussion to focus on the cause or pathology of an injury and not the actual disability. The SB 899 amendments refer to a singular injury relating to the employer's liability, stating employers are liable only for the percentage of permanent disability directly caused by the injury arising out of and occurring in the course of employment.

As such, even though 62 percent of Benson's permanent disability was directly caused by more than one injury arising out of and occurring in the course of Benson's employment with Permanente, each distinct industrial injury directly caused only half of the permanent disability.

CalChamber Recommendation

The CalChamber recommends that employers report all workplace injuries as required by law:

- *Injury and Illness Incident Report* - Form 301;
- *Log of Work-Related Injuries and Illnesses* - Form 300;
- *Summary of Work-Related Injuries and Illnesses* - Form 300A.

Employers should also:

- Promptly investigate workplace injuries to determine if additional training, support, etc. is necessary; and
- Communicate consistently with your workers' compensation carrier and legal counsel about this evolving area of the law.

Staff Contact: Jessica Hawthorne

Climate Change Committee Plots Strategy

Lucinda Starrett (right), chair of the CalChamber Climate Change Policy Committee, leads a discussion on best practices for disseminating factual information about the impacts of California's landmark legislation. At left is CalChamber Policy Advocate Amisha Patel, who tracks climate change and energy issues for the organization.

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