ALERT

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CalChamber
CALIFORNIA CHAMBER OF COMMERCE

Analysis

Deficit Spending, Tax Hikes in Latest Budget Proposals

Governor, Republicans Urge Reforms, No New Taxes

The state budget, taxes and massive new debt have emerged at the top of the Legislature's agenda this month. Some wonder how the Legislature could have been working on any issues other than jobs, the economy and the budget, given the gravity of the fiscal problem. But making up for lost time, legislative leaders have laid on the table billions in new taxes and added a stunning proposal for new deficit spending into the mix.

Deficit Spending

After two weeks of proposals and counterproposals, the Assembly Democratic leadership this week doubled down on the deficit, proposing to borrow more than $9 billion to paper over part of the current deficit, avoiding the tough decisions needed to bring the budget into balance over the long term.

The Assembly Democratic proposal funds existing programs for which California currently doesn't have the resources by borrowing money and increasing taxes to pay that new debt off over the next 20 years. All these programs will be left on the books with no revenues to pay for them next year—other than more deficit financing and increased taxes.

The borrowing would be repaid by using fees and taxes that consumers and manufacturers pay for recycling beverage containers, and disability insurance premiums paid by California workers. The programs formerly supported by these revenues would instead be financed by proceeds from a new tax on oil extracted only in California.

Anticipating that two-thirds of legislators won't vote for a tax increase on California oil, the proposal relies on a deliberately illegal maneuver: reducing the sales tax by an amount matching the increase in the oil extraction tax to avoid the people's stated intent (placed in the state's Constitution) to have all tax increases approved by a two-thirds vote.

So, if you have a tax decrease equal to the amount you're increasing, how does this get you additional money?

See Analysis: Page 4

Business Coalition Voices Concerns Over Impending Rules on Green Chemistry

The California Chamber of Commerce, along with a broad coalition of trade associations and companies, expressed concerns this week to the state Department of Toxic Substances Control (DTSC) over draft green chemistry regulations that are expected to be released in the next several weeks.

In a 10-page letter to DTSC Acting Director Maziar Movassaghi, the coalition outlined its concerns surrounding several problematic regulatory concepts that DTSC has indicated may be included in the green chemistry regulations.

The business coalition, known as the Green Chemistry Alliance (GCA), has worked with the department since the passage of the Green Chemistry Initiative in 2008 to craft regulations that are workable, practical, grounded in generally accepted scientific principles, and that follow the intent and vision of the law.

That law, authorized by AB 1879 (Feuer; D-Los Angeles, Chapter 559) and SB 509 (Simitian; D-Palo Alto, Chapter 560), gives DTSC broad authority to regulate the use of potentially hazardous substances in consumer products.

Problematic Concepts

Although the draft regulations have not yet been released, the concerns

See Green: Page 3

Inside

Cal/OSHA Corner

Federal Safety Program Change Starts Clock on Review of State Process

Mel Davis
Cal/OSHA Advisor

Our corporation has facilities in other states besides California. Will our California facility be affected by the new federal Occupational Safety and Health Administration (OSHA) program targeting "severe violators"?

The specifics of how your California facility will be affected won't be certain until California completes the regulatory process required after the adoption of new federal rules.

California already has in place a High Hazard Compliance Unit that is responsible for inspecting identified employer worksites in high hazard industries, those that the federal revision will address.

California identifies worksites for inspection through a regional targeting plan or through referrals following an accident or complaint.

Federal OSHA, located within the U.S. Department of Labor, announced the policies and procedures for its new Severe Violator Enforcement Program on April 22. The new program will take effect within 45 days of that date.

Within six months of the adoption of the new federal rules, California must provide notice of its intent to adopt policies or procedures identical to or at least as effective as the federal ones.

Federal Program

The new federal program is intended to focus OSHA enforcement resources on recalcitrant employers who endanger workers by demonstrating indifference to the employers' responsibilities under the law.

The Severe Violator Enforcement Program includes increased OSHA inspections of these worksites, including mandatory OSHA follow-up inspections and inspections of other worksites of the same employer where similar hazards and deficiencies may be present.

The program will focus enforcement efforts on significant hazards and violations relating to high gravity/high emphasis hazards, such as specific fall standards or standards covered in the National Emphasis Programs.

The National Emphasis Programs, for example, focus on amputations, lead, shipbreaking and process safety management—those industry operations or processes that expose employees to the most severe occupational hazards.

In addition, OSHA will administratively increase the existing penalties for serious violations and serious willful violations to $12,000 and $250,000, respectively, in the near future.

The complete enforcement instructions for the new federal program are available at ***www.osha.gov/dep/svep-directive.pdf***.

State High Hazard Unit

The California High Hazard Compliance Unit has one district office in Northern California, located in Oakland, and a second in Southern California, located in Santa Ana.

A listing of high hazard industries is available by going to the Cal/OSHA website at ***www.dir.ca.gov/dosh/hhu.html*** and clicking on the "high hazard industries" link.

A listing of recent enforcement actions by the High Hazard Compliance Unit is available at ***www.dir.ca.gov/dosh/citation.html***.

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.

CalChamber Calendar

Public Affairs Council Spring Retreat:
June 15, Sacramento

Next Alert: June 11

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Green Chemistry Rules Cause Concern

From Page 1
articulated in the coalition letter are based on summary documents that have been provided by DTSC to the public, ongoing conversations with the department, and presentations made by the department's Green Ribbon Science Panel.

The CalChamber notes that while significant progress has been made since the release of DTSC's "Straw 2" proposal seven months ago (see November 6, 2009 ***Alert***), serious issues will likely still need to be addressed in the draft regulations.

"We think we're in a much better place with these regulations than we were late last year," said CalChamber Policy Advocate Robert Callahan. "However, as always, the devil will be in the details."

Areas of Concern

In the letter, the GCA acknowledges that although the impending draft regulation will be just that—a draft—the details are critical and could have sweeping ramifications on virtually all industry sectors that manufacture or sell consumer products in the state.

Some of the primary points made in the letter are as follows:

- The process of prioritizing and evaluating chemicals in products must be based on exposure as well as hazard, and avoid duplicative and conflicting regulatory requirements.
- Regulations should apply only to intentionally added ingredients that serve a functional purpose at or above 0.1 percent, consistent with other state, federal and international systems by which manufacturers are currently regulated.
- If DTSC fails to implement a science-based approach to screening out products with low likelihood of harm, the program will surely collapse under its own weight.
- DTSC should ensure that the regulations anticipate and fully leverage the wealth of quality information on chemicals in commerce from government agencies and inter-governmental bodies around the world as required by AB 1879.
- DTSC must ensure that the regulations are crafted in a manner that utilizes both public and private resources as efficiently and effectively as possible.
- The regulations should provide the option for manufacturers to conduct the alternatives assessment of the chemical in question.
- Confidential business information must be protected. The ability to protect certain information from competitors is essential to defending the competitive position of companies in the marketplace.
- A third party certification process for alternatives assessments it must be an option for manufacturers—not a mandate.
- The regulatory enforcement provisions should provide for industry safeguards and flexibility in regulatory actions.
- The coalition is highly opposed to certificates of compliance for all priority products whether in compliance or exempt from regulation.
- The draft regulations must ensure that manufacturer compliance with the program does not lead to excessively burdensome economic impacts.

Workable Rules

The CalChamber and the GCA are working to promote a workable and practical approach that is grounded in generally accepted scientific principles and follows the intent and vision of the green chemistry law.

By meeting the goals outlined in the coalition letter, DTSC can help ensure that the regulations are designed in an effective and cost-efficient manner so that California's economy and the environment are protected.

Staff Contact: Robert Callahan

CalChamber-Sponsored Seminars/Trade Shows

More information at *www.calchamber.com/events*.

Business Resources

Business Excellence and Installation Gala. Beverly Hills Chamber of Commerce. June 10, Beverly Hills. (310) 248-1000.

Toward Sustainable Groundwater in Agriculture. Water Education Foundation. June 15–16, San Francisco. (916) 444-6240.

International Trade

7th World Chambers of Commerce. International Chamber of Commerce. June 8–10, Mexico City. (212) 703-5065.

Export Compliance Training. International Traffic in Arms Regulations (ITAR). June 10, Hawthorne. (310) 973-3148.

National Export Initiative – Medical Devices. Minnesota Trade Office Department of Employment and Economic Development. June 11, Minneapolis. (651) 259-7482.

Rebuild Chile Expo. Kallman Worldwide. June 15–17, Santiago, Chile. (201) 251-2600.

Agri Livestock Fisheries SMEDEX 2010. Sri Lanka Consulate in Los Angeles. June 18–20, Colombo, Sri Lanka. (213) 387-0214.

Business Future of the Americas Conference. The American Chamber of Commerce of Peru. June 21–22, Lima, Peru. (510) 705-8000.

7th Annual Global California Conference. Monterey Bay International Trade Association (MBITA). June 23, Los Angeles. (831) 335-4780.

Indo Aquaculture 2010 and Indo Livestock 2010. Indonesia Directorate General of Livestock Services, Department of Agriculture. July 8–10, Jakarta, Indonesia. *kontakt@merebo.de*.

Africa's Big Seven. Exhibition Management Services. July 18–20, Johannesburg, South Africa. *admin@exhibitionsafrica.com*.

Indowater 2010, Indowaste 2010 and Indomeelex 2010. PT. Napindo Media Ashatama. July 28–30, Surabaya, Indonesia. *contact@merebo.de*.

India Trade Conference. Port of Los Angeles, Southern California Edison and Quanta Consulting. July 29, Irwindale. (949) 480-9466.

Analysis: Deficit Spending, Tax Hikes in Latest Budget Proposals

From Page 1

It doesn't, but it gives you a revenue stream to borrow against for the next 20 years to pay for programs that you can't otherwise afford without deficit financing.

The $9.2 billion in loans from dedicated special funds are dressed up in elaborate legal and financial finery that, taken together, (1) punitively raises taxes on an important sector of the California economy and would make California oil the highest taxed in the nation (see chart); (2) places the state's recycling program at risk for funding shortfalls and the beverage manufacturers at risk for even higher fees and taxes; and (3) puts off tough decisions on $10 billion in ongoing programs for which there is no current funding by adding to the state's debt for the next 20 years.

Tax Increases

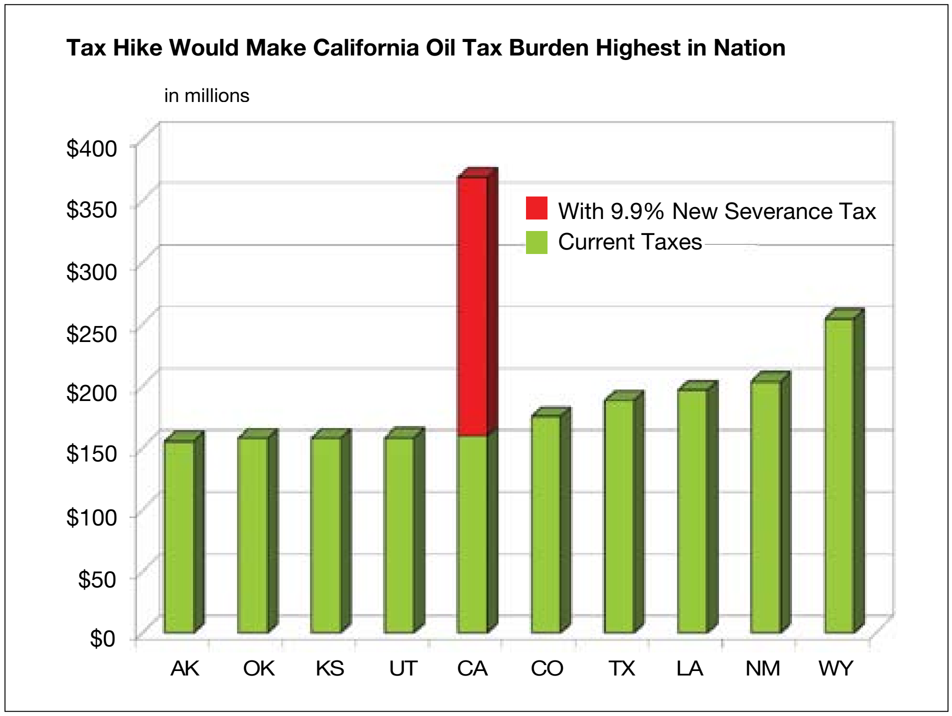
Earlier, the Senate Democratic leadership, relying in part on some suggestions offered last week by the Legislative Analyst, proposed nearly $5 billion in tax increases to address the budget shortfall, including:

- Delay by two years the business tax incentives adopted since 2008, including the optional single sales factor for multistate corporate taxpayers (and making that mandatory), carry back of net operating losses, and use of tax credits by corporate affiliates.
- Continue suspension of the net operating loss carry forward deduction.
- Extend for two years the temporary one-quarter percentage point increase in personal income tax rates originally enacted in 2009.
- Extend for two years the temporary reduction in the tax credit for dependents.
- Extend for two years the temporary increase in the vehicle license fee.
- Increase the alcoholic beverage tax.

Reforms, No New Taxes

The Governor's Office and legislative Republicans swiftly rejected the proposed tax increases, recognizing that adding even more new taxes during a recession would hobble the state's tentative recovery.

The kinds of deep cuts reluctantly recommended by the Governor are an inevitable consequence of the deep recession and a jobs and investment climate that will unfortunately cause California to trail the nation's recovery.



Comparison of oil production taxes in top 10 oil producing states in December 2008 report of LECG—a global expert services firm. Compares state and local taxes (property, sales, corporate income and severance taxes) assessed on a representative company producing 100,000 barrels of oil a day in each of the nation's top 10 oil producing states. The price of oil is assumed to be $58/barrel.

Data sources: U.S. Energy Information Administration, U.S. Census Bureau, State Governments (Alaska, California, Colorado, Kansas, Louisiana, New Mexico, Oklahoma, Texas, Utah, Wyoming), Council of Petroleum Accountants Societies, Federation of Tax Administrators.

Not to be lost among the frenzy of tax and debt proposals, the Governor two weeks ago released the May Revision of his budget proposal, identifying a nearly $18 billion gap between projected revenues and program demands.

He put forward no new taxes, set out an additional $4 billion in program cuts beyond his January proposal, and insisted on substantive budget and public pension reforms as a condition of signing a budget.

Perception Gap

In 2004, voters adopted constitutional provisions to prevent borrowing to fund state budget deficits.

The events of the past two weeks highlight not just the state's budget gap, but the gap between the real-world recession experiences of taxpayers and employers, and the other-world demands of public sector programs and government employees.

The Democratic proposals also illustrate the extremes to which the Legislature will venture to avoid facing the simple truth that the public sector appetite for spending has exceeded the economy's capacity to satiate it.

When the economy was strong, there was plenty of money to pay for California's essential and necessary programs. When the private sector economy isn't strong, all segments of government will suffer. We need to be focusing our efforts on improving our economy, not barriers to job creation.

Contact: Loren Kaye, California Foundation for Commerce and Education

U.S. Economic Upturn Continues; State's Economy Weak, But Signs Point Up

U.S. Economy

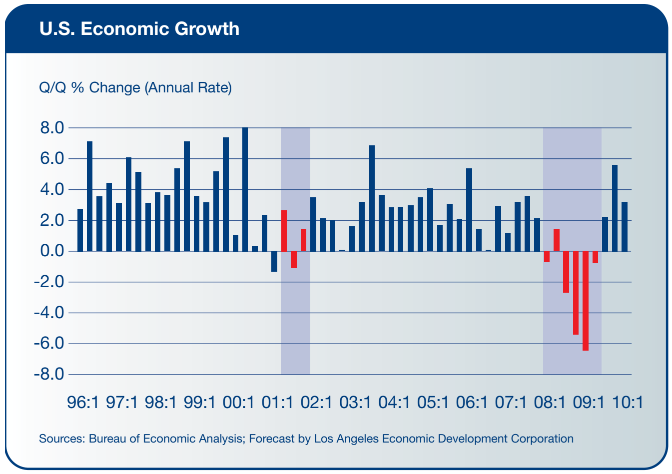
Many economic statistics for the nation have turned up during the last three to six months, a welcome improvement over last winter and spring. Reflecting the underlying trends, the government's preliminary estimate of gross domestic product (GDP) in the first quarter came in at a +3.2 percent annual rate, after a +5.6 percent uptick in the fourth quarter.

Progress was widespread in the first quarter, but not universal. Consumer spending, business investment in equipment and software, exports and federal government spending all increased. Collectively, they contributed +4.1 percentage points to first quarter GDP growth. Private-sector inventories actually grew by $31 billion last quarter, the first uptick in two years. This change had the effect of adding +1.6 percentage points to the economy's growth rate.

On the downside, however, higher imports, lower spending by state and local governments, reduced business spending for non-residential structures and lower residential investment sliced -2.5 percentage points from GDP growth last quarter.

As shown in the chart, final domestic demand (which includes spending by U.S. consumers, business firms and all levels of government, but excludes changes in inventories and net exports) was up by +1.2 percent last quarter compared with first quarter 2009. This increase was the largest since late 2007 and marks the economy's continued improvement after a very deep downturn.

Other economic news has been more mixed. After declining for nearly two years, non-farm payroll employment across the nation has shown signs of stabilizing recently, rising twice in three months during the first quarter. Even so, the recessionary losses have been severe. By March 2010, the cumulative loss in employment was -8.3 million jobs.



The biggest job losses were in manufacturing, construction, professional and business services, especially temporary help services, and retail trade. These four sectors together accounted for about four-fifths of the drop-off in total employment.

There also have been significant employment declines in information (especially publishing), transportation, wholesale and retail trade, and in the real estate and financial sectors. Meanwhile, the nation's unemployment rate, which peaked at 10 percent in fourth quarter 2009, edged down to 9.7 percent during first quarter 2010.

Not surprisingly, consumer sentiment continues at very low levels. Weak consumer confidence reflects the current poor labor market conditions and continued anxiety about the personal impact of the recession.

Zero Inflation Rate

In a bit of positive news, recent trends on the inflation front have continued generally favorable outside of energy. Excluding food and energy, consumer inflation rates are running near 0 percent. Crude oil prices, while volatile, have ranged around $85/barrel lately, nearly twice the level of early 2009. In California, regular gasoline is hovering around $3/gallon.

Concerns about the nature of the recovery have replaced recession worries as incoming monthly information turned increasingly positive.

The California Chamber of Commerce Economic Advisory Council applauds the improvement in economic activity, but remains wary about the fundamental strength of the upcoming recovery once the impacts of expansionary monetary policy and federal stimulus programs begin to wind down.

In addition, past recoveries have been slowed by financial industry restructuring. Some caution about the recovery still seems appropriate.

Interest Rates/Financial Markets

While it acknowledges the economic recovery is under way, the Federal Reserve's main concern continues to be low levels of resource utilization (i.e., high unemployment rates and low capacity utilization). The Federal Open Market Committee shows no inclination to raise rates soon from current rock-bottom levels despite the improving economic situation.

Meanwhile, the Fed has wound down most of the specialized facilities created during the financial crisis. The remaining issue concerns when and how to dispose of the Fed's huge portfolio ($1.25 trillion) of mortgage-backed bonds.

Conditions in many parts of the credit markets have improved markedly. Corporate and emerging market bond spreads have narrowed, leading firms and nations to issue large volumes of new debt. Despite the progress being made, capital market participants remain skittish, as shown by their reaction to the troubles of some European nations.

Outside of the capital markets, credit conditions for households and small-to-midsize business firms still remain tight. Households and firms face strict credit quality constraints when they apply for new mortgages and business loans from commercial banks.

See U.S.: Next Page

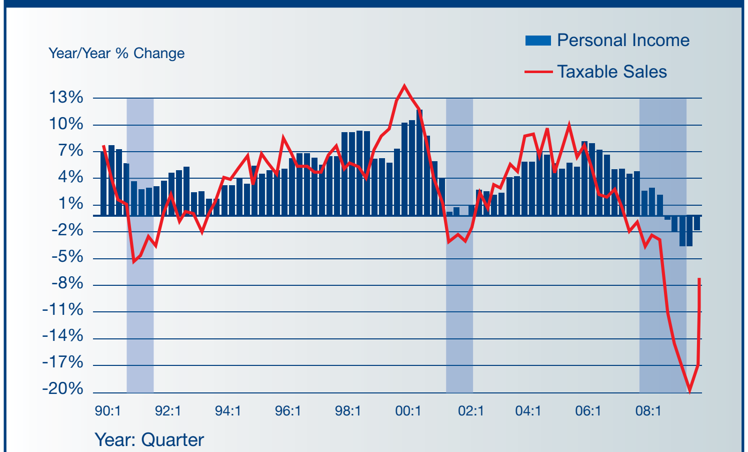
U.S. Upturn Continues; State's Economy Weak, But Signs Point Up

From Previous Page

Indeed, banks' consumer and commercial bank loan balances are decreasing. Many non-money-center banks are wrestling with delinquency problems and consequently are reluctant to take on additional risks.

The Advisory Council's prognosis: The financial situation has improved significantly, but it's unclear when the central bank will be able to return to traditional policymaking.

California Personal Income and Taxable Sales



Sources: U.S. Bureau of Economic Analysis, California Board of Equalization

California: Still Weak, But Signs Point Up

California's economy began to see some positive signs during the last quarter, though not in labor markets. The state lost an estimated 1.37 million non-farm jobs during 2008 and 2009, a most distressing figure. About 10,000 more jobs disappeared in the January-March quarter, but this was the smallest quarterly loss since late 2007.

California's unemployment rate was 12.5 percent during first quarter 2010, compared with 10.2 percent a year earlier and the cycle low of 4.4 percent during first quarter 2007. Recent jobless rates were the highest since before World War II.

Other broad-based indicators paint a somewhat less gloomy picture. Personal income earned in California decreased by 1.5 percent during the fourth quarter of 2009 compared to fourth quarter 2008 (latest data available). This marked the fifth consecutive quarter of decline, the first sustained drop in personal income since quarterly data were recorded. Problems in the state's construction, manufacturing and finance sectors accounted for much of the drag on the state's earnings growth.

Taxable sales sagged markedly in the recession, plunging by about -15 percent during 2009. The estimated year-to-year decline, however, halved during the fourth quarter, a sign of progress.

Though data are sketchy, sales declines have been most severe for California's motor vehicle dealers, furniture stores and building materials dealers. The dollar value of taxable sales appears to have hit bottom in the second quarter of 2009 and turned up during the second half of the year.

Similarly, the level of personal income may have troughed in the third quarter. Both figures are still subject to revision, however.

Probably reflecting the changing economic momentum (and conservative revenue forecasts), tax receipts have been coming into the General Fund faster than expected.

For the nine months ending March 2010, tax revenues were about $2.3 billion better than expected, bolstered by higher receipts of the major taxes. In addition, government disbursements ran $572 million below expectation over this period, meaning the General Fund's deficit (receipts less spending) was $2.8 billion smaller than expected.

California is not yet out of the woods, however, as the state still faces a chronic budget gap. Some caution about the budget situation still seems to be warranted.

Employment may finally have reached bottom in California, as non-farm job counts in March were 32,000 higher than December (on a seasonally adjusted basis)—a welcome sign. The state lost a total of -443,000 non-farm jobs over the 12 months to March, however, with most industries reporting negative results.

On the plus side, the only major sectors with higher job counts were private educational services, health care services and the federal government. Job counts fell in all other major sectors.

Employment declined the most in California's construction, manufacturing, retail trade, state and local government, professional, scientific and technical services, retail trade, and leisure and hospitality sectors. Together, firms in these six industries reduced payrolls by about -332,000 workers, while other sectors reported smaller declines.

Exports of goods made in California increased by +16 percent in January–February 2010 after a sharp decline (-17 percent) during 2009. The largest category of exports—high tech manufactures (computers, peripherals and so forth) jumped by +23.6 percent in dollar terms. Exports of California agricultural products (farm produce, livestock and beverages) rose by +18.2 percent, while non-electrical machinery exports grew by +20.6 percent. Exports of other important California-made products also increased, including chemicals (+16.3 percent) and miscellaneous manufactures (up by a stunning +39.2 percent). Transportation equipment exports provided a negative note, decreasing by -17.5 percent.

Metro Areas

Reviewing the state's major metro areas, regional employment trends continued weak in the first quarter of 2010, though most areas showed smaller job losses than in the previous quarters. All of the state's major metro areas continued to report significant year-to-year losses in non-farm employment.

Job losses were relatively moderate in two areas of the Central Valley—Stockton (-1.7 percent) and Modesto (-1.8 percent), followed by Bakersfield, Fresno and Sacramento (at -3.3 percent, -3.4 percent and -3.5 percent respectively).

Four Southern California metro areas—San Diego, Orange, Los Angeles and Ventura counties—reported losses of

See U.S.: Next Page

U.S. Upturn Continues; State's Economy Weak, But Signs Point Up

From Previous Page

-2.8 percent or -2.9 percent. Employment declines were most severe (-4.5 percent) in Riverside-San Bernardino, however.

Bay Area performance ranged from San Jose (at -2.9 percent) to Oakland metropolitan statistical area (MSA) and San Francisco MSA (both reporting -3.9 percent).

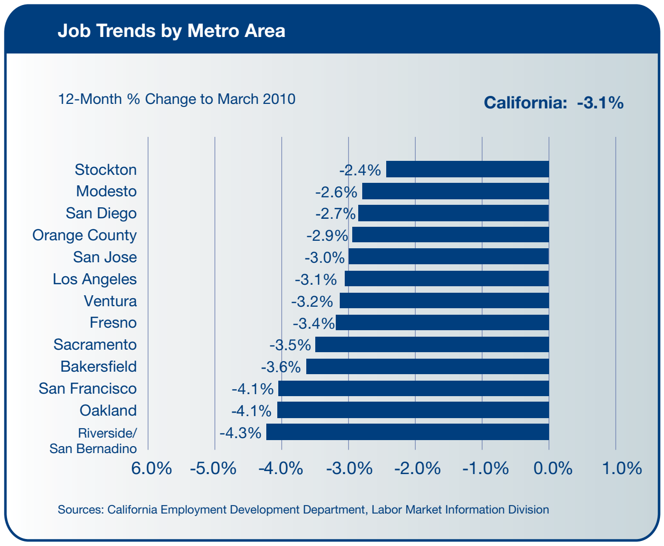
In the Bay Area during the first quarter, the level of employment edged up in the San Jose metro area, flattened out in the San Francisco area and fell more slowly in the Oakland area (using seasonally adjusted figures).

Compared with last year, construction activity has fallen around the bay, with job counts down by -11 percent (East Bay) to -20 percent (San Jose area). Retail trade jobs continued to decrease, especially in the East Bay.

Manufacturing job losses were smaller in San Jose, as several high tech manufacturers added workers in response to increased demand for their products. In the San Francisco area, travel and tourism indicators look better this year, with higher passenger traffic through San Francisco International Airport and increased hotel occupancies (though room rates have continued to fall).

Demand for temporary employees also has turned up throughout the Bay Area, an early signal of economic recovery. However, local schools and governments have reduced head counts.

Non-farm employment drifted upward across Southern California during the first quarter on a seasonally adjusted basis. Compared with early 2009, the downturns in construction and manufacturing combined with retail industry distress continued to generate employment losses across the region. Freight traffic through the area's ports has turned up strongly, with both exports and imports on the rise. The change has had an impact, not just on the ports themselves, but also on the transportation, wholesale trade and distribution centers of Los Angeles, Orange County and the Inland Empire.



The region's entertainment sector looks better this year. Domestic and international box office receipts for films have continued to increase. Also, entertainment companies are taking advantage of the state's new filming incentives to schedule productions in California.

In addition, television and cable producers have purchased a large number of new pilots and more commercials are being developed. Southern California also is seeing some progress on the tourism front, with occupancies up (though room rates are down).

Aerospace firms are stable for the moment. However, new U.S. Department of Defense proposals for fiscal year 2011 include declines in several procurement budgets of regional interest, which could have a mixed-to-negative impact on the region's key aerospace industry. Also, state/local employment is falling due to the tight budget situation.

Agriculture/Resources

California's agriculture sector is seeing some improvement in early 2010 after a difficult 2009. Prices of several products have increased, including dairy, protein products, nuts, citrus and grapes. Demand for premium California-grown products is still soft, but beginning to improve.

California-grown agricultural exports increased by +18.2 percent in the first two months of 2010 over early 2009. Declining feed costs helped to mitigate most concerns about farms' profitability.

Many California farms were forced to tap limited groundwater supplies in 2009 and had to reduce production. While winter precipitation has been normal across the state this year, the state's farms still face difficult decisions in the year ahead.

Water continues to be a serious concern everywhere in California. The recent string of dry years, up through 2009, left storage at very low levels in the state's water systems and the Colorado River area.

While the rainy season was better this last winter, the State Water Project and the Central Valley Project will have to restrict deliveries again in 2010, though perhaps not as much as in 2009. Water that must transit the Delta faces more cutbacks to protect fish. A package of water bills to help resolve the state's water problems, which requires $11.8 billion in new bonds, is up for voter approval in November.

The supply of electricity in California should be adequate in the near-term, as industrial demand weakened markedly during the recession and will take some time to recover. Electricity prices are moving sharply higher, however, reflecting the utilities' costs associated with mandated investments to reduce their environmental footprints and to improve their distribution networks.

Real Estate/Construction

Existing home sales in California have been quite healthy (greater than 500,000 sales transactions, at an annual rate) since September 2008. Here are some recent statistics for the state's resale home market:

- Existing single-family home sales in California increased by +2.5 percent over the year to March 2010, while condo sales were up by +27.8 percent.
- Prices have stabilized or risen in many areas; statewide, the median price of single-family homes sold in March 2010 (at $301,790) was up by +20.8 percent compared to March 2009.

See U.S.: Next Page

U.S. Upturn Continues; State's Economy Weak, But Signs Point Up

From Previous Page

● The number of homes available for sale represented 5 months supply (at March's sales rate) compared to 5.6 months a year earlier.

Several factors supported the housing market in the first quarter. Mortgage rates were relatively low, due at least in part to the Federal Reserve's purchases in the secondary mortgage market, which ended in March. In addition, the federal government offered temporary tax credits to encourage would-be homebuyers to act. This program ended in April.

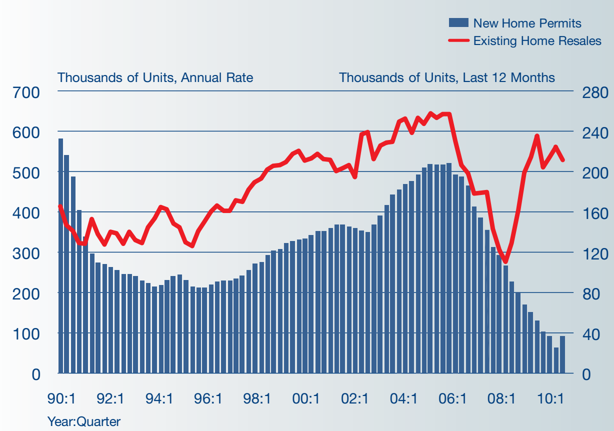
The plunge in transaction prices means many home sales in California now fall inside the government housing agencies' conforming loan limits (up to $729,750 in 2009), which increases the availability of mortgage loans to well-qualified buyers.

However, the outlook for home sales is uncertain. The end of the Federal Reserve's mortgage purchase program and expiration of buyer tax credits imply that demand for homes will weaken, at least for the next six months or so. On the supply side, mortgage defaults have continued to grow.

While the availability of foreclosed homes has declined in recent months due to banks needing more time to complete processing, the volume of distressed homes seems unlikely to shrink, though when lenders will bring these homes onto the market is uncertain. While the housing market environment looked favorable last quarter, significant further improvements in the pace of sales seem unlikely until the economy—and buyers' confidence—begins to revive.

Residential construction activity continued at very low levels across the state during first quarter 2010, though activity was higher than in all quarters of 2009, the low point for this down-cycle. Total housing permits were issued at a preliminary annual rate of 43,800 units during first quarter 2010, up by +28 percent from first quarter 2009. Single-family permits jumped by +34 percent, while multi-family permits rose by +22 percent over the year.

California Housing Market



Source: U.S. Census Bureau, California Association of Realtors

While any improvement is welcome, the current construction pace represents a drastic decline of -79 percent from the peak permit level of 2004. Furthermore, much of the surge of activity seen over the winter reflected builders' efforts to attract first-time buyers using federal tax credits. It's not clear how strong the underlying level of demand will be in the second half of 2010 after these programs have expired.

As construction collapsed, new home builders' inventories of unsold homes have shrunk noticeably, especially single-family detached units. Inventories of attached housing units (condominiums and apartments), however, are dropping more slowly. Finding buyers for all of the unsold condominium units will take a while longer.

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

California's commercial real estate markets also have developed deep fissures. Specifically, availability rates have risen markedly over the last year, asking rents are falling, and external development funding has virtually disappeared.

The situation is most problematic for retail, office and industrial space. Retail sales declined sharply during the recession. Though sales turned up late in 2009, several chains declared bankruptcy or closed down altogether, and this trend is expected to continue in the near term.

With most lenders unwilling to commit new funds for commercial real estate development, construction of new retail space has plunged. Even so, vacancies are surging and rents are dropping.

Most areas of California are experiencing high 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.

Office Space/Vacancies

Demand for office space was mixed in the first quarter, as high vacancy rates continued to reflect weaker employment trends in most office-based industries. Many firms are still reluctant to hire new workers and are vacating or subleasing excess space. However, in some areas, office vacancy rates declined slightly in the first quarter.

In San Diego County, the average office vacancy rate was 20.4 percent in 1q10, compared with 21.1 percent during 4q09 and 21.6 percent during 3q09.

In San Jose, the rate declined to 18.6 percent after edging down to 19 percent (4q09) from 19.1 percent (3q09). In Oakland, the rate fell to 15.7 percent in 1q10 from 17 percent (4q09).

Meanwhile, in Ventura County, the rate also fell for the second consecutive quarter to 15.8 percent (4q09) from 16.5 percent (3q09) and 16.7 percent (2q09) [latest data available].

In the Inland Empire, office vacancy rates rose to 24 percent (after holding steady the previous quarter).

Vacancies also continued to rise in Sacramento (20.6 percent), San Francisco (17.6 percent) and Los Angeles (16.6 percent).

Orange County experienced a sharp increase—jumping to 26.9 percent during the first quarter from 19.9 percent (4q09).

Unsurprisingly, rents continue to weaken in most locations. Statewide, the

See U.S.: Next Page

U.S. Upturn Continues; State's Economy Weak, But Signs Point Up

From Previous Page

value of new office construction permits jumped by +87 percent in first quarter 2010 compared with early 2009. However, the level of activity was very low, -72 percent below 1q2008. Though the office construction pipeline has nearly run dry, vacancies in most areas will likely continue rising until employment turns around.

Industrial vacancy rates also were on the rise during the first quarter, though construction activity grew by +129 percent from 1q09 (to a level still -47 percent below 1q08).

The lowest vacancy rates were in Los Angeles County, at 3.4 percent, followed by the East Bay, at 4.7 percent, and Orange County, at 7 percent.

Vacancy rates were highest in San Jose (15.2 percent), Sacramento (12.8 percent), San Diego (12.5 percent) and the Inland Empire (11.9 percent). These are areas where substantial new construction took place even as demand for distribution space dwindled during the recession.

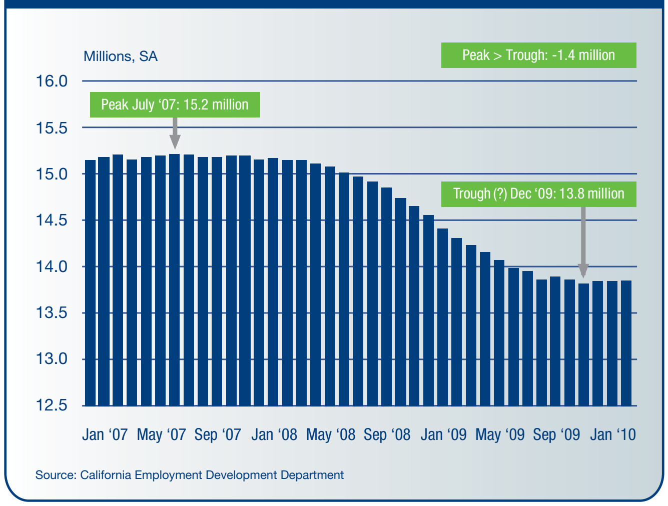
The total value of non-residential building permits in California dropped by -7.3 percent during first quarter 2010 compared with early 2009. Permits for new buildings declined by -11.9 percent, while the value of alterations and additions (which are more often owner-financed) fell by -4.5 percent.

Several major metropolitan areas posted significant gains in total non-residential permit activity during the first three months of 2010 compared with the same period last year: San Francisco (+61.5 percent), Oakland (+48.1 percent), Sacramento (+39 percent), Ventura (+27.1 percent), Orange County (+15.1 percent) and the Inland Empire (+13 percent).

Lagging behind were San Jose (-33.5 percent), San Diego (-29.5 percent) and Los Angeles (-14.9 percent).

It is extremely difficult to obtain financing for most types of commercial real estate projects, so owner-financed projects will account for a larger share of activity than normal this year. These are typically smaller projects, suggesting that non-residential permit values will continue at relatively low levels through much of 2010.

California Total Employment



Source: California Employment Development Department

Risks

Risks appear to be more balanced than in previous reports. The economy has just passed the bottom of a serious, lengthy recession, and the *level* of activity is still low. Uncertainty is high because we do not know yet what the recovery will look like.

One key risk would be renewed volatility in global capital markets. Central banks and governments around the world have poured trillions of dollars into their financial sectors. While the results are clear, markets are still fragile and easily upset (consider the recent reaction to disclosure of Greece's debt woes).

The financial industry's problems, however, won't be "cured" until loan problems are dealt with and capital ratios restored, not easy in such a weak economy. Another round of financial instability would cause many financial institutions to cut back on lending even further. Small and medium-size businesses would bear the brunt of this change because they rely heavily on commercial bank financing.

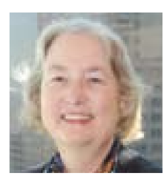
A second set of risks concerns the state's still-troubled housing industry. The housing and residential real estate industries have been supported by several federal government programs that just ended. Mortgage rates could well increase just as home sales relapse. We simply don't know if the industry—already weakened after several bad years—will be strong enough to weather such a downturn.

There is an upside risk best described as "Optimism returns." Consumers and businesses have been worried about the economy and their own financial situations for more than two years now.

And yet the economy is definitely beginning to stir. Retail sales have improved and so have international trade flows. Industrial production rates are rising, especially in the state's high technology sector, as businesses discover they've reduced their inventories too much and need more to support the current increase in their sales. Attitudes are beginning to improve right along with revenues.

Economic recoveries often begin slowly, and then run faster than economists project. The council would be delighted if this recovery follows such a path!

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 Sidhu, vice president and chief economist, Los Angeles County Economic Development Corporation.

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

CFCE California Foundation for Commerce & Education

State Water Resources Board Revises Once-Through Cooling Policy

On May 4, the State Water Resources Control Board adopted its once-through cooling policy for coastal power plants—a plan that could force 19 California power plants to phase out once-through cooling systems if it's approved by the state Office of Administrative Law (OAL).

Once-through cooling refers to power plant systems that use open intakes to pump water from an ocean, estuary or bay to cool generators or turbines and then discharge the water after one cycle of cooling.

The new once-through cooling policy is expected to reduce the impact on aquatic wildlife as this process is currently used by 19 power plants in California.

This new policy is intended to provide clear standards and consistency in implementing the federal Clean Water Act, which requires the use of best technology available in the interest of protecting marine life.

Cost to Power Plants

If approved by the OAL, plant operators will have about six months to submit details of how they would comply with the new regulations. Options include installing closed-cycle systems such as cooling towers. The cost for retrofitting, or using the best technology available could ultimately cost power plants millions of dollars.

The new provision would allow the California Independent System Operator to make its recommendations to the State Water Resources Control Board on power plants that are essential to maintaining the reliability of the electric system, a recommendation that the State Water Board will weigh significantly in considering whether to suspend or amend final compliance dates.

Most plants will have until 2015 to phase out once-through cooling systems, while those in the Los Angeles area will have until 2020 due to the city's more complex and challenging power needs. The San Onofre and Diablo Canyon nuclear power plants have until 2022 and 2024 to comply.

More Information

For more information about state policy on coastal and estuarine water use for power plant cooling, refer to the State Water Resources Control Board website at ***www.swrcb.ca.gov***.

Staff Contact: Brenda M. Coleman

Mandatory Leave Legislation Places Hardships on Employers

OPPOSE

A California Chamber of Commerce-**opposed** bill that mandates every employer grant every employee up to three days of unpaid bereavement leave per year is on the Assembly floor.

AB 2340 (Monning; D-Carmel) potentially makes the management of overlapping leave requests unfeasible or unfair and could create staffing shortages that temporarily halt operations by requiring every employer to provide every employee with up to three days of unpaid bereavement leave per year.

The bill further prohibits any adverse action against employees for requesting and taking such leave and creates a private right of action for violations of the bill's provisions.

Incorrect Approach

The CalChamber supports employers having a policy of providing bereavement leave and opposes AB 2340, not because it promotes bereavement leave, but the manner in which it does so. The CalChamber does not believe a private sector mandate in this area is the appropriate role of government or the correct policy approach. While the CalChamber understands that AB 2340 is aimed at unreasonable employers, the bill could have unintended negative consequences for reasonable, well-intentioned employers.

By making a three-day bereavement leave mandatory in every situation, AB 2340 removes flexibility employers need to balance bereavement leave requests with pressing leave requests by other employees for other reasons, such as to care for a sick family member. Coordinating overlapping leave requests can be especially challenging for small businesses with limited staff.

For example, a small business that can accommodate only two days of bereavement leave, without being unfair to other employees or bringing operations to a halt, should not have to face a lawsuit.

Voluntary Basis

The CalChamber believes bereavement leave should be left to employers to provide on a voluntary basis.

Today, many employers voluntarily provide bereavement leave to their employees along with other types of leaves and will make every effort to accommodate time off for the loss of a loved one.

Small business bankruptcies are at an all-time high, and many employers are struggling to keep their doors open and to keep employees on the payroll. Moreover, California already has one of the most burdensome legal and regulatory climates in the nation, which is a significant factor in many businesses choosing not to invest in the state.

Imposing a new leave mandate will only exacerbate these problems.

Action Needed

AB 2340 will be considered next by the entire Assembly. Ask your Assembly representative to **oppose AB 2340**.

Staff Contact: Marti Fisher

Webinar on Demand Outlines Health Care Law Impact on Business

To help employers understand the impact of the federal health care reform law, the California Chamber of Commerce recently conducted a webinar on the subject.

The 90-minute session, ***What Health Care Reform Means to Your Business***, is available now as a webinar on demand.

Presented by Darren Willcox, director of the Health Care Practice at Dutko Worldwide, the webinar explains how the reforms affect employers and their employees.

Following are some examples.

Mandate/Penalties

All individuals will be required to have health insurance, with some exceptions, beginning in 2014. The law does not mandate that each individual have insurance through his/her own employer, however.

Although employers are not mandated to provide health coverage, the penalties associated with not providing coverage begin January 1, 2014. For larger employers, the penalty for not providing insurance is imposed on a monthly basis.

Small businesses with fewer than 50 full-time equivalent employees are not subject to the penalty.

Small Business Tax Credit

Small employers with no more than 25 employees and average annual wages of less than $50,000 that purchase health insurance for employees can receive a tax credit in 2010–2013 of up to 35 percent of their contribution toward the employee's health insurance premium if the employer contributes at least 50 percent of the total premium cost or 50 percent of a benchmark premium.

The full credit will be available to employers with 10 or fewer employees and average annual wages of less than $25,000.

W-2 Changes

Beginning in 2011, employers will have to start reporting the value of health insurance coverage they provide to employees on the employee's Form W-2.

The amount reported will not be included as income and taxed.

More Information

Key topics covered in the webinar for large employers include its impact on part-time workers; insurance reforms and grandfathered group health plans; modifications to the Medicare Part D drug subsidy, Medicare Advantage reductions and other fees and taxes.

For small employers, the webinar covers premium subsidies and individual responsibility.

Also included is a legislative and regulatory forecast for 2010 to explain the U.S. Department of Health and Human Services timeline for issuing rules to put the reforms into practice.

Registration

Registration information for the on-demand webinar on health care reform is available at ***www.calbizcentral.com/training*** or by calling (800) 331-8877.

CalChamber Positions on June Ballot Propositions

Proposition	Subject	Position
Proposition 13	Bars property tax increases on construction for seismic retrofits	Support
Proposition 14	Increases right to participate in primary elections	Support
Proposition 15	Repeals ban on public funding of political campaigns	Oppose
Proposition 16	New two-thirds voter approval for local public electricity providers	Support
Proposition 17	Makes continuous coverage auto insurance discount portable	Support

CalChamber Advertising Opportunities

A number of advertising opportunities are now available for businesses interested in messages targeting California Chamber of Commerce members.

Ad options include the following. Rates shown are for CalChamber Preferred members and above. Non-member rates are double those listed.

- ***Daily Headlines*** e-mail: $2,000 per month.
- ***Alert***: $2,000 per issue for full-page color ad.
- Website - ***www.calchamber.com***: $2,000 per month.

For more information, contact Dave Kilby, *dave.kilby@calchamber.com*, (916) 444-6670, ext. 202.

ALERT

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