

ALERT

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81st Annual Host Breakfast

Governor, CalChamber Emphasize Strong Economy

Governor Arnold Schwarzenegger and California Chamber of Commerce Chair Russell Gould this week highlighted cooperative efforts that have produced positive results for California and its economic future.

The Governor and Gould spoke at the 81st Annual Sacramento Host Breakfast, sponsored by Sacramento business leaders and attended by more than 1,300 business and civic leaders from throughout the state.

Governor

Governor Schwarzenegger celebrated his partnership with the business community, highlighting the success in enacting cost-saving workers' compensation reforms, the persistent defeat of "job killer"

legislation, the promotion of California products through several trade missions — including one to Canada next week — and the need to reform the state's costly health care system and secure an adequate water supply for California's future.

Emphasizing his work with the business community, Governor Schwarzenegger said, "And since day one, I think it was very clear that we have become really good partners, and we have worked together on so many things. And look at the kind of things that we have accomplished, if it is reforming workers' compensation, or if it is reducing frivolous lawsuits, or creating more than 860,000 new jobs, or reducing our

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CalChamber Summit Highlights Health Care, Political Reform, Presidential Election

Health care reform, political reform and presidential politics were featured topics at the 20th annual California Business Legislative Summit sponsored by the California Chamber of Commerce this week.

Business owners and local chamber of commerce delegations from throughout the state heard a journalist and a physician/health care foundation chief discuss the economic, legal and political realities behind the various health care reform proposals circulating in the Legislature.

Dr. Mark Smith, president and chief executive officer of the California Health-Care Foundation, gave a synopsis of cost, access and quality — three central issues of the health care discussion. The foundation presents information at www.chcf.org.

Dan Weintraub, public affairs columnist for the *Sacramento Bee*, commented on the interplay between various interest groups and the state proposals under discussion.

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Governor Arnold Schwarzenegger emphasizes the importance of a strong economy in remarks at the 81st annual Sacramento Host Breakfast on May 22. Seated (from left) are Sacramento Host Committee Chair F. Frederick Brown and Russell Gould, chair of the CalChamber Board of Directors.

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Labor Law Corner

Employers Accountable for Ensuring Employees Take Meal Breaks



Barbara Wilber
Labor Law Consultant

We have employees who simply don't want to take a meal period. We had them sign an on-duty meal agreement, but now we question whether that agreement is OK.

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Your concerns are well-founded. On-duty meal periods are allowed only in certain circumstances that are outlined in the Industrial Welfare Commission (IWC) orders. Unless other factors are present, simply the fact that employees do not want to take a meal period does not meet the criteria.

On/Off-Duty Breaks

As a general rule, the IWC orders provide that, if working a shift longer than six hours, employees must receive an unpaid, 30-minute meal period by their fifth hour of work, during which they are relieved of all duties and are free to leave the premises.

The orders further provide that employees may take an on-duty meal period if:

- the nature of the work prevents an employee from being relieved of all duty;
- the break is agreed to in writing by the employee and employer;
- the break is paid; and
- the written agreement states that the employee may revoke the agreement at any time. (The revocation statement is not required for agricultural occupations covered by IWC Order 14).

Employer Responsibility

The burden rests with the employer to establish by the facts that the on-duty exception is being used properly. Pay close attention to the phrase "nature of

the work." A Division of Labor Standards Enforcement opinion letter stated that the following factors should be considered:

- the type of work;
- whether other employees are able to relieve the employee;
- consequences to the employer if the employee is relieved of all duty;
- the ability of the employer to anticipate and mitigate consequences, such as rescheduling; and
- whether the work process will be destroyed or damaged.

All these factors as a whole should point to the impossibility of providing an off-duty meal period. Be prepared to justify your decision, as most situations do not warrant the use of an on-duty meal period.

Any agreement based on factors that do not meet the criteria described would be invalid.

An employer is obligated to ensure that employees are relieved of all duty, not performing any work, and are free to leave the worksite (specific and limited exceptions exist in Orders 4 and 5 for the health care industry as defined). Failure to meet this obligation would subject employers to additional wages of one hour for each day the employee does not receive the required meal period, as well as other possible penalties.

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.

Seminars/Trade Shows

For more information on the seminars listed below, visit www.calchamber.com/events.

Business Resources

Ready Eureka! California Volunteers
Office of the Governor. Bayside, June 18. (916) 650-6959.

Next Alert: June 8

Make a difference on proposed laws

calchambervotes.com



Remarks by CalChamber Chair Russell Gould

Commitment to California Will Encourage Development, Opportunities for State

Following are excerpts from remarks by California Chamber Chair Russell Gould at the Sacramento Host Breakfast on May 22. Gould is senior vice president of Wachovia Bank.

I look out this morning and see a number of people from the business community, the public sector, and community leaders and recognize that my career has allowed me to venture into the same areas.

For those from the Sacramento Host Committee, I am one of your native sons, born in Sacramento and raised not far from here. One of my early remembrances is of my father, a second-generation plumber who worked for the State at the Capitol building and who considered the small brick building on 12th and L Street in the Capitol lawn, "his" office.

My father gave me the best and most direct advice at the age of 8. Upon viewing my mechanical skills while working on repairing my bicycle, he strongly encouraged me to go to college and get a desk job.

I took his advice and entered the University of California at Berkeley, which provided an education that exposed me to a huge new world beyond that which I had experienced.

When I graduated from Berkeley, I had only two career goals: one was to be a Foreign Service officer; and the second — not move back to Sacramento. Poverty being a great motivator shortly led me to a position as a budget analyst in state government in Sacramento while I sorted out my next set of career goals.

From my initial start in state government, I ultimately was given the opportunity to serve as Secretary of Health and Human Services and Director of Finance under Governor Pete Wilson. As you may recall, during Pete Wilson's first term,

California was mired in a deep recession in which the state lost more than 700,000 jobs. I still remember the Governor pulling me aside and telling me that we were going to bring California back one job at a time. As it was his re-election year, he was very clear that we should start with his job and mine. His leadership in recognizing the importance of jobs and a strong

in trying to make it while facing intense worldwide competition.

These varied careers shaped my view that it takes all of us from the public and private sector to preserve what California has to offer. Maybe it is from my past experiences, but I am passionate about public policy and California's economic future. I was drawn to the California

Chamber as the state's leading business organization because it is a broad-based business group with members on essentially every Main Street and board room throughout the state — a group that looks at issues with a big picture view focused on California jobs and long-term economic development, not the perspective of any one industry or geographic region of the state.

The CalChamber is at the front line to ensure that we sustain this vibrant economy. The CalChamber's presence is built on principles, not on politics. Similar to the Governor's call to an era of post-partisanship, the CalChamber is focused on sound fundamentals, not on political affiliation. The CalChamber today represents 16,000 companies and 25 percent of private sector jobs in the state. The 120-year history of the CalChamber is focused on long-established principles. I

would like to speak to six principles established by our founders:

1. Protect and encourage economic development.

The CalChamber is focused on common-sense policies that make it affordable to do business in California.

The CalChamber has promoted common-sense workplace reforms, such as the 40-hour workweek, to put us on the same footing as our worldwide competition. We also have played defense in identifying 40 job killer bills introduced by the state Leg-

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It will take a commitment from the business community to be an active positive force in assuring that the California dream is preserved.

economy was never lost on me. I take great pride in my public service and have great memories of raising my family in Sacramento.

I left government over 10 years ago to become a partner in a small investment management company that grew to five successful companies and ultimately were sold to investment firms including Wachovia Bank. The opportunity to put your ideas and commitment to a private venture was a great learning experience. It also allowed me to fully experience the challenges business leaders face today

Commitment to California Will Encourage Development, Opportunities

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islature in 2006, and with Governor Schwarzenegger's support, we have had great success in defeating those initiatives, with only two becoming law.

Workers' compensation reform: We were in strong support of Governor Schwarzenegger when he pulled together the varied interests and achieved comprehensive reforms his first year in office — reforms that have resulted in both improved benefits and billions of dollars in savings to multiple sectors of the economy, not just business.

2. Exert leadership in areas relating to public finance.

The CalChamber consistently pushes for bipartisan agreement on expenditures and supports the Constitution's required two-thirds majority vote on tax increases and the state budget. We recognize that proposals lacking long-term funding represent a significant detrimental economic and job impact on our state.

In addition, last June we successfully opposed a personal income tax increase that would have established a costly and ill-conceived massive new preschool bureaucracy.

In November there were four other proposals to increase taxes on the ballot, and the voters agreed with our opposition.

3. Support adequate transportation facilities.

The CalChamber is a longtime advocate for a transportation network that can support our economy by efficiently moving people, goods and services. We have supported bonds to fund investments in our streets, highways and transit, and helped lead the 2002 campaign that won overwhelming support (70 percent "yes") for a proposition to require that the sales tax on gasoline be dedicated to transportation.

The CalChamber has maintained a constant call for increased infrastructure investment, including our support and leadership on the comprehensive \$19.9 billion bond package on last November's ballot that was overwhelmingly approved by the voters.

4. Encourage economic research on issues that affect government.

To meet this goal, the CalChamber has revitalized the California Foundation for Commerce and Education to serve as a not-for-profit, non-partisan think tank.

Our initial areas of research include health care reform and education. This foundation's independent work will help frame the most important economic and public policy issues of the day.

5. Support development of the state's education resources.

The CalChamber has been a strong proponent of a K-12 system that provides fundamental skills necessary for movement into higher education or joining the workforce. We also support a K-12 system that must be held accountable for success.

The CalChamber has also been a strong supporter of the master plan for higher education and funding which ensures the continued excellence of these institutions. The CalChamber recognizes the critical role of our community colleges and both technical and transfer education. We compliment Governor Schwarzenegger's efforts in revitalizing vocational education and providing support and respect for those that perform these important jobs.

We strongly support the California State University System, the largest public university in the United States, and its vital role in training our teachers and other professionals in the workforce.

The CalChamber also recognizes that the vital importance of our high tech industry, born in the Silicon Valley, and our expanding biotech industry would not be possible without our exceptional research universities under the banner of the University of California.

As an indication of our support for higher education, the CalChamber Board has four members who serve on the governing boards of the Community Colleges, the California University System, and the University of California.

6. Support policies that serve the public benefit for all Californians.

This year we have appreciated the Governor's leadership to focus us on the complex world of health care. While solutions are hard to find in this area, we do have strong reservations about a single government-run health care bureaucracy. We also continue to support discussions of how to ensure that children and those individuals with pre-existing conditions who are often barred from health care coverage are a priority.

On the environmental front, we have a long history of speaking out to be sure

environmental measures balance benefits with costs, and steering the state toward approaches that permit the full ingenuity of industry to help devise solutions.

The CalChamber also continues to support political reform efforts to change our current method of reapportionment. The public never will have confidence in a redistributing process with the inherent conflict of being by politicians and for politicians.

The CalChamber must continue to take a big picture, wide-angle lens approach to these issues and determine what is good for the whole. These principles will guide the CalChamber, not for a single year, or for a governor's term, but for the long run.

I think Ronald Reagan had it right when upon receiving the Presidential Medal of Freedom at the White House in 1993 he said, "Presidents come and go, history comes and goes, but principles endure."

When you boil it down, California is built on a promise of opportunity. First, that people can find good jobs and places to live that help them raise their families. Secondly, the same opportunity must be there for our children to develop and achieve their own goals.

In many ways, California is a great social experiment — a population built of immigrants with no majority population, a melting pot of people with the same dreams and aspirations. We are blessed with our geography and a land of great beauty and rich soil. Its entrepreneurs led this state to have the most diverse economy in the United States. While having these gifts, it will take a commitment from the business community to be an active positive force in assuring that the California dream is preserved.

Let me close with my final Ronald Reagan quote: "We are the showcase of the future. It is within our power to mold the future, this year and for years to come. It can be as grand and as great as we make it. No crisis is beyond the capacity of our people to solve, no challenge too great."

Please join me in the commitment to a California built on sound principles that establishes opportunities for all who strive to succeed. Whether you are from business, a community leader or a public servant, we must all take up the challenge to be engaged at the state and local levels, to bring about solutions and make California an exceptional place to live and do business for generations to come.

CalChamber Honors Business Advocates

The California Chamber of Commerce honored five small business executives on May 21 with its 2007 Small Business Advocate of the Year Award, recognizing recipients for their advocacy efforts on behalf of small businesses.

In addition, the CalChamber recognized two local chambers of commerce for outstanding advocacy efforts.

The CalChamber presented the awards at a luncheon before about 600 attendees at the 20th Annual CalChamber Business Legislative Summit in Sacramento.

Small Business Advocates

The 2007 Small Business Advocate of the Year Award winners are:

- Blake Christian, CPA, partner, Holt-house Carlin & Van Trigt, LLC, Long Beach;
- Jamil Dada, vice president, Provident Bank, Moreno Valley;
- Timothy L. Fowler, owner/sole proprietor, Betterton Mason & Wyatt, Lockeford;
- Greg Lippe, managing partner, Lippe, Hellie, Hoffer & Allison, LLP, Woodland Hills; and
- Jim Schmidt, banker and attorney (retired), La Mesa.



The winners of the 2007 CalChamber Small Business Advocate of the Year Award are (from left): Blake Christian, Long Beach; Oscar Valdepena, executive director, Moreno Valley Chamber, accepting for award winner Jamil Dada; Timothy L. Fowler, Lockeford; Greg Lippe, Woodland Hills; Jim Schmidt, La Mesa.

Profiles of award recipients will appear in future *Alerts* and at www.calchamber.com.

Advocacy Partners

Also receiving recognition as strong representatives of the business perspective were Advocacy Partner of the Year Award winners the Greater Fresno Area

Chamber, represented by Al Smith, president and chief executive officer, Ruth Evans, vice chair of governmental affairs, and Amy Huerta, governmental affairs manager; and the Greater Riverside Chambers, represented by Cindy Roth, president and chief executive officer.
Staff Contact: Dave Kilby

Summit Highlights Health Care, Political Reform, Presidential Election

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Presenting the case for the need to reform the state's redistricting process was political and media strategist Daniel Schnur of Command Focus.

Schnur reviewed the interplay between proposals to alter term limits, redistricting and political reform.

Schnur co-chairs Voices of Reform,

a bipartisan coalition of 100 community leaders working to eliminate the conflict of interest arising from legislators drawing the boundary lines for the districts in which they will campaign.

The coalition maintains a website at www.voicesofreform.org.

Howard Fineman, chief political correspondent for *Newsweek*, concluded the

Summit with comments on California's role in the 2008 presidential primaries.

Now that the California primary has been moved to February, it will be one of the first and one of the most influential, Fineman said. With so many early primaries, he added, on February 6, 2008, Americans will know who the Republican and Democratic nominees are.



Mark Smith



Dan Weintraub



Daniel Schnur



Howard Fineman

Governor, CalChamber Emphasize Strong Economy

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state's budget deficit, not raising taxes, or our infrastructure package that we passed last year."

The Governor also highlighted his record of saying, "hasta la vista, baby" to the "job killer" bills and promised to "terminate" future "job killers," saying his list is similar to the CalChamber's 2007 "job killer" bill list.

As a result of the "job killer" bill vetoes, the Governor said, "our business climate has dramatically improved, and our economy is strong. Unemployment is at its lowest in three decades, and personal income is growing, and California revenue projections are right on target, with \$101.3 billion."

He praised the passage of the infrastructure bonds and touted the benefits their implementation will bring: "So now it's about time that we are building our roads, our freeways, our highways, onramps, offramps, tunnels, bridges, our schools, fix our levees, build affordable housing and so on. I always said I want to see cranes everywhere, and now we are building once again," he said.

The Governor reminisced about previous trade missions and explained that he is looking forward to the mission to Canada at the end of the month, "because without any doubt the world is our marketplace, and California's businesses are leading the way. And we have the best products, like I said, we have the hardest working people, and we have the best innovations."

Schwarzenegger told the attendees that he wants to be as successful with reforming the health care system as he was with workers' compensation. "The only way we can fix the system is if everyone works together, and through shared responsibility." The Governor reiterated his opposition to a single-payer, government-run health care program, noting that government-run health care in the state's prisons has performed so poorly it has been taken over by a federal receiver.

He emphasized the need to take action to ensure the state has reliable, clean drinking water in the future. Water storage was not included in the infrastructure bonds negotiated last year.

"Now we are going to negotiate water, because we've got to fix the Delta, we've got to create more conveyance, and we've got to have more above-the-ground water

CalChamber Photo by Steve Snyder



Governor Arnold Schwarzenegger greets representatives from the armed forces following the Sacramento Host Breakfast on May 22.

storage," the Governor said.

In closing, the Governor urged everyone to work together because, "if we all work together we can create a great, great future for our golden state."

CalChamber Chair Remarks

Gould, senior vice president of Wachovia Bank, highlighted the CalChamber's role on the front lines to ensure that the state sustains a vibrant economy. He commented that the CalChamber's presence is "built on principles, not on politics. Similar to the Governor's call to an era of post-partisanship, the CalChamber is focused on sound fundamentals, not on political affiliation," Gould said.

Gould said that he is passionate about public policy and the state's economic future, and was attracted to the CalChamber as the state's leading business organization because "it is a broad-based business group with members on essentially every Main Street and board room throughout the state — a group that looks at the issues with a big picture view focused on California jobs and long-term economic development, not the perspective of any one industry or geographic region of the state."

Echoing the Governor's call to action to push past partisan politics to protect businesses and the economy, Gould said, "It takes all of us from the public and private sector to preserve what California has to offer." Gould commended the Governor's leadership on transportation issues, workers' compensation reform, fiscal responsibility, revitalizing vocational education and taking action "to focus us on the complex world of health care."

Gould noted, "While solutions are hard to find in this area, we do have strong

reservations about a single government-run health care bureaucracy. We also continue to support discussions on how to ensure that children and those individuals with pre-existing conditions who are often barred from health care coverage are a priority."

In light of new environmental measures that call for a reduction in greenhouse gases and carbon emissions, Gould noted that California has a long history of speaking out to be sure environmental measures "balance benefits with costs and steering the state toward approaches that permit the full ingenuity of industry to help devise solutions."

The CalChamber "must continue to take a big picture, wide-angle lens approach to these issues and determine what is good for the state. These principles will guide the CalChamber, not for a single year or a governor's term, but for the long run," Gould said.

"Whether you are from business, a community leader or a public servant, we must all take up the challenge to be engaged at the state and local levels to bring about solutions and make California an exceptional place to live and do business for generations to come," Gould concluded.

This year, the Sacramento Host Breakfast closed the CalChamber's annual Business Legislative Summit. For 81 years, the Sacramento Host Breakfast has offered decision-making leaders in California finance, government, education, agriculture, military and industry the opportunity to exchange views, establish and renew friendships, and create statewide atmospheres of good will and understanding, all at a common table.

Staff Contact: Vince Sollitto

State Economy, Housing Market Keep Pace with Nation's; Job Growth Crawls Ahead

U.S. Economy

The U.S. economy has moderated to a 2 percent average growth rate over the last three quarters. The persistent slowdown in housing is largely responsible, with declining home construction subtracting around 1 percent from gross domestic product (GDP) growth over the last three quarters. As yet, the problems in housing have not seriously impacted other sectors of the economy.

To the contrary, consumer spending expanded at a robust 3.8 percent annual rate in the first quarter of 2007, down slightly from 4.2 percent growth in the fourth quarter of 2006. Going forward, there should be slower growth in consumer spending due to tighter credit conditions, variable mortgage rate adjustments, and lower home valuations. Still, members of the advisory council believe a recession will be averted, largely due to the healthy labor market and adequate gains in personal income.

There should be some acceleration in business spending in coming months. In recent quarters, business investment has been disappointing, as firms have used large cash hoards for share buybacks and mergers. If a recession is averted, businesses should regain confidence and begin to replace aging equipment and software.

Indeed, signs of revival were evident in the first quarter of 2007, when equipment and software spending increased at a 1.9 percent annual rate following a 4.8 percent decline in the fourth quarter of 2006. The state should also continue to see healthy non-residential construction spending, which will partially offset weak home construction.

Energy prices remain a key risk to the outlook. The recent rebound in oil and gasoline prices will reduce discretionary income and will erode consumer spending on non-energy items. The recent surge in food prices — in part tied to rising corn-based ethanol demand — will further reduce discretionary income.

While both energy and food prices, which together account for about a quarter of household spending, may subside in coming months, there remain considerable upside risks for both types of commodities. Energy prices, in particular,

in food and energy prices. Inflation, measured by the annual change in the personal consumption deflator, was 2.4 percent in March.

Core inflation, excluding food and energy prices, was 2.1 percent, slightly above the Federal Reserve's comfort zone of 1 to 2 percent. Productivity growth has decelerated, and the unemployment rate has declined to 4.4 percent, putting upward pressure on wages. Under these conditions, the Fed is inclined to sit tight.

The massive amount of excess liquidity in the global capital markets also makes it difficult for the Fed to ease monetary policy. Indeed, there remains a risk of additional Fed rate hikes if inflation accelerates. Members of the advisory council do not believe that this will be necessary.

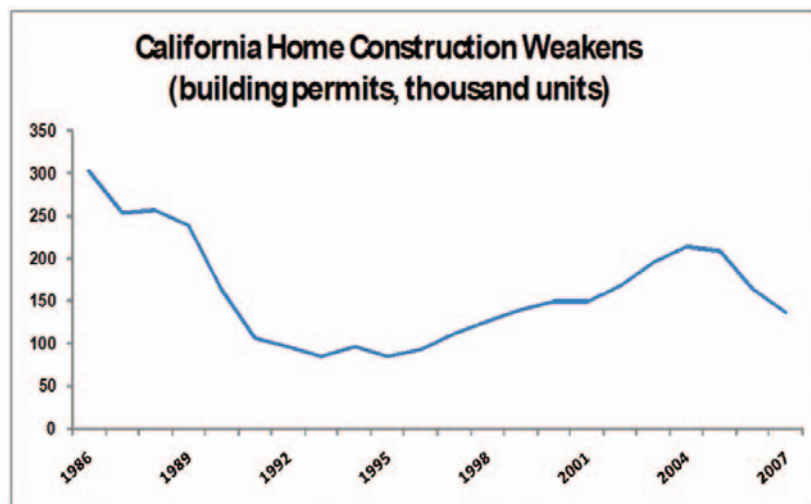
Most likely, the Fed will stay on hold for the remainder of this year, with an outside chance of a rate cut toward the end of the year, when there is more conclusive evidence of lower inflation. But this will be a difficult period for the Ben Bernanke-led Fed as it will face growing pressure from investors, businesses and politicians to cut rates in a slower

growth environment and in the lead-up to presidential elections. With the Fed on hold, the yield curve should remain fairly flat. Relatively low long-term interest rates will continue to cushion the housing downturn and provide ample liquidity to support business investment.

California Economy

Following substantial employment and personal income data revisions, it appears that the California economy has closely matched the performance of the U.S. economy over the last couple of years. Recently, California job growth has moved slightly ahead of the United States.

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remain vulnerable to geopolitical developments, as well as the onset of the hurricane season. U.S. refiners have struggled to keep up with gasoline demand in light of changing fuel blending requirements and unanticipated bottlenecks at some refineries. Imported gas always can fill the gap, but, as we learned after Hurricane Katrina, this will lead to higher pump prices.

Interest Rates

The Federal Open Market Committee (FOMC) remains on hold following the last hike in the Fed funds rate, to 5.25 percent in June 2006. FOMC members have continued to express concern about inflation, accentuated by recent increases

State Economy, Housing Market Keep Pace with Nation's

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In March, state non-farm payrolls registered a 1.7 percent year-over-year gain, compared to a 1.4 percent increase at the national level. The strongest job gains remained concentrated in business services (+3 percent year/year), education and health services (+2.8 percent year/year), and leisure and hospitality (+2.7 percent year/year). Somewhat surprisingly, construction employment in March was 1 percent above year-ago levels. In part this reflects booming non-residential construction, but it also may be due to weather-related factors.

California's manufacturing sector has seen a modest decline in employment over the last year. But the state's manufacturers have fared better than other parts of the country due to their concentration in high tech capital goods and export-oriented industries.

California export growth accelerated from 6.2 percent in 2005 to 9.4 percent in 2006. This is partly due to the weaker dollar, but the state also saw solid improvements in exports to countries with more stable currencies. Exports to China increased 27 percent last year, solidifying China's position as the state's fourth largest export destination (after Mexico, Canada and Japan). With China still booming, another strong trade performance is expected this year. But there may be slower growth in exports to Mexico and Canada, as these economies are decelerating in response to U.S. slowdown. Mexico also is suffering from declines in U.S. remittances resulting from job losses in U.S. construction.

California's personal income expanded 6.4 percent in 2006, slightly above the 6.3 percent gain at the national level. Personal income tax receipts came in below Department of Finance estimates during the July 2006-March 2007 period, which could indicate somewhat slower growth. There should be a better reading on this once receipts are fully tabulated from the 2006 tax year.

Regardless, it is expected that the state economy will slow this year, in line with the U.S. economy. Still, it is comforting that the problems in the housing sector do not seem to have spread into other sectors of the California economy so far.

The San Francisco Bay Area has continued to show stronger economic improvement than other major California regions. There has been vibrant job growth in Silicon Valley, although employment levels remain below peaks of the dot-com era. While venture capital spending is also well below levels seen during the dot-com boom, there is increased start-up activity in Silicon Valley and subsequent demand for technically trained workers.

While the Southern California economy has seen a housing-induced slowdown (including considerable layoffs at large mortgage lenders in the area), it continues to benefit from its diversity, with solid performances in international trade, technology, aerospace and tourism. Despite the recent slowdown, council members maintain the view that California's diverse business structure will enable it to withstand the ongoing slowdown in the housing market. Going forward, regional growth differentials likely will reflect differences in housing market performance. Housing problems aside, there has been a convergence of growth rates between California regions over the last few years.

Real Estate

The U.S. housing market remains depressed. It is difficult to say whether housing starts and home sales have bottomed due to weather-driven volatility over the last few months. Regardless, advisory council members believe that home sales will remain sluggish for the rest of this year. Average home prices are down slightly from last year, but this hides substantial regional differences.

Fortunately, mortgage rates have remained stable, so that price declines have improved housing affordability. Homebuilders continue to manage their inventories with substantial price and in-kind discounts, putting downward pressure on existing home prices as well. Rapidly rising foreclosures are also contributing to price weakness.

While the pace of decline in home sales and construction will taper off, this is just the first stage of the housing downturn. The next stage, already underway, will result from tighter credit conditions, adjustable mortgage rate increases and the negative wealth effects of lower home valuations. These factors will have a

negative impact on consumer spending.

So far problems have been largely confined to the sub-prime mortgage market, but there also should be some credit deterioration in "Alt-A" and prime mortgage markets as well in coming months. Still, the advisory council believes that these problems will not become severe barring substantial weakening in the growth of jobs and income.

The California housing market has followed similar trends to the national market. But sales declines have been sharper due to the faster run-up in previous years. The California Association of Realtors (CAR) reports single-family home sales were down 20.8 percent year-over-year in March, compared to an 11.9 percent decline at the national level. Median home prices were still up 3.2 percent year-over-year according to CAR, compared to a 0.9 percent decline at the national level.

But California home price inflation peaked at a much higher rate than the U.S. average. Unsold single-family home inventories in California equaled an 8.7-month supply in March, compared to only a 4.7-month supply a year ago. This is slightly above the national average of a 7.2-month supply. CAR reports sharp year-over-year sales declines in the Riverside/San Bernardino (-48 percent), High Desert (-45 percent), Monterey County (-35 percent), Central Valley (-32 percent), Palm Springs (-30 percent), Ventura (-28 percent) and Sacramento (-26 percent) regions.

U.S. commercial real estate markets have continued to improve and are providing an economic offset to the deteriorating residential real estate market. Non-residential construction activity rose at double-digit rates last year, with particular strength in office and hotel construction. The pace of growth has slowed in early 2007, except for hotel construction, which continues to surge. But this may be a good sign since too much construction could lead to gluts that have characterized the commercial real estate sector in earlier decades.

The office sector should remain strong this year, with the main risk being a significant slowdown in payroll job growth. Construction of industrial facilities, which

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lagged during the current business cycle, has gained strength and should remain healthy in 2007. The apartment sector was very strong in 2006, but has softened (with substantial regional variations) as the glut of condominiums is causing some reconversion to apartment rental units. Vacancy rates in the retail property sector may rise as consumer spending slows and new construction catches up with absorption.

California's commercial real estate markets still enjoy solid market fundamentals, with activity remaining vibrant throughout the state. Markets remain very healthy in Los Angeles and Orange County. Northern California commercial real estate markets are still not as strong as Southern California, but have been improving rapidly. There has not been substantial oversupply in most regional markets, as high construction costs deter construction and rents do not always justify new commercial development. Still, with the economy slowing, there may be some oversupply over the next couple of years. San Diego and Orange County may see a rise in office availability as new speculative construction outpaces short-term demand.

Tourism

Based upon recent job reports and anecdotal information, it appears that California's tourism sector has held up in 2007, following a very strong 2006. State payroll data indicate that 40,000 leisure and hospitality jobs were created in the year ending March 2007. Including other tourist-related sectors (such as retail trade), the job contribution is considerably larger. Hotel occupancy rates have also continued to rise, although this could reverse, given the considerable amount of hotel construction underway in the state. With the economy slowing and gas prices soaring again, there is reason to expect a slowdown in tourism this year. But this could be offset by foreign tourism as the weaker dollar (especially against the euro) encourages foreign visits to the United States.

Banking

Mortgage and home equity lending continues to be crimped by the housing slowdown. As sub-prime mortgage

delinquencies have risen, there has been a notable tightening of mortgage lending standards. New regulatory guidance is discouraging creative financing techniques such as interest-only loans and option adjustable-rate mortgages. As home equity lending has declined, there has been some pickup in credit card borrowing, which has slowed considerably over the last couple of years. Commercial and industrial lending, which has lagged in the current business cycle, remains robust.

Fed surveys show continued lax lending standards for commercial and industrial loans, although these may also tighten up as the economy slows. The slowdown in consumer lending, the flat yield curve, and deteriorating asset quality (due largely to rising mortgage delinquencies) has begun to weigh on bank profits. Although bank loan credit quality and profits are expected to diminish further in 2007 (especially for smaller regional lenders), the council expects the overall health of the banking sector to remain sound. But there will continue to be fallout among non-bank, sub-prime mortgage lenders, a number of which are domiciled in California.

Agriculture and Resources

California agriculture continues to face cost pressures deriving from several sources, and it is unlikely that farmers will be able to fully pass on these costs to retail customers. The run-up in corn (and related grain) prices — resulting from soaring ethanol demand — has pushed up feed costs. Given the anticipated growth in ethanol demand, there will be little let-up in these price pressures. Rising energy costs and farm labor shortages also have hurt profit margins. Farmers face substantial water supply cutbacks during the coming year. The depreciating dollar has provided some offsetting positive impetus to profits.

Below-average rainfall (the Sierra snowpack is about 40 percent of normal this year) has reduced California water supplies. Although current water supplies (including reservoirs) are sufficient following last year's wet winter, most water districts are requesting voluntary (and in some cases, mandatory) cutbacks this year. Farmers face 50 to 85 percent of

normal water allocations this year.

The state's electricity supplies look sufficient in the short term due to some new capacity and rising electricity imports resulting from transmission line improvements. Still, California's medium- and long-term electric reliability problems and peak-capacity issues are unsolved. Utilities are investing heavily in upgrading their distribution infrastructure. This much-needed investment, which will likely go on for five to 10 years, will result in higher power costs.

Risks

With the economy growing at a subdued pace, vulnerability to exogenous events is higher than normal. Once again a key risk is oil and gasoline prices, which still have an upward bias tied to geopolitical events. With home valuations and home equity borrowing falling, higher energy prices will probably impact consumer spending more than it did last year.

Another risk revolves around Federal Reserve interest rate policy. Although the Fed appears content with its current policy stance, there is a prospect of higher interest rates if inflation persists near current levels.

Finally, there is a risk that a negative event in the credit markets could lead to widening spreads in mortgage and corporate bond markets. Rising finance costs would weigh on consumer and business spending.

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 Sheldon Engler, vice president and head of fixed income research, Charles Schwab Investment Management, Inc.

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

2007 Legislative Summit Opinion Poll

1. From a business perspective, do you believe things in California are going in the right direction or are on the wrong track?

47% Wrong track
46% Right direction
7% Don't know

2. How are business conditions in California compared with 18 months ago?

38% Same
34% Better
28% Worse

3. During the next six months, do you believe the state's economy will:

56% Stay about the same
26% Worsen
19% Improve

4. Of the following issues, which is MOST IMPORTANT to you and your business?

21% Health care costs
14% Finding skilled workers
14% Legislators who understand business
13% Transportation, infrastructure issues
10% Complying with regulatory requirements
7% Energy costs
6% Illegal immigration
5% Housing costs
3% Legal liability/tort reform
3% Redistricting
3% State labor laws
2% Workers' comp costs
1% Adequate water supply
1% Taxes
0% Unemployment insurance

5. And from the same list, which is your second choice?

16% Health care costs
14% Legislators who understand business
12% Housing costs
11% Transportation, infrastructure issues
9% Finding skilled workers
8% Complying with regulatory requirements
5% Energy costs
5% Illegal immigration
5% State labor laws
4% Legal liability/tort reform
4% Redistricting
3% Taxes
3% Workers' comp costs
2% Adequate water supply
1% Unemployment insurance

6. Do you currently provide health care coverage for your employees?

84% Yes
16% No

7. If not, why not? (Choose up to two)

50% High premiums
32% Can't find affordable policy due to firm size or newness
29% Employees covered elsewhere
6% Administrative hassle
3% Employee turnover
0% Can attract good employees without offering insurance
0% Seriously ill employee

8. If you do provide health care coverage, what is the likelihood that you will make select changes in 2008?

	Very likely	Somewhat likely	Not too likely	Not at all
Increase amount employees pay for premiums	22%	29%	30%	19%
Increase amount employees pay for co-insurance or co-pay	17%	33%	31%	18%
Increase amount employees pay for prescription drugs	10%	29%	38%	22%
Increase amount employees pay for deductibles	16%	31%	34%	18%
Restrict employee eligibility	3%	6%	52%	39%
Drop coverage entirely	2%	1%	21%	77%

9. Do you believe there is an adequate supply of water to meet future state needs or accommodate population growth?

74% No
16% Not sure
10% Yes



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2007 Legislative Summit Opinion Poll

10. How closely have you been following the work the California Air Resources Board is doing to implement the landmark global warming bill (AB 32) signed last year by the Governor?

36% Not too closely
32% Somewhat closely
20% Very closely
12% Not at all

11. How have your electricity prices changed in the last five years?

53% Slightly increased
38% Dramatically increased
6% Stayed the same
2% Slightly decreased
1% Dramatically decreased

12. What impact does the cost of electricity have on your decision making when determining whether to expand, add new employees or invest in additional or new capital for your business?

47% No impact
38% Some impact
15% Big impact

13. Which of the following best describes what has happened to your workers' compensation insurance over the past year?

31% Decreased 1-9%
22% Decreased 10-25%
3% Decreased more than 25%
27% Stayed the same
12% Increased 1-9%
3% Increased 10-25%
1% Increased more than 25%

14. And which of the following best describes what has happened to your workers' compensation insurance over the last TWO YEARS?

25% Decreased 1-9%
30% Decreased 10-25%
10% Decreased more than 25%
16% Stayed the same
15% Increased 1-9%
3% Increased 10-25%
2% Increased more than 25%

15. As a result of savings from workers' compensation reforms, have you (check all that apply):

67% No change
21% Increased wages/benefits for employees
12% Added employees
10% Expanded business

16. If your workers' compensation costs increase again, how will you deal with the added costs (check all that apply)?

31% Pass increased costs on to customers
30% Not sure
28% Reduce other business costs
18% Cut jobs
18% Delay business expansion
4% Other
3% Close California operations

17. How likely is it that a California business like yours will be hit at least once by a frivolous or unfair lawsuit?

36% Very likely
27% Somewhat likely
25% Somewhat unlikely
12% Very unlikely

18. How threatening is California's current litigation environment to a business's survival or ability to succeed in California?

57% Very threatening
33% Somewhat threatening
8% Somewhat unthreatening
2% Very unthreatening

19. Which type of lawsuit do you believe is the most threatening to California businesses?

45% Class action lawsuits
36% Disabled access (ADA) lawsuits
13% Proposition 65 lawsuits
6% Unfair competition lawsuits

20. Which of the following do you believe is the most significant problem with California's legal system?

62% Too easy to file frivolous lawsuits
15% Losing plaintiffs don't have to pay anything
12% Jury awards are unreasonable or unpredictable
11% Legal standards and rules favor plaintiffs

21. What are your company's workforce plans for the next six months?

65% No changes anticipated; will remain the same
28% Plan to expand our workforce and hire new employees in California
4% Employee layoffs or cutbacks anticipated
3% Plan to expand our workforce, but hire new employees outside California

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