

The Kiplinger California Letter

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Dear Client:

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Gov. Schwarzenegger has met his match in groups fighting his ambitious agenda. He won't succeed the way he did in 2004 on workers' comp, tort and health measures. His initiatives threaten many factions that will come up with big money to beat them.

GOVERNOR

Democrats see no reason to cut a deal with a governor who is highly popular but whose approval rating is on the decline. Lawmakers will wait for opposition to grow. They'll exploit unintended consequences of the plans that affect many interest groups.

Localities fear his spending cap, which cuts automatic funding for local police. Schwarzenegger's own after-school program would be harmed as well because it would no longer receive funds automatically every year.

Police and firefighters' groups are upset over the pension plan, which would replace traditional pensions with 401(k)s. If it's approved, workers would lose death and disability benefits, according to a summary written by the attorney general, a Democrat. But Republicans disagree.

Merit pay for teachers is being fought hard by their unions, which financed an expensive and hard-hitting campaign against the idea. The governor's reapportionment plan has bipartisan opposition. Democrats worry about losing their jobs. The GOP fears losing more seats if districts are redrawn by retired judges to reflect population shifts.

Democrats have four initiatives of their own up their sleeves: A "car buyer's bill of rights", making it easier to return lemons and providing fuller disclosure of credit scores and costs of materials. Reregulation of electricity, overturning 1990s' deregulation. Creation of drug-purchasing pools for retired public employees. Keeping a majority vote to change measures that were approved by majority vote. It would undermine an initiative from business groups to require a two-thirds vote to impose fees for past lead poisoning instead of the simple majority required under the original legislation.

Look for compromise down the stretch as reality hits both sides. First lady Maria Shriver may be a force, as she was last year, in shaping the governor's approach to problems. She or his advisers may help the governor save face by postponing the initiatives until 2006. Any concessions could be a signal of Schwarzenegger's plans. If he makes some compromises, rather than championing his own agenda, it could mean that he's ready to campaign next year for a second term.

INSIDE THIS LETTER

Southern Calif. Oil price impact
San Diego Living-wage odds
Central Calif. Coastal oil drilling
Bay Area Oakland Mayor Brown
Northern Calif. Roseville mall
Tenants in Common They're hot
Real Estate Office rent outlook
State Business Privatization
Workers' Comp A ray of hope

SOUTHERN
CALIF.

Rising oil prices will exact a toll on the region's businesses. When pump prices rise, refineries produce a higher proportion of gasoline, causing a scarcity of ethylene and other oil-based products. Most vulnerable: Furniture manufacturers, to the high cost of Styrofoam protectors. Makers of cosmetics and hair care products, to rising prices of mineral oil and petroleum jelly. And farmers, to costly pesticides, fertilizer, tires and fuel for heavy equipment.

Kia Motors America will build a new headquarters in Irvine, moving from its current Irvine offices to Jamboree Business Center East. The Hyundai Motor Co. subsidiary had a 10% sales gain over the past year.

UC Riverside has a good chance of landing a medical school. A statewide university study cited the need for more doctors in the area, and UCR's chancellor, France Córdoba, was named to a planning committee to study UC's needs. Another candidate for a medical school is UC Merced.

Plans for the Outdoor Adventure Center have been scaled back. The \$60-million complex in Grand Terrace will focus on small retailers... stores selling sporting goods and bikes...rather than on boat dealers. A lake for testing speedboats will be reduced from 12 acres to three.

Developers get a few breaks in a Mojave Desert conservation plan: Environmental review of projects will be speeded up in Victorville and 11 other desert cities under a Bureau of Land Management proposal to be voted on in May. But builders will pay per-acre fees of \$385 on already-developed land and \$770 or more on unimproved property.

Heavy rain cost Inland Empire dairy producers \$38 million. Cows become stressed when lying on wet ground and produce less milk.

SAN DIEGO

A living-wage law has a good chance in San Diego. On April 12, the city will consider making firms receiving contracts of \$500,000 or more pay \$9 per hour, \$2.25 above the state minimum wage. Those that don't offer health insurance would pay \$2 on top of that.

Lots of construction work lies ahead in San Diego County. Carlsbad Research Center will open more offices. Faraday Spectrum will open in January, eventually to house nine office and R&D buildings. Oceanside is entertaining bids for a mixed-use development with a big parking lot and garage and 9000 sq. ft. of retail space. Near Chula Vista, the Shops at San Miguel Ranch will be built by McMillin Commercial. It will contain specialty shops and restaurants.

CENTRAL
CALIF.

New oil drilling is proposed off the coast near Vandenberg AFB by Plains Exploration & Production. But approval will be tough to win: A similar proposal by Nuevo Energy was rejected three years ago. Kern County's new airport terminal at Meadows Field opens in Nov. near Bakersfield. Officials expect flights by Delta to Salt Lake City. Center Point business park is planned near Madera on 308 acres. An energy company has signed up, and 10 other firms are negotiating. Reedley will limit growth for five years, yielding to the state, which wants a new sewage treatment plant to precede any new development. Tulare is becoming a big trucking hub. Knight Transportation is hiring more drivers and will probably expand its new trucking center, which already handles north-south shipments for Wal-Mart and Kraft Foods. Other customers and trucking companies are interested in the area.



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BAY AREA

Oakland Mayor Jerry Brown will probably meet his housing goal of 10,000 new residents that he set when he took office in 1999. His efforts are helped by low interest rates and high housing demand.

Condos are popping up everywhere, including the Uptown Project on San Pablo and Telegraph avenues, City Walk at 13th and 14th streets, Housewives Market near Clay Street and the Mandela Gateway Gardens.

A 3100-home project near Jack London Square is likely to be OK'd after Signature Properties works out some environmental cleanup issues.

The challenge is to bring in retailers, which prefer Emeryville.

Housing is thriving in other cities, too, as prices keep rising. S.F. expects to add 11,000 homes by approving three big projects at Rincon Hill, the Transbay Terminal and the mid-Market district.

Santa Cruz will clear the way for 70 condos along River Street. Walnut Creek has approved Riviera Homes, a five-story project with 48 units east of Interstate 680. Most will cost more than \$600,000. 324 homes will replace industrial property near Santa Clara Univ.

New hotels are also in the works. In Menlo Park, Stanford Univ. and Rosewood Hotels & Resorts plan a 120-room hotel at Sand Hill Road.

In S.F., the Holiday Inn Downtown will reopen as a Hilton hotel toward year end. Prices of the 565 rooms will go up by \$100 a night.

Monterey County has OK'd Pebble Beach Company's development plan for 160 hotel rooms, 33 homes, a new golf course and employee housing.

NORTHERN CALIF.

Roseville will get a new shopping mall near the Galleria. Called The Fountains, it will have a Main Street look similar to San Jose's Santana Row. Construction starts in about a year.

A smart-growth project with 2500 homes is planned in Lincoln. Five villages with public parks will be a quarter mile from shopping.

Jackson Hills Golf Community in Jackson will have 540 houses and a golf course along French Bar Road and Highway 49 in Amador County.

A good year is ahead for whitewater rafting, thanks to deep snow and swollen rivers. Some operators began a few weeks early, in mid-March.

The outlook is also good for Sonoma County's tourism industry, aided by a growing U.S. economy, more foreign tourists and S.F.'s upturn.

TENANTS IN COMMON

One reason the commercial property market in California is hot: Tenants-in-common (TIC) syndicates, which pool investors' money to buy real estate and defer taxes on capital gains. These investors are fueling sales of large apartment buildings, small shopping malls and other safe commercial property usually priced under \$50 million.

They make use of a section of the IRS code that allows sellers to defer taxes by buying similar property within six months.

TIC syndicates purchase commercial property at a fast pace to meet the deadline. When they want a property, they usually get it. No other buyer can bid as high, and few can move forward so quickly.

These syndicates will become an even more powerful force as their benefits impress investors. Even Wall Street may join in.

One danger: Inflated property values. TIC promoters are in a hurry to spend, and investors are desperate for a tax break.



REAL
ESTATE

Now's a good time to sign a long-term lease for office space.
That's because rents will edge up this year in most areas.
It will become more difficult to wring concessions from landlords.
And vacancy rates are dropping just about everywhere in Calif.,
according to consultants Colliers International and Marcus & Millichap.

The rent outlook in various markets as commercial leases pick up:
Inland Empire, up 3%. Its 9% vacancy rate is the nation's lowest.
Los Angeles, up 3%. An upturn in jobs will fill up more offices.
Strongest areas: San Fernando Valley, Burbank, Glendale and Pasadena.
But rents will hold steady in the South Bay and parts of the Westside.
San Diego, up 3%, in one of the nation's strongest markets.
Demand will be especially hot in La Jolla, Downtown and Mission Valley.

Orange County, up 2%. Vacancy rates are going to drop below 10%
by year end. The biggest demand is in Irvine and near John Wayne Airport.
San Francisco, up 2%. Fewer office buildings will be available
as more of them are converted to housing. Vacancy rates will stay high...
near 20%...but that's still a big improvement over the past four years.
Biotech firms will help San Mateo County reduce its 26% vacancy rate.
Sacramento, up 2%. The 15% vacancy rate will start declining
as the glut of office buildings is reduced. Rapid population growth
in the Roseville/Rocklin area will make up for government cutbacks.

Oakland, up 1%. Class A space will pick up, but not Class B.
San Jose, up 1%. Cisco Systems, Hewlett-Packard and Intel
are expanding, but slow job growth will keep vacancy rates above 20%.

STATE
BUSINESS

Expect the state to turn more work over to private industry,
especially with a Republican as governor. Schwarzenegger will try
to sell \$50 million worth of surplus or underutilized state buildings
and other property. Also expect efforts to privatize forestry management
and to establish more toll road operations to absorb highway costs.

Calif. will benefit from the revival of the aerospace industry.
Total U.S. sales of aircraft, missiles and commercial space equipment
will grow 8% this year to \$170 billion. Sales to the Pentagon are brisk
because of the Iraq war. Exports of military equipment are strong, too.

WORKERS'
COMP

The 2004 workers' comp reforms are starting to leave their mark.
A likely 10.4% decrease in average rates is just the beginning
of a downward trend. The July 1 reduction recommended by a trade group,
the Workers' Compensation Insurance Rating Bureau, is advisory only,
but California insurers are likely to follow up with similar rate cuts.

The decline doesn't take into account still more reforms
that were written into the law last year but took effect this year.
They include tougher limits on workers declaring a permanent disability.
Assuming they reduce insurers' costs, they will lead to more rate cuts.

The changes aren't a panacea for the state's workers' comp mess.
Rates won't return to 1990s' levels, but at least some relief is ahead.

Yours very truly,

The Kiplinger Editors
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