The Kiplinger California Letter

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INSIDE THIS LETTER

If you expect a big high-tech revival... Don't hold your breath waiting for it. Better enjoy the mild upturn under way. This is about as good as it's going to get.

TECH OUTLOOK

Tech is becoming a mature industry, with 5% to 6% revenue growth likely in coming years. Forget double-digit increases.

Job growth will be modest for some time. Silicon Valley is still losing employees. And in 2005, it will gain only 30,000 workers, well below the 209,000 it has lost since 2000. Outsourcing of work overseas has taken a toll.

The uptick is fueled by businesses, which are buying replacements for PCs, servers, mainframes and other equipment they purchased in the Y2K spending frenzy of the late 1990s.

The cycle is set to run its course in mid-2005. The next high-technology rebound won't come until at least 2006 or 2007, when Microsoft releases Longhorn, the next version of Windows software.

A wave of consolidation is coming, shrinking the number of firms that can hire hardware and software workers, managers and researchers.

Small suppliers will be eaten up as they lose their market share to large businesses with proven track records. Executives will be pushed by stockholders to acquire companies as a way to fatten bottom lines.

The software industry is vulnerable. A recent antitrust ruling giving Oracle the right to acquire PeopleSoft sets a major precedent. Though PeopleSoft has resisted the merger, other firms will copy Oracle. Potential targets: BEA Systems, QAD, Siebel Systems and Lawson Software.

Security software vendors will be popular. McAfee and Symantec are likely to add features to their programs by buying small companies.

A slow shakeout in semiconductors is ahead over the next decade. Small manufacturers will be pushed aside as demand moves from businesses to consumer goods, such as home appliances, home networks and TV/audio.

Telecommunications is ripe for mergers, too, as phone rates drop and profits are hard to come by. AT&T and MCI are especially vulnerable.

Slow growth will keep office vacancies high in tech areas such as San Jose, San Francisco, western Los Angeles and Ventura County.

A film merger shows the impact consolidation has on real estate. After combining with Sony, MGM will drop many of its 1300 L.A. workers and vacate much of the 341,000-sq.-ft. MGM Tower in L.A.'s Century City.

It will take years to fill up the tower, where the lease expires in 2018.

LODGING In resort areas, more mixed-use projects will include time-shares to complement hotels and vacation homes as places to stay. Time-shares have high occupancy rates because they're paid for in advance and are less vulnerable than other lodging to tourism's ups and downs.

Time-share companies can entice frequent guests at nearby hotels to buy their product as a way to avoid paying pricey nightly rates. They share swimming pools, tennis courts and golf courses with hotels.

Lodging firms prefer to get paid up front rather than wait years to recover their initial investments bit by bit from hotel room bookings.

More time-shares are being built in cities popular with tourists, such as San Diego, San Francisco, Carmel, Las Vegas and Laguna Beach.

SOUTHERN CALIF. Unions have gotten a lift from L.A. Mayor James Hahn, a Democrat who wants union-scale benefits in city construction contracts. Though his plan has a long way to go, it's sure to be a political issue in 2005 because Hahn's likely foe, Bernard Parks, opposes the idea.

The Torrance industrial market is hot. A local investment group paid nearly $100 per sq. ft. for a 74,038-sq.-ft. industrial building. With port traffic surging, nearby warehouses are staying especially busy.

Competition is heating up for DHL's planned air cargo hub. San Bernardino and Ontario airports and the former March Air Reserve Base are trying to land the Inland Empire facility that DHL wants to open. Although the March Joint Powers Commission recently approved funds for the hub, opposition from local organizations could scare off DHL.

Materials shortages are slowing construction of replacement homes for the 2400 houses destroyed or badly burned in the Oct. 2003 wildfires. A scarcity of truss systems, the framework that supports the roof, is a problem for Stonefield Development in the Whispering Ridge area of Scripps Ranch. Move-ins planned for Dec. will be delayed a few months.

A San Bernardino County mall will feature outdoor-sports stores. Grand Terrace city officials have approved the Outdoor Adventure Center, which will also have a 12-acre lake for demonstrating watercraft.

Ontario's convention-marketing efforts seem to be paying off. Revenue from current and future convention bookings is up 17% from 2003.

Escondido has OK'd a novel project with five "shopkeeper" homes. The owners run street-level businesses in a popular entertainment area and live in units above the stores. Prices start in the low $500,000s.

SAN DIEGO Don't worry, San Diego isn't about to go bankrupt, despite a fuss over the $1.17-billion shortfall in the city's pension system. City officials secretly backloaded the pension to pay out benefits long before they had the money for them. Debt payments are coming due, and the fund no longer has a soaring stock market to bail it out.

The city will be rescued by a strong economy. This year's revenue is running ahead of projections, and the telecom industry is reviving, with 36,000 technology jobs paying an average wage of $80,000 a year.

But there will be repercussions. GOP Mayor Dick Murphy is shaky, with a better-than-even chance of being sacked by voters in November.

Lots of city employees may join him on the unemployment rolls. Those who stay will get no raises and will have to pay more for benefits. Retirement age for police may go from 50 to 55. Others, from 55 to 60.

The SEC will fine the city. And criminal charges are possible.

BAY AREA Richmond is emerging as a potential Las Vegas of Northern Calif. Five casinos are being planned along a 10-mile section of I-80, though some of them will be stopped by opponents of legalized gambling. The biggest plan is for a card room in San Pablo that's to be converted to a casino with 2500 slot machines on land acquired by an Indian tribe. If even one project goes ahead, it will be a boon for local development.

Expect BART's Fremont-Santa Clara extension to be scaled back. The feds are pressing transit officials to end the southward extension in Milpitas rather than build the line through downtown San Jose.

S.F. hotels will keep operating during the strike and lockout by using replacement workers. Note that many area hotels aren't affected. But the dispute could be a long one, and it may spread to Los Angeles.

Prospects for a new S.F. Transbay Terminal have picked up steam. The Board of Supervisors has voted to assert the right of eminent domain over a developer who wants to build a condo project on the same land.

CENTRAL VALLEY UC Davis will become a greater force in biosciences this month when it opens its Genome & Biomedical Sciences Facility Oct. 13. The $95-million building will host research in genomics, pharmacology, toxicology, biomedical engineering and other cutting-edge technologies.

Sacramento will get a mortgage-processing center at Mather Field. Ameriquest Mortgage Co. will employ about 600 at the former air base.

Redding has landed a small water-sports company, Comptech Marine. The firm is moving its Sky Ski hydrofoil facility from Lake Elsinore.

A Clovis shopping center is likely to grow. Sierra Vista Mall, which is nearly full, wants a theater, several restaurants and shops.

CENTRAL COAST San Luis Obispo County has approved expansion of oil drilling. Plains Exploration and Production of Houston plans 95 oil wells and 30 steam-injector wells in the Price Canyon area east of Pismo Beach.

Santa Barbara County will get a time-share/condominium project. Trendwest Resorts is going to build 76 units on Alisal Road in Solvang.

LABOR DATA You can view complete labor market data for California on a Web site run by the state's Employment Development Dept. For employers, the most popular feature is a list of average pay scales for various occupations. Go to *www.labormarketinfo.edd.ca.gov*.

GROWTH TRENDS High housing prices won't keep people out of California. A study on long-term demographics by the UCLA Anderson Forecast challenges the notion that newcomers will be deterred by steep costs.

Homes are so costly because people want to live in prime areas, even if they are expensive. In fact, people tend to move to Calif. at the same time that housing prices are rapidly increasing.

Population growth is often driven by jobs. In the early 1990s, when Calif. was losing population, the unemployment rate was high. Residents grew in number during the dot-com boom of the late 1990s.

High density won't make big cities less popular. In the 1990s, New York grew 1% a year, despite having 24,000 people per square mile. To paraphrase a line from a popular movie, the UCLA report concludes:

Build it, and they'll come. Stop building, they'll come anyway.

Gov. Schwarzenegger's economic council is decidedly probusiness. In establishing the Council of Economic Advisors, the governor drew heavily on two conservative organizations, the Hoover Institution and the University of Chicago economics department. Among the big names on the team are Milton Friedman, Gary Becker and Arthur Laffer.

Count on the group to suggest free-market solutions...tax breaks and other lures to business...rather than regulations and tax increases.

But there's no guarantee Schwarzenegger will buy all its ideas. For example, he is to the left of most members on environmental issues.

Redevelopment of industrial sites in big cities will get a boost from a law signed by the governor. It protects developers from liability once they have met state standards in cleaning up brownfield property. But they're not shielded if more waste is found after a cleanup is OK'd.

BUSINESS COSTS

The governor faces an uphill battle in luring businesses to California. A few out-of-state firms have answered his call in an advertising campaign, but high costs in Calif. will deter many.

Nearly all California cities have higher costs than competitors in western and central states. A study by a site selection consultant, The Boyd Company, found 18 California metro areas in the top 19 in cost. The study counted labor costs, rent, utilities, travel and workers' comp but not taxes for a typical telecommunications firm with 125 employees.

Highest costs, in order: S.F., San Jose, Oakland, Orange County, L.A., Santa Rosa, Vallejo, Ventura, Santa Barbara, San Diego, Sacramento, Riverside/San Bernardino, Bakersfield, Portland, Ore., Stockton, Visalia, Salinas, Modesto, Fresno, Kansas City, Mo., Denver, Phoenix, Las Vegas.

But the price gap isn't huge. S.F. costs $12.1 million a year, and Las Vegas, $10.2 million. Cheapest: Sioux Falls, S.D., $9.4 million.

PHONES

Local telephone competition will be reduced under a ruling by the Public Utilities Commission in favor of SBC. Several firms have already said that they will stop marketing local telephone service because the PUC will make them pay 20% more to access SBC's phone lines. Phone rates won't go up, but costs for add-ons such as call waiting will.

HOSPITALS

Expect many more Calif. hospital closures to follow the shutdowns of San Jose Medical Center and Elastar Community Hospital in East L.A. So far this year, nine hospitals in the state have closed.

The next to go will likely be Southern Calif. urban hospitals, but not branches of the major chains. Most of them are in better shape than Tenet Healthcare, which is selling off 19 of its Calif. hospitals.

Seismic rules are a big factor. Hospitals must retrofit buildings or build new ones with no state aid. Cost of repairs: About $24 billion.

Other problems abound: Medicaid reimbursement rates are lower than in any other state. New minimum nurse-staffing rules are costly. And hospitals are left in the lurch if ER patients can't pay their bills.

Hospital troubles will be felt by businesses. Firms will hesitate to locate in areas where employees have poor access to medical care.

Yours very truly,

The Kiplinger Editors

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