HdL Companies

CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

DECEMBER 2022

Mono County, CA

Delivering Revenue, Insight and Efficiency to Local Government Since 1983

HdL provides relevant information and analyses on the economic forces affecting California's local government agencies. In addition, HdL's Revenue Enhancement and Economic Development Services help clients to maximize revenues.

888.861.0220 | solutions@hdlcompanies.com | hdlcompanies.com

STATEWIDE SALES TAX TRENDS

TOTAL 2022/23 | 2023/24 — 3.8% | 0.4%

Overview: Over the last few months, slight inflation improvements materialized in various industries, however real change has yet to take hold. Households remain nervous about the economy sliding into a recession. Nevertheless, customer spending remained strong through the holiday season. Experts vary on whether a recession will occur and to what extent. Unemployment rates remain a key indicator of whether this adverse economic situation will occur. From a sales tax perspective, the forecast does reflect a slowdown in taxable merchandise spending to 0.4% in FY 2023/24 as the higher cost of utilities, food and other necessities limit dollars available for discretionary and non-essential items.

2022/23 | 2023/24

Autos/Transportation — 2.9% | -3.0%

Auto inventory available for sale is finally increasing from historic lows after recent supply chain disruptions and computer chip shortages ease. The lack of inventory caused the prices for both new and used vehicles to soar. However, the market now appears to be at an inflection point. Prior to the recent shift, expensive trucks and SUVs were in demand and US manufacturers overproduced. Now consumers prefer less costly, fuel-efficient vehicles which were in short supply amid summer's high gas prices. Additionally, used car prices are declining on the wholesale market as quantities rise. Escalated financing costs bring additional uncertainty to a market already squeezed by affordability concerns. These factors are expected to crimp auto demand and result in a minor dip in revenue growth in the next fiscal year.

Building/Construction — 4.3% | 1.0%

Statewide construction permit data continues to reflect vigorous growth as permit values rose 23% during the summer, the fourth consecutive quarter of growth. While this is a good sign, the San Joaquin Valley had signs of a slowdown as the majority of counties reported lower YTD permit values. Demand for new hotels, parking garages and office space remains strong. Higher mortgage interest rates dampened construction of single-family homes, but new construction has not stopped. The increased borrowing rates are fueling renovations on existing properties, and home improvement centers are reporting contractors still have sizeable project backlogs. Construction material costs remain above pre-pandemic levels. Pricing will be offset by major Infrastructure and Investment Jobs Act (IIJA) funded projects in 2023 and the corresponding demand for materials. By FY 2024/25, construction patterns will normalize as mortgage rates moderate and the mix of construction projects favors single-family homes more heavily.

Business/Industry — 5.1% | 2.0%

The Business and Industry group swelled 10% during the Q3 sales period with most of the group's 21 unique business types expanding. Comprising 24% of this category's revenues, fulfillment centers surged 11.5%, boosted by early online holiday shopping. Industrial growth continued with strong demand, high cost of materials and a slight relief in supply chain and labor challenges. Project-related buying pushed the electrical equipment sector up double digits while technology investments and other B2B needs buoyed business services outcomes. HdL projects solid growth through the end of 2022, and modest overall improvement in 2023, into early 2024. Given the unique composition of this group, predictions vary based on the size and character of local businesses and industry taxpayers within each community.

2022/23 | 2023/24

Food/Drugs — 1.1% | 2.0%

Grocery stores saw a 3% increase on the sale of taxable goods this past quarter, due to the uptick in food costs. Recent polls showed cannabis usage and related revenues declined due to escalated product costs. Cannabis tax continues to be an alluring revenue source and many recent voter-approved measures will likely increase the permitted licenses throughout the state. Like other areas of this projection, a pullback in consumer spending keeps the estimates up only 1% in FY 2022/23, though spending in FY 2023/24 and beyond should grow at a more traditional rate.

Fuel/Service Stations — 0.4% | -7.7%

While war and global economic uncertainty caused petroleum per barrel costs to skyrocket last spring, gas prices have steadily dropped for two consecutive quarters. As of December 2022, the average per gallon rate is at its lowest point in 2022 and will continue to experience downward pressure. Other factors helping lower the associated sales tax include reduced oil barrel, diesel, and jet fuel prices, paring back on both consumption and demand for fuel and volatility tied to Federal Reserve interest rate adjustments. Due to recent results and outlooks, our forecast for actual sales tax receipts for the next three quarters (Q4'22-Q2'23) has been lowered. FY 2023/24 should see a decrease from the prior year's historic gains linked to the events noted herein.

General Consumer Goods — 0.9% | -0.1%

Consumer spending and strong demand sustained positive sales tax receipts from general consumer goods retailers throughout the summer. Local tax receipts came in as expected for the third quarter of the year reflecting positive, yet modest gains. Trends observed this past spring were extended, reinforcing the impact that rising prices and elevated borrowing costs are having on low to middle income households. This was most apparent in the apparel categories. During the 2022 summer gas price peak, tax proceeds from discount department stores selling fuel increased due to shoppers wanting to purchase inexpensive fuel. HdL predicts returns will remain flat with a possible mild slowdown mid-2023. Beyond inflation and interest rates, low personal savings rates combined with growing credit card usage might indicate future headwinds for consumers.

While Proposition 172 (1/2 Cent for Public Safety) growth projections closely track with the statewide Bradley-Burns, calculations vary somewhat due to the state's allocation methodology. HdL forecasts a statewide increase of 3% for fiscal year 2022/23 and .46% for 2023/2024. As some counties rebound from significant sales tax losses these past two years, and the Bradley-Burns allocations were adjusted to reflect direct allocations for some internet-related sales, Proposition 172 pro-rata factors have shifted significantly for many counties.

STATEWIDE
SALES TAX TRENDS

Restaurants/Hotels

2022/23 | 2023/24
8.6% | 2.5%

Restaurant receipts once again improved compared to prior quarter filings, yet the increases are the result of higher menu prices compensating for slower foot traffic. Despite increased admission costs in the entertainment industry, the demand for experiences was high and Q3 recorded the largest percentage improvement over the comparable period. Regional performance varied, impacted by tourism trends and the return to office on a limited basis. Per the National Restaurant Association survey, 77% of consumers planned to order from restaurants during the holidays, which suggests visits lag 2019 levels. Ever-increasing prices and continued recovery are pushing hotels and leisure/entertainment to post strong gains. Though leisure travel remains hearty, business travel has yet to rebound. The restaurant and hotel industries do not expect patron prices to decrease, keeping the group's forecast at an all-time high.

State and County Pools

2022/23 | 2023/24
6.2% | 4.5%

The combined efforts of online activities anchored to conveniences, access to large volumes of merchandise, and quick shipment pledges helped trigger 7% greater use taxes. Following earlier trends, gains came primarily from private party auto sales and small value business-based purchases. General retail sales have been flat or down in the pools this calendar year. Trends show a shift away from mobile ordering as individuals spent more on travel and/or experiences. E-commerce makes up about one sixth of overall retail sales and is predicted to grow modestly in the years ahead. Initial holiday shopping data divulged online spending up 8% as many merchants discounted products to move out bloated inventories. The percentage increases listed for this group reveal increased demand from industrial and equipment related orders along with greater cost of goods on the consumer front.

NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

U.S. Real GDP Growth

2022/23 | 2023/24
0.8% | 2.5%

National GDP has functionally stagnated; it was roughly the same level in Q3 of 2022 as it was in Q4 of 2021. During that period, prices in the U.S. rose sharply. In response to both underlying inflation and the Federal Reserve's rate hikes, interest rates have shot up, rising from record lows to levels that align with long term historical averages. While interest rates are not high from a long run perspective, their rapid increase from such a low floor has sent asset markets reeling. Today's economy is fragile and highly susceptible to further negative shocks. Beacon Economics does not view a recession as a foregone conclusion as many other forecasts have suggested. However, we acknowledge that certain choices by policymakers in the months ahead could trigger an economic crisis.

U.S. Unemployment Rate

3.9% | 4.4%

The U.S. economy is not currently in a recession despite the lack of overall GDP growth. Despite the addition of 4 million payroll jobs since the start of this year, the U.S. unemployment rate remains well below 4%, and the job openings rate is at 6.3%, well above the pre-pandemic peak of 4.8%. At the same time, industrial production is at a record high, manufacturing orders are still rising and overall inventories remain low. The U.S. economy is clearly operating at capacity, the exact opposite of what economists refer to as a 'recession' — a period during which an economy, driven by some type of negative shock, produces less than it could. In contrast, today's economy is one that is running at full speed. The U.S. is struggling with meeting demand, rather than a lack of demand.

CA Unemployment Rate

3.7% | 3.9%

Employers in the state have struggled to hire workers and fill positions. Typically, there are more unemployed workers in the state than there are job openings, but since the outbreak of the pandemic, this paradigm has flipped. Since October 2021, there have been more job openings in California than there are workers to fill these positions, meaning that worker availability has been the primary constraint on job growth in the state.

CA Total Nonfarm Employment Growth

2022/23 | 2023/24
3.4% | 1.9%

In October, California's economy reached a milestone, having finally recovered all jobs that were lost during the outset of the pandemic. The state reached this milestone more slowly than the national economy and many other states, because California is experiencing a pronounced labor shortage. States that exhibited labor force expansion have also had the highest job growth, while job counts have yet to recover to pre-pandemic levels in states where the labor force contracted significantly. This phenomenon has also played out regionally within California, with job recovery closely tied to labor force expansion in many counties across the state.

CA Residential Building Permits

123,921 | 106,724

To meaningfully lower the costs of home ownership in California, the supply of housing must increase, particularly in the state's largest metropolitan areas. California, given its high housing prices, is a net exporter of workers with lower levels of earnings and formal education, and a net importer of workers with higher levels of formal education. This represents a key policy challenge for the state as the economy produces (and needs) jobs that pay a range of wages. Ultimately, California, and particularly its large metropolitan areas, needs to allow more housing development to increase overall supply and prevent its lowest income workers from being priced out of the state.

CA Median Existing Home Price

$651,840 | $606,891

The drop in home sales has led to an increase in the number of available homes on the market, although the current level remains far below pre-pandemic inventories. This means that, despite the drop-off in sales, housing supply in the state remains incredibly constrained. Tight housing supply will have two consequences. First, when interest rates begin to fall, the consequent increase in buyers will again place upward pressure on housing prices. Second, while prices can and may go lower (prices have already started to turn down slightly), there is not enough supply in the market to provide the type of overhang that could lead to acute price declines.

Scan to view the *HdL California Consensus Forecast 3Q22* webinar recording. Email solutions@hdlcompanies.com to learn more.

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888.861.0220 | solutions@hdlcompanies.com | hdlcompanies.com

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California's allocation data trails actual sales activity by three to six months. HdL compensates for the lack of current information by reviewing the latest reports, statistics and perspectives from fifty or more economists, analysts and trade associations to reach a consensus on probable trends for coming quarters. The forecast is used to help project revenues based on statewide formulas and for reference in tailoring sales tax estimates appropriate to each client's specific demographics, tax base and regional trends.

Beacon Economics LLC

310.571.3399 | BeaconEcon.com

Beacon Economics has proven to be one of the most thorough and accurate economic research/analytical forecasting firms in the country. Their evaluation of the key drivers impacting local economies and tax revenues provides additional perspective to HdL's quarterly consensus updates. The collaboration and sharing of information between Beacon and HdL helps both companies enhance the accuracy of the work that they perform for their respective clients.