

HdL⁺ Companies

CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

SEPTEMBER 2022



Napa, 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.



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Overview: Though a new fiscal year commenced in July, many of the economic challenges seen in early 2022 remain prevalent. Inflation will continue to top historical norms into 2023. Despite a fourth interest rate hike, prices on taxable goods show no signs of lessening. More expensive mortgage rates will slow housing sales and cause weakened demand for appliances, furnishings and other related products. Crude oil prices have dipped from extraordinary peaks allowing consumers to budget in other areas of life. The shift back to experiences and services plays a significant role in the forecasted decelerated growth. Overall, consumer's confidence in the economy is best described as uncertain.



Autos/Transportation

2022/23 | 2023/24

4.5% | -3.0%

Auto sales tax revenues continue to increase. Last quarter experienced a modest 5% growth rate. A YOY comparison shows this is far less than the 22% surge seen amid the pandemic rebound. Recent reports state the lack of dealer's inventory remains the key factor in preventing better results. Despite inventory nearing all-time lows, it is now higher than at any point since June 2021. The short-term outlook remains strong as growth is expected to reaccelerate as production increases over time. New car pricing continues to set new monthly records, but this hasn't deterred consumers; dealership purchases increased and luxury vehicles linger as one of the strongest segments of the market. The medium-term outlook is more subdued. Increasing financing rates, a sluggish economy, losses in financial assets and the growing possibility of a recession point to a downturn in the next year.



Building/Construction

3.1% | 1.0%

Statewide construction permit data from second quarter 2022 offered a mixed outcome with overall permit valuations up 51%, while regional data shows slowing trends. The number of permits issued for single family homes narrowly increased .7% in the second quarter. In response, permits issued for multi-family housing and non-residential projects were up 57% and 65%, respectively. Hotels, parking garages and office spaces are seeing significant increases in proposed new starts. As higher mortgage rates cool the new housing market, owners of existing properties stay focused on home renovations. Most supply costs rose at the start of the third quarter. Extremely high pricing and long delivery wait times is causing project delays. Gains in the first half of FY 2022/23 will be followed by a flattening of sales as impacts from lower material prices drive down overall sales totals. HdL predicts normal growth will return in FY 2024/25.



Business/Industry

3.7% | 3.2%

As expected, this group swelled 7% during the second quarter 2022 and most of the category's 21 unique business types expanded returns over the prior year period. The pandemic pushed medical and biotech to the forefront and spending on equipment and supplies has still not subsided. Industrial growth remained steady, boosted by strong demand, costlier goods, and a softening of supply chain and labor challenges. Bolstered by large projects, the electrical equipment sector experienced another uptick. Technology demands and other B2B needs bolstered business services outcomes. Warehouse, farm, and construction equipment generated positive revenue results, though garden and agricultural supply revenues dipped. Fulfillment centers edged up 6% comprising 24% of all business and industry revenues. Modest gains are predicted as companies are expected to front load large purchases this year to stay ahead of product costs increasing due to inflation.



Food/Drugs

2022/23 | 2023/24

2.0% | 2.0%

Modest overall improved food and drug sales occurred last quarter. Although inflation has increased overall food costs, improved numbers from grocery and drug store revenue helped make up for declines from cannabis retailers. Several bills aimed at strengthening cannabis laws recently passed, expanding the legal market and pushing this sector to reach saturation points in some parts of that state. Senate Bill 1186 will be challenging for local governments, as it preempts local bans on delivery of medicinal cannabis. Anticipated segment gains are predicted to hold at restrained levels for the foreseeable future.



Fuel/Service Stations

6.8% | -7.7%

For the first time in several months, fuel and services stations are experiencing downward pressure. While most underlying economic factors remain strong throughout the State, crude oil and pump prices have been steadily dropping after setting record levels in second quarter 2022. Demand for fuel is expected to be lower in 2023. As a result of these combined factors, the short-term revenue projections are price-based pressures still generating large dollars throughout 2022. Comparative data from the extraordinary tallies dating back to March suggests declines through 2023. Meager gains are expected through the end of next fiscal year. Looking ahead, HdL foresees totals are expected to be flat in FY 2024/25.



General Consumer Goods

0.6% | -0.3%

The resiliency of consumer spending was prevalent in the second quarter of 2022 despite inflationary pressures and federal attempts to cool demand. Although taxable sales continued to outpace expectations, many categories indicated changes in household spending and priorities. Retailers that target audiences in the low to middle income bracket experienced a notable pullback in sales compared to last year. In contrast, many luxury brands recorded double-digit growth, thereby reflecting the disparity across income levels. Retailers have made it clear they are seeing demand shift to non-durable goods leading to expectations of a heavy discount season through the end of 2022. Prices are driving positive sales tax proceeds, while sales volumes have started to diminish. Due to the continued inflationary environment, shifting spending patterns and rising interest rates, only miniscule gains are forecasted for FY 2022/23.

Proposition 172 projections vary somewhat from statewide Bradley-Burns calculations due to the state's utilization of differing collection periods in its allocations to counties. HdL forecasts a statewide increase of 3.1% for fiscal year 2022/23 and .7% for 2023/2024.



Restaurants/Hotels

2022/23 | 2023/24
7.3% | 3.2%

The travel and tourism industry is optimistic restaurants and hotels will continue to see grander tax filings in the coming months. New business openings and the resulting expanded tax base boosted trends for both segments. High menu prices and occupancy rates also contributed. Several growing restaurant chains have more than doubled the number of stores in the last 12 months. The increased demand of restaurants is a direct response to the rising cost of groceries. Catering companies have also noticed increased sales as more workers return to offices. Overall, consumer desire to spend more disposable dollars on leisure and entertainment has contributed to this positive outlook.



State and County Pools

2022/23 | 2023/24
5.5% | 4.5%

E-commerce spending is here to stay. Statewide, pools have moved into the top performing sales tax group thanks to the addition of Wayfair taxpayers, a pandemic-induced shift in spending priorities, and consumer preference for the convenience and ease of shopping remotely. The close of FY 2021/22 shows pools revenues were 60% above the annual tallies captured in the pre-pandemic FY 2018/19. B2C sales remain the largest component and B2B sales comprise about one third of the use taxes paid into California. With economic uncertainty and retailers constant adaptations to better meet shopper's online needs, 5% gains are estimated through 2023.



BEACON
ECONOMICS

NATIONAL AND STATEWIDE ECONOMIC DRIVERS



U.S. Real GDP Growth

2022/23 | 2023/24
4.1% | 2.1%

Beacon maintains that the U.S. economy is sturdy, though subject to policy errors to be made by the Federal Reserve. The massive fiscal outlays during the pandemic have flushed households and businesses with excess liquidity with which to continue spending. However, the U.S economy is fast approaching the end of a very hot business cycle, thus the forecast for slower real growth.



U.S. Unemployment Rate

4.2% | 3.4%

As the economy slows down, the unemployment rate will inch up modestly. During and following the pandemic years, the labor force shrunk substantially. Beacon predicts the labor market will see a positive spike in participation, however, companies will be faced with modest layoffs as companies right-size in anticipation of an economic slowdown and higher interest rates.



CA Unemployment Rate

5.7% | 4.4%

California's unemployment rate is expected to be in line with the national average. As the economy slows and when the Federal Reserve begins reducing its balance sheet, marginal tightening of economic conditions will nudge the unemployment rate higher. As of September 2022, California job creation has been limited by the availability of the right labor force mix for the available jobs.



CA Total Nonfarm Employment Growth

2022/23 | 2023/24
6.4% | 3.6%

The pandemic and lack of affordable housing were key contributors to California's substantial net emigration to other states, notably from many of prime working age. Many corporations and jobs followed suit and the reduction in population and labor force have hindered job creation in the post-pandemic recovery phase. It is predicted job growth in California will be in line with the national trend.



CA Residential Building Permits

118,532 | 120,077

The slowing of the economy in fiscal year 2023-24 will decelerate residential development activity modestly. Low-density development and the "Not In My Backyard" mindset continue to impact the overall California real estate landscape.



CA Median Existing Home Price

\$669,680 | \$686,369

Over the next 24 months, home prices are expected to progressively rise. The pandemic unleashed a strong desire to purchase a home in California and heralded a wave of interest in real estate from private equity or institutional buyers. While increasing mortgage rates and tighter financial conditions will pose challenges on financed purchases, cash buyers and institutional buyers will welcome the decreased competition and support pricing.

Scan to view the *HdL California Consensus Forecast 2Q22* webinar recording. Email solutions@hdlcompanies.com to learn more about HdL services that can help your agency maximize revenue.





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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.

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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.