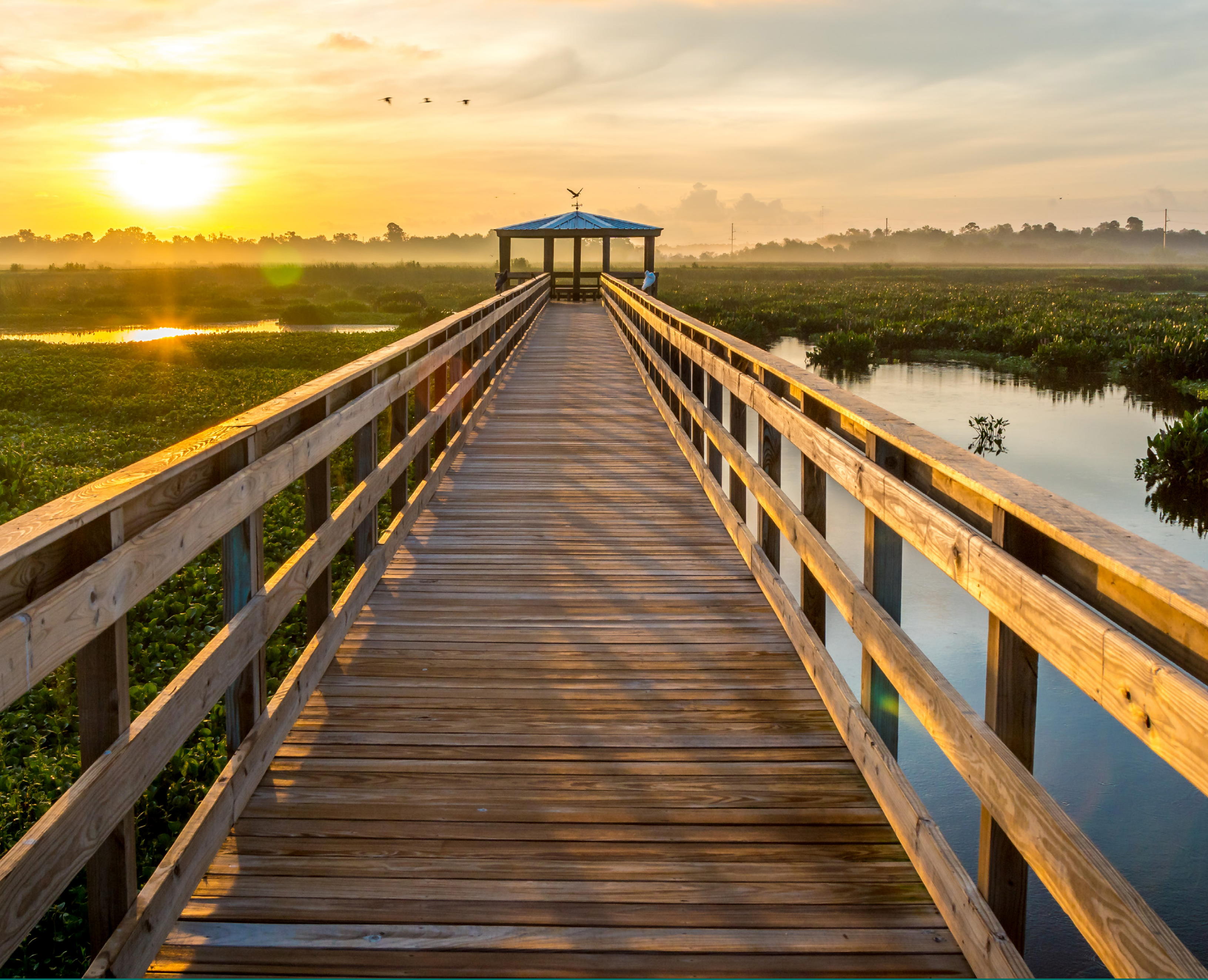
HdL Companies

JUNE 2021

TEXAS FORECAST

SALES TAX TRENDS AND ECONOMIC DRIVERS



Beaumont, TX

Delivering Revenue, Insight and Efficiency to Local Government Since 1983

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

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HdL Companies
2021 FORECAST

Summary

The June 2021 quarterly update to *HdL's Texas Forecast: Sales Tax Trends and Economic Drivers* arrives with the COVID-19 pandemic still a focus of attention. With 40% of Texans fully vaccinated, the pandemic is not yet in the rear-view mirror. However, as Governor Abbott has lifted mask mandates, increased capacity of businesses and facilities to 100%, and opted out of further federal unemployment compensation support, a return to "normalcy" is clearly the political and economic objective in Texas. With injections of American Rescue Plan Act (ARPA) funds and adaptations and efficiencies honed by business and industry in response to the pandemic, a resilient Texas economy is well-positioned to move beyond rebound to full recovery through calendar year-end 2022. As for politics, the 87th Texas Legislature adjourned its regular biennial session without enacting any new laws of general significance to state and local sales and use tax. Nonetheless, the lack of action clears the path for full implementation of sales and use tax consummation of sale rule changes adopted by the Comptroller in May 2020.

HdL Consensus Forecast

The Texas economy, which proved resilient through the pandemic and the record-setting February 2021 weather event, remains poised for continued rebound in calendar year 2021 with recovery to pre-pandemic levels within calendar year 2022, the time horizon considered in this forecast. Public health officials continue to caution the public about the need for personal vigilance as virus strains mutate, vaccination rates slow, and mask mandates and capacity restrictions are lifted --- a not-so-subtle reminder the pandemic is far from over. Nonetheless, adaptations made by business and industry in response to the pandemic, coupled with stimulus funds from the American Rescue Plan Act (ARPA), are expected to fuel the Texas economy from rebound to recovery. HdL's forecast contemplates Texas will continue to benefit from brisk construction activity in response to population growth, continued stabilization of oil and gas production in response to growing demand, accelerated consumer spending across most sectors, and steady progress toward pre-pandemic employment levels. Price increases due to supply chain considerations and inflation have also been considered.

The 87th Texas Legislature adjourned on May 31, 2021, without enacting any new laws of general significance to sales and use tax. However, the lack of action clears the path for full implementation of sales and use tax rule changes adopted by the Comptroller in May 2020, some aspects of which were delayed from implementation to allow those opposed to the rule changes to seek legislative remedy. HdL's forecast anticipates the delayed rule changes, which clarify the treatment of taxable orders placed remotely through shopping networks, websites, apps, and the like, will be implemented as scheduled by the Comptroller on October 1, 2021.

This forecast update reflects actual sales and use tax allocation data through June 2021 and extends business group trend projections through calendar year-end 2022. Also included is the June 2021 edition of Beacon Economics' National and Texas Economic Drivers, providing insight about the macroeconomy and key drivers impacting national, state, and local economies. HdL continues to segment its forecast and related reports into the eight unique business groups defined by HdL. For all forecasted periods and for each defined business group, trends reflect the forecasted percent change over the same period in the prior year with quarterly projections applied equally across each month of the quarter.

HDL CONSENSUS FORECAST – JUNE 2021

STATEWIDE SALES TAX TRENDS

TOTAL 3Q21 3.4% | 4Q21 2.8% | 1Q22 3.6% | 2Q-4Q22 2.6%

(Based on Sales Tax Allocation Month)

Construction & Manufacturing

3Q21 1% | 4Q21 1%
1Q22 4% | 2Q22 2% | 3Q-4Q22 2%

Residential construction is expected to remain brisk fueled by population growth, suburban shift, and attractive mortgage rates, while contraction is expected in the home improvement and "do it yourself" retail segment. Commercial construction is projected to remain below pre-COVID levels as demand for retail and office space remains soft. The outlook for manufacturing remains positive with steady recovery projected. Crude oil prices are expected to increase throughout 2021 as demand increases and supply is controlled in response. Supply chain concerns are expected to reduce the overall rate of growth across this category.

General Retail

3Q21 5% | 4Q21 3%
1Q22 3% | 2Q22 2% | 3Q-4Q22 2%

Robust retail activity is projected through year-end 2021 as in-person shopping is expected to edge upwards in response to pent-up demand and a return to leisure shopping, especially through the summer months. Ironically, this business category, in decline prior to the pandemic, is emerging from the pandemic ready to make up ground lost to on-line retail. Thanks in part to the pandemic, in-store retail establishments adapted to the competitive threat of on-line retail at an accelerated pace by refining merchandise offerings and instituting flexible shopping options, including same-day curbside pickup and home delivery. In addition, many shopping centers and malls are poised to respond to attract eager shoppers with a refreshed mix of tenants. In-store year-end holiday shopping activity is also expected to be brisk as shoppers, hungry for a more traditional holiday shopping experience, return to malls and shopping centers.

Internet Retail

3Q21 10% | 4Q21 6%
1Q22 3% | 2Q22 3% | 3Q-4Q22 3%

Year-over-year growth in internet retail is projected through year-end '21 and the general long-term outlook for this business category remains positive even as in-store shopping activity is projected to increase. Year-over-year rates of increase are projected to cool as compared to the unprecedented levels experienced during the pandemic when lockdowns dove-tailed with incremental sales tax reporting by marketplace providers and remote sellers in response to the Wayfair Supreme Court decision.

Grocery Stores & Pharmacy

3Q21 -3% | 4Q21 -3%
1Q22 -2% | 2Q22 2% | 3Q-4Q22 2%

Consumer demand in this category is expected to contract beginning Q3 '21, fueled by increased vaccination rates and the lifting of mask mandates and occupancy restrictions on restaurants. Driven by pent-up demand for leisure activities, consumer spending at grocery stores will cool in deference to increased consumption of meals not prepared at home. Pandemic-inspired adaptations put in place by grocery stores and pharmacies such as ready-to-cook meals, on-line ordering, curbside pick-up, and home delivery will remain attractive competitive consumer options as consumers return to pre-pandemic daily living routines.

Restaurants & Entertainment

3Q21 15% | 4Q21 8%
1Q22 10% | 2Q22 5% | 3Q-4Q22 5%

This business category, which suffered greatly during the throes of the pandemic, is expected to reap the most benefit from the release of pent-up consumer demand, particularly through the summer months and the forthcoming year-end holiday season. The proliferation of vaccines, the lifting of gathering place restrictions, and consumer interest in travel and leisure activities away from home will drive positive results for restaurants and entertainment venues for the foreseeable future. As a protracted return to pre-pandemic employment levels is expected for this business category, service accommodations put in place by restaurants and bars to attract customers and survive collapse during the pandemic are expected to continue, including scaled-back menus tailored for efficiency, digital ordering, curbside pickup, and home delivery. Restaurants and bars alike will also benefit from recent legislative activity as "alcoholic drinks to go", an adaptive strategy first approved during the pandemic, is now lawful in Texas.

Professional & Financial Services

3Q21 3% | 4Q21 3%
1Q22 3% | 2Q22 3% | 3Q-4Q22 3%

Encompassing a wide array of services provided by professionals and other specially trained personnel across a variety of sectors, this business category proved relatively resilient throughout the pandemic. Quarter-over-quarter performance through 2022 is expected to continue to trend positive as public and private sector enterprises and individual consumers maintain spending on essential services even in the face of anticipated price increases.

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STATEWIDE SALES TAX TRENDS

TOTAL 3Q21 3.4% | 4Q21 2.8% | 1Q22 3.6% | 2Q-4Q22 2.6%

(Based on Sales Tax Allocation Month)

Utilities & Other Service Providers

3Q21 -6% | 4Q21 3%
1Q22 2% | 2Q22 3% | 3Q-4Q22 3%

With internet access fees no longer subject to state and local sales tax due to the Internet Tax Freedom Act (ITFA) effective with the September 2020 sales tax allocation, and nearly half of all business in this category involved in providing internet access in some form, this business category will continue to trend negative in the near-term through Q3 '21. Long-term trends will move into positive territory as demand proliferates in response to population growth, brisk residential construction, and hybrid work from anywhere business models.

Unclassified

3Q21 3% | 4Q21 3%
1Q22 3% | 2Q22 3% | 3Q-4Q22 3%

Businesses that appear in this category are for the most part businesses that report sales activity to the Texas Comptroller of Public Accounts using a NAICS code of "0". Between the release of quarterly forecast updates, HdL continues to make best efforts to review and re-classify businesses to other categories to reduce the significance of the category. A standard inflationary trend factor has been applied for forecast purposes.

NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

2020/21 | 2021/22

U.S. Real GDP Growth 6.8% | 6.2%

With many states doing away with the last vestiges of the pandemic lockdown, the U.S. economy is now near the top of the "V" shape recovery that we predicted last year. The transition from online back to the real world has led to pockets of supply and demand misalignment leading to shortages and sharp price increases in certain markets such as lumber and used auto sales. We expect these distortions to moderate in 2022 as the labor market recovers. Rebounding consumer spending and government stimulus measures will continue to filter through the economy powering a strong recovery, albeit with higher levels of inflation, through 2022.

U.S. Unemployment Rate 5.4% | 3.9%

Similar to the overall economy, segments of the labor market, particularly in the service sector, remain volatile as firms face difficulties to re-staff in order to meet pent up consumer demand this summer. We expect these market pressures will moderate as wage hikes induce more workers to return to full-time, part-time or side jobs in the post-pandemic world. This will help drive down the unemployment rate to 3.9%, a far lower mark than the years after the 2008 financial crisis. Last year's labor market devastation will be close to fully healed in 1H2021 as total employment returns to pre-pandemic levels.

TX Total Nonfarm Employment 12.2M (-4.2%) | 12.6M (3.4%)

Employment continues to surge as the state gets back to work after pandemic restrictions were lifted over the spring in Texas. This will help bring back into the labor force the roughly half-million (490,000) workers who left their jobs since the start of the pandemic. Our forecast predicts that total nonfarm employment will return to pre-pandemic levels by the 2021Q4. We expect employment will continue to rise in 2022 as the national and global economy surge driving further external demand for goods and services produced by firms in Texas.

TX Unemployment Rate 7.7% | 5.1%

At 6.5%, the State's unemployment is already half the pandemic peak which reached 12.9% in April of 2020. The massive rebound in demand has helped bring down the unemployment rate but further declines will be slowed by supply side issues. With labor markets as well as supply chains yet to completely digest the pandemic induced changes in the economy, we expect the unemployment rate to remain slightly elevated through 2022 at 5.1%. Recovery to pre-pandemic unemployment, which reached 3.5% in 2021Q1 still remains a few years away.

2020/21 | 2021/22

TX Median Home Price $257,216 | $286,086

Median prices continue to surge in Texas following a national housing frenzy that has only gained steam as summer approaches. The rise in building permits will offset some of this rapid increase but secular changes to the economy and changing consumer preferences mean that demand for Texas homes will continue to put upward pressure on prices. With that said, our most recent forecast (compared to our March forecast), actually predicts lower prices in both 2020 and 2021 under the expectation that prices will come under control through slightly higher interest rates in the coming years. While we think the price rises in Texas have been sustainable, nationally we remain concerned that the stratospheric rise could deflate as an increasingly hawkish U.S. Federal Reserve draws down monetary stimulus in late 2022 or early 2023.

TX Residential Building Permits 222,558 | 257,783

Developers in Texas will look to capitalize on the surge in housing prices over the next year. While rising interest rates may dampen the building frenzy beyond 2023, we expect permits will surge to upwards of 257,000 next year.

TX Consumer Price Index 1.0% | 3.4%

Recent inflation data has buttressed our case that inflation remains a threat to the U.S. economy in the coming years. With a rapid economic recovery in Texas well underway, we think that inflation is likely to be particularly elevated in the state in the coming years.

TX Gasoline Prices $1.82 | $2.31

With oil prices near pre-pandemic levels, we do not project any rapid surge in prices at the pump as supply ramps up to meet resurgent demand from U.S. commuters and travelers hitting the road this summer. While we think flexible working arrangements in the post-pandemic world will be a headwind for oil prices, other secular factors, such as record U.S. production capacity are more important in keeping a cap on prices from returning to pre-2015 levels.

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HdL provides relevant information and analyses on the economic forces to over 500 cities, counties and special districts across the nation. In addition, HdL's Revenue Enhancement and Economic Development Services help clients to maximize revenues. Visit hdlcompanies.com for more information.

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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.

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