

HdL[®] Companies

CALIFORNIA FORECAST

SALES TAX TRENDS

AND ECONOMIC DRIVERS

JUNE 2021



Santa Barbara 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.



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HDL CONSENSUS FORECAST - JUNE 2021

STATEWIDE SALES TAX TRENDS

2020/21 | 2021/22
 **TOTAL** 8.5% | 9.5%

Autos/Transportation 2020/21 | 2021/22 14.5% | 2.9%

This major industry group experienced a classical V-shaped recovery in the aftermath of the COVID-19 recession. New car sales dropped 68% or more at many dealers around the State in the initial weeks after the State's pandemic shutdown order in March 2020. Sales have since steadily rebounded and are now 13% higher than the same period in 2019, a year before the crisis began. Limited supply has been overwhelmed by strong demand. Consumers are treating themselves to more expensive models, with new cars reported to be 8% more costly this year. The California New Car Dealer's Association reports that Porsche, Mercedes and Tesla have been the most sought-after brands in 2021. S&P Global and other research firms are forecasting continued growth in the 15% range for the remainder of the year before sales begin to flatten out in 2022.

Building/Construction 2020/21 | 2021/22 10.4% | 5.4%

Home construction, while very robust in many parts of the state, severely lags demand; the combination of impatient buyers and low interest rates are sending new and existing property prices to indefensible levels. Savvy homeowners are refusing to cash out and then pay a premium to the seller of the next house. Instead, people are taking current equity and creating their dream home. This demand for improvements has contractors booking orders well into next year with smaller scale projects coming to an end this summer. Lumber and steel prices continue to rise even though mill output has expanded significantly. Several large mill operators are planning expansions that should further increase output next year. Common lumber prices are adding as much as \$50,000 to a new home cost. The run-up in material costs, expected to rise into late 2022 before stabilizing, has some commercial developers reworking plans to incorporate cheaper materials. Permit levels for all types of projects are at their second highest level in two years. Office activity, while less active right now, should see an uptick once the post-COVID workplace trends are determined.

Business/Industry 2020/21 | 2021/22 12.8% | 11.9%

Many of the business types captured in this segment are rallying including agriculture and farm equipment and energy/utilities. As the segment's largest business type, fulfillment center's taxes boomed from increased online sales. Additionally, a large taxpayer altered its business structure effective 1Q21, which resulted in a sizeable portion of revenues from the statewide pools shifting to agencies with fulfillment centers. Medical/Biotech also surged, with acquisition of medical equipment, pharmaceuticals and the return of elective and non-emergency medical procedures. Conversely, business closures plagued areas such as food service equipment, office supplies/furniture, business services, government/social organizations and entertainment. California industry lags compared to prior periods as it faces challenges such as raw materials and qualified worker shortages. Overall, this group should perform beyond pre-pandemic levels, however, given its unique mix, each jurisdiction's experience will differ according to the size and character of its specific business/industrial base.

Food/Drugs 2020/21 | 2021/22 5.1% | 1.7%

The first three months of 2021 captured mixed outcomes. While convenience stores and cannabis merchants reported considerable upturns, grocer's sales dipped. Drug store's declines pulled overall returns lower and included a reduction of outlets in some regions. However, offering vaccinations has improved foot traffic in recent months. Customers expectations for safer methods of shopping for groceries amid the pandemic prompted company modifications such as online ordering and in-store pickup. Delivery competitors have also chipped away at sales as their revenues are reflected in autos/transportation. Independent supermarket operators have consumed more market share over the past decade, a positive trend that puts pressure on large, national chains. Cannabis openings secured fiscal year 20/21 gains. Even with inflationary impacts baked in, modest increases in this category are expected next year.

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2020/21 | 2021/22



Fuel/Service Stations -7.5% | 18.7%

As the State begins to emerge past the negative impacts from COVID-19, all indicators are now pointing toward upward pressure on pricing in this classification. The average price of a gallon of gasoline in California is now higher than the pre-pandemic peak levels experienced in the fourth quarter of 2019 as demand for fuel is picking up significantly across Europe, the U.S. and California. Oil barrel prices are projected to rise to the mid-\$70 range in late summer 2021. Travel spending is up and the price of jet fuel is at the highest level since the end of January 2020. Given consumption improvement and price expectations, a significant recovery-based growth is expected starting in the second quarter and through the end of calendar year 2021.



General Consumer Goods 6.0% | 8.3%

Core retail sales in the first quarter of 2021 demonstrated California consumers are willing to spend. Tax receipts rebounded with more than a 10% increase from the same period in 2020 when COVID-19 tangibly impacted physical stores along with consumer's ability to purchase goods. For perspective, while the rebound exceeded expectations, revenues remained 2% below pre-pandemic levels (1Q19). The third round of fiscal stimulus lifted spending on taxable goods in the last month of the first quarter, but impacts are expected throughout 2021. A large concentration of spending remains at discount department stores and other well-known chains, but scars remain from the volume of struggling and closed small businesses which is still visible in many sectors and communities. Anchored to an 'open for business' economy, robust consumer spending along with recent fiscal stimulus drives our forecast for general consumer goods spending beyond pre-pandemic levels by fiscal year 2021/22. As the service sectors also rally, growth should stabilize as consumers shift spending back towards experiences after more than a year of above average durable goods consumption.

2020/21 | 2021/22



Restaurants/Hotels -12.1% | 26.1%

Regions of the State that saw the biggest declines are due to see the hospitality industry come roaring back as soon as operational restrictions are lifted. In some counties, restaurants are already back to pre-pandemic levels of sales activity. Hotel vacancy rates are nearing 2019 levels and domestic travel is the vacation of choice this summer. Pockets of recovery vary, especially for locals who heavily rely on international tourists. Rising menu prices are furthering the gains while the labor shortage is a looming concern. Entertainment venues are opening up with varying capacity limitations. In-person conferences are expected to return later in 2021. Still lagging behind the surge are business travelers, universities and office campuses which will likely have a new reality in the post-pandemic world.



State and County Pools 23.5% | 7.3%

Again, consumer behavior was anchored to online shopping as the preferred alternative to making multiple trips to various retail establishments. Since early 2020, companies accelerated efforts to make e-commerce shopping easier, especially as they offered flexible payment and delivery options. Recent studies show customers value convenience more now than prior to the pandemic. Many experts note e-commerce behaviors which accelerated over the past year are here to stay; thus, the forecast shows steady improvement through the next fiscal year. Projections are lessened to some extent as HdL monitored changes in a taxpayer's business structure that required portions of what were use tax pool revenues being remitted to local agencies with in-state fulfillment centers beginning in the first quarter of 2021. This change is reflected in the growth percentages noted herein.

Proposition 172 projections vary from statewide Bradley-Burns calculations due to the state's utilization of differing collection periods in its allocation to counties. HdL forecasts a statewide increase of 8.2% for Fiscal Year 20/21 and 10% for 2021/2022.



U.S. Real GDP Growth

2020/21 | 2021/22

12.9% | 6.0%

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. These distortions should 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

6.9% | 4.4%

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. These market pressures should 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 the first half of 2021 as total employment returns to pre-pandemic levels.



CA Total Nonfarm Employment Growth

-5.5% | 6.0%

California’s labor market continues to bounce back in 2021 as households unleash pent up savings from the pandemic. The state has added more than 100,000 jobs, but the return to pre-pandemic employment levels (roughly 17.5 million jobs) is still far off and will not likely be reached until the beginning of 2023.



CA Unemployment Rate

2020/21 | 2021/22

7.8% | 5.7%

California’s unemployment rate will remain higher than the national average even as the economy recovers rapidly next year. The good news is that the unemployment rate has already dropped precipitously from a pandemic peak of 16% to around 7.9%. This confirms Beacon’s view that the current labor market recovery will be far more rapid this time around compared to the years after the Great Recession. As in other states, a return to extremely low unemployment levels of the pre-pandemic era will extend into 2023.



CA Median Existing Home Price

\$591,026 | \$657,404

California is once again near the front of the pack of a nationwide housing boom. Home sales have surged as homeowners look to cash in on their new-found wealth. In some markets, such as Southern California, single family home prices have risen by 20% from April of last year. This trend should continue into next year but concerns remain over the sustainability of these stratospheric price rises especially as an increasingly hawkish U.S. Federal Reserve considers drawing down monetary stimulus in late 2022 or early 2023.



CA Residential Building Permits

119,036 | 123,546

The lack of housing supply remains one of the largest long-term factors that are increasing home prices across the state. While we expect more permits to be issued next year (123,546), the number of new housing units will fall short of meeting demand in the post-pandemic landscape. Public policy in Sacramento, Washington D.C. and local governments will be key in determining how many building permits are issued rather than the current high demand.

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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.



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