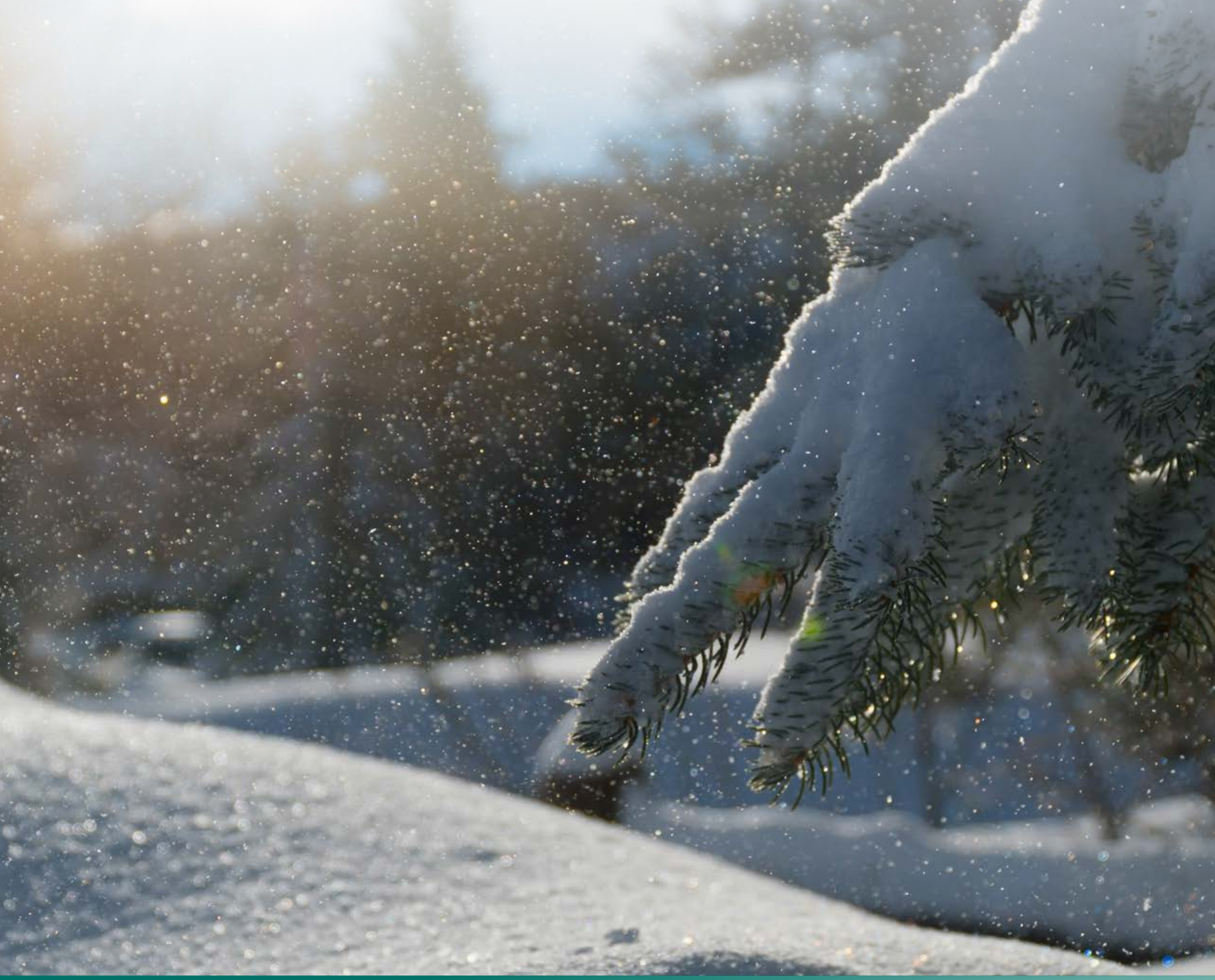
HdL Companies

CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

DECEMBER 2021



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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STATEWIDE SALES TAX TRENDS

HdL Companies

	2021/22 | 2022/23
TOTAL	10.8% | 3.5%

Overview: Common economic influences across the following tax generating groups include ongoing COVID pandemic impacts such as supply chain disruptions, manufacturing slowdowns and employment shortages. Further, our forecast incorporates higher labor and raw material costs along with inflationary pressures that drive taxable goods prices upward now and through the next fiscal year.

2021/22 | 2022/23

Autos/Transportation — 7.7% | 4.1%

A strong demand dynamic boosted the cost of new cars by 10% and used cars by 26%. Consumers with money traded up, buying more expensive luxury brands. The higher per vehicle amounts more than offset the reported 13% third quarter drop in U.S. manufacturer new vehicle volumes. It is quite a contrast to a 15.6% jump in overall taxable receipts. Available inventory, while still expected to be constrained through 2022, is loosening slightly. Tax revenue from this category should exceed its long-term trend rate of growth in the year ahead.

Building/Construction — 5.4% | 0.5%

Lumber prices slumped between late May and August but shot up again in September due to commodity availability issues. Retailers are trying to absorb these costs as contractors are already passing along these surges to project owners. Prices should remain high through mid-2022. Third quarter construction values reported a 14% drop. Fourth quarter permit activity shows office development is picking up while Bay Area construction starts are growing. Prior wildfire damage is being addressed by short-term repairs and recent heavy rains should intensify demand for needed materials. This forecast retains a 2022 flattening of tax generation followed by moderate growth thereafter.

Business/Industry — 10.9% | 3.5%

Fulfillment centers heavily influenced third quarter growth through online sales and the continued shift of taxes from countywide pools to agencies with these in-state facilities. Medical/biotech increased by purchases of medical equipment, pharmaceuticals and investment in research and development. Business-to-business witnessed big gains as companies adapted to new ways of doing work. The state still struggles with pandemic-related challenges such as raw material and qualified worker shortages, but new orders and increased production pushed industrial-related receipts higher by 12%. In totality, this group is hitting pre-pandemic tax levels.

Food/Drugs — 1.7% | 2.0%

Results from the third quarter noted a modest 1% improvement. Cannabis firms declined slightly. Consumers are increasingly savvier about how to shop for groceries and medicine as many turned to app-based solutions. This trend should continue for the foreseeable future. Investment in digitized solutions, low-cost delivery options and inventory optimization could help merchants try to hold the bottom line, offsetting price pressures brought about by greater employee compensation outlays and markedly greater cost of goods.

2021/22 | 2022/23

Fuel/Service Stations — 30.3% | 2.0%

Demand for all fuels is much higher than one year ago. The average price of a gallon of gas reached a record level of $4.75 per gallon as of November 2021. Diesel and jet fuel rates are reaching peak levels. More people are hitting the road to work, shop and take vacations. HdL is not anticipating a significant negative impact on the future consumption of fuel. As a result of these positive factors, strong, short-term gains are projected over the next three quarters, specifically, 50% in 4Q21, 20% in 1Q22, and 7% in 2Q22 followed by long-term annual escalations of 2%.

General Consumer Goods — 11.5% | 1.8%

Retailers throughout California are reporting strong sales figures into the second half of 2021. Concerns related to COVID case rates do not seem to be impacting consumer's ability and willingness to spend at retail establishments. Short-term expectations remain elevated, driven by higher customer charges and solid household fundamentals. The outlook for place-of-sale transactions should be subdued as behavior and technology shift more to e-commerce. Merchandise price points begin to affect demand in 2022. The cost of taxable goods is expected to rise faster than sales. Tax receipts could revert to the conventional growth rates of 1-2%.

Restaurants/Hotels — 32.9% | 5.2%

When measured against 2019's same period, 2021 third quarter overall collections rose 0.5%. Increased menu prices, the resumption of inbound international tourists and an uptick in business travel will keep the growth rate high for 2021/22. Recent results from hotels and entertainment venues demonstrate consumer desire to travel and spend more. Quick-service and casual dining establishments are the dominant tax-producing segments, and this won't change anytime soon. Looking ahead, rates of growth will likely vary significantly by region.

State and County Pools — 4.6% | 6.5%

2021 year-to-date collections reflected that 42% came from marketplace facilitators and general retailers, another third from business-industry companies and 11% from vehicle acquisitions (primarily private-party sales processed through the DMV). These ratios should not alter much going forward and are inclusive of taxes reallocated to fulfillment centers. Aligned with recent national trends, the rate of e-commerce growth has slowed. Sellers of all kinds have boosted prices to address economic challenges. Forecasts going forward will capture percentage gains that pattern historical trends.

Proposition 172 projections vary 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 12.3% for Fiscal Year 2021/22 and 3.1% for 2022/2023.

HdL Companies Consensus Forecast
December 2021

BEACON ECONOMICS

NATIONAL AND STATEWIDE ECONOMIC DRIVERS

2021/22 | 2022/23

U.S. Real GDP Growth — 3.0% | 2.0%

The real U.S. GDP growth rate in the 3rd quarter came in at 2.1% (seasonally adjusted annualized). In a normal year, this would be applauded as a solid growth trend. In the wake of the pandemic recession, these metrics have disappointed some economists and analysts – and set off calls to continue, or at least slow the reduction of, various Federal government stimulus programs. These reactions are based on a simplistic vision of what an economic "recovery" is. When considered more fully, it's clear that not only has the U.S. economy recovered from the effects of the pandemic but looks like it's becoming dangerously overheated. Beacon believes it is time to withdraw public stimulative efforts to prevent more harm than good to the next economic expansion. After the snap back from the depths of the recession, GDP growth will normalize over the next two years.

CA Residential Building Permits — 120,665 | 125,170

As of October 2021, there was 1.8 months' worth of housing inventory available on the market in California. Inventory refers to the number of months it would take for all the current homes for sale on the market to sell. A healthy housing market usually has approximately six months of inventory. In the year prior to the pandemic, there was more than 3.5 months of housing inventory in the state. The pandemic has exposed and accelerated pre-existing housing supply constraints which can only be solved by more supply or a weaker consumer.

CA Median Existing Home Price — $662,170 | $680,881

In the third quarter of 2021, the median home price in California was up 17% compared to one year earlier. With mortgage rates at historic lows, coupled with healthy consumers, limited housing inventories have led to a surge in prices. In the short-term, the only relief from higher home prices could come from higher interest rates. In the longer-term, more supply is the key to relieving upward pressure on prices in the state.

2021/22 | 2022/23

U.S. Unemployment Rate — 4.3% | 3.9%

The nation added 210,000 jobs in November as the unemployment rate fell to 4.2%. This figure is elevated compared to pre-pandemic levels but is low by historical standards. The real problem in today's labor market is the 3-million-person decrease in the U.S. labor force, which has occurred over the last eighteen months. While unemployment typically rises in a downturn, the labor force does not typically decline. The current contraction has been driven primarily by retiring baby boomers. Record job openings indicate that there are ample opportunities for workers, and that labor shortages are the fundamental constraint on employment expansion.

CA Unemployment Rate — 6.0% | 5.2%

The elevated unemployment rate is one of the most striking features of California's recovery. In October 2021, the state's unemployment rate stood at 7.3%, compared to 4.6% nationally. Prior to the pandemic, the state's unemployment rate was 4.1%. The difference between the state and the nation is chiefly due to the jobs recovery that has occurred since the depths of the pandemic fallout. Early in the pandemic, some speculated that California's safeguards against the pandemic, such as constraints on business activity, which were stricter than in other states, accounted for the state's relatively severe job losses. However, capacity limits and distancing requirements have been removed for months. Currently, labor supply issues are the biggest constraint on employment expansion.

CA Total Nonfarm Employment Growth — -2.1% | -0.5%

While California added jobs at a healthy rate in 2021, as of November 2021, there were 825,800 fewer people employed in the state than in pre-pandemic February 2020. Total nonfarm employment in California has contracted 4.7% since that time compared to a 2.6% drop nationally. The state's labor force, defined as the population of workers who hold a job plus those looking for work, is still 414,700 workers lower than the pre-pandemic peak. While rising wages should draw workers back into the labor force, challenges including slow housing supply growth and recent constraints on international migration, pose difficulties to labor force expansion in the state.

Scan to view the *HdL Consenus Forecast 3Q21* webinar recording.

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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.