

CALIFORNIA FORECAST SALES TAX TRENDS AND ECONOMIC DRIVERS

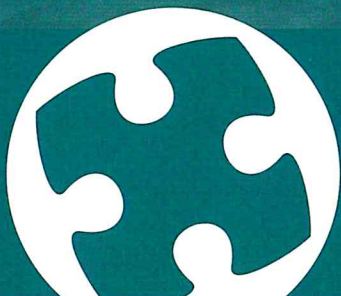
HdL[®] Companies

APRIL 2019

Lake Elsinore, CA

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.

HdL serves over 500 cities, counties and special districts in California and across the nation.



*Delivering Revenue, Insight and Efficiency
to Local Government Since 1983*

HDL CONSENSUS FORECAST – APRIL 2019

STATEWIDE SALES TAX TRENDS

 2018/19 | 2019/20
TOTAL 2.5% | 1.2%

 **Autos/Transportation** 2018/19 | 2019/20
1.9% | -0.6%

A slight dip in auto sales is expected as the lending environment transitions from easy credit to the highest vehicle loan rates in a decade. Despite the solid economy, signs of strain are building as recent data indicates record number of Americans are 90-days or more behind on their car loans. An additional threat is possible enactment of automotive import tariffs as political rhetoric and trade brinkmanship escalate internationally. While the purchase of more expensive, clean-fuel vehicles has boosted tax revenue in recent quarters, this recent trend is expected to temporarily wane and exacerbate the expected near-term slow down.

 **Building/Construction** 5.4% | 3.3%

This winter's heavy rains have not been a deterrent to ongoing construction. While delaying new projects' earthwork, most developments that had foundations in place before the rains came are experiencing few lost days of productivity. The current momentum from existing projects is expected to continue but concerns over stagnate home prices, rising interest rates and construction material prices are causing home builders to reconsider new starts. In fire and flood impacted areas, remediation work will keep contractors busy while home supply stores and rock aggregate sellers should also see brisk business.

 **Business/Industry** 2.3% | 1.9%

This sector as a whole appears to have settled in at a growth rate of roughly 2% per quarter. Investment in software, new technology, data storage, artificial intelligence and automation to offset the tightening labor market are primary drivers. Purchases of construction and transportation equipment remain strong. Surveys indicate optimism about general business conditions although the uncertainty of future tariffs and the potential impact of federal policy changes on California's economy remain a concern.

 **Food/Drugs** 2.5% | 2.5%

Tax receipts improvement during the final quarter of 2018 came from cannabis-related operations. Results declined from drug stores while grocery merchant's returns were flat. Automation and robotics are integral ingredients to holding down supermarket and drug store costs while enhancing customer alternatives including at-home delivery. Competition remains fierce between prepared meal providers, traditional stores and boutique alternative concepts. Cannabis businesses should contribute to the overall increases as more state and local agency permits are issued for growing, manufacturing and dispensary facilities.

 **Fuel/Service Stations** 2.8% | -2.2%

Extraction from the Permian Basin in West Texas now has the U.S. on track to become a net exporter of crude oil within the next few years. Reports are this production has a breakeven of about \$35-\$40 per barrel, ensuring future supply even if global prices decrease from the current market value. In California, spring is upon us and local gas prices are on the rise as the refineries switch over to the more expensive summer blend. Peak consumer prices should not exceed last year, so overall sales tax revenue will likely decrease as a result.

 **General Consumer Goods** 0.0% | 0.0%

Structural changes within the retail industry influenced by consumer preferences, younger shoppers and increased technology has led to a shift in retailer's growth strategies. Sprawling floor plans are being shifted to smaller store concepts with more personalized merchandise offerings. Diminishing the physical and digital divide is integral to the customer experience as a focus on promoting in-store pickups gains momentum. Struggles of ingrained brands continue to overshadow many success stories like the expansion of off-price shopping and beauty concepts. A tightening of the global economy and public perceptions could curtail discretionary spending.

 **Restaurants/Hotels** 2.1% | 2.0%

Forecasted trends decelerated for the fifth quarter in a row in the restaurant category. The number of newly opened restaurants outpaced population growth resulting in declines in same-store sales. Along with other continuing challenges, the staffing crisis in the industry is impacting ability to provide the highest level of service at a time when service is the key attribute of the restaurant/hotel experience. Revenue increases will moderate when compared to patterns of the past three years.

 **State and County Pools** 5.7% | 5.0%

CDTFA begins collecting taxes in April from specific out-of-state retailers who prior to the SCOTUS 'Wayfair' decision were not subject to collection. Payment is required from merchants that sell tangible goods for delivery into California through the internet, catalog, telephone or other means. The State Legislature seems poised to adopt AB 147 prior to this start date, providing clarifying laws including taxpayer exemption limits. E-commerce strategies such as chatbots, specialized brand creation, artificial intelligence (AI) and expanded marketplace offerings should contribute to future upticks in countywide pools revenues.

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 3.33% for Fiscal Year 2018/2019 and a gain of 0.87% in 2019/2020.

NATIONAL AND STATEWIDE ECONOMIC DRIVERS



U.S. Real GDP Growth

2018/19 | 2019/20
2.6% | 2.2%

From a technical or data standpoint not much has changed in Beacon Economics' forecast for the U.S. economy. The framing of the outlook is another story. While little has changed in the actual economy, much of the public discourse surrounding the economy has taken a sharp turn for the worse. This new wave of pessimism has likely been driven by the recent sell-off in the stock market, slowing home sales and rising interest rates. Yet, as we see it, these short run trends do not amount to anything that could truly threaten the current expansion. So, for now, Beacon Economics is forecasting the expansion to continue and, barring some unexpected external impact, does not anticipate any major change in economic growth leading up to the 2020 election.



U.S. Unemployment Rate 3.8% | 3.7%

Aside from the rapidly growing Federal budget deficit, the U.S. economy looks to be well-balanced in terms of the structure of growth and is exhibiting solid fundamentals including healthy private sector debt levels, adequate consumer savings rates, rising wages and an increased pace of homebuilding and business investment. Unemployment is also low, yet job growth remains steady. Economic expansions do not have life cycles. Rather they continue until there is a sustained negative shock to the system. Predicting a recession is a function of foreseeing that shock. At this point, there are some pressure points in the economy—but nothing in its current form could cause an economic downturn.



CA Total Nonfarm Employment Growth 1.8% | 1.6%

Looking ahead through 2019, the question is, where will growth occur in California? The answer depends on the type of growth. Over the past three years, half of the job gains among the state's industries have occurred in its population serving sectors. California can count on employment increases in its population serving industries to continue in the coming quarters, but if the state wants to increase the size of its economic pie, its external industries will need to fuel that growth. This is a key challenge for California's newly elected governor and the rest of the state.



CA Unemployment Rate 4.1% | 3.9%

California's unemployment rate inched up to 4.2% in December, a 0.1 percentage point increase over November. However, the driving force behind the increase was an uptick in the state's labor force, which grew by 75,800 during the month. While labor force growth was slow from a year-over-year perspective earlier in 2018, stronger growth over the past several months has helped push year-over-year gains to 1.1%. This bodes well for the year ahead as employers can count on workers to fill open positions.



CA Median Existing Home Price \$487,900 | \$507,500

Mortgage rates are now hovering just below 4.5%, up one percentage point from where they were a couple of years ago. But while this is a recent high, it is hardly a historic one. In fact, it is still lower than at any time between 1968 and 2008. Rates are higher but they certainly aren't high. The California housing market slowed last year as a result of the bump in mortgage rates. However, there is a big difference between a housing pause and a housing bust. That the market is responding to changes in interest rates is a good thing. Prices need to adjust to a higher carrying cost; once that happens, the market should get back on track. The slowing pace of sales is part of that process.



CA Residential Building Permits 122,500 | 132,700

California has consistently failed to build enough new housing to keep pace with population growth. CEQA, NIMBY-ism, local permit ordinances and fees plus Proposition 13 have all played a role in the under-supply of new housing units. Mitigating the unintended consequences of each of these should remain a policy objective for the state moving forward. Beacon's current forecast calls for residential permits to exceed 130,000 new units next fiscal year, and gradually increase thereafter. However, these new units are not expected to be enough to stem the tide of under-supply.

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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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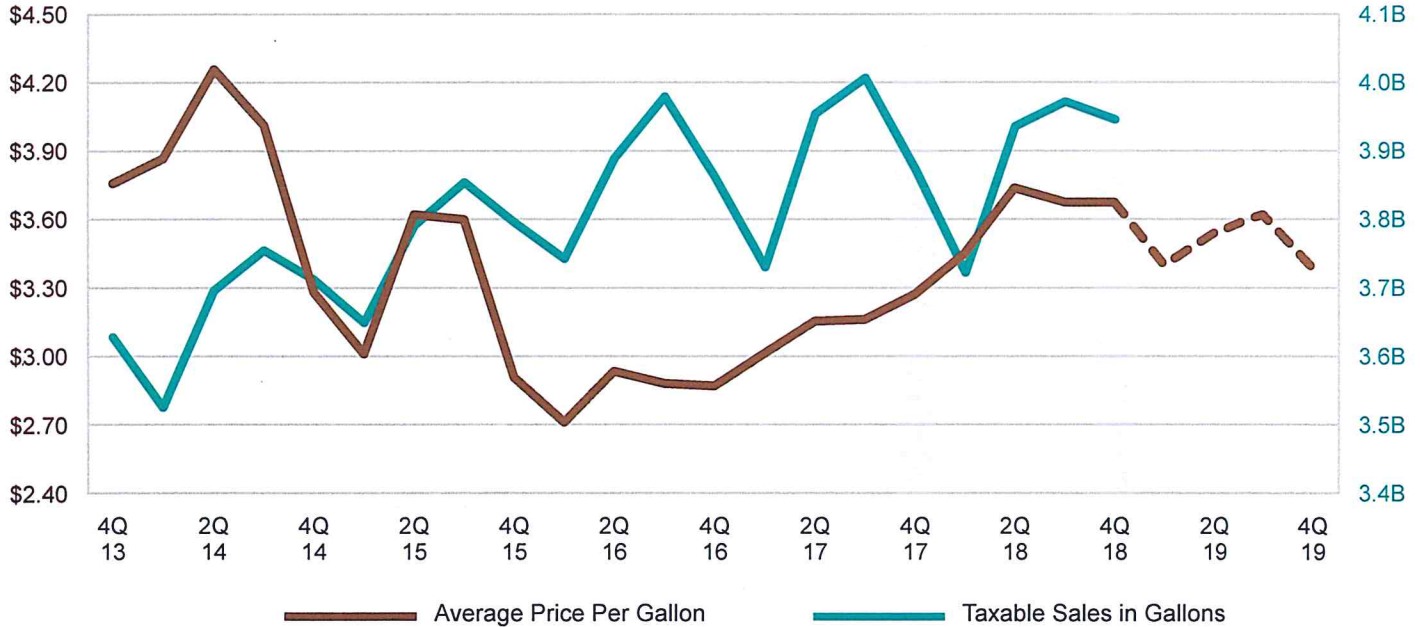
STATE OF CALIFORNIA

GASOLINE AND DIESEL TRENDS

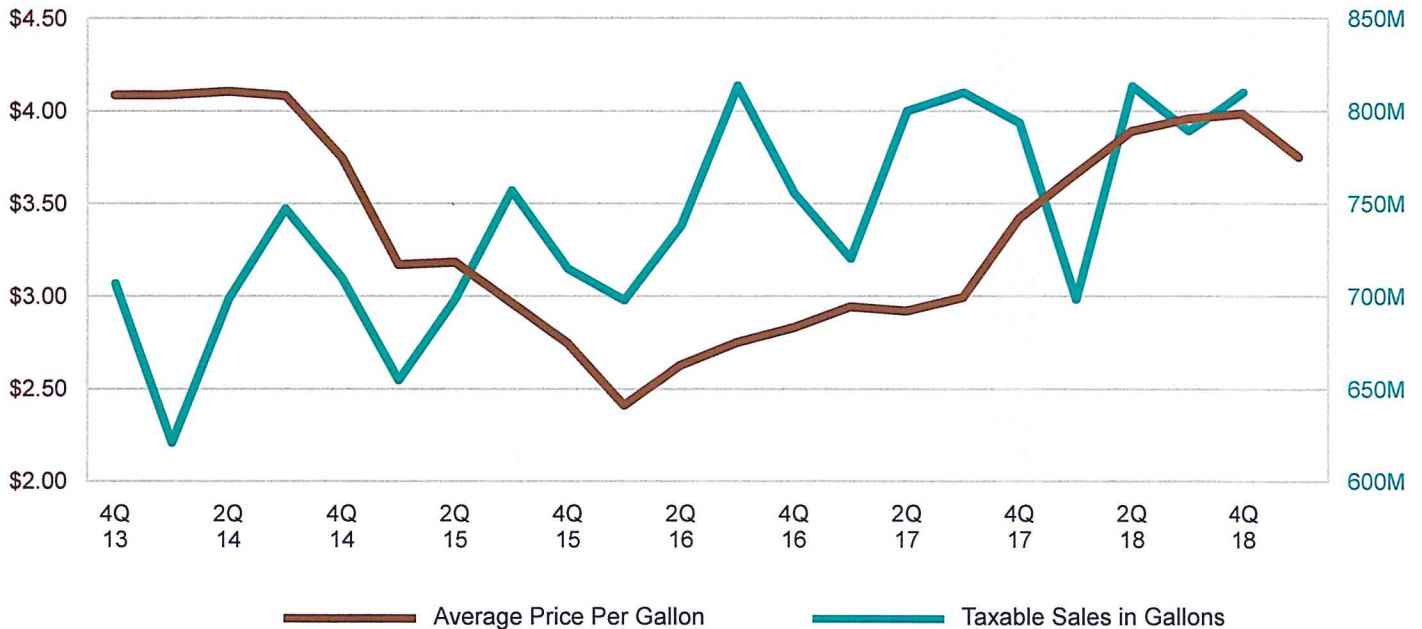
Gasoline Data	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19*	2Q19*	3Q19*	4Q19*
Average Price Per Gallon	\$3.27	\$3.45	\$3.74	\$3.68	\$3.67	\$3.40	\$3.54	\$3.62	\$3.39
% Change from Prior Quarter	3.50%	5.47%	8.27%	-1.65%	-0.05%	-7.47%	4.12%	2.26%	-6.35%
% Change from Same Qtr Prior Year	13.98%	14.50%	18.43%	16.24%	12.26%	-1.51%	-5.29%	-1.53%	-7.74%

* - Estimate

Gasoline Prices and Sales



Diesel Prices and Sales



Sources: Board of Equalization, California Department of Tax and Fee Administration, Energy Information Administration, The HdL Companies

