HdL Companies

CALIFORNIA FORECAST
SALES TAX TRENDS AND ECONOMIC DRIVERS
JUNE 2020

San Clemente, California

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 – JUNE 2020

STATEWIDE SALES TAX TRENDS

HdL Companies

2Q20 | 2020/21

TOTAL -27% | -1.1%

2Q20 | 2020/21

Autos/Transportation -35% | -7.4%

Industry forecasts have projected a wide range for new vehicle sales in 2020. Firms such as Moody's, JD Power, the California New Car Dealer's Association, and ALG made recent projections for a decline in the range of 15% to as much as 34%. Recent news reports were more positive; many dealers had strong sales in May on popular truck and SUV models as the economy reopens. Pricing concerns remain with the threat of possible bankruptcies by car rental firms triggering a glut of used cars on the market. Shortages of popular models could also be a problem later this year after recent factory closures. Job and income losses are expected to contribute to weakness in the next few quarters followed by a slow recovery. A 20% drop in overall sales is projected this calendar year.

Building/Construction -3% | 0.8%

The lifting of Bay Area restrictions on construction projects in May coupled with the fact that other counties' restrictions were much less severe than anticipated, relieved the downward pressure on construction spending. While there is still apprehension regarding the direction taken by developers as they consider whether commercial projects will pencil out in the end, the backlog of work created by the Bay Area shutdowns along with the persistent demand for new housing are expected to boost statewide spending for the next two quarters. Growth is expected to flatten during FY 2020-21 in response to so many consecutive quarters of lower permit issuance across the state. However, strong increases are expected in FY 2021-22 following a return to positive trends in the rest of the economy.

Business/Industry -27% | -3.8%

Private sector data suggests this group bottomed out in April 2020. However, supply chain disruptions along with COVID-19 social distancing and other protocols are reported to limit production capacity for many companies through fall. Firms supplying hospitals and ecommerce related storage, sales and delivery activities are anticipated to post gains. Tax from buses and public carriers funded by federal grant programs may produce one time revenues for some agencies. Most other segments are not expected to surpass 90% of previous levels until adequate virus testing and vaccines are available. Each jurisdiction's experience will differ due to the size and character of its business/industrial tax base.

2Q20 | 2020/21

Food/Drugs 5% | 2.5%

Cannabis, grocery and drug stores have remained operational during shelter in place mandates. As such, revenues improved during the first quarter of this year. Households which chose to avoid long lines and limit merchant location trips utilized online ordering capabilities in much greater numbers. To retain shoppers, vendors adapted quickly by further implementing BOPIS, mobile checkouts and other safe means of completing transactions. Retailers invested in employee and customer safety. Less frequent dining out causes greater sales of food and beverages. Cannabis dispensaries, manufacturers and growers provide additional taxes for this category.

Fuel/Service Stations -55% | -4.7%

As the shelter in place restrictions resulting from COVID-19 have slowly been lifted, there are now small signs of positive economic activity. While crude oil barrel prices plummeted last quarter due to reduced demand and oversupply, they have ratcheted back up. This is reflected in the average price of a gallon of gas in California inching positively toward $3 per gallon. Oil barrel prices are forecasted in the low $40 range by mid-summer, nevertheless, this does not translate into higher fuel and service station sales until demand picks up. Taxes will rise when consumer confidence and willingness to travel approach pre-COVID-19 levels. The short term outlooks is reduction in receipts through the end of 2020 with enhanced returns occurring during the first quarter of 2021.

General Consumer Goods -45% | 1.3%

As restrictions were implemented to combat the spread of COVID-19 in an effort to flatten the curve, brick and mortar retail was heavily impacted in the second quarter. In what is being dubbed by some as the Great Disruption, nonessential retail across most of the state came to a standstill. Job losses, stay-at-home orders and diminished wealth all substantially decreased consumers ability to spend even by those not facing income losses. As doors closed and immediate demand fell, many national retailers restructured; some permanently shuttered their footprint. Reopening in June drives a slight boost tied to pent-up demand before settling below pre-crisis levels for some time. While trends have been shifting for a while, the pandemic significantly sped up the timeline as customers were forced to explore shopping through different channels. Will these behaviors be long-lasting and how will stores adapt has yet to be seen.

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STATEWIDE SALES TAX TRENDS

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	2Q20	2020/21
TOTAL	-27%	-1.1%

Restaurants/Hotels

	2Q20	2020/21
Restaurants/Hotels	-50%	-11.7%

Quick service restaurants were the least affected by shelter in place, as drive thru's quickly adapted to social distancing; some chains even saw gains in the first quarter. Casual dining scrambled to establish to go/delivery options, but still most reported revenues down more than 50% through May. Most fine dining and leisure/entertainment temporarily closed while hotels recorded 85% vacancy rates. Reopening is at varying stages, with dining room capacity reduced to accommodate six feet of separation. Numerous agencies are allowing outdoor seating in parking lots and streets to help reach the needed seating capacity for restaurants to operate. People anxious to eat out provide a short term boost, but higher prices and reduced capacity result in a long recovery for this sector.

State and County Pools

	2Q20	2020/21
State and County Pools	20%	10.9%

The irony is not lost. While many categories have suffered from the worldwide virus outbreak, the 2018 SCOTUS Wayfair decision and subsequent implementation yielded double digit percentage growth each of the last four quarters. Annual pool revenues now exceed one billion dollars; the upward trend stays the course. Marketplace facilitator's compliance extends until third quarter 2020 which completes full implementation. For reasons stated throughout this forecast, online spending behavior has exploded as buyers seek deals and order needed products as people work differently from past norms. Non-store retail grabbed a larger share of the market sooner than expected; experts believe a portion of this behavioral shift is permanent which is reflected in the figures presented.

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 decrease of -6.3% for Fiscal Year 2019/2020 and -1.3% for 2020/2021.

NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

BEACON ECONOMICS

U.S. Real GDP Growth

2020/21 | 2021/22

-0.8% | 3.4%

With most of April's data in, the Federal Reserve Bank of Atlanta's GDPNow forecast for second quarter growth currently sits at a startling -51% annualized pace – five times worse than the worst quarter for growth ever recorded in the United States. The Congressional Budget Office (CBO) released a recent forecast that predicted U.S. economic output at the end of 2022 will be 5% smaller than if there had been no pandemic, and a full recovery could take a decade – very similar to what transpired after the Great Recession. The good news is that the second quarter, as bad as it's expected to be, will still be significantly better than this early GDPNow prediction. The -51% growth will only occur if May and June look like April. However, the pieces of data that have been coming in for May all suggest that the nation is already past the trough of economic activity and things are rebounding. Moreover, evidence continues to build that the third quarter will be even better. Despite continued dismal outlooks from a broad group of pundits, economists, and government officials, the "V" shaped recovery is already underway.

U.S. Unemployment Rate

8.1% | 4.5%

Two of the most important stimuli plans implemented to date include the Paycheck Protection Program, which gave forgivable loans to businesses, and expanded unemployment benefits, which increased the number of workers who could receive benefits as well as providing an additional $600 per week in payments. The data for May suggest that 22 million Americans are receiving unemployment benefits—functionally speaking, that is everyone who is unemployed. And with the supplemental payment, anyone who was earning less than $42,000 per year is actually making more money being unemployed. Beacon Economics continues to forecast a strong, rapid economic recovery. We expect the economy to reach close to pre-virus levels of production by the end of the year and unemployment to decline to the 5% range. The 2020 coronavirus recession will be one of the sharpest and shortest on record.

CA Total Nonfarm Employment Growth

1.5% | 1.3%

In April 2020, total nonfarm employment in California fell by 2.3 million positions compared to the month earlier. This represents a 13.5% drop in the number of nonfarm jobs in the state over the course of just one month. The number of jobs in California has not been this low since March 2013 – seven years of job gains lost in the blink of an eye. California's Leisure and Hospitality sector led job declines in April, shedding 866,200 positions. This translates into an extraordinary 44% drop in one month for the sector. The state's highest paying sectors have not been immune to lay-offs. In the Professional and Business Services sector, 242,800 (-9%) jobs were shed during the month, and in the Information sector, the number of jobs fell by 40,500 (-7%). The release of national data on June 5, revealed that the national economy added jobs in May, returning a relatively small, but not insignificant, number of employees to work. The expectation is that these national gains will filter through to California, and that employment growth will have also returned to the state in May following April's losses.

CA Unemployment Rate

2020/21 | 2021/22

4.0% | 4.0%

From March to April, 1.8 million workers were added to the state's unemployment ranks. The number of unemployed workers, at just shy of 3 million, is now the highest on record. At 3.7%, December 2019 marked the best unemployment rate in California history. Four months later, at 15.5%, April 2020 marked the state's worst unemployment rate in more than 80 years. Today, now that stay-at-home health mandates have eased, California's employment picture is brighter than it was in April. We can take comfort in the fact that 75% of the state's unemployed workers report their layoffs as being temporary, and that employment growth returned to the national economy in May.

CA Median Existing Home Price

$532,216 | $564,823

The state's Median Existing Home Price increased 1.5% between the fourth quarter of 2019 and the first quarter of 2020. This represents a year-over-year increase of 6.4%, reaching $513,250. Current home prices show no effects from the pandemic, especially as national shelter inflation remains elevated – having swiftly recovered in May after a brief dip in April. Home sales, generally a leading indicator of prices, fell by 3,160 in the first quarter, ending the year-long recovery from the mortgage rate spike that occurred in the Fall of 2018. The decline in sales is assuredly due to stay-at-home mandates, but whether its strong enough to move the needle remains to be seen. Beacon Economics will continue to monitor the situation and adjust its forecast accordingly.

CA Residential Building Permits

126,449 | 131,572

Residential permits in California dipped slightly in the first quarter of 2020. Beyond typical seasonal influences, it appears that the COVID-19 pandemic and related closures have had a small impact, although Beacon Economics does not foresee any drastic shifts on the horizon. Still, the state is in the midst of a housing shortage and this ultimately puts pressure on housing prices and threatens California's labor force.

HdL Companies

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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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