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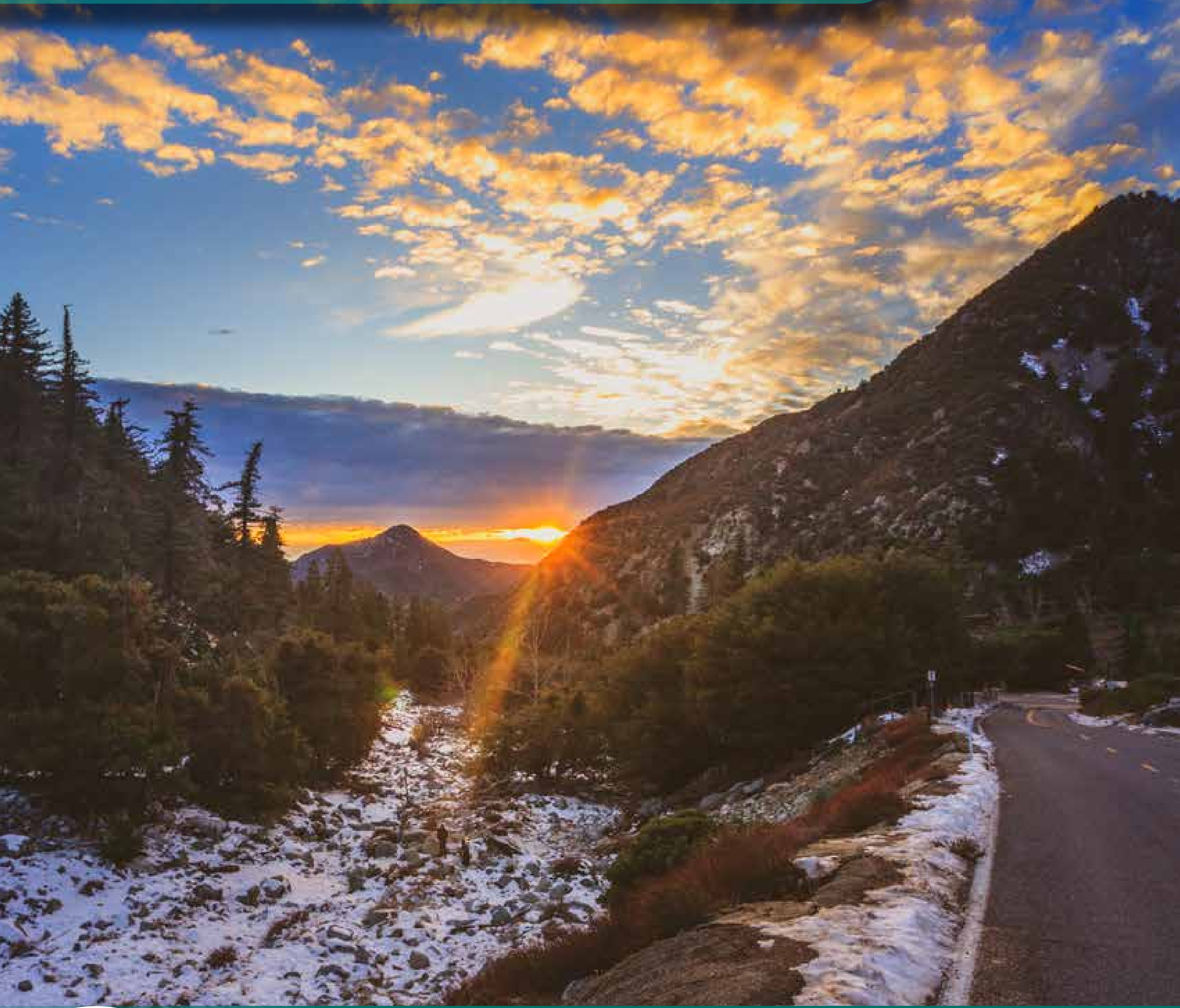
CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

DECEMBER 2024



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HdL Companies

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STATEWIDE SALES TAX TRENDS

2024/25 | 2025/26

TOTAL -0.8% | 2.6%

Overview: Sluggish third quarter 2024 tax filings and mixed short-term performance coming from the eight groups noted below combine to reduce sales taxes expectations for fiscal year 2024-25. This negative outlook reflects a second year of statewide revenue declines. Contributing factors in this uncertain economy include higher business operating costs and to what extent Federal Funds interest rates may decline further into 2025. Looking ahead, election results have introduced additional economic uncertainty. Nationally, consumer confidence and sentiment recently soared but future policy decisions could exert upward pressure on prices, resulting in fewer sales transactions.

2024/25 | 2025/26

Autos/Transportation -0.9% | 3.5%

Affordability concerns have weighed on car sales, but a gradual easing of new vehicle prices, declining interest rates, and a strong labor market are expected to support demand over time. With the average age of vehicles on the road now at a record 12.6 years, significant pent-up demand has positioned the market for recovery. Short-term factors, such as the threat of potential tariffs and year-end incentives to clear excess inventory, could provide a temporary boost. The recovery is likely to be gradual, however, as structural challenges including high insurance costs, limited affordable models, and added complexity posed by the transition to electrification will continue to act as headwinds to the market.

Building/Construction -1.8% | 2.6%

This quarter's results repeated much of what happened last quarter. Sales at big box home improvement centers extended their slide while lumber and roofing supply sales held steady in the northern and southern ends of the state. Retailers providing rooftop solar materials and installation have yet to find the bottom of that market as sales receded yet again. Asphalt and cement batch plants reported a stable sales volume overall, but any progress came from outside the Central Valley. Optimism for future construction-related gains has been dampened by the Fed's cautious and minimal adjustments to interest rates so far, while the specter of higher tariffs and uncertainty over the future of the home loan industry leave many unanswered questions.

Business/Industry 0.0% | 1.8%

Ecommerce continues to rule as consumers embrace the convenience of shopping online. Related sales jumped and CA-based fulfillment centers filled more "local" orders, contributing 27% of all B&I revenues. While business-to-business edged a little higher, most other categories remained relatively flat or declined as economic variables such as high interest rates stunted growth. The industrial and information technology sectors broke even compared to last year. Medical/-biotech, office supplies/furniture, and garden/agricultural supplies all declined. Solar/energy projects across the State slowed as well. Given the diversity of this group, the outlook is modest. With twenty-one unique tax segments, predictions vary widely based on the size and character of local businesses.

Food/Drugs -1.8% | 0.4%

Grocery stores' profits grew 1.4% as more customers ate at home because of elevated restaurant menu prices, especially for lower-income patrons. Convenience/liquor markets see shrinkages as consumers pivot and buy more snack foods and alcohol at big box merchants. Cannabis retailers' gross receipts tumbled for the fourth consecutive quarter; yielding an (-11.6%) return over this period. Additionally, national brands' recent announcements accelerating outlet closures could provoke drugstore graveyards while product inventory is scarce in some local communities. As such, until the drugstore category is transformed, anticipate this group to finish lower at the end of June and fiscal year 2025-26 to stay relatively flat.

2024/25 | 2025/26

Fuel/Service Stations -8.3% | 3.7%

The 13% decline in July to September payments revealed a drop in consumption, down 10% over the year ago quarter, as well as reductions in per gallon fuel rates paid by buyers. This sector again is expected to endure significant downward pressure on regular, diesel, and oil barrel prices compared to a year ago. As a result, the overall forecast in fiscal year 2024-25 is lower. Recent legislation and regulations imposed on suppliers of fuel in California are likely to have an upward pressure on fuel prices, which will offset the overall reduction in sales tax toward the second half of 2025. As a result, anticipate a slow recovery beginning in fiscal year 2025-26.

General Consumer Goods -1.9% | 1.4%

Numerous classifications remained depressed throughout the third quarter, contracting more than anticipated as the group absorbed some of the impact caused by lower gas prices. Despite cost reductions of some core goods, consumers battled stubborn inflation in non-taxable areas, forcing more attention on balancing needs versus wants. Brick-and-mortar storefronts remain in competition with the convenience of and investment in online shopping which has added negative headwinds for overall direct tax allocations across this segment. The outlook is cloudy with expectations for lower receipts throughout fiscal year 2024-25 and a return to mild growth in the following year driven by a bump in the overall costs of goods.

Restaurants/Hotels 1.2% | 3.7%

The restaurant industry is experiencing moderate growth, substantiated by a 1% increase in the recent quarter. However, higher labor and food costs persist as significant challenges, leading to menu prices increasing about 7% on average over the last year. This trend is causing budget-conscious diners to reduce their restaurant visits. Both fine dining and leisure-entertainment categories saw declines in 3rd quarter returns with price sensitivity remaining a big factor. While recent hotel stays have slowed, the outlook for room rates and occupancy in the coming year is positive.

State and County Pools 3.0% | 3.5%

Large audit corrections tied to county pools over allocations in prior years hurt cash payments in the third quarter of 2024, while economic basis gains of 3% were right in line with estimates for this period. Retail ecommerce holiday season sales growth rose once again, doubling the increase seen at physical retail locations. Perceptive companies looking to enhance sales are making future investments in warehouse automation, artificial intelligence tools, and augmented reality; all with an eye toward directing shoppers to spend more purchasing time on devices to satisfy spending needs. The forecast captures steady year over year improvement, overcoming the (-0.5%) decline that occurred fiscal year 2023-24.

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NATIONAL AND STATEWIDE
ECONOMIC DRIVERS

2024/25 | 2025/26

U.S. Real GDP Growth — 2.6% | 2.5%

As 2024 comes to an end, the U.S. economy continues to exceed expectations. Real GDP growth has averaged 3% over the past nine quarters, and preliminary data for the final quarter of 2024 suggests this momentum remains intact. Beacon Economics expects real GDP growth to continue, driven by the strength of U.S. household finances, which in turn is characterized by falling debt-to-income ratios, a decent savings rate, record high net worth, and rising real incomes. Consumer spending accounts for nearly 70% of U.S. economic output, meaning when consumers are doing well, the broader economy tends to follow suit.

CA Unemployment Rate — 5.3% | 5.1%

While the U.S. unemployment rate held steady at 4.1% in October, California's labor market is showing clear signs of strain. The state's unemployment rate ticked up from 5.3% in September to 5.4% in October 2024—0.3 percentage points higher than October 2023 and a full percentage point above pre-pandemic levels. In contrast, the national unemployment rate is just 0.5 percentage points above pre-pandemic levels, and without California, the national unemployment rate drops to 3.98%. California's increased unemployment rate is not driven by more people entering the labor force, as the state's labor force participation rate has shrunk by nearly one percentage point since February 2020. In September, California had nearly two unemployed individuals for every job opening; a ratio of 1.9. The U.S. ratio remains significantly lower at 0.9, indicating that California's challenges may stem as much from a shortage of job openings as from a constrained labor force.

CA Total Nonfarm Employment Growth — 1.2% | 1.0%

Total nonfarm employment in California fell to approximately 18.1 million on a seasonally adjusted basis in October, a decline of 5,500 positions. These losses were largely concentrated in the public sector, while the private sector added 2,000 jobs. The state has faced three months of job declines this year, with the first drop in service-sector employment occurring last month. Meanwhile, California's household and payroll surveys continue to diverge: Payroll employment has risen 1.8% over the past two years, while household employment has remained nearly flat. A downward correction in payroll numbers may be on the horizon in March, when the annual revision takes place.

2024/25 | 2025/26

U.S. Unemployment Rate — 4.3% | 4.1%

The nation's unemployment rate continues to hover around historically low levels, despite rising slightly to 4.2% in November 2024. This rate represents an improvement over July 2024 and solid wage growth continues to underscore the U.S. economy's strong performance. In October 2024, there were approximately 1.1 job openings for every unemployed person in the nation, indicating a tight labor market despite a decline from 1.44 job openings per person a year earlier. The U.S. job openings rate was 4.6% in October 2024, down from its peak in March 2022, but still at a historically elevated level, a sign of a persistently tight labor market.

CA Residential Building Permits — 98,521 | 102,959

Residential permits in California have declined in eight of the last twelve quarters YoY, including a nearly 13% drop in Q3 2024. High interest rates and borrowing costs, which have strained the housing market for two years, continue to hinder progress. The current pace of permitting remains far below what is needed to close the state's substantial housing supply gap. Although recent Federal Reserve rate cuts have lowered short-term borrowing costs and offered relief to developers, the number of permits being issued remains far lower than demand. With further rate cuts expected, modest growth in permits is likely, but without accelerated issuance and more aggressive efforts to increase supply, California's housing shortfall will persist, leaving homeownership out of reach for many residents.

CA Median Existing Home Price — $719,877 | $728,425

After several quarters of sluggish activity, California's housing market is beginning to show signs of recovery despite ongoing affordability challenges. Single-family home sales rose nearly 11% year-over-year in November 2024, with the median price up nearly 6%. A drop in mortgage rates to 6.43% has encouraged hesitant sellers to return to the market, but high prices and limited supply keep affordability out of reach for many. Flattening mortgage rates are anticipated in 2025, which will likely spur additional demand and provide stability in the market. With the combined effects of stable mortgage rates and increased market activity, home prices are expected to continue rising, particularly in the latter half of the year, as demand intensifies, and inventory remains tight.

Proposition 172

Total fiscal year 2023-24 Proposition 172 (P-172) statewide revenues ended about 1% lower than the prior year. The December projection anticipates a similar result for the 2024-25 fiscal period with a projected 1.1% decrease. Fiscal year 2025-26 reflects anticipated growth of 2.7%. Current county projections include updated pro-rata factors published by the SCO in September 2024. As the calendar year Bradley-Burns results fluctuate due to taxpayer modifications, statewide audits, economic impacts, etc. – Proposition 172 pro-rata factors and resultant P-172 revenues will vary for many counties.

Watch our webinar for more info!

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Delivering Insight, Revenue, and Efficiency to Local Government

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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.