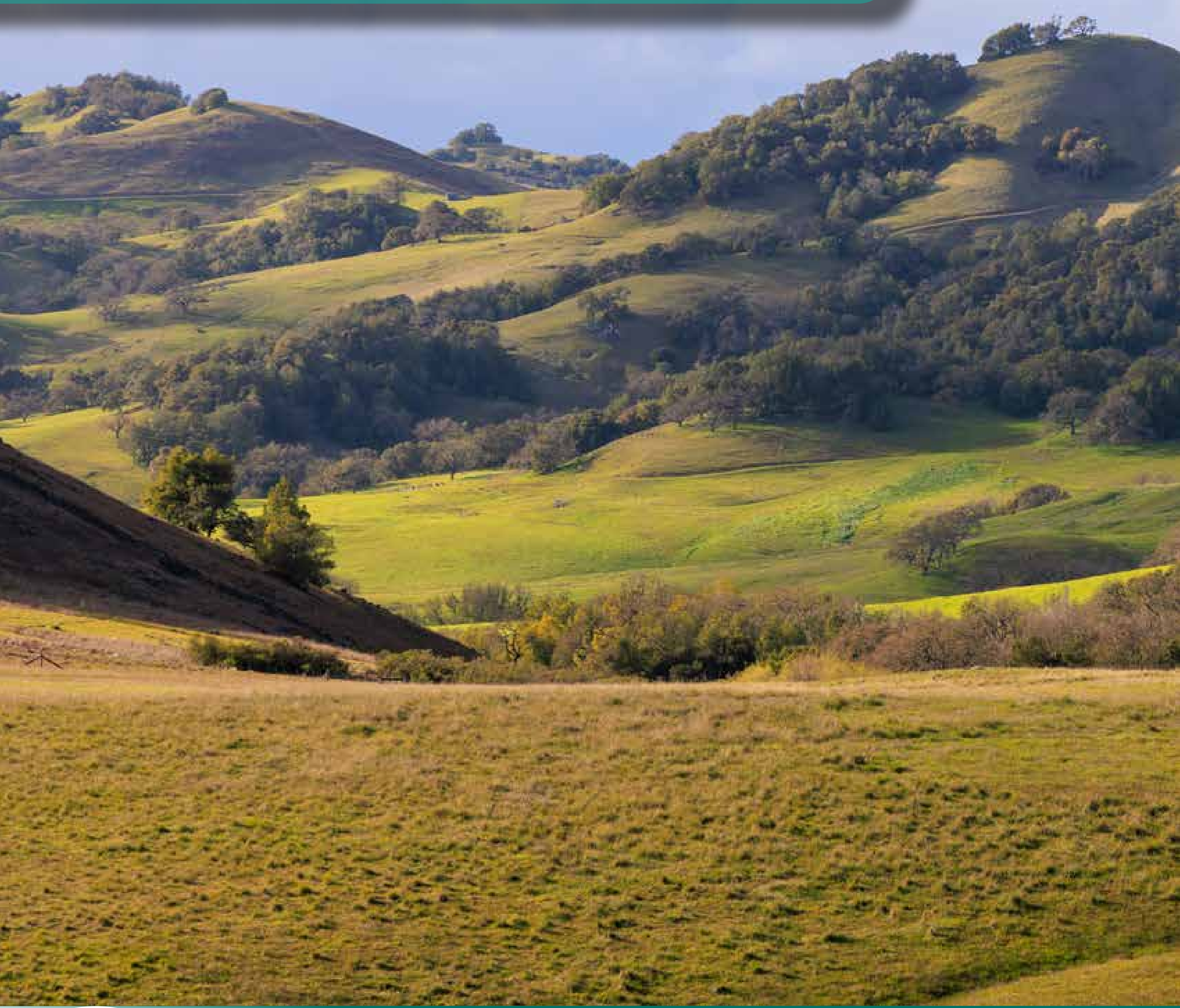
CALIFORNIA FORECAST

SALES TAX TRENDS & ECONOMIC DRIVERS

MARCH 2025



Mt. Burdell, Marin County

HdL Companies

888.861.0220 | solutions@hdlcompanies.com | hdlcompanies.com

STATEWIDE SALES TAX TRENDS

HdL Companies

TOTAL 2024/25 | 2025/26: -1.0% | 1.6%

Overview: The economic outlook is characterized by uncertainty. Ambiguity in national public policy leads to delays and curtailment in capital investment. Tariff impositions fluctuate daily, often lacking specificity, with changing start dates and unclear product details. Other sources of volatility include global events, inflation concerns, and potential reductions in the Fed Funds rate. Prioritized day-to-day expenditures erode discretionary spending due to weakened consumer confidence. Retailers acknowledge that shoppers are experiencing price fatigue. While people continue to spend, tax allocations are continually shifting. Our statewide forecast has weakened in the short term, with limited growth expected in FY 2025-26.

2024/25 | 2025/26

Autos/Transportation -0.6% | 1.4%

Uncertainty looms over the auto industry as tariff proposals and trade conflicts threaten supply chains, potentially pushing historically high vehicle prices even higher. Weakening consumer sentiment may reduce willingness to make big-ticket purchases. Persistently high interest rates have further strained affordability and contributed to a two-year decline in tax receipts. Given these factors, the forecast is cautious. Expect a temporary revenue boost over the next two quarters as buyers rush to make purchases ahead of potential tariff increases, pulling future demand forward. In the remainder of the year, consumers may adopt a more guarded stance, awaiting clarity on the economy and tariff policy, resulting in slower vehicle sales growth.

Building/Construction -2.9% | -1.0%

The prior forecast anticipated improving interest rates and lower commodity prices to gradually boost new construction by the start of FY 2025-26. However, vacillating tariff policies, potential migrant deportations, the Federal Reserve's decision to forgo future interest rate adjustments and uncertainty around federal funding for infrastructure and affordable housing projects have placed the construction industry on hold. Despite mortgage interest rates dropping below 7%, home prices remain too high. Construction loan interest rates and unpredictable materials costs prevent new project starts. Contractors stockpiling material ahead of planned tariffs may see short-term benefits. In wildfire areas, expect 18-month delays for the start of home replacement construction.

Business/Industry 0.1% | 1.6%

During the busy shopping season, Californians relied heavily on ecommerce, with local orders from CA-based fulfillment centers surging to a surprising 32% of all B&I revenues. Technology-related purchases boosted business-to-business sales, while energy demand contributed to electrical equipment sales. However, many categories remained relatively flat or declined as economic variables stunted progress. Sales of warehouse, farm, construction equipment, trailers, and auto parts dropped, partly due to one-time revenues from the previous year. The conclusion of many large solar/energy projects in the State caused related payments to plummet. The statewide outlook anticipates a dip in the current fiscal year and modest growth thereafter.

Food/Drugs -3.6% | -0.5%

Grocery stores contracted by 1% in 4Q24 as food commodities began to climb once again. Convenience/liquor markets experienced declining traffic, inflationary pressures, and competition from online and value stores. Cannabis retailers shrank for the fifth consecutive quarter, down 11% as they faced competition from CBD products on the open market which do not need a regulatory license. Additionally, the closure of a national brand's outlets required consumers to pivot to other merchants for products once sold in this group. While private equity investments are anticipated, expect a decrease through the end of June, with FY 2025-26 remaining relatively flat.

2024/25 | 2025/26

Fuel/Service Stations -9.1% | 3.0%

Over the past ten years, statewide motor vehicle fuel consumption declined 10% while overall sales taxes rose 6.5%. This pattern of growth is closely linked to a 67% surge in gas prices over the same period. In 4Q24, oil barrel and pump prices were down significantly, netting 14% lower revenues. Factors contributing to this downward pressure include slowing consumption and falling pump and oil barrel prices. Conversely, California's legislation and stringent environmental regulations have provided upward offsets, potentially pushing local refineries out of state. Expect a down year now, followed by gradual recovery in FY 2025-26.

General Consumer Goods -2.2% | 1.1%

The 2024 holiday quarter showed resilience from shoppers, with overall consumer goods spending increasing by 1%. Direct allocations associated with retail storefronts contracted 2% while overall gains were supported by online retail activity. A fractional decline can be attributed to some absorption of lower gas prices, but most business types reported lower taxable sales. The outlook remains cloudy, with consumer sentiment falling for three consecutive months and reaching a low March reading seen only a handful of times in the past 40 years. Consumers expect current policy decisions to spur inflation, posing a headwind for households and retailers alike. Expect growth to be mild in FY 2025-26 driven by higher costs of goods relative to consumption.

Restaurants/Hotels 1.3% | 2.8%

Despite a softer statewide sales tax generation outlook, there is a bright spot: consumers are spending more on dining out than on food at home. Aggressive menu price increases to offset higher operating costs have moderated restaurant traffic. Customers continue to seek experiences and value. Hotels have plateaued, with budget-conscious travelers deterred by room rates, but a slow and steady return of international travelers exerting a positive impact on the industry. Restaurant closures and limited expansions/openings remain an ongoing concern as these enterprises struggle to stay profitable over the next two years.

State and County Pools 3.0% | 3.0%

Pools posted a solid 4% improvement in 4Q24 compared to the year ago quarter. Analysis showed that business-related out-of-state orders performed better than online merchants who sold general retail goods. This latter segment follows the business-industry group trend, with more in-state fulfillment centers diverting some taxpayer's dollars away from the pools. Even with prevalent uncertainty in shopper's minds, expert research indicates an ever-expanding share of overall retail sales coming from ecommerce transactions. Projections reflect U.S. retail marketplace sales expanding once again in 2025 driven by a combination of existing players doing well and upstarts capturing market share, particularly among the younger demographics focused on affordable products.

NATIONAL AND STATEWIDE ECONOMIC DRIVERS

2024/25 | 2025/26

U.S. Real GDP Growth — 2.4% | 2.0%

Real GDP expanded at an annual rate of 2.5% in the fourth quarter of 2024, driven by gains in consumer and government spending, but partially offset by a decline in investment. Given the central role consumers play in the U.S. economy, concern over weakening consumer confidence amid ongoing Federal policy uncertainty is warranted. Although consumer confidence has declined in 2025, inflation-adjusted consumer spending grew by a solid 2.8% over the past year. While the United States is still on track for a reasonable pace of GDP growth in 2025, sustained momentum will depend on whether consumers remain confident.

CA Unemployment Rate — 5.1% | 5.2%

California's unemployment rate has climbed to 5.4% as of January 2025, up from 5.1% in December 2023, which is a full 1.4 percentage points above the national average. Despite this increase, the labor force has expanded by over 136,000 people over the same period. The 2024 annual benchmark revision by the California EDD revised labor force estimates up by 300,000. However, labor force participation remained unchanged at 62.1%, suggesting the increase was driven more by population growth than higher workforce engagement. This is reinforced by California's gain of 233,000 residents from 2023 to 2024 following years of decline and stagnation.

CA Total Nonfarm Employment Growth — 1.2% | 1.0%

California's job market has hit a standstill, with total nonfarm employment increasing by just 22,000 year-over-year in January 2025, a modest 0.1% rate of growth. Recent revisions showed the state added fewer jobs than originally estimated, with the tech sector standing out in the downward adjustment. Stagnant workforce participation continues to be a key challenge hindering employment growth. The state's unemployment rate has been gradually rising, adding complexity to the labor market's outlook. While California's economic fundamentals remain strong, uncertainty around monetary, fiscal, and trade policy is likely to limit the potential for more robust employment growth this year.

2024/25 | 2025/26

U.S. Unemployment Rate — 4.2% | 4.3%

Despite rising 0.6 percentage points YoY to 4.1% in February 2025, U.S. unemployment remains low by historical standards. Job openings have not seen year-over-year growth since July 2022, and in January 2025, there were 1.13 nonfarm job openings per unemployed person, marking a return to pre-pandemic levels. January's nonfarm job openings rate stood at 4.7%, which is consistent with long-term trends. After some gains in 2023, U.S. labor force participation has stabilized between 62.4% and 62.7%, still below the pre-pandemic rate of 63.3%. While the nation's labor market remains resilient, slowing job growth and stagnant participation rates point to a more uncertain outlook in the months ahead.

CA Residential Building Permits — 97,713 | 102,581

Residential permitting in California remains stagnant, preventing any meaningful progress in addressing the housing crisis. Permits in 2024 remained below levels seen in 2021 and 2022, with each quarter showing a year-over-year decline. In the fourth quarter, permits fell by 7%, underscoring the ongoing slowdown in construction activity. Despite growing demand for housing, strict zoning laws, regulatory barriers, and high construction costs are limiting new residential projects. While recent cuts in interest rates and a series of housing bills stemming from the Assembly Permitting Reform Committee may encourage some new development, the limited increase in permits is unlikely to ease upward pressure on home prices in the short term.

CA Median Existing Home Price — $733,389 | $744,794

Housing affordability remains a challenge for California residents. Single-family home sales rose 0.05% year-over-year in February 2025, while the median price climbed by 6%. However, there is room for optimism. The average mortgage rate has dropped nearly 1 percentage point from its peak of 7.62% in October 2023. Inventories have also been growing as sellers adjust to higher mortgage rates, with year-over-year inventory growth exceeding 20% every month since May 2024. This trend is expected to continue as policy uncertainty drives investors toward safer assets, leading to an increase in demand for longer-term bonds and a decline in interest rates. Despite this, the fundamental issue in California's housing market remains a lack of supply, limiting price declines.

Proposition 172

Following a 1% decrease in FY 2023-24 statewide Proposition 172 (P-172) revenues, the updated forecast anticipates a 1.6% decline for the 2024-25 fiscal period; modest growth for FY 2025-2026. Current county projections include updated pro-rata factors published by the State Controller's Office (SCO) in September 2024 (based on calendar year 2023 actuals). Expectations are new factors come in April 2025 (based on calendar year 2024 actuals). As the calendar year Bradley-Burns results fluctuate due to taxpayer modifications, audits, economic impacts, etc. – Proposition 172 pro-rata factors and resultant P-172 revenues will vary for many counties.

Watch our webinar for more details!

HdL Companies

Delivering Insight, Revenue, and Efficiency to Local Government

HdL Companies

888.861.0220 | solutions@hdlcompanies.com | hdlcompanies.com

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.

Beacon Economics LLC

310.571.3399 | BeaconEcon.com

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.