



## CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

March 9, 2015

The Honorable City Council  
Palo Alto, California

### **City of Palo Alto Sales Tax Digest Summary - Third Quarter Sales (July - September 2014)**

The following files are attached for this informational report for which no action is required.

#### **ATTACHMENTS:**

- Attachment A: Sales Tax Digest Summary - Background and Discussion(PDF)
- Attachment B: MuniServices Sales Tax Digest Summary (PDF)
- Attachment C: Economic Categories and Segments (PDF)
- Attachment D: MuniServices Economic Overview (PDF)

Department Head: Harriet Richardson, City Auditor





CITY OF  
**PALO  
ALTO**

# Office of the City Auditor

Sales Tax Digest Summary – Third Quarter Sales (July – September 2014)

## Informational Report to the City Council

### BACKGROUND

Sales and use tax represents about 15 percent, or \$26 million, of projected General Fund revenue in the City's Adopted Operating Budget for fiscal year 2015. This revenue includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.<sup>1</sup>

The Office of the City Auditor contracts with MuniServices LLC (hereafter MuniServices), the City's sales and use tax consultant, to obtain sales and use tax recovery services and informational reports. The Office of the City Auditor uses the recovery services and informational reports to help identify misallocation of tax revenue owed to the City, and to follow up with the State Board of Equalization to ensure the City receives identified revenues. The Office of the City Auditor includes information on sales and use tax recoveries in our quarterly reports to the Policy and Services Committee.

The California Revenue and Taxation Code, Section 7056, requires that sales and use tax data remain confidential. As such, the City may not disclose amounts of tax paid, fluctuations in tax amounts, or any other information that would disclose the operations of a business. This report, including the attached Sales Tax Digest Summary, includes certain modifications and omissions to maintain the confidentiality of taxpayer information.

The Office of the City Auditor also shares the information provided by MuniServices with the Administrative Services Department (ASD) for use in revenue forecasting and budgeting, and with Economic Development for business outreach strategies. We coordinated this informational memo with them.

### DISCUSSION

The attached report (Attachment B) was prepared by MuniServices and covers calendar year 2014 third quarter sales (July through September 2014). These funds are reported as part of the City's fiscal year 2015 revenue. In March, ASD should receive information from the State on aggregate sales and use tax receipts for fourth quarter 2014.

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<sup>1</sup> See definitions on page 4.

Following are some highlights of the sales and use tax information we received:

- In Palo Alto, overall sales and use tax revenue (cash receipts) for the third quarter ending September 2014 increased by approximately \$125,000, or 2.1 percent, including pool allocations, compared to the third quarter ending September 2013. For all jurisdictions in Santa Clara County, sales and use tax revenue for the third quarter ending September 2014 increased by \$8.1 million, or 8.6 percent, compared to the third quarter ending September 2013.
- Statewide, almost every region in California experienced an increase in sales and use tax revenue for the year ending September 2014. Statewide sales and use tax revenue has shown growth of 5.7 percent during the third quarter ending September 2014 compared to the third quarter ending September 2013.
- In Palo Alto, sales and use tax revenue totaled \$25.7 million for the year ending September 2014, a decrease of 10.3 percent from \$28.7 million in the prior year ending September 2013. This change is due in part to an unexpectedly high and one-time flow of revenue in FY 2013 and not from a decrease in base receipts. This amount includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.
- Excluding pool allocations and adjusting for prior period and late payments, Palo Alto's sales and use tax revenue for the third quarter ending September 2014 decreased by 1.1 percent compared to the third quarter ending September 2013. On a yearly basis, Palo Alto's sales and use tax revenue for the year ending September 2014 decreased by 12.2 percent compared to the prior year ending September 2013. The explanation for this decrease is provided in the previous bullet.

More detailed information is shown in Attachment B.

### **Economic Influences on Sales and Use Tax**

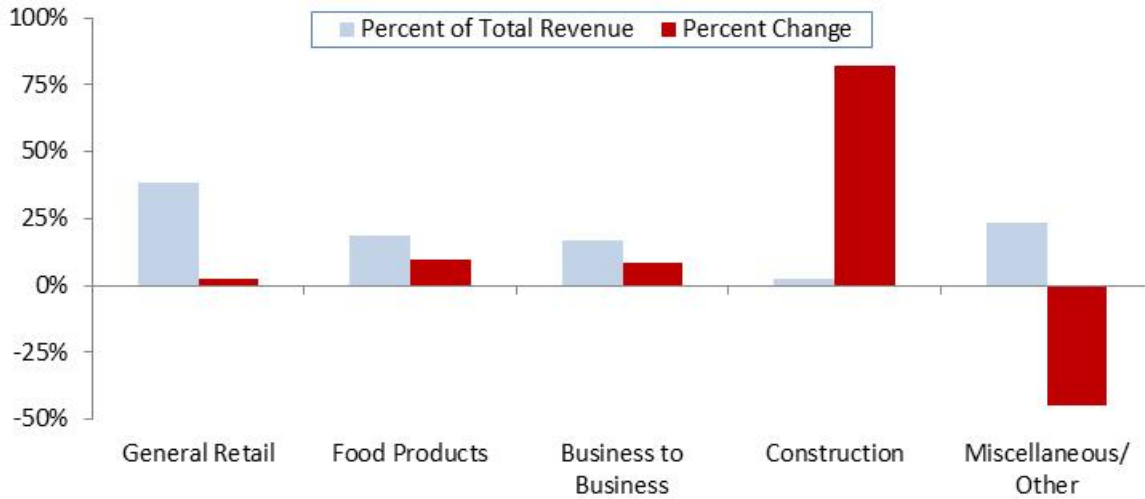
In its Economic Overview (Attachment C), MuniServices discusses economic influences, including national and state economic trends, the job market, auto and retail sales, and forecast information that may affect the City's sales and use tax revenue.

Preliminary estimates from the State of California Employment Development Department show that the December 2014 unemployment rate, which is not seasonally adjusted, is 4.5 percent in Santa Clara County and 2.3 percent in Palo Alto.

### **Economic Category Analysis**

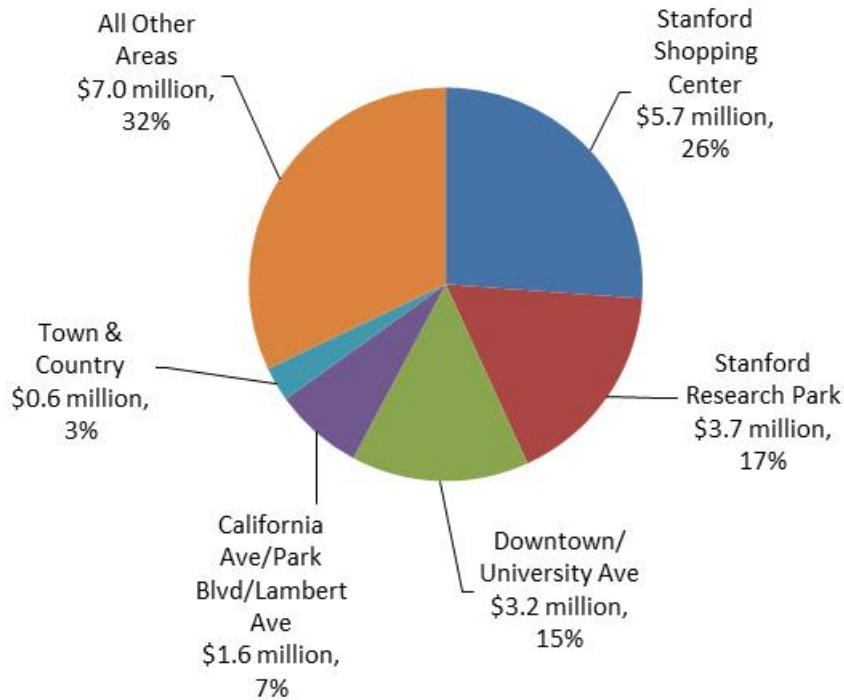
MuniServices' analysis of economic categories for the year ending September 2014 shows that General Retail comprised 38.5 percent of Palo Alto's sales and use tax revenue and increased by 2.6 percent compared to the prior year. Food Products comprised 18.8 percent of total revenues and increased by 9.7 percent. Business to Business comprised 16.9 percent of total revenues and increased by 8.6 percent.

**Exhibit 1 - Comparison of Palo Alto's Sales and Use Tax Revenue and Percent Change by Economic Category for the Year Ending September 2014**



The following chart shows sales and use tax revenue by geographical area based on information provided by MuniServices.

**Exhibit 2 – Palo Alto's Sales and Use Tax Revenue by Geographical Area For the Year Ending September 2014 (Amounts include tax estimates and exclude pool allocations)**



## DEFINITIONS

In California, either sales tax or use tax may apply to a transaction, but not both. The sales and use tax rate in Palo Alto is 8.75 percent.

**Sales tax** – imposed on all California retailers; applies to all retail sales of merchandise (tangible personal property) in the state.

**Use tax** – generally imposed on consumers of merchandise (tangible personal property) that is used, consumed, or stored in this state; purchases from out-of-state retailers when the out-of-state retailer is not registered to collect California tax, or for some other reason does not collect California tax; leases of merchandise (tangible personal property).

**Countywide/statewide pools** – mechanisms used to allocate local tax that cannot be identified with a specific place of sale or use in California. Local tax reported to the pool is distributed to the local jurisdiction each calendar quarter using a formula that relates to the direct allocation of local tax to each jurisdiction for a given period.

Examples of taxpayers who report use tax allocated through the countywide pool include construction contractors who are consumers of materials used in the improvement of real property and whose job site is regarded as the place of business, out-of-state sellers who ship goods directly to consumers in the state from inventory located outside the state, and California sellers who ship goods directly to consumers in the state from inventory located outside the state.

Other examples of taxpayers who report use tax through the pools include auctioneers, construction contractors making sales of fixtures, catering trucks, itinerant vendors, vending machine operators and other permit holders who operate in more than one local jurisdiction but are unable to readily identify the particular jurisdiction where the taxable transaction takes place.

Respectfully submitted,



Harriet Richardson  
City Auditor

Sources: MuniServices; California State Board of Equalization; State of California Employment Development Department; City of Palo Alto Fiscal Year 2015 Adopted Operating Budget

Audit staff: Lisa Wehara

Attachment B

# City of Palo Alto

## Sales Tax Digest Summary

### Collections through December 2014

### Sales through September 2014 (2014Q3)

#### California Overview

The percent change in cash receipts from the prior year was 5.7% statewide, 6.2% in Northern California and 5.2% in Southern California. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments. When we adjust for non-period related payments, we determine the overall business activity decreased for the year ended 3rd Quarter 2014 by 2.5% statewide, 3.8% in Southern California and increased by 0.3% in Northern California.

#### City of Palo Alto

For the year ended 3rd Quarter 2014, sales tax cash receipts for the City declined by -10.3% from the prior year. On a quarterly basis, sales tax revenues increased by 2.1% from 3rd Quarter 2013 to 3rd Quarter 2014. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments.

Excluding state and county pools and adjusting for anomalies (payments for prior periods) and late payments, local sales tax decreased by -12.2% for the year ended 3rd Quarter 2014 from the prior year. On a quarterly basis, sales tax activity declined by -1.1% in 3rd Quarter 2014 compared to 3rd Quarter 2013.

#### Regional Overview

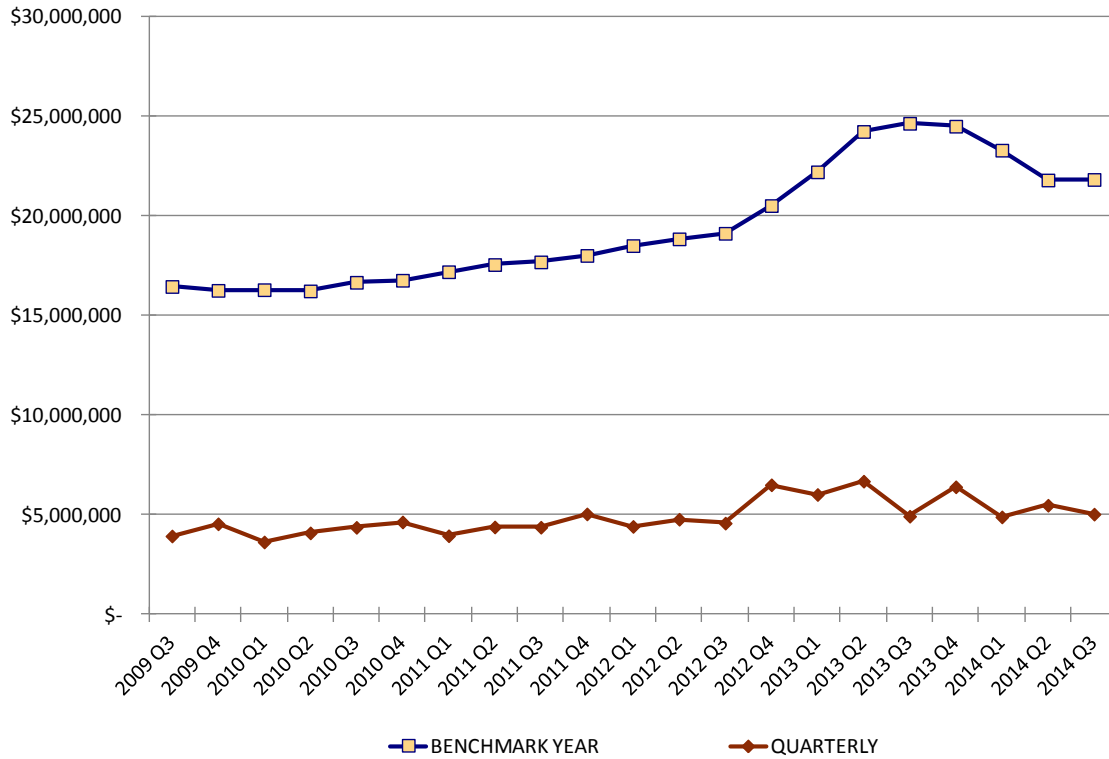
This seven-region comparison includes estimated payments and excludes net pools and adjustments.

#### CITY OF PALO ALTO

BENCHMARK YEAR 2014Q3 COMPARED TO BENCHMARK YEAR 2013Q3

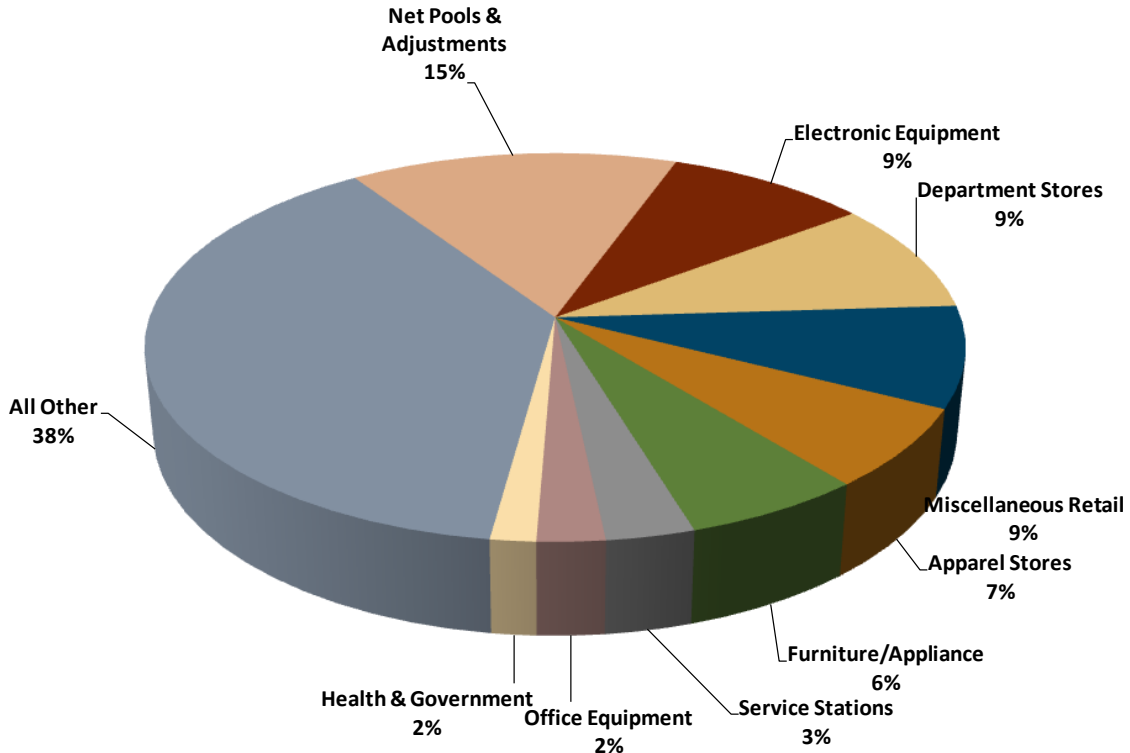
ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 3rd QUARTER 2014									
% of Total / % Change	City of Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	Inland Empire	North Coast	Central Coast
General Retail	38.5 / 2.6	28.4 / 2.3	27.4 / 2.2	28.1 / 1.1	30.3 / 3.7	28.9 / 1.9	26.8 / 3.8	27.9 / 0.2	32.1 / 1.1
Food Products	18.8 / 9.7	19.5 / 5.6	20.7 / 6.7	16.5 / 4.7	15.9 / 3.4	20.4 / 5.3	16.8 / 7.1	18.4 / 3.6	30.2 / -0.1
Construction	2.3 / 82.2	9.1 / 4.6	9.2 / 6.0	10.8 / 6.0	11.4 / 6.7	8.0 / 3.3	10.9 / 4.4	12.5 / 2.4	9.4 / 6.8
Business to Business	16.9 / 8.6	16.8 / 4.4	19.4 / 5.8	14.0 / 2.1	14.2 / 2.9	16.9 / 3.9	15.7 / 5.4	9.0 / 4.9	5.3 / 0.6
Miscellaneous/Other	23.4 / -44.7	26.2 / 4.1	23.3 / 3.9	30.6 / 4.7	28.3 / 4.2	25.8 / 3.7	29.9 / 5.5	32.2 / 1.7	23.0 / 3.7
<b>Total</b>	<b>100.0 / -12.2</b>	<b>100.0 / 2.5</b>	<b>100.0 / 4.5</b>	<b>100.0 / 3.4</b>	<b>100.0 / 4.0</b>	<b>100.0 / 3.5</b>	<b>100.0 / 5.2</b>	<b>100.0 / 2.0</b>	<b>100.0 / 1.8</b>
ECONOMIC SEGMENT ANALYSIS FOR YEAR ENDED 3rd QUARTER 2014									
	City of Palo Alto	State Wide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	Inland Empire	North Coast	Central Coast
Largest Segment	Restaurants	Restaurants	Restaurants	Auto Sales - New	Department Stores	Restaurants	Service Stations	Service Stations	Restaurants
% of Total / % Change	16.8 / 11.5	13.5 / 6.8	14.5 / 7.8	11.9 / 7.7	13.7 / 1.3	14.7 / 6.4	12.1 / 2.1	13.7 / -1.3	21.5 / 3.4
2nd Largest Segment	***	Auto Sales - New	Auto Sales - New	Department Stores	Service Stations	Auto Sales - New	Department Stores	Department Stores	Misc. Retail
% of Total / % Change	*** / ***	10.5 / 8.5	10.1 / 7.2	11.4 / 0.5	11.1 / -0.9	10.7 / 8.3	11.0 / 1.8	11.2 / -0.8	9.9 / 3.6
3rd Largest Segment	Department Stores	Department Stores	Department Stores	Restaurants	Auto Sales - New	Department Stores	Restaurants	Auto Sales - New	Service Stations
% of Total / % Change	10.9 / -3.7	10.0 / 0.7	8.4 / 0.4	10.6 / 5.9	10.1 / 11.4	9.7 / 0.5	10.6 / 7.5	10.3 / 6.6	9.8 / 0.6
*** Not specified to maintain confidentiality of tax information									

Gross Historical Sales Tax Performance by Benchmark Year and Quarter (Before Adjustments)



Net Cash Receipts for Benchmark Year 3rd Quarter 2014: \$25,702,133

\*Benchmark year (BMY) is the sum of the current and 3 previous quarters (2014Q3 BMY is sum of 2014 Q3, Q2, Q1 & 2013 Q4)



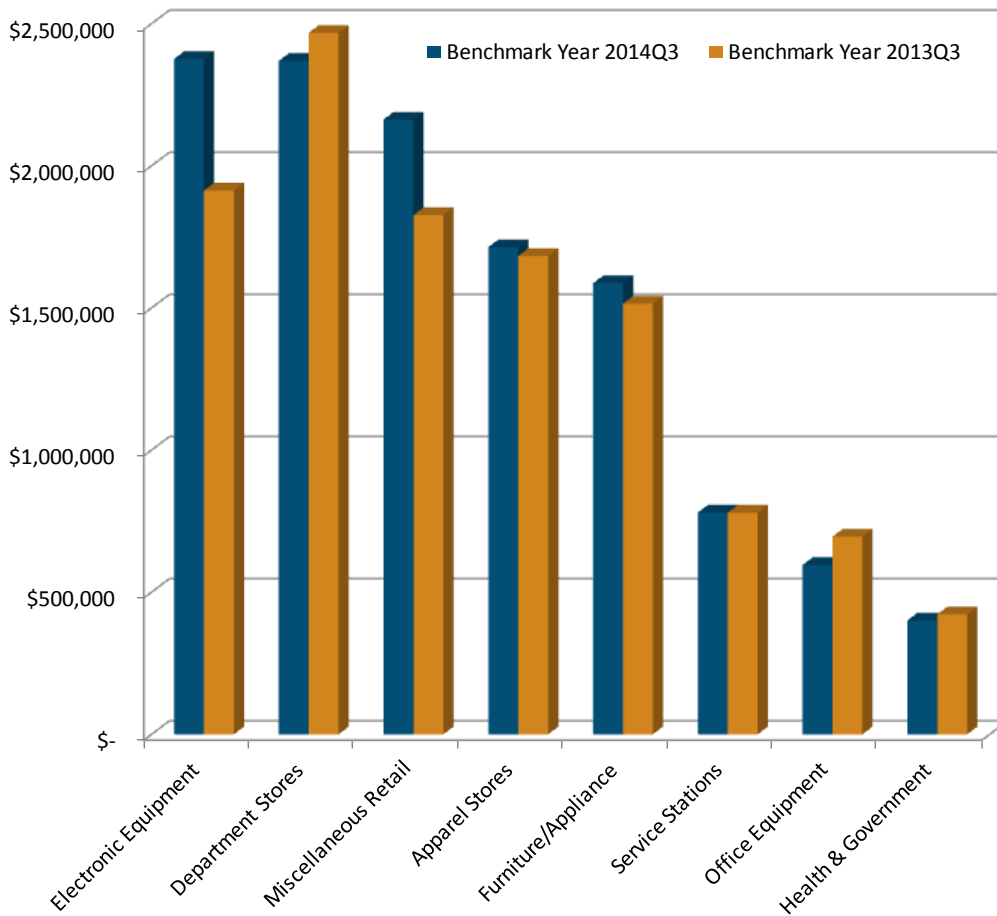


**TOP 25 SALES/USE TAX CONTRIBUTORS**

The following list identifies Palo Alto’s Top 25 Sales/Use Tax contributors. The list is in alphabetical order and represents the year ended 3rd Quarter 2014. The Top 25 Sales/Use Tax contributors generate 50.4% of Palo Alto’s total sales and use tax revenue.

Anderson Honda	Keeble & Shucat Photography	Tesla Motors
Apple Stores	Loral Space Systems	Tiffany & Company
Audi Palo Alto	Macy's Department Store	Urban Outfitters
Bloomingdale's	Magnussen's Toyota	Valero Service Stations
Carlsen Motor Cars	Neiman Marcus Department Store	Varian Medical Systems
CVS/Pharmacy	Nordstrom Department Store	Volvo Palo Alto
Fry's Electronics	Pottery Barn Kids	Wilkes Bashford
Hewlett-Packard	Shell Service Stations	
Integrated Archive Systems	Stanford University Hospital	

**Sales Tax from Largest Non-confidential Economic Segments**



Historical Analysis by Calendar Quarter

Economic Category	%	2014Q3	2014Q2	2014Q1	2013Q4	2013Q3	2013Q2	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4
General Retail	33.3%	1,994,264	2,032,155	1,791,298	2,585,931	1,945,413	1,959,201	1,759,098	2,444,528	1,913,125	2,009,452	1,701,757	2,440,953
Miscellaneous/Other	23.4%	1,400,415	1,437,507	1,283,210	1,553,169	1,196,569	2,974,293	2,796,863	2,067,125	958,899	899,455	844,868	843,618
Food Products	17.6%	1,054,462	1,051,681	972,997	1,009,848	950,359	966,208	882,949	905,156	877,520	886,852	816,336	838,138
Business To Business	10.0%	596,226	970,762	858,119	1,268,059	848,634	800,341	592,136	1,101,068	843,770	993,147	1,064,996	932,723
Net Pools & Adjustments	15.8%	945,653	786,945	1,013,633	1,095,801	924,963	1,227,552	1,162,968	1,155,841	603,635	840,789	754,099	725,000
<b>Total</b>	<b>100.0%</b>	<b>5,991,020</b>	<b>6,279,050</b>	<b>5,919,257</b>	<b>7,512,808</b>	<b>5,865,938</b>	<b>7,927,595</b>	<b>7,194,014</b>	<b>7,673,718</b>	<b>5,196,949</b>	<b>5,629,695</b>	<b>5,182,056</b>	<b>5,780,432</b>

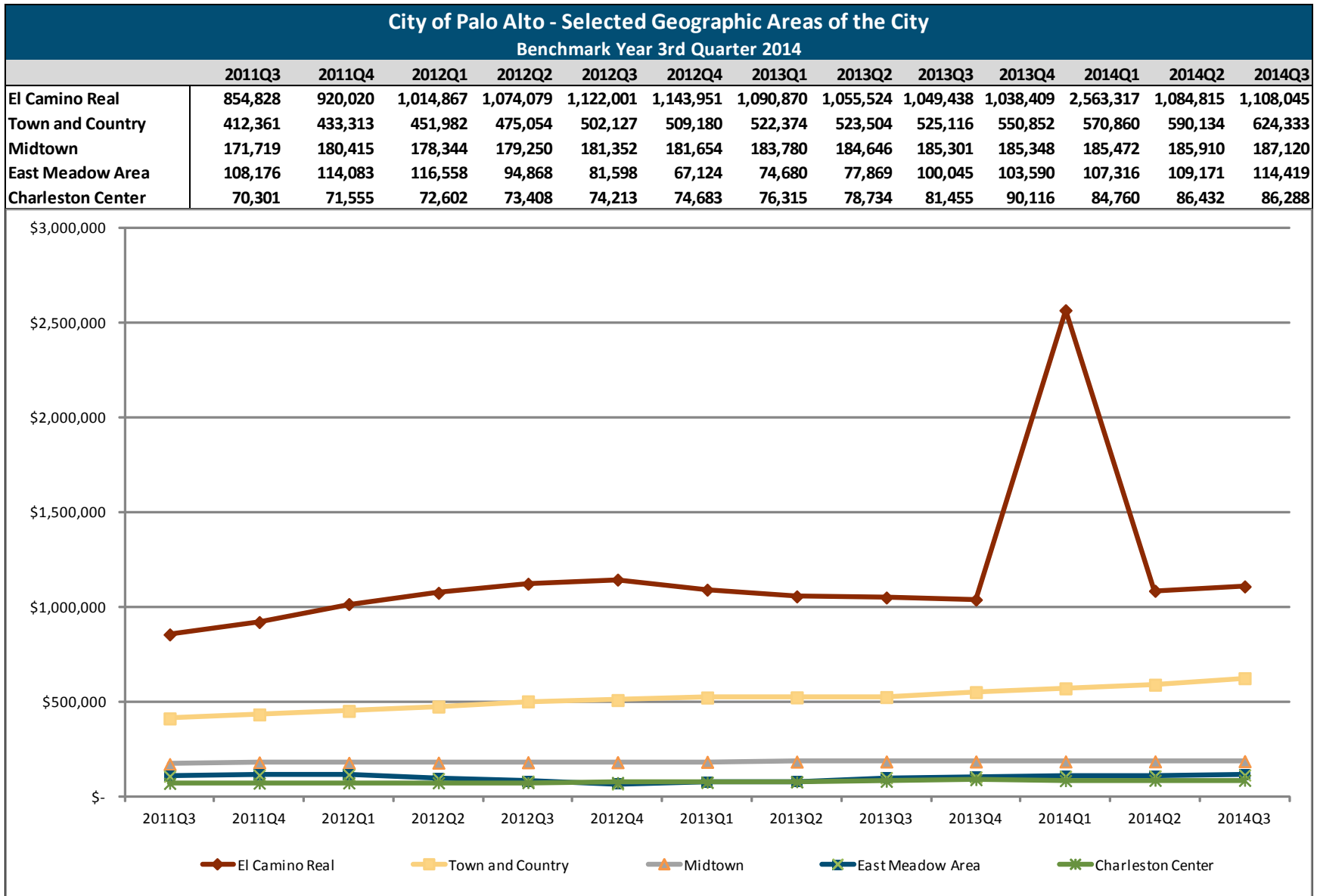
  

Economic Segments	%	2014Q3	2014Q2	2014Q1	2013Q4	2013Q3	2013Q2	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4
Miscellaneous/Other	36.9%	2,211,697	2,577,014	2,328,959	3,184,808	2,230,000	3,943,660	3,584,353	3,451,258	1,967,348	2,091,371	2,660,028	2,876,362
Restaurants	15.6%	936,160	940,540	870,158	890,739	833,865	845,107	771,596	782,184	760,929	780,314	714,487	783,595
Miscellaneous Retail	8.5%	508,061	514,133	481,305	661,268	458,124	471,954	393,506	584,169	429,989	456,771	347,112	488,492
Department Stores	9.2%	548,595	591,500	472,857	762,760	574,389	603,773	509,699	779,973	584,178	608,894	382,336	573,750
Apparel Stores	6.7%	398,747	429,748	365,777	515,296	400,201	404,202	372,909	496,073	383,337	402,471	178,409	171,472
Service Stations	3.4%	203,484	215,162	184,185	177,096	214,276	196,568	187,333	182,060	198,973	198,604	90,636	101,023
Food Markets	1.8%	105,600	98,705	90,272	104,592	104,815	106,760	99,711	110,625	106,652	95,807	37,116	38,854
Business Services	1.1%	66,163	62,060	63,768	61,832	57,139	67,759	63,791	73,619	69,722	71,828	6,634	9,046
Recreation Products	1.1%	66,860	63,243	48,343	58,616	68,166	60,260	48,148	57,916	92,186	82,846	11,199	12,838
Net Pools & Adjustments	15.8%	945,653	786,945	1,013,633	1,095,801	924,963	1,227,552	1,162,968	1,155,841	603,635	840,789	754,099	725,000
<b>Total</b>	<b>100.0%</b>	<b>5,991,020</b>	<b>6,279,050</b>	<b>5,919,257</b>	<b>7,512,808</b>	<b>5,865,938</b>	<b>7,927,595</b>	<b>7,194,014</b>	<b>7,673,718</b>	<b>5,196,949</b>	<b>5,629,695</b>	<b>5,182,056</b>	<b>5,780,432</b>

\*Net Pools & Adjustments reconcile economic performance to periods' net cash receipts. The historical amounts by calendar quarter: (1) include any prior period adjustments and payments in the appropriate category/segment and (2) exclude businesses no longer active in the current period.

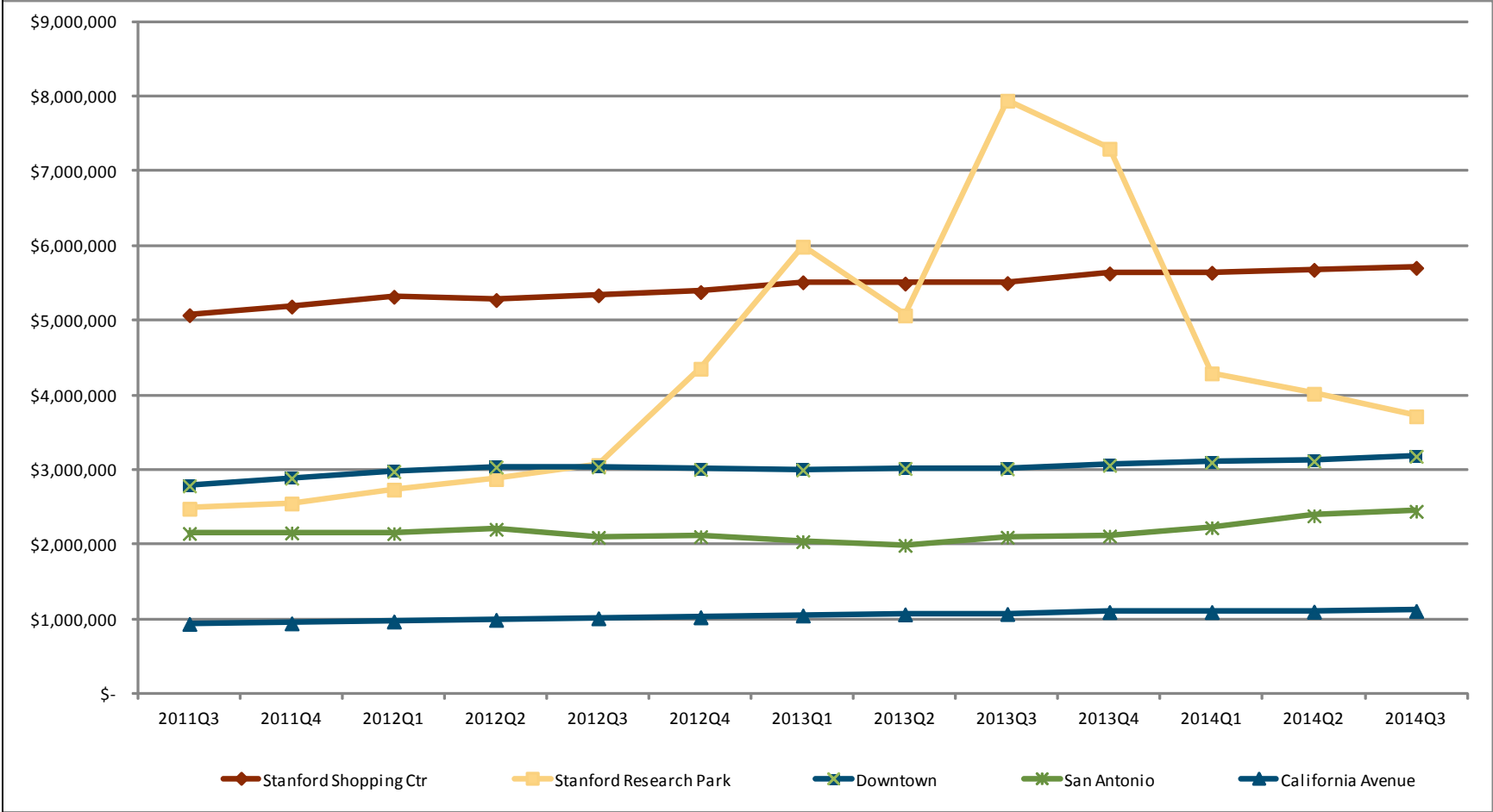
Quarterly Analysis by Economic Category, Total and Segments: Change from 2013Q3 to 2014Q3

	General Retail	Food Products	Construction	Business to Business	Misc./Other	2014/3 Total	2013/3 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	-1.0%	6.8%	0.5%	-14.3%	3.3%	2,309,101	2,323,190	-0.6%	Bldg.Matls-Retail	Business Services	Office Equipment	Bldg.Matls-Whsle
Cupertino	-2.1%	7.4%	315.9%	46.9%	-5.3%	6,587,792	4,659,340	41.4%	Business Services	Bldg.Matls-Whsle	Misc. Vehicle Sales	Department Stores
Gilroy	4.6%	5.3%	12.6%	5.5%	12.3%	3,486,711	3,245,653	7.4%	Auto Sales - New	Apparel Stores	Service Stations	Misc. Vehicle Sales
Los Altos	1.3%	9.5%	-9.6%	6.8%	0.8%	541,225	517,758	4.5%	Food Markets	Restaurants	Bldg.Matls-Whsle	Florist/Nursery
Los Gatos	3.8%	4.4%	13.8%	14.0%	-7.5%	1,764,831	1,729,136	2.1%	Miscellaneous Retail	Restaurants	Auto Sales - New	Miscellaneous Other
Milpitas	-11.6%	5.1%	75.8%	7.2%	8.5%	4,367,083	4,201,813	3.9%	Office Equipment	Bldg.Matls-Whsle	Furniture/Appliance	Electronic Equipment
Morgan Hill	4.9%	1.1%	6.6%	-22.4%	4.8%	1,834,457	1,840,797	-0.3%	Misc. Vehicle Sales	Office Equipment	Electronic Equipment	Bldg.Matls-Whsle
Mountain View	1.1%	13.7%	3.3%	7.3%	2.9%	3,904,958	3,685,218	6.0%	Restaurants	Light Industry	Business Services	Apparel Stores
Palo Alto	1.7%	10.0%	131.9%	-30.2%	-0.7%	5,045,367	5,103,527	-1.1%	Restaurants	Bldg.Matls-Whsle	Electronic Equipment	Heavy Industry
San Jose	4.5%	6.3%	7.2%	1.3%	0.3%	37,159,452	35,746,634	4.0%	Restaurants	Auto Sales - New	Heavy Industry	Service Stations
Santa Clara	1.1%	24.8%	-5.8%	8.8%	6.2%	10,785,623	10,050,110	7.3%	Restaurants	Office Equipment	Bldg.Matls-Whsle	Furniture/Appliance
Santa Clara Co.	10.6%	3.4%	8.9%	29.2%	2.4%	1,106,545	1,031,561	7.3%	Bldg.Matls-Whsle	Furniture/Appliance	Auto Sales - Used	Light Industry
Saratoga	-6.3%	1.3%	9.8%	-37.6%	-2.6%	247,975	253,474	-2.2%	Food Markets	Food Processing Eqp	Office Equipment	Service Stations
Sunnyvale	-0.8%	4.2%	9.6%	-0.3%	4.3%	6,646,525	6,509,059	2.1%	Auto Sales - New	Electronic Equipment	Office Equipment	Light Industry



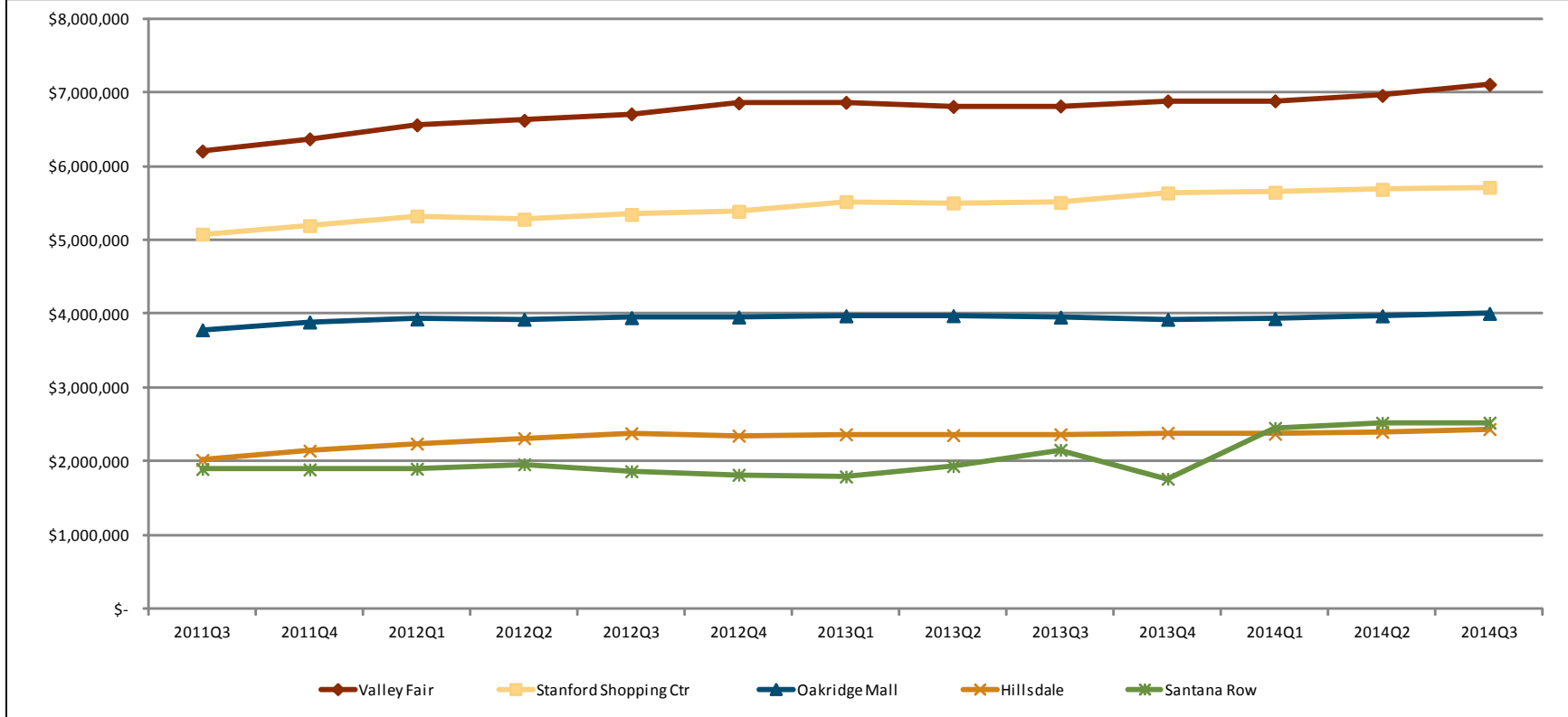
*\*Benchmark year (BMY) is the sum of the current and 3 previous quarters (2014Q3 BMY is sum of 2014 Q3, Q2, Q1 & 2013 Q4)*

City of Palo Alto - Selected Geographic Areas of the City													
Benchmark Year 3rd Quarter 2014													
	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Stanford Shopping Ctr	5,079,526	5,194,491	5,325,435	5,281,772	5,345,618	5,388,747	5,519,326	5,501,836	5,508,513	5,637,256	5,647,210	5,685,894	5,713,169
Stanford Research Park	2,487,708	2,557,399	2,744,058	2,884,600	3,073,009	4,362,778	5,995,489	5,075,848	7,949,998	7,307,557	4,299,015	4,027,889	3,724,671
Downtown	2,793,987	2,897,003	2,986,093	3,044,755	3,047,356	3,013,183	3,007,123	3,027,279	3,022,194	3,068,553	3,108,592	3,124,224	3,189,273
San Antonio	2,156,535	2,164,335	2,155,721	2,212,977	2,103,881	2,114,306	2,047,925	1,997,654	2,106,291	2,122,586	2,234,235	2,393,463	2,453,548
California Avenue	945,340	952,300	976,897	999,421	1,020,704	1,034,151	1,058,098	1,072,925	1,078,153	1,104,341	1,104,237	1,109,685	1,119,047



\*Benchmark year (BMY) is the sum of the current and 3 previous quarters (2014Q3 BMY is sum of 2014 Q3, Q2, Q1 & 2013 Q4)

City of Palo Alto - Regional Shopping Mall Comparison													
Benchmark Year 3rd Quarter 2014													
	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Valley Fair	6,204,976	6,370,656	6,559,394	6,621,598	6,708,343	6,855,987	6,865,443	6,808,919	6,815,517	6,883,838	6,885,378	6,958,214	7,108,448
Stanford Shopping Ctr	5,079,526	5,194,491	5,325,435	5,281,772	5,345,618	5,388,747	5,519,326	5,501,836	5,508,513	5,637,256	5,647,210	5,685,894	5,713,169
Oakridge Mall	3,782,531	3,888,402	3,928,855	3,925,454	3,947,751	3,957,195	3,972,739	3,974,067	3,954,094	3,924,360	3,934,469	3,972,556	4,005,370
Hillsdale	2,019,678	2,145,957	2,241,553	2,315,120	2,381,548	2,348,668	2,367,315	2,356,855	2,367,935	2,387,185	2,374,185	2,401,370	2,438,295
Santana Row	1,897,528	1,892,070	1,900,328	1,961,561	1,867,513	1,819,616	1,795,942	1,938,742	2,156,984	1,765,101	2,453,638	2,523,193	2,525,349



*\*Benchmark year (BMY) is the sum of the current and 3 previous quarters (2014Q3 BMY is sum of 2014 Q3, Q2, Q1 & 2013 Q4)*

<b>Economic Categories and Segments</b>		
<b>Economic Category</b>	<b>Economic Segment</b>	<b>Description</b>
Business to Business - sales of tangible personal property from one business to another business and the buyer is the end user.  Also includes use tax on certain purchases and consumables.	Business Services	Advertising, banking services, copying, printing and mailing services
	Chemical Products	Manufacturers and wholesalers of drugs, chemicals, etc.
	Electronic Equipment	Manufacturers of televisions, sound systems, sophisticated electronics, etc.
	Energy Sales	Bulk fuel sales and fuel distributors and refiners
	Heavy Industry	Heavy machinery and equipment, including heavy vehicles, and manufacturers and wholesalers of textiles and furniture and furnishings
	Leasing	Equipment leasing
	Light Industry	Includes, but is not limited to, light machinery and automobile, truck, and trailer rentals
	Office Equipment	Businesses that sell computers, and office equipment and furniture, and businesses that process motion pictures and film development
Construction	Building Materials – Retail	Building materials, hardware, and paint and wallpaper stores
	Building Materials - Wholesale	Includes, but is not limited to, sheet metal, iron works, sand and gravel, farm equipment, plumbing materials, and electrical wiring
Food Products	Food Markets	Supermarkets, grocery stores, convenience stores, bakeries, delicatessens, health food stores
	Food Processing Equipment	Processing and equipment used in mass food production and packaging
	Liquor stores	Stores that sell alcoholic beverages
	Restaurants	Restaurants, including fast food and those in hotels, and night clubs

<b>Economic Categories and Segments</b>		
<b>Economic Category</b>	<b>Economic Segment</b>	<b>Description</b>
General Retail – all consumer focused sales, typically brick and mortar stores	Apparel Stores	Men’s, women’s, and family clothing and shoe stores
	Department Stores	Department, general, and variety stores
	Drug Stores	Stores where medicines and miscellaneous articles are sold
	Florist/Nursery	Stores where flowers and plants are sold
	Furniture/Appliance	Stores where new and used furniture, appliances, and electronic equipment are sold
	Miscellaneous Retail	Includes, but is not limited to, stores that sell cigars, jewelry, beauty supplies, cell phones, and books; newsstands, photography studios; personal service businesses such as salons and cleaners; and vending machines
	Recreation Products	Camera, music, and sporting goods stores
Miscellaneous/Other	Miscellaneous/Other	Includes but not limited to health services, government, nonprofit organizations, non-store retailers, businesses with less than \$20,000 in annual gross sales, auctioneer sales, and mortuary services and sales
Transportation	Auto Parts/Repair	Auto parts stores, vehicle and parts manufacturing facilities, and vehicle repair shops
	Auto Sales - New	New car dealerships
	Auto Sales - Used	Used car dealerships
	Miscellaneous Vehicle Sales	Sale and manufacture of airplanes and supplies, boats, motorcycles, all-terrain vehicles, trailers and supplies
	Service stations	Gas stations, not including airport jet fuel



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# Economic Overview

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January 2015 Edition

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January 20, 2015

Clients,

Happy New Year! This report includes excerpts from a selection of related news articles through the date of publication. Readers should note that some articles may require a subscription to review complete articles.

Our research team monitors public and subscription sources including news releases about articles that may have an impact on your sales and use tax, including those that may indicate the performance of future revenues. Sources for this report include selections from business journals, local, regional and national newspapers, specialty newsletters, radio and television, and industry publications. We also draw from legislative resources particularly in a year when sales tax reform has become “front burner news” at our State Capitol. Our team also attends economic forums to gather data for this report.

**Supplement:** January of each year represents ‘economic forecast season’ and includes forums held by universities, think tanks, chambers of commerce organizations throughout the State and Country to present regional, statewide and national forecast data and trends. This newly released data combined with other economic news sources is especially important in local government management and decision-making, particularly at the beginning of a year. Our team will publish a supplement containing a synopsis of selected forecast data and reports to this report.

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- Labor and Employment
- Auto Sales, Borrowing and Gasoline
- Retail
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- Tax Modernization and the Economy
- Broadband Technology and Business Attraction

Please contact the City’s respective Client Services Manager for a local perspective on economic trends, or with questions or comments regarding this report.

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## Global and the U.S. Economy

### Here are some key indicators to signal the health of the global economy in the New Year

**Source:** *Wall Street Journal*, January 1, 2015

Federal Reserve Chairwoman Janet Yellen has been laying the groundwork to raise interest rates in the new year for the first time since 2006. Economists have focused on the Fed's June meeting as a possible starting point for rate increases. If she pulls it off, it would signal a long-awaited return to normal for U.S. monetary policy. But the amount, and timing, of the change will be crucial, either rattling or soothing investors.

As of November, the U.S. labor market had already notched the best year for job growth since 1999. If that momentum continues for another year the current economic expansion may begin to look like a boom. But for the past five years the economy has given several head fakes, where job growth looked to be achieving real velocity only to falter. And wage growth remains weak.

Global investors have been unable to rest easy, fearing Europe's debt crisis could flare up again at any moment. Now, the European Central Bank is considering purchasing government bonds to help Europe's economies—just as a new round of uncertainty has emerged around Greece's national elections in January, where a left-wing party challenging the ruling conservatives wants to push back on austerity measures. Spain, too, will hold elections this year amid widespread discontent at the country's 24% unemployment rate. Even Germany, long the eurozone's economic engine, stumbled in 2014 with its economy shrinking 0.1% in the second quarter and growing just 0.1% in the third.

Japan begins the New Year having approved a \$29 billion fiscal stimulus package. The Bank of Japan ratcheted up its monetary stimulus in October by boosting the size of its bond-purchase program. Will the new phase of Prime Minister Shinzo Abe's economic strategy, known as Abenomics, be more successful? The first phase also included massive fiscal and monetary stimulus measures. But Japan's economy still suffered two quarters of declining GDP after a national sales tax increase in April.

After decades of growth averaging 10%, the outlook for China is now threatened by enormous debts taken on to finance infrastructure, an aging population and explosive urbanization. Rebalancing an economy with 1.4 billion people to rely more on consumer spending—what many observers say China needs—is much easier said than done.

The Dow Jones Industrial Average recently hit 18,000, up more than 170% since the darkest days of 2009. Another record-setting year could swell investment accounts and confidence even further. But if the five-year equity boom proves to be near its end, that could deflate hopes in the broader economy as well.

The collapse of petroleum prices has brought cheaper gasoline to consumers, but it could challenge the domestic oil boom that stretches from Texas to North Dakota. The question is whether having fewer paychecks spent at the fuel pump outweighs the downside to the energy industry—such as lower investment in drilling and potential job cuts.

## GDP Increases in Third Quarter: “Third” Estimate of GDP

**Source:** Council of Economic Advisers/ U.S. Department of Commerce, December 23, 2014

Real gross domestic product (GDP) increased 5.0 percent in the third quarter of 2014, according to the “third” estimate released by the Bureau of Economic Analysis. In the second quarter, real GDP increased 4.6 percent.

### Increase in GDP in the third quarter reflected the following:

- Consumer spending increased 3.2 percent, compared with 2.5 percent in the second quarter.
- Spending on both goods and services increased.
- Business investment rose, notably in transportation equipment and industrial equipment as well as in intellectual property products.
- Exports of goods increased; industrial supplies and materials was the largest contributor.
- Federal government spending increased, mainly for national defense spending.

### The 1.1 percentage points upward revision to the GDP growth rate reflected the following:

- An upward revision to consumer spending, reflecting upward revisions to health care and recreation services.
- An upward reward revision to business investment, mainly to structures and intellectual property products.
- An upward revision to private inventory investment by wholesale trade industries, notably the nondurable goods industry.

### Corporate profits increased 3.1 percent at a quarterly rate in the third quarter after increasing 8.4 percent in the second quarter:

- Profits of domestic nonfinancial corporations increased 2.5 percent after increasing 11.9 percent.
- Profits of domestic financial corporations increased 3.6 percent after increasing 8.0 percent.
- Rest of the world profits increased 4.2 percent after decreasing 0.9 percent.
- Over the last 12 months, corporate profits rose 1.4 percent.

## Economic Outlook

**Source:** *Kiplinger*, January 2015

- **GDP:** 2% growth in Q4, with 3% likely in '15
- **Unemployment:** 5.8% at end '14; 5.3% by end '15
- **Interest rates:** By end '15, 10-year T-notes at 3%; mortgages, 4.5%
- **Inflation:** 0.9% for '14; 2% for '15
- **Business spending:** Up about 5% in '14; increasing by 7% in '15

- **Energy:** Crude oil trading from \$70 to \$75/bbl. by March
- **Housing:** New single-family home starts and sales up 25% in '15
- **Retail sales:** Up 5% in both '14 and '15; noncar sales strengthening
- **Trade deficit:** Widening by 5% in '14; 10% increase in '15

## Five Surprising Economic Trends in 2014, and What They Mean for 2015

**Source:** *New York Times*, January 1, 2015

It was a confounding year in global financial markets. Not because it was a disaster for most investors; American stocks and bonds both rose in value. It was confounding because of some major moves that defied expert consensus this time a year ago — not only what was predicted, but what was even thought plausible. But by understanding what the biggest market moves were, you can also understand the forces that will shape the global economy in 2015.

**There was an epic collapse in oil prices.** It's not that the price of oil has never moved as far and as fast as it did in 2014. It's just that usually when that happens, it occurs against the backdrop of much more global volatility, like in a worldwide recession at the end of 2008 and early 2009. What's remarkable about the roughly 50 percent decline in the price of oil in the second half of the year is that it occurred amid such stability; nothing radical changed in that time about either the global economic outlook or even the supply and demand picture for oil itself. Rather, years of effort to increase drilling in the United States, paired with a continued tepid world economy and with decisions by Saudi Arabia and other oil producers not to pull back on production to defend high prices, created a stunning sell-off. **Implication:** This was the year (2014) when oil prices plunged, but 2015 is the year when we will truly start to understand the consequences.

**Long-term interest rates kept falling.** Analysts expected a strengthening economy and a winding down of Federal Reserve easing policies to mean higher interest rates in 2014. The yield on United States Treasury bonds fell significantly over the course of the year; the government can borrow money for 30 years for a mere 2.8 percent, down from 4 percent at the end of 2013. These lower costs have translated into cheaper home mortgages and lower borrowing costs for businesses, and higher bond prices (but lower future returns) for investors. As for 2015 implications, the remarkably low long-term interest rates would seem to signal a return to a predicament facing the American economy in the middle of the last decade. Alan Greenspan called it a "conundrum" — that the Fed's power to influence longer-term interest rates was weak, perhaps because of very strong global demand for safe securities like United States Treasury bonds. Regardless of the cause, it raises the prospect that even as the economy continues to strengthen and the Fed raises rates in 2015, cheap longer-term rates will be here to stay.

**The U.S. stock market kept cruising.** The stock market had a remarkable rally in 2013, and some were skeptical that it could continue the run in 2014. It did, but only in the United States. The core reason is that the American economy has performed better than its counterparts in much of the rest of the world, with Europe and Japan facing stagnant growth and emerging markets slowing their once-gangbuster pace. A related factor is that the dollar has appreciated compared with other currencies, so the dollars that American companies make are becoming relatively more valuable. Yet another

year of stock prices that rise faster than corporate earnings certainly increases the risk of a sharp correction or a period of subpar returns. But in the meantime, Americans can take comfort in the fact that the referendum of global financial markets is that the United States will continue to be the driver of global economic recovery.

**The Dollar Appreciated Sharply in 2014.** A schism has opened up between the Federal Reserve and its counterparts overseas. The European Central Bank and the Bank of Japan are trying to stimulate growth and fight deflation in their countries (the B.O.J. has already expanded its easing programs, and the E.C.B. appears on the verge of undertaking a form of bond-buying of its own). But the Fed has been signaling higher rates and tighter money. That has made the dollar more attractive, as has the sense that it is a beacon of economic strength in a troubled world economy. Those factors explain the 12 percent drop in the euro against the dollar and the 14 percent drop in the Japanese yen. But the strengthening dollar has implications for 2015 far beyond the finances of Americans thinking of visiting Paris this spring.

**The outlook for inflation fell.** Global investors are betting on very, very low inflation, for many years to come. That is the implication, anyway, of the relative prices of inflation-adjusted bonds and regular bonds in the United States and almost every other major economy. The decline in oil and other commodity prices will put downward pressure on prices in 2015. But a broader shift in sentiment happened in recent months. Investors seem to think that very low inflation will persist even after the oil price declines of the last few months fully spread through other consumer prices. Bond prices currently imply that inflation from 2019 to 2024 will be 2.14 percent a year, down from 2.65 percent a year ago.

**Investors expected lower future inflation.** Over the course of 2014, expectations for inflation as measured by the bond market fell steeply, both for the years immediately ahead and the more distant future. Expected annual inflation implied by bond prices; 2019–2024 is more precisely known as the five-year-five-year forward inflation rate; 2014–2019 is the five-year breakeven rate. Investor expectations suggest that the Fed may have more leeway than it had seemed a few months ago to keep interest rates low, especially if they see continued weakness in the economy.

## Choppy Seas Ahead

**Source:** *Wall Street Journal*, January 2, 2015

The U.S. economy has entered 2015 with the strongest momentum in at least a decade, but it stands alone. We take a look at whether the U.S. can thrive when so much of the world is stumbling. The eurozone remains lethargic. While plunging oil prices will help lift demand in much of the world, they threaten to slow economic growth in some regions ranging from Russia to Africa to Latin America. China's economy is grappling with a downshift toward more sustainable growth and geopolitical concerns weigh heavy. But international turmoil has a history of only denting U.S. growth, rather than undermining it, and data show the country is in a position of relative strength. The U.S. has recovered all the jobs lost during the recession and the housing market, while falling short of expectations in 2014, enters the New Year on a steady note. We also note that the Federal Reserve's top policy-making body is likely to appear more united this year than last after the regular rotation of voting seats but the prospect of a mid-2015 rate rise depends on the economy maintaining its momentum.

**Health and Taxes:** After the first year of the Affordable Care Act, a tricky tax-filing season is on the way. Our story looks at the health law's impact on millions of Americans as they prepare their 2014 tax returns. All filers must indicate on federal tax forms whether they had health-insurance coverage last year and received tax credits to help pay for it. Those who didn't have coverage could face a fine, although the so-called individual mandate is expected to be lightly enforced because of reduced staffing at the Internal Revenue Service and changes to the law, according to tax preparers. Meanwhile, millions who got subsidies may find they are getting smaller-than-expected refunds or owe the IRS because credits they received to offset their insurance premiums were too large. With filers bound to be full of questions, the season could be a lucrative one for tax preparers.

**Paying for Premium:** Consumer-goods companies have taken an old strategy to emerging markets: asking customers to pay more for premium products. We report that companies such as Unilever and P&G are packing more features into personal-care products and raising prices, enticing customers in India and Brazil with conditioner, deodorant and liquid laundry detergent. Price increases and innovation are increasingly crucial to the bottom line, compensating for waning sales growth in emerging markets. Unilever is under even more pressure than its rivals to succeed in the developing world because that's where it generates nearly 60% of its \$67 billion in annual revenue. The company is increasingly turning to beauty and personal care after abandoning its goal of becoming the world's largest packaged-food maker.

## State and Local Economy – Trends and Tools

### California's Economy Improves for 7th Straight Month

Source: *San Diego Times*, January 9, 2015

Comerica Bank said its monthly index of California economic activity grew in October for the seventh straight month, showing "positive momentum" in the Golden State's economy. The index increased by half a percentage point to a level of 115.9, which is 32 points, or 38 percent, above the low of 83.8 during the Great Recession. "Our California Economic Activity Index increased in October, for the seventh consecutive month, showing ongoing improvement to the U.S.'s largest state economy," said Robert Dye, chief economist at Comerica Bank. "We expect to see positive momentum in the California economy through 2015. "Recent job growth has been stronger than the U.S. average and real estate markets remain tight. The state's unemployment rate is still higher than the U.S. average, but is trending down steadily, falling to 7.2 percent by November. Lower gasoline prices are a boon to California consumers and to the state's very important tourism industry."

## Income Inequality Hurts the State's Budget

**Source:** *San Francisco Chronicle*, October 8, 2014

In California, the 1 percent account for more than half the state's tax revenue. The top 10 percent's share: 80 percent. Forgetting the complaints of the put-upon wealthy for a moment, that's not good — for the economy in general or the state's budget in particular — says one of the country's biggest ratings agencies. And we have rising income inequality to blame for it. According to an analysis by Standard & Poor's, as the income gap has widened over the years, growth in state tax revenue has declined, from 11 percent annually from 1950 to 1979 — before the income gap began to noticeably widen — to 7 percent since 2009. Bottom line, according to the report, "increasing income inequality is undermining the rate of state revenue growth" in California and nationwide. Added to that is the volatility of California's finances, caused primarily by its heavy reliance on the rich, whose fortunes have had a habit of going up and down along with the stock market.

"California's budget has been looking better in the past two years, but it's still just one large market correction away from renewed problems," said Gabriel Petek, managing director at S&P's San Francisco office and primary author of the report. That, he added, explains why California, despite its reputation as the comeback kid, has the third-lowest credit rating in the country — single-A, albeit with a "positive" outlook. "Good times can prove to be ephemeral," Petek said.

Cue "secular stagnation," a late-1930s notion refashioned by some mainstream economists, including former Treasury Secretary Lawrence Summers, suggesting that a broad-based rise in consumer demand, living standards and real incomes is a thing of the past. That scenario threads through a just-published report on "the challenge of improving economic conditions for low- and moderate-income Bay Area residents and workers." According to the report, funded by federal and local government agencies, more than one-third of Bay Area workers make less than \$18 an hour; the majority of those 1.1 million workers make less than \$12 an hour — and the number of those workers is expected to rise in the next few years.

But, the report acknowledges, the barriers to higher-paying jobs are immense, middle-wage jobs as a percentage of total employment are shrinking, almost half of lower-wage workers are older than 35, and three-quarters of them haven't gone beyond high school. Plus, "the strategies described in this report are set against a backdrop of ... growing income inequality nationally and globally." One particularly sobering data point, according to Steve Levy, president of the Center for Continuing Study of the California Economy, is that "there are 1.1 million low- and moderate-wage workers in the region and only at most 300,000 to 400,000 total middle-wage job openings over the next decade."

But as a whole, the housing market fell short of expectations amid tepid demand, rising prices and continued complaints from buyers about the quality of inventory. "The market overpriced itself this year, and buyers are very price sensitive right now," said Glenn Kelman, chief executive of real-estate brokerage Redfin.

Nela Richardson, the firm's chief economist, said they expect the market to be less competitive this year. "Homes that had four offers now have one," she said, although there is still "a lot of price pressure in a really small number of neighborhoods."



After a two-year rebound, housing demand faltered halfway through 2013 amid inventory shortages, rising prices and a sudden increase in mortgage rates. Demand stayed soft in early 2014, during a particularly cold winter, but improved in the summer, a period during which mortgage rates floated down. The average 30-year fixed-rate mortgage stood at 3.87% for the week ended (based on date of publication), according to Freddie Mac, near its lowest level of the past year. Sales of previously owned homes are running around 4% below the year-earlier level through the first 11 months of 2014. Still, sales climbed throughout the middle of the past year, from a 4.59 million seasonally adjusted annual rate in March to 5.25 million in October. They slid 6% in November to a 4.93 million rate, according to the National Association of Realtors.

Sales of new homes have been essentially unchanged over the past year, falling far short of economists' expectations for double-digit gains in new home sales. That's happened in part because builders have focused on constructing larger, more expensive homes. Broad sales measures don't fully capture other dimensions the housing market's recovery. In particular, the share of homes selling out of foreclosure accounted for as many as a third of home sales in 2012. The share of distressed sales has fallen sharply, to around 9% in recent months. The upshot is that traditional sales now account for a far larger share of the market—a sign of improvement. Home prices tell a similar story. After falling nearly one-third from their peak in 2006, prices began rebounding sharply in February 2012 and since then have risen nearly 25% through October, according to the S&P/Case-Shiller index.

Some of the price declines were exacerbated by a glut of foreclosures. The subsequent rebound reflected increased investor demand for those bargain-priced properties, most of which were either quickly repaired and flipped for a profit or held off the market as rentals. As foreclosures have faded and investor-purchasers stepped back from the market, price gains have slowed. In October, home prices had increased 4.6% from their year-earlier level, compared to a year-over-year gain of 10.9% in October 2013.

An open question in the coming year is whether price gains stabilize at those lower levels or whether they weaken further. Research firm Zelman & Associates expects price gains of 4% in 2015 and 3% in 2016. But some market specialists say prices may need to give if sales are to rise. "In a few markets, there will be price declines," Mr. Kelman said, "and maybe in more than a few." In expensive markets such as Southern California, "we have an affordability problem again," said John Burns, chief executive of a home-builder consulting firm in Irvine, Calif. "The market is flat."

## Labor and Employment

### Employment growth fuels restaurant industry

**Source:** *Nation's Restaurant News*, January 13, 2015

One thing is certain: recent employment growth has been a boon to the restaurant industry. "The No. 1 thing is jobs," said Wyman Roberts, CEO of Brinker International Inc., which operates or franchises 1,622 restaurants under the Chili's Grill & Bar and Maggiano's Little Italy brands.

Denny's CEO John Miller said workers rely on restaurants during the workday. "People who are at work are not at home to prepare their own meals," he said. Gas prices, which are \$1 a gallon lower than they were a year ago at this time, are also providing many consumers with a sudden and unexpected infusion of cash. But whether that cash is flowing to the restaurant industry is more a matter of debate.

Those were the underlying themes at the ICR XChange consumer conference in Orlando, Fla., where numerous restaurant chain executives made presentations to Wall Street investors. "Overall historically, gas prices haven't correlated with restaurant sales," Roberts said. "That said, no one has seen gas prices drop a buck either."

Gas prices fluctuate from time to time and are periodically given credit for influencing restaurant sales, but there is little evidence gas price changes influence restaurant sales one way or the other. "Everybody talks about gas," said Dunkin' Brands Group Inc. CEO Nigel Travis. "But there's no correlation between gas and [same-store sales]."

However, the latest gas price decline is unprecedented. The price of a gallon of gas has fallen for more than 100 straight days, according to AAA, and in 2014 Americans saved \$14 billion due to lower gas prices. Someone who uses around 60 gallons of gas a month now saves nearly \$70 from what they spent a year ago.

Some say it's difficult to imagine that at least some of that isn't flowing into restaurants, and late-year sales seem to bear that out. The NRN-MillerPulse survey recently reported its best month in eight years in December. Black Box Intelligence said its fourth quarter index was the best in six years. "It's hard to say it's not," Miller said. "When they drop this far, someone's got to get some occasions out of that. That's real money."

Popeyes Louisiana Kitchen Inc. reported double-digit same-store sales growth in the U.S. of 10.7 percent in the company's fiscal fourth quarter. That has capped a strong, seven-year run for the chicken chain.

In 2008, the company's market share of the quick-service chicken market was 15.8 percent. By the end of 2013, it grew to 23.2 percent. In 2014, the chain opened 201 new locations, which executives said is likely a company record. Average unit volume in the system increased from \$1.2 million in 2008 to \$1.6 million in 2013.

A big reason for the company's growth, according to CEO Cheryl Bachelder, is the profitability of Popeyes' franchisees. The chain is the only franchise restaurant that reports franchisee profitability numbers in its SEC reports, and those numbers have grown.

The average operating profit for a franchise unit in 2008 was \$176,000, Bachelder said. By 2013, it was \$279,000, for an operating margin of 21.6 percent.

Zoe's Kitchen Inc. was one of the top performers among restaurant companies that went public in 2014. The chain has 132 units and expects to open 30 locations this year. Much of that growth will be credited to the chain's health halo, due to its Mediterranean menu and the reported health benefits of such a diet. And young adults are well versed in health, CEO Kevin Miles said. "My 17-year-old daughter was far more educated on nutrition than I ever was until I was in my 40s," he said. "It's out there, and they start at a very young age."

The key for Zoe's is to ensure that it gets fresh produce, its top food product. That means whole lettuce, for instance, not bagged. Miles also said that consumers want transparency in their food — they don't care so much whether it's organic. "They want to know what they're putting in their mouth," he said.

Miles said Zoe's main competition is not other restaurant chains, but Whole Foods and its prepared food section. "That's who we compete with," he said.

Mobile technology isn't just a luxury for restaurants these days; it's a must, according to executives attending the conference. That includes Noah Glass, who founded mobile ordering provider Olo a decade ago. At that time, when relatively few people had a smartphone, mobile app development was not a priority at the executive level. Glass had to convince operators that mobile ordering was a good idea. Glass would get to talk with the chief marketing officer "if I was lucky." These days, he said, restaurant company CEOs task chief information officers with developing apps. "It's table stakes now," Glass said.

Most restaurant companies presenting at ICR highlighted their technology development initiatives. That included Papa Murphy's Holdings Inc. The Vancouver, Wash.-based take-and-bake pizza chain has been behind its pizza competitors on the technology front, but president and CEO Ken Calwell insisted it will catch up.

The company has been converting its 1,400-unit system from cash registers to a point-of-sale system, and hopes to be fully integrated by 2016 to enable online ordering.

While the chain is following, Calwell said, it is a "fast follower," meaning it will still be ahead of most of the pizza sector. "Pizza is a \$45 billion category," he said. Domino's and Pizza Hut "only make up 35 percent of that, so 65 percent of the category doesn't have online ordering."

Papa Murphy's stock price was relatively weak in 2014 for a newly public chain, due in part to weakness in some of the company's newer markets. Calwell said the company has stopped expanding in new markets and is instead expanding in existing markets more quickly. Doing so, he said, enables the chain to develop critical mass more quickly, so it can start advertising on television in those markets. Papa Murphy's doesn't advertise nationally. The company is also directing some marketing dollars to less-penetrated markets, where operators follow company guidelines. It is showing operators evidence that restaurants that do a better job of operating have stronger sales. Papa Murphy's has a five-star operations program in place. Units get stars for their ability on various operations metrics, such as speed, customer satisfaction, quality of service and cleanliness and profitability. "Basic blocking and tackling," Calwell said. Those units that score five stars on that program see a 10-percent same-store sales improvement. Those with no stars? A 3.6-percent same-store sales decline.

Sales for Dunkin' Donuts were largely considered a disappointment in 2014, which CEO Travis acknowledged. "No one takes comps more seriously than me," he said. "We were disappointed in our 2014. But we're going to do better this year." Travis acknowledged that he was "a little surprised" by the weakness this year, but said, "We learned a lot from it. We're better prepared, and had a little pickup at the end of the year."

## Private-sector job growth picked up in December, ADP reports

**Source:** LA Times, January 9, 2015

ADP says private-sector job growth improved to 241,000 in December. Broad-based gains, including in high-paying construction and manufacturing, boosted Dec. job growth, ADP says. Private-sector job growth accelerated in December with U.S. businesses adding 241,000 net new jobs, payroll firm Automatic Data Processing.

The figure was an increase from 227,000 in November, which was revised up from an initial estimate of 208,000. Economists had forecast December job growth to be 235,000. "The job market continues to power forward," said Mark Zandi, chief economist of Moody's Analytics, which assists ADP in preparing the report. "Businesses across all industries and sizes are adding to payrolls," he said. The ADP data is watched closely as a harbinger of the Labor Department's jobs report, which covers private- and public-sector hiring and is scheduled to be released Friday. Economists expect that report to show job growth slowed in December to 245,000 after a surprisingly strong November in which payrolls expanded by 321,000.

If they're close to correct, December would be the 11th straight month the economy added more than 200,000 net new jobs. The unemployment rate is forecast to have ticked down to 5.7% last month, which would be the lowest since mid-2008. ADP said there were broad-based job gains in December. Manufacturers increased their payrolls by 26,000, up from 16,000 in November. Another high-paying job sector, construction, increased its hiring as well. Firms added 23,000 net new jobs in December, compared with 20,000 the previous month. The service sector also boosted its hiring, adding 194,000 net new jobs after an 187,000 increase in November.

## States with the Fastest Job Growth in 2014

**Source:** Department of Commerce: GDP Data, December 8, 2014

**The good news keeps coming in the job market, pointing to an increase in labor market momentum going into 2015.** Expect a pickup in 2015 monthly job gains to 250,000 — about 3 million for the year.

These gains will keep incomes and consumption fueling healthy economic growth. In November, companies hired 321,000 more workers, the largest one-month gain in nearly three years. Gains were widespread across nearly all industries. A bit of good news for lower-skilled workers is that retail and food service have added 212,000 jobs in the past three months, and that's likely the reason for the recent strong employment gains among those with less than a high school diploma, especially among women. What's more, the number of those who are working part-time but would like to work full-time declined for the fifth straight month, and the number of long-term unemployed continued to slide, pointing to real improvement in the labor market.

**Look for the unemployment rate to end the year about where it is, at 5.8%, with a gradual decline to around 5.3% likely over the course of 2015.** Most of the drop in the unemployment rate will continue to come from reduced numbers of long-term unemployed, as the ranks of those unemployed for less than six months is already near its prerecession level. Meanwhile, wage growth is likely to bump up a small amount in 2015 to 2.4%. It remained at a steady 2.2% rate in November for nonsupervisory workers -- about the same as last year. This number could be deceptively low, however, because a large number of retiring higher-earning older workers may be depressing the overall average. In any case, there is little evidence yet of upward pressure in the measure.

## **Auto Sales, Borrowing and Oil**

### **Carmakers finish strong in 2014; are even better days ahead?**

**Source:** Associated Press

Confident in the economy and cheered by cheap gas, Americans are likely to push new car sales to their highest level in a decade this year. Analysts expect sales to reach 17 million for the first time since 2005. That's close to the record of 17.3 million set in 2000. Low gas prices are giving buyers more confidence, whether they're buying their first subcompact or upgrading to a larger SUV. Gas prices started this year at an average of \$2.23 per gallon, down 33 percent from the beginning of 2014, according to AAA. The Energy Department estimates that lower gasoline prices will save U.S. households \$550 this year -- about four months of lease payments on a 2014 Honda Civic. Popular new vehicles, like the Jeep Cherokee and Subaru Outback, are also drawing buyers. Sales have now grown for five consecutive years -- a rarity in the volatile auto industry. While sales are growing, the pace has slowed from double-digit increases in 2011 and 2012. That's good news for buyers, who can expect to see bigger discounts in competitive segments like midsize cars as automakers fight to steal sales from each other.

Alec Gutierrez, an analyst with the car buying site Kelley Blue Book, thinks sales could stay in the 17-million range for the next two or three years if interest rates stay low and the U.S. economy remains healthy. December, with its holiday discounts and warmer-than-usual weather, brought buyers out in droves, with sales up 11 percent over the previous year. Automakers reported December and full-year sales.

For all of 2014, sales were up 6 percent to 16.5 million vehicles, according to Autodata Corp. That was the biggest year for the industry since 2006. Back then -- as now -- the Ford F-Series was the country's best-selling vehicle and the midsize Toyota Camry was the best-selling car. The top-selling SUV was the Ford Explorer, but it was only No. 14 among all vehicles sold, according to Ward's AutoInfoBank. In 2014 two smaller SUVs -- the Honda CR-V and the Ford Escape -- cracked the top 10 in sales as customers turned away from small and midsize cars as car-like handling and low gas prices made such vehicles more appealing. Toyota, Fiat Chrysler and General Motors all reported 2014 sales increases, and

Nissan, Subaru, Hyundai and Honda reported record numbers for the year. Ford's sales were flat, but the Ford brand remained the top-selling brand in the U.S. Among major automakers, only Volkswagen's sales fell.

**Here are more details about 2014 and trends to watch for this year:**

**Best-sellers:** General Motors -- with its Buick, Chevrolet, Cadillac and GMC brands -- sold the most vehicles in the U.S. in 2014 despite a scandal over the delayed recall of faulty ignition switches in older small cars. GM sold just over 2.9 million vehicles, up 5 percent from 2013.

**Winners and losers:** Among major automakers, Subaru was the biggest gainer, with sales up 21 percent to 513,693 vehicles in 2014. Subaru's three new utilities -- the Crosstrek, Forester and Outback -- drove sales. FiatChrysler was the year's other big gainer, with sales up 16 percent to 2 million, thanks to strong demand for its Jeep and Ram brands. Volkswagen had a difficult year, as sales fell 10 percent while the German automaker waited for new vehicles to hit U.S. showrooms. Mini also struggled as gas prices fell, with sales down nearly 20 percent.

**SUV boom:** Gas prices accelerated the switch from cars to SUVs. Light trucks, the category that includes SUVs, outsold cars in 2014 -- the first time that's happened since 2011, according to car shopping site Edmunds.com. That's partly because automakers are offering more types of SUVs, including fuel-efficient subcompacts such as the Buick Encore, to appeal to young families and Baby Boomers. The trend is likely to continue in 2015 as more small SUVs, like the Honda HR-V, Jeep Renegade and Mazda CX-3, hit the market.

**Luxury growth:** As the stock market rose, so did sales of expensive vehicles. BMW, Audi, Porsche and Land Rover all reported record U.S. sales in 2014. Lexus luxury sales outpaced mass-market sales last year, and they're expected to do so again this year. Luxury makers are offering more models, like the new Maserati Ghibli sedan and Lincoln MKC SUV, and they're expanding their customer base with lower-priced models like the Mercedes GLK-Class and Jaguar XE due out this year. Mercedes-Benz was expected to be the top-selling luxury brand in the U.S. for 2014.

**Pickup wars:** Ford's F-Series, the best-selling truck in the U.S. for 38 years, saw sales drop in 2014 as the company temporarily halted production to prepare for its new aluminum-sided F-150. The new truck arrived at dealerships in December, but inventory won't be at normal levels until the middle of 2015. In the meantime, rivals are offering big deals to lure customers away. Ram truck sales rose 24 percent in 2014, while Silverado sales gained 10 percent.

## **New Car Sales Predicted to Top 17 Million in the US in 2015**

**Source:** *The Detroit Bureau*, December 22, 2014

TrueCar expects the luxury vehicle segment to experience the largest sales growth in 2015. A catalytic combination of an improving economy and lower gas prices will result in record results for the auto industry in 2015. TrueCar, the online car-selling and data service, is predicting that new vehicle sales will exceed 17 million units next year and total sales will be more than 55.7 million units. To boil down TrueCar's expectations for 2015, the firm expects that companies selling cars will sell more than ever and make more money on each sale next year than they did in 2014. The most eye-popping number may be the prediction of new vehicle sales hitting 17 million units, which would be a 2.6%

increase over the expected result for this year. The record for annual sales is 17.4 million, which occurred in 2000. However, TrueCar isn't alone in predicting 17 million units for next year. Mike Jackson, CEO of AutoNation, said the same in late October during the company's third quarter conference call. "Of course, anything that begins with a 17 has only happened twice before, I recognize that. But I think indeed, the market will break through 17 million," he said during the call. However, not everyone is willing to stretch to the "Magic 17" as the National Automobile Dealers Association has officially pegged next year's number at 16.9 million, but allows for a possibility that it could push through to 17 million if younger buyers come out in force.

**Other numbers to know, include:**

- Total market sales, including new and used, should rise 3.4% to 55.4 million units over about 54 million in 2014.
- Total revenue of \$1.2 trillion based on average transaction prices, which is a 5.5% annual increase.
- New vehicle revenue, based on transaction prices, is projected to reach \$553 billion, a 5% increase
- Average transaction prices of new vehicles in 2015 will rise 2.4% to a record \$32,589
- Average transaction prices of used vehicles should increase 2.1% to \$16,678 next year.
- Used vehicle volume will grow 3.8% to 38.4 million units, up from 37 million in 2014.

In addition, sales across nearly every segment will rise next year and luxury auto sales will lead the charge with a 9.8% segment increase, which should rise to \$116.7 billion in 2015 compared with \$106.3 billion in 2014. The fascination with utility vehicles isn't expected to abate any next year either as TrueCar expects that segment to rise 5% to \$192.1 billion, and pickups to reach \$95.7 billion, up 4.5%. "Ford's redesigned F-Series pickups, Mazda's CX-3 crossover as well as the Mercedes GLA luxury crossover should be standout models in their respective segments next year," Krafcik said. "Mass-market cars, pickups, utility vehicles and premium autos – the four 'Super Segments' TrueCar identified previously – will grow next year, though cars will cede market share as more consumers move to utilities and luxury."

### **U.S. Auto Sales Surge in December**

**Source:** *Wall Street Journal*, January 5, 2015

December new-car sales jumped 11% over a year ago to 1.5 million vehicles, aided by low interest rates, cheap gasoline and an improving job market, returning overall demand last year to pre-recession levels.

Auto makers reported their strongest annual U.S. sales since 2006, taking advantage of low fuel prices and interest rates to rebound from a global financial crisis that hammered results and forced some companies to undergo government-brokered restructurings.

Sales of light cars and trucks in the U.S. rose 5.9% from a year earlier to more than 16.5 million in 2014, according to market researcher Autodata Corp. December sales were roughly 1.5 million, up nearly 11% from a year earlier, Autodata said. The sales results buoyed car executives, blunting the overhang of a record year for recalls that began with General Motors Co.'s acknowledgment of a faulty ignition switch in older cars now linked to 42 U.S. deaths. Fiat Chrysler Automobiles NV also faces scrutiny over fiery crashes involving older Jeep models, and almost all car companies are

dealing with the fallout from defective air bags manufactured by Japanese supplier Takata Corp. But those recalls are taking a backseat in the mind of consumers wooed by low fuel prices, zero-interest financing deals and more money in their pockets. Car sales are surging ahead of new vehicle releases at this month's North American International Auto Show, and auto makers expect to keep up the improved sales pace this year.

"The 2015 economic indicators remain robust and the fundamentals are poised for a continuation of the momentum we saw in the latter part of 2014," said Ford Senior Economist Emily Kolinski Morris. She said low fuel prices are boosting consumers' disposable incomes alongside gains in the job market. Still, auto sales gains are likely to cool this year and the Federal Reserve is poised to begin raising interest rates by mid-year. Auto executives and others played down any potential fallout from rising rates, suggesting that incremental increases would keep rates at historically-low levels and still entice buyers.

"This year looks pretty good," said Mark Wakefield, a managing director at turnaround and consulting firm AlixPartners LLP. He expects a moderate rise in auto sales this year largely because of low fuel prices but cautioned interest rates are "the big thing we worry about" starting around 2017. A significant rate hike can raise vehicle prices by thousands of dollars and force auto makers to ramp up incentives that "murder their profitability," he said. Consumers are flocking to higher-margin and less fuel-efficient pickup trucks and sport-utility vehicles. "I am usually looking for the black swans when it comes to auto sales, but this year I see nothing but white swans," said Mike Jackson, chief executive of AutoNation Inc., the largest U.S. auto retailer. "There had been a slow migration back to SUVs and pickup trucks. Now, with cheap gas, I think that may turn into a stampede. I think it will be very difficult for small cars and especially the hybrids and electrics," he said GM and Chrysler posted double-digit sales gains in December. GM said its sales jumped 19% in December to 274,483 light vehicles. Pickup-truck sales added nearly 87,000, GM said. For the year, GM sold about 2.9 million light vehicles, the company said.

Chrysler said it sold 193,261 vehicles in December and more than two million units for the year, its best December in a decade and year since 2006. Chrysler benefited from strong demand for its Ram trucks and Jeep SUVs. Ford Motor Co.'s sales were flat in December, rising slightly to 219,369. The figure was held back by intentionally fewer sales to rental-car companies and a limited supply of its best-selling F-150 pickup. Ford said it sold nearly 2.5 million vehicles in 2014, down slightly from a year ago.

Ford's weaker results pushed its shares down 3.9% amid a broad market decline. GM shares fell 1.5%, Toyota was off 1.8%, Honda 2% and Fiat Chrysler lost 3.8%. December is traditionally a strong month for auto sales as auto makers offer holiday deals and discount to clear out older models. Consumers are currently flocking to showrooms amid low gasoline prices and an improving U.S. job market.

The month marked the highest average transaction price on record for light vehicles, according to Kelley Blue Book. The average rose nearly 3% year-to-year to \$34,367 and was up 1.6% from November. GM said much of its 19% December sales increase over a year earlier came from retail transactions, while pickup-truck sales surged 43%. The company said it was its best December since 2007. Ford's combined truck and SUVs sales rose 4% in December although sales of its F-series pickups fell slightly for the month. Its car sales, meanwhile, declined 1.1%.



Nissan Motor Co. said it sold 117,318 vehicles last month, up 6.9% from a year earlier. Much of the gain came from its car sales, which rose more than 12%. The company's Sentra, Altima and Leaf cars posted strong gains. The Japanese company said it set an annual U.S. sales record of 1.4 million light vehicles.

Honda Motor Co. said it sold more than 1.5 million vehicles in the U.S. during 2014, the company's second-best total. Its U.S. sales last month rose 1.5% to 137,281 vehicles, as growth in sport-utility sales offset a decline in car sales.

Toyota Motor Corp. said its overall U.S. December sales rose 13% from a year earlier to 215,057 light vehicles. Its full-year U.S. sales rose 6% to nearly 2.4 million vehicles, putting it third behind GM and Ford. Toyota executives pointed to higher sales of trucks and SUVs. In addition, the auto maker's 25-year-old luxury Lexus brand posted a monthly sales record of 39,879. Sales of its Camry sedans were up more than 5% in December, and up 5% to more than 428,000 for the year. Sales of Toyota's Prius hybrid fell 8% and 12% for the month and year, respectively, amid low gas prices. BMW AG reported an 11% December sales increase in its namesake brand, retaining its rank as the best-selling U.S. luxury brand for the month and year. It sold 41,526 vehicles last month and 339,738 for the year, topping [Daimler](#) AG's Mercedes-Benz brand, which was the second-best seller for the full year. Toyota's Lexus brand was the second-best selling luxury brand for the month in the U.S. and third-best for 2014. Mercedes-Benz sales rose 3% for the month to 34,009 and 5.7% for the full year.

## Why Are So Many Recent Car Loan Borrowers Missing Payments?

**Source:** Associated Press, January 9, 2015

Like my new wheels? I got it through an 8-year loan with a 22% APR. In 2014, new car sales increased to 16.5 million, the highest level since 2006, but did too many car buyers take on more than they could afford?

A Wall Street Journal/Moody's report looks at just those consumers who took out a car loan in the first quarter of 2014. In that short period of time, more than 2.6% of these borrowers have missed at least one payment.

That percentage might not seem terribly high to you, but it is the highest level of early loan trouble since 2008. At that time, early delinquencies rose above 3% just before the housing market crashed. During the recession, lenders tightened their underwriting restrictions, making it more difficult for loan applicants with less-than-pristine credit to qualify for car loans. But as the economy stabilized, banks began opening up those loans to subprime borrowers. In 2013, around 1-in-4 car loans were written to subprime borrowers, some of whom faced interest rates higher than 20%. So while these consumers had more access to credit, that credit may have come at a cost that some could not afford.

The WSJ analysis found that 8.4% of subprime auto loan borrowers during the first quarter of 2014 had missed at least one payment by November. Again, this represents the highest early delinquency level since 2008, when passed the 9% mark.

While the general level of all car loan borrowers who have missed at least one payment (3.4%) is slightly higher than 3.2% during the same time last year, that rate is still below the 4.2% high water mark from 2009.

The U.S. Office of Comptroller of Currency, which regulates the largest banks, says that it has seen a trend toward relaxed standards and riskier behavior in auto loans.

“We’re putting banks on notice that we have concerns,” the OCC’s deputy comptroller of supervision risk management tells the Journal. “It’s definitely an area that warrants some attention.”

Last summer, the Dept. of Justice issued a subpoena to General Motors regarding its subprime auto loans, requesting that the car maker turn over documents related to the underwriting criteria it used to make subprime auto loans since 2007, as well as information about the representations GM made about the criteria when the loans were pooled into securities.

If you’re in the market for a new or used car and need to take out a loan, please remember to not be sweet-talked into buying a more expensive vehicle just because you *can* get financing. Buying what you know you can afford — even if it’s not going to turn heads in the parking lot — is the best way to avoid missed payments or being saddled with a car you’ll take big loss on when you eventually resell it.

## California Gas Prices Increase with State’s Cap and Trade Rules

**Source:** *Government Executive*, January 13, 2015

Gas prices have plummeted across the country and California is no exception. Except, in one significant way it is. Camouflaged by the steeper overall drop in prices, the cost of gasoline in the Golden State has ticked up in response to the state’s cap-and-trade rules.

As *The Sacramento Bee* reports, the rise in California fuel prices is part of the state’s 2006 climate change law, which requires larger corporate enterprises to purchase carbon offsets to compensate for the level of greenhouse emissions they produce.

Under the law, companies are given a set allowance of greenhouse emission levels. If they exceed those levels, they are required to purchase credits for additional carbon levels. The market-based approach was first produced in a rare alliance between Republicans in the U.S. House and environmentalists in the early 1990s but has since fallen out of favor with most national lawmakers.

Proponents of the approach say it allows businesses to continue to grow while paying a reasonable fee, rather than having development brought to a halt by inflexible laws or regulations. In addition, the carbon taxes are micro-targeted to those directly producing the emissions, rather than imposing a broad based set of fees on everyone.

Still, opponents of the law have warned that those carbon offsets could generate a major spike in California's gas prices. But according to the fuel price aggregator GasBuddy.com, prices have only gone up by two cents since the carbon trade requirement went into effect on Jan. 1.

That sentiment was echoed by Air Resources Board spokesman Dave Clegern, who told the paper: "We don't see them going up more than a dime, at the most, based on any current cap-and-trade compliance costs. We won't speculate on fuel price projections, but the high-end numbers would require the cost of carbon allowances to increase more than six times beyond where they are now." California already has some of the nation's most expensive gasoline, trailing only New York, Alaska and Hawaii. But most motorists probably did not notice the uptick in prices over the last few days when weighed against the far larger overall drop in prices compared to one year ago today.

The Air Resources Board is one of several organizations that make carbon credits available for sale to companies on the open market. It plans to make more credits available to offset increased demand, according to the *Bee*.

California fuel prices are likely to continue to marginally rise in the coming years even if fuel prices remain static, as the cut off in the state's cap-and-trade law will slightly decrease annually over the next several years, meaning that companies will be required to purchase more carbon credits.

Gov. Jerry Brown, sworn in for his fourth term in office, has called on the state to increase its use of renewable energy sources to help ease the impacts of climate change. "We must demonstrate that reducing carbon is compatible with an abundant economy and human well-being," the governor said, according to The Associated Press. A portion of the revenue generated from the California's cap-and-trade program is being used for the construction of the state's ambitious high-speed rail project.

### **Fears of a 'hidden gas tax' were vastly overblown**

Source: San Francisco Chronicle, January 17, 2015

Throughout 2013, the oil industry and its allies warned that California's gasoline prices would soar in January, when the state's cap-and-trade system to fight global warming would expand to include fuels. The change, they argued, would amount to a clandestine tax on California families, who could end up paying 76 cents more per gallon as a result.

January is now halfway through — and California's gas prices are falling.

The state's average for a gallon of regular has dropped 10 cents since the start of the year to reach \$2.54 on Friday, according to AAA. Not since May 2009 — during the recession — has California seen gas this cheap. Fuel market experts say cap and trade did, indeed, boost prices. But the increase was so small and happened so fast that almost no one noticed. The state's average rose from \$2.63 on Jan. 1 to \$2.66 on Jan. 5 and then started sliding again, pulled down by the worldwide plunge in oil prices.

“California did see a little bump from cap and trade, but it’s being washed out by the larger trends in the oil market,” said UC Davis economist James Bushnell. “Absent a big change in the carbon price, we’ve already seen what the impact is going to be from cap and trade.”

### **Why it started**

Introduced in 2012, the cap-and-trade system forces companies to buy permits, or “allowances,” for every ton of carbon dioxide and other greenhouse gases they pump into the atmosphere. The system was designed to expand over time, at first covering mainly factories and power plants. Now, oil companies must buy allowances for the emissions that come from burning gasoline and other fuels sold in California.

At the current allowance price, just over \$12, most economists expected cap and trade to add perhaps 10 cents to the state’s average gasoline price. But the oil industry, which wanted its fuels to be exempt from the system, touted studies suggesting the cost could be much higher.

A network of advocacy groups funded by the industry waged a public relations campaign warning that the state’s economy would suffer. That campaign continued even as global oil prices started tumbling in the fall.

“It shows the lack of credibility of the oil industry on this issue, because while oil prices were going down, the sky-is-falling predictions kept ratcheting up,” said Timothy O’Connor, director of California climate programs at the Environmental Defense Fund. Catherine Reheis-Boyd, president of the Western States Petroleum Association, said California drivers are paying more due to cap and trade, even if the added cost is hard to see.

“Current costs at the pump are a direct result of the dramatic increase in domestic energy production in the United States,” she said. “These lower prices will be partly offset in California by the higher costs associated with the ongoing expansion of the cap-and-trade program.”

The fight over including fuels under cap and trade grew so heated last year that consumer groups claimed the oil industry might try to manufacture a price spike in a bid to kill the system, or at least win an exemption from it. While industry representatives called that claim ridiculous, state officials did appoint a committee of economists to monitor the fuel markets and assess the exact impact of cap and trade.

### **Hard to figure**

Since gasoline prices are falling nationwide, it’s hard to tell precisely how much cap and trade has added in California. The national average for regular has dropped 15 cents this month — 5 cents more than California’s average — to reach \$2.09 per gallon, according to GasBuddy.com. Arizona’s average has fallen 20 cents to hit \$1.96. “Cap and trade costs are really being masked right now,” said Denton Cinquegrana, chief oil analyst with the Oil Price Information Service. “You have a really cheap market.” It may not stay that way. California’s gasoline prices often rise in February, as the state’s refineries undergo maintenance and switch to making a blend of gasoline designed for use in warm weather. And the refineries tend not to keep much inventory in stock, so an unexpected problem at one of them can push prices higher.

## Governor's Proposed 2015 State Budget - Overview

**Source:** *Legislative Analysts' Office*, January 13, 2015

**Oil Price Collapse - Forecast Does Not Reflect Recent Changes.** *The administration's new economic forecast projects that real gross domestic product (GDP) for the U.S., a key measure of overall economic activity, rose 2.2 percent in 2014 and will grow by 2.6 percent in 2015 and 2.8 percent in 2016. (A comparison of the administration's economic projections with other recent forecasts will be posted on our California Economy and Taxes blog.) This is a reasonable forecast, but by necessity, the administration had to complete most of its forecasting work before the sharp fall in worldwide oil prices. Like the prices in California's primary oil field displayed in Figure 5, worldwide oil prices have fallen sharply in recent months from over \$100 per barrel to about \$50 per barrel, with much of this drop occurring during December. By contrast, the administration's forecast assumes roughly \$80 per barrel oil prices in the final quarter of 2014, as well as all of 2015. At the same time that oil price declines are helping the economy in various ways, other key economic data have been strong. For example, the preliminary estimate of California's November 2014 job growth (90,100) was the second-highest seasonally adjusted monthly increase since 1990. Based on all these trends, we currently assume that real GDP will grow slightly faster than the administration estimates in 2014 and 2015.*

**Low Oil Prices Help Economy in Near Term.** Oil accounts for more than one third of all U.S. energy use, mostly as vehicle fuel. Some recent studies estimate that lower oil prices should cause overall U.S. economic output to rise by 0.5 percent to 1 percent on a one-time basis, accounting for both the gains to oil users and the losses to oil producers. The positive effect of a price decline on California would most likely be in the same range, if not slightly above the national average. Although California is a net consumer of oil, some areas of the state (such as Kern County) are net producers. Cheaper oil can hurt these local economies.

**Gasoline Prices Affect Transportation Funding.** As oil prices have dropped, so have California's gasoline prices. In early January the average retail price of gasoline in California was \$2.72 per gallon—down a dollar since the first week of October. When prices drop, consumers buy more gasoline. California's transportation funding relies heavily upon gasoline excise taxes. The state's gasoline excise tax has two parts, and low gasoline prices affect each part differently. The first one—an 18-cent "base" excise tax—depends only on the amount of gasoline sold. Low prices lead to higher gasoline consumption, which leads to higher revenue from the base excise tax. The second excise tax on gasoline—resulting from California's fuel tax swap—has a rate that varies from year to year. In the short run, revenue from this tax depends only on the amount of gasoline sold, so low gasoline prices lead to higher revenue. However, the year-to-year rate changes are based on a formula that incorporates past gasoline prices. That means that low gasoline prices this year will lead to a lower excise tax rate—and therefore lower revenue—in future years.

## Retail

### U.S. Holiday Sales Rose 4%, Just Shy of Prediction

**Source:** Bloomberg News, January 14, 2015

U.S. holiday sales rose 4 percent from a year earlier, marking the biggest increase since 2011, even amid signs of a consumer-spending slowdown in December, according to the National Retail Federation. Holiday spending growth had been forecast to rise a slightly higher 4.1 percent in the period, which spans November and December. Still, the increase was well above the previous year's 3.1 percent gain and the 10-year average of 2.9 percent, the Washington-based trade group said.

While the gain was nearly in line with the estimate, U.S. Commerce Department figures raised concerns spending slowed in December. Retailers spread out the holiday season this year, encouraging shoppers to make more purchases before Thanksgiving. That may have robbed some sales from the weeks leading up to Christmas, even as lower unemployment and cheap fuel put more money in consumers' pockets.

"While December's figures are disappointing, holiday sales in 2014 are the best we've seen since 2011," NRF Chief Economist Jack Kleinhenz said in a statement. "We remain positive about the future and expect to see consumers continue to benefit from the extra income gained from an improved job market and the dramatic fall in gas prices."

### Broader Slump

The Commerce Department figures showed that December retail sales slumped by the most in almost a year. The 0.9 percent drop reflected a broad-based decline among nine of 13 major categories, including electronics and clothing stores.

The NRF figures exclude auto sales, gas stations and restaurants, so they give a different picture of the economy. Still, the NRF also measured a 0.9 percent drop in seasonally adjusted month-to-month sales in December.

Total holiday spending rose to \$616.1 billion, according to the NRF. E-commerce sales outpaced broader spending, climbing 6.8 percent to \$101.9 billion.

During the holiday season, retailers relied less on major events such as Black Friday, the day after Thanksgiving, opting instead for a steady stream of promotions.

A separate research firm, First Data, said retail sales increased 3.2 percent from Nov. 1 to Jan. 4, up from a 0.5 percent gain in the year-earlier period. Sales climbed 5.3 percent from Thanksgiving through Cyber Monday, which follows the Black Friday weekend, the Atlanta-based firm said. That also suggests spending slowed down in December.

ShopperTrak, meanwhile, had a more optimistic view. It said holiday spending jumped 4.6 percent from a year earlier. That was the biggest rise since 2005 and exceeded the Chicago-based company's forecast for a 3.8 percent gain.

“Retailers were very proactive this year about trying to get a share of the consumers’ wallet early,” said Christa Hart, senior managing director in the retail and consumer products practice of FTI Consulting Inc.

### **Black Friday Fizzles With Consumers as Sales Tumble 11%**

Source: *Bloomberg*, December 1, 2014

Mark Ellwood, author of “Bargain Fever,” and Willem Buitter, chief economist at Citigroup, talk about Black Friday retail sales and the watering down of Cyber Monday. Even after doling out discounts on electronics and clothes, retailers struggled to entice shoppers to Black Friday sales events, putting pressure on the industry as it heads into the final weeks of the holiday season. Spending tumbled an estimated 11 percent over the weekend from a year earlier, the Washington-based National Retail Federation said yesterday. And more than 6 million shoppers who had been expected to hit stores never showed up.

**Black Friday:** Consumers were unmoved by retailers’ aggressive discounts and longer Thanksgiving hours, raising concern that signs of recovery in recent months won’t endure. Retailers also were targeted by protesters, who called on consumers to boycott Black Friday to make a statement about police violence. Still, the NRF cast the decline in a positive light, saying it showed shoppers were confident enough to skip the initial rush for discounts. Consumer spending fell to \$50.9 billion over the past four days, down from \$57.4 billion in 2013, according to the NRF. It was the second year in a row that sales declined during the post-Thanksgiving Black Friday weekend, which had long been famous for long lines and frenzied crowds.

**Doorbuster Deals:** Retailers rolled out their usual doorbuster specials in a bid to lure customers. Wal-Mart Stores Inc. sold an RCA tablet for \$29, DVD movies for \$1.96 each and a 50-inch high-definition television for \$218. Best Buy Co. had a 55-inch Samsung 4K television for \$899, hundreds less than its usual price. Even so, many shoppers stayed home. The NRF had predicted that 140.1 million customers would visit retailers, a small decline from last year’s 140.3 million. Instead, only 133.7 million showed up. The slow start may make it harder for retailers to hit sales targets over the next month. The NRF had predicted a 4.1 percent sales gain for November and December -- the best performance since 2011.

Retailers’ shares dropped this morning following the report. Wal-Mart (WMT), based in Bentonville, Arkansas, fell 1.4 percent to \$86.36 as of 10:14 a.m. in New York. Macy’s Inc. declined 2.7 percent to \$63.16, and J.C. Penney Co. decreased 5.2 percent to \$7.59.

**Early Promotions:** An effort by some retailers to put items on sale ahead of Thanksgiving may have contributed to sluggish demand on Black Friday, Shay said. The slower foot traffic means retailers will have to wring more money from consumers in December, including during Cyber Monday e-commerce blitz. Holiday shopping is key for retailers -- with sales in November and December accounting for about 19 percent of annual revenue, according to the NRF -- and more of that is shifting online.

**The Internet:** The Web may not be a savior for traditional retail, though. While e-commerce orders are growing, they’re still dwarfed by brick-and-mortar sales. The novelty of Cyber Monday is dimming. So far (at the time of the article), holiday shoppers have spent \$22.7 billion online this season, up 15 percent from a year earlier, according to ComScore

Inc. That includes more than \$1.5 billion on Black Friday. The e-commerce growth means shopping malls have to work harder to get people in the door.

**Spending Amount:** The average shopper spent an estimated \$380.95, a 6.4 percent drop, according to an NRF-commissioned survey of more than 4,600 people by Prosper Insights & Analytics. Retailers also had to contend with demonstrations from protesters angered by the decision not to indict a white police officer in the killing of an unarmed black teenager in Ferguson, Missouri. Events were held at stores and malls nationwide on Black Friday, with some of the protests leading to brief standoffs with police. Demonstrators also called on consumers to boycott retailers, using the hashtag #NotOneDime to promote the campaign on Twitter.

The industry's focus now shifts to Cyber Monday, when e-commerce sites release another wave of discounts. Almost 127 million Americans will shop online today, Prosper predicts, down from 131.6 million a year earlier. That lends evidence to the notion that Americans are less enticed by one-day sales events.

**Seeking Equilibrium:** Many consumers also don't feel like the economy has recovered from the recession yet, Shay said. That makes it difficult to gauge how much they plan to spend. "The challenge is looking for a new equilibrium, and we just haven't found it," he said. Retail chains have spruced up their websites in recent years, though they've struggled to keep pace with Amazon.com Inc. Sales at Amazon, the world's largest online retailer, jumped 46 percent on Saturday and 24 percent on Black Friday, according to ChannelAdvisor Corp. That exceeded total e-commerce growth on those days, the research firm found.

Cheaper gasoline prices, meanwhile, are working in the retail industry's favor. The average cost of a gallon of regular gasoline was \$2.81, the lowest in four years, according to the automobile group AAA. That's leaving more money in shoppers' wallets -- and making it less expensive to take a trip to the mall.

## U.S. Retail Stores Closing, Chains Downsizing & Retailer Bankruptcies in 2015

Source: *USA Today*, January 8, 2015 and [www.retailindustry.about.com](http://www.retailindustry.about.com)

It was announced that J.C. Penney and Macy's will be closing several stores around the country, and laying off thousands of their employees. According to WWD, J.C. Penney will start 2015 by shutting the doors on 39 stores, and laying off 2,250 store associates. Topping the list of store closures is Pennsylvania with five, while North Carolina has four. Many other states, such as California, Florida and Washington, do not have any locations that are on the store closure list.

While this does not come as a surprise from the retailer as it announced the closure of more than 30 locations last January, for Macy's it does come as a shock. The retail giant also announced its plans to close 14 stores, completely revamp its marketing plans and shift more focus onto online sales. "Our business is rapidly evolving in response to changes in the way customers are shopping across stores, desktops, tablets and smartphones. We must continue to invest in our business to focus on where the customer is headed — to prepare for what's next," said Terry J. Lundgren,



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Macy's chairman and chief executive officer. And while Macy's will be opening 9 new stores in 2015, J.C. Penney will not have any new locations this year. Macy's is also looking to open its first international location in 2018, at Al Maryah Central, a "super-regional shopping destination" in Abu Dhabi. Both retailers are working with employees to provide separation packages, and help find employment in nearby locations. Even before the end of calendar year 2014, the largest U.S. retail chains had announced hundreds of store closings that will be happening in the calendar year 2015.

The general opinion among U.S. retail consumers and casual U.S. retail industry observers is that store closings are "bad" and a sign of weakness, while store openings are "good" and a sign of growth, expansion, and success. The store closings by U.S. retail chains in 2015 are not so easily categorized. Retail store closings in the U.S. have less to do with economic implications and more to do with sociological insights. Store closings are no longer about discretionary income as much as they are about consumer empowerment and how retail consumption is shapeshifting in response to rapidly changing consumer behaviors and preferences.

The amount of commercial retail store space in the U.S. grew 12% from 1970 to 2010. In a consumer-driven economy where approximately 70% of the GDP is dependent on the purchase of goods and services, this seems like a positive indicator of economic expansion and strength. But during that same time period, the population of the U.S. consumers only grew 52%. So rather than being a sign of economic stability, the number of retail stores in the U.S. is more of a sign of retail store supply exceeding retail store demand.

Does the U.S. marketplace need 50 square feet of retail space for every man, woman, and child within the country's borders? The ongoing and steady post-recession stream of store closings since seems to indicate that the answer is "no." It's not that consumers haven't been making money and spending it on retail goods and services since the Great Recession. Rather, it's that consumers are losing interest in and patience for the retail store distribution model.

Below is a list by retailindustry.about.com that was last updated on January 5, 2015 that captures announced store closures. The closures of J.C. Penny, Macy's and Wet Seal closures were announced after that date.

400	Office Depot / Office Max (by 2016)	80	Wolverine World Wide (2015 - Stride Rite & Keds)
250	Office Depot (2015)	77	Sears (2015)
225	Staples (through 2015)	70	Coach (fiscal 2015)
223	Barnes & Noble (through 2023)	63	Pep Boys ("in the coming years")
200	Radio Shack (through 2017)	55	Staples (2015)
180	Abercrombie & Fitch (by 2015)	54	Golf Galaxy (by 2016)
175	Aeropostale ("over the next several years")	50	Express (through 2015)
75	Aeropostale (through January 2015)	50	Guess (through 2015)
66	Bottom Dollar Food	50	Wet Seal
170	Jones Group (by mid-2014 )	25	Build-A-Bear (through 2015)
150	American Eagle Outfitters (through 2017)	20	Pick 'n Save (by 2017)

## Housing

### 2015 California Housing Market Forecast

Source: *California Association of Realtors*, October 7, 2014

**California home sales to increase slightly, while prices post slowest gain in four years.** With more available homes on the market for sale, California's housing market will see fewer investors and a return to traditional home buyers as home sales rise modestly and prices flatten out in 2015, according to the "2015 California Housing Market Forecast."

The C.A.R. forecast sees an increase in existing home sales of 5.8 percent next year to reach 402,500 units, up from the projected 2014 sales figure of 380,500 homes sold. Sales in 2014 will be down 8.2 percent from the 414,300 existing, single-family homes sold in 2013. "Stringent underwriting guidelines and double-digit home price increases over the past two years have significantly impacted housing affordability in California, forcing some buyers to delay their home purchase," said C.A.R. President Kevin Brown. "However, next year, home price gains will slow, allowing would-be buyers who have been saving for a down payment to be in a better financial position to make a home purchase."

"Moreover, prospective buyers should know that it's a misperception that a 20 percent down payment is always required to buy a home. There are numerous programs available that allow consumers to buy a home with less down payment, including FHA loans, which lets buyers put down as little as 3.5 percent," continued Brown. C.A.R.'s forecast projects growth in the U.S. Gross Domestic Product of 3 percent in 2015, after a projected gain of 2.2 percent in 2014. With nonfarm job growth of 2.2 percent in California, the state's unemployment rate should decrease to 5.8 percent in 2015 from 6.2 percent in 2014 and 7.4 percent in 2013.

The average for 30-year fixed mortgage interest rates will rise only slightly to 4.5 percent but will still remain at historically low levels. The California median home price is forecast to increase 5.2 percent to \$478,700 in 2015, following a projected 11.8 percent increase in 2014 to \$455,000. This is the slowest rate of price appreciation in four years.

"With the U.S. economy expected to grow more robustly than it has in the past five years and housing inventory continuing to improve, California housing sales and prices will see a modest upward trend in 2015," said C.A.R. Vice President and Chief Economist Leslie Appleton-Young. "While the Fed will likely end its quantitative easing program by the end of this year, it has had minimal impact on interest rates, which should only inch up slightly and remain low throughout 2015. This should help moderate the decline in housing affordability we saw occur over the past two years." "Additionally, the state will continue to see a bifurcated market, with the San Francisco Bay Area outperforming other regions, thanks to a more vigorous job market and tighter housing supply."

### California home sales rise in December on stronger economy

Source: *Associated Press*, January 15, 2015

California home sales jumped in December, buoyed by a stronger economy and lower interest rates, a research firm said. Prices rose modestly. The median sales price for new and existing single-family houses and condominiums was \$388,000, up 1.8 percent from \$381,000 in November and up 6.3 percent from \$365,000 in December 2013, according to CoreLogic DataQuick. It was the 34th straight month of annual price increases, but percentage gains have been single-digit since July. There were 36,468 homes sold, up 23.8 percent from an anemic 29,459 sales in November and up 4.3 percent from 34,949 sales in December 2013. Sales were particularly strong in the San Francisco Bay Area.

The numbers suggest job growth and low borrowing rates are attracting buyers who live in their homes, as opposed to cash-paying investors. Absentee buyers, mostly investors, made up 18.3 percent of San Francisco Bay Area sales last month, down from 22.5 percent a year earlier. Absentee buyers accounted for 23.4 percent of Southern California sales, down from 26.9 percent a year earlier and the lowest level since October 2010. Tight inventories kept a lid on sales. CAR said there was a 3.3-month supply of unsold single-family homes in the state last month, down from 4.4 months in November and 3 months in December 2013. A normal supply is considered five to seven months.

Analysts said they didn't anticipate any surge in home construction and that it was unclear if there would be enough sellers to satisfy demand. Selma Hepp, senior economist for the Realtors' group, said inventories improved throughout the year but fell in December as buyers snapped up remaining supplies. The median sales price in the San Francisco Bay Area was \$603,000, little changed from \$601,000 in November and up 9.9 percent from \$548,500 in December 2013, CoreLogic DataQuick said. There were 7,456 homes sold in the nine-county region, up 24.2 percent from November and up 14.1 percent from December 2013. The median sales price in Southern California was \$415,000, barely changed from \$412,000 in November and up 5.1 percent from \$395,000 in December 2013. It was the smallest annual price increase in percentage terms since April 2012. There were 19,205 homes sold in the six-county region, up 22.8 percent from November and up 4.3 percent from December 2013. December sales are typically higher than the previous month but the numbers alleviated concerns after an unusually weak November. "There's lots of solid job growth and people are just more confident," said Christopher Thornberg, founding partner of Beacon Economics, a Los Angeles-based consulting firm. "I think November was a blip. December is back on trend."

## Tax Modernization and the Economy

### A smart California tax bill points the way to needed reform

**Source:** *Los Angeles Times*, December 17, 2014

He's a freshman state senator showing no fear, no hesitation and seemingly no political sense. His first bill is a huge, historic tax hike. Sen. Robert M. Hertzberg (D-Van Nuys), of course, is no ordinary babe-in-the-woods, backbench freshman. He's a former Assembly speaker and lifelong political junkie who grooves on public policy. He's also a certified reformer — previously active in government reform groups — and a human dynamo who always seems to run rather than walk. Hertzberg's tax increase — introduced as SB 8 immediately after he was sworn in Dec. 1 — actually is long-

needed tax reform, the kind that causes most politicians to avert their eyes. The measure finally would extend the state sales tax to services, the fastest growth sector of California's economy.

Healthcare and education services would be exempt. So would small businesses with under \$100,000 in sales — gardeners and babysitters, for example. But not Hertzberg's fellow lawyers or political consultants, among others. At the same time, if enough money were generated by taxing services, personal income taxes would be lowered. Corporation taxes also would be reduced, tied to paying "a more reasonable minimum wage," the senator says. "Ninety percent of corporations are small businesses — muffler shops, auto repair shops," Hertzberg says. "Maybe corporations of under \$5 million wouldn't pay at all." This is very much a work in progress. "I want to put everything on the table and think it through," he says. The goal is to generate \$10 billion more. "To me, if you can't raise \$10 billion it's not worth the effort," he says. He'd spend the money this way: \$3 billion for K-12 schools and community colleges, \$2 billion for the two university systems, \$3 billion for local governments, and \$2 billion for a new earned income tax credit for poor families.

However, he'd only extend the state portion of the tax rate, up to 6.5%, depending on what's included. Local governments wouldn't be allowed to raise their piece. Isn't Hertzberg afraid of being viewed as a dreaded tax-and-spender? "Not at all," he says. "This is an area I'm interested in. It's why I ran — not to sit on the sidelines. I want to work on the tough stuff. That's the purpose of being in government. I'll shy away from no discussion. I'm 60 years old.

"Will I be successful? I have no idea. But I've got to step up to bat." Hertzberg will need a two-thirds legislative vote to raise taxes. Good luck with that, let alone securing the governor's signoff. But broadening the sales tax to services will ultimately be needed if California is to ever stabilize its revenue system to match the 21st century economy. The current tax code is an outdated relic of the post-World War II era.

#### **Hertzberg's bill sets out the reason for taxing services:**

"California's \$2-trillion economy has shifted from being mainly agricultural and manufacturing in the 1950s and 1960s ... to one based on information and services, which now accounts for 80% of all economic activities in the state," the measure reads. "To achieve a future as promising as California's past, we need a tax system that is based on this real economy ... while ensuring that new revenue is invested in strengthening the ladder of mobility for all our residents." So Hertzberg calls it the Upward Mobility Act. Yes, that's a little cornball. But the bill's basics are right. Back when California's tax system meshed with the times, the state could afford to invest in education and infrastructure, creating a growing economy and good jobs. But in recent decades, Hertzberg says, opportunities have diminished and income inequality has widened.

California is relying less on the sales tax, which applies only to purchased goods, while leaning heavily on the richest 1%, whose incomes fluctuate like a roller-coaster. In 1950, the sales tax generated 60% of all state revenue, the income tax just 10%. Today, the sales tax brings in around 25%, the income tax more than 60%. "Not only does it increase the uncertainty of tax collections," the Hertzberg bill asserts, "but there is evidence that California's high rates may be driving high income earners out of the state." Hertzberg doesn't want to meddle with the property tax or Proposition 13. Not worth it, he says. It wouldn't raise enough money even if assessments were raised on commercial property, as many

Democrats advocate. But here's a subtle touch legislative historians might appreciate: Hertzberg numbered his bill after the landmark AB 8 that reallocated California tax revenue — bailing out local governments and schools — after Prop. 13 dramatically reduced property taxes 36 years ago.

## Broadband Technology and Business Attraction

### Obama Seeks to Allow More Broadband Building by Cities

**Source:** *Wall Street Journal*, January 13, 2015

President Barack Obama will push the Federal Communications Commission to overturn state laws that prevent cities and towns from building their own high-speed broadband networks. Building on his previous call for the FCC to regulate broadband access as a utility, the president will use the trip to tout a series of steps designed to encourage the availability of high-speed broadband access, particularly in rural areas.

The centerpiece of the initiative is a call for the FCC to pre-empt laws in 19 states that can prevent cities and localities from building their own high-speed broadband networks, or from attracting new competitors into the local broadband market. FCC Chairman Tom Wheeler has already hinted that he is strongly considering the move. The FCC declined to comment.

“There is no question the state laws tilt the playing field to prevent new entrants,” Jeffrey Zients, National Economic Council director, said on a conference call with reporters. “What we are calling on the FCC to do is ensure all states have a playing field that allows for a vibrant and competitive market for communications services,” he added. White House officials pointed to Cedar Falls; Wilson, N.C.; and Chattanooga, Tenn. as examples of cities that built their own superfast broadband networks and have attracted new businesses and entrepreneurs as a result.

Mr. Zients said most Americans have no choice when it comes to high-speed broadband providers, a point Mr. Wheeler also has emphasized in past speeches. “Even when we’re unhappy with the speed and performance of our Internet service, we don’t have a choice. There are no alternative providers we can switch to,” Mr. Zients said. “In fact, three out of four Americans live in a location that has no competition or no service at the broadband speeds increasingly required for many online services.” Proponents of such laws say broadband networks operated by local governments are costly and risky to taxpayers and discourage private investment. The White House plan focuses on increasing broadband deployment, though surveys show the primary impediment to broadband adoption for most Americans without home access is cost, not availability. The White House plans to convene a summit of mayors and county commissioners committed to building superfast broadband networks in their communities, as well as a new council of more than a dozen federal agencies dedicated to speeding up broadband deployment. In addition, the administration will offer \$50 million in new grants through the U.S. Department of Agriculture to carriers that help connect rural areas that are unserved or underserved by broadband access.