HOUSTON'S SALES TAX

HIGH VALUE, HIGH VOLATILITY

BUDGET & FISCAL AFFAIRS COMMITTEE

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OFFICE OF CITY CONTROLLER CHRIS HOLLINS

This review focuses on sales tax, Houston's second-largest revenue source

As the City's second-largest revenue source, sales tax is essential but **highly sensitive to economic and consumer spending** changes. Understanding its volatility is critical to sound financial planning.

This presentation will focus on:

- How sales tax is generated and allocated to the City;
- Why sales tax is more volatile than other major revenue sources;
- Historical trends and periods of significant growth or decline;
- What current economic conditions could mean for future collections; and
- Key risks and expectations moving forward.

The City of Houston collects a penny from every dollar spent within city limits

Example: A Houston residents buys a $100 pair of Nike shoes

1 Purchase

Pair of Shoes

Item Price	$100.00
Sales Tax	$8.25
Total Paid:	**$108.25**

The seller collect 8.25% at checkout

2 Sales tax collected

$8.25

Total Sales Tax

(8.25% of $100)

3 How the $8.25 splits

State of Texas
$6.25
6.25% general revenue

City of Houston
$1.00
1.00 % municipal share

METRO
$1.00
1.00 % transit

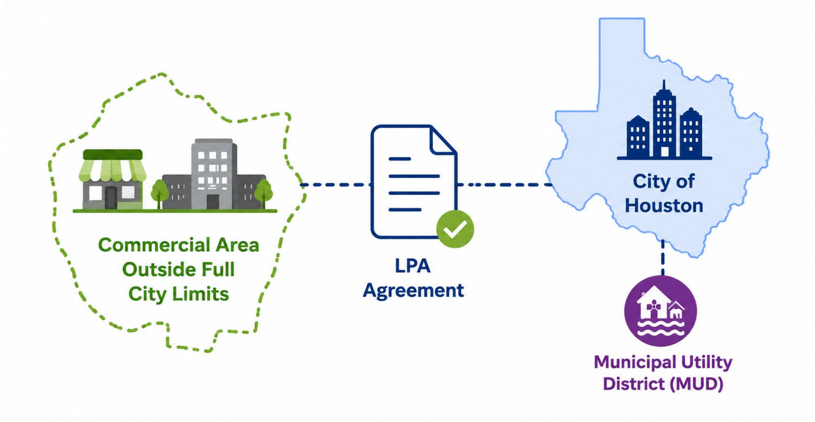
4 When Houston receives

Distributed to the City ~two months later

Limited purpose annexations (LPAs) allow Houston to collect and share sales tax outside its full city limits

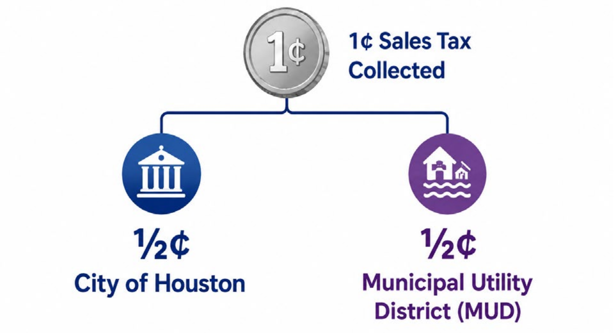
1. What is an LPA Agreement?

An LPA is an area outside Houston's full city limits where the City has limited authority, primarily through an agreement with a Municipal Utility District (MUD).



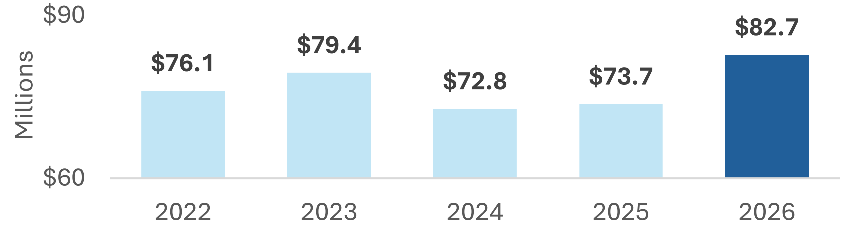
230 Current LPA Agreements

2. What is Houston's share?



MUDs receive their share through LPA Payments from the General Fund

3. How much are LPAs worth to the City?



$82.7M

↑ 12%

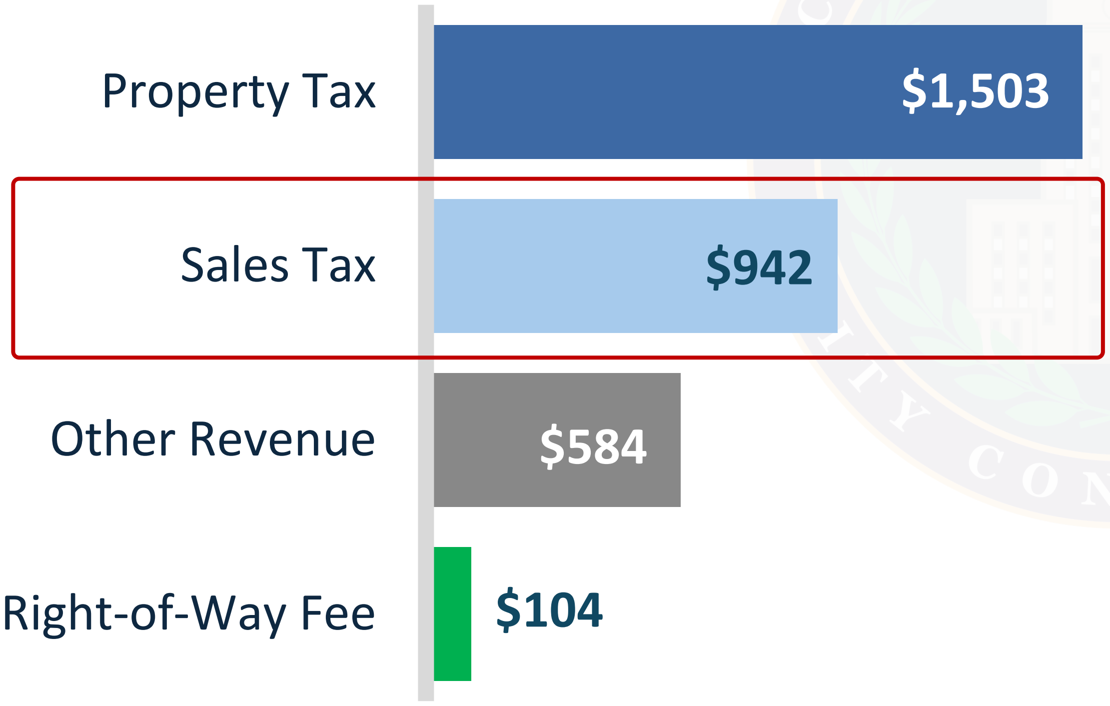
From FY2025

FY2026 collections are not yet final. The $82.7 million estimate represents approximately 9% of total sales tax collections, consistent with the five-year average.

Sales Tax is the second-largest revenue source within the General Fund

FY2027 General Fund Revenue, $ millions

Total = $3.1 Billion



Property Tax (48%)

Tax charged on residential and commercial property based on its assessed value

Sales Tax (30%)

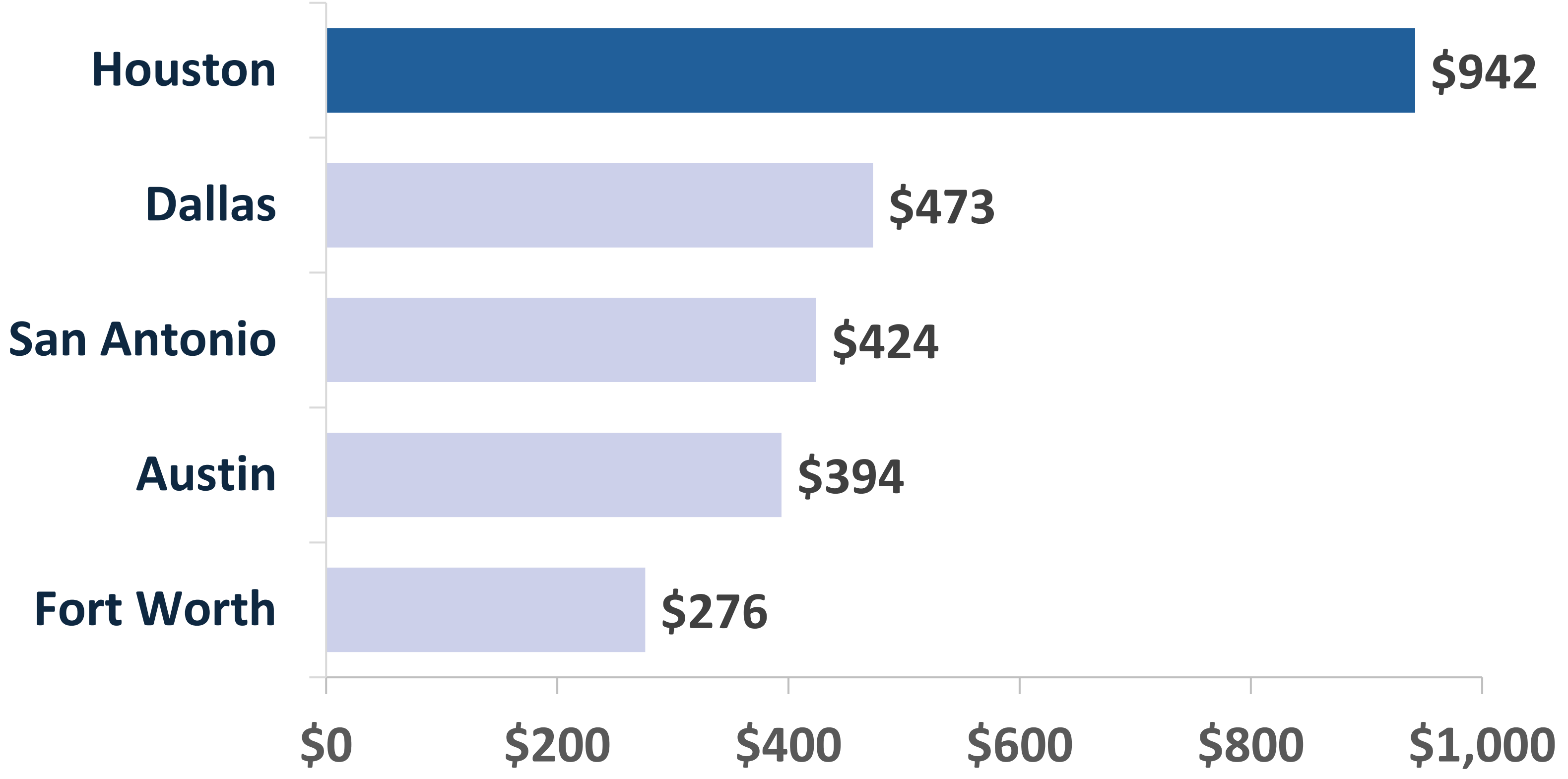
Tax added to the price of goods and services

Right-of-Way Fee and Other Revenue (22%)

Includes franchise fees (5%), charges for services (3%), licenses and permits (1%)

Houston relies on sales tax more than any other Texas city

Annual Sales Tax Revenues, $ millions



$942M

in annual sales tax revenue

2X

Houston collects nearly twice the sales tax revenue of the next-highest city

30% of GF revenue

Sales tax is a major source of Houston General Fund revenue

Why it matters

Greater sales tax reliance increases Houston's exposure to changes in consumer spending and economic conditions

Source: FY26/27 Adopted budget; General Fund or comparable operating fund

Sales tax is volatile[1] because it is impacted by forces beyond our control

Outside forces

National and global events such as inflation, interest rates, geopolitical conflict, natural disasters, major sporting events all contribute to the volatility in sales tax.

Houston economy

Outside forces can have a major impact on the Houston economy by way of oil prices, job loss, price of groceries, and home sales.

Spending habits

Changes in income, job security, costs, and confidence influence whether households and businesses spend, save, expand, or cut back.

City sales tax

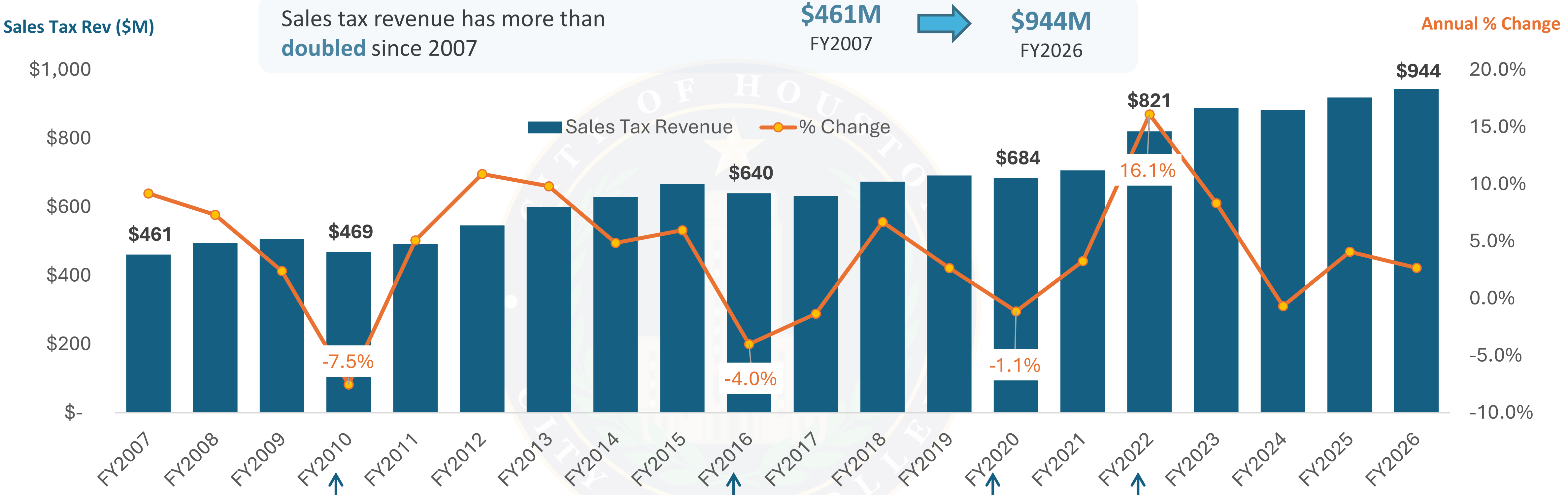
As taxable spending increases or decreases, the City's sales tax collections rise or fall.

1. Volatility does not necessarily mean sales tax is declining. It means collections are less stable and predictable from one period to the next.

Sales tax tends to grow over time, but can shift quickly

Sales tax revenue has more than **doubled** since 2007

$461M FY2007 → **$944M** FY2026



Great Recession
-7.5%
FY2010
Reduced consumer spending led to a steep drop in sales tax revenue

Energy Downturn
-4.0%
FY2016
Lower energy prices impacted economic activity and spending

Global Pandemic
-1.1%
FY2020
COVID-19 caused a decline in sales tax revenue

Post-Pandemic Surge
+16.1%
FY2022
Strong consumer spending drove record rebound in collections

Slower employment growth creates near-term pressure on Houston sales tax

The University of Houston's Center for Economic Growth and Opportunity expects sales tax growth to remain constrained as Houston faces slower hiring and policy-related economic headwinds, partially offset by the 2026 FIFA World Cup.

1. Economic Headwinds

- Immigration enforcement is expected to constrain Houston's labor force and economic activity.
- Tariffs and international trade uncertainty create additional pressure for Houston's trade-oriented economy.
- Shift in federal energy policy is not expected to produce an immediate energy boom.

2. Employment Growth ↓

- Houston-area employment growth is the most important factor in predicting sales tax allocations.
- Baseline employment growth is projected at **0.8%** annually, compared with an otherwise expected **1.6%.**

3. World Cup Provides Temporary Lift ↑

- Center for Economic Growth and Opportunity assumes a **4%** bump in sales tax allocations in **Q3 2026** associated with FIFA World Cup Activity.

Sources: UoH CEGO's Houston Economic Outlook and Forecast for sales Tax Allocations – Spring 2026

Our sales tax model has consistently predicted actual results

The Controller's Office's in-house sales tax model uses key economic indicators, including oil prices, employment, upstream energy employment, and CPI, to develop **conservative**, **base**, and **optimistic** scenarios. The forecast focuses on underlying economic trends and **does not include one-time events** such as the World Cup.

Fiscal Year	Conservative	Base	Optimistic	Actual/Proj	Base Variance
FY2024	$878.1M	$882.0M	$884.2M	$883.1M	0.1%
FY2025	$914.5M	$918.3M	$924.3M	$919.3M	0.1%
FY2026	$940.0M	$948.0M	$951.0M	$943.9M	0.4%
FY2027	**$937.7M**	**$988.4M**	**$1,010.5M**	**TBD**	**TBD**

Used for FY27 Trends

Strong collections today do not guarantee strong collections tomorrow

- **Sales tax is inherently volatile** and can shift quickly with changes in economic conditions and consumer spending.
- **Conservative forecasting helps protect the budget** from unexpected revenue declines.
- **One-time sales tax gains should not support recurring commitments** that remain after the additional revenue disappears.
- **Sustainable decisions should be based on long-term trends**, not a single year of strong collections.

THANK YOU!

For additional information contact:

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