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To: Honorable Commissioner Jesus Garcia

From: Ammar M. Rizki
Chief Financial Officer
Office of the Chief Financial Officer

Date: November 8, 2018

RE: Chief Financial Officer response to Budget Presentation question

Dear Honorable Commissioner Garcia,

Please find below the response to the question presented to the Chief Financial Officer after the October 10, 2018 Budget Presentation:

1. Can you provide a detailed explanation for the increase in expected revenue between your report to the Board on June 19th and the October 10, 2018 Budget Presentation?

The FY2019 Executive Recommendation revenues for the General fund increased by \$56.1M over the FY2018 adopted budget and by \$45.6M over the preliminary forecast in June. As you noted the single largest difference in revenue estimates between June and October comes from the \$15.4M increase in the projections in Sales Tax revenue the County expects to receive in FY2019. To explain the difference, it would first help to understand the Bureau of Finance's (BOF) Sales Tax projection methodology and approach. BOF uses a statistical model which has found a very strong correlation (80.4% over the last decade) between national GDP (nominal, non-inflation adjusted) and Taxable Sales in the County. The BOF model currently uses the June Federal Reserve median consensus nominal GDP forecast, adjusted for the historical year-ahead forecast error of .9%. Each year "reasonableness" of the model is reviewed, including accuracy, consistency between the Federal Reserve and other independent forecasters (Survey of Professional Forecasters, Wall Street Journal Survey, Congressional Budget Office, regional growth estimates, etc.), online sales growth, impact of legislative changes to tax rates, tax base, etc., and the model is updated as needed. In the end, the projected GDP growth rate is used to project Taxable Sales, and the County's sales tax rate is applied to the projected Taxable Sales to project the associated revenues.

In June 2018, the expected FY2018 Sales Tax receipts were projected at \$818.1M, based on six months of data, and the projection still included a possible slowdown in the second half of FY2018. As part of the Executive Recommendation, BOF had ten months of sales tax collection data, which showed that FY2018 Sales Tax revenue continued to show strength in consumer spending, also reflected in the August 2018 report to the Board. As a result, the BOF assumed continued strength in consumer spending for the

remaining two months in FY2018, and the year-end estimate for FY2018 was revised to \$835.6M. This \$17.5M increase in FY2018 expected Sales Tax revenue in turn raised the base for FY2019, and increased the projection for FY2019 by \$15.4M (or roughly the same amount as the increase for FY2018, as would be expected).

BOF projected FY2019 Sales Tax based on a 2% nominal GDP growth rate. The Federal Reserve¹ forecast 4.5% GDP growth for FY2019 which BOF would normally adjust downwards to 3.6% to account for systematic errors, as noted above. BOF chose a more conservative growth rate of 2% to account for the risk of an economic slowdown (consumer spending is expected to slow down going into next year per research published recently by the Congressional Budget Office² and as demonstrated by recent declines in the stock market, which is a leading economic indicator), as well as risk factors such as slower growth in the US mid-western region, unusual growth in untaxed online sales, etc.

Although the revenue estimate for FY2019 Sales Tax increased from \$816.1M in June to \$831.5M in October (or by 1.9%), we believe the revised projections are prudent as they account both for our actual experience to date, and for an expected slowdown in the economy next year.

Sincerely,
Ammar M. Rizki
Chief Financial Officer

¹ www.federalreserve.gov/monetarypolicy/files/fomcproitabl20180613.pdf

² www.cbo.gov/publication/54318