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Ratings

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Summary:

Cambridge, Massachusetts; General Obligation

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Summary:

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Credit Profile		
US$92.3 mil GO mun purp loan of 2022 bnds due 02/15/2042		
Long Term Rating	AAA/Stable	New
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Cambridge, Mass.' 2022 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating on the city's existing GO debt. The outlook is stable.

The city's full-faith-and-credit pledge, subject to Proposition 2-1/2 limitations, secures the GO debt. Despite commonwealth levy-limit laws, we did not make a rating distinction between Cambridge's limited-tax GO pledge and general creditworthiness because our analysis of its financial and economic conditions already includes the tax limitation imposed on its revenue-raising ability.

We understand officials intend to use series 2022 bond proceeds to fund various citywide projects.

Credit overview

Cambridge is an affluent suburb immediately adjacent to Boston. Home to both Harvard University and the Massachusetts Institute of Technology (MIT), the city is at the epicenter of biotech, pharmaceutical, and other technology-based sectors, which continue to generate growth in the tax base. While it faces challenges in addressing housing, transportation, and other infrastructure needs, we expect Cambridge to remain a desirable location to live and work with sustained economic growth and a management team working to address these issues. Its credit profile is characterized by significant budgetary flexibility, a history of comprehensive long-term financial planning, and well-embedded financial management policies. We do not expect to revise the rating in the two-year outlook period.

Cambridge's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013 on RatingsDirect, U.S local governments are considered to have moderate sensitivity to national risk. The city's predominantly locally derived revenue base supports our view that debt repayment is at limited risk of negative sovereign intervention .

The long-term rating reflects our view of the following factors for the city, including its:

- High wealth and income metrics with a continuously growing tax base in both residential and commercial sectors, along with access to a broad and diverse metropolitan statistical area (MSA);

- Well-embedded financial policies with significant forward-looking planning and a strong institutional framework;
- Stable revenue and expenditure profiles leading to very strong reserve levels and material excess levy capacity, despite planned drawdowns; and
- Stable debt profile but with a large unfunded retirement obligation.

Environmental, social, and governance

While not directly on the Atlantic Ocean, we believe Cambridge is vulnerable to environmental risks, including rising water levels from climate change that could directly affect taxable properties. The city has a history of proactively addressing future challenges, and, to this end, management maintains long-term plans to improve environmental resiliency. We analyzed Cambridge's social and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

While unlikely, if reserve drawdowns resulted in a significant decline, or if debt service and retirement costs were to significantly increase, we could lower the rating.

Credit Opinion

Dynamic knowledge-based economy supporting very strong economic metrics

Directly adjacent to Boston, Cambridge is an integral part of the larger broad and diverse MSA. Two subway lines, multiple highways, and a commuter rail connect it directly to downtown Boston. Harvard University and MIT, its two leading employers and two of the largest taxpayers, anchor the local economy. They serve as knowledge centers and focal points for dozens of start-ups, research centers, and life-science and high-technology companies. Microsoft, Google, Amazon, Apple, Facebook, Kayak, Pfizer, IBM, and Pegasystems all have offices in the city.

The tax base is about 55% residential and 45% commercial and industrial. While some knowledge-based companies are decentralizing and putting into question the future state of commercial real estate, we believe that the high concentration of lab-space and life-science investment in Cambridge, and its integration into the surrounding universities, may limit exodus from the city, particularly as demand for commercial lab space remains very high. The vacancy rate for commercial office space is 5.8% and 0.3% for lab space. A two-year moratorium on new lab and office space is being considered for the Alewife area of the city, to allow for the development of planning and zoning ordinances for the area. Developers continue to develop plans for Alewife and lab development is ongoing in other parts of the city. Ultimately, we expect material development in Alewife over the long term and overall expect Cambridge's tax base to continue to grow, with underlying wealth and income metrics remaining stable.

At the county level, the unemployment rate spiked to 15% in June 2020, according to the Bureau of Labor Statistics. Employment has largely recovered and as of December 2021, the unemployment rate was 1.8%. We continue to monitor the effects elevated unemployment may have on our view of the city's economic profile and ultimately on its finances, but do not expect a revision in our view of its economy at this time.

Very strong financial management environment expected to continue through personnel changes

We understand that the city manager is retiring within the next year. Cambridge has a long-standing history of maintaining continuity of the financial management team and overall financial management environment through developing and promoting from within. While the city is undertaking an extensive external search for a new manager, we expect the financial management environment will remain very stable, given the well-embedded policies and practices and continuity across the team.

The city's annual budget development process supports its overarching goals, which include significant investments in its education system, housing, transportation network, environmental goals, and other quality of life issues, while maintaining financial balance. Active management of discretionary spending and ongoing monitoring of spending ensure adherence to the adopted budget. Budget-to-actuals and investments are reported quarterly to the finance and investment committees, respectively. Management uses historical trend analysis to develop line-item and departmental expenditure and revenue assumptions.

The annually updated five-year financial and capital investment plans outline immediate fiscal challenges while determining and prioritizing capital needs. The city invests in the state-run Massachusetts Municipal Depository Trust (MMDT) and bank deposits. We understand it is revising its investment policy to meet investment goals related to its socially responsible investment goals, but we do not expect this to add risk to its portfolio. Its formal debt management policy goes beyond debt limits prescribed by commonwealth statute that include informal targets for debt service-to-budget limits and net present value savings thresholds for refunding transactions. In terms of budgetary reserves, city policy affirms its commitment to maintaining an unassigned fund balance in excess of 15% of the ensuing fiscal year's operating revenue and total general fund balance at least 25% of the following fiscal year's operating revenue.

Stable revenue and expenditure profiles but with continued budgeted use of reserves

The city is continuing its multiyear budgeting plan to appropriate and expend reserves for capital items and to lower the property tax rate. In fiscal 2019, it transferred about $29 million from the general fund to the capital projects fund. In 2020, the transfer to the capital fund grew to about $60 million and was $44.5 million in 2021. The city's budgeted use of reserves also increased, from $20 million in fiscal 2020 to $49 million in 2021, following a midyear adjustment from the initial $22 million reserve appropriation. Given the strength of the city's reserve profile, along with its flexibility under the levy limit--it has $197 million in unused levy capacity, about 26% of 2022 budgeted operating expenditures--we believe it has the budgetary flexibility to continue its reserve expenditure plan. The fiscal 2022 initial budget included a $22.5 million reserve appropriation, which could grow to nearly $60 million, if all adjusted budget appropriations are expended. We continue to view its performance as adequate, as we believe management is executing a well-formulated budgetary plan, but is ultimately relying on one-time measures to support ongoing needs. We expect it to maintain very strong reserves and cash balances over the foreseeable future.

The city's revenue and expenditure profile remains predictable, with local property taxes accounting for about 65% of fiscal 2021 operating revenues. Departmental revenue was about 13% and intergovernmental aid was 12%. With some minor variations, these levels are consistent year to year, which we expect to continue. We understand that the city's hotel and meal excise taxes as well as parking fee revenues continue to rebound from the recession, with management reporting that parking revenues are about at pre-pandemic levels. Noncapital expenditures are largely personnel costs, which are predictable. As the city prepares its fiscal 2023 budget, we expect it will continue to look to expend reserves to maintain the tax rate and address capital needs, but with limited change in budgeted revenues and expenditures. Over the long term, its unfunded retirement liability carrying charges may increase, but we expect it will continue to incorporate these into the annual levy. We do not expect to revise our view of performance, flexibility, or liquidity profiles during the outlook period.

Stable debt profile with manageable costs, likely to remain so

Cambridge has about $581 million of total direct debt outstanding, of which we consider about $94 million self-supporting sewer debt. Approximately $15 million of the current issuance is sewer debt we expect to be self-supporting. The city also had several notes with the state clean water trust and water authority for which it receives user charges to support.

As the city continues investments in schools, fire stations, and other tax-backed projects, we believe it could add debt at a rate faster than outstanding principal is paid. Current debt outstanding fell below our 60% debt-to-revenue threshold, but given future debt issuances, we believe it is likely to grow to more than 60% over the next two years. Ultimately, we do not believe there is likely to be significant movement in the city's debt profile.

In our opinion, a credit weakness is Cambridge's large pension and other postemployment benefit (OPEB) obligation. Its combined required pension and actual OPEB contributions totaled 7.4% of total governmental fund expenditures in 2021. Of that amount, 4.7% represented required contributions to pension obligations, and 2.7% represented OPEB payments. The city made 101% of its required pension contribution in 2021. The funded ratio of the largest pension plan is 90.6%.

Manageable retirement costs, but a large unfunded liability and expected cost growth

- Cambridge's large pension and OPEB obligation is a credit weakness. While actuarially determined, we believe some of the assumptions used to build the pension required contribution are permissive and could lead to fluctuating costs.
- Additionally, the adopted funding schedule relies on significant cost escalation to meet a rapid amortization goal.
- While the city is contributing $2 million annually above the OPEB pay-as-you-go cost, its plan to address these costs relies on full funding of the pension plan. In the interim, we expect costs will continue to rise.

As of June 30, 2021, the city participated in the following pension plans:

- City of Cambridge Retirement System: 91% funded, $125 million proportionate share of the net pension liability; and
- Single-employer defined-benefit OPEB Plan: 2.8% funded, $915 million net OPEB liability.

The pension system maintained its 7.25% discount rate, which it had lowered to in recent years, but it remains above the 6.0% discount rate we view as likely to mitigate contribution volatility. The system's updated its adopted funding schedule, which continues to meet the city's goal of full funding in 2026. It relies on at least 11% growth in total annual contributions through 2026, which is likely to outpace overall budgetary growth, resulting in rising pension costs as a percentage of expenditures. However, we believe management is planning for these costs as part of its long-term financial planning and due to the high funded ratio, potential cost volatility may be mitigated. If the city is able to meet its 2026 funding target, it expects to shift a portion of the annual pension payment above the normal cost to funding its OPEB liability. While the OPEB liability decreased $15 million over the past year, we expect costs will continue to rise and the liability will remain large. Despite this, we believe the city has a credible plan, given its tax base and budgetary flexibility, to address costs and liabilities.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Cambridge, MA -- Key Credit Metrics

	Most recent	Historical information		
		2021	2020	2019
Very strong economy				
Projected per capita EBI % of U.S.	172			
Market value per capita ($)	553,801			
Population			115,480	114,686
County unemployment rate(%)			7.3	
Market value ($000)	63,952,954	60,234,893	54,948,000	
Ten largest taxpayers % of taxable value	26.0			
Adequate budgetary performance				
Operating fund result % of expenditures		(2.6)	(3.2)	2.9
Total governmental fund result % of expenditures		0.3	2.3	3.4
Very strong budgetary flexibility				
Available reserves % of operating expenditures		39.0	43.0	53.0
Total available reserves ($000)		305,164	321,661	351,275
Very strong liquidity				
Total government cash % of governmental fund expenditures		50	54	61
Total government cash % of governmental fund debt service		526	559	675
Very strong management				
Financial Management Assessment	Strong			
Adequate debt & long-term liabilities				
Debt service % of governmental fund expenditures		9.5	9.7	9.0
Net direct debt % of governmental fund revenue	59			
Overall net debt % of market value	1.0			
Direct debt 10-year amortization (%)	81			
Required pension contribution % of governmental fund expenditures		4.4		
OPEB actual contribution % of governmental fund expenditures		2.6		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019