S&P Global Ratings

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Summary:

Cambridge, Massachusetts; General Obligation

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Credit Profile		
US$90.62 mil GO mun purp loan of 2019 bnds due 02/15/2039		
Long Term Rating	AAA/Stable	New
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed
Cambridge GO rfdg bnds ser 2017 due 02/15/2029		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating and stable outlook to Cambridge, Mass.' series 2019 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating, with a stable outlook, on the city's existing GO debt.

Under our criteria, titled "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect, we rate Cambridge higher than the sovereign because we believe the city can maintain better credit characteristics than the nation in a stress scenario based on its predominantly locally derived revenue base and our view that pledged revenue supporting bond debt service is at limited risk of negative sovereign intervention. In 2018, local property taxes generated 64% of revenue, which demonstrated a lack of dependence on central government revenue.

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 2019 bond proceeds, totaling approximately $90 million, to fund various citywide projects, including school renovations and sewer improvements.

The rating reflects our opinion of Cambridge's extremely strong property tax base that continues to grow within the Boston metropolitan statistical area (MSA), supporting continued positive budgetary performance that has led to improved reserves. The city has a favorable debt profile with the ability to absorb additional debt plans.

The rating also reflects our opinion of the city's:

- Very strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental-fund level

in fiscal 2018;

- Very strong budgetary flexibility, with available fund balance in fiscal 2018 of 54% of operating expenditures, coupled with the flexibility to raise additional revenue despite commonwealthwide tax caps;
- Very strong liquidity, with total government available cash at 71.2% of total governmental-fund expenditures and 7.6x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt-and-contingent-liability position, with debt service carrying charges at 9.3% of expenditures and net direct debt that is 58.6% of total governmental-fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 79.7% of debt scheduled to be retired within 10 years, but significant medium-term debt plans and a large pension and other-postemployment-benefit (OPEB) obligation; and
- Strong institutional framework score.

Very strong economy

We consider Cambridge's economy very strong. The city, with an estimated population of 113,081, is in Middlesex County in the Boston-Cambridge-Newton MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 165% of the national level and per capita market value of $433,116. Overall, market value has grown by 12.3% during the past year to $49 billion in fiscal 2019. County unemployment was 3% in 2017.

Directly north of Boston, two subway lines, multiple highways, and a commuter rail connect Cambridge directly to the area economy. Harvard University and Massachusetts Institute of Technology (MIT), its two leading employers, anchor the local economy and serve as knowledge centers and focal points for dozens of start-ups, research centers, and life-science and high-technology companies. Other leading employers include Novartis Institutes for Biomedical Research; Mount Auburn Hospital; and Biogen, each of which employ upward of 2,000. Microsoft, Google, Amazon, Apple, Facebook, Kayak, Baxalta, Pfizer, Sanofi/Genzyme, and Takeda/Millennium have offices in the city.

Economic expansion continues, particularly in the biotechnology and technology sectors; this has contributed to sustained tax base growth. During the previous three years, the city has averaged 12.2% growth. The tax base is about 60% residential and 37% commercial and industrial. The 10 leading taxpayers account for 22% of the tax base, indicating moderate taxpayer concentration. Officials report a number of developments they expect will have a positive effect on the tax base, including the addition of almost 2,400 housing units throughout Cambridge and the construction of more than 1.8 million square feet of commercial and residential space.

MIT has agreed to purchase the former Volpe Transportation Research Center from the U.S. General Services Administration. It will develop this site into commercial space totaling 1.7 million square feet and residential space totaling 1.1 million square feet. During the long term, while we do not expect the Volpe center to greatly affect the city's property tax revenue, we believe it will likely aid continued economic growth.

DivcoWest Real Estate has plans to develop, renovate, and rebrand the 45-acre North Point district into Cambridge Crossing. The area's revitalization will include a green-line expansion for public transportation; 2.1 million square feet of technology and office space; and up to 1,900 condominiums and apartments, as well as the 700 residences already in the project. Construction has begun, and will continue to increase, as projects progress. Therefore, we expect that Cambridge's economy will continue to improve and that it will be a desirable location for employee and residents.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Key factors include management's:

- Conservative revenue and expenditure assumptions during the budgeting process that focus on five years of historical information;
- Quarterly reports on budget-to-actual results and investments to the city's finance and investment committees, respectively;
- Long-term financial plan with credible assumptions;
- Five-year capital plan with identified funding sources, which it is expanding to include a municipal-facilities-improvement plan;
- Robust debt and investment policy it reviews at least annually to demonstrate adherence; and
- Reserve policy that requires maintaining a minimum 15% of expenditures.

Strong budgetary performance

Cambridge's budgetary performance is strong, in our opinion. The city had operating surpluses of 5.8% of expenditures in the general fund and 9.5% of expenditures across all governmental funds in fiscal 2018. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from fiscal 2018 results during the next few fiscal years. General fund operating results have been stable during the past three fiscal years, with 5.4% of expenditures in fiscal 2017 and 3.9% in fiscal 2016.

The city has reported seven consecutive surpluses, including fiscal 2018. We adjusted the data for recurring transfers and bond-proceed spending. Property taxes generated 64% of total general fund revenue in fiscal 2018. The fiscal 2019 operating budget has increased by 4.22% since fiscal 2018 to $636 million due largely to a 2.5% increase in salary costs, a 5.4% increase in health insurance, and a 6.6% increase in employee pension costs. The city used $9 million in surplus cash to lower the property tax increase, which it expects to make up through better-than-budgeted results in fiscal 2019. According to city officials, revenue and expenditures are on budget.

We think rising debt-service costs and increasing health insurance, with cost increases as high as 7% in fiscal 2021, could add pressure to the budget. However, we expect astute management, with regular oversight and planning, will likely shield the budget from cost pressure. Therefore, we expect our assessment of budgetary performance will likely remain strong.

Very strong budgetary flexibility

Cambridge's budgetary flexibility is very strong, in our view, with available fund balance in fiscal 2018 of 54% of operating expenditures, or $334.6 million. We expect available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. In addition, the city has the flexibility to raise additional revenue despite commonwealthwide tax caps, which we view as a positive credit factor.

Budgetary flexibility remains very strong with no plans to spend down reserves materially. We include the budget-stabilization fund in our calculations; this fund has grown during each of the past three fiscal years, and it currently has a balance of $67.7 million. In addition, Cambridge's excess levy capacity, which increased by 4.2% year over year to $189 million in fiscal 2019, which represents approximately 30% of adjusted revenue, provides additional flexibility.

Very strong liquidity

In our opinion, Cambridge's liquidity is very strong, with total government available cash at 71.2% of total governmental-fund expenditures and 7.6x governmental debt service in fiscal 2018. In our view, the city has strong access to external liquidity if necessary.

Cambridge is a regular market participant that has issued GO bonds frequently during the past several years. We understand the city has not entered into any bank loans, direct-purchase debt, or contingent-liquidity risks from financial instruments with payment provisions that change upon the occurrence of certain events. It has consistently had very strong liquidity; we do not expect these ratios to change, which is consistent with our view of the city's strong budgetary performance.

Adequate debt-and-contingent-liability profile

In our view, Cambridge's debt-and-contingent-liability profile is adequate. Total governmental-fund debt service is 9.3% of total governmental-fund expenditures, and net direct debt is 58.6% of total governmental-fund revenue. Overall net debt is low at 1.2% of market value and approximately 79.7% of direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors. Negatively affecting our view of the city's debt profile is its significant medium-term debt plans.

Cambridge has $550 million of total direct debt outstanding, $125 million of which is self-supporting water and sewer debt. During the next four fiscal years, the city currently expects to issue $421.6 million, $186.8 million of which it will issue within our two-year outlook period. The majority of debt will fund school reconstruction and sewer improvements.

In our opinion, Cambridge's large pension and OPEB obligation is a credit weakness. Cambridge's combined required pension and actual OPEB contribution totaled 8% of total governmental-fund expenditures in fiscal 2018: 4.6% for contributions to pension obligations and 3.4% for OPEB payments. The city made its full annual required pension contribution in fiscal 2018. The largest pension plan's funded ratio is 88%.

Cambridge is part of Cambridge Retirement System, which is a member of Massachusetts Contributory System. The city has always contributed 100% of the actuarial determined contribution, which was $30.7 million in fiscal 2018. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the city's net pension liability was about $187.6 million with 88% funded at Jan. 1, 2018, based on an assumed rate of return of 7.5%. Pension costs are expected to continue to increase through fiscal 2022 and then level off with officials expecting to fully fund the pension liability by fiscal 2026.

At June 30, 2018, Cambridge reported an OPEB unfunded actuarially accrued liability of $622.3 million. In 2015, the city established an irrevocable trust fund, which has a current balance of $17 million; officials expect to add $2 million to the trust annually between fiscal years 2020 and 2022. We consider prefunding the OPEB liability a positive, and the city's large and growing OPEB liabilities will remain manageable as the budget continues to grow while pension payments level off and the plan becomes fully funded.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Cambridge's healthy and growing economy, which has aided in continued strong financial performance, supported by very strong management. While we understand Cambridge expects to issue a significate amount of debt during the next few years, we, however, do not expect financial performance to deteriorate. Therefore, we do not expect to change the rating within the next two years because we believe Cambridge will likely sustain current financial performance and comparably high reserves.

While unlikely, we could lower the rating if fund balance were to deteriorate significantly or debt were to weaken substantially.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.