



City of Cambridge

Executive Department

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I am very pleased to inform you, our residents, and the entire community, that the City of Cambridge has received a AAA rating from each of the nation's three major credit rating agencies.

This is a unique and noteworthy honor. Not only is Cambridge one of only 26 cities in the entire United States with this distinction, the City has earned these ratings, from Moody's Investors Service, S&P Global Ratings, and Fitch Ratings, every year since 1999.

This is further validation of our fiscal policies and practices, and more importantly, has clear and tangible benefits for the overall community, including our ability to provide exceptional service, while also continuing to invest in the community and implement and expand important new initiatives and programs.

It should be noted, the City has faced unprecedented challenges, at many different levels, related to COVID-19. However, throughout the pandemic, the City maintained a high level of service to the community and continued our increased support for important City priorities and initiatives. The experience helped demonstrate the importance of adhering to our fiscal policies, sustaining financial flexibility, maintaining adequate reserves, and careful monitoring of revenues and expenditures.

We continue to remain cognizant of financial impacts coming out of the pandemic, especially in regard to new economic pressures on office space, inflation, the labor market, and new construction. These ratings however, send a strong message about the strength and direction of our overall economy; management; leadership; and fiscal stability; and enhances our unique capacity to invest in major municipal and infrastructure projects, while limiting the burden placed on taxpayers in the community.

Achieving this credit rating allows the City to continue to finance important capital projects (i.e. school construction projects; sewer/stormwater improvements; street and sidewalk reconstruction; and municipal facilities improvements) throughout Cambridge at the most favorable interest rate, and preserves financial flexibility, which will be critical when considering the potential for future major projects and investments.

These ratings are in conjunction with the City's sale of \$93.6 million in General Obligation bonds. The competitive sale took place on March 1, 2023. Capital projects funded in this bond issuance include Fire headquarters construction; street and sidewalk reconstruction; River Street reconstruction; Tobin Montessori and Vassal Lane Upper School construction; East Grand Junction Path construction; sewer reconstruction and repairs; and climate change projects.



The rating agencies highlighted the City's strong financial position; a large, stable, and diverse tax base; ample excess levy capacity under Proposition 2 ½; budgetary flexibility; and a strong and experienced management team. However, the rating agency reports provide factors which could result in a negative rating in the future related to controlling expenditures; declining assessed taxable values and/or the city's overall economic strength; controlling long-term obligations; large decline in reserves and liquidity; or a significant decrease in revenues. All of these factors will continue to be closely monitored.

Below and the pages that follow highlight key points from the Moody's, Standard & Poor's, and Fitch credit reports. Attached are the individual rating opinions.

Moody's Investors Services

Summary

Cambridge (Aaa stable) benefits from high resident income and full (equalized) value per capita and a strong economy that continues to outperform the nation in GDP growth. The economy is driven by the presence of world renowned higher education institutions and the impressive biotechnology and pharmaceutical sectors. The city's financial position is very healthy with large reserves and liquidity that are maintained by formal policies and conservative fiscal management. The city's leverage as a percent of revenue and fixed costs ratio are average for the highest rating category and are likely to remain relatively stable given the city's capital plans and funding towards pension and OPEB liabilities.

Credit strengths

- Healthy economy anchored by institutional presence
- Strong reserves and liquidity as a percent of revenue
- Ample operating flexibility given a large amount of unused levy capacity under the tax levy limit
- Aggressive funding schedule towards the city's unfunded pension liability

Credit challenges

- Taxpayer concentration in research and development
- Maintaining service levels in line with community expectations

Rating outlook

The stable outlook reflects the city's strong fiscal management that is committed to maintaining a healthy financial position given conservative multiyear budget forecasting and adherence to formally adopted fiscal policies. The outlook also incorporates the significant institutional presence that helps to maintain a strong labor force and attract private investment in the city.

Factors that could lead to a downgrade

- Significant growth in leverage as a percent of revenue
- Material weakening of the economy
- Large decline in reserves and liquidity as a percent of revenue

Credit Considerations

Economy

Cambridge's economy benefits from the presence of Harvard and MIT which together enroll around 33,000 students and provide employment to almost 22,000 full-time positions (roughly 16% of the city's workforce). The city's largest industries are professional and business services and education and health services including the vibrant biotechnology and pharmaceutical sectors. The residential housing market

remains strong as does class-A office and lab spaces. The city has reported a softening of the class-B space but believes that it remains suitable for entrepreneurial, innovation and tech-driven research and development type businesses. The potential economic impact on the city from increased remote work is still unknown but the ongoing demand for lab space which lends itself to in-person work stations should help mitigate any negative impact

Financial Operations

The city's financial position is likely to remain stable over the next few years because of conservative multiyear budget planning. Across all governmental funds and business-type activities, the city closed fiscal 2022 (the latest audit ending June 30, 2022) with an available fund balance and net unrestricted current assets of \$435.2 million representing 49% of revenue.

Leverage

Cambridge's leverage is average for the highest rating category and will likely remain relatively unchanged over the next few years given a large capital plan while continuing to aggressively fund the pension plan and make annual deposits into the OPEB trust.

Pensions and OPEB

Cambridge's pension and OPEB liabilities are larger than its debt burden and though manageable at this time, represent a potential future credit challenge.

ESG Considerations

The City of Cambridge's ESG credit impact score is neutral-to-low (CIS-2), reflecting moderately negative environmental exposure, very low exposure to social risks and a strong governance profile that supports the city's credit rating, resilience and capacity to respond to shocks.

Environmental

Cambridge's E environmental issuer profile score is moderately negative (E-3). While carbon transition, natural capital, and water and pollution risks are modest, the city is exposed to physical climate risks associated with the city's location including exposure to sea level rise and extreme weather events including hurricanes and nor-easters.

Social

Cambridge's S social issuer profile is positive (S-1). The city benefits from favorable educational attainment, a strong labor force and positive health and safety. City residents also have access to basic services and the city benefits from stable demographics. Housing affordability is a neutral to low risk but is a growing challenge.

Governance

Cambridge's G governance issuer profile score is positive (G-1). The city has a favorable institutional structure, transparency and disclosure. The city also consistently approves and releases its budgets and audited financial statements in a timely manner. Cambridge's budget management and policy credibility and effectiveness are strong and is reflected in its healthy financial position and trend of balanced operations.

S&P Global

Credit Overview

Cambridge is an affluent community adjacent to Boston with an economy and property tax base anchored by 2 large universities and many leading science and technology companies which have provided stability

to the city. The city's management team operates with established and well embedded policies and procedures that allow for housing, transportation, and infrastructure needs to be addressed while sustaining financial stability.

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

- High wealth and income, residential and commercial tax base growth;
- Very strong management with strong financial-management policies, practices under our Financial Management Assessment (FMA) methodology - with well-embedded financial policies will forward-looking planning, providing stability through the recent management transition - and strong Institutional Framework score;
- Stable revenue and expenditure profiles, allowing the city to sustain very strong reserves, despite recent planned drawdowns; and
- Stable debt profile with continuous debt issuance, with a large other postemployment benefit (OPEB) obligation.

Environmental, social, and governance factors

we consider Cambridge vulnerable to environmental risks, including rising water levels from climate change that could directly affect taxable properties due to its location along the Charles River. The city has been proactively addressing challenges and it maintains long term environmental resiliency plans. We have analyzed Cambridge's social and governance risks relative to its economy, management, financial measures, and debt-and-liability profile; we view both as neutral in our credit rating analysis.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Cambridge economic profile and very strong management environment, which allows the city to manage finances to include the maintenance of reserves despite some use to support city goals and initiatives.

Downside scenario

We could lower the rating if reserves were to decrease significantly or if debt service and retirement costs were to increase meaningfully.

Credit Opinion

A tax base bolstered by institutional stability, very strong wealth and income

The tax base is about 53% residential and 44% commercial and industrial properties. The city's reliance on lab space and activity associated with large universities have provided stability to the real estate market. The moratorium on lab and office development in the Alewife area remains through calendar 2023, and the city is nearing the end of a zoning process intended to preserve commercial and lab space but also provide for additional housing.

Cambridge expects that mixed-use development, led by MIT, at the current federal Volpe complex will greatly affect the tax base in fiscal 2027 following the upcoming relocation of federal facilities. We expect development will likely continue in each of the city's economic development districts, leading to a steady tax base growth and helping generate activity to support an overall very strong economy and high income.

Very strong management, sustained through the transition to a new city manager

Cambridge has recently hired a new city manager after an extensive search. The new manager took the position in September 2022 after starting the transition in July 2022. A steadiness within other senior

positions and well embedded policies, practices supported the transition.

The budget development process supports Cambridge 's goals, including 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 spending monitoring ensure an adherence to the adopted budget. Management makes quarterly budget to actual and investment management reports to finance and investment committees, respectively. Management uses historical trend analysis to develop line item and departmental expenditure and revenue assumptions.

A stable revenue profile, anchored by property tax revenue, with reserve use to support key goals

Cambridge 's revenue and expenditure profile remains predictable with local property taxes accounting for about 67% of fiscal 2022 operating revenue. Departmental revenue was about 12% and intergovernmental aid was 10%. We understand hotel tax revenue is still below pre COVID-19 levels due primarily to business travel recovery while meal excise taxes and parking fee revenue have surpassed pre COVID-19 levels.

A stable debt profile with manageable costs

Cambridge has about \$605 million of total direct debt outstanding, about \$103 million of which we consider self-supporting sewer debt. Approximately \$38 million of the current issuance is sewer debt, which we expect to be self-supporting. Current debt outstanding has passed our 60% debt-to-revenue threshold, and it is likely to grow in excess of the threshold during the next 2 years. We do not think there is likely to be significant change in our view of the city 's debt profile.

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

Cambridge 's large pension and OPEB obligation is a credit weakness, in our opinion. We think some assumptions used to build the required pension contribution are permissive, which could lead to fluctuating costs. In addition the adopted funding schedule relies on significant cost escalation to meet a rapid amortization goal. Cambridge contributes \$2 million annually above the OPEB pay-as-you-go cost, and it's plan to address these costs relies on full pension plan funding. In the interim, we expect costs will likely continue to increase.

Fitch Ratings

The city's 'AAA' GO bond rating and IDR reflect Fitch's expectation for Cambridge to maintain a high level of financial flexibility through economic cycles, consistent with a history of strong operating performance and budget controls. The rating further reflects the city's robust resource base and future potential for continued tax base increases, along with manageable expenditure growth and demonstrated ability to reduce expenditures during economic downturns.

Fitch expects long-term liabilities to remain low when compared to the resource base based on the city's manageable capital needs, very rapid pace of principal amortization, continued growth in economic resources and a practice of fully funding actuarially determined pension contributions.

Key rating drivers

Revenue Framework: 'aaa'

Revenue Framework: 'aaa': Revenues are derived primarily from property taxes, and total annual general fund revenue growth over the past 10 fiscal years has exceeded U.S. GDP rates, reflective of strong growth in Cambridge's economy and tax base. Prospects remain strong for future economic advancement. The city maintains significant excess levy capacity under the state's Proposition 2 1/2 law,

providing for a high legal ability to raise revenues.

Expenditure Framework: 'aa': The natural pace of spending growth is expected by Fitch to be in line with or slower than natural revenue growth over time. Carrying costs for debt and retiree benefits claim a moderate proportion of governmental spending. Fitch expects carrying costs to remain moderate even with future debt issuances and budgeted annual increases in other-post employment benefit (OPEB) and pension contributions. The city maintains strong legal control over headcount and other key employment terms as provided by state statute.

Long-Term Liability Burden: 'aaa': Cambridge's direct debt, net of water and sewer debt paid from user charges, and Fitch-adjusted net pension liabilities (NPL) are low at approximately 5% of residents' personal income. Fitch anticipates Cambridge's long-term liability burden will remain in line with the 'aaa' assessment based on expected growth in the city's population and personal income, future debt plans, and a rapid pace of principal amortization. OPEB liabilities compared to personal income are high when compared to debt and NPLs, but management is actively managing these costs.

Operating Performance: 'aaa': Careful expenditure management combined with moderate tax levy increases that have aligned with tax base changes and conservative financial forecasting have led to the maintenance of considerable reserves over the past decade. Fitch expects the city will continue to demonstrate a superior level of gap-closing capacity and maintain a high level of fundamental financial flexibility throughout future economic cycles.

Rating Sensitivities

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A sustained increase in expenses outpacing revenues leading to a decline in unrestricted reserves and reducing overall financial flexibility.
- A significant decline in taxable assessed values leading to substantial diminishment of the city's excess banked levy capacity.

Current Developments

Cambridge's financial profile remains very strong as its economy rebounds from only moderate impacts due to the pandemic. Tax base values continue to grow due to new development and improved overall valuations, notwithstanding higher office vacancy rates compared to pre-pandemic levels, contributing to growth in property tax revenues, the city's largest revenue source at roughly two-thirds of revenues.

While Cambridge is not immune to changes in the office market, these vacancy rates will be influenced by the level of new office space coming into the market, particularly higher tier properties; and, as demand for lab space remains very active, class B office space has been undergoing conversions to lab space. Year-over-year lab vacancy rates remain very low at 2.1% for the fourth quarter of 2022.

Credit Profile

The city is an important economic component of the Boston metropolitan area and Massachusetts as a whole and benefits from the presence of both Harvard University and Massachusetts Institute of Technology. These institutions are the city's top two employers and other major employers include the city itself, Mt. Auburn Hospital and a number of biotechnology companies including Takeda Pharmaceuticals, Biogen, Novartis, and Sanofi.

Cambridge continues to strengthen its position as a national leader in the life sciences and high-tech sectors. Expansion in these sectors has contributed to notable tax base, employment and resident income

growth over the past several years and is projected by the city to continue for at least the near term. Wealth levels are above state and national averages and the unemployment rate (2.0% as of December 2021) is consistently below them.

Operating Performance

Fitch expects the city to maintain a high level of financial resilience throughout economic cycles given its historically strong revenue performance, conservative budgeting practices and superior degree of inherent budget flexibility. The steady growth in revenues has supported surplus operations over the past several fiscal years and the city has maintained its reserves at strong levels, supporting its high level of financial flexibility.

During times of economic weakness, management has controlled spending and staffing levels to offset reductions in revenues and Fitch expects management will continue this practice during future downturns. The city's strong budget monitoring practices and financial planning bolster the city's operating environment.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.