

RatingsDirect®

Summary:

Cambridge, Massachusetts; General Obligation

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Summary:

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Credit Profile		
US\$93.625 mil GO mun purp loan of 2023 bnds ser 2023 due 02/15/2043		
Long Term Rating	AAA/Stable	New
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' rating to Cambridge, Mass.' roughly \$93.625 million series 2023 general obligation (GO) municipal-purpose loan bonds.
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's existing GO debt.
- The outlook is stable.

Security

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 2023 bond proceeds to fund various citywide projects.

Credit overview

Cambridge is an affluent community adjacent to Boston with an economy and property tax base anchored by two 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 with 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 benefits (OPEB) obligation.

Environmental, social, and governance

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's 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

Cambridge is an integral part of the larger broad, diverse Boston MSA. Two subway lines, multiple highways, and a commuter rail connect the city directly to downtown Boston. Harvard University and Massachusetts Institute of Technology (MIT), its two leading employers and two of the leading taxpayers, anchor the local economy; they serve as knowledge centers and focal points for dozens of startups, research centers, and life-science and high-technology companies. Microsoft, Google, Amazon, Apple, Facebook, Pfizer, and IBM are among companies with offices in the city.

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. Vacancy rates for commercial office space is 8.7% and lab space is 1.2%, and management reports new construction and conversion of office space to lab facilities have continued. In addition, the development and permitting of additional residential development citywide has remained steady. 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 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.

Annually updated five-year financial and capital-investment plans are part of the annual budget process, outlining immediate fiscal challenges and prioritizing capital needs. The city invests in the state-run Massachusetts Municipal Depository Trust and bank deposits. Its formal debt-management policy goes beyond debt limits prescribed by commonwealth statute, including informal targets for debt service-to-budget limits and net-present-value-savings thresholds for refunding transactions. City policy affirms its commitment to maintaining unassigned fund balance in excess of 15% of the ensuing fiscal year's operating revenue, as well as a total general fund balance of at least 25% of the following fiscal year's operating revenue.

The Institutional Framework score for Massachusetts municipalities is strong.

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.

Cambridge has continued to use reserves to support capital initiatives and control tax rate growth. In fiscal 2022, the transfer into the capital fund was about \$44.6 million; the budgeted use of reserves totaled \$39 million in fiscal 2022. The fiscal 2023, \$801 million budget is a 6.5% increase over fiscal 2022, including a \$19 million appropriation of free cash that allowed a lower-than-expected tax rate increase. Other free cash uses to support capital and facility needs total \$36 million to date, or approximately \$65 million at fiscal year-end 2023. While the city is relying on one-time revenue to support some initiatives, this has been relatively consistent with a planned use during the past few years and it does not indicate structural imbalance.

We expect available fund balance will likely remain more than 30% of expenditures, including the budget-stabilization fund, which the city accounts for in committed general fund reserves. The overall reserve profile and \$201 million in unused levy capacity, about 25% of fiscal 2022 budgeted operating expenditures, provide budgetary flexibility and stability as the city pursues its goals.

Cambridge is developing its fiscal 2024 budget, aiming to sustain all services and continue to ease the burden on taxpayers. The fiscal 2024 budget and future budgets address demands from wages and new positions, including the

introduction of a facilities department to consolidate design; construction; and maintenance across city and school facilities, which should provide some operational-cost savings.

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 two years. We do not think there is likely to be a 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 its plan to address these costs relies on full pension plan funding. In the interim, we expect costs will likely continue to increase.

As of June 30, 2022, the city participated in:

- Cambridge Retirement System, which is 99.8% funded, with a \$2.8 million proportionate share of the net pension liability; and
- Cambridge's single-employer, defined-benefit OPEB plan, which is 3.7% funded, with a \$760 million net OPEB liability.

The pension system's discount decreased to 7.1%, but it remains above the 6% discount rate we view as likely to mitigate contribution volatility. The system updated its adopted funding schedule, which continues to meet the 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 increasing pension costs as a percent of expenditures. However, we think management plans for these costs as part of long-term financial planning; the high funding ratio could mitigate potential cost volatility.

If the city meets its 2026 funding target, it expects to shift a portion of the annual pension payment above the normal cost to fund the OPEB liability. While the OPEB liability decreased during the past year, we expect costs will likely continue to increase; the liability will remain large.

Ratings above the sovereign

Cambridge's GO bonds are eligible to be rated above the sovereign because we think the city can maintain better credit characteristics than the nation in a stress scenario. The city has a predominately locally derived revenue source with 67% of governmental activity revenue from property taxes with independent taxing authority and treasury management from the federal government. (For further information, see "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect.)

Cambridge, Massachusetts Select Key Credit Metrics				
	Most recent	--Historical information--		
		2022	2021	2020
Very strong economy				
Projected per capita effective buying income (EBI) (%) of U.S.	175.3			
Market value per capita (\$)	619,114			
Population			114,906	115,480
County unemployment rate(%)			4.6	
Market value (\$000)	71,139,913	63,952,954	60,234,893	
10 largest taxpayers as a % of taxable value	23.4			
Adequate budgetary performance				
Operating fund result as a % of expenditures		(3.0)	(2.6)	(3.2)
Total governmental fund result as a % of expenditures		(0.3)	0.3	2.3
Very strong budgetary flexibility				
Available reserves as a % of operating expenditures		35.7	39.0	43.0
Total available reserves (\$000)		280,445	305,164	321,661
Very strong liquidity				
Total government cash as a % of governmental fund expenditures		51.4	50.2	54.2
Total government cash as a % of governmental fund debt service		549.4	526.4	559.0
Very strong management				
Financial Management Assessment	Strong			
Adequate debt and long-term liabilities				
Debt service as a % of governmental fund expenditures		9.3	9.5	9.7
Net direct debt as a % of governmental fund revenue	60.8			
Overall net debt as a % of market value	0.9			
Direct debt 10-year amortization (%)	80.7			
Required pension contribution as a % of governmental fund expenditures		4.6		
Other postemployment benefits actual contribution as a % of governmental fund expenditures		2.7		
Strong Institutional Framework				
Data points and ratios may reflect analytical adjustments.				

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
- 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
- 2022 Update Of Institutional Framework For U.S. Local Governments

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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