CITY OF CAMBRIDGE
Finance Department

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TO: Yi-An Huang City Manager

FROM: Claire Spinner, Assistant City Manager, Fiscal Affairs

DATE: May 6, 2025

SUBJ: FY26 Budget Background- Property Tax Levy

This memo responds to the City Council's request for information regarding the potential impact of further increases to the property tax levy on the City's financial stability and on taxpayers.

Beginning in the fall, we have kept the City Council, City department heads and staff informed of our concerns about unfavorable macroeconomic trends. These trends may weaken the City's financial position by increasing our reliance on property tax revenue to balance the budget and by reducing our excess levy capacity. We are also monitoring a possible shift in tax burden from commercial to residential properties, which may result if commercial values decline, and residential values increase or stay relatively flat.

Following more than a decade of rising property values and strong new development—factors that expanded our tax base and generated additional revenue through building permits—Cambridge's commercial real estate market is now experiencing higher vacancies, declining valuations, and a slowdown in new construction. During the fall, the Finance Committee held a series of meetings to discuss the city's economic outlook and consider strategies to maintain our long-term financial flexibility so that we can sustain our existing programs and services, respond to community needs, and invest in new initiatives. As a result, we proposed a multi-year plan to moderate budget growth, including a budget growth cap of 4% for FY26 and a target for budget growth of less than 5% annually for FY27 through FY29. This approach aims to keep tax levy increases sustainable—no more than 8% in FY26 and below 7% in FY27–FY29—even as reliance on property tax revenue grows.

Budget and Tax Levy Targets Set in Fall 2024

	FY26	FY27	FY28	FY29
Operating Budget Increase	<4%	<5%	<5%	<5%
Tax Levy Increase	<8%	<7%	<7%	<7%

Since then, new federal developments have added further uncertainty to our economic outlook. The US economy shrank over the first quarter of 2025; consumer sentiment is at its lowest since the 1990 recession and unclear tariffs are leading to a slowdown in new investment. Our earlier economic projections are likely optimistic at this point and the last three months have reinforced the need to safeguard the City's financial resilience.

FY26 Submitted Budget

Developing the City's annual operating and capital budgets requires significant engagement with and work by each department. As we collaborated with department staff to craft the FY26 budget, the focus was to continue to provide the high level of operations, services, and programs that residents and businesses expect and to sustain investments in important council and community priorities, while meeting the budget and tax levy targets established for FY26. Departments were asked to absorb increased costs wherever possible, and to minimize requests for additional funding. Department heads and their staff are key partners in budget development, and the FY26 budget represents their expertise and judgement about the funding levels necessary to support the work of their departments.

The submitted FY26 Operating Budget totals $991.2 million, and represents an increase of $35.6 million, or **3.7%**, compared to the FY25 budget. A total property tax levy of $677.7 million will support the FY26 operating and capital budgets. This represents an increase of $49 million, or **7.85%**, compared to the FY25 property tax levy.

Impact of FY26 Levy Increase on Residential Properties

While we do not have assessed property valuation data for FY26 yet, which is needed to set the actual tax rates for the FY26 bills, we can estimate the impact of the 7.9% levy increase on tax bills as compared to FY25, using FY25 values. The estimated increases by residential property classes are illustrated below. The actual tax rate will be determined in the fall as part of the property tax and classification process and will depend on updated valuations.

Estimated Change in Median Tax Bill by Residential Property Class- FY25 to FY26*

(Based on Property Tax Levy of $677.7 Million)

	FY25 Value	FY25 Tax Bill	Est. FY26 Tax Bill	$ Change Tax Bill	% Increase
Single Family	$1,767,700	$8,055	$8,689	$634	7.9%
Two Family	$1,594,700	$6,956	$7,504	$548	7.9%
Three Family	$1,857,550	$8,625	$9,304	$679	7.9%
Condominium	$767,300	$1,702	$1,836	$134	7.9%

* Includes Residential Exemption

The cumulative impact of tax levy increases over several years is also an important consideration. Tax levy increases in the past three years (FY23, FY24, and FY25) were 7.45%, 8.27% and 9.28% respectively, resulting in a cumulative property tax levy increase of 25%. The chart below shows the change in median residential tax bills since FY22.

Three-Year Change in Median Residential Tax Bills*
FY2022 -FY2025

	FY22 Tax Bill	FY25 Tax Bill	3 Year $ Change	3 Year % Change
Single Family	$6,306	$8,055	$1,749	28 %
Two Family	$5,772	$6,956	$1,184	21%
Three Family	$7,046	$8,625	$1,579	22%
Condominium	$1,641	$1,702	$61	4%

* Includes Residential Exemption

Impact on Commercial Properties

We have also analyzed the potential impact on commercial properties. Both residential and commercial properties will be affected by the same proposed 7.85% levy increase. However, a significant decrease in office and lab values will drive a steeper increase in the tax rate and will shift the tax burden within commercial classes. We anticipate increases in tax bills for restaurants, retail and hotels of more than 7.9%, perhaps as much as 10-15%, because of the declining value of office and labs. To note, higher tax rates within restaurants and retail classes will disproportionately affect our small and local businesses. The tax bills are typically passed through to the tenants in commercial properties.

Impact of Additional Increases to FY26 Expenditures on Property Tax Levy

Because we are experiencing an overall decline in non-property tax revenues, primarily driven by lower commercial development, any increases to the FY26 budget will be funded through higher property taxes. Each one percent increase to the property tax levy results in an additional $6.8 million in revenue and will impact the amount of taxes property owners will pay. The chart below compares estimated FY26 median residential tax bills if the City were to increase the budget, and thus the property tax levy by another $10 million or $15 million. As above, the estimates are based on using FY25 residential values.

Comparison of Impact on Estimated Median Residential Tax Bills*
With Additional Tax Levy Increases

	FY26 Budget $677.7 M Levy *+7.9%*		+ $10 Million $687.7 M Levy *+9.4%*		+ $15 Million $692.7 M Levy *+10.2%*	
	Tax Bill	**$ Change from FY25**	**Tax Bill**	**$ Change from FY25**	**Tax Bill**	**$ Change from FY25**
Single Family	$8,689	$634	$8,816	$761	$8,816	$824
Two Family	$7,504	$548	$7,613	$657	$7,613	$712
Three Family	$9,304	$679	$9,440	$815	$9,440	$883
Condominium	$1,836	$134	$1,863	$161	$1,863	$174

* Includes Residential Exemption

Shift of Tax Burden from Commercial Properties to Residential Properties

State law allows municipalities the option to allocate the tax levy between residential and commercial properties using different tax rates. However, there are limits: Commercial properties may pay no more than 175% of their full, fair cash value share of the levy ("commercial factor") and residential properties must pay at least the historic minimum residential percentage as determined by the Department of Revenue, currently 34%, of the levy. Under the formula today, Cambridge commercial properties pay 66% of the levy and residential properties pay 34%. However, in an economic climate where commercial values are declining and residential values are increasing, this proportion may change and shift more of the tax burden to residential properties, accelerating tax increases for residents while reducing taxes for commercial properties.

The City's Assessing Department has modeled several potential scenarios, to understand when the shift could occur and what the financial impact of this shift would be for residential properties. The two scenarios below compare the impact of a moderate decline in commercial property values with a more pessimistic scenario in which commercial values decline more rapidly. In both scenarios, the tax levy increases 8% in FY26, and 7% in FY27 through FY29 (i.e. in line with our moderate budget growth targets).

In the more moderate Scenario I, the commercial properties reach the maximum commercial factor in FY29, which increases the residential percentage of the tax levy to 35%, resulting in a 11.9% levy increase for residential properties, even though the overall levy increase is 7%. The commercial property tax levy increases only 4.5%. The cumulative residential increase from FY25 through FY29 is 43.2%.

Scenario I: Moderate Decline in Commercial Values

	2025 RECAP	**2026 Projection**	**2027 Projection**	**2028 Projection**	**2029 Projection**
Residential Percentage	33.8%	33.8%	33.8%	33.8%	35.3%
Commercial Factor	140%	155%	167%	174%	175%
Residential Levy Increase	9.3%	8.0%	7.0%	7.0%	**11.9%**
Commercial Levy Increase	9.3%	8.0%	7.0%	7.0%	**4.5%**
Cumulative Residential Increase	**9.3%**	**17.3%**	**24.3%**	**31.3%**	**43.2%**

In the more pessimistic Scenario II, the commercial properties reach the maximum commercial factor next year in FY27, which increases the residential percentage of the tax levy to 36%, resulting in a 14.6% levy increase for residential properties, even though the overall levy increase is 7%. The commercial property tax levy increases only 3%. This impact would accelerate going forward. In FY28 and FY29, the residential percentage continues to increase, to 41% and 44% respectively, triggering levy increases of 21.4% and 15.7% respectively. In this scenario, the cumulative residential increase from FY25 through FY29 is 69.1%.

Scenario II: Major Decline in Commercial Values

	2025 RECAP	**2026 Projection**	**2027 Projection**	**2028 Projection**	**2029 Projection**
Residential Percentage	33.8%	33.8%	36.2%	41.1%	44.4%
Commercial Factor	140%	162%	175%	175%	175%
Residential Levy Increase	9.3%	8.0%	**14. 6%**	**21.5%**	**15.7%**
Commercial Levy Increase	9.3%	8.0%	**3.1%**	**-1.2%**	**0.9%**
Cumulative Residential Increase	**9.3%**	**17.3%**	**31.9%**	**53.4%**	**69.1%**

Importance of Preserving Excess Levy

A significant benefit of the level of new development in Cambridge has been the expansion of our tax base through new taxable property value, particularly commercial, providing the capacity to fund new initiatives and community priorities despite the constraints imposed by Proposition 2½.

Proposition 2½ sets a tax levy limit and an annual levy limit increase for each city: An automatic 2.5% increase from the prior year levy limit plus any new growth. Excess levy capacity, which is the difference between the levy limit and the tax levy in any given year and represents the amount of additional taxes a city may levy. The City of Cambridge has been able to maintain a healthy level of excess levy capacity due to new growth, providing us with the ability to increase our tax levy beyond 2½ percent annually. This is a flexibility that most cities and towns in Massachusetts do not have. Being levy constrained restricts not only the ability to invest in new initiatives, but even to simply maintain existing programs and services. Annual cost-of-living increases, new union contracts, inflation in the cost of supplies and services, and the rising cost of health and other benefits are often greater than 2.5% , which results in painful budget reductions and layoffs in communities at their levy limit, unless an override vote is passed.

As development activity slows, the amount of new growth that the City adds to its levy capacity on an annual basis will decrease. During periods of slower growth, it is important that the City moderate budget growth to preserve financial flexibility as well as stability. If the City reaches its levy limit, significant budget reductions would likely be necessary to balance the annual operating budget.

In fact, our analysis indicates that if the City did not have any excess levy capacity today (i.e. we were at our levy limit), Cambridge would only be able to support a $9 million budget increase. This would not cover basic maintenance of effort and would mean not only no new spending, but the need to make cuts. **The total impact would be the need to find $27 million in savings compared to the currently submitted budget.**

The charts below illustrate how quickly excess levy capacity may be depleted if we do not moderate tax levy increases.

The first scenario (Chart I) is based on moderated budget growth that aligns with the targets set in Fall 2024, with tax levy increases of no more than 8% in FY26, and less than 7% in FY27-29. In this scenario, the excess levy capacity declines from $189 million in 2025 to $138 million in 2029.

CHART I: Moderated Budget Growth

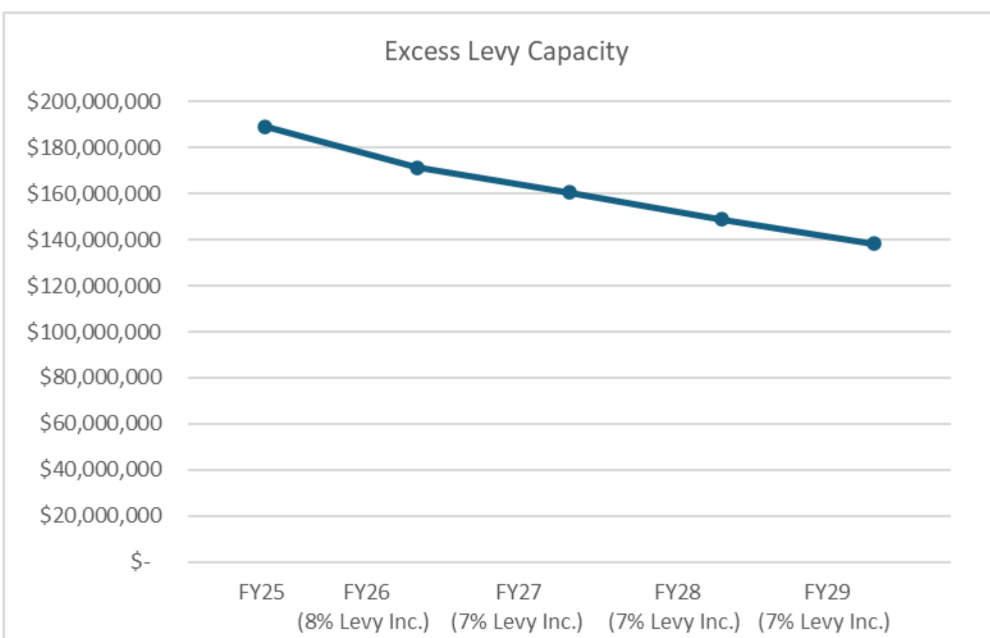
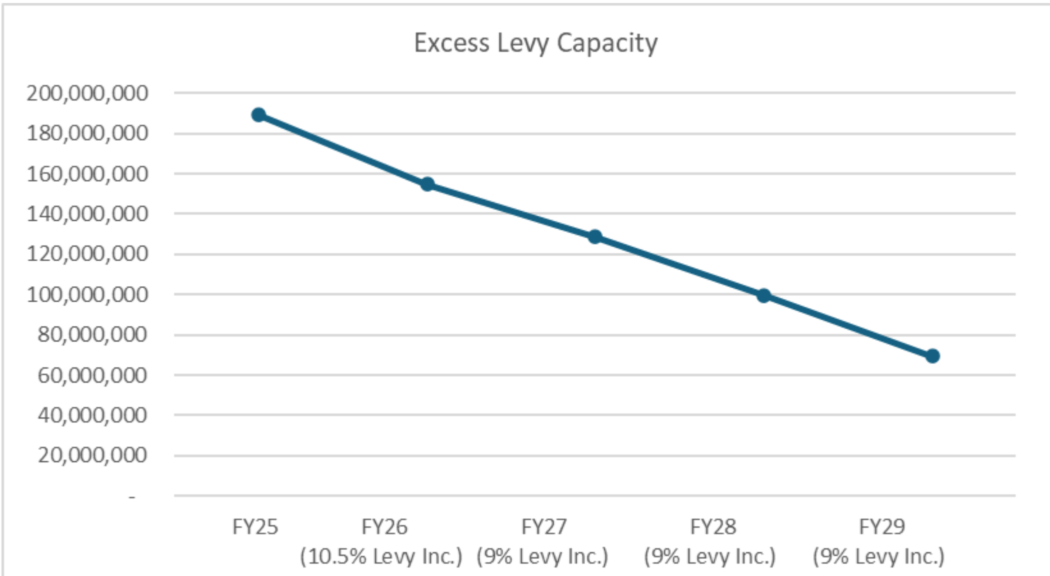


Chart II is based on continued high budget growth, with a tax levy increase of 10.5% in FY26, and 9% increases in FY27-FY29. In this scenario, the excess levy capacity declines from $189 million in 2025 to $69 million in 2029. Given the rapid changes at the federal level, these scenarios could be determined to be overly optimistic.

CHART II: Continued High Budget Growth



Proposed $5 Million Federal Funding Stabilization Fund

While a significant portion of the City's budget continues to support core services such as public safety, infrastructure, and education, we've been fortunate in recent years to also invest in new City Council priorities. Over time, the share of the budget dedicated to these initiatives has grown. However, we are now at a financial inflection point.

At the April 16th Finance Committee meeting, we outlined a process for prioritizing future capital and large-scale programs that the Council may wish to pursue. We also discussed growing concerns about the economic and financial uncertainty driven by potential federal funding reductions, which may be important for the City to mitigate, and which complicates fiscal planning for new initiatives.

To address the uncertainties and challenges of potential federal funding reductions in the upcoming fiscal year, we have proposed allocating $5 million of free cash to a Federal Funding Stabilization Fund. While the full extent federal funding actions are unknown, we do know that there are already more programs being threatened by federal cuts than this amount will support. But, there are limits to our ability to absorb lost federal revenue into our operating budget, which is why we have set the funding amount at $5 million. As discussed, moderating budget growth is essential to preserving the City's long-term financial flexibility. To integrate this $5 million into our operating budget while still meeting our FY27–FY29 budget growth and tax levy targets, we will need to identify savings. We are committed to doing so in a fiscally responsible way that maintains the quality of city operations and services and preserves the important programs that the City Council has established over the years.

FY 26 Budget – City Council Process

The budget process begins in December and involves significant efforts across City department leaders and staff working with the budget team. For the FY26 budget, a key directive was to moderate our budget growth, and this meant both finding resources within existing budgets and holding back on new proposed investments.

The City will also continue to work hard to find efficiencies that will allow for greater financial flexibility. In FY26, we made a significant shift in pension policy recognizing that we have made healthy commitments during the past decade and are in a strong position to extend our timeline to be fully funded. This has been a key part of how we have managed to moderate our budget growth for FY26.

Like the process that we have proposed regarding prioritizing major new investments, we are also open to discussions with the City Council regarding shifting Council priorities that may affect how we allocate the City's budget across major areas, particularly if this represents a change in direction or emphasis. We would expect this would require deeper conversation and engagement with the community, for instance, if we were to explore a material change in our investments in parks and playground or street infrastructure.

Conclusion

Cambridge faces a critical fiscal juncture that requires disciplined financial stewardship and strategic planning. The FY26 budget reflects a concerted effort to maintain essential services, support community priorities, and meet the budget and tax levy targets set last fall—all while navigating mounting economic uncertainty, shifting property valuations, and increasing dependence on property tax revenue. The potential shift in tax burden from commercial to residential properties and the erosion of excess levy capacity highlight the need for careful moderation in budget growth. By implementing a multi-year fiscal framework, preserving financial flexibility, and preparing for federal funding risks through targeted reserves, the City is taking proactive steps to ensure long-term stability. As we move forward, continued collaboration between the City Council, staff, and the broader community will be essential to making informed choices that sustain Cambridge's financial health and its capacity to invest in a resilient and equitable future.