



**CITY OF
CAMBRIDGE**

FY25 Operating Budget & Tax Levy Projections



City Council Finance Committee Hearing

February 28, 2024

Executive Summary

- Today, we are sharing preliminary projections for this year's operating budget and supporting tax levy, as well as recommendations to ensure the City's future financial health.
- The money we spend to run the city, our operating budget, is mostly and increasingly supported by property taxes.
- To prevent cities from making large annual property tax rate increases, Massachusetts State Proposition 2.5 sets a tax levy limit and restricts the growth of this levy limit from year to year.
- During the past decade new property growth significantly added to our levy limit, allowing us to stay well below the levy limit and make strategic investments in multiple priority areas.
- Looking ahead, new property growth is expected to slow while our budget continues to grow, bringing us closer to the levy limit, which will erode financial flexibility.
- The City's financial outlook remains strong; however, we need to moderate budget growth to preserve future financial flexibility. This will require critical decisions and tradeoffs in the future.
- While we likely will need a ~10% tax levy increase in FY25 and FY26 to support existing commitments, we will need to moderate tax levy increases moving into FY27 and beyond.

Proposition 2.5 information and definitions

What is MA Prop 2.5?

Enacted in 1980 by state-wide voter initiative, Prop 2.5 is a piece of MA state legislation that **restricts a municipality's maximum potential tax levy**, without needing an override. The legislation had two main measures, targeted at protecting tax-payers from significant tax increases from year-to-year:

1. Established an annual Levy Ceiling of 2.5% of the municipality's total taxable assessed value.
2. Established an annual levy limit.

Key terms & definitions

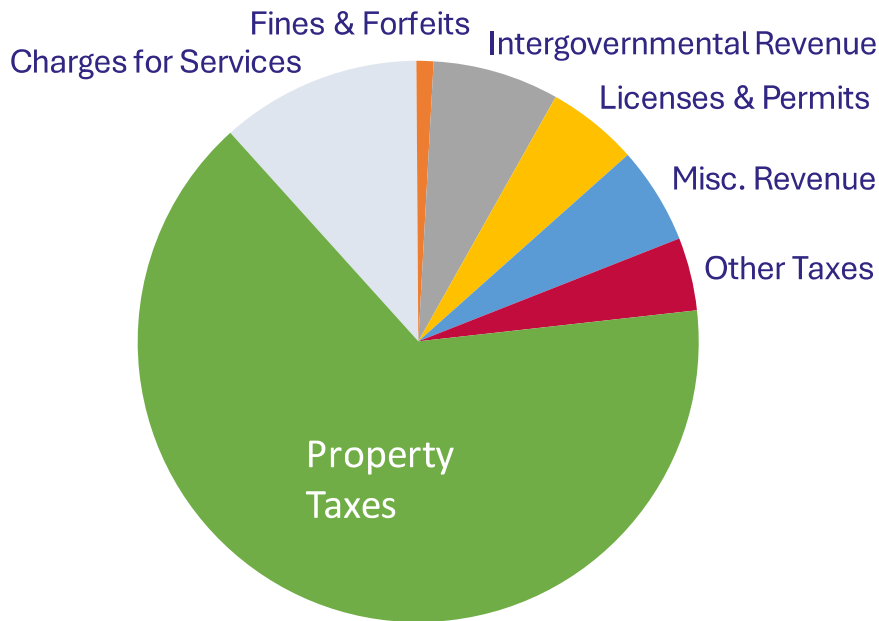
- **Tax Levy:** Revenue raised through real and personal property taxes; is the largest source of revenue for City of Cambridge budget
- **New Growth:** Additions to community's tax base in the prior year (does NOT include higher market values; must result from a change in physical condition, taxable status, or taxable unit of a property)
- **Levy Limit:** The maximum dollar amount a community can routinely levy through taxes in a given year. A given year's levy limit = The prior year's levy limit + 2.5% of the prior year's levy limit + plus any new growth factor.
- **Excess Levy Capacity:** The difference between the levy limit and actual taxes levied
- **Levy Ceiling:** The maximum levy limit in a given year, calculated as 2.5% of the municipality's total taxable assessed value.

The money we spend to run the city, our operating budget, is mainly supported by property taxes

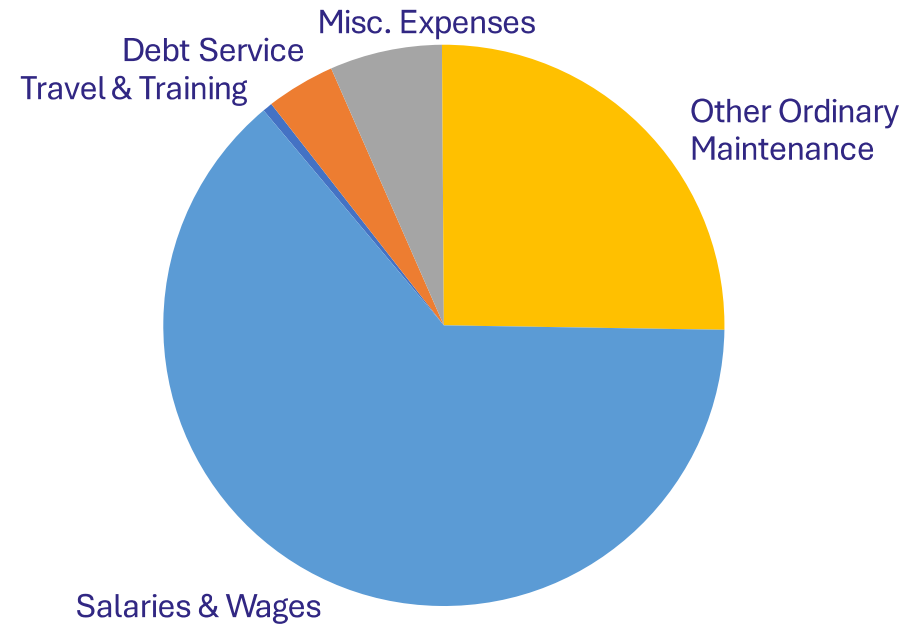
Operating Revenue



Operating Expenditures



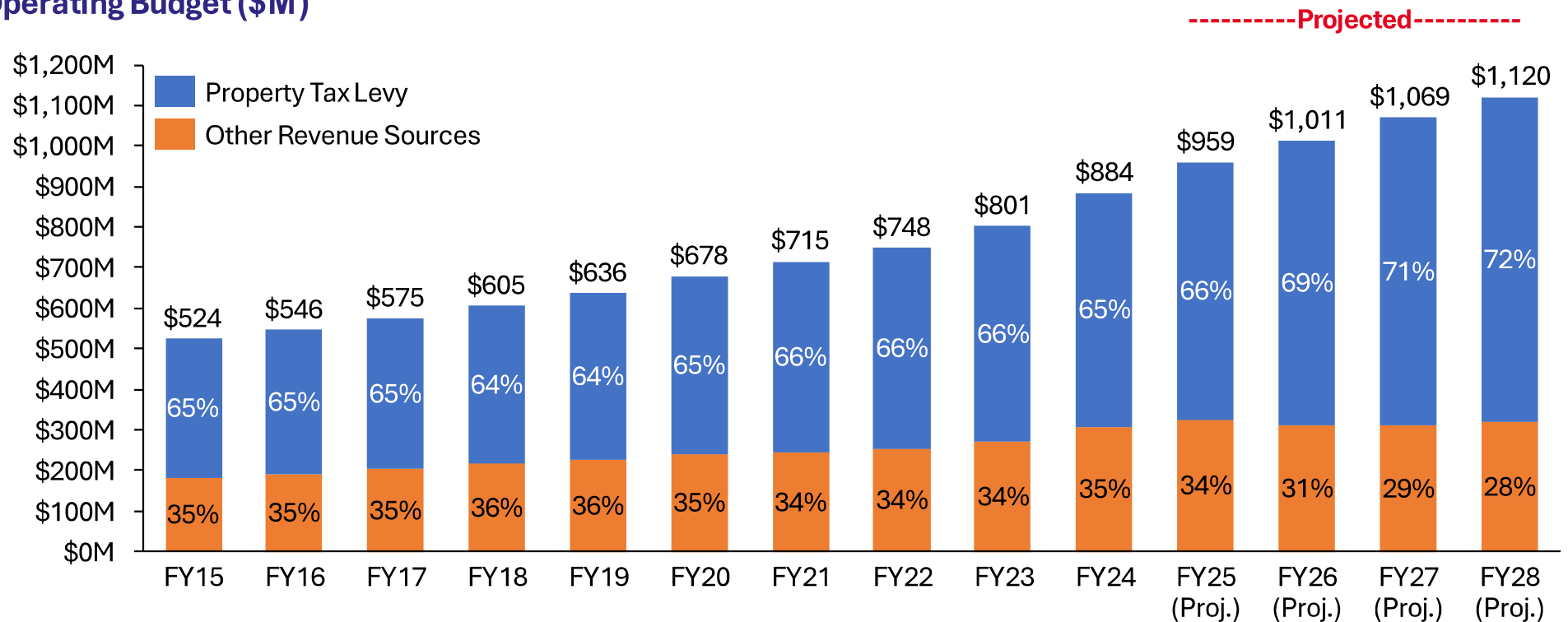
Property Tax Breakdown
Commercial: 66%
Residential: 34%



Graph breakdowns taken from FY24 operating budget figures.

As the City's operating budget grows, projections show an increasing reliance on the property tax levy

Operating Budget (\$M)



- FY25 - FY28 projections for “Other Revenue Sources” show little to no growth; therefore, increases to the property tax levy will be needed to support projected rising expenditures.

Projections are subject to change.

MA Proposition 2.5 sets a tax levy limit and an annual levy limit increase for each city, to prevent large annual property tax rate increases

- The most important Prop 2.5 metric is the **Levy Limit**, which is the **maximum allowable** tax levy each year (without an override), originally set as % of a municipality's total assessed value
- Prop 2.5 restricts the annual increase to the Levy Limit to include two factors: an automatic 2.5% increase from the prior year levy limit **AND new growth**.
- **Excess Levy Capacity** is the difference between the levy limit and the tax levy in any given year. It represents the amount of additional taxes the City may levy if necessary.
- Excess Levy capacity is an important component of the City's overall financial stability. When the tax levy stays below the levy limit, we preserve future flexibility to raise additional taxes when necessary.
- To preserve this flexibility, we need to maintain a careful balance between how fast the tax levy is growing and the rate at which the levy limit is increasing.



Illustrative example: What if we had no excess levy capacity?

Scenarios at the Levy Limit (i.e., no excess levy capacity)

	Scenario 1 (historic new growth)	Scenario 2 (lower new growth)
FY23 Property Tax Levy	\$531.4M	\$531.4M
<i>Plus 2.5% growth of levy limit</i> ($\$531.4M \times 2.5\%$)	+\$13.3M	+\$13.3M
<i>Plus new growth factor</i>	+\$23.1M	+\$13.0M
<i>Equals FY24 hypothetical</i> levy limit	= \$567.8M	= \$557.7M
Actual FY24 Tax Levy	\$575.4M	\$575.4M
<i>Unsupported Budget</i>	-\$7.6M	-\$17.7M

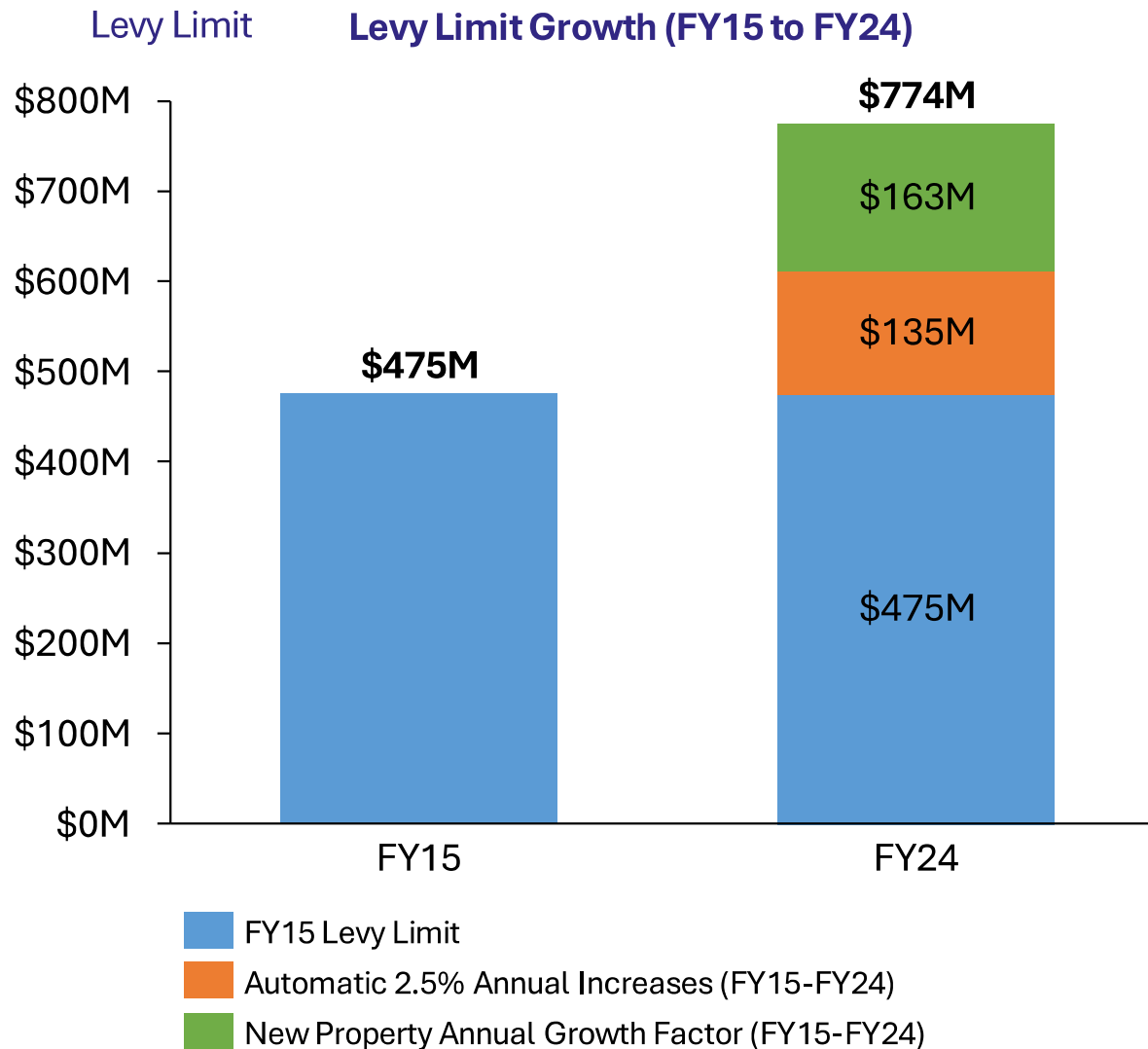
A healthy level of excess levy capacity provides financial flexibility.

The City has used this flexibility to support community priorities such as:

- Universal Pre-Kindergarten
- Extended hours in Cambridge Public Schools
- Open space / park upgrades
- Pilot CDD/DHSP programs
- Community Safety Dept.
- Debt service for public investments

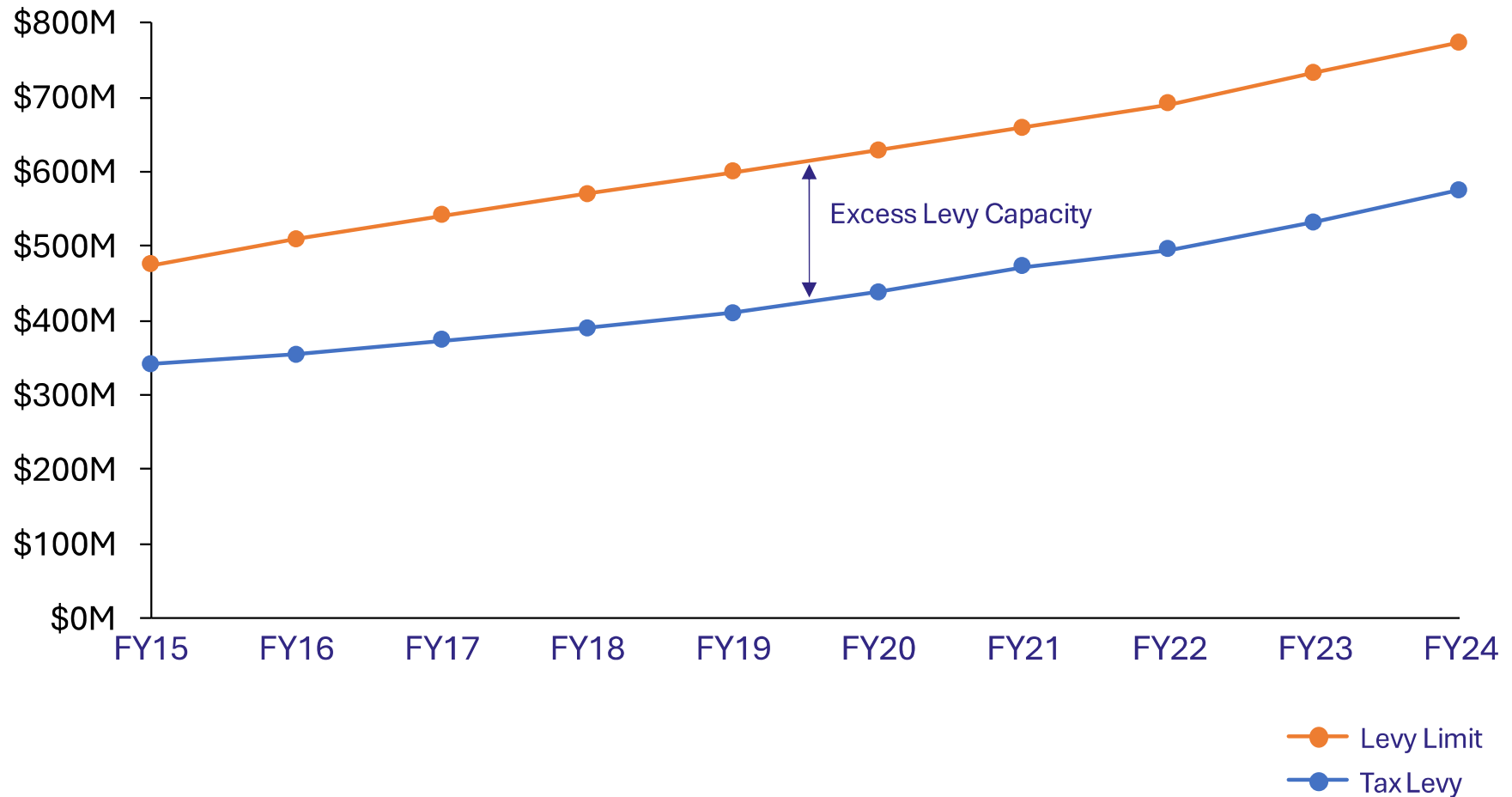
- For both hypothetical scenarios, the tax levy would have been meaningfully lower than the actual FY24 tax levy (especially in the scenario with lower new growth).
- Communities facing such a scenario must reduce budgets or get an override passed.

New property growth has contributed significantly to our levy limit over time



- Significant new growth expanded our taxable base (levy limit) and contributed to higher building permit revenue
- From FY15 to FY24, the levy limit grew \$299 million, with 55% of the increase attributable to new growth.

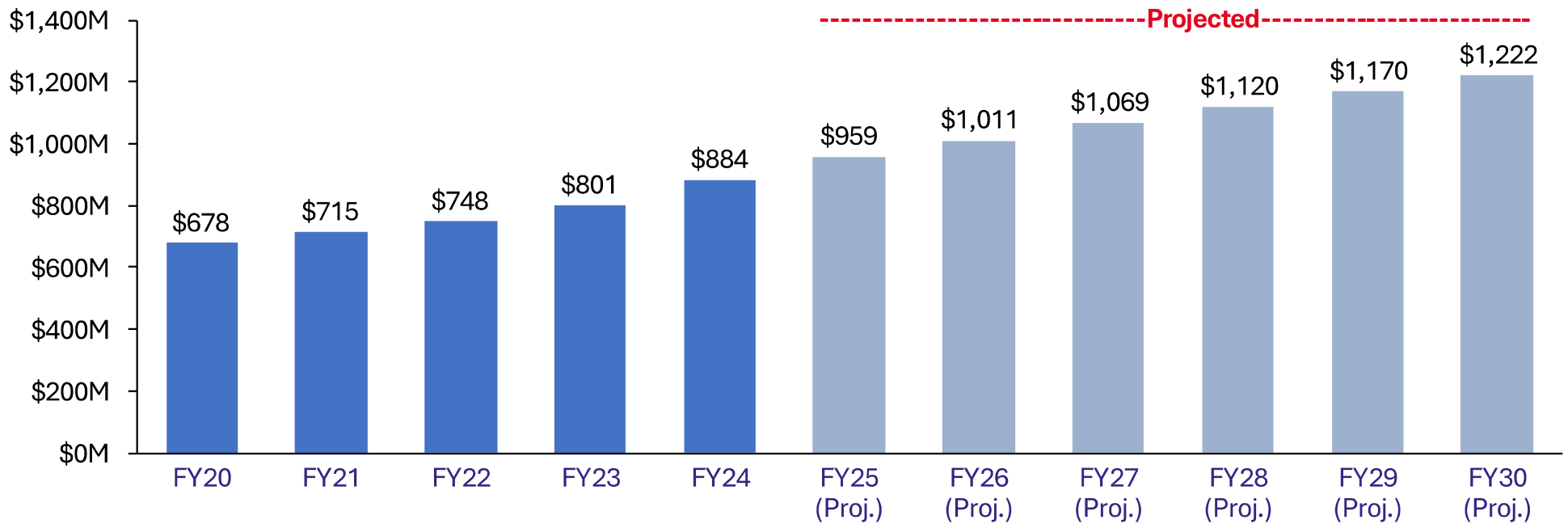
Historically, we have been able to stay well below the levy limit



This has enabled us to make strategic investments while maintaining excess levy capacity

- However, in future years, new property growth is expected to slow.
- We will need to moderate operating budget growth and tax levy growth to avoid eroding our excess levy capacity.

Operating Budget

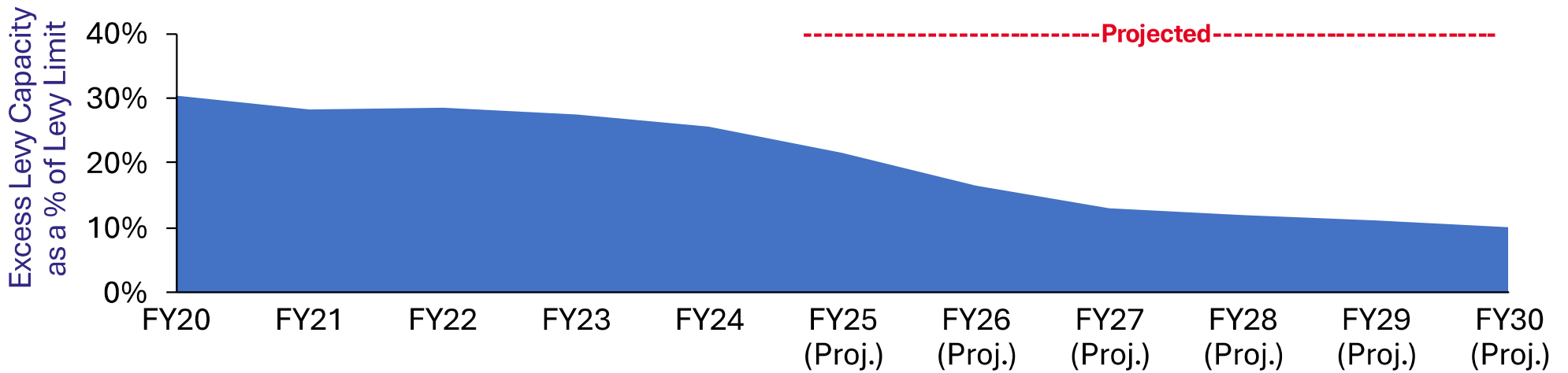


Op. budget growth rate	6.6%	5.4%	4.6%	7.1%	10.3%*	8.5%	5.5%	5.7%	4.8%	4.4%	4.4%
Tax levy growth rate	6.9%	7.8%	4.7%	7.4%	8.3%	10.1%	10.5%	8.5%	5.6%	5.0%	5.0%

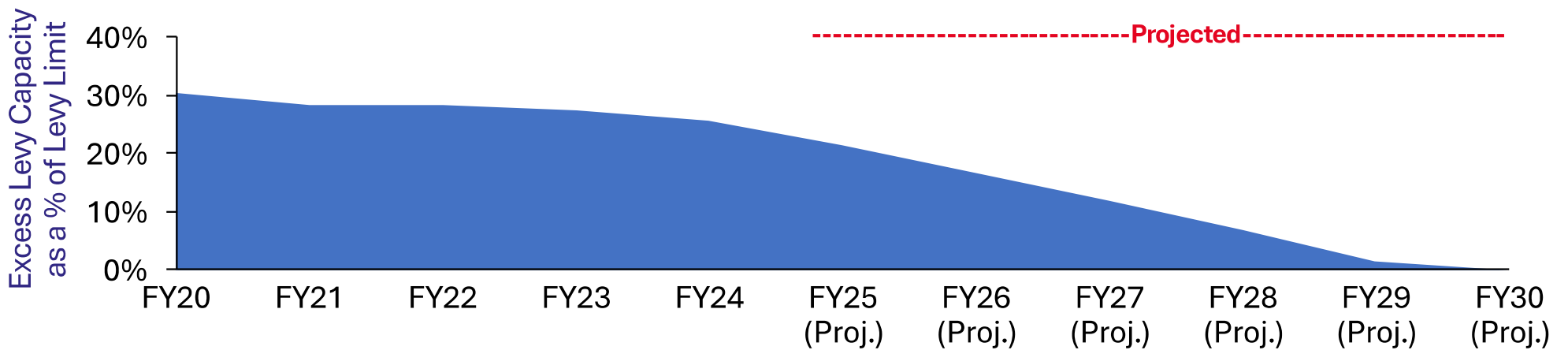
* Part of increase due to accounting methodology changes
Projections are subject to change.

While the City's financial outlook remains strong, we need to moderate tax levy growth and budget growth to preserve future financial flexibility

Scenario 1: Moderated budget growth, with tax levy growth at ~5% per year post FY27

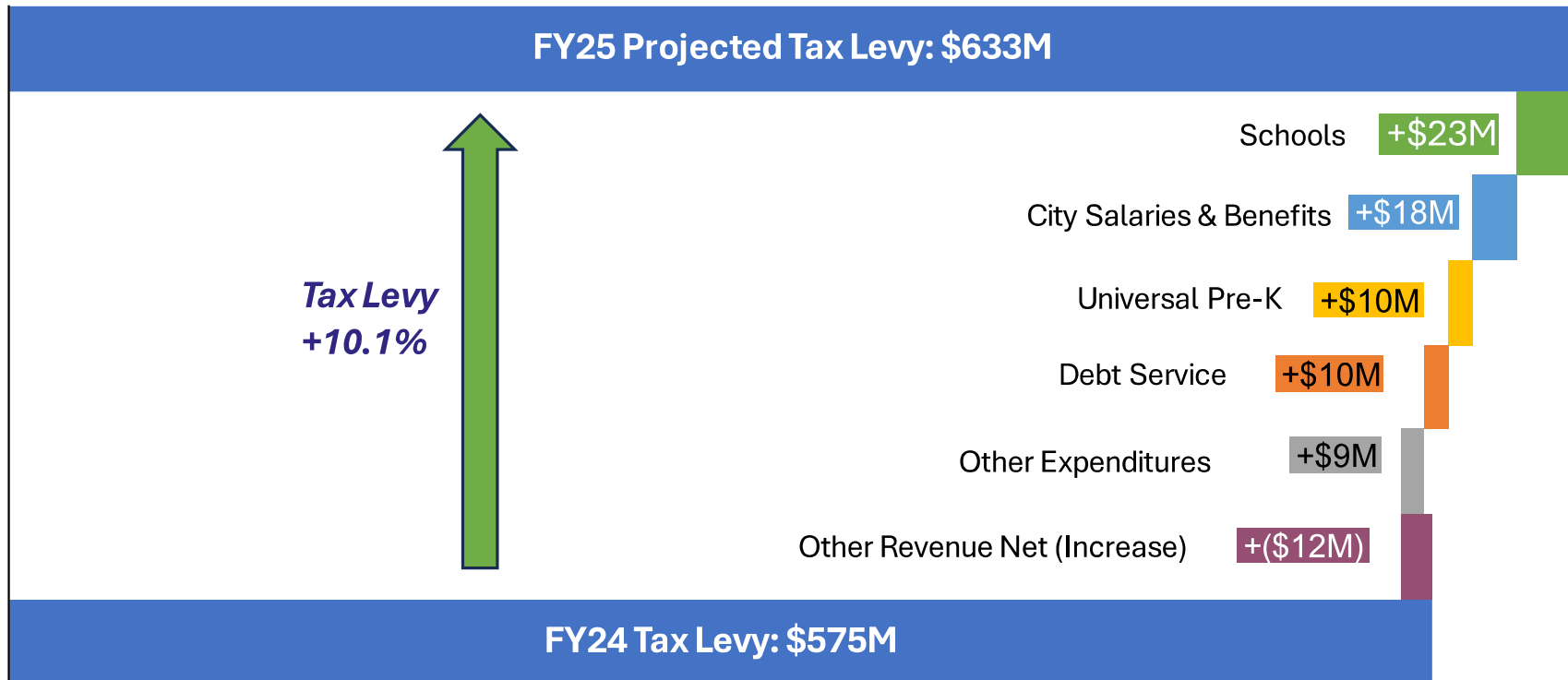


Scenario 2: Continued high budget growth, with tax levy growth at ~10% per year FY25 -FY30



Projections are subject to change.

Preliminary projections of revenues and expenditures indicate the likely need to increase the tax levy by 10% in FY25



Projections are subject to change.

The City is at a critical inflection point and will need to take action to preserve future financial stability

Takeaways

1

In upcoming years, new property growth is projected to slow down from the historically high new growth levels seen in the past decade, contributing to slower levy limit growth.

2

When the levy limit increases more slowly, our tax levy and operating budget must also grow more slowly to preserve our excess levy capacity and thus, our financial flexibility. This will require prioritization and making trade-offs.

3

For FY25 and FY26, we recommend setting annual tax levy increases to no more than 10%, and to moderate further in future years to maintain adequate excess levy capacity in perpetuity.

We look forward to collaborating with the Council to meet our community's priorities while keeping the City financially healthy for future Cambridge residents!