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Ratings

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Summary:

Cambridge, Massachusetts; General Obligation

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Credit Profile		
US$106.0 mil GO mun purp loan bnds ser 2021 due 02/15/2041		
Long Term Rating	AAA/Stable	New
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed
Cambridge GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Cambridge, Mass.' 2021 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating on the city's existing GO debt. The outlook is stable.

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 2021 bond proceeds to fund various citywide projects, including school renovations and sewer improvements, as well as to refund certain outstanding maturities on the city's 2010 and 2011 bonds.

Credit overview

Cambridge is an affluent suburb immediately adjacent to Boston. Home to both Harvard University and the Massachusetts Institute of Technology (MIT), the city is at the epicenter of biotech, pharmaceutical, and other knowledge-based sectors, which continue to generate growth in the tax base. It faces challenges in addressing housing, transportation, and other infrastructure needs. However, it has a history of significant forward-looking financial planning and a track record of consistently outperforming the budget. We expect Cambridge to remain a desirable location to live and work, sustaining economic growth that will assist management in meeting future challenges. Despite a drawdown in reserves in fiscal 2020, which may continue into subsequent years as the city works to balance its tax rate, balance sheet, and capital needs, we believe it will maintain balanced long-term financial performance and significant budgetary flexibility, given its high reserve levels and unused levy capacity. The economic climate may continue to pressure certain nontax revenues, but we do not expect to revise the rating over the next two years.

We rate Cambridge higher than the sovereign based on the application of our "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" criteria (published Nov. 19, 2013, on RatingsDirect). 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.

The long-term rating reflects our view of the following factors:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2020, which closed with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 43% of operating expenditures, and the flexibility to raise additional revenues despite statewide tax caps;
- Very strong liquidity, with total government available cash at 54.2% of total governmental fund expenditures and 5.6x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 9.7% of expenditures and net direct debt that is 60.6% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 83.3% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

The rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the city's social risks in line with those of the sector. While not directly on the Atlantic Ocean, we believe Cambridge is vulnerable to environmental risks, including rising water levels from climate change that could directly affect taxable properties. The city has a history of proactively addressing future challenges, and, to this end, management maintains long-term plans to improve environmental resiliency. We analyzed Cambridge's governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

While unlikely, if economic growth were to stagnate, along with a significant decline in available reserves, we could lower the rating.

Credit Opinion

Very strong economy

We consider Cambridge's economy very strong. The city, with a population of 114,686, is in Middlesex County in the

Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 169% of the national level and per capita market value of $525,216. Overall, market value grew by 9.6% over the past year to $60.2 billion in 2021.

Directly adjacent to Boston, Cambridge is an integral part of the larger broad and diverse MSA. Two subway lines, multiple highways, and a commuter rail connect Cambridge directly to downtown Boston. Harvard and MIT, its two leading employers and two of the largest taxpayers, anchor the local economy. They serve as knowledge centers and focal points for dozens of start-ups, research centers, and life-science and high-technology companies. Microsoft, Google, Amazon, Apple, Facebook, Kayak, Pfizer, IBM, and Pegasystems have offices in the city.

The tax base is about 60% residential and 38% commercial and industrial. While some knowledge-based companies are decentralizing and putting into question the future state of commercial real estate, we believe that the high concentration of lab-space and life-science investment in Cambridge, and its integration into the surrounding universities, may limit any exodus from the city. We expect Cambridge to continue to see growth in its tax base and believe its wealth and income metrics will remain stable.

At the county level, the unemployment rate spiked to 15% in June 2020, according to the Bureau of Labor Statistics, before falling to 6.0% in December 2020. We continue to monitor the effects elevated unemployment may have on our view of the city's economic profile and ultimately on its finances, but do not expect a revision in our view of its economy at this time.

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.

The city's annual budget development process supports its overarching goals, which include significant investments in its education system, housing, transportation network, and other quality-of-life issues, while maintaining fiscal balance. Active management of discretionary spending and ongoing monitoring of intrayear spending ensure adherence to the adopted budget. Budget-to-actuals and investments are reported quarterly to the finance and investment committees, respectively. Management uses historical trend analysis to develop line-item and departmental expenditure and revenue assumptions.

The annually updated five-year financial plan and five-year capital improvement plan (CIP) outline immediate fiscal challenges while determining and prioritizing immediate capital needs. The city invests in the state-run Massachusetts Municipal Depository Trust (MMDT) and bank deposits. It has formal debt management policies beyond debt limits prescribed by commonwealth statute that include informal targets for debt service-to-budget limits and net present value savings thresholds for refunding transactions. In terms of budgetary reserves, city policy affirms its commitment to maintaining an unassigned fund balance in excess of 15% of the ensuing fiscal year's operating revenue and total general fund balance at least 25% of the following fiscal year's operating revenue.

Adequate budgetary performance

Cambridge's budgetary performance is adequate, in our opinion. The city had deficit operating results in the general fund of negative 3.2% of expenditures, but a surplus result across all governmental funds of 2.3% in fiscal 2020. Our assessment accounts for the fact that we expect budgetary results could improve from 2020 results in the near term.

Our assessment of the city's budgetary performance accounts for ongoing uncertainty in both revenues and expenditures stemming from the pandemic and economic recovery. While we do not expect material change in the city's economic profile, we believe certain revenues are likely to remain volatile, such as departmental revenues, parking fees, and other excise taxes and fees. We have also accounted for the city's track record of producing better-than-budgeted results and the planned use of reserves to invest in capital projects and offset revenue losses in fiscal 2020, which we expect to continue through at least fiscal 2021.

The city significantly increased transfers out to its capital and affordable housing trust funds in fiscal 2020 relative to 2019. Transfers to the capital fund increased approximately $36 million and the transfer out to the housing fund rose $25 million, resulting in a negative operating result of $23.7 million. We believe management may continue to expend reserves in 2021 and beyond as it works to limit growth in its tax rate and to expend reserves in excess of its upper reserve policy target range. However, we believe this is part of a targeted plan and given the city's holistic financial profile, including available reserves and excess levy capacity, in our opinion, this constitutes adequate budgetary performance.

In fiscal 2020, local property taxes accounted for about 63% of audited general fund revenue. Intergovernmental aid was about 12% and departmental revenue was 11%. With some minor variations, these levels are consistent year to year, which we expect to continue. We believe the high reliance on local property taxes provides predictability, but believe there could continue to be some variation in departmental revenues and hotel and meals excise taxes (3%). The fiscal 2021 budget increased about 5.1% over the adjusted 2020 budget, with expenditure increased due to primarily to salaries, health insurance, pension and OPEB costs. The 2021 budget includes an appropriation of $22 million in unassigned reserves. While the city has a history of outperforming the budget, we believe it could again draw down at the close of fiscal 2021.

Very strong budgetary flexibility

Cambridge's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 43% of operating expenditures, or $321.7 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor, along with the city's flexibility to raise additional revenues despite statewide tax caps.

We expect budgetary flexibility to remain very strong, given the city's existing reserves and significant flexibility under the levy limit. We include the budget-stabilization fund in our calculations, which the city accounts for in committed general fund reserves. We do not anticipate a material change in available reserves, despite increased use of reserves in the current fiscal year. We also believe the city has significant flexibility under the state levy cap. It currently has $187 million in unused levy capacity, about 25% of the adopted 2021 operating budget expenditures.

Very strong liquidity

In our opinion, Cambridge's liquidity is very strong, with total government available cash at 54.2% of total governmental fund expenditures and 5.6x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

We adjusted available cash to exclude cash held in the capital fund, housing trust, and certain special revenue funds, which we believe is generally not available for liquidity purposes. Cambridge is a regular market participant that issues GO bonds frequently, supporting what we view as strong access to external liquidity. We understand the city has not entered into any bank loans or direct-purchase or variable-rate debt, and does not have contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. It has consistently had a very strong liquidity profile, which we expect to continue.

Adequate debt and contingent liability profile

In our view, Cambridge's debt and contingent liability profile is adequate. Total governmental fund debt service is 9.7% of total governmental fund expenditures, and net direct debt is 60.6% of total governmental fund revenue. Overall net debt is low at 0.8% of market value, and approximately 83.3% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Cambridge has about $567 million of total direct debt outstanding, of which we consider about $93 million self-supporting enterprise debt. Approximately $22 million of the current issuance is sewer debt we expect to be self-supporting. The city also had several notes with the state clean water trust and water authority that it receives user charges to support.

As the city continues investments in schools, fire stations, and other tax-backed projects, we believe it could add debt at a rate faster than outstanding principal is paid, but at this time we do not expect our view of the debt profile to change.

In our opinion, a credit weakness is Cambridge's large pension and OPEB obligation. Cambridge's combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2020. Of that amount, 4.5% represented required contributions to pension obligations, and 3.3% represented OPEB payments. The city made 101% of its annual required pension contribution in 2020. The funded ratio of the largest pension plan is 89.8%.

Pension and other postemployment benefits (OPEBs)

- In our opinion, Cambridge's large pension and OPEB obligation is a credit weakness.
- While actuarially determined, we believe some of the assumptions used to build the required contribution are permissive and could lead to fluctuating and rising costs.
- The city's net OPEB liability totals $930 million. Its OPEB trust fund is 2.2% funded. We expect these costs to continue to rise.

As of June 30, 2019, the city participated in the following pension plan:

- City of Cambridge Retirement System: 85.8% funded with a $183.6 million proportionate share of the net pension liability.

Cambridge's combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2020. Of that amount, 4.5% represented required contributions to pension obligations, and 3.3% represented OPEB payments. The city made 101% of its annual required pension contribution in 2020.

The system recently lowered its discount rate to 7.25%, which we view positively, but it remains above the 6.0% discount rate we view as likely to mitigate contribution volatility. The system's updated adopted funding schedule, which continues to meet the city's goal of full funding in 2026. It relies on at least 11% growth in annual contributions through 2026, which is likely to outpace overall budgetary growth, resulting in rising pension costs as a percentage of expenditures. However, we believe management is planning for these costs as part of its long-term financial planning. While the combined unfunded pension and OPEB liability is large, we believe the city has a credible plan, with the tax base and budgetary flexibility, to address costs and liabilities.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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

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