FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Cambridge, MA's $106MM Series 2021 GO Bonds 'AAA'; Outlook Stable

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Fitch Ratings - New York - 22 Feb 2021: Fitch Ratings has assigned a 'AAA' rating to the following city of Cambridge, Massachusetts general obligation (GO) bonds:

--$106,000,000 GO municipal purpose loan of 2021 bonds.

Proceeds of the bonds will be used to finance various city, sewer and school related projects. The bonds are scheduled to sell competitively on March 3, 2021.

In addition, Fitch has affirmed the rating for the city's outstanding GO bonds totaling approximately $457 million and the city's Issuer Default Rating (IDR) at 'AAA'.

The Rating Outlook is Stable.

SECURITY

The bonds are a general obligation of the city and are backed by its full faith and credit and a property tax levy that is limited by state statute.

ANALYTICAL CONCLUSION

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 wealthy resource base and future potential for continued tax base increases, along with moderate expenditure growth and demonstrated ability to reduce expenditures during economic downturns. Fitch expects long-term liabilities to remain low based on the city's capital needs, very rapid pace of principal amortization, continued growth in economic resources and a practice of fully funding actuarially determined pension contributions.

ECONOMIC RESOURCE BASE

Cambridge is located in Middlesex County across the Charles River from the city of Boston and has an estimated 2019 census population of 118,927, which is up 13% since 2010.

KEY RATING DRIVERS

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 both U.S. GDP and CPI for the same period, reflective of strong growth in Cambridge's economy and tax base. Pandemic related declines in revenues and property values are likely to slow growth in the near term but prospects remain strong for future 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 to below 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 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 6% 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, 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 high level of financial resilience and gap-closing ability throughout the current and future economic cycles.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Upgrades are not possible for 'AAA' rated entities.

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

--Failure to implement available policy measures that offset risks associated with a return to economic contraction consistent with Fitch's coronavirus downside scenario, resulting in an erosion of the city's gap-closing capacity;

--Although not expected, a significant decline in taxable assessed values leading to substantial diminishment of the city's excess banked levy capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sector-wide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 3Q21. In its baseline scenario, Fitch anticipates a slower recovery in early 2021 with vaccine rollout to vulnerable, key workers and older individuals in 1H21, but limited for most of the population until late 2021. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update," published on Dec. 7, 2020, and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Government," published on Dec. 16, 2020 on www.fitchratings.com.

Cambridge Coronavirus Impact

On March 23, 2020, Governor Baker announced the closing of all non-essential businesses across the Commonwealth and instituted a phased-in approach to re-opening with certain restrictions through the remainder of the year. Due to a spike in COVID-19 cases the Governor instituted temporary capacity and gathering restrictions on most business establishments effective Dec 26, 2020. The capacity limits do not apply to manufacturers, laboratories, or construction.

Cambridge's financial performance remains solid despite pandemic-related revenue pressures. The city's primary source of revenues is derived from property taxes, which represent 63% of fiscal 2020 revenues and have not been affected to date due to the pandemic. Management reports a tax collection rate of 99.79% through Jan. 31, 2021. The temporary closure of certain businesses and institutions of higher education, stay at home measures and continued social distancing practices has affected hotel and meals tax revenues of the city similarly to other local governments nationwide. These revenues only accounted for 3% of fiscal 2020 general fund revenues.

Sewer use fees, recorded in the general fund, represent 8% of revenues and were under budget by 3% in fiscal 2020 due to lower occupancy of commercial buildings and universities. These local revenues, along with fines, fees and other charges for services including parking fees (reported outside the general fund), remain vulnerable to declines as the impact from the pandemic continues to hamper leisure and travel activity and the presence of office workers and university students.

Moderna, the pharmaceutical and biotechnology company headquartered in Cambridge, and Pfizer, with lab facilities in the city, have been dominant in the creation of the coronavirus vaccine and their work along with those of other major biotech companies in the city has contributed to the very strong demand for lab space in the city.

Management expects a softening of taxable values associated with certain commercial properties, primarily office, hotel and retail due to the pandemic, but it will be somewhat offset by the growth in the life and sciences sector. Office vacancy rates were 7.8% at the end of fourth quarter 2020 compared with 4% at the start of the pandemic and asking rents declined slightly but are still up 5% from a year ago according to CB Richard Ellis (CBRE) reports. This compares with the lab vacancy rates of 1.3% for fourth-quarter 2020 and a 4% increase in rent compared with third-quarter 2020. According to management, many companies in the city maintain long-term leases and some have begun subletting to offset costs; however, the yoy increase in subletting activity is not significant and is well below levels reported in Boston.

New development and construction activity for office, lab, residential and mixed use has not slowed down, notwithstanding a four-month moratorium on construction from March through June of 2020. Fitch expects workers to slowly return to offices as the vaccine becomes more widely distributed and then companies will make decisions on office needs which could lead to near-term increases in vacancy rates. However, Fitch expects demand long-term to be sound due to Cambridge's central location near the city of Boston, the city's importance as a research center for life and sciences companies, and the presence of the country's leading institutions of higher education, Harvard and MIT.

The city experienced revenue declines in the fourth quarter of fiscal 2020 (ending June 30) as departmental revenues and other non-ad valorem revenues declined compared to budget. Additional expenses were incurred as the city took measures to assist its residents and businesses affected by the pandemic. General fund net operating results for fiscal 2020 reflect a $24 million deficit (3.2% of spending), decreasing the city's unrestricted fund balance to $357 million or a still healthy 48% of spending. Planned transfers out of $70 million were for capital projects and management appropriated $15 million to the city's affordable housing trust fund as part of its initiative to improve affordable housing in the city. Management appropriated $2.2 million from the general fund for coronavirus-related expenses in fiscal 2020 but to date has spent $17.9 million. The city used $10 million of a CAREs Act grant for a portion of coronavirus-related spending and plans to seek reimbursement from FEMA for its other costs.

The fiscal 2021 general fund budget of $702 million was adopted June 15, 2020 and is up around 5% from the fiscal 2020 adjusted budget. Expenditure drivers are associated with employee salaries and benefit costs. The bulk of the increase in revenues is provided for by a 7.85% increase in the tax levy. A combination of reserves and free cash totaling $24 million was appropriated to reduce the tax burden. Charges for services, fines and forfeits and licenses and permit fees are up modestly from prior year results. Intergovernmental revenues, which are mostly state aid for education, are up 6% yoy and account for 8% of revenues.

Adjustments were made in the fall, at the time the tax rate was certified, to reflect lower than anticipated hotel and meals taxes (reduced by $14 million) compared with the budget and certain other minor adjustments including a $2.4 million decrease in state aid and increased assessments. A planned $8 million replenishment of the city's debt stabilization fund (reported in the general fund) was eliminated and instead, these funds will be earmarked to cover the shortfall in non-ad valorem revenues. A portion of reduced expenses associated with cancelled vacant positions along with certain non-ad valorem revenues were allocated to cover these adjustments and keep the tax levy increase below

8%. Certain initiatives in the fiscal 2021 budget have since been delayed, including the filling of approximately 125 vacant positions, to mitigate potential revenues declines. On a positive note, building permits are estimated to exceed budget by close to $16 million.

The FAST scenario analysis tool, which relates the city's historical general fund revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. The current coronavirus downside scenario results in a first and second-year decline in Cambridge's revenues. FAST is not a forecast (actual revenue declines will vary from FAST), but it provides a relative sense of revenue risk exposure across Fitch's local government portfolio.

Fitch expects management will continue to manage expenditures to meet changes in revenues and may continue to rely on available reserves and its very high level of excess tax levy capacity if necessary to support future operations. Fitch also expects that the city will take measures to restore its reserve position as necessary during times of recovery to maintain its significant level of financial resilience.

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 Biogen, Novartis, Sanofi and Takeda Pharmaceutical.

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 (4.6% as of Dec. 2020) is consistently below them.

Cambridge also continues to attract research and development companies, ranging from startups to international companies. Several major software and internet companies have established research and development operations in Cambridge, including Microsoft, Google, Amazon, Facebook and EMC/VMware.

While space for new development is somewhat limited in Cambridge, new construction or rehabilitation of existing properties is underway in various areas of the city and should provide some support for demand. Taxable assessed value (TAV) performance reflects this activity as well as growth in residential values. TAV grew another 10% in fiscal 2021 to $60.2 billion following growth of 12% in each of fiscal 2020 and 2019. TAV per capita is very high at approximately $506,000. Economic development districts located in the city continue to provide opportunities for current and future economic expansion and new housing opportunities. The city is projecting a moderate 3% decline in TAV for fiscal 2022, due to the pandemic, and a moderate increase through 2024, which Fitch considers reasonable based on new commercial and residential construction underway and proposed; however, the full impact remains uncertain.

REVENUE FRAMEWORK

Property taxes make up approximately 63% of fiscal 2020 general fund revenues. Intergovernmental revenues, primarily for education, and sewer use charges, accounted for another 12% and 8%, respectively, of revenue. Excise taxes on hotel, meals and motor vehicles and payment in lieu of taxes provide an additional moderate source of general fund revenues.

Fitch expects revenue growth to continue to be strong following the pandemic based on the city's solid underlying economic fundamentals and expectations for future tax base growth from new commercial and residential projects.

Pursuant to state law, Proposition 2 1/2 limits the city's ability to levy property taxes by: 1) a 'levy ceiling', an absolute cap on the level of property taxation, set at 2.5% of the overall property tax valuation (primary limit); and 2) a levy limit which restricts the annual growth in taxation to 2.5% over the previous year's levy plus the value of new growth (secondary limit). Taxation in excess of the levy limit (plus any new growth) requires voter approval.

Management has typically levied below the ceiling each year. Any excess in levy capacity is carried forward and available for use at any time. The city's excess tax levy limit decreased to $187 million in fiscal 2021 from $190 million in fiscal 2020, the first decline in several years. This excess levy capacity totals approximately 27% of the fiscal 2021 operating budget and provides for high revenue raising flexibility if needed.

EXPENDITURE FRAMEWORK

Education is the city's largest expenditure, comprising 36% of fiscal 2020 general fund expenses. Public safety follows at 22% of expenditures.

General fund expenditure growth has historically been in line with or below the pace of revenue growth and the city has solid flexibility to reduce expenditures if necessary. Fitch expects expenditure growth to be driven by an increase in population and services, but remain aligned with revenues going forward.

Carrying costs for debt service, pensions and OPEB contributions were a moderate 16.5% of fiscal 2020 governmental spending and Fitch expects such costs to remain moderate going forward. Employee salary and benefit costs as well as moderate annual increases in debt service continue to drive annual expenditure increases. Debt service costs will trend upward based on plans for additional debt to finance various schools, sewer and other city projects. The carrying cost metric includes debt service costs for GO sewer debt for which the city levies user charges.

Education will continue to be a driver of spending and management is planning moderate annual increases in education spending over the next four years as part of its commitment to the overall improvement of its school system and to accommodate projected enrollment growth.

Approximately 80% of the city's employees belong to a union or collective bargaining group. Management has the ability to impose employee layoffs and furloughs if necessary. Public safety contracts are subject to arbitration, although the city council has the ability to vote down an award. In such a case, both parties continue to bargain within the arbitration process.

LONG-TERM LIABILITY BURDEN

Long-term liabilities for net overall debt plus the Fitch-adjusted NPL are low at 6% of estimated personal income. Outstanding debt, net of self-supporting water and sewer debt, accounts for 53% of the liability metric, with the city's NPL making up the remainder. Fitch expects the burden to remain low as a percentage of personal income based on pension funding practices, future debt plans and expectations for future growth in population and residents' personal income.

Management is projecting the issuance of an additional $622 million in additional debt (roughly 5% of current personal income) through 2025. Roughly 25% of this debt is expected to be supported from user fees which Fitch considers self-supporting and the new debt will be partially offset by the principal repayment of bonds and notes outstanding; approximately $246 million of outstanding and pro-forma principal from the 2021 bonds is scheduled to mature in the next four fiscal years (2022-2025). Principal amortization of outstanding GO debt including sewer debt is rapid at 86% over the next ten years (fiscal years 2022-2031).

The city is one of four employers participating in the Cambridge Retirement System. The city consistently funds at least its full actuarially determined contribution and the current actuarial schedule for pension funding has the city reaching full funding of its net pension liabilities by 2026. The fiduciary net position to total pension liabilities for the system was reported at 86% as of Dec. 31, 2019 based on a 7.25% discount rate, a .25% reduction from the previous valuation. Using Fitch's more conservative 6% investment rate of return, the estimated funded ratio was 75%.

The city's net OPEB liability totaled $930 million as of June 30, 2020, based on GASB 74 reporting requirements, and represents 8% of personal income. The liability was determined using a blended 2.34% discount rate which is down from the prior year's rate of 3.67%. City management created an OPEB trust fund in December 2009 and has made contributions totaling $19 million since that time with a current value of $21 million. Management projects a $2 million annual contribution to the trust for each of the next four fiscal years, based on the city's current financial forecast.

OPERATING PERFORMANCE

Fitch expects the city to maintain a high level of financial resilience throughout the current and future 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 built up its reserves to high 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 the current slowdown. The city's strong budget monitoring practices and financial planning bolster the city's operating environment.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR

ENTITY/DEBT	RATING			PRIOR
Cambridge (MA) [General Government]	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
• Cambridge (MA) /General Obligation - Limited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Cambridge (MA)	EU Endorsed, UK Endorsed

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