September 30, 2013

To The Honorable, the City Council:

The establishment of the FY14 property tax rate by the Board of Assessors, subject to the approval of the Massachusetts Department of Revenue, is the final step in the fiscal process that begins in the spring with the submission of the annual budget to the City Council. With this memo, I am transmitting to you my recommendations for the required votes necessary to minimize taxes on residential properties. In addition, you will find analyses of the FY14 property tax levy, property values and other supporting information.

OVERVIEW

I am pleased to inform you that the actual FY14 property tax levy of $328,544,945 reflects a $11,597,175 or 3.66% increase from FY13, which is significantly lower than the estimated increase projected in May 2013 and what was presented to the rating agencies in January. The FY14 Budget adopted by the City Council in May 2013 projected a property tax levy increase of $13.7 million, or 4.32%, to $330,630,145 in order to fund operating and capital expenditures. The FY14 adopted operating budget increased by 3.81%. This 3.66% tax levy increase is the lowest since FY06.

Based on a property tax levy of $328.5 million, the FY14 residential tax rate will be $8.38 per thousand dollars of value, which is a decrease of $0.28, or -3.23% from FY13. The commercial tax rate will be $20.44, which is a decrease of $1.06, or -4.9% from FY13.

In May, the City Council was informed that the actual tax levy increase was likely to change. This was based on the possible use of additional non-property tax revenues, which would become available based on FY13 actual collections.

Following our assumptions, the use of additional non-property tax revenue and other adjustments have allowed an overall reduction of $2,085,200 from the original projected property tax levy. This is due to increased non-property tax revenues, which include $250,000 from meals excise, $2,041,370 from increases to building permit revenues and $200,000 in in-lieu payments. Also included is an increase of $44,945 in current year overlay adjustments. $361,225 is required to offset a net decrease in the Cherry Sheet, prior year overlay deficits and reductions in various revenues based on actual FY13 collections and revised estimates.

Tax Levy Changes	Amount
Property Tax Levy As Adopted	**$330,630,145**
Net Cherry Sheet	+$301,235
Prior Year Overlay Deficits	+$46,990
Non-Property Tax Revenue	-$2,478,370
Overlay Adjustment	+$44,945
Actual Property Tax Levy	**$328,544,945**

This resulted in a final property tax levy for FY14 of $328,544,945, an increase of 3.66%. This is the lowest increase the City has proposed since FY06. With approval of these recommendations, the nine-year average increase in the property tax levy will be 4.42%. In March, the City Council approved a 0% increase in the FY14 water rate for the third consecutive year, and a 4.2% increase in the sewer rate, resulting in a combined rate increase of 2.9% for FY14.

This recommendation includes the use of $11.0 million in reserve accounts to lower the property tax levy: $2.0 million from overlay surplus; and $9.0 million in Free Cash. It should be noted that the certified Free Cash amount of $142.2 million is the highest amount in the City's history and represents a $26.3 million increase over last year. Also, approximately $0.6 million from the School Debt Stabilization Fund and $1.0 million from the City Debt Stabilization Fund is used to offset increases in debt service costs that would otherwise have been funded from property taxes.

This strategy of using an increased amount of non-property tax revenues and reserves to lower property taxes will not jeopardize our long-term fiscal health. However, if the City used all of its reserves in one year to artificially reduce property taxes it would mean that in the following year the City would be required to either increase taxes significantly, since the reserves would no longer be available, or dramatically reduce expenditures (services). The City's prudent and planned use of its reserves has been positively recognized by the three major credit rating agencies and is reflected in our AAA credit rating.

IMPACT ON TAXPAYERS

Approximately 74.1% of residential taxpayers will see a reduction, no increase or an increase of less than $100 in their FY14 tax bill. In addition, another 13.5% of residential taxpayers will see an increase between $100 and $250. Therefore, a total of 87.6% of the residential taxpayers will see no increase or an increase of less than $250. This will be the ninth year in a row that a majority of residential taxpayers will see a reduction, no change or an increase of less than $100. This accomplishment should not be taken for granted given the national economic uncertainties. We have been able to achieve this while maintaining City and school services that citizens have come to expect and while providing a strong capital improvement program highlighted by major projects such as the Mayor Russell/West Cambridge Youth and Community Center, Healy Public Safety Facility, Main Public Library, War Memorial Recreation Center, CRLS and most recently, the Alice K. Wolf Center/5 Western Avenue building. In addition, funds for the design and reconstruction for the Martin Luther King and King Open Elementary Schools have been included in the City's financial plan.

TABLE I
Change in the Residential Tax Bills*

Change in Tax Payment	Number of Parcels	Percentage	Cumulative %
Less than $0	12,357	57.5%	-
> $0 and less than $100.00	3,562	16.6%	74.1
>$100.00 less than $250.00	2,897	13.5%	87.6
>$250.00 and less than $500.00	1,671	7.8%	95.4
Greater than $500.00	991	4.6%	100%
Totals	**21,478**	**100%**	

* Based on Single, Two, Three Family and Condominiums and assumes the Residential Exemption for each parcel in both years.

MEDIAN TAX BILLS

The analysis below explains in further detail how the City determined property values and property tax rates for FY14. There are three major factors which determine a property tax bill. These factors are: 1) the Budget, 2) Commercial-Residential Property Tax Classification and 3) Property Values. As discussed below, all three factors contributed to lower tax bills for many homeowners.

The Budget: If the City Council adopts the proposed recommendations, there will be a 3.66% increase in the property tax levy required to balance the FY14 Budget, which supports the City Council Goal of "evaluating expenditures with a view of maintaining a strong fiscal position and awareness of the impact on taxpayers while providing a high quality of City services."

Commercial-Residential Property Tax Classification: Tax classification allows municipalities to tax commercial taxpayers at a higher rate than residential taxpayers. In FY14, commercial property owners will pay 65.4% of the property tax levy, the same share as in FY13. Consequently, residential property owners' share of the FY14 tax levy is 34.6%, also the same as in FY13.

Property Values: Every January 1st, the City of Cambridge must meet Department of Revenue requirements to certify that property values represent full and fair market value. Based on market activity in calendar year 2012, which is the basis of the FY14 property assessment, total residential property values increased by approximately 6.91%. Total commercial property values also increased by 10.05%. The increase in total values reflects the robust real estate market which has been driven by continued new construction in both residential and commercial classes, as well as the continued desirability of the Cambridge market. These factors, coupled with the City's improved ability to analyze and incorporate adjustments to residential values using the mass appraisal model, have allowed the City to make changes to various assessment districts.

It should be noted that the City has successfully completed the Department of Revenue's (DOR) triennial certification process of the City's real and personal property values, system and methodologies.

The following chart shows the change in the median tax bills by property class. It is important to note that while the overall total residential assessed value increased in FY14, assessed values of existing homes remained relatively stable. The median value is the mid-point value, which has an equal number of values below and above it.

TABLE II
Change in the Median Value and Tax Bill by Property Class*

	FY13 Value	FY13 Tax Bill	FY14 Value	FY14 Tax Bill	Dollar Change	Percent Change
Single Family	$699,000	$4,298	$741,600	$ 4,407	$109	2.54%
Condominium	$375,300	$1,495	$389,500	$1,457	-$38	-2.54%
Two Family	$649,100	$3,866	$690,150	$ 3,976	$110	2.85%
Three Family	$732,300	$4,586	$786,900	$4,787	$201	4.38%

* Includes Residential Exemption

CITY-WIDE ASSESSED VALUES

FY14 values are based on market activity that occurred during calendar year 2012, during which the overall valuation of both the City's residential property and commercial property increased. This reflects an increase in commercial rental rates and a slight decrease in commercial vacancies, which has an impact on existing commercial property values. The major components which impact the commercial values are the construction of life science buildings and the personal property associated with these developments.

For FY14, the total assessed value of taxable property in the City of Cambridge equals $27,161,648,788, a 7.72% increase over FY13 values. The actual FY14 total assessed values are significantly greater than the projections presented to the rating agencies in January 2013 due to continued strength in the Cambridge real estate market.

For several years prior to FY06, escalating residential values outpaced increases in commercial values, resulting in a shift of the tax burden from commercial to residential property owners. However, in FY06 this trend reversed. In FY14, the market for both commercial and residential properties has increased, not unlike most of the Greater Boston area, resulting in the continuation of a tax distribution similar to FY13 between commercial taxpayers and residential taxpayers.

The table below breaks out new construction values and tax base levy growth due to new construction by property type. This new construction growth, coupled with moderate budget increases, has allowed the City to maintain the shift in taxes and increase the City's excess levy capacity.

TABLE III
New Construction Breakdown in FY14

Property Class	New Value	FY14 Tax Base Levy Growth (New Growth)
Commercial Property	$374,707,638	$ 8,042,341
Personal Property	$200,495,595	$ 4,309,013
Residential Property	$ 243,133,913	$ 2,105,118
Total New Growth	**$ 818,337,146**	**$ 14,456,472**

TABLE IV
Assessed Values (in millions)

	FY10	FY11	FY12	FY13	FY14
Commercial Property	$ 8,467	$8,379	$8,478	$8,577	$9,439
Personal Property	$911	$959	$951	$1,070	$1,080
Residential Property	$14,894	$14,824	$15,018	$15,567	$16,642
Total Assessed Value	**$24,272**	**$24,162**	**$24,447**	**$25,214**	**$27,161**

For FY14, the City was able to increase its levy limit by approximately $25.0 million, to $446.0 million. Approximately $14.5 million of this increase was due to new construction. State law allows the City to increase its tax levy limit by an amount equal to the total FY14 value of newly constructed or renovated property, multiplied by the FY13 tax rate. The remaining $10.5 million is the 2.5% increase over the FY13 levy allowed by Proposition 2½. The City's excess levy capacity increased by approximately $13.4 million, or 12.87%, to $117.5 million in FY14.

TABLE V
Tax Levy/Tax Levy Limit/Excess Levy Capacity
(in thousands)

	Actual FY09	**Actual FY10**	**Actual FY11**	**Actual FY12**	**Actual FY13**	**Estimated FY14**
Levy Limit	$347,606	$367,222	$383,312	$401,733	$421,052	$446,046
Actual Levy	$254,946	$268,663	$283,962	$299,091	$316,948	$328,545
% Actual Levy Increase over Prior Year	5.20%	5.38%	5.69%	5.33%	5.97%	3.66%
Excess Levy Capacity	$92,660	$98,559	$99,350	$102,642	$104,104	$117,501
% Actual Excess Levy Capacity Increase Over Prior Year	5.0%	6.4%	0.8%	3.3%	1.4%	12.9%

In addition to providing greater flexibility under Proposition 2½, tax payments from newly constructed properties also work to mitigate increases on existing properties.

For a detailed listing of assessment changes by district, please see Attachment 1.

FY14 VALUATION PROCESS

Each year, the Board of Assessors conducts a reappraisal of all property within the City of Cambridge using the residential and commercial valuation models first introduced in FY05. The City chose FY05 to coincide with the Commonwealth of Massachusetts Department of Revenue (DOR) triennial mass appraisal review and certification process, to ensure a complete and thorough review of the new valuation models. Since that time, the model has been refined each year to reflect market conditions which have impacted assessed values. This fiscal year, the DOR conducted its vigorous triennial review and certification and once again it certified the City's valuation models. In the interim years, a statistical analysis is performed and approved by the DOR.

The FY14 valuation model is based upon sales of property that occurred during calendar year 2012, to establish the market value of all property as of January 1, 2013. For FY14, the number of assessing districts has remained unchanged. In prior years, some consolidation of districts took place to create a larger sales sample size.

The ultimate test for any mass appraisal model is the comparison between actual sales not part of the model building process and the predicted value from the model. Comparing the FY13 model to calendar year 2012 sales data, the model showed the following results:

TABLE VI
Residential Sales Price/Assessment Comparison

Property Type	Sale Count	Median Sale Price	Median Assessment
Single Family	**115**	**$855,000**	**$753,100**
Two Family	**39**	**$870,000**	**$738,000**
Three Family	**17**	**$905,000**	**$721,100**
Condominiums	**797**	**$438,000**	**$388,200**

The assessment ratios were between 80%-90% of calendar year 2012 sales, reflecting increasing market values during the last year.

Calendar year 2012 sales demonstrated that the FY13 model needed to be updated based on current market trends and overall property class statistics. The individual neighborhoods also showed some inconsistent growth trends and required review. As a result, sales data from the calendar year 2012 real estate market has been utilized, along with what was learned from the prior year abatement activity, to establish the FY14 assessed values as of January 1, 2013. Using technologies such as the Geographical Information System (GIS) allowed for a more in-depth review of data. Using GIS, the Board of Assessors was able to visually display market activity and thereby validate the assessing districts using this information. For FY14, the number of assessing districts remained at 17, which allowed for adequate sample sizes for the neighborhoods.

Modifications were made to the residential and condominium models, as well as to residential land values. The residential land had adjustments for neighborhood, while the residential model was recalibrated for use, grade, finished basements and condition adjustments. The condominium model was adjusted by neighborhood for market conditions as of the assessment date. In addition, approximately 4,700 inspections were completed along with a detailed field review of property. These inspections served to ensure consistency within neighborhoods and across the city. The analysis for determining property values depends on several factors: the trends of the real estate market in the areas of sales; property improvements; changes in the economics of real estate finance and the high demand for real estate in the city. To arrive at full and fair cash values for approximately 24,436 parcels, the Assessing Department uses a state-of-the-art Computer Assisted Mass Appraisal system (CAMA). Market adjusted cost approach models, extracted from residential sales for calendar year 2012, were refined to best reflect the equity of comparable properties as demonstrated in the various neighborhoods. Sales of 968 houses and condominium units were analyzed to develop these valuation models by property type (one-family, two-family, three-family and condominium units).

COMMUNITY PRESERVATION ACT SURCHARGE

In November 2001, Cambridge voters approved adoption of the Community Preservation Act (CPA), a State law that allows the City to receive matching funds from the State for money raised locally in support of affordable housing, historic preservation and protection of open space. The local portion of CPA funding is raised through a 3% surcharge on taxes. To date, the City has appropriated/reserved a total of $131.3 million in CPA funds. The City has received approximately $46.7 million in state matching funds through FY13 and expects to receive an additional $1.9 million in October 2013. It should be noted that this is the sixth year that the City will not receive a 100% state match, which is a result of additional communities participating in CPA and a reduction in the CPA Trust Fund collections through the Registry of Deeds. The FY14 state match to be received by the City is estimated to be 23%. A recent change in the law does provide a mechanism for an increase in the state match in future years, but this is not guaranteed.

The CPA surcharge has an essentially neutral impact on tax bills because funding of affordable housing and historic preservation initiatives has been shifted from the tax levy to the surcharge. However, the State match has enabled the City to provide additional funding for these initiatives. To date, Cambridge has received more CPA matching funds from the Commonwealth than any other participating community. Consequently, Cambridge residents will continue to benefit from affordable housing, historic preservation and open space initiatives throughout the City for years to come.

TABLE VII
Community Preservation Act Surcharge

	FY13 Median CPA Surcharge Amount	**FY14 Median CPA Surcharge Amount**	**FY14 Median Tax**	**FY14 Median Tax & CPA Surcharge Amount**
Single Family	$103	$107	$4,407	$4,514
Condominium	$19	$19	$1,457	$1,476
Two Family	$90	$94	$3,976	$4,070
Three Family	$112	$118	$4,787	$4,905

RECOMMENDATIONS

1. That the City Council vote to authorize the use of $9,000,000 in Free Cash to reduce the FY14 tax rate.

2. That the City Council vote to authorize $2,000,000 in overlay surplus/reserves to be used for reducing the FY14 tax rate.

3. That the City Council vote to authorize $586,670 from the School Debt Stabilization Fund to be used as a revenue source to the General Fund Budget, which was included in the FY14 Adopted Budget.

4. That the City Council vote to authorize $1,000,000 from the City Debt Stabilization Fund to be used as a revenue source to the General Fund Budget, which was included in the FY14 Adopted Budget.

5. That the City Council appropriate $12,000,000 from Free Cash to the City Debt Stabilization Fund.

6. That the City Council classify property within the City of Cambridge into the five classes allowed for the purpose of allocating the property tax. It is further recommended that the City Council adopt a minimum residential factor of 56.4071%.

7. That the City Council approve the maximum residential exemption factor of 30% for owner occupied homes, which should result in a residential tax rate of $8.38 and commercial tax rate of $20.44 upon final approval by the Massachusetts Department of Revenue.

8. That the City Council vote to double the normal value of the statutory exemptions.

9. That the City Council vote to increase the FY14 exemption allowed under Massachusetts General Laws (MGL) Chapter 59, Section 5, Clause 17D from $293.00 to $298.00.

10. That the City Council vote to increase the FY14 asset limits allowed under Massachusetts General Laws (MGL) Chapter 59, Section 5, Clause 17E from $58,197 to $59,151.

11. That the City Council vote to increase the FY14 income and assets limits for elderly persons (age 65 or older). Income limits of $24,063 to $24,458 for those who are single and $36,095 to $36,687 for those who are married, asset limits of $48,125 to $48,914 for those who are single and $66,172 to $67,257 for those who are married, as allowed under MGL, Chapter 59, Section 5, Clause 41D.

12. That the City Council vote the income limit for deferral of real estate taxes by elderly persons (at least 65 years old) as determined by the Commissioner of Revenue for the purposes of MGL, Chapter 62, Section 6, subsection (k), for a single person who is not head of household ($53,000) and for a married couple ($80,000), as allowed under MGL Chapter 59, Section 5, Clause 41A. The dollar amounts listed may be indexed by Massachusetts DOR for FY14. The reduction of the interest rate to 4% for deferred taxes, which was approved by the City Council previously, will continue.

ISSUES/REQUIRED VOTES

As the City Council is aware, by the time the classification vote is taken in the fall of each year, the options for the City are fairly limited. Failure to approve the recommended classification, residential exemption and the doubling of statutory exemptions would result in significantly higher taxes for residential property owners. After the classification vote is taken, the establishment of the tax rate is a fairly simple mathematical calculation: the tax levy required to support the City budget divided by the total assessed valuation (less any exemptions) equals the tax rate for FY14.

The following is a summary of the votes required by the City Council.

- **Authorize $9,000,000 in Free Cash to Reduce the FY14 Tax Levy.** For the fiscal year that ended June 30, 2013, the City of Cambridge has a certified Free Cash balance of $142,176,089, an increase of approximately $26.3 million from the previous year. This balance represents the highest amount in the City's history.

  The $9.0 million in the Free Cash authorization is requested at this time from the City's Free Cash balance in order to reduce the property tax levy increase.

  The Department of Revenue (DOR) does not allow formal authorizations of Free Cash by the City Council until the DOR has certified a Free Cash balance at the conclusion of the fiscal year.

- **Transfer of Excess Overlay Balances.** The City is authorized to increase each tax levy by up to five percent as an "overlay" to provide for tax abatements. If abatements are granted in excess of the applicable overlay, the excess is required to be added to the next tax levy, or transfers may be made from surplus balances from prior fiscal years.

  Overall, the City has approximately $12.6 million in overlay balances as of June 30, 2013. However, there are cases pending at the Appellate Tax Board for which the City must have sufficient balances to cover abatements if it loses these cases. Based upon the overall size of the overlay surplus, I am recommending that the City use $2.0 million of this surplus to decrease the tax levy. Based on the level of the overall current surplus, the City would continue to use $2.0 million for this purpose in future years. This conservative approach will allow the City to maintain a sufficient overlay reserve while reducing older overlay balances to help lower the tax levy.

- **Authorize $586,670 in School Debt Stabilization Funds.** In recognition of increases in debt service costs related to major capital projects, the City established a School Debt Stabilization Fund and has made contributions to it over the past several years. The balance in this Stabilization Fund is approximately $4.8 million as of June 30, 2013. The Adopted FY14 Budget included $586,670 from this source to fund debt service costs for the War Memorial.

- **Authorize $1,000,000 in City Debt Stabilization Funds.** In recognition of increases in debt service costs related to major capital projects, the City established a City Debt Stabilization Fund and has made contributions to it over the past several years. The Adopted FY14 Budget included $1.0 million from this source to fund debt service costs related to the elementary school reconstruction program.

- **Authorize the use of $12,000,000 in Free Cash to the City's Stabilization Fund.** This Free Cash Authorization of $12.0 million to the City's Stabilization Fund will be used to mitigate anticipated debt service costs in future years for the City's major capital projects especially in relation to the Elementary School reconstruction plan. This appropriation will help stabilize tax levy increases in future years.

- **Classify Property and Establish Minimum Residential Factor.** Since 1984, the City Council has voted annually to follow State law allowing the classification of property according to use (residential or commercial) and to allocate the legal maximum portion of the tax levy to the commercial class. State law allows the residential portion of the tax levy to be as low as 50% of what it would be if there were single tax rates. However, there are two exceptions to the 50% minimum:

  The residential percent of the levy cannot drop to less than its lowest level since classification was initially voted by the City Council (34.5615% in 1985 in Cambridge); and the 50% level does not cause the commercial class to bear a portion of the levy greater than 175% of what it would be if both classes were taxed equally; and

  The City Council sets the levy distribution each year by voting for a Minimum Residential Factor. The result of voting for the Minimum Residential Factor of 56.4071% this year will be a residential property share of the total tax levy of 34.5615%. Commercial property will pay 65.4385% of the levy, which brings the commercial portion of the levy to 169% of what it would be with a single tax rate.

- **Residential Exemptions.** Home Rule Legislation allowing the City of Cambridge to increase the residential exemption from 20% to 30% was filed by a unanimous vote of the City Council and signed into law in September 2003. This change enables the City to grant owner occupants of residential properties a deduction of up to 30% of the average residential parcel value before the tax rate is applied. I am recommending that the City Council accept the Maximum Residential Exemption of 30%. This amount is deducted from the assessed value of each owner occupied property prior to applying the tax rate. The residential exemption serves to reduce the effective tax rate on lower valued properties while raising it on higher valued properties. Since the same amount is deducted from every value, its impact is greatest on the lower valued properties. The residential exemption is paid for by raising the residential tax rate sufficiently to cover the number of taxpayers claiming the residential exemption.

  For FY14, there are approximately 14,350 residential exemptions on the Assessing Department files. Overall, approximately 91% of the owner occupied homes benefit from the 30% residential exemption. The Assessing Department conducts random audits and responds to inquiries about individuals claiming the residential exemption, to ensure the validity of the program.

  If Cambridge did not adopt a residential exemption, the residential tax rate would be $6.82 instead of $8.38. The higher tax rate results in a "break-even" value over which the higher valued residential properties are assessed higher taxes than would be the case if there were no residential exemption. In FY14, the break-even assessed value is approximately $1,158,420.

30% Residential Exemption

	FY2012	FY2013	FY2014
Value Exempted	$198,085	$202,699	$215,649
Tax Savings	$1,679.76	$1,755.37	$1,807.14

- **Double Statutory Exemptions/Exemption Increases.** State legislation requires cities and towns to grant a variety of tax exemptions to elderly taxpayers, blind taxpayers, veterans and surviving spouses who qualify by virtue of residency, income and assets. There are also two pieces of legislation which authorize cities and towns to increase the amounts of these exemptions.

  The first allows cities and towns to double the statutory amount of exemption for taxpayers whose tax bills have increased over the prior year's bill. The City Council must vote annually for this increase. I am recommending that the Council do this for FY14, as it has since FY87.

  The second allows cities and towns under Massachusetts General Laws (MGL) Chapter 59, Section 5, Clause 17D to increase the amount of the exemption for a senior citizen 70 or older, surviving spouse, or minor with a deceased parent, by the increase in the cost-of-living as measured by the Consumer Price Index (CPI).

  It should be noted that the cost of living adjustment (COLA), as determined by the DOR, is measured by the increase in the United States Department of Labor, Bureau of Labor Statistics Consumer Price Index for Urban Consumers (CPI-U) during the previous calendar year. The percentage increase for this period was 1.64%. Therefore, the FY14 exemption amounts, income limits or asset limits under these local options will increase over the FY13 amounts and limits. Therefore, the FY14 exemption will be $298.

  In addition, under Clause 17E, cities and towns can increase the asset amounts by the CPI percentage for this same group. The FY14 amounts increases to $59,151 from $58,197.

  MGL Chapter 59, Section 5, Clause 41D allows cities and towns to increase the income and assets limits for elderly persons (age 65 or older) by the CPI percentage. For FY14 the income limits will be $24,458 for those who are single, $36,687 for those who are married, and the asset limits will be $48,914 for those who are single and $67,257 for those who are married.

- **Income Limit for Tax Deferral.** Another form of tax relief available to property owners under state law is found in MGL Chapter 59, Section 3, Clause 41A. This statute allows taxpayers who are at least 65 years old to defer tax payment until they are deceased or the property is transferred. The statutory income limit for this deferral is $40,000. However, a change in the statute, allows the City Council to vote to increase the income limit for deferral of real estate taxes by elderly persons (at least 65 years old) from $40,000 to the amount determined by the Commissioner of Revenue for the purposes of subsection (k) of section 6 of chapter 62, (currently $53,000 for a single person and $80,000 for a married couple, which may be indexed by Massachusetts DOR for FY14), as allowed under MGL Chapter 59, Section 5, Clause 41A. I am recommending that the City Council vote to adopt the deferral amount. The City Council has previously voted to reduce the interest percentage to 4% on deferred property tax balances.

CONCLUSION

In May, the City Council adopted an FY14 Budget which accomplishes the following: maintains City and school services that citizens have come to expect, supports City Council Goals and provides for a strong capital plan, which includes funding to continue the multi-year elementary school reconstruction program in conjunction with the School's Innovation Agenda. In addition, it continues to addresses our unfunded pension liability in a prudent and responsible manner. The above has been achieved with a moderate increase in the property tax levy, which supports the City Council Goal of "evaluating expenditures with a view of maintaining a strong fiscal position and awareness of the impact on taxpayers while providing a high quality of city services." This Budget continues to provide stability and reinvestment in our community and, given the fiscal challenges facing many cities and towns in the Commonwealth, this is a major achievement.

Approximately 66% of the revenues that fund the City's budget are raised through property taxes. Massachusetts communities are limited in how they can raise revenues, resulting in a greater reliance on the property tax, since it is the largest and most stable revenue. The City of Cambridge has been able to achieve a lower property tax rate and lower residential property tax bill than surrounding communities due to its ability to generate diverse non-property tax revenues, foster new construction, control budget growth and plan prudent use of reserves.

Overall, continued sound financial management and planning have enabled the City Council to limit the growth of residential property taxes in FY14. In addition, with City Council approval, the City will use $12.6 million of reserves in FY14 to lessen the amount to be raised from the property tax levy, which translates into a lower property tax burden for the taxpayers of the City.

Additionally, the appropriation of $12.0 million from Free Cash to the City's Debt Stabilization Fund will be used to offset anticipated debt service costs in future years for the City's major capital projects, especially in relation to the Elementary School reconstruction plan. This appropriation will help stabilize tax levy increases in future years.

I believe that lessening the tax burden on our taxpayers is a prudent use of the City's reserve balances that we have created over the years, while maintaining our fiscal flexibility and continuing to position Cambridge as a favorable place to live and do business. This is reinforced by the very positive feedback in the latest biennial Citizen Survey (2012).

The City is also currently compiling a list of prioritized projects that will require funding from the increased balance in the FY13 certified Free Cash. We hope to come to you for authorization as soon the analysis is complete and we have a prudent financial plan, as has been our practice in prior years. It is anticipated that this recommendation will include major City projects such as the completion of LED street light conversion, audiovisual enhancements at municipal facilities, the I.T. strategic plan and energy efficiency upgrades at municipal buildings. If the opportunity arises, we may make a recommendation to acquire land for a DPW facility in the future.

The FY14 property tax levy of $328,544,945 reflects a 3.66% increase over FY13, which is a much lower increase than included in the adopted budget. With approval of these recommendations, the nine-year average increase of the property tax levy will be only 4.42%.

In addition, approximately 74.1% of residential taxpayers will see a reduction, no increase or an increase of less than $100 in their FY14 property tax bill. Another 13.5% of residential taxpayers will see an increase between $100 and $250. Therefore, a total of 87.6% of the residential taxpayers will see no increase or an increase of less than $250. This will be the ninth year in a row that a majority of residential taxpayers will see either a reduction, no change or an increase of less than $100. The average annual percentage of residential taxpayers who, over the last eight years, will see either a reduction, no change or an increase of less than $100, stands at 73.5%. This accomplishment is remarkable, given the fiscal challenges over the same time frame.

The past fiscal year was the strongest financial year in the City's history, with total assessed values and excess levy capacity increasing and actual revenues far exceeding projections and prior year collections. While the City used approximately $24.5 million in Free Cash in FY13, it was still able to increase its Free Cash position to $142.2 million, which is a major accomplishment. However, it would not be prudent for the City to expect or project future revenues based on FY13 actuals. The City will continue to monitor revenues and will adjust projections once reliable trends have been established.

These strong financial indicators, combined with an AAA credit rating, provide the City with enormous flexibility to respond to the many needs facing this community and to provide the services that the majority of our residents expect from the City, without sacrificing our fiscal stability and flexibility. The strategic use of Free Cash is not only used to reduce the tax levy, but is also available to fund one-time items. This planned approach has allowed us to maintain our Free Cash balances, which is especially important during these uncertain times.

OUTLOOK

While overall economic conditions have improved, there are ongoing uncertainties that will force us to be cautious in the next fiscal year and beyond. These uncertainties include: the impact of significant federal budget reductions on local and state governments; the impact of future declines in State Aid to cities and towns; the impact of increasing health insurance costs; the impact of demands on Information Technology; the impact of the school reconstruction program and the possibility of an extended school day and early childhood education programs.

Fortunately, the City Council and Administration have been prudent in maintaining a healthy excess property tax levy capacity, saving and building our reserves and prudently managing our budget growth, which has allowed us to maintain our City services.

We will continue to use our five year financial and capital plan, debt and reserve policies and the City Council Goals as a blue print for our long-range planning to maintain stability and predictability in our budgeting and financial planning processes. Our financial projections indicate that we will be able to produce future budgets that will reflect a moderate growth in the property tax levy, which is our primary revenue stream. However, the issues noted above could have a negative impact on our financial projections.

Our five year debt schedule, based on current estimates, is projected to be approximately $175.8 million. The multi-year elementary school reconstruction program makes up $144.5 million (which completes construction of two schools) of this total and is therefore one of the major priorities affecting future City budgets.

In FY14, the City transferred $1.0 million from the City Debt Stabilization Fund to help mitigate debt service costs (which would otherwise have been funded from property taxes) associated with the elementary school reconstruction program. The City projects that it will continue to use the City Debt Stabilization Fund (which, with this recommendation, will have a balance of approximately $21.0 million) to help offset some of the debt service costs of the reconstruction program over the next five years. The City also hopes to partially offset some of the costs with Massachusetts School Building Authority (MSBA) reimbursements as we update our financial analysis of future debt.

The City is awaiting its Other Post Employment Benefits (OPEB) actuarial study as of June 30, 2013. The City began its annual appropriation of $1.0 million funding to the OPEB Liability Trust Fund in FY13 and increased this to $2.0 million in FY14, yielding a total of $5.0 million in contributions to date. It is the City's intention to continue the $2.0 million annual appropriation to the OPEB fund and to use the excess appropriations that will result when the pension liability is met to increase our contributions to the OPEB Liability Trust fund.

Based on the City's most recent Pension Actuarial study as of January 2012, the funding schedule will remain the same as in 2010 to meet our current target, to be fully funded by 2029.

There are some serious fiscal challenges that will continue to affect the City both in the short and long-term. However, the long-term outlook for Cambridge continues to be very strong as long as we continue to manage our resources wisely. This has been confirmed by our having concluded the strongest fiscal year in the City's history and our continued AAA bond rating.

As we are aware, Cambridge is not insulated from ever-changing economic realities, but we have positioned ourselves well to respond to these challenges in order to preserve the high level of municipal services which residents have come to expect, as well as meet the needs of our infrastructure.

It is my belief that we have collectively listened and responded to the taxpayers and residents through our actions, which has been aided by prudent financial planning.

Very truly yours,

Richard C. Rossi
City Manager

Attachment

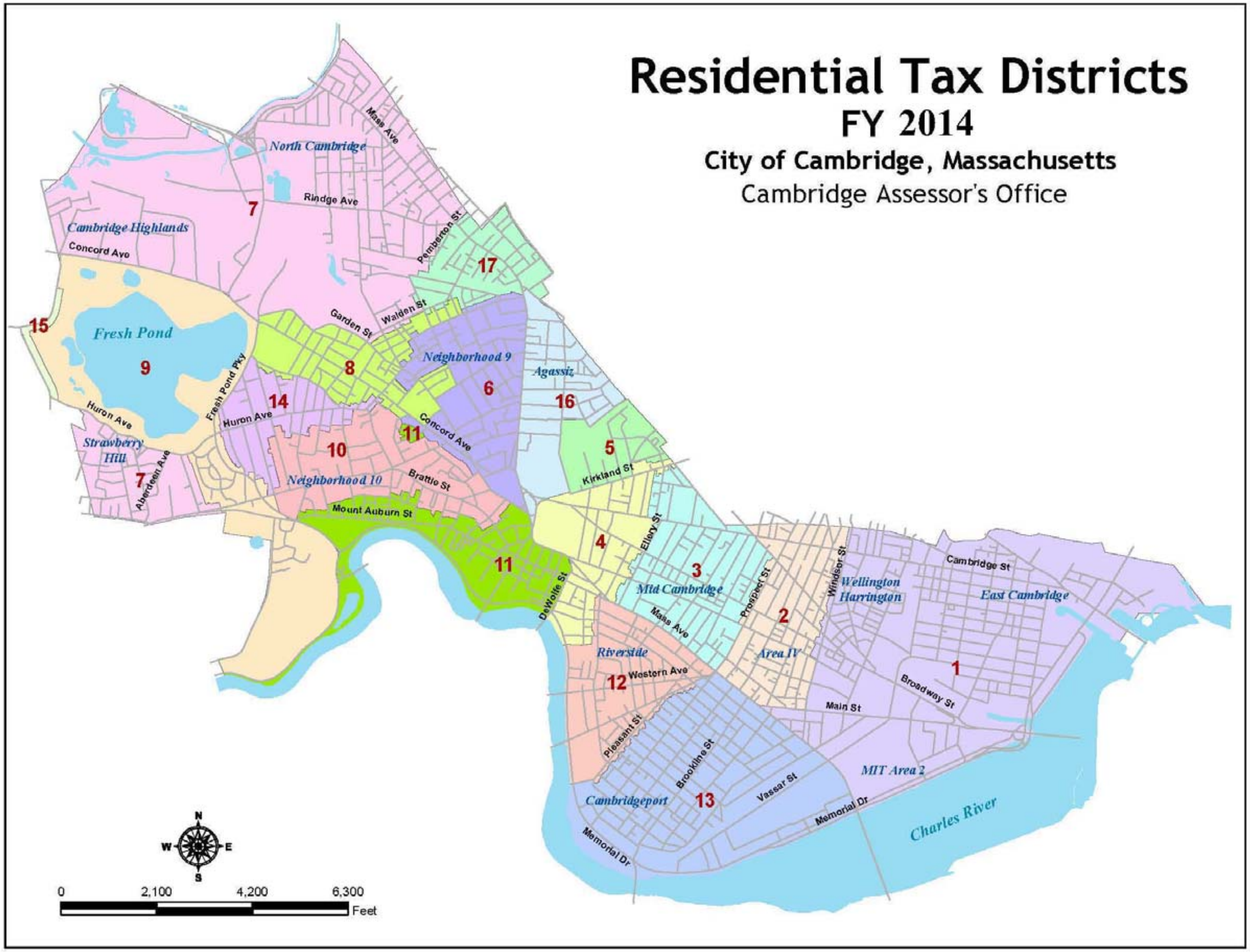
ATTACHMENT 1

FY2014 Single Family Assessment Data				
Median Assessed Values				
NBHD	Count	FY2013 Median	FY2014 Median	Change
R1	391	$ 396,600	$ 427,000	7.7%
R2	206	$ 432,300	$ 482,950	11.7%
R3	229	$ 760,200	$ 831,400	9.4%
R4	86	$ 786,350	$ 788,100	0.2%
R5	61	$ 2,175,000	$ 2,133,000	-1.9%
R6	348	$ 1,311,550	$ 1,389,000	5.9%
R7	649	$ 470,500	$ 494,600	5.1%
R8	226	$ 689,700	$ 709,150	2.8%
R9	202	$ 1,072,000	$ 1,109,950	3.5%
R10	336	$ 2,575,700	$ 2,599,550	0.9%
R11	167	$ 1,122,800	$ 1,212,700	8.0%
R12	179	$ 544,000	$ 577,400	6.1%
R13	233	$ 577,800	$ 666,100	15.3%
R14	140	$ 1,056,700	$ 1,090,450	3.2%
R15	33	$ 815,900	$ 860,700	5.5%
R16	151	$ 846,000	$ 898,400	6.2%
R17	187	$ 640,400	$ 642,900	0.4%

FY2014 Condominium Assessment Data				
Median Assessed Value				
NBHD	Count	FY2013 Median	FY2014 Median	Change
R1	2727	$ 397,500	$ 407,400	2.5%
R2	668	$ 345,100	$ 356,150	3.2%
R3	2048	$ 357,300	$ 367,300	2.8%
R4	646	$ 322,200	$ 326,600	1.4%
R5	15	$ 1,248,100	$ 1,292,400	3.5%
R6	1644	$ 339,300	$ 345,550	1.8%
R7	1660	$ 337,900	$ 351,100	3.9%
R8	414	$ 450,700	$ 471,700	4.7%
R9	42	$ 466,400	$ 484,550	3.9%
R10	37	$ 1,312,400	$ 1,451,100	10.6%
R11	517	$ 596,900	$ 634,300	6.3%
R12	1068	$ 355,800	$ 373,900	5.1%
R13	1162	$ 388,600	$ 411,200	5.8%
R14	336	$ 471,200	$ 498,300	5.8%
R16	359	$ 376,700	$ 389,500	3.4%
R17	524	$ 436,800	$ 456,350	4.5%

FY2014 Two Family Assessment Data				
Median Assessment				
NBHD	Count	FY2013 Median	FY2014 Median	Change
R1	292	$ 435,000	$ 473,500	8.9%
R2	173	$ 499,100	$ 547,000	9.6%
R3	217	$ 810,100	$ 890,400	9.9%
R4	49	$ 949,300	$ 961,800	1.3%
R5	8	$ 1,945,550	$ 1,899,050	-2.4%
R6	85	$ 1,093,200	$ 1,171,900	7.2%
R7	625	$ 580,900	$ 601,500	3.5%
R8	213	$ 700,300	$ 743,300	6.1%
R9	12	$ 822,750	$ 830,300	0.9%
R10	12	$ 1,960,600	$ 1,973,850	0.7%
R11	34	$ 1,153,700	$ 1,240,350	7.5%
R12	162	$ 601,750	$ 637,550	5.9%
R13	222	$ 667,900	$ 772,000	15.6%
R14	205	$ 865,500	$ 882,300	1.9%
R16	88	$ 869,600	$ 944,750	8.6%
R17	136	$ 678,200	$ 688,600	1.5%

FY2014 Three Family Assessment Data				
Median Assessed Values				
NBHD	Count	FY2013 Median	FY2014 Median	Change
R1	239	$ 557,100	$ 601,000	7.9%
R2	147	$ 663,300	$ 722,400	8.9%
R3	125	$ 934,200	$ 1,016,700	8.8%
R4	32	$ 1,077,350	$ 1,103,200	2.4%
R5	3	$ 3,043,900	$ 3,100,800	1.9%
R6	33	$ 1,323,300	$ 1,391,200	5.1%
R7	178	$ 698,600	$ 733,900	5.1%
R8	54	$ 912,250	$ 928,900	1.8%
R9	1	$ 530,000	$ 537,700	1.5%
R10	1	$ 3,168,500	$ 3,215,600	1.5%
R11	18	$ 1,138,050	$ 1,230,200	8.1%
R12	118	$ 716,300	$ 748,600	4.5%
R13	160	$ 731,250	$ 848,300	16.0%
R14	41	$ 925,400	$ 967,200	4.5%
R16	45	$ 921,600	$ 1,021,300	10.8%
R17	59	$ 773,400	$ 799,900	3.4%


Residential Tax Districts
FY 2014
City of Cambridge, Massachusetts
Cambridge Assessor's Office
North Cambridge
Cambridge Highlands
Concord Ave
Rindge Ave
Mass Ave
Pemberton St
Walden St
Garden St
Fresh Pond
Fresh Pond Pky
Huron Ave
Strawberry Hill
Aberdeen Ave
Neighborhood 9
Agassiz
Neighborhood 10
Brattle St
Mount Auburn St
Kirkland St
Ellery St
DeWolfe St
Mid Cambridge
Prospect St
Windsor St
Wellington Harrington
East Cambridge
Cambridge St
Area IV
Riverside
Western Ave
Broadway St
Main St
Pleasant St
Brookline St
Vassar St
MIT Area 2
Cambridgeport
Memorial Dr
Charles River
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
N
S
E
W
0
2,100
4,200
6,300
Feet