City of Cambridge
Executive Department

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City Manager

October 7, 2024

To The Honorable, the City Council:

The establishment of the Fiscal Year 2025 (FY25) 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 with the submission of the annual budget to the City Council. The City's Operating and Capital Budgets, property classifications, and property valuations are major factors in determining property tax bills.

This memo includes recommendations for the required votes which will help minimize taxes on residential properties. In addition, there are analyses of the FY25 property tax levy, property values, and other supporting information.

Overview

The FY25 Adopted Operating Budget is $995.6 million which is an increase of 8.1% (or $71.8 million) over the FY24 Adopted Budget. The FY25 Budget responds to Council goals, feedback, and input, which is reflected in funding commitments and investments across several key priority areas.

The FY25 Budget adopted by the City Council in June 2024 projected a property tax levy increase of $53.4 million, or 9.28%, to $628.8 million in order to fund operating and capital expenditures.

With approval of the recommendations in this memo, the actual FY25 tax levy required to support the FY25 Budget is $628,388,753 which is an increase of $52,970,264 or 9.21% from FY24 This increase is slightly lower than the estimated increase of 9.28% projected in June 2024 as part of the Adopted Budget, due in large part to higher than projected investment earnings.

The property tax levy increase of 9.21% is higher than the FY24 increase of 8.3%. The five-year (FY21-FY25) annual average increase is 7.51%, and the ten-year (FY16-FY25) annual average increase is 6.31%.

While this is the highest levy increase in recent years, it supports an FY25 Budget that includes significant new investments related to long established priorities and planned initiatives such as the new Cambridge Preschool Program; increased school department funding to support a longer school day; and an increase in debt service costs related to major capital projects including the Tobin School, fire station renovations and reconstruction of fire headquarters, and essential improvements to municipal buildings.

The Budget process for FY25 began in the fall of 2023. The FY25 Operating ($955.6 million) and Capital ($74.9 million) Budgets were formally adopted by the City Council on June 3, 2024. The FY25 Budget is guided by policy direction set by the Council, based on City Council meetings, policy orders, and consistent communication which has allowed for feedback on existing initiatives and department operations, and helped to identify key city priorities.

The FY25 Budget process included close collaboration with Finance Committee Co-Chairs and more public hearings than prior years, which covered the operating budget, capital budget, police budget, and updates on federal ARPA funding.

The FY25 Budget includes over $24.6 million in direct support to the Affordable Housing Trust. In addition, the Community Preservation Act (CPA) allocation for affordable housing in FY25 is over $17 million, totaling approximately $41.7 million in support to the Affordable Housing Trust in FY25.

The FY25 budget includes funding ($34 million total across City and School budgets) for the first year of the Cambridge Preschool Program, the universal prekindergarten program that launched in September 2024. Universal pre-kindergarten (UPK) has been a long-standing goal of the City Council. The expanded program will place all four-year-olds and prioritized three-year-olds in a high-quality pre-school program across Cambridge Public Schools, Department of Human Services Program (DHSP) preschools, Head Start, and community programs.

The FY25 Budget includes funding to support a new 3-year teacher contract and represents a significant investment in public education in the City, including more instructional time for elementary and upper school students, additional collaboration time for educators, and a meaningful increase in educator salaries.

A Municipal Facilities Improvement Plan (MFIP) allocation of $4.35 million in FY25 will fund ongoing deferred maintenance and projects to help meet targets associated with the Net Zero Action Plan and the City's Building Energy Use Disclosure Ordinance (BEUDO). Key activities related to the Net Zero Action Plan and BEUDO in FY25 are intended to assist property owners in complying with the new performance standards and decarbonizing their buildings. There is also funding for major capital repairs, sewer and stormwater, and investments in roofs and drainage to ensure the city will be prepared for greater extreme weather events. It is important to also recognize that many large-scale capital and infrastructure projects that were previously approved and initially funded through the issuance of bonds, can have significant impacts on future operating budgets through debt service (principal and interest payments) costs. The FY25 Debt Service Budget is $101.9 million.

Making streets safer for all users is a key priority for the City and is reflected in investments in infrastructure to repair damaged roads, improve accessibility, and address dangerous intersections. The Cycling Safety Ordinance informs several ongoing projects including floating bus stops with separated bike lanes and other pedestrian improvements, improved accessibility on sidewalks, increased plantings, and upgraded utilities. The budget also includes funding for continued investments as part of the Complete Streets program including projects on River Street, Huron Avenue, the Port, Massachusetts Avenue in Harvard Square and Central Square, and Massachusetts Avenue Partial Construction.

The FY25 Capital Budget includes Pay-As-You-Go funding of $17.3 million ($12.9 million Free Cash; $4.4 million Property Tax) to support citywide projects; Egov initiatives; and Participatory Budgeting Cycle 10 projects.

OTHER REVENUES, STATE AID, AND OVERLAY ACCOUNT

In determining the actual property tax levy, several adjustments were made based on updated information since the budget adoption in June. The City increased the amount of additional non-property revenues related to interest earnings by $1.075 million. This increase counters small increases in the Net Cherry Sheet charges, and an adjustment to the Overlay Reserve that need to be included in the Budget.

TABLE I
Summary of Changes from Adopted Budget

Tax Levy Changes	Amount
Projected Property Tax Levy *(as Adopted)*	**$628,830,105**
Net Cherry Sheet Change	$440,783
Increased Non-Property Revenues	($1,075,000)
Overlay Adjustment	$192,865
Actual Property Tax Levy	**$628,388,753**

The overlay is an account established to fund abatements and exemptions of committed real and personal property accounts. As part of the annual budget and tax rate process, the assessors review the balance in the overlay account and determine whether it is adequate to fund anticipated property tax abatements and exemptions in the upcoming year in addition to any existing abatement or exemption exposure for all previous fiscal years, and increase or decrease the amount accordingly. As of June 30, 2024, the City has approximately $15.8 million in overlay balances. The FY25 budget included a projected increase to the overlay account of $4.5 million which was adjusted upward by $192,865 after submission of property values and classification process. Based on the Assessor's review of the prior year overlay balance and the estimated ATB cases, the FY25 budget projected a surplus of $2 million in balances in the overlay account accumulated over prior fiscal years. This amount will be transferred to an overlay surplus reserve. This letter also includes a recommendation to use $2 million from the Overlay Surplus reserve to lower the property tax levy.

IMPACT ON TAXPAYERS

Based on a property tax levy of $628,388,753 the FY25 residential tax rate will be $6.35 per thousand dollars of value, subject to Department of Revenue approval. This is an increase of $0.43, or approximately 7.3% from FY24. The commercial tax rate will be $11.52, which is an increase of $1.06, or 10.1% from FY24. Establishing the tax rate is a straightforward calculation: the total tax levy divided by the total assessed valuation (less any exemptions), equals the tax rate for FY25.

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

	FY24 Value	FY24 Tax Bill	FY25 Value	FY25 Tax Bill	$ Change Tax Bill
Single Family	$1,754,550	$7,468	$1,767,700	$8,055	$587
Two Family	$1,596,900	$6,535	$1,594,700	$6,956	$421
Three Family	$1,848,300	$8,023	$1,857,550	$8,625	$602
Condominium	$750,900	$1,527	$767,300	$1,702	$175

* Includes Residential Exemption

TAX BILLS

The analysis that follows explains in further detail how the City determined property values and property tax rates for FY25. There are three major factors which determine a property tax bill: 1) the Budget, 2) Commercial-Residential Property Tax Classification, and 3) Property Values.

The Budget: If the City Council adopts the proposed recommendations, there will be a 9.21% increase in the property tax levy required to balance the FY25 Budget.

Commercial-Residential Property Tax Classification: Tax classification allows municipalities to tax commercial taxpayers at a higher rate than residential taxpayers. For this year, commercial property owners will pay 66.199% of the property tax levy, similar to FY24. Consequently, residential property owners' share of the FY25 tax levy is 33.8010%.

Property Values: Each January 1st, the city of Cambridge must meet Department of Revenue requirements to certify that property values represent full and fair market value. As a result of the market activity in calendar year 2023, which is the basis of the FY25 property assessments, total residential property values increased by 1.7%. Total commercial property values *decreased* by 0.9%. These mixed results; slightly negative on commercial, and lightly positive for residential, indicates the softening of the commercial and industrial markets and the sluggish residential market with little inventory and high interest rates.

While the City has no control over the increase in property values, it does have control over levy increases, which ultimately impact taxes paid by property owners. This year, both the residential and commercial property tax rates will increase. A major concern going forward is that if residential values increase and commercial values continue to decline, the City could hit the ceiling for the property tax classification shift. Once the classification ceiling is reached, the residential class will bear all tax levy increases while this condition persists.

COMPARISON TO OTHER COMMUNITIES

Below is a comparison of the residential percent of the tax levy paid by Cambridge residents compared to neighboring towns. Cambridge continues to have the lowest residential and commercial tax rates compared to neighboring communities. Additionally, Cambridge residents are paying the lowest proportion of the levy when compared to other nearby towns.

TABLE III
Comparison of Residential Percent of Tax Levy Paid

Municipality	Residential % paid of prop. tax levy	Commercial % paid of prop. tax levy	Residential Tax Rate	Commercial Tax Rate
Cambridge*	**33.8**	**66.2**	**$6.35**	**$11.52**
Boston	41.7	58.3	$10.90	$25.27
Watertown	50	50	$11.70	$23.08
Somerville	67.1	32.9	$10.52	$18.20
Brookline	83.9	16.1	$9.77	$16.41
Newton	85.3	14.7	$9.76	$18.33

*Cambridge rates are for FY25, all others are for FY24

CITY-WIDE ASSESSED VALUES

FY25 values are based on market activity that occurred during calendar year 2023. For FY25, the total assessed value of taxable property in the City equals $76,240,599,650, or a 0.5% increase, over prior year values.

Most residential classes saw little increase in values, with only modest increases in certain neighborhoods. Higher interest rates during 2023 muted value increases for all residential property types. The residential market showed little appreciation during calendar year 2023 for single, two and three families in Cambridge, while apartments saw a leveling off of rents. Condominiums show a slight increase in value (2%) after lagging other residential property types since the COVID pandemic. It is also important to point out that condominiums now compromise a very large percentage of the residential tax bills.

In the commercial sector, all classes of office as well as the lab sectors decreased. Class A, B and C office buildings and lab sectors continue to show the effects of higher vacancy rates and higher supply in the lab development pipeline. Additionally, the impact of hybrid work continues as companies analyze square footage needs. Retail and restaurants are holding their own and hotels have returned to pre-pandemic values with slightly lower occupancy but also higher room rates.

The following table breaks out new construction values and tax base levy growth due to new construction by property type. The new growth for FY25 was supported by the Volpe site transaction. MIT has completed the new US General Services Administration building, which is a 400,000 square foot state of the art research facility. The remaining 10 acres of the site, transferred to MIT on January 26th for $750 million. This moves the exempt Federal land to a taxable, mixed-use development. This will allow for continued growth for the next 5-10 years for this Kendall Square site.

TABLE IV
New Construction Breakdown

Property Class	New Growth Value	FY25 Tax Base Levy Growth (New Growth)
Residential Property	$621,871,620	$3,681,480
Commercial Property	$97,911,098	$1,024,150
Industrial Property	$1,323,607,575	$13,844,935
Personal Property	$538,760,573	$5,635,436
Total New Growth	**$2,582,150,866**	**$24,186,001**

TABLE V
Assessed Values (in millions)

	FY21	FY22	FY23	FY24	FY25
Residential Property	$34,136	$35,118	$37,466	$39,460	$40,134
Commercial Property	$24,221	$26,875	$31,465	$33,983	$33,569
Personal Property	$1,878	$1,960	$2,209	$2,438	$2,537
Total Assessed Value	**$60,235**	**$63,953**	**$71,140**	**$75,881**	**$76,240**

For FY25, the City's levy limit increased by approximately $43.53 million, to $817.49 million. Approximately $24.19 million of this increase was due to new construction and amended FY24 new growth. State law allows the City to increase its tax levy limit by an amount equal to the total FY25 value of newly constructed or renovated property, multiplied by the FY24 tax rate. It should be noted that industrial property (lab space) values had a new growth value of $1.3 billion, which translated into a levy limit increase of $13.84 million. Aside from new growth, the remaining $19.34 million is the 2.5% increase over the FY24 levy allowed by Proposition 2½.

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

	Actual FY21	Actual FY22	Actual FY23	Actual FY24	Estimate FY25
Levy Limit	$659,697	$691,327	$732,560	$773,962	$817,489
Actual Levy	$472,520	$494,732	$531,601	$575,418	$628,389
% Actual Levy Increase over Prior Year	7.9%	4.7%	7.45%	8.3%	9.2%
Excess Levy Capacity	$187,177	$196,595	$200,959	$198,544	$189,100
% Change of Excess Levy Capacity Over Prior Year	(1.67%)	5.03%	2.2%	(1.2%)	(4.8%)

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

FY25 VALUATION PROCESS

Each year, the Board of Assessors conducts a reappraisal of all property within the City. The residential and commercial valuation models are refined each year to reflect market conditions which have impacted assessed values.

The FY25 valuation model is based upon sales of property that occurred during calendar year 2023, to establish the market value of all property as of January 1, 2024.

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 demand for real estate in the city. To arrive at full and fair cash values for all parcels, the Assessing Department uses a Computer Assisted Mass Appraisal system (CAMA). Market adjusted cost approach models, extracted from residential sales for calendar year 2023, were refined to best reflect the equity of comparable properties as demonstrated in the various neighborhoods.

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 open space. The local portion of CPA funding is raised through a 3% surcharge on taxes.

TABLE VII
Community Preservation Act Surcharge

	FY24 Median CPA Surcharge Amount	FY25 Median CPA Surcharge Amount	FY25 Median Tax	FY25 Median Tax & CPA Surcharge Amount
Single Family	$206	$223	$8,055	$8,277
Condominium	$28	$32	$1,702	$1,734
Two Family	$178	$190	$6,956	$7,146
Three Family	$223	$240	$8,625	$8,865

RECOMMENDATIONS

1. That the City Council vote to authorize $2,000,000 in overlay surplus/reserves to be used for reducing the FY25 tax rate.

2. 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 64.2099%.

3. That the City Council approve the residential exemption factor of 30% for owner occupied homes, which should result in a residential tax rate of $6.35 upon final approval by the Massachusetts Department of Revenue. In addition, based upon final approval by the Massachusetts Department of Revenue the commercial tax rate is anticipated to be $11.52.

The City Council has previously approved (1987) several tax exemptions to elderly taxpayers, blind taxpayers, veterans and surviving spouses who qualify by virtue of residency, income, and assets:

- 17D-Elderly (over 70), Surviving Spouse or Minor Child of Deceased Parent
- 41C-Elderly (65 or older)
- 22 (22A, 22B, 22C, 22D, 22E, 22P) Veterans-exemption
- 37A-Legally blind
- 41A-Tax Deferral over 65

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 and residential exemption 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 FY25.

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

- **Transfer of Excess Overlay Balances.** Based a review of overlay balances and the estimated cases pending at the Appellate Tax Board for which the City must have sufficient balances to cover abatements if it loses these cases, the Board of Assessors has identified $2 million as surplus in this account. I am recommending that the City use this $2 million to decrease the tax levy.

- **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. Under the 175% Shift state law allows the residential portion of the tax levy to be as low as 50% of what it would be if there were a single tax rate. However, there are two exceptions to the 50% minimum:

  The residential percent of the levy could not 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.

  Under the requirements for classification, 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 64.2099% this year will be a residential property share of the total tax levy of 33.8010%. This means that Commercial property will pay the remainder, 66.199% of the levy. This results in a residential rate of $6.35 and a commercial rate of $11.52 for FY25.

- **Residential Exemptions.** Home Rule Legislation allowing the City 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 Residential

Exemption at 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 this year there are approximately 13,650 residential exemptions on the Assessing Department files of owner-occupied homes. The Assessing Department conducts random audits and responds to inquiries about individuals claiming the residential exemption, to ensure the validity of the program.

30% Residential Exemption

	FY2023	FY2024	FY2025
Value Exempted	$470,823	$493,012	$499,263
Tax Savings	$2,759	$2,919	$3,170

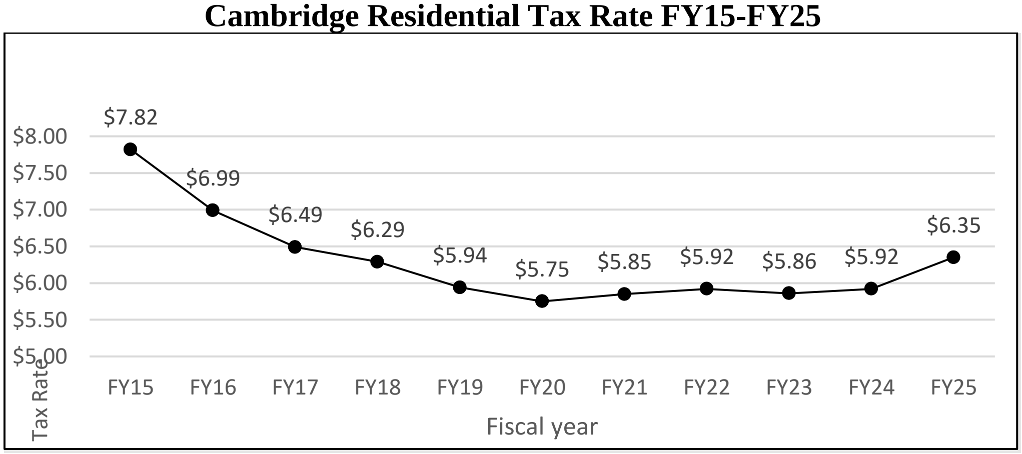
CONCLUSION

The FY25 property tax levy and correlating residential and commercial tax rates are a reflection of continued and expanded investments in several key priority areas including affordable housing and homelessness, school services, early childhood, climate initiatives, transportation safety, municipal facilities, stormwater infrastructure, technology, and major street projects.

It is important to point out that 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 source. Sixty five percent (65%) of the revenues that fund the City's Operating Budget come from property taxes, therefore it is important to remain cognizant of the potential impact and burden placed on residential taxpayers.

The City has consistently been able to achieve a lower property tax rate and lower residential property tax bill than surrounding communities, while also continuing to make significant investments back into the community. The City has also maintained high standards for fiscal management, strategic planning, and setting and adhering to prudent policies. The City maintained its AAA bond rating from all three major rating agencies this year and continues to plan for long-term financial sustainability and health.

TABLE VIII
Cambridge Residential Tax Rate FY15-FY25



There are however significant changes in the macroeconomic environment, which are out of the City's direct control, that will have financial impacts on the City. While assessed values overall in the City saw a modest increase for FY25, it is not anticipated that values will increase in the near future. On the contrary, there are several indications that commercial values in particular will remain flat or decline over the next several years. Furthermore, some key factors don't necessarily reflect a one-time impact, but rather a structural shift in the real estate market, particularly in the office sector. Telework is driving high office and retail vacancy rates, while interest rates and construction costs have constrained growth and new development. This in turn can lead to a shift in values which would place an increased burden on residential taxpayers, as well as limits on the level of financial flexibility, particularly related to excess levy capacity and reserves, that the City has experienced in recent years.

While Cambridge is still in an advantageous position compared to other Massachusetts municipalities, in large part due to adherence to strong and longstanding fiscal policies and practices, it is important to recognize the relationship between the annual budget and the associated impact on property tax bills, and proactively find ways to control budget growth. Several potential large projects and investments may require further discussions regarding prioritization, timing, and possibly tradeoffs.

Over the past fiscal year, the City has worked closely with City Council, through the Finance Committee, to consider the FY25 Budget in the context of multi-year budget growth projections; slower growth in assessed commercial property values; increased use of reserves; and new anticipated areas of spending. It is anticipated that these types of discussions will continues as we look to FY26 and beyond. The City is committed to the professional management of our finances to ensure that we can continue to deliver high-quality services, build and maintain essential infrastructure, and invest in key Council and community priorities.

I would like to thank the City Council for their support; the community for their trust; as well as staff for their hard work; as we continue to move forward in building an innovative and inclusive Cambridge for everyone, while also providing strong and prudent fiscal management.

Very truly yours,

Yi-An Huang
City Manager