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Los Angeles Schools Face Fiscal Woes.

- **District challenged by deficits, pensions, falling enrollment**
- **Bonds are trading at better levels than that of Texas**

Los Angeles Unified School District has credit ratings others would envy — yet faces challenges that if left unchecked could undermine its stellar reputation with investors.

The bonds of the nation's second-largest school system are ranked AAA by Fitch Ratings and Aa2 by Moody's Investors Service though the district, like others in California, wields little power to raise revenue and relies on a state funding formula pegged to student enrollment. And that enrollment is in steady decline, with the 2019-2020 class rolls projected to be more than a third lower than in 2003.

So far, its borrowing costs don't seem to be reflecting any concern, as a sample of the district's 5-year and 10-year general-obligation bonds shows them yielding less than similar debt from Texas, a state that carries the top rank from all three major credit raters, data compiled by Bloomberg show.

The school administration, which forecasts deficits within two years, saw contracts for all but one of its bargaining units expire Friday. It's a "significant" time for officials, who haven't built in any related cost increases for future budgets, said Moody's analyst Helen Cregger. Meanwhile, contributions for pensions and lifetime retiree health-care benefits are escalating.

"We may be at an important inflection point," Cregger said. "Going forward, annual increases in state funding may be more moderate. So the pressures will be compounded."

Los Angeles officials are taking action, laying off and reassigning some employees while hoping through contract negotiations to slow the growth in retiree health-care liabilities that have reached $13.6 billion, or 366 percent of payroll. The district must also contend with a rising pension tab as general-fund contributions for retired teachers will reach $497 million in fiscal 2021 from $215 million seen in 2014.

Ksenia Koban, municipal strategist at Payden & Rygel, anticipates the district's debt rating falling within three to five years to the A-level category and spreads over benchmark bonds widening. While the rating companies assign the district a stable outlook, their analyst reports and interviews flag the potential for the school system's challenges to deepen. Administration officials declined to comment on the prospect of future ratings downgrades.

"The fundamental problems it has to address are almost insurmountable," said Koban, who has stopped adding to the firm's holdings of district bonds. "I don't know how you can get out of this in two years, forget ten."

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By Romy Varghese

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