Thoughtful Thursday
An Essay on School Finance

Introduction

Recent political events have focused a spotlight on independent schools. For the record, Blundell's is a registered charity, and we are a not-for-profit organisation. Any surplus that we make goes back into the school accounts. We are an educational institution, and we are also a business, in so much as the finances must be managed in such a way that the school remains viable.

At times it is difficult and even uncomfortable to reconcile the idea that a school is about giving children an outstanding education, whilst simultaneously needing to be a smartly operated business. At times there is a tension, but good education and good business do not have to be at odds with each other. A good educational offering (the product) is essential to generate revenue, and what all consumers are interested in – alongside affordability – is value. In a utilitarian sense, value is when the cost can be justified for what is received in return. A great educational offering can be better value than a lesser product at a much lower price. And parents tend to be savvy investors and therefore, like all good investors, will seek out value.

Good financial management means that investment in education (teachers, facilities, resources, etc) and efficiency in managing costs (staff, maintenance, etc) ensure an educational product that parents believe is worth spending their money on.

This paper is intended to be generic in principle, but where appropriate I will use our experiences at Blundell's as the case study. All charities are required to display their financial accounts on the Charity Commission website, where they are available to the public.

The Economy: A necessary contextual perspective

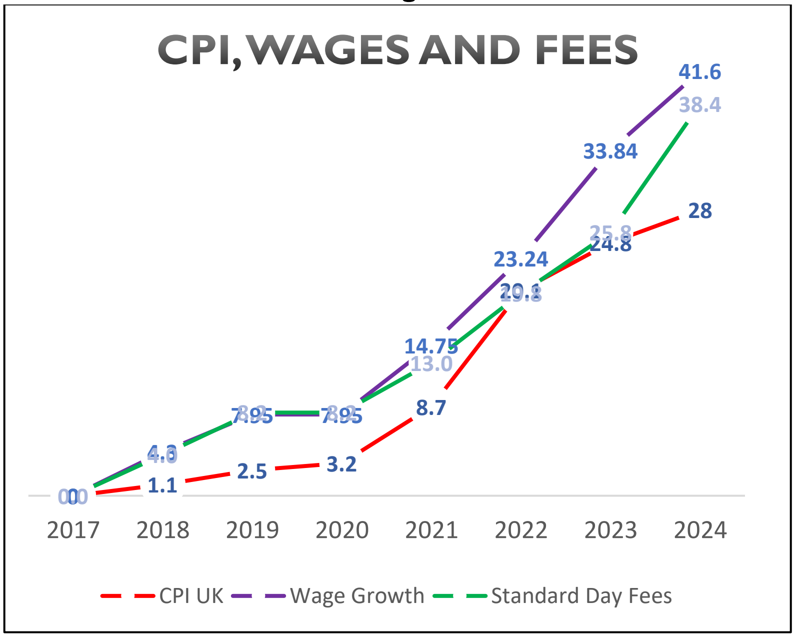
It is worth keeping in mind that over the past 7 or so years the macro-economic environment has been extraordinarily unstable. Britain officially left the EU on the 31st of January 2020, and we entered our first Covid lockdown in March of that same year. When the war in Ukraine broke out in February 2022, we were still emerging from a post-Covid world, and we were trying to figure out the ramifications of Brexit. We also experienced a period of significant inflation caused by the spike in energy prices triggered by the war in Ukraine.

During this period of time, we have seen four Conservative Prime Ministers – including an economically catastrophic cameo from Liz Truss – and a change of Government. The rest of the world has also faced considerable economic upheavals, and we wait to see, with fascination and apprehension, what may emerge from the new Presidency across the Atlantic. It is not unreasonable to say that this has been a period of unprecedented instability and uncertainty, and not just for Independent schools.

A school like Blundell's is not immune to all these matters and both our revenue generating capabilities (mainly through fees), as well as management of our cost base, are profoundly affected by these macroeconomic events.

Chart 1 shows three related sets of data: CPI (a measure of inflation), wage growth across the UK, and fee increases at Blundell's.

Chart 1: Combined CPI, Wage Growth and Fee Increase



Source: Office of National Statistics

The Consumer Price Index (CPI) is an indicator of the rate at which prices of a standardised basket of goods goes up from one period to another. We generally refer to CPI as inflation. Over the period since the beginning of 2017, prices have increased by 28%. In the UK, inflation is targeted to be within a percentage point of a 2% target, but whilst that target was broadly achieved until 2020, the impact of Brexit, Covid and the war in Ukraine (and its impact on energy prices) has meant we have deviated from the target, and successive governments have struggled to bring it back.

Chart 1 clearly shows how, after a period of stability, prices escalated rapidly between 2020 and 2022 and have since stabilised again to a more regular level nearer to the target of 2%.

Inflation has had a major effect on things like energy prices and food costs. We have largely been protected from the worst of the energy spikes through long term contracts and because of pre-emptively investing in solar power and greater insulation (which has been made possible through the Energy Surcharge). However, we were not able to avoid the huge increase in food costs. The other factor that was considerably affected has been wages and salaries.

Chart 1 includes wage growth over the same period. Wage growth is measured as an average, so clearly not everyone is affected in the same way, but it is the standard measure of wage growth in the UK. Traditionally, there is a time lag between wage growth and CPI; high prices tend to lead to higher wages. The chart shows that wages froze during the pandemic, although just prior to that there was a period where wages grew at a considerably faster rate than CPI. Wage growth is also a driver of inflation, and one reason why inflation is not coming back down to target is because wages are still trending upwards at a rate considerably above inflation.

After Covid, when inflation kicked in, wages rose rapidly. However, when CPI settled down in 2022/23, the momentum in wages did not abate and wage growth continued even after price increases had slowed down. Whilst inflation has returned to more normal levels, wages continue to rise, and may continue to do so under the current Government whose largesse towards public sector workers might see inflation remain stubbornly above target, making it less attractive for the bank of England to lower interest rates.

In this context it is worth considering how fees at Blundell's have changed over this same period. The press is quick to point out high levels of fee increases. The current Chancellor repeatedly points to the fact that parents have 'accepted' above-inflation fee increases as a rationalisation of VAT on school fees. Clearly, as parents have kept paying the fees, a slight 20% bump won't make too much difference!

I am mindful that Chart 1 indicates Standard Day Fees and the fee changes at different parts of the school will be different, but for the sake of the illustration, I have used this segment of the school population. In Chart 1 the fee freeze during covid is evident, but the period immediately after that does have a steeper trajectory than the period immediately preceding Covid. However, the trajectory is nothing like as steep as that of the increase in prices, or the increase in wages, and the steepest trajectory of all is caused by the levying of VAT. It is worth noting that we only passed on a part of the VAT – a full VAT implementation would see an even steeper rise.

In a normal economy, one would hope to see a real growth in wages over time – as that suggests that the population is better off – but from 2022 the gap has grown unusually large. School fees have been above the rate of inflation, but at no point have school fees exceeded the rate of wage growth. On balance, school fees are no less affordable – although I dare say that for many people it does not feel that way. On average, statistically at least, Blundell's fees remain within the boundaries of wage growth, even when factoring in VAT.

Financial Challenges: Overview of generic issues confronting the Independent School sector

Teachers' Pension Scheme (TPS)

In the last few years there have been some very specific challenges to school finances. The first of these came in the form of the **Teachers' Pension Scheme (TPS)**. The TPS is a generous defined benefits pensions scheme to which all schools traditionally belonged. It is an attractive pension seen, in part, to compensate for relatively modest salaries in the educational sector.

In 2018 the employer contribution to the TPS was 16.48%. That figure is reviewed every 5 years, and it is generally expected to increase. However, the 43.7% increase from 16.48% to 23.68% was unexpected and unprecedented. Some schools immediately negotiated an exit from the TPS and moved to a defined contribution scheme. We made a defined contribution scheme available to our teaching staff, but understandably, not many staff took that option.

Blundell's do not typically pay much above the state level of pay. If we were to remove the TPS from the remuneration package of staff, then recruitment would become more challenging, and we would have to increase salaries considerably in order to match the total remuneration package in the state sector. Remaining in the TPS at that time cost the school around £400k per annum. In retrospect I believe that remaining in the TPS was the right thing to do, particularly as the strategy from that moment was to make it clear that any further increase in employer contributions would not be borne by the school.

In 2024 the employer contributions again went up, this time by a more modest 21%, from 23.68% to 28.68%. Staff had been well prepared for this eventuality, and when Governors announced that the school would be withdrawing from the TPS, there was little resistance, and the scheme is now closed to new joiners. Staff who chose to remain in the TPS have had to cover the increase in costs themselves. In comparison to the trauma this has caused at many other schools, where strike action and various other forms of resistance were rife, I am very proud of how this was managed at Blundell's. It is testimony to the goodwill of both Governors and teaching staff to work together to find win-win solutions. I believe this outcome is a very positive one but the cost of the increase in pensions over the past 6 years has been substantial.

Covid and a National Lockdown

As we were working through the financial consequences of the increases in TPS costs to the school, news emerged of a virus in Wuhan, China. That was in January of 2020, and I remember our cricketers going on tour to India over the February Half Term. Soon after their return, rumours gathered strength that schools would close, and we would be going into a national lockdown. It seemed incomprehensible and I think I probably wrote to parents in my Bulletin that I did not think that a full school closure was likely.

A week before Half Term we gathered the Upper Sixth in the chapel for an impromptu farewell service, after which they packed their bags, and school was not reopened until September – and then only for a while before a second lockdown was declared in January 2021 (when the weather was not quite as nice).

Although we were able to furlough some of the support staff, the reality is that we needed teachers to keep teaching. Considering that staff pay (support and teaching) make up more than two thirds of the schools' expenses, it was not very easy to save money during lockdown. We could save on food and on energy costs, but with payroll making up such a large proportion of the costs of running the school, savings were not substantial.

Understandably, parents were reluctant to pay the full fees, and some were disappointed by the size of the fee reduction that Blundell's was able to offer. However, the cost of Covid to the school was approximately £2m. It is a substantial amount of money and equates to two years' worth of cash surpluses. We were fortunate to have a bit of headroom and some cash reserves, but it was an uncomfortable time and a costly one to the capital development ambitions of the school. Those were the cash reserves that we would have been able to spend on various projects. Some parents have expressed frustration at the lack of investment in certain facilities such as the astros, but we cannot forget the impact Covid had on our cash reserves. I imagine it would have been the same for many businesses who were in the service industries.

Staff Costs

Staff costs make up around two thirds of the total costs of running the school. At the Prep School it is over 70% and at the Senior School around 65%. The Prep School has lower grounds and maintenance costs and hence the difference in proportions.

There are two sides to staff costs, Support Staff and Academic Staff.

The National Minimum Wage was £7.50 per hour in 2017. This year it will increase to £11.44 per hour, a 52% increase. Of course, it is not just those staff on the minimum wage (cleaners, porters, etc) but also those just above it who are affected. National Insurance contributions will also increase from 13.8% to 15% with a threshold of £5,000 rather than £9,000. These are the costs that are difficult for the school to control. Our Support Staff are invaluable members of our school community and serve the school through the catering department, the grounds and gardens teams, our House matrons, as well as numerous other support functions. The cost increases have well outstripped inflation, and school fee increases.

In A Level Economics classes you learn that if the cost of labour increases, then the natural consequence is that businesses can afford to employ fewer people. We are trying to strike a balance between ensuring that our Support Staff continue to be able to provide the excellent level of service that they do, against the need to be financially prudent.

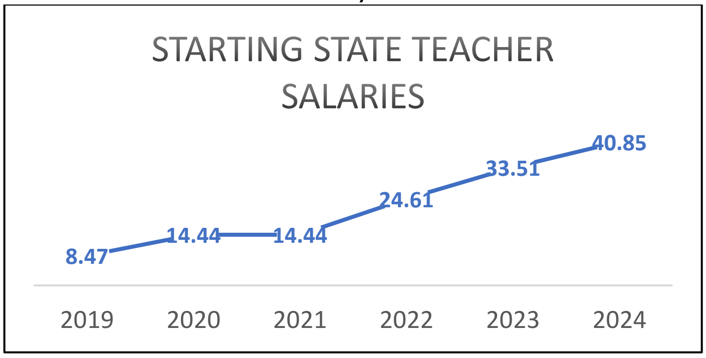
Teaching shortages in England have been well reported in the press. One of the contentious aspects of the levying of VAT on school fees is that it will allow another 6,500 teachers to be employed. Good luck in finding them! Many schools – not just those in the maintained sector – are finding it impossible to appoint qualified staff in many subject areas – especially in key subjects like Computer Science, Design Technology, Maths, Physics, Business Studies and Economics.

We continue to appoint fantastic staff who are not just accomplished and motivated classroom practitioners, but who also want to play an active part in boarding school life, don't mind teaching on Saturdays, and who contribute to coaching sport and running activities. Teaching at Blundell's is truly wonderful – great kids, wonderful environment, good food, etc – but it is demanding. It is 6-days a week and it involves regular evening duties until 22:30 at night. Coaching sport can involve returning from away matches late on Saturday evening. It is a big commitment, and it is not for everyone. What we have found in recent years is that for normal teaching jobs, the list of applicants to choose from is getting shorter and shorter. All we need is one outstanding candidate and we manage that – but the fields are getting smaller. I remind myself every day how fortunate we are to have such a strong teaching staff, because we cannot take it for granted.

Being able to attract the best staff is fundamental to the success of the school and offering an attractive package is essential. However, that is becoming a challenge as the state sector has seen above inflation wage increases since 2017. Chart 2 indicates that following the pay freeze immediately following Covid (which also was the case for Blundell's staff), salaries in the state sector have risen at a rapid rate. Matching that is a challenge and adds to the cost pressures of schools like ours.

A starting salary for a newly qualified teacher is just over £30,000 – which is comparable to other industries, except that there are no bonuses, and no big pay rises to look forward to in the future. That is someone with a minimum of two, and often three degrees (and the student debt to prove it). Someone working 40 hours per week on the minimum wage would be earning around £24,000 p.a. It highlights some of the challenges we face in the education sector when you ask teachers to work +50 hours per week. Of course, teachers get terrific holidays, but if you are working six, sometimes seven days a week, then those holidays become a necessity rather than a luxury if you want energetic and inspirational staff. That is not to say that staff are discontented by any means, but it is important structure a package that will attract excellent staff – but it also highlights why it is sometimes difficult to entice Maths, Physics or Economics graduates from fields where their earning potential is considerably more.

Chart 2: Teachers' salary increases



Source: institute of Fiscal Studies

There are other factors too, like the high levels of inflation and higher energy prices. The Governors' decision to prioritise investment in energy efficient interventions over sports facilities was prudent and we are now benefiting from lower energy costs. It pains me to think that my Headship will be remembered for roofs, windows and solar panels; we certainly have spent a fair bit on those in the past few years. Those projects are not especially sexy – not like shiny new sports facilities or teaching blocks – but they are part of making good decisions for the long-term financial robustness of the school. Any investment requires a trade off, and we have prioritised energy efficiency. That is not only financially smart, but it is also ethically the right thing to have prioritised.

And finally, our new government has recently introduced contentious policies around Business Rate Relief (BRR) and VAT on school fees. BRR relief will cost the school approximately £250k per annum. We have approached the council to ask for their consideration in this regard, appealing to them to phase in the increase over a few years, but that was rejected out of hand.

VAT has been well debated in the national press, and I have little to add to that. It is what it is. As a school we made the choice to share the load with parents. The mitigating discount that we have offered parents who have been exposed to VAT will cost the school around a £1m this academic year alone. We are fortunate to be in a robust financial position, despite the headwinds of the past few years.

I try not to dwell on what the financial picture might have looked like without these setbacks: what we might have been able to do. It is what it is.

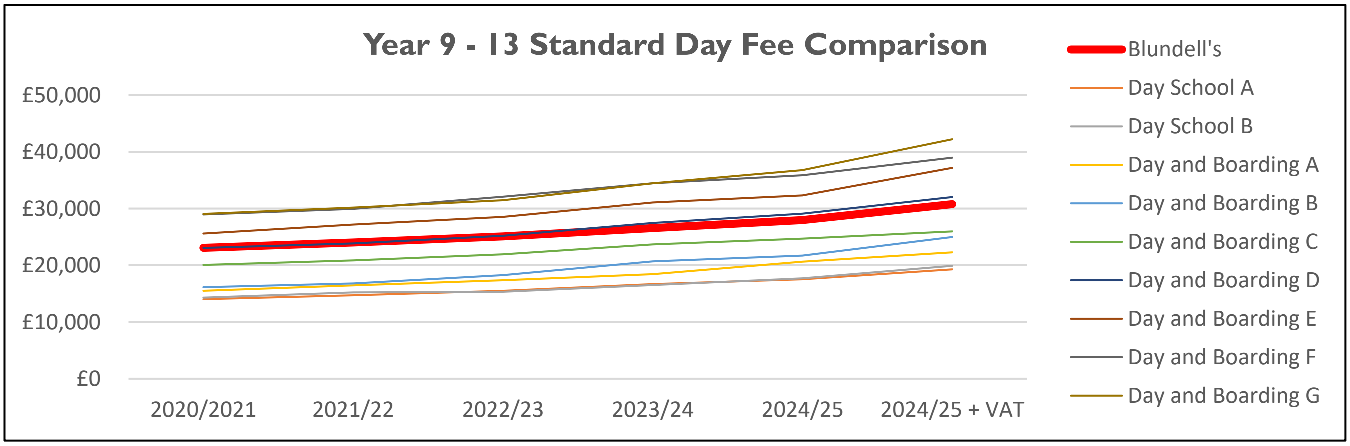
School Fees: A careful balancing act

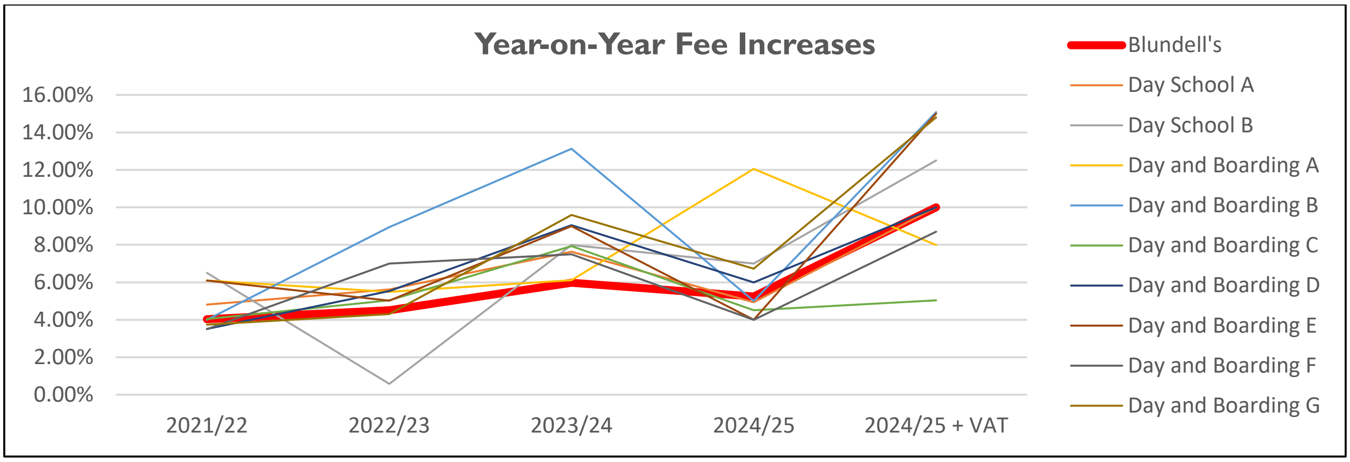
There are four main factors that are considered when Governors make decisions on fees:

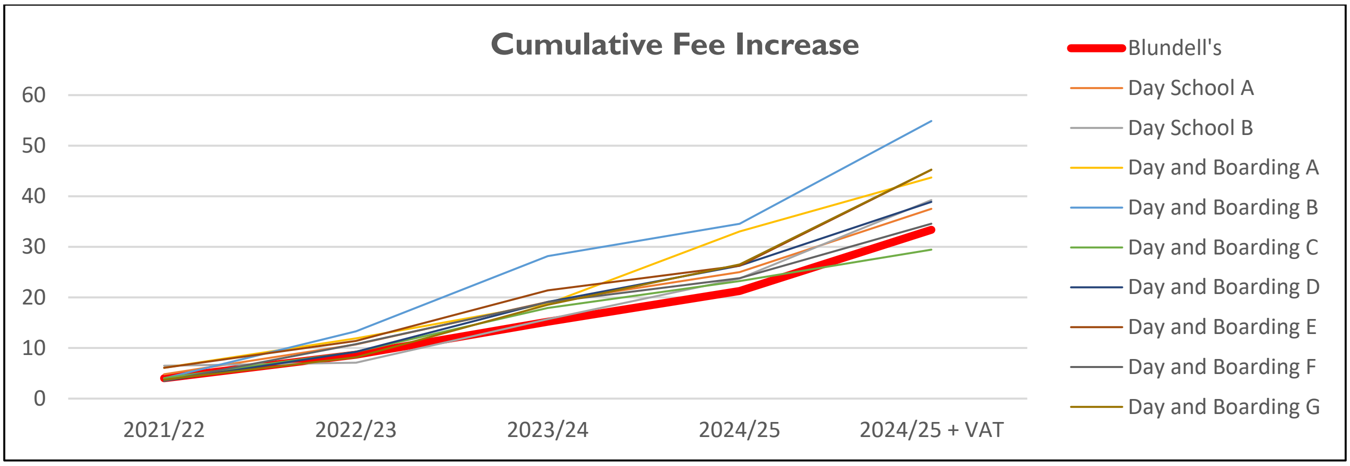
1. Economic environment – as explained above with regards to inflation and wage growth, for example.
2. Costs of the school. What do we need to pay staff and what other costs (like TPS or higher food costs) need to be covered?
3. Pupil numbers for the forthcoming year. Full Boarders contribute more to the bottom line than local day pupils, so it is not just what the numbers look like, but also the distribution of day pupils and boarders.
4. What are other schools doing with regards to fees?

The first three are largely self-explanatory and I have referred to them already, but the depth of analysis that goes into monitoring competitor school fees may be of interest.
For the past 6 years we have collected data on approximately 20 schools in the South-West and we therefore have an accurate picture of how school fees at other schools are tracking. This forms part of our decision-making when we set the fees. We have data sets for every section of the school community and below I have shared one set of data with you.

<u>Year 9 – 13 Standard Day</u>







- In the sample of ten schools in the South-West the highest fee is £42,233 and the lowest is £19,289, although at Day Schools the lunches are charged over and above the fees. At £30,789, Blundell's fees are 5% above the mean. In 2020/21 we were 10% above the mean and we have intentionally brought this down to its current level of 5% above the mean.
- In the second chart the Blundell's line is less erratic than most other schools. Most lines follow a similar pattern but there are some exceptions.
- The range in the cumulative effect of fee increases over this period is not as big with the bottom end being 29.45% and the top 54.88%. Blundell's is second lowest at 33.37%.

One pattern stands out across all the sectors, and that is that our year-on-year fees are more stable and less erratic than any of our competitors. I would like to think that is because of careful financial planning and thoughtful decision making.

Other Revenue Streams: Sweating the Assets and Foreign Ventures

Before 2018 Blundell's had little in the form of alternative income streams, and one of the first objectives was to establish a profitable lettings programme to ensure that the school was generating income during the holidays, especially during the long summer break.

After launching the initiative in 2019 it was all put on ice during Covid, and the programme was relaunched in summer of 2022. We have now had three years of summer holiday lets and the revenue in 2024 was around £500k, with a surplus of approximately 30% - 40%. We are learning quickly, and we believe there is more scope in this business. The intention is that the money we make from lettings goes back into the school, and specifically into investing in the boarding houses. We are also exploring lets at other times of the year although this is much more disruptive as pupils would need to pack up their rooms to accommodate these.

Many UK independent schools receive an income from schools abroad. We have been exploring opportunities and are actively engaged with partners in India and China. Nothing has come of that yet, but we remain open to the idea. There are different models of partnership, ranging from the school constructing the building from the ground up, to a simpler and less lucrative franchising arrangement.

Capital Expenditure – Shiny New Things

We were very pleased to be able to announce a £4m investment in new sports facilities very recently. It has been a long time in coming and it has been a frustration that we have not been able to do things sooner.

As I have explained earlier in this piece, cash flow has been a key aspect to this and the various headwinds that we have faced has meant that the cash that may have been available to spend on new facilities has gone into ensuring that we remained financially robust through the pandemic and that we did not need to pass all the VAT onto parents.

In addition to that, the school had a substantial loan that we have been paying off at a rate of £500k per year. Of the annual cash surplus of approximately £1m, more than 50% has gone into loan repayments leaving the other £500k for smaller projects – and there have been many of those. However, it has not allowed us to do any major projects, and we also have not wanted to increase our borrowing.

Having said that, we have not stood still, despite all of the above. We have redeveloped spaces like the FoB's Café and the Beale Centre. The Maths Department has been completely refurbished, and the Music School has been extended and refurbished. Petergate has had substantial investment and lower grade refurbishments have happened in the Geography and History departments. New lights have been erected over the hockey pitches, and investment in excellent equipment has allowed our grounds department to do their jobs brilliantly. Roofs have been replaced, windows double glazed and solar panels attached on every roof top available. At the Prep School we have installed a new science lab, added a dance studio and also added solar panels. We really have not stood still, but we also have not had a signature piece of work done.

Our long-term loans are almost entirely paid off and our annual servicing of that debt will fall from £544k per annum to £144k per annum. This means we have more cash left over and it means that we can borrow a bit too. We have also been given a generous gift from an Old Blundellian, and we have sold a small parcel of land. All of this means that we can commit £4m to investment without it impacting on the profit and loss account.

The £4m will be spent primarily on sports facilities and will include a new ¾ size astro pitch (MUGA – Multi Use Games Area) at the Prep, a resurfacing of the older astro at the senior school, investment in outdoor cricket facilities, work in the Sports Hall, and an extension, refitting and re-equipping of the Fitness Suite. The second phase of the project will see an extension and refurbishment of the Sports Pavilion to include better changing facilities, an entertainment area and classrooms and offices to house the PE department. We also intend to put a roof over the swimming pool.

Future development – ensuring we continue to invest in the site

Capital Expenditure is financed through three sources of finance:

1. Cash Surplus: This is the difference between cash received (fees, lettings income) and expenditure (salaries, food, energy, maintenance, etc). Some of that cash surplus goes towards servicing of debt and the rest is available to be reinvested in the school. It is also sensible to build up cash reserves for the proverbial rainy day – or pandemic or earlier than anticipated VAT charges and the like.

2. Donations and Legacies: The school is fortunate to have a generous and supportive community of Old Blundellians and past and present parents who have supported the school in different ways. We have not run a specific campaign for some years, but many school will raise millions towards specific projects through the generosity of its community. Donations fall into different categories:

    a. Restricted Funds – Bursaries: Some donations are made with the specific intent of giving financial support to pupils who could otherwise not afford to come to Blundell's. Sometimes those funds are intended to be spent immediately, but more often than not we manage them as endowments whereby we draw down a certain amount per year but keep the capital sum intact. That allows the donation to continue to support pupils in perpetuity.

        As an example, from a fund of £1m we would draw down £40,000 (4%) per annum to support bursaries. If the fund grew at a rate faster than 4% then the fund would grow. If it performed poorly and returned less than 4%, we would still draw down the £40,000 and the fund would shrink a little bit. Restricted funds mean that the money must be used for the specific purpose for which it was intended. That can be quite broad (for bursaries) or it can be specific (for pupils want to learn to play the organ). The school usually does not have much control over the restriction.

    b. Restricted Funds – Capital Projects: Some donations are made for a specific purpose. For example, a gift may specifically be for the chapel or the theatre. The school can therefore only use the money for that purpose. Money raised through a fundraising appeal aimed at a particular project cannot be repurposed for something completely different without the agreement of those who made the donations.

    c. Unrestricted Funds are gifts and donations made to the school without any specification. These are what are known as unrestricted funds and can be used for any purpose the school sees fit.

3. Borrowing: The school has worked hard to pay down its debts over the past 10 years. Borrowing does allow a good cash injection and in recent years interest rates have been relatively low. However, it ties up cash during the duration of the loan period. As with all borrowing, it is cash now instead of cash later and at times that is perfectly sensible and economically justifiable. However, at a time when we have used up quite a lot of cash, there has been an understandable reluctance to commit to more cash outflows whilst the debt servicing commitments were quite significant. At the end of 2025, a large proportion of the long-term loan will be paid and that will free up opportunities to borrow more money. However, we need to strike a balance between securing new loans and building up our cash reserves.

Final Comments

Sound financial management has never been more important in Independent schools than it is in our current tumultuous times. The challenge is to find the appropriate balance between managing costs and increasing fees. If we cut costs too much then parents pay more for the same, or an inferior product. On the other hand, raising fees more allows more investment, but fees are already out of reach for many families. To me, the target is to ensure that we provide good value for money. It is more palatable to pay a lot for something that is very good, and that is the target.

As someone with far greater credentials than myself once said: "It is better to have a great product at a fair price, than a fair product at a great price".