SAIS Fundamentals Conference

April 16-18, 2023 | Charleston, SC
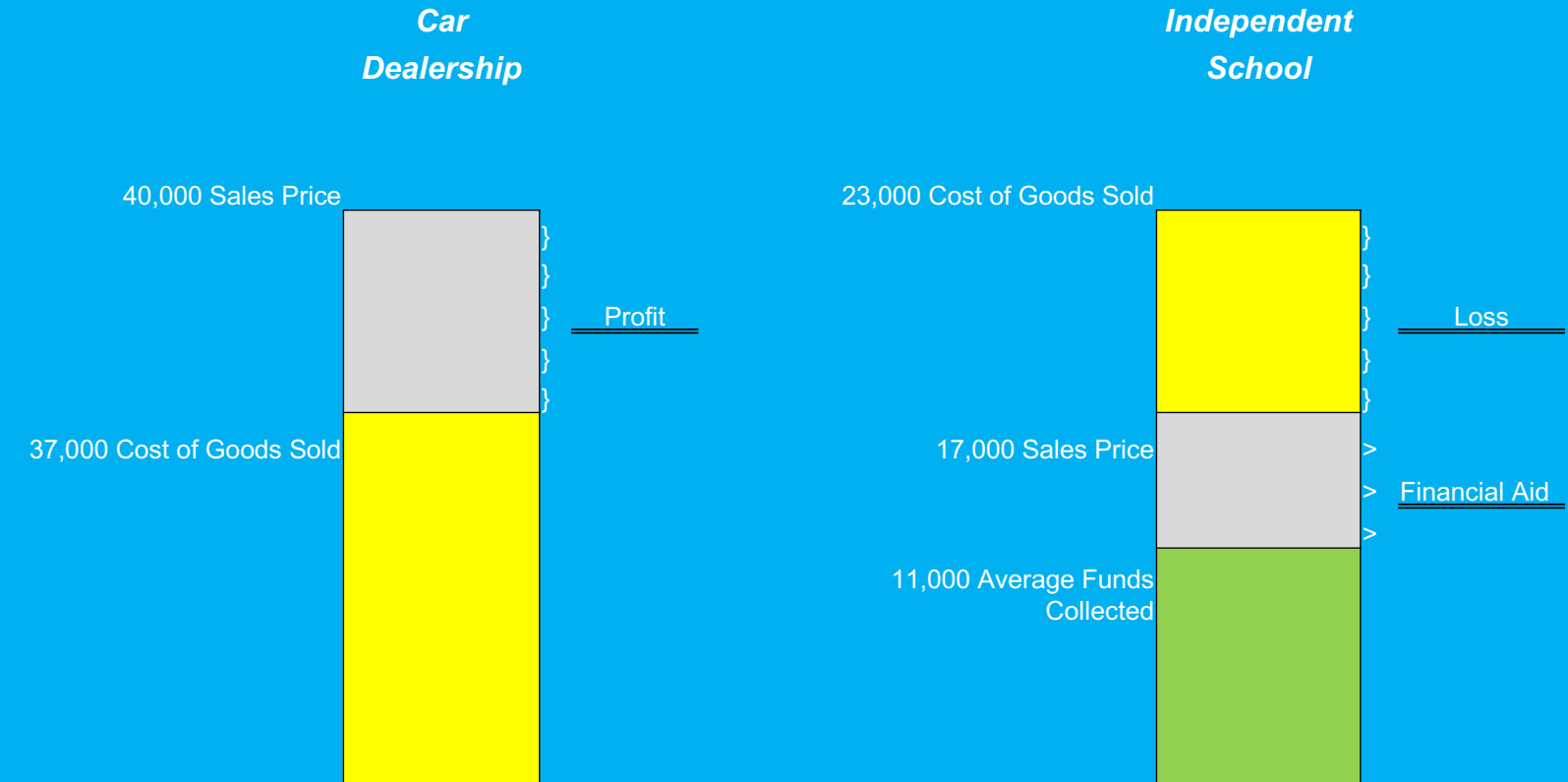
Independent School Finance

Palmer Ball

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Most Independent Schools are a Bad Business Model…

… they charge less than it costs to educate each student!

Most Independent Schools are a Bad Business Model…

Most Independent Schools are a Bad Business Model…

How many home builders sell a house for less than what it costs to build the house?

How many restaurants sell a meal for less than what it costs to prepare and serve it?

How can schools afford to sell their product for less than it costs?

They cover the shortfall through annual fund donations, endowment earnings, auxiliary operations, etc.

Most Independent Schools are a Bad Business Model…

It is helpful to calculate the "tuition gap" and let parents know what it is.

It is not uncommon for the gap to be in excess of $5,000 per student.

When parents complain about how much the school is spending on financial aid, the school can tell them *every* student is effectively getting a financial aid award of *at least* $5,000.
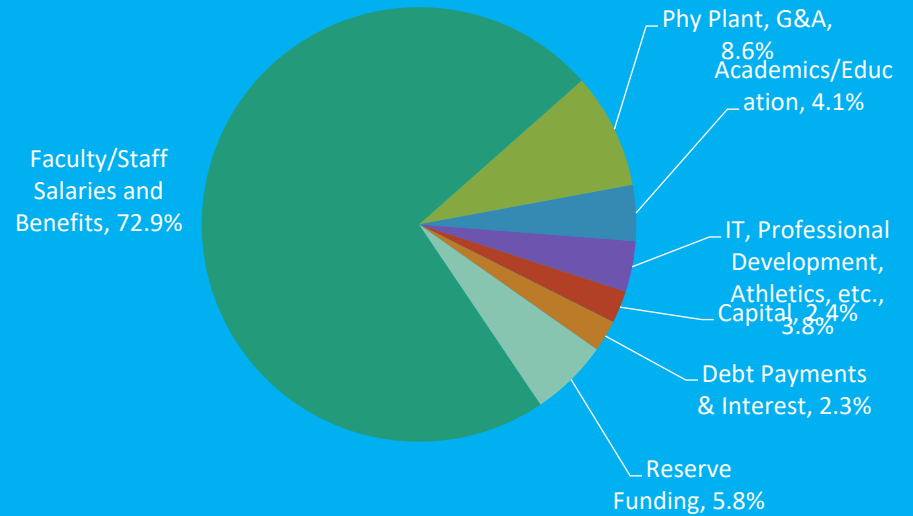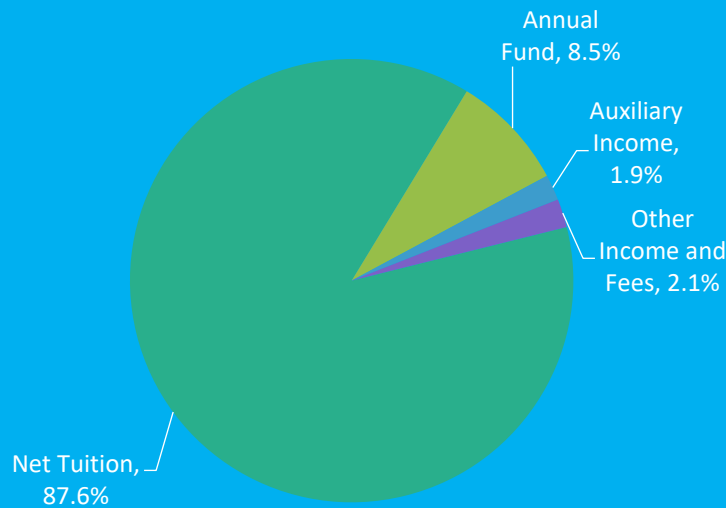
General Financial / Miscellaneous Information

Typically, net tuition revenue represents 70 – 90% of a school's revenue.

Typically, salaries and benefits expenses represent 70 – 90% of a school's expenses.

Thus, tuition dollars typically pay for employee costs (i.e. tuition pays for the faculty and staff) and all other expenses of the school are paid by gifts, earnings, other revenue sources, etc.

On the expense side, the largest expense categories, besides salaries and benefits, will be debt, financial aid and physical plant costs (primarily utilities).

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General Financial / Miscellaneous Information - Revenue and Expense Pie Charts

General Financial / Miscellaneous Information

Financial aid (including tuition remission) is typically 20 – 22% of gross tuition (discount rate); many schools are spending > 30% on financial aid, which negatively impacts their future financial viability.

Over the last 10 years, on average, the largest employee headcount growth has come in the area of Instructional Support staff (counselors, learning support, trainers, etc.), which are typically "customer service" areas.

- This gives the appearance that faculty salaries have stagnated while non faculty salaries have grown, but the non faculty salary growth has primarily come from <u>new bodies</u> in the Instructional Support area, not necessarily from higher salaries to existing staff.

School safety and Covid concerns are clearly impacting budgets.

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General Financial / Miscellaneous Information

Be aware of FTE (Full Time Equivalent) Creep, whereby employee headcount numbers increase even when enrollment is flat or where FTEs remain the same or go up when enrollment drops.

Make pricing changes gradually vs large every few years.
- How do you boil a frog?
- For example, make a small change in lunch prices every year (5 cent increase each year vs 25 cent increase every 5 years)
- Increase the deposit slightly each year vs a large increase every 2 – 3 years
- the school won't get credit for having not increased fees for 5 years, but they will get criticized for the big increase

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General Financial / Miscellaneous Information

No school can fund every program they want to have. You need to evaluate your programs and occasionally drop some – you can't continue to add a new program every few years without dropping some. Pat Basset's quote that I love is *"If you add Chinese, you have to drop German."*

Another quote of Pat's that I love is *"can you afford to be the school that you have become?"* Along those same lines, can *your parents* afford for you to be the school you have become, or, more importantly, the school you are *planning to become* in the next 5 years?

General Financial / Miscellaneous Information

How much of the budget CAN the Head of School control?

o Salaries and benefits are clearly the big ticket items and the most likely place to achieve significant budget cuts

o The next largest budgets typically contain service contracts and other items for which budget savings can only be achieved through efficiencies or renegotiating service contracts -
- o Physical Plant - utilities and service contracts (waste disposal, internet, alarm, HVAC, etc.)
- o General Administration - property insurance, copier leases, audit fees, student billing and payroll vendors, etc.
- o Technology - large leases and computer service contracts

o Thus, it is hard to expect budget managers to achieve 10% departmental budget savings, for example, when so much of the budgets are beyond their control.

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General Financial / Miscellaneous Information

How much of the budget CAN the Head of School control?

o   The budgets that are able to be managed for cost savings are more likely to be departmental or other budgets, but saving $500 in the English budget or $250 from the Yearbook budget isn't going to amount to much.

o   On the income side, there is not typically much to be made on auxiliary programs (summer camps, late stay, etc.), net of expenses, unless you have a pool or dorms.

o   From an endowment standpoint, very little is undesignated or board designated and available for unrestricted spending.

o   *End result – salaries and benefits are THE place for a Head to find significant budget adjustments.*

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Budget Process *(varies by school)*

A School's budget should support and be driven by it's Mission Statement, and when one exists, it's Strategic Plan.

Best scenario for budget preparation is when there is a strategic plan that maps the way. For example, budget preparation and Board support is easy if the strategic plan goal is for:

- faculty salaries to be at 85% of SE NAIS faculty salaries by 2025, 90% by 2027, etc., or

- tuition to be at 95% of a school's benchmark schools, or

- to strengthen STEM programming

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Budget Process *(varies by school)*

High Involvement – a Budget Committee comprised of administration and staff prepare and review the budget (faculty and board are possibly on the committee). This **would** include meeting with each budget manager and evaluating departmental activity and needs.

Medium Involvement - budget managers submit requests, Business Officer and Head review, prioritize requests, and prepare budget. This **might** include meeting with each budget manager and evaluating departmental activity and needs.

Low Involvement - most simplistic – Business Officer prepares budget based on prior year activity with limited input from others on campus **(likely a budget freeze situation).**

Variations could include Zero Based Budgeting, "super focused" budgeting on a set of rotating departmental budgets each year (i.e. each departmental budget might receive "super focused" attention every 5 years), etc.

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Budget Process *(varies by school)*

We used a "Rubic's Cube" budgeting process one year at my school to address the various "levers" of the budget:

- LS Head prepared salary increase,

- Technology Director prepared tuition increase projection,
- Development Director prepared enrollment projection, etc.

This demonstrated how decisions on one of these major "levers" of the budget impacted the other major "levers" similar to how changing one square of the Rubic's Cube changes the other sides.

The result was increased buy-in, understanding of the process, etc. by those most affected by budget decisions. This was especially important in the sensitive areas of tuition and salary increases.

Typical Budget Time Table

For a school with *solid* enrollment:

- Board approves in December, and
- Tuition and salary increases announced in Jan / Feb
  (boarding schools announce tuition earlier)

For a school with *less solid* enrollment:

- Board approves a *tentative* budget in January,

- Tuition and salary increases are announced in February, and

- Board approves final budget in May, based on enrollment contracts received to date.

Notice "cart before the horse" situation.

Typical Budget Time Table

For a school with *shaky* enrollment:

- tuition increase announced in February,
- salary increase and employment contracts
   released sometime between February and
   May,
- a *tentative* budget is approved in May, and
- Board approves final budget in September
   when enrollment is finalized.

Notice MAJOR "cart before the horse" situation.

(In prior years, I ran 3 budget scenarios that showed
opening enrollment of 480, 490, and 500).

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Typical Budget Time Table

For a school with less solid or shaky enrollment, it is obviously hard to decide salary increases and faculty headcount needs in January, when enrollment and staffing needs won't be known until spring or even late summer.

Due to this quandary, one year my school actually approved a very modest salary increase (2%) in January, but said if Net Tuition Revenue exceeded "x" in September, an additional amount *up to 3% more* would be provided, retroactive to the start of the new salary year.

Thus, the Board wasn't awarding salary dollars based on future students we *hoped* to enroll. And we hit the target that year and gave retroactive raises.

This also provided buy-in by ALL employees in the need to recruit students, and their role in that effort.

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Net Tuition Revenue (NTR) vs. Student Headcount

I am a HUGE believer that NTR needs to be the focus of everyone's Admissions efforts and NOT student headcount.

- o NTR = published tuition less financial aid award
- o NTR per student = total gross tuition less financial aid divided by the number of students in the school

School leaders need to zero in on the NTR (and NTR per student) being produced by students vs the number of students enrolled.

As Heads of Schools work with Admissions Officers, they should keep this philosophy in mind.

Exceptions can exist when a school needs warm bodies to be able to field a sports team (for example), but for the most part, the focus needs to be on NTR.

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Net Tuition Revenue (NTR) vs Student Headcount

Sample School Net Tuition Revenue Calculation	Headcount Focus	NTR Focus	
	Actual 6/30/19	Actual 6/30/20	
Net Tuition Revenue	4,485,101	4,766,527	
Increase in Tuition Income	244,526	264,375	
Change in Other Tuitions	-8,970	-19,663	
Change in Financial Aid	-183,740	36,714	
Increase in Net Tuition Revenue	51,816	281,426	
	0	0	
Percentage Change in Net Tuition Revenue	1.2%	6.3%	
Percentage of Tuition Increase Realized	22%	115%	
Net Tuition Revenue per Student	9,442	10,229	
Change in Net Tuition Revenue per Student	10	786	
Enrollment	475	466	
Change in Enrollment	5	(9)	
Percentage Change in Enrollment	1.1%	-1.9%	

Heads need to work with their Finance Committee and Board on this paradigm shift.

General Comments on Financial Aid

I think schools should consider Financial Aid to be a revenue generator to increase enrollment NOT an expense to be limited

I think schools should seek to receive more from their financial aid recipients, **on average**, than they give in financial aid awards.
- use 51% / 49% metric to track
- an 80% award needs to be counterbalanced by a 20% award

Set goals before financial aid award season on the number of new 80% + awards you will provide

Consider moving to Flexible Tuition to keep families in the admissions funnel longer (show range of tuitions on website)

Follow NAIS Best Practices

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The Importance of Tuition Insurance

Tuition insurance is an important tool that allows the school to "guarantee" its opening enrollment tuition dollars.

My school used to refund tuition to a family if they moved out of town during the year. Each year, I hoped and prayed we gained more new students mid-year than we lost.

Sure enough, one year we lost more than we gained and had a tuition shortfall, even though the budget was based on solid opening enrollment numbers. The next year we changed to a "no refund policy" and started offering tuition insurance.

The Importance of Tuition Insurance

Tuition insurance covers a portion of "missed tuition" if a student leaves the school. Thus, the school is guaranteed to collect a percentage of the tuition related to the missed days, even though the student is no longer enrolled. The percentage ranges and is commonly between 60 – 75% of the missed tuition.

Typically, schools require the purchase of tuition insurance by families on extended payment plans, but it is voluntary for parents that pay upfront.

Remember, the school's costs don't necessarily decrease if a family leaves (i.e. the 3rd grade teacher's salary doesn't decrease, etc.) so the school needs to count on those tuition dollars.

Bundling of Fees

Some schools bill students for every little thing (yearbook, graduation fees, computer lab fees, student activity fee, sports fee, etc.).

Other schools bundle their fees into tuition and bill it all at once. It is easier to bundle -

- o less manpower than managing multiple billings, collections, bad debt, etc.

- o less phone calls, questions and complaints from parents about each little fee
  - o downside - bundling might make the school's published tuition artificially higher than competitor's tuition, but that can be explained

- o will minimize "nickeling and diming" and will possibly allow financial aid to be applied to these fees.

- o prevents the possibility that a student might not take a class or participate in a sport because they can't afford the additional fees.

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Baumol's Disease *(aka the reason tuition increases faster than inflation each year)*

- Inflation is the change in the cost of a market basket of goods over one year (loaf of bread, gallon of milk)

- Technology leads to efficiencies that decrease costs in ***non labor intensive industries*** (i.e. technology helps make loaf of bread faster so more loaves can be made)

- The costs of ***labor intensive industries*** (i.e. K-12, higher education, medical profession, etc.) increase more than other industries because technology doesn't improve the efficiency / cost effectiveness
  - Smartboards or online classes don't eliminate the need for a teacher

- Thus, labor intensive industries' costs increase more than inflation

- Commonfund's HEPI (Higher Ed Price Index) shows school costs going up 2% more than inflation

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Baumol's Disease -
Higher Education Price Index (HEPI) Restated Tuition

Commonfund HEPI Index (Higher Ed Price Index) calculates CPI + 2%

Tuition	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
2% Tuition Increase	17,000	17,340	17,687	18,041	18,401	18,769
HEPI Conversion	1.16	1.13	1.10	1.08	1.05	1.00
Restated Tuition Using the HEPI Index	19,757	19,631	19,450	19,463	19,326	18,769
Effective tuition increase each year		(127)	(180)	12	(137)	(556)
				Covid 2nd Quarter		
3% Tuition Increase	17,000	17,510	18,035	18,576	19,134	19,708
HEPI Conversion	1.16	1.13	1.10	1.08	1.05	1.00
Restated Tuition Using the HEPI Index	19,757	19,823	19,834	20,041	20,095	19,708
Effective tuition increase each year		66	10	207	54	(387)
				Covid 2nd Quarter		

Miscellaneous Comments About Tuition

Research by ISM and NBOA shows there is NO correlation between tuition increases and changes in enrollment

Tuition Guarantees -

- Easy for High Schools (4 year commitment)

- Good Shepard Episcopal (Dallas, TX) (PS - 8) –

NBOA Innovation Award Winner - Net Asset Magazine, May / June, 2021

Continuous Enrollment –

- no longer ask families if they plan to return each year
- change the attitude / assumption that the expectation is students will return unless they tell you otherwise.

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Benchmarking

Feature of NAIS's DASL (Data Analysis for School Leadership) and NBOA's BIIS (Business Intelligence for Independent Schools) and many regional organizations.

Allows schools to identify other schools they want to compare themselves to.

Provides comparative information for the school and its benchmark schools. Comparative *salary* info is limited (MUST have 10 schools in the group and doesn't show individual school data).

I recommend 2 sets of benchmark schools (regional schools with similar enrollment in similar cities, and aspirational schools, even though larger enrollment and larger cities, higher tuition, etc.). Some differences with aspirational schools can be minimized by calculating per student costs (i.e. endowment per student, etc.).

Change in 12th grade tuition over 5 years compared to benchmark schools
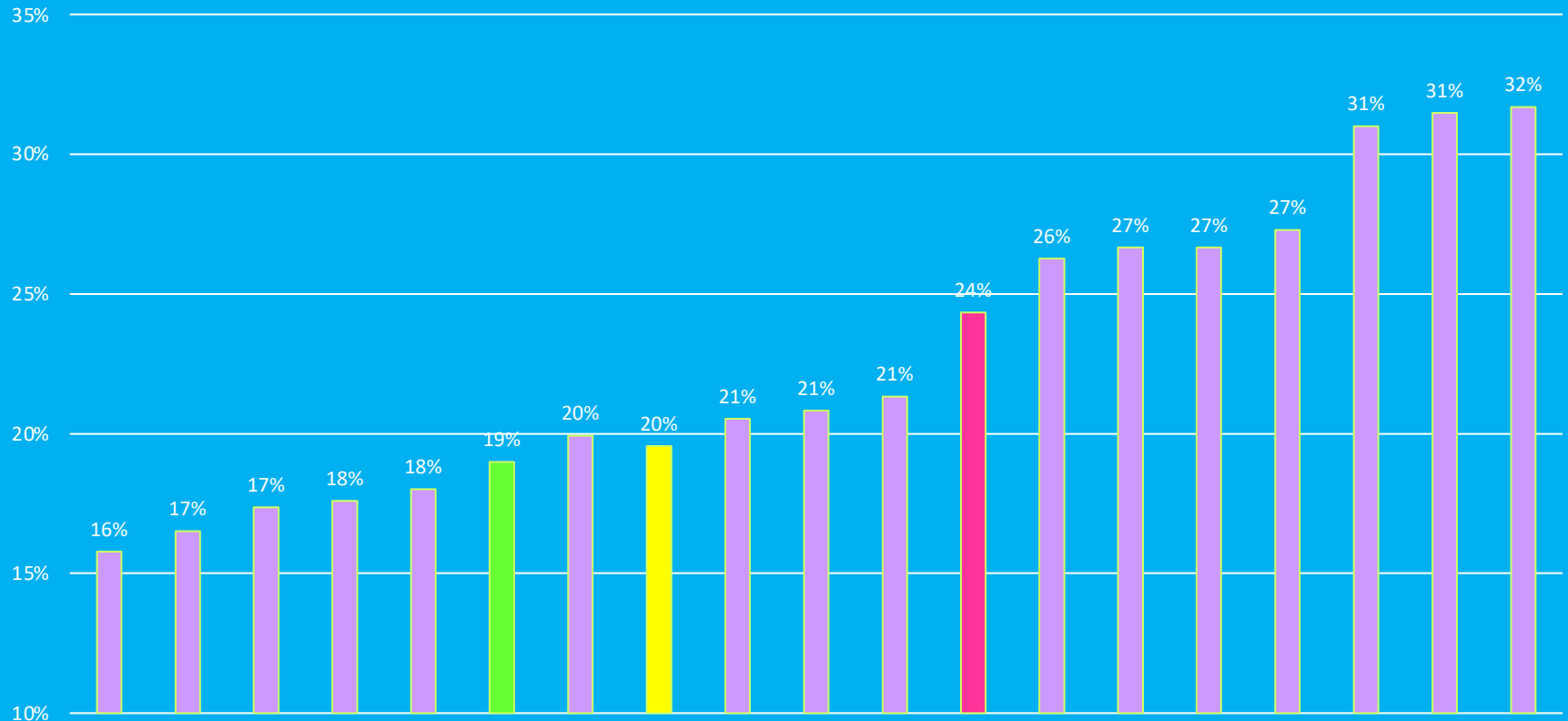
Heads need to be knowledgeable about…

There are a number of things Heads need to know about but others are responsible for overseeing, producing, managing, etc. Heads aren't expected to be experts on these topics, but they need to be familiar.

Most new heads won't know about these things. That's okay. Ask questions. Acknowledge you need to get up to speed on these things. Lean on your staff to educate you about these items.

A frequent complaint I hear from experienced CFOs is they want to teach their new Heads about these things, but the Heads feel threatened or insecure about their lack of knowledge with these areas and get defensive. Be honest. Acknowledge you haven't dealt with these areas in your prior roles. Ask for help. Lean on your CFO to teach you about these things. It's not a sign of weakness to not know about these things. Most people wouldn't have dealt with these areas as division heads, administrative leaders, etc.

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The Beginner's Creed by Peter J. Denning

I am a beginner.

I am entering a new game about which I know nothing.

I do not yet know how to move in this game.

I see many other people playing in this game now.

This game has gone on for many years prior to my arrival.

I am a new recruit arriving here for the first time.

I see value to me in learning to navigate in this domain.

There is much for me to learn:

> The basic terminology
> The basic rules
> The basic moves of action
> The basic strategies

While I am learning these things I may feel various negative reactions:

> Overwhelmed at how much there is to learn
> Insecure that I do not know what to do
> Inadequate that I lack the capacity to do this
> Frustrated and discouraged that my progress is so slow
> Angry that I have been given insufficient guidance
> Anxious that I will never perform up to expectations on which my career depends
> Embarrassed that everyone can see my mistakes

The Beginner's Creed by Peter J. Denning

But these moods are part of being a beginner. It does not serve my goal and ambition to dwell in them. Instead,

> If I make a mistake, I will ask what lesson does this teach.
>
> If I make a discovery, I will celebrate my aha! moment.
>
> If I feel alone, I will remember that I have many friends ready to help.
>
> If I am stuck, I will ask for help from my teachers.

Over time, I will make fewer mistakes.

I will gain confidence in my abilities.

I will need less guidance from my teachers and friends.

I will gain familiarity with the game.

I will be able to have intelligent conversations with others in the game.

I will not cause breakdowns for promises that I lack the competence to keep.

I have an ambition to become competent, perhaps even proficient or expert in this game. But for now,

I am a beginner.

Shared by Howard Teibel
Teibel Education Consulting

Outsourcing

Many schools outsource services such as janitorial, landscaping, food service, bookstore, security, payroll, student billing, HR, etc.

Pros –
- o Corporate resources are available in case of on-site personnel emergencies (illness or death of employee, etc.)
- o Corporate expertise (tax laws, Covid requirements, etc.) is typically better than in-house expertise
- o Assumption of all personnel issues related to hiring and firing, turnover, unemployment comp, worker's comp, etc.
- o Many national companies provide Annual Fund and Campaign donations, investment in equipment and facilities, etc. ***This is typical and you should ask for it!***

Cons –
- o Typically higher personnel turnover, less loyalty to the school and staff, etc.
- o On-site operation is typically only as good as the on-site manager
- o Profit motive typically causes declining services in later years, requiring more oversight by school

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Insurance Coverages

HOS needs to be aware of major areas of coverage:

Property (flood, windstorm / hail, hurricane)
Automotive - school owned vehicles, buses
General Liability
Sexual Abuse and Molestation
Athletic Traumatic Brain Injury
Educators Legal Liability (including D&O)
Umbrella
Student Accident
Fiduciary Liability
Cyber Liability (recent Blackbaud Data Breach)
International Travel
Travel Programs (teacher led trips during summer, breaks)

Meet with the CFO and broker for their annual review and ask questions. Get the broker to explain the various coverages to you. Ask lots of questions. You are not expected to be an expert but you are expected to be knowledgeable. Participate in this meeting every few years, just to learn.

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Insurance Coverages

Recommend using a broker that understands nuances of independent schools (student trips, sports, nurses, etc.). There are several in this space that have great reputations.

There are brokers that will do free risk assessments of your campus and insurance coverages. They can also do safety and security audits.

Advice from your broker to find out any specific exclusions that would apply to schools
- o Football
- o Athletic Fields (flood in Atlanta - track not covered)

Plant Fund (PPRRSM)
(Provision for Plant Replacement, Renewal and Special Maintenance)

○ Physical plant is likely the largest asset on the school's balance sheet (larger than endowment)

○ PPRRSM is a sinking fund to counteract major expenses that would be difficult to absorb in a yearly operating budget (new boiler, HVAC units, new roof, resurface parking lot, etc.)

○ Facilities department should maintain a schedule of building replacement values and large capital items, as well as a long term capital maintenance chart

○ Rule of thumb is that schools should fund their PPRRSM account each year with an amount equivalent to 3 – 5% of plant replacement costs (could be hundreds of thousands of dollars per year)

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Capital Expenses and Capital Assets

Capital expenses are typically "bricks and mortar" things (roof, HVAC, driveway) or physical assets (computers, buses, etc.). Usually, the school sets a dollar threshold to be considered capital expenses (for example, assets > $5,000 each).

Capital expenses are required to be depreciated over the estimated life of the asset and thus are not recorded in the operating budget (i.e. departmental budgets), but instead in the capital budget.

Typically, funding for capital assets is separate from funding for operating budgets. Accreditation standards *require* that funds be invested in the physical plant / capital assets each year. This would explain why a school might have very limited funds for raises, but have available money in their capital budget for computers or equipment. These are truly 2 separate pools of money.

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Endowment

How much of your endowment is restricted (scholarships, department or program funds, etc.)?

- o How much is unrestricted and available for general budget support?
- o How much is quasi or board designated?

Total return withdrawal of 5% or less for budget support is considered reasonable

- o Does your school use a multi-year averaging calculation for annual withdrawals to weather the stock market fluctuations?

What if you need to draw from the endowment in a crisis?

- o Is any debt tied to endowment / liquidity?
- o Uniform Prudent Management of Institutional Funds Acts (UPMIFA) concerns if endowments are underwater due to market fluctuations

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Important Relationships

Head / CFO –

- Trust

- No surprises

- Keep CFO informed of any decisions / permissions you give budget managers. No surprises!!

- Seek the guidance of the CFO before making promises that you might not be able to deliver on because of outside requirements (accounting regulations, internal policies (i.e. no benefits to part time employees), etc.)

- Always consult with the CFO on any big decisions – not to "ask permission" but instead to ask what impact you might not have considered, the long term ramifications of your decision, etc.

- ALWAYS follow the proper channels – don't let a parent sidestep the Business Office for financial aid appeals, an employee sidestep the CFO's decision on something, etc. ALWAYS refer folks back to the CFO or else you will create a culture where they will go around the CFO to get to you to get the answer they want.

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Important Relationships

Head / CFO / Board – no surprises, no going outside the reporting channels, CFO should keep the Head informed of any direct communication from the Board, etc.

Head / Advancement / CFO – important that everyone is on the same page and everyone is in the loop on decisions made, permissions granted, etc.

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Session Evaluation

Scan the QR code or go to
www.sais.org/23FCpb
to complete the session evaluation.

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