Education sector insights series.

Independent schools: Beyond 2020

Navigating the new normal.

Re-set and rebalance – how independent schools are building business resilience.

Support through uncertain times.

No sector of the economy has been untouched by the fallout from the COVID-19 crisis – and the education sector has faced some of the toughest challenges right across the board, from early learning centres to universities.

2020 has presented a raft of unforeseen challenges to the 1,148 independent schools that are operating across the country, as they maintain their core focus on educating and supporting a new generation of Australians, some 600,000+ students in total.

With costs rising and uncertain revenues, independent schools have been working particularly hard on multiple fronts and with all stakeholders – helping students adapt to online learning fulltime during lockdowns, navigating the new rules for health, safety and social distancing when in the classroom, providing pastoral care, and helping sometimes financially-stressed parents to manage fee payments.

In a recent member survey by the Association of Heads of Independent Schools Australia (AHISA), one in five heads of independent schools reported a critical financial outlook for their school.

Many schools are offering fee reductions, deferrals and payment plans for those financially impacted by the pandemic crisis.

One in five heads of independent schools has reported a critical financial outlook for their school.

On top of this, school leaders are grappling with crucial business decisions, including staffing dilemmas and whether to spend on capital works – which typically enhance their competitiveness – or save for an unpredictable future.

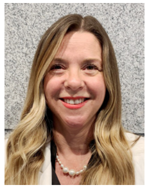
At Westpac, we've been working very closely with independent schools to help them manage through the crisis, offering support and, when requested, advice and services to improve prevalent cash flow and liquidity issues, delivering flexible payment solutions, and revisiting loan agreements.

We've learned a lot about the current dilemmas independent schools are facing and we've captured the highlights of our learnings in this report, 'Independent schools: Beyond 2020, Navigating the new normal', which draws on expertise from across the independent school sector, insights from Westpac partner organisations and our own skills and experience.

The report has been designed both to shed light on the immediate challenges being encountered and to explore independent schools' strategies for managing the now and the next.

It's a thought-provoking mix, and I hope you find it useful. Should you wish to discuss any of the ideas or insights on the pages that follow, please don't hesitate to be in touch.

We're here to help and we're always keen for your feedback.



Michelle Johnston, National Head of Education, Westpac Commercial Banking

Meeting the challenges of the COVID-19 crisis.

Rising costs and unpredictable revenues are the new reality for independent schools.

The COVID-19 crisis represents one of the biggest challenges in history – from a financial, educational and health perspective – for Australia's independent schools. As Independent Schools Council of Australia interim CEO Dr David Mulford observes, the sector is facing a "true black swan event" from which it will take time to emerge.

"Schools would have set their budgets back in November for 2020 and were only two months into the year when suddenly, whammo, the coronavirus hit," says Mulford, the former Headmaster of Newington College in Sydney.

In a sector that relies on student fees for the bulk of revenue, the pandemic's king-hit on the economy has forced some schools to offer fee cuts or payment deferrals, as families try to ride out the crisis. Simultaneously, operational costs for cleaning and the delivery of online learning have risen.

A recent member survey of the Association of Heads of Independent Schools of Australia (AHISA) found one in five principals are reporting a critical financial outlook for their schools, while 46 per cent have lost enrolments due to the pandemic and other recent events, such as last summer's severe bushfire season.

> "Schools would have set their budgets back in November for 2020 and were only two months into the year when suddenly, whammo, the coronavirus hit."
>
> **Dr David Mulford**, interim CEO, Independent Schools Council of Australia

The future remains uncertain, but as the crisis continues to play out Michelle Johnston, National Head of Education, Westpac Commercial Banking, says the bank is listening to customers and deploying financial market specialists to assist with any funding and transactional needs. "Westpac is here to help," she says.

This report examines the challenges schools are facing and how they can respond and recover.

Snapshot of Australia's independent schools sector, pre COVID-19.

1,148
NUMBER OF INDEPENDENT SCHOOLS IN AUSTRALIA

631,762
STUDENTS ATTENDING AN AUSTRALIAN INDEPENDENT SCHOOL*

Fees and funding:

$5,430
Median annual fee of an Australian independent school.

Average Australian Government recurrent funding per student:

$18,390
Government school.

$11,720
Catholic school.

$9,890
Independent school.

Staff and employment:

96,862
Total number of people employed by Australian independent schools.

19,350
Primary teachers.

30,620
Secondary teachers.

$7.4 billion
Total annual staff salaries and wages.

SOURCE: Independent Schools Council of Australia, 2020 NB: Statistics are from 2019 and derived from ABS, DET, and Productivity Commission data. Funding figures use the latest available data which is for financial year 2017-18 or calendar year 2018.
*The total student figure of 631,762 includes independent Catholic schools.

Mixed fortunes present across the sector.

Cash flow is a key focus, with some schools more critically impacted than others.

COVID-19 has disrupted cash flow for some, but not all, independent schools.

The immediate fear at the outset of the pandemic was that schools' revenue "would fall off a cliff and expenditure would continue unabated", according to Nigel Bartlett, Manager, Funding and Accountability at Independent Schools Victoria.

"That has not happened," he says. "We haven't seen large numbers of parents pulling their children out of schools mid-year."

What has occurred, however, is a multi-layered scenario. Well-resourced schools with financial reserves appear to be weathering the short-term cash flow crisis reasonably comfortably, while schools in lower socio-economic communities that receive most of their funding from government seem secure.

Caught in the middle are aspirational schools, including many in regional areas, which draw fairly high fees from families of significant to modest wealth who may now be doing it tough and thinking of moving their children into free government schools.

With jobs on the line, businesses struggling and housing prices facing potential vulnerability in some suburbs and towns, Westpac's Michelle Johnston says parents could be facing a 'double or triple whammy'. "Schools (catering to those families) are the ones I expect to come under greatest pressure," she says.

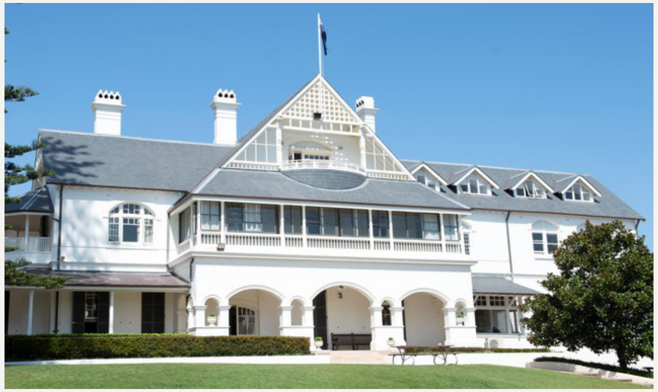
What to expect next.

Peter Goss, education sector consultant and former School Education Program Director at the Grattan Institute, says the next critical phase will be to assess enrolments for 2021, as financially squeezed families confirm their schooling decisions in a radically different economic environment.

He believes the continuing drag of COVID on the economy could result in quite substantial student withdrawals in the non-government sector, especially if government support programs are wound back early.

CASE STUDY: KAMBALA

Balancing priorities.



A resilient school community and careful planning and execution by the school's leadership have helped Kambala, a prestigious girls' school in Rose Bay, Sydney, fare well during COVID-19.

Michael Nicholls, Business Manager, attributes the good outcomes achieved by Kambala to a well-planned and executed approach to solving the challenges thrown up by COVID-19. The school has an appropriate risk and governance structure in place that befits the quite complex commercial and organisational challenges that come its way. He says, "The reality of schools like Kambala is that they're medium-sized businesses and so sound business practices and culture are called for."

Kambala took a sensitive and flexible approach to managing the financial challenges that families faced when paying fees. "We aimed to assist them to rebalance their personal financial circumstances after the financial shock of COVID. The feedback was that e-learning worked well, but parents were keen to get their girls back into a face-to-face learning environment."

Kambala has not put capital expenditure plans on hold. "But we'll monitor the situation and make decisions to match the circumstances we are in," Nicholls adds.

Strategies to alleviate the crunch.

Schools pull out the stops, from fee cuts to bursaries and deferred payments.

With lower or slower cash flow, school boards and leaders are expected to run the rule over all operational and capital expenditure costs.

Staffing costs comprise about three-quarters of independent school budgets. "So, it's much harder to turn that ship around in the short term because schools still need teachers," Mulford says.

> "Dropping fees would be a signal to the market that the school is under pressure – and that may well set off a downward cash flow spiral that it can't recover from."
>
> **Peter Goss**, Education sector consultant and former School Education Program Director, Grattan Institute.

Casual or contractor staff, especially in co-curricular programs, may be vulnerable. One third of schools have already stood down staff, according to the AHISA survey.

The survey also reveals that, in a bid to alleviate financial strain on families, 94 per cent of school leaders say they have allowed parents to delay their fee payments, 71 per cent have provided bursaries and 68 per cent have granted fee reductions.

While schools may continue to freeze fees, they will be reluctant over the longer-term to waive or cut fees dramatically because they have a business model based on being in demand and delivering, Goss says.

Salary reductions could also be on the table, Goss says, noting that the senior leadership teams at a number of schools have volunteered to take a pay-cut. "That's a difficult choice, but an admirable one."

Dean O'Neill, Relationship Director, Westpac Commercial Banking, says some schools are also seeking to ramp up fundraising and donations after a period of inactivity. "Cash flow is tight for everybody in the community, so that source of revenue will require a whole lot more attention and a smart strategy."

Alleviating financial hardship.

Insights from exclusive analysis of available data from Equifax on Australia's independent schools and demographics of fee-paying parents, indicate that[1]:

- Parents of independent school students have better than average credit quality and a high motivation to maintain payments.
- Many parents will have savings, investments or mortgage payments in advance that they are able to draw on to cover short-term financial stress.
- Schools may need to offer payment deferrals or other assistance to parents to help with short-term financial stress.
- When financially stressed, consumers prioritise mortgage payments over unsecured facilities. Similarly, parents are likely to prioritise school fee payments over other commitments, due to:
  - Emotional factors – friendship groups;
  - Perceived educational advantages;
  - Difficulty of re-entry to school due to waiting lists.

According to AHISA's member survey, three most common strategies adopted by independent schools to alleviate the financial hardship of families are[2]:

Delaying the payment of fees:	Providing bursaries:	Reducing fees:
94% OF SURVEY RESPONDENTS	71% OF SURVEY RESPONDENTS	68% OF SURVEY RESPONDENTS

SOURCES: 1. Equifax report **2.** Schooling and extreme events, AHISA member survey, June 2020

Getting a hand up from government.

A range of government measures has been designed to help schools through tough times.

Independent schools have, for the most part, welcomed a range of government initiatives designed to help them combat financial strain during the pandemic.

A $10 million school hygiene assistance fund is supporting COVID-19 cleaning efforts in non-government schools. "More than 2,700 non-government schools will share in $9.4 million under this measure to support schools to provide a safe learning environment for teachers and students," says a spokesperson for the Department of Education, Skills and Employment.

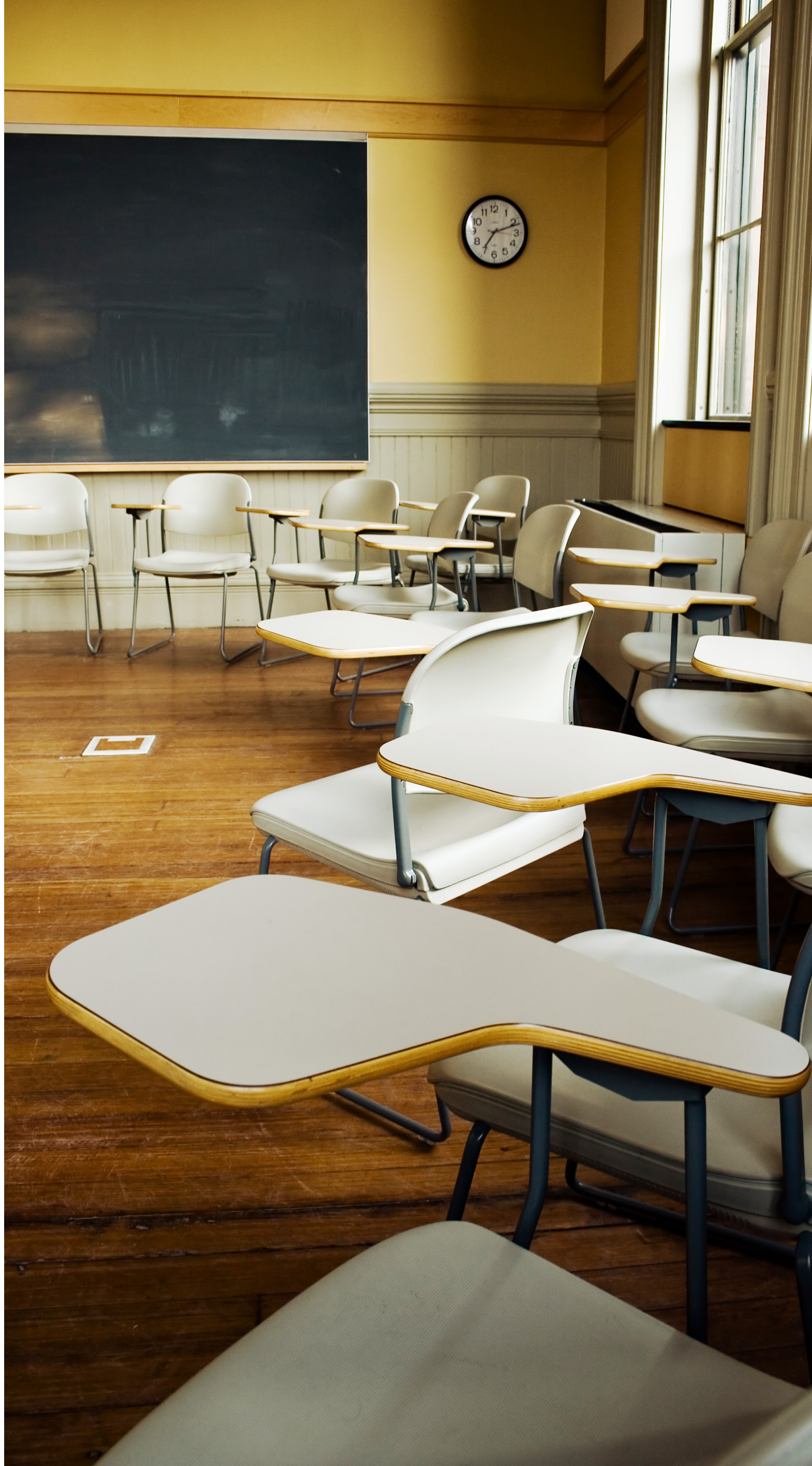
Schools have also been able to access JobKeeper payments and may have opted for early access to their July 2020 recurrent funding, which represents 25 per cent of their Commonwealth recurrent funding – eligibility for advances was based on schools having a plan to return to face-to-face learning. The Department of Education says this approach allowed schools to follow health advice relevant to their jurisdiction in determining when students would return to school, adding that nationally, a total of 678 schools opted-in to bring forward part of their July 2020 recurrent funding to May 2020, and 677 schools opted-in to bring forward payments to June 2020.

Bartlett says while the recurrent funding offer was not insignificant, "you'd need to be pretty close to the margin in terms of your cash flow for a 25 per cent Commonwealth payment being brought forward to actually make a difference".

All up, $82.2 billion of Commonwealth funding has been allocated for independent schools to 2029.

Key take-outs:

- **Aspirational schools with high fees but families of modest wealth are most at risk of enrolment withdrawals.**
- **Casual and contractor staff are often the first target for spending cuts.**
- **Dropping fees could be a signal to parents that a school is struggling, or in decline.**



Why flexible options are vital.

From lines of credit to changing payment methods, there's a multitude of ways to ward off liquidity woes.

To succeed in the post-COVID-19 world, schools will need liquidity – ready access to cash to cover expenses and make investments – at a time when usually reliable revenue streams from fees are under threat.

An IBISWorld report suggests revenue for private schools will decline 3.9 per cent in the current year, while sector revenue growth is expected to be subdued for the next five years.

A positive is that many independent schools have strong skills on their boards – accountants, bankers, lawyers and other professionals with capabilities and experience in liquidity management.

Payment flexibility.

Although most of its education customers appear to be faring well, Westpac has approved new credit lines to some schools to enhance liquidity.

O'Neill says the roll out of more flexible payment solutions for parents via PayWay, a secure online solution enabling businesses to collect and manage payments, has been of particular value to schools and parents.

It has given families greater ability to pay school fees in weekly or monthly instalments, rather than being locked into annual payments. "It's also made it easier for the schools to track and reconcile payments," O'Neill says.

Mentone Grammar, a Westpac customer of more than 25 years, is one school that approached the bank seeking alternative payment solutions. The co-ed grammar school in Melbourne has also negotiated with the bank for further financial assistance on a secured basis, if needed.

Johnston says Westpac's pledge is to respond quickly to school customers' needs during COVID-19. The bank has offered to waive any covenant breaches if borrowers cannot meet the terms of loan agreements.

While schools clearly try to avoid any such breaches, Johnston says, "we are prepared to give relief if it's required."

Keeping liquidity flowing.

Schools need to balance the competing priorities of financial performance with reputational risk in pursuing collection of overdue payments. According to the Equifax research[1]:

- Staff salary expenses represent the largest cost to schools.
- Schools have some ability to address a short-term drop in income by reducing expenses (e.g. staff and extra-curricular activities), deferring capital expenditure and borrowing.
- 89% of capital expenditure is funded by parents and community.
- Some schools have limited borrowings to fund capital expenditure: $3.8B in 2018 with debt servicing representing 1.3% of recurrent expenditure.

The AHISA survey shows most common strategies independent schools used to address COVID-19 financial challenges are[2]:

Applying for COVID-19 government assistance (eg. JobKeeper):
47%
OF SURVEY RESPONDENTS

Requesting delayed loan repayments:
22%
OF SURVEY RESPONDENTS

Seeking longer payment terms from suppliers:
12%
OF SURVEY RESPONDENTS

Applying for other government assistance (eg. federal Special Circumstances funding):
11%
OF SURVEY RESPONDENTS

SOURCES: 1. Equifax report **2.** Schooling and extreme events, AHISA member survey, June 2020

The capex conundrum.

In the balance is the need to calibrate for liquidity now and for building assets into the future.

Taking on more international students, initiating asset sales, or setting up new profit-making centres are among the options for schools to improve cashflow and liquidity.

Many independent schools have grown co-curricular and pastoral programs to add value to their whole child offerings, Mulford notes, but they may now be assessing the cost of these initiatives versus their value as a differentiator in a highly competitive market.

Westpac's Johnston believes any new revenue opportunities for schools will revolve around capital expenditure initiatives, such as classroom expansions, to increase student numbers and, in turn, fee revenue.

Conspicuous consumption?

One of the hallmarks of elite independent schools is their infrastructure. Great sports facilities and fields. Modern science labs. Inspiring music and creative arts spaces. But, as COVID-19 causes financial hardship for many families, schools have had to be wary of engaging in what maybe seen as 'conspicuous consumption' programs. Spending money on buildings at a time when parents may be suffering with fees, unless it is crucial to the education program, may not send a good message, Mulford says, adding that if enrolments drop post-COVID-19, the need for more infrastructure could diminish.

In preparing worst-case scenarios for the pandemic, many schools did discuss deferring capital works programs to ease pressure on liquidity and demonstrate financial restraint, Independent Schools Victoria confirms. However, Westpac observes some high-fee schools are now considering major capital expenditure programs again, while others are gearing up to invest in more classrooms to boost enrolments. "The fact that schools are considering those major projects is a sign of confidence," O'Neill says. "And now is a great time to consider such projects for schools that can afford it, because who can say how long the low borrowing costs will last?"

What do changes in global financial markets mean?

Despite the repricing of debt, affordable funding remains accessible.

As independent schools consider their financing options in the new normal, the cost of funding has risen. Internationally, there has been a major re-pricing and re-positioning in financial markets, which means that banks and markets are facing growing challenges in lending and funding due to the higher price of debt. Yet regulatory reforms in the wake of the GFC mean that major Australian banks now have greater resilience.

Acting CEO of Westpac Institutional Bank Curt Zuber explains that, along with the Australian Government's stimulus packages, the Reserve Bank of Australia has lowered rates by 25 basis points and implemented quantitative easing – conventional monetary policy never before seen in Australia.

"The central bank has bought about $50 billion in government bonds, which is critical in stabilising the bond market and providing liquidity," Zuber says. "We've seen a number of corporate issuers and financial institutions being able to issue in the marketplace again."

The RBA has also provided a term-funding facility to the major Authorised Deposit-taking Institutions (ADIs), which reduces the funding costs for banks like Westpac and, in turn, helps to reduce interest rates for borrowers. So what does this mean with regard to Westpac's approach to lending in the wake of COVID-19?

Westpac's Johnston says, while the bank's financial market specialists are having frank discussions with customers about the cost of funding and the implications for schools, they are still able to access affordable funding. "If a school is seeking more borrowing at the moment, because the cash rate is so low, those borrowings are still likely to be very well priced."

Key take-outs:

- **Funding costs have risen for banks as a result of COVID-19.**
- **The low cash rate means the price of funding for schools remains relatively low.**

Looking to the next normal.

As schools keenly watch their 2021 enrolment figures, strategic support is at hand.

As the impact of COVID-19 continues, state and federal governments are expected to ensure the viability and success of Australia's independent schools.

The commitment of independent school students' parents to pay fees is estimated to save governments about $4.8 billion a year in schooling costs, based on the extra funding that would be required if all independent school students attended government schools.

Given that economic imperative, Bartlett says all eyes will be on school enrolments in the medium to long term. "Because fundamentally schools rise or fall with their enrolment," he says.

Against this backdrop and given the ongoing dynamism in global financial markets, Westpac remains well-positioned to help independent school customers with strategic support and advice.

O'Neill says Westpac is ready and willing to help schools navigate this uncharted territory, including providing expertise within the bank through webinars on subjects ranging from cashflow and liquidity management to cyber security.

"We're a partner for the schools and we want to support them through a tough period."

> "We're a partner for the schools and we want to support them through a tough period"
>
> **Dean O'Neill**, Relationship Director, Westpac Commercial Banking

More information

This information is general in nature and has been prepared without taking your objectives, needs and overall financial situation into account. For this reason, you should consider the appropriateness of the information to your own circumstances and, if necessary, seek appropriate professional advice.

If you have any questions or would like to know more about the information contained in this report, please contact the author:

Author
Michelle Johnston,
National Head of Education
M: +61 403 125 714
E: michellejohnston@westpac.com.au

We're here to help.
www.westpac.com.au/education

The Westpac Group, 275 Kent Street, Sydney, NSW 2000, AUSTRALIA.