

Lynden Gate Residents Ltd

Accounts to 30th June 2014 and service charge projections

At the AGM in January 2013 we indicated that service charges could be held at £4,000 for the foreseeable future. We remain of that view and so now propose that fees for the company's financial year to 30th June 2016 are to remain at £4,000 per annum.

The "Directors' Report and Financial Statements" have been circulated with the AGM papers. In this note I explain our expenditure and financial position, both now and for a few years into the future. I also discuss the level of service charges that we will need to levy, outlining the unknown factors with which we have to contend and the choices that we will have to make.

The Basics

In very simple terms the annual service charge covers two types of expenditure:

- Administrative Expenses, typically £110,000 to £115,000 per annum for such things as salaries, garden maintenance, utilities, insurance and general running costs.
- Exceptional Items, mainly periodic or one-off maintenance costs, of which the periodic redecoration is by far the largest. The redecoration cost was £654,000 this time but may be up to around £900,000 each time in future depending on specification. In some years there have also been abnormal, non-recurring, Administrative Expenses, mainly legal expenses relating to litigation.

The annual accounts always show a profit and cash surplus in a year when there is no redecoration. This profit is accumulated and held as a "Reserve for redecoration" which recognises the future liability to redecorate. Likewise, the balance of cash built up in the balance sheet will eventually be spent on the redecoration. In the years in which we carry out a redecoration we make a loss which reduces both the balance of that reserve and, obviously, the balance of cash in the balance sheet. Then we start all over again.

There are 70 houses on the estate and last year the annual fees were £4,000. In very rough terms £1,600 of this covered the Administrative Expenses and £2,400 was accumulated to provide for the Exceptional Items, that is, the periodic redecoration and other one-off maintenance costs.

The last few pages of the Directors' Report and Financial Statements show the accounts in summary over the last 5 years.

Administrative Expenses

There are no major issues relating to normal Administrative Expenses although residents may wish to quiz directors over their stewardship. The summary of the last 5 years shows a fairly consistent annual cost of around £100,000-£115,000.

Redecoration and maintenance costs

Routine repairs and maintenance (of the gates and pumps for example) is included in Administrative Expenses. In addition we incur larger amounts of one-off redecoration and maintenance costs. These account for about 60% of the service charges.

The cost of redecoration is the single most expensive item although we currently only spend the money once every 5 years. The total cost of the most recent redecoration was £654,000 of which

approximately £30,000 was spent on refurbishment of the gate house. Of the total redecoration cost, £207,000 was accounted for in 2012/13 and £447,000 has been expensed in 2013/14.

We occasionally incur smaller one-off maintenance costs and, as the estate ages, we need to be prepared for such expenditures. In 2013/14 £5,180 was spent on a new buggy for rubbish collection and a new computer for the office.

In the balance sheet the outstanding balance due to Creditors comprises, Trade Creditors, that is, outstanding contractors' invoices for the redecoration as at the accounting year end (30 June 2014) and Other Creditors, being cash held by the company on behalf of residents for discretionary property repairs.

There are several choices that we have to make in managing these costs and providing the funds for them. These are discussed below in the context of a review of our long-term maintenance requirements which was carried out for us in 2009 by King Sturge and which is due to be updated in 2015.

The key cost drivers

The King Sturge review identified 4 main areas which will drive our costs:

- continual one-off repairs such as road patching or drain repairs;
- the periodic redecoration;
- replacement of the total road surface;
- replacement or repair of all underground services – drains and electricity.

Continual one-off repairs covers items such as the repairs to the road surface as it ages, plus maintenance and repairs for drains, other utility services, walls or any parts of the common estate. This does not cover routine and minor maintenance costs which are included in Administrative Expenses.

It is impossible to forecast the level of continual one-off repair costs with any accuracy. For the purposes of fee calculations we have assumed £20,000 per annum for the foreseeable future.

The periodic redecoration cost of £654,000 for the recent redecoration is considerably cheaper than the £900,000 that we had been expecting and which we might need to spend in 2018/19. So we were right to avoid the Olympics year, and we also benefitted from a particularly competitive period in the construction industry.

Although we have in the past had a redecoration every 3 years we now believe that the consensus is that we should go for a 5-year gap. The gap between redecoration has a substantial impact on annual fees. The longer the time between redecoration allows more years over which we can save up the required funds though the renovation work may need to be somewhat more extensive given the elapsed time since the last maintenance cycle. Typically, a "Mid-term" mini redecoration is undertaken to address the more pressing maintenance matters.

The replacement of the total road surface would cost at least £1,000,000. It would be a major logistical exercise, probably involving the demolition of some garages to allow alternative access to the site. Something of a nightmare but, as has been discussed in previous years, we do not believe that this work actually needs to be done. The subject was first raised as a cosmetic exercise, increasing the value of our properties by having a better looking road. Time has passed and economic circumstances have changed and we do not believe there would now be any consensus of residents' opinion in favour of such a project unless it became absolutely necessary. We might well face the need to carry out underground repairs or replacement of substantial *parts* of the road surface but we would do this using our patching methodology and not as a total surface replacement.

Replacement or repair of all underground services would only arise if we were to undertake the replacement of the total road surface. In those circumstances it would be foolish NOT to replace the underground services. However, since we do not believe we will go for total surface replacement, we are similarly unlikely to go for total replacement of underground services although we might well have to deal with them piecemeal.

All in all this is a picture that continues to have many uncertainties and variables. Now that the current redecoration has been completed the Board intends to work with Jones Lang LaSalle to update the 2009 long-term maintenance plan. The results of the planning process will be shared with residents to agree a programme of major works. The programme of work will be an essential input to the long-term financial plan which will also include allowance for the operating costs of the estate plus savings to fund future redecoration and discretionary works.

Meanwhile, let us now turn to the level of service charges that is appropriate given the current situation, foreseeable anticipated expenses and the uncertainties.

Service charges

We believe that residents do not wish to be faced with cash demands out of the blue to deal with emergencies or unforeseen circumstances and that, given the degree of uncertainty in requirements, it is better to build reserves and prepare for generously estimated costs. The lower than expected cost of the current redecoration has given us a cushion that leaves us comfortably placed to deal with any likely future requirements. But we should plan for a much higher cost (around £900,000) in 2018/19

It was agreed at the AGM in December 2012 that we would set service charges to £4,000, probably for the foreseeable future thereafter. The word “probably” was inserted because although this feels like a long-term commitment, in practice we only make the decision for one year at a time and all assumptions are reviewed before setting the charges for the next year.

The impact of all the current assumptions, is:

- service charges stay at £4,000 per annum
- Administrative Expenses are assumed to increase on average at 2.5% per annum
- there is an underlying annual Operating Profit (accumulated for redecoration and one-off repairs) of around £160,000 on average over the 5 year forecast
- there is an interim “touch-up” in the summer of 2016 (budgeted at £40,000) and a new redecoration starting in 2018 expected to cost £900,000 (£300,000 in 2018 and £600,000 in 2019)
- we have allowed £20,000 per annum for one-off repairs
- there is no allowance for any substantial road resurfacing or underground work in the period
- there is no specific building of reserves for future road resurfacing or underground works although we do have a cushion created by the lower-than expected cost of the current redecoration ...
- so, if our assumptions here prove to be wrong, it might be necessary in the future to increase service charges.

These projections are similar to those made last year. We believe that they remain reasonable (although, as I am bound to say, we might have to face unforeseen circumstances). Therefore it will be proposed at the AGM in January 2015 that service charges for 2015/16 (i.e. through to 30 June 2016) be kept at £4,000 per annum as discussed above.