

Lynden Gate Residents Limited

Accounts for the year to 30 June 2015 and service charge projection

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, currently around £120,000 per annum for such things as salaries, garden maintenance, utilities, insurance and general running costs. Routine repairs and maintenance costs (of the gates and pumps for example) are included in Administrative Expenses.
- Exceptional Items, mainly periodic or one-off maintenance costs, of which the periodic redecoration is by far the largest. The last redecoration cost £654,000 but the expense may be around £900,000 in future depending on the project specification. In some years there have also been abnormal non-recurring expenses, mainly legal costs 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 the accounts will show a loss rather than a surplus, reducing both the balance of that reserve and 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 £1,700 of this covered the Administrative Expenses and £2,300 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. Actual costs in the financial year to June 2015 were £119,000. Expenses include, salaries, which were increased in line with London’s living wage rate, an upgrade to the Lynden Gate web site, repairs to the main gates and water pumps plus the usual gardening, audit, accountancy and general running costs.

Contracts for both electricity and telephone/broadband have been renegotiated with expected savings of 25% in each case. Overall Administrative Expenses are projected to remain around £120,000 in future years though subject to any underlying inflation.

Exceptional Items

Exceptional Items occur in the normal running of the estate but are typically one-off costs above the normal recurring expenses, typically where the benefits are realised over more than one year.

The cost of estate redecoration is the single most expensive item, accounting for about 60% of the service charges, although we currently only spend the money once every 5 years.

Annually £20,000 is budgeted for smaller one-off maintenance costs and, as the estate ages, we need to be prepared for such expenditures. In 2014/15 the exceptional item of £6,381 is primarily the cost of major tree pruning, including the removal of some conifers plus clearance to provide line-of-sight for the new security system and residual costs associated with the gatehouse renovation. Since the financial year end we have invested in the new security CCTV system, the cost of which will appear in next year's financial statements.

In the balance sheet the outstanding balance due to Creditors comprise, Trade Creditors, that is, outstanding contractors' invoices as at the accounting year end (30 June 2015), Corporation Tax due on interest earned and Other Creditors, being cash held by the company on behalf of residents for example, 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.

The Key Cost Drivers

The King Sturge 10-year maintenance review in 2009 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 next time. So we were right to avoid the Olympics year, and we also benefited from a particularly competitive period in the construction industry.

Paint technology has improved significantly in the past 30 years, with longer lasting paint permitting longer gaps between redecorations, so while originally the estate was redecorated every 3 years, we now believe that the consensus among residents is that we should continue to have a 5-6 year gap, as between the last two redecorations in 2007 and 2013. The gap between redecorations has a substantial impact on annual fees. The longer the time between redecorations the more years over which we can save up the required funds, allowing the service charges to be kept substantially lower. The renovation work may need to be somewhat more extensive given the elapsed time since the last maintenance cycle, however a mid-term "mini redecoration", as in 2010, can be 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.

There are several variables that allow us a degree of flexibility and options for the continual maintenance of the estate. The last major redecoration commenced in the spring of 2013. Some minor repairs will be undertaken in 2016 as part of the normal mid-term "mini redecoration". Planning for the next major redecoration is currently scheduled to begin in 2017, allowing plenty of time for consultation with residents on the timing and specification before any work commences in subsequent years. The programme of work for the next major redecoration will be an essential input to the long-term financial plan. The financial plan also includes allowance for the operating cost 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 prudently allow for a much higher cost (around £900,000) for the next redecoration.

It was agreed at the AGM in December 2012 that we would set service charges at £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 contribution to reserves (accumulated for redecoration and one-off repairs) of around £135,000 on average over the 5 year forecast
- there is an interim "touch-up" in the summer of 2016 (budgeted at £40,000) and, assuming a 5-yearly redecoration cycle, the next redecoration would start in 2018 and for budget purposes is 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 previous 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 2016 that service charges for 2016/17 (i.e. through to 30 June 2017) be kept at £4,000 per annum as discussed above.

Peter Brazier
16 Beaufort Close

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