

Why Are Service Charges Estimated and not Actual?

As a leaseholder, you may have wondered why your service charges are **estimated** rather than **actual**. This is a common question, and understanding the reasoning behind this can help clarify the process. The primary reason for estimating service charges is to ensure that the development has the funds needed for ongoing maintenance and services throughout the year, while providing an approximation of what costs may be.

This leaflet explains why service charges are based on estimates, and gives an example to show how the estimated costs can differ from the actual costs at the end of the year.

Why Are Service Charges Estimated?

1. **Unpredictable Costs:** Certain costs for maintenance, repairs, and services can vary throughout the year due to factors beyond anyone's control, such as weather conditions, emergencies, or unforeseen repairs.
2. **Budgeting for the Year:** The estimated service charge ensures that enough funds are available to cover the anticipated costs for the year. This gives the property management company or freeholder a budget to work with, even though some expenses might not be fully known at the time.
3. **Cash Flow Management:** The estimated figure provides enough working capital to continue paying for ongoing services (such as cleaning, maintenance, insurance) while awaiting the actual costs. The service charge income is typically collected upfront or in instalments to maintain smooth cash flow.
4. **Annual Reconciliation:** At the end of the year, the **actual costs** are calculated, and any overpayment or underpayment is reconciled. This means that if your actual service charge was less than the estimate, you might receive a refund or have the surplus deducted from next year's charges. If actual costs are higher than estimated, you may be asked to pay the difference.

Example Budget

Here's an example of a service charge budget with estimated and actual costs to illustrate how they can differ:

Category	Estimated Cost	Actual Cost	Explanation
Building Insurance	£3,000	£3,200	The insurer raised the premium due to higher-than-expected risk assessments
Cleaning Services	£2,000	£1,800	A change in the cleaning contract led to lower costs for the year
Repairs & Maintenance	£4,500	£5,200	An unexpected plumbing issue in the communal area required emergency repairs.
Garden Maintenance	£1,000	£900	Fewer seasonal plants needed, reducing overall gardening costs
Management Fees	£1,500	£1,700	Increased security needs due to higher foot traffic and added security systems.
Automatic Gate Maintenance	£1,500	£1,700	The gates required more frequent servicing due to mechanical issues, increasing maintenance costs.
Lift Maintenance	£1,200	£1,300	Increased service costs due to required parts replacement and extra servicing.

Why Do Actual Costs Vary?

- **Insurance:** The actual insurance cost can increase if the insurer raises premiums or if there is a change in coverage. For example, if the building is found to have increased risks due to external factors (such as a rise in flood risk), this can affect the premium.
- **Cleaning Services:** A decrease in cleaning costs might happen if fewer hours or services are required, such as fewer instances of maintenance or less frequent deep cleans.
- **Repairs & Maintenance:** Unexpected issues like a burst pipe, an elevator breakdown, or structural repairs can push the actual cost beyond the estimate. Emergency repairs are often necessary to keep the building in safe and functioning condition.
- **Garden Maintenance:** Garden maintenance costs can be affected by the weather and seasonal needs. If there's a mild winter, for example, fewer plants might need to be replaced, lowering the cost.
- **Management Fees:** These fees can rise if the property management company has to handle extra work, such as additional coordination for major repairs or increased administrative tasks.

What Happens at the End of the Year?

Once all actual costs are calculated for the year, a reconciliation process occurs:

- **If Actual Costs are Lower:** If the actual costs are lower than estimated, you may be entitled to a **refund** or a reduction in the next year's service charge.
- **If Actual Costs are Higher:** If the actual costs are higher than estimated, you may be required to **pay the difference** through a supplementary charge.

You should receive a statement detailing the difference between estimated and actual costs, along with any adjustments that need to be made.

Benefits of Estimating Service Charges

- **Predictable Payments:** By estimating the service charge, leaseholders can budget more effectively and pay regular amounts throughout the year rather than being hit with a large one-time bill at the end.
- **Flexibility:** The estimated charge allows flexibility in covering unexpected repairs or changes in service needs, without waiting for precise figures.
- **Transparency:** Leaseholders are given an estimated figure to ensure everyone is aware of the expected costs, with the understanding that final amounts will be reconciled.

Key Takeaways

- Service charges are estimated because it's difficult to predict exact costs for maintenance and services throughout the year.
- Estimates ensure that enough funds are available for ongoing work, and the actual costs are reconciled at the end of the year.
- If actual costs are higher, you may need to pay the difference. If they are lower, you may receive a refund.
- Regular communication and annual statements from your management company will help keep you informed about the service charge breakdown.

Any Questions?

If you have any queries about your Service Charge, please contact your Property Manager at Charles Cox.