Insight
Published Wednesday, 13 September, 2023

- Insight
- Devolution
- Local government

- Mark Sandford

A ‘section 114 notice’ means a council cannot make new spending commitments. What options do councils have if this happens?

Update: This Insight was updated following Birmingham City Council's issue of a section 114 notice on 5 September 2023.

On 5 September 2023, Birmingham City Council issued a ‘section 114 notice’. This decision was made as the council anticipated a gap of £87 million between income and expenditure for the (current) 2023/24 financial year.

In addition to this gap, the council estimated that it would have to pay £650 million to £760 million in backdated equal pay claims, following a court judgment in 2012.

This decision received widespread media coverage, much of which reported Birmingham as having ‘gone bankrupt’. However, UK local authorities cannot go bankrupt. A section 114 notice simply indicates that the council’s forecast income is insufficient to meet its forecast expenditure for the next year.

This Insight examines what would happen if a council cannot meet its spending commitments, and what councils’ options are if this happens.

Why are councils facing financial difficulties?

Local authorities in England have seen considerable reductions in the grants they receive from the Government since 2010. The National Audit Office estimated in 2018 that local authorities' spending power had fallen by 29% in real terms between 2010/11 and 2017/18. The Institute for Government estimates the fall in spending power as 31% between 2009/10 and 2021/22.

Cost pressures such as a growing population and rising demand for local government services, particularly adult and children's social care, are also anticipated to increase through the 2020s.

The recent rises in inflation are also causing budgetary difficulties for councils. The Local Government Association has forecast that inflation, including pay demands and energy price rises, will add £2.4 billion to previous budget forecasts for 2023/24.

Press reports suggest other councils may also face disputes over equal pay.

What are councils' options?

A council's chief financial officer has a statutory duty to issue a 'section 114 notice' if they believe the council will be unable to meet its expenditure commitments from its income. The chief financial officer does not need councillors' consent to issue this notice.

A section 114 notice means the council cannot make new spending commitments and must meet within 21 days to discuss what to do next.

Previously, most councils in this situation have then passed an amended budget reducing spending on services. This is what happened after the severe financial problems in Northamptonshire (2018) and Croydon (2020): more details of these can be found in the Library briefing Local authority financial resilience.

In the early 2020s, a number of councils facing financial difficulties have sought 'capitalisation directions' from the Government. These provide special permission to use their capital funds – for instance, from selling assets or property – to top up service spending. Capitalisation directions have sometimes been incorrectly described as 'bailouts'.

The Government has powers to intervene in how council services are run (see the Library briefing Local government in England: structures). This does not happen automatically when a section 114 notice is issued. However, many councils that have issued section 114 notices have subsequently been subject to intervention: these include Woking Borough Council, Slough Borough Council, Thurrock Council, Nottingham City Council, and the London Borough of Croydon.

Another option would be for the Government to legislate to reduce the range of councils' statutory duties. Instead of increasing councils' income, this would reduce the services that councils are required by law to provide. This option was set out in a letter from Kent and Hampshire county councils to the Government in November 2022. The letter stated that, even if their services were reduced in "unpalatable" ways, they would need immediate financial assistance and a long-term plan for financial sustainability from Government to avoid bankruptcy.

Since then, many other councils have been reported as having concerns that they may need to issue a section 114 notice. Examples include Middlesbrough, Coventry, Somerset and Hastings.

Could councils increase their income?

English councils have relatively few options for increasing their income.

Councils needing additional income can raise their council tax. This cannot be done mid-year and therefore any additional income from this source would take some time to appear. Since 2012, the Government has set national limits on the amount council tax can be raised by annually – typically by around 2% to 5%. The Autumn Statement in November 2022 stated that the limit for 2023/24 would be 5% for councils with social care functions. Croydon, Slough and Thurrock were all permitted additional headroom (15%, 10% and 10% respectively) for 2023/24 in the light of their financial difficulties.

If all councils had raised council tax by the maximum permitted in the 2022 Autumn Statement, this would raise approximately £1.6 billion extra in 2023/24. Within this headline figure, different local authorities would raise different amounts via a council tax increase. In general, less deprived areas have more valuable properties and would therefore raise more council tax than more deprived areas.

In the last few years, the Government has provided small additional grants to councils at the Local Government Finance Settlement in December (for the financial year beginning in the following April). For instance, the 2021–22 settlement included a Social Care Grant of £1.71 billion, and the 2022–23 settlement included a Lower Tier Services Grant of £111 million. The 2023–24 settlement provided a social care grant of £1.345 billion.

Councils also retain a proportion of new business rates revenue. This could provide some extra income, but business rate revenue has been volatile in the aftermath of the Covid-19 pandemic and few councils would be able to rely on it.

Councils in the UK have few other powers to raise income locally. Reports in recent years have explored options for additional powers to raise taxes, including a tourism tax, a local income tax, stamp duty, and taking revenue from VAT and corporation tax for a specific purpose.

These reports include the Institute for Fiscal Studies' Taking Control: which taxes could be devolved to English local government and the Local Government Association's Reforming revenues: options for the future financing of local government. Most proposals in these reports would require new primary legislation. However, many of them would raise only small amounts of additional money, which would not be sufficient to meet current needs.

About the author: Mark Sandford is a researcher at the House of Commons Library specialising in local government and devolution in England.
Photo by Mangopear creative on Unsplash

Corrections and clarifications

This Insight was updated following Birmingham City Council's issue of a section 114 notice on 5 September 2023.

The Insight was amended on 4 October 2023 to correct the financial year in the first sentence. The anticipated £87 billion gap between income and expenditure is for the 2023/24 financial year, not 2024/25.