Financial crisis at Birmingham City Council: Part 2 – what next?

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Part 1 of this note detailed the context of Birmingham City Council's s114 notice. Part 2 will now comment on the upcoming budgetary consultation, and the strategy Council is following to address the issues raised in the s114 notice. There is a significant concern that further budget cuts, following a decade or more of austerity, will increase risks across children's services, adult social care, homelessness and temporary accommodation. Cuts may therefore prove counterproductive because they displace problems, creating new costs elsewhere, and undermine the Council's ability to deliver crucial statutory services. Other measures, such as the fire sale of assets or the capitalisation of debt may also create expensive legacy costs reminiscent of PFIs in the 2000s.

Birmingham City Council's Adjustment Plan

The financial tests discussed in Part 1, namely the need to set a short-term balanced budget and post adequate General Fund reserves whilst maintaining statutory services, have several implications for what the council does next. The council must: (1) create a plan to close the £300m in-year budget gap and (2) restructure the balance sheet to address the £700m hole in the General Fund. We discuss each of these in turn below.

i. Closing the £300m budget deficit

The Cabinet agenda dated 12 December 2023 provides a sketch of the Council's response to the s114. The Council have identified £149m of the £300m total savings, with a further £151m found in 2025/26 (Table 1).

Table 1: Proposed Council Savings

Directorate	Services within this Directorate	Savings in 2024/25 £000	Net Budget (Adjusted for controllable income) £000	Savings as a percentage of Net Budget %
Adult Social Care	Social Care, Principal Social Work	21,903	437,738	5.0%
Children & Families	Education & Early Years, SEND, Social Care.	57,041	428,801	13.3%
City Operations	Regulation & Enforcement, Street Scene & Neighbourhoods, Highways & Infrastructure.	29,210	206,198	14.2%
City Housing	Housing Management, Homelessness.	5,816	24,457	23.8%
Places, Prosperity and Sustainability	Corporate Landlord, Transport & Connectivity, Sustainability, Planning.	9,075	54,736	16.6%
Strategy, Equalities and Partnerships	Public Health, Communications, Chief Executive Office, Cabinet Office, City Observatory.	2,597	8,195	31.7%
Council Management	People Services, Digital & Customer Services, Legal & Democratic Services, Finance, Customer Services, Business Support, Revenues and Benefits.	15,630	31,363	49.8%
Cross-cutting savings*	Contract savings, consolidation, digital tools, and automation	8,500	N/A	N/A
TOTAL		**149,772**	**1,191,487**	**12.6%**

These cuts are among the steepest any city has faced, including those experienced under austerity in the Cameron/Osborne administration. Furthermore, BCC are looking to identify these cuts on an accelerated timescale and are already late in opening the statutory budget consultation. The precise detail of where £150m of savings will be made within those budget categories is still to be released, but the latest Cabinet documents suggest both service reductions and redundancies. The council also propose asset disposals to generate capital receipts; transferring some existing activities into the ringfenced Public Health budget (effectively cutting other Public Health activities) and Council Tax rises by more than the legal maximum of 4.99%.

While the detail is light,some of the high level figures - the £21.9m savings in adult social care, the £57m saving in children's services, and the £5.8m saving in housing - should sound alarm bells. Cuts in these areas often lead to increasing costs elsewhere as problems are displaced. These costs will be borne directly by the council (for example the cost of bed and breakfast temporary accommodation for homeless families), the NHS (for example the inability to discharge patients), or the wider economy (for example getting young people into employment). In the context of a decade of austerity budgeting at local government, there is now very little left to cut and services are already threadbare. These cuts are therefore likely to have an immediate impact on vulnerable people and/or major operational and business continuity consequences.

This displacement effect is well recognised (see Brackley et al., 2021; LGA; The King's Fund etc). In the case of Birmingham, this can already be seen in both rising service pressures and in specific budgetary overspends. The most recent internal audit report, for example, identified a cost pressure of £11m in excess of budget in relation to temporary accommodation, which contrasts sharply with the figure disclosed in the 2023 to 2027 financial plan which suggested there would be a £5.5m underspend in 2023/24. That, already, accounts for £16.5m of the £87m in-year overspend in 2023/24 that can almost certainly be traced, at least in part, to the various cuts to community charities, outreach work, mental health services, youth centres, programmes to help young families and so on. With respect to the growth in temporary accommodation costs, for example, the Council have effectively replaced a network of support designed to prevent child and vulnerable person homelessness with a system that instead pays several times over when these families reach crisis point – all in the name of balancing the books.

The Council will therefore need to explain (1) whether these cuts risk putting the council in a position in which they are breaching their statutory duties to vulnerable people and (2) the medium and long term costs created by these cuts to the Council, the NHS, and the wider local economy.

ii. Asset sales and transfers between reserves

In addition to the setting of a hard savings target of circa £300m across 2024/25 and 2025/26, the council also needs to address the adequacy of General Fund reserves. There is even less information here on how the larger £700m negative balance will be addressed. Furthermore, there remains significant uncertainty over the equal pay liability, noting that the calculation has not been made public and has not, as yet, been audited.

Table 2: Birmingham City Council's General Fund Position

Useable Reserves	Value (£m)
Balance at 31st March 2022	**£596.8m**
Reserves used in 2022/23	(£336.2m)
Latest forecast 31st March 2023	**£260.6m**
Estimated reserves usage in 2023/24	(£25.6m)
Latest forecast 31st March 2024	**£235.0m**

Of the £235.02m, £172.2m is available for use.

There are ***additional draw-downs*** *which need to be addressed.*

Reserves available for Overspend and Other Items	£172.2m
Overspend for 2023/24	(£87.4m)
Oracle Costs (multi-year)	(£46.5m)
Extra Pay Award Costs 23/24 (assuming 6.5%)	(£11.2m)
Equal Pay Liability, midpoint £650m-£760m future yr	(£705.0m)
Negative Reserves	**(£677.9m)**

- Useable reserves is currently defined as the sum of the Delivery Plan Reserves, Financial Resilience Reserve, Other Corporate Reserves, and Earmarked Reserves;
- Our expected 2023/24 reserves position forecasts that we could have up to £172.2m of usable reserves to address the challenges above;
- *This is before the impact of Equal Pay, and the costs of borrowing to fund Equal Pay;*
- There are also other risks such as Highways PFI.
- As such, from an accounting perspective we are in a **negative general fund position**.

In the December Cabinet papers, there are some references to how this gap might be plugged. In particular, the s151 officer references conversations with national government on the possible "capitalisation" of debt in relation to the sale of assets, the precise value of which remains to be agreed:

"The precise value of a 'minded to' capitalisation from DLUHC[1] is to be confirmed later in the budget setting process following assurance of the savings programme. This would need to be large enough to cover provisions for Equal Pay, capitalisation costs involved in a redundancy scheme, and the forecast budget deficit 2024/25. The precise amount that will actually be capitalised will only be determined at year-end such that if the Council overdelivers then the capitalisation value will reduce."

This refers back to the accounting treatment described in Part 1 of this report – in particular, the ability of a Council to, in certain circumstances, post movements in their reserves to 'protect' the General Fund. In this case, by selling capital assets such as land and buildings the Council would be able to transfer funds from 'unusable' capital reserves into the General Fund. The above quote and the associated discussion are somewhat ambiguous, but the suggestion seems to be that if the council identifies assets with a worth in the region of £500m to £700m then the government would allow the council to borrow against the value of these assets in order to release funds for the General Fund reserve right away, rather than waiting for the actual sale of assets. If the council then successfully deliver on their hard budget target or make successful asset sales in excess of asset book value by March 2024, then some of this capitalisation will be reversed.

This leaves open several questions. Firstly, it appears that the second financial test ('adequacy of reserves') is being used to incentivise a hard budget – so that in previous years where a savings target was not deliverable it could be accommodated by the General Fund, this year any savings not 100% delivered could trigger a further s114 in the new year. Second, the above wording appears to incentivise assets to be sold as quickly as possible – essentially a 'fire sale'

[1] Department for Levelling Up, Housing and Communities

– which is supported by other quotes in the Cabinet minutes which assert that asset sales must "commenc[e] as soon as possible to generate capital receipts”. Thirdly, simply transferring these losses into unusable reserves does not make the future commitments go away – as the cash settlements for equal pay claims come in, for example, this would still need to be found via future cuts to the revenue budget. In short, the solution to the second test proposed by the DLUHC appears to be a further hollowing out of the Council’s balance sheet, with little consideration of the longer term financial viability of the Council.

It is not entirely clear from the documentation presented to date whether the above is also motivated by a cash flow problem within the Council, or solely the statutory duty to maintain adequate reserves. Indeed, the underlying cash position of the Council seems to have been barely discussed by Cabinet. In terms of the possible value that the Council could release, there was a total figure of £2.6bn of property, equipment, and heritage assets measured at fair value in the most recent set of accounts(as at 31 March 2022). Any fire sale of these assets would, however, have major public interest implications, and should only be done on a value for money and public interest basis – not in order to close a deficit in reserves which could in any case be closed with the agreement of the DLUHC. In the worst case, for instance, one could imagine the Council entering into sale and lease back or expensive short term borrowing agreements that closely resemble PFI type arrangements.

Further to the recommendations suggested above, we would therefore add point (3) in relation to the sale of assets: the Council should provide a full value for money and public interest case for any asset sales, and not engage in asset sales simply to underwrite transfers between reserves that could otherwise be approved by the DLUHC.

Summary of recommendations to the Council:

(1) Provide a full assessment of whether cuts outlined in the 2024/25 budget consultation risk putting the council in a position in which they are breaching their statutory duties to vulnerable people.

(2) To assess the medium and long term costs created by these cuts to the Council, the NHS, and the wider local economy.

(3) In relation to the sale of assets the Council should provide a full value for money and public interest case, and not engage in asset sales simply to underwrite transfers between reserves.

And from Part 1 to this blog:

(4) Request an assurance statement on the equal pay liability, along with full disclosure of how the amount has been calculated and what audit work has been performed.