DFE-137515

Title: The Renewable Heat Incentive Schemes (Amendment) Regulations 2017	**Regulatory Impact Assessment (RIA)**
	Date:
	Type of measure: Secondary Legislation
Lead department or agency: Department for the Economy	**Stage:** Partial
	Source of intervention:
Other departments or agencies: N/A	**Contact details:** Lucy Marten
	Renewable Heat Branch, DfE
	Ext 29257

Summary Intervention and Options

What is the problem under consideration? Why is government intervention necessary? (7 lines maximum)
On 1 November 2012, DETI launched the non-domestic Renewable Heat Incentive (RHI) in support of the NI Executive's target of 4% renewable heat by 2015 and 10% by 2020. By February 2016, the non-domestic and the domestic RHI (introduced in December 2014) had incentivised over 4,700 renewable heating installations and the Executive's 2015 target of 4% renewable heat had been exceeded. The current assessment is 6% of heat is from renewable technologies. However, the unprecedented success of the schemes and other budgetary pressures led the DETI Minister, Jonathan Bell, to suspend the domestic and non-domestic RHI schemes for new applications from 29 February 2016. Even with scheme closed to new applications, available AME budget from 2016/17 onwards has been exceeded by existing RHI commitments. An NIAO Report indicates that the cost of meeting the obligation to existing recipients will add £140m on the NI block over 5 years.

What are the policy objectives and the intended effects? (7 lines maximum)
RHI is intended to provide a 'reasonable' rate of return for scheme recipients. However, evidence suggests that the current average rate of return is around 42% rather than in the range of 8% to 22% anticipated in November 2012. Further, State Aid requirements mean that only 'useful heat' should be eligible for payment under the RHI scheme (heat that would otherwise have to be met by fossil fuels). The proposed amendments to the Regulations will assist DfE to balance its budgetary obligation to the schemes with its wider obligation to safeguard the public purse. The amendments will allow DfE to continue to provide a reasonable rate of return for RHI recipients and ensure that the scheme does not provide perverse incentives to produce unnecessary heat.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base) (10 lines maximum) Options considered are:

- Option One: Biomass Tariff Changes: Reduce the current biomass tariffs in line with a revised assessment of the incentive required to offset the additional costs of renewable heating
- Option Two: Buy-Out of RHI Entitlement: Reduce the amount of RHI liability by offering to buy out customer RHI entitlements
- Option Three: Tariff Tier & Annual Cap: Apply a tiered tariff arrangement similar to that already in place for post 18 November 2015
- Option Four: Tariff Tier Only: Apply a tariff tier across the board for all biomass installations
- Option Five: Cap Only: Apply an annual cap in kWh's for all accredited installations
- Option Six: Progressive Tier: Apply a progressive tariff tier to reflect the point of entry into the RHI scheme and the different investment costs
- Option Seven: (Do Nothing) Continue to provide support for existing recipients of the non-domestic RHI scheme at the tariff level and current rate of return.

Will the policy be reviewed? Yes	**If applicable, set review date:** N/A

Does Implementation go beyond minimum EU requirements?			**NO** ☒	**YES** ☐
Are any of these organisations in scope?	**Micro** Yes ☒ No ☐	**Small** Yes ☒ No ☐	**Medium** Yes ☒ No ☐	**Large** Yes ☒ No ☐

The final RIA supporting legislation must be attached to the Explanatory Memorandum and published with it.

Approved by: Date:

Summary: Analysis and Evidence

Description: Make Regulations to establish suspension mechanism and suspend both schemes after Regulations come into operation

ECONOMIC ASSESSMENT (Net benefit £ m NPV)

Costs (£m)	Total Transitional (Policy) (constant price)	Years	Average Annual (recurring) (excl. transitional) (constant price)	Total Cost (Present Value)
Low	**Optional**		**Optional**	**Optional**
High	**Optional**		**Optional**	**Optional**
Best Estimate	**0**		**£ (npc)**	**£m**

Description and scale of key monetised costs by 'main affected groups' Maximum 5 lines

Other key non-monetised costs by 'main affected groups' Maximum 5 lines

Benefits (£m)	Total Transitional (Policy) (constant price)	Years	Average Annual (recurring) (excl. transitional) (constant price)	Total Benefit (Present Value)
Low	**Optional**		**Optional**	**Optional**
High	**Optional**		**Optional**	**Optional**
Best Estimate			**£ m (npv)**	**£ m**

Description and scale of key monetised benefits by 'main affected groups' Maximum 5 lines

Other key non-monetised benefits by 'main affected groups' Maximum 5 lines

Key Assumptions, Sensitivities, Risks Maximum 5 lines

BUSINESS ASSESSMENT (Option)

Direct Impact on business (Equivalent Annual) £m				
Costs: N/A	**Benefits:** N/A	**Net:** N/A		

Cross Border Issues (Option)

How does this option compare to other UK regions and to other EU Member States (particularly Republic of Ireland) Maximum 3 lines

Evidence Base

There is discretion for departments and organisations as to how to set out the evidence base. It is however desirable that the following points are covered:

- Problem under consideration;
- Rationale for intervention;
- Policy objective;
- Description of options considered (including do nothing), with reference to the evidence base to support the option selection;
- Monetised and non-monetised costs and benefits of each option (including administrative burden);
- Rationale and evidence that justify the level of analysis used in the RIA (proportionality approach);
- Risks and assumptions;
- Direct costs and benefits to business;
- Wider impacts (in the context of other Impact Assessments in Policy Toolkit Workbook 4, economic assessment and NIGEAE).

Inserting text for this section:
Text can be pasted from other documents as appropriate.

Background

In September 2010, the Executive adopted a target of 10% renewable heat in Northern Ireland by 2020 and an interim target of 4% by 2015. The target was in line with obligations under the EU Renewable Energy Directive (RED) that each Member State had to secure certain levels of renewable energy by 2020. In November 2012, the Renewable Heat Incentive Schemes were introduced in pursuit of these targets.

The RHI schemes have been very successful. Around 4,700 renewable heating installations have been incentivised to date under the NI RHI schemes and the Executive's 2015 target of 4% renewable heat has been exceeded. It is currently estimated that around 6% of Northern Ireland's heating needs are provided through renewable heating technologies.

The RHI tariffs were designed using a similar methodology to the GB tariffs and were intended to fund the difference in cost between oil based heating systems and the renewable heat alternative. This included capital costs, operating costs and the non-financial 'hassle' factors that are involved in replacing existing heating systems with renewable heating technologies.

Except for solar thermal, the initial tariffs for the Northern Ireland RHI were intended to provide an average rate of return of 12% over the lifetime of the technology (range of 8% to 12% depending on boiler size).

Initially, low levels of uptake created a £15m under-spend in the first 3 years of the RHI scheme's life. In 2013, DETI widened the scheme to new technologies, introduced a domestic scheme, introduced sustainability requirements and annual cost control measures. Publicity campaigns aimed at promoting uptake were run during 2014 and early 2015 led to a significant increase in uptake in the Spring 2015.

This increased pressure on budgets and subsequently, the DETI Minister obtained Assembly approval for additional cost control measures, which included tariffs for biomass, a change in biomass banding and an annual cap of heat payments.

Problem under Consideration

Funding for the NI RHI is provided through Annual Managed Expenditure (AME) by Treasury, and is additional to the NI Block Grant. However, in 2015, Treasury confirmed that, from 2016/17, any NI RHI expenditure in excess of 3% of GB funding must be met from NI DEL. The increase in committed RHI payments associated with the influx in non-domestic applications meant that the NI AME allocations from 2016/17 onwards would be exceeded. This situation was exacerbated by the UK Government's November Spending Review, which included a significant cut in future RHI funding.

The unprecedented success of the schemes and the other budgetary pressures led the DETI Minister, Jonathan Bell, to suspend the domestic and non-domestic RHI schemes for new applications from 29 February 2016. Even with scheme suspension for new applications, available AME budget from 2016/17 onwards has been exceeded by existing RHI commitments. An NIAO Report indicates that the cost of meeting the obligation to existing recipients will add £140m on the NI block over 5 years.

When DETI introduced the RHI scheme, it guaranteed that recipients would receive support for 20 years. Additionally, to ensure investor confidence and consistent with the GB scheme, DETI committed to the principle of 'grandfathering'. In practical terms, this means that any changes to tariff levels (higher or lower), only affect new projects accredited on or after the introduction of any new support levels.

However, RHI is intended to provide a 'reasonable' rate of return for scheme recipients. Evidence suggests that the current average rate of return is around 42% rather than in the range of 8% to 22% anticipated when the scheme launched.

Further, State Aid requirements mean that only 'useful heat' is eligible for payment under the RHI scheme. In other words, only, heat which would otherwise have to be met by fossil fuels. This eliminates any incentive for generating heat simply to receive payments.

Rationale for Intervention/Policy Objective

Changes to the Regulations are required to (i) ensure a reasonable rate of return (ii) ensure that the scheme does not provide perverse incentives to waste heat; and (iii) assist DfE to balance its budgetary obligation to the schemes with its wider obligation to safeguard the public purse

Rationale and evidence that justify the level of analysis used in the RIA (proportionality approach)

Description of Options Considered

Option One: Biomass Tariff Changes - This option would reduce the current biomass tariffs in line with a revised assessment of the incentive required to offset the additional costs of renewable heating

Option Two: Buy-Out of RHI Entitlement – This option would offer to buy out customers' RHI entitlement in order to reduce the amount of RHI liability

Option Three: Tariff Tier & Annual Cap – This option would apply a tiered tariff arrangement similar to that already in place for post 18 November 2015

Option Four: Tariff Tier Only – this option would apply a tariff tier across the board for all biomass installations

Option Five: Cap Only – This option would apply an annual cap in kWh's for all accredited installations

Option Six: Progressive Tier – This option would apply a progressive tariff tier to reflect the point of entry into the RHI scheme and the different investment costs

Option Seven: Do Nothing – Under this option DfE would continue to provide support for existing recipients of the non-domestic RHI scheme at the tariff level and current rate of return.

Analysis of Each Option (Incl Admin Burden)

An analysis has been completed for each option to compare funding costs to the Department and the NI Block against the support provided to existing RHI recipients.

Option One: Biomass Tariff Changes

The Department could reduce the current biomass tariffs in line with a revised assessment of the incentive required to offset the additional costs of renewable heating. Most installations are in the medium biomass banding which attracts a tariff of 6.5 pence per kWh. The costs of biomass renewable heating boilers has reduced considerably since the introduction of the RHI in 2012 and a reduction in tariff could be justified in this regard. A reduced tariff would bring the rate of return back towards the 12% agreed rate.

Any reduction in tariff rates goes against the “grandfathering” principle, which is enshrined in RHI legislation. Grandfathering fixes the rate at point of scheme entry for the 20-year duration subject to annual review in line with the Retail Price Index (RPI). Any move to reduce tariffs would be very unpopular and at high risk of successful legal challenge given the legislative position. A reduction in tariff may actually encourage boilers to be utilised more of the time to gain higher payments potentially producing unnecessary heat

Option Two: Buy-Out of RHI Entitlement

It may be possible to reduce the amount of RHI liability by offering to buy out customer RHI entitlements. The proposal would offer the possibility of reducing the budgetary liability for RHI whilst at the same time providing compensation for those customers who chose to leave the scheme early.

The amounts required to encourage uptake by customers could be excessive and this would negate any cost savings. Customers may not view any buy out scheme as viable at all given their entitlement under RHI and therefore uptake could be very low.

Option Three: Tariff Tier & Annual Cap

A tiered tariff arrangement similar to that already in place for post 18 November 2015 installations could be put in place. Given that this arrangement is already in place for more recent installations the systems and processes are already in place and could potentially be extended at relatively low administrative cost.

The same arrangements would apply to all installations and would have the desired effect of bringing the rate of return back towards the agreed 12%. Customers would continue to receive the current tariffs and achieve a reasonable return on their investment. It would discourage abuse of the system by customers producing more heat than their business need requires and the cap puts a ceiling on maximum payment.

Any reduction in entitlement for existing accredited installations could be viewed as going against the “grandfathering” principle, which is enshrined in RHI legislation. Grandfathering fixes the rate at point of scheme entry for the 20-year duration subject to annual review in line with the Retail Price Index (RPI). Applying the same tier and cap across the board could be viewed as unfair as it would not take account of the different investment costs depending on when applicants joined the scheme. Any move to introduce a tier and cap for previously accredited installations would be very unpopular and at high risk of successful legal challenge given the legislative position.

Option Four: Tariff Tier Only

A tariff tier could be applied across the board for all biomass installations. Given that this arrangement is already in place for more recent installations the systems and processes are already in place and could potentially be extended at relatively low administrative cost.

The same arrangements would apply to all installations and would have the desired effect of bringing the rate of return back towards the agreed 12%. Customers would continue to receive the current tariffs up to the tier limit and reduced tariff thereafter and achieve a reasonable return on their investment. It would discourage abuse of the system by customers producing more heat than their business need requires.

Any reduction in entitlement for existing accredited installations could be viewed as going against the “grandfathering” principle, which is enshrined in RHI legislation. Grandfathering fixes the rate at point of scheme entry for the 20-year duration subject to annual review in line with the Retail Price Index (RPI). Applying the same tier across the board could be viewed as unfair as it would not take account of the different investment costs depending on when applicants joined the scheme. Any move to introduce a tier for previously accredited installations would be very unpopular and at high risk of successful legal challenge given the legislative position.

Option Five: Cap Only

An annual cap in kWhs could be applied for all accredited installations. Given that a cap arrangement is already in place for more recent installations the systems and processes are already in place and could potentially be extended at relatively low administrative cost. . The same cap arrangements would apply to all installations and would have the desired effect of bringing the rate of return back towards the agreed 12%. Customers would continue to receive the current tariffs up to the cap limit and no payments thereafter. It would discourage abuse of the system by customers producing more heat than their business with the cap putting a ceiling on maximum payment possible.

Any reduction in entitlement for existing accredited installations could be viewed as going against the “grandfathering” principle, which is enshrined in RHI legislation. Grandfathering fixes the rate at point of scheme entry for the 20-year duration subject to annual review in line with the Retail Price Index (RPI). Any move to introduce a cap for previously accredited installations would be very unpopular and at high risk of successful legal challenge given the legislative position.

Option Six: Progressive Tier

A progressive tariff tier could be applied to reflect the point of entry into the RHI scheme and the different investment costs. Given that this arrangement is already in place for more recent installations the systems and processes are already in place and could potentially be extended at relatively low administrative cost although a range of tiers would add some complexity and perhaps extra cost. A progressive tier would take account of when applicants joined the RHI scheme and the investment at the point of entry. Customers would continue to receive the current tariffs up to the tier relevant tier limit and reduced tariff thereafter and achieve a reasonable return on their investment. It would discourage abuse of the system by customers producing more heat than their business need requires.

Any reduction in entitlement for existing accredited installations could be viewed as going against the “grandfathering” principle, which is enshrined in RHI legislation. Grandfathering fixes the rate at point of scheme entry for the 20-year duration subject to annual review in line with the Retail Price Index (RPI). Any move to introduce a tier for previously accredited installations would be very unpopular and at high risk of successful legal challenge given the legislative position

Option Seven: Do Nothing

DfE could continue to provide support for existing recipients of the non-domestic RHI scheme at the current tariff level and rate of return. However, this would do nothing to ease existing and future risk to the NI Block and would not ensure that the scheme does not encourage unnecessary heat.

- Direct Costs and Benefits to Business
- Wider Impacts
- Competition Assessment

Environmental Impact and Sustainable Development

The agenda for developing renewable energy solutions and securing real reductions in energy consumption to enhance sustainability is driven by environmental policy aimed at reducing harmful emissions. The preferred option must support RHI to deliver benefits that include a reduction in CO2 emissions as fossil fuels are displaced, an increase in fuel security as Northern Ireland's dependence on imported heating fuel diminishes and encourage growth for 'green jobs' as companies benefit from opportunities presented by renewable heat.

Rural Proofing

A rural proofing exercise has been carried out and the policy of the closure of the NIRO has been screened out

Enforcement and Sanctions

Conclusion

Monitoring and Review

The Department, in liaison with the Utility Regulator and Ofgem, will continue to monitor the operation of the Northern Ireland renewable heat market to assess if the elements of the incentive scheme are delivering the anticipated benefits.

Ofgem will continue to be responsible for developing and administering the scheme on behalf of DfE. Ofgem has significant experience in the delivery of large-scale energy incentive schemes such as the Renewables Obligation (RO) and the Feed-in-Tariff (FiT). In addition, Ofgem has administered the Northern Ireland Renewables Obligation (NIRO) and the

Renewable Heat Incentives since their inception and therefore has an understanding of the local energy market and a working relationship with the Department.