

From: Connolly, Samuel
To: [Hutchinson, Peter](#)
Cc: [McCutcheon, Joanne](#); [Stewart, Susan](#); [Murphy, Shane](#)
Subject: RE: RHI v Challenge Fund
Date: 14 March 2012 10:43:00
Attachments: [RHI v Challenge Fund.doc](#)
[OTOP.png](#)
[image001.png](#)

Peter,

See attached a few ASU suggestions in relation to the rhi v challenge fund note.

happy to discuss

Sam

Samuel Connolly

Analytical Services Unit
Department of Enterprise, Trade & Investment
Netherleigh
Massey Avenue
Belfast, BT4 2JP
Tel: 028 9052 9287 (ext: 29287)
Textphone: 028 9052 9304
Web: www.detini.gov.uk



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From: Hutchinson, Peter
Sent: 12 March 2012 17:11
To: Connolly, Samuel
Cc: McCutcheon, Joanne; Stewart, Susan
Subject: RHI v Challenge Fund

Sam,

As discussed, some draft wording on RHI v CF.

Grateful if you would consider and revise as appropriate.

Thanks,

Peter

High level option selection

On consideration of the potential options the Northern Ireland RHI option was selected for a number of reasons.

Affordability

In terms of administration, the costs of running a Challenge Fund were deemed to be prohibitive especially in comparison to potential costs of administering the NI RHI. Previous experience of running *Reconnect* demonstrated administration costs of £1.48m for a grant scheme worth £10.5m (14%). The *Reconnect* scheme was for domestic customers only and on a ‘first-come-first-served’ basis. A challenge fund, dealing with commercial applications and involving complex evaluation metrics, could be expected to be at least as, if not more, costly than the *Reconnect* scheme – equating to potentially £3.5m over the first 4 years. **This would not be available within DETI budget.**

The RHI option, whilst requiring complex administration arrangements, can be implemented through variations in systems already in place for the GB RHI. The expected costs of the RHI scheme have been assessed and shows development costs of £386k and running costs of £710k over the first 4 years. These administration costs are affordable in comparison to the Challenge Fund option.

Ability to meet targets over set timescales

The RHI scheme provides the most certainty in terms of achieving the targets of 4% and 10% renewable heat by 2015 and 2020 respectively, as set out in the Programme for Government. Whilst the Challenge Fund could also meet the targets, and potentially deliver more renewable heat, it is likely that this is at a later date. As designed currently the RHI would achieve around 11% renewable heat by 2020.

Risk

It has been considered that the RHI presents a lower level of risk than the potential Challenge Fund, this is largely due to the fact that incentives would be paid on “actual heat output”. RHI payments will only be made on metered heat output with installers paid for the amount of heat generated. This ensures that installations are kept in working order and used – therefore meeting the renewable heat targets.

As the Challenge Fund would be contributing to the capital costs of the installation (rather than the whole life costs under the RHI) a risk would develop that after a short time installations would stop generating renewable heat – this could be because the renewable heat fuel is no longer affordable, that a fossil fuel alternative is more attractive, that the site is no longer in business etc. In these circumstances clawback arrangements would need to be initiated, which could be costly and complicated, and the target would be hindered. As the RHI only rewards actual heat output there is less risk and less impact if sites stop generating renewable heat.

Consistency with GB

Whilst energy is a devolved matter DETI is mindful that a high number of commercial operators wishing to avail of support for renewable heat in Northern Ireland will operate jointly in GB. Whilst it is wholly appropriate for a specific incentive mechanism to be developed in Northern Ireland given the variances in the two energy markets, DETI is conscious that consistency in approach with GB would be beneficial to those availing of support in both Northern Ireland and GB. Therefore a specific NI RHI, whilst addressing the NI heat market, would be a more consistent approach with GB and will assist policy development options in the future.

Example of the NIRO

The NIRO was launched in Northern Ireland in 2005 to support the development of renewable electricity installations. Similar to the RHI, the NIRO offers no up-front capital support for installations but instead offers 20 years of payments over the lifetime of the technology with payments determined by actual energy output. This example has proved successful with installers and has led to an increase of renewable electricity levels from 3% to over 12% currently. This example increases confidence in a RHI scheme to generate investment in renewable heat. The potential uptake under the Challenge Fund option would be largely unknown.

Challenge Fund assumptions

Under the Challenge Fund options it is assumed that only the most cost effective systems are incentivised given that applications are ranked via evaluation criteria. On reflection, it has been deemed that this assumption is flawed in that it relies on cost effective applications being made – if applicants only focus on less efficient technologies then the scheme will be skewed towards these less efficient systems. The experience learned from *Reconnect* was that in a capital grant scheme applicants will focus on technologies that are most affordable, not the most appropriate or efficient. Under *Reconnect* the technology which was installed most often (50% of the time) was solar thermal. As part of this analysis solar thermal is shown to be the most costly and least efficient renewable heating technology. If this experienced was repeated the target would be missed and funding skewed towards the most costly and inefficient systems.

The RHI operates a technology neutral approach in that the same methodology is used to determine each tariff and a specific tariff set for each technology – this, in theory, results in each technology being as attractive as each other and therefore consumers are free to select the most appropriate application. As the tariff factors the wholelife cost of the technology (capex, opex, fuel and non-financial ‘hassle’ costs) consumers are expected to select the most efficient system, this in turn supports the achievement of the set targets.

Peter Hutchinson

Renewable Heat
Department of Enterprise, Trade & Investment
Netherleigh
Massey Avenue
Belfast, BT4 2JP
Tel: 028 9052 9532 (ext: 29532)
Textphone: 028 9052 9304
Web: www.detini.gov.uk



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High level option selection

The report examining the potential for a renewable heat incentive for Northern Ireland, prepared for DETI by CEPA and AEA Technology, focused on two main types of options. These included capital grant/challenge fund options, which would provide a one off payment to consumers, and renewable heat incentive options that provide a long term, 20 year, stream of payments to consumers to make up the difference in the wholelife cost of a renewable heating system compared to an oil based heating system.

The June 2011 economic appraisal recognised that each approach had its own merits but it was not necessarily unequivocal in its overall conclusion. In addition, since then, we have had the benefit of some further work by OFGEM on the cost of administering an RHI scheme.

Whilst the June 2011 analysis suggested that a challenge fund option could produce the most renewable heat at the lowest cost, DETI were conscious that there are a number of other key factors that needed to be taken account of in the final policy decision. These factors have very influential in the conclusion, by DETI, to proceed with the RHI option. They include the following:

Affordability Of Administration

In terms of administration, the costs of running a Challenge Fund were considered to be prohibitive, especially in comparison to potential costs of administering the NI RHI. Previous experience of running *Reconnect* demonstrated administration costs of £1.48m for a grant scheme worth £10.5m (14%). The *Reconnect* scheme was for domestic customers only, and on a 'first-come-first-served' basis. A challenge fund, dealing with commercial applications and involving complex evaluation metrics, could be expected to be at least as, if not more, costly than the *Reconnect* scheme, equating to potentially £3.5m over the first 4 years. **This would not be available within DETI budget.**

The RHI option, whilst requiring complex administration arrangements, can be implemented at a fraction of the cost through building on existing systems already in place for the GB RHI. The expected costs of the RHI scheme have been assessed and project development costs of £386k and running costs of £710k over the first 4 years. These administration costs are much more affordable in comparison to the Challenge Fund option.

Challenge Fund Assumptions

Under the Challenge Fund options it is assumed that only the most cost effective systems are incentivised given that applications are ranked via a set of evaluation criteria. On reflection, it has been considered that this assumption is much too idealistic, in that it relies on cost effective applications being made in the first instance. If, however, applicants unduly focus on less efficient technologies then the scheme will be skewed towards these less efficient systems. The experience learned from *Reconnect* was that in a capital grant scheme applicants will focus on technologies that are most

affordable, not the most appropriate or efficient. Under *Reconnect* the most popular technology, the one installed most often (50% of the time), was solar thermal. Within this analysis solar thermal is shown to be the most costly and least efficient renewable heating technology. If this experience was repeated, in a RH grant scheme, the target would be missed, funding would be skewed towards the most costly and inefficient systems and the appraisal's NPC would undoubtedly be wide of the mark.

The RHI operates a technology neutral approach in that the same methodology is used to determine each tariff and a specific tariff set for each technology. This, in theory, results in each technology being as attractive as each other and therefore consumers are free to select the most appropriate application. As the tariff factors the whole-life cost of the technology (capex, opex, fuel and non-financial hassle costs) consumers are expected to select the most efficient system. This in turn supports the achievement of the renewable heat targets, as well as helping to build overall capacity within the renewable heating industry as it should support a wider range of technologies, helping this market to grow further than might be expected under a challenge fund.

Ability to meet targets over set timescales

The RHI scheme provides the most certainty in terms of achieving the targets of 4% and 10% renewable heat by 2015 and 2020 respectively, as set out in the Programme for Government. This is because an RHI will deliver more heat earlier than a challenge fund as the initial annual payments to consumers will be smaller compared to capital grants, thus enabling more installations to be facilitated within each budgetary period. Whilst the Challenge Fund could also meet the targets, and potentially deliver more renewable heat, it is likely that this would be at a later date. As designed currently the RHI will achieve around 11% renewable heat by 2020.

Risk

It has been considered that the RHI presents a lower level of risk than the potential Challenge Fund. This is largely due to the fact that incentives will be paid on actual heat output. RHI payments will only be made on metered heat output with installers paid for the amount of heat generated. This ensures that installations are kept in working order and used therefore meeting the renewable heat targets.

As the Challenge Fund would be contributing to the capital costs of the installation (rather than the whole life costs under the RHI) a risk would develop that, after a short time, installations would stop generating renewable heat. This could be because the renewable heat fuel is no longer affordable, that a fossil fuel alternative (such as gas) become available or more attractive, that the site is no longer in business etc. In these circumstances clawback arrangements would need to be initiated, which could be costly and complicated, and the target would be hindered. As the RHI only rewards actual heat output there is less risk and less impact if sites stop generating renewable heat.

Also, in terms of risk, an RHI delivers earlier against the Target. In the event that corrective action were required then the RHI option would identify this need earlier and also allow more time, scope and budgetary flexibility for action to be taken to put the scheme back on track.

Consistency with GB

Whilst energy is a devolved matter DETI is mindful that a high number of commercial operators wishing to avail of support for renewable heat in Northern Ireland will operate jointly in GB. Whilst it is wholly appropriate for a specific incentive mechanism to be developed in Northern Ireland given the variances in the two energy markets, DETI is conscious that consistency in approach with GB would be beneficial to those availing of support in both Northern Ireland and GB. Therefore a specific NI RHI, whilst addressing the NI heat market, would be a more consistent approach with GB and will assist policy development options in the future.

Example of the NIRO

The NIRO was launched in Northern Ireland in 2005 to support the development of renewable electricity installations. Similar to the RHI, the NIRO offers no up-front capital support for installations but instead offers 20 years of payments over the lifetime of the technology with payments determined by actual energy output. This example has proved successful with installers and has led to an increase of renewable electricity levels from 3% to over 12% currently. This experience increases confidence in a RHI scheme to generate investment in renewable heat. On the other hand the potential uptake under the Challenge Fund option would be subject to greater unknowns.

From: [Hawthorne, Jill](#)
To: [McAvera, Gerry](#)
Subject: FW: Business Case for DFP - Northern Ireland Renewable Heat Incentive
Date: 22 March 2012 10:32:07
Attachments: [RHI - Business Case for DFP.DOCX](#)
[Annex A - Study into the potential development of the NI Renewable Heat market - AECOM and Poyry 2010.pdf](#)
[Annex B - Economic Appraisal of the NI RHI - CEPA and AEA 2011.pdf](#)
[Annex C - Addendum to Economic Appraisal - CEPA 2012.pdf](#)
[Annex D - Ofgem Feasibility Study.docx](#)
[Annex E - RHI Risk Register.ppt](#)
[Annex F \(i\) - NI RHI State Aid notification paper.doc](#)
[Annex F \(ii\) - Northern Ireland Renewable Heat Incentive scheme - ADDENDUM - revised tariff values - issued to UKREP.DOC](#)
[Annex G - NI RHI Strategic Outline Case - 21 Oct 2011.pdf](#)
[Annex H - Domestic biomass tariff.xlsx](#)
[Annex I - Small commercial GSHP tariff.xlsx](#)
[Annex J - Biogas tariff.xlsx](#)
[image001.png](#)
[OTOP.png](#)

Gerry,

Could you save this on TRIM please?

Thanks,

Jill

Jill Hawthorne

Finance Accounts/Accountability/Invest NI Casework
Department of Enterprise, Trade & Investment
Netherleigh
Massey Avenue
Belfast, BT4 2JP
Tel: 028 9052 9616 (ext: 29616)
Textphone: 028 9052 9304
Web: www.detini.gov.uk



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From: Hutchinson, Peter
Sent: 21 March 2012 17:23
To: Hawthorne, Jill
Cc: Hepper, Fiona; McCutcheon, Joanne; Connolly, Samuel; Sinton, Dan; Stewart, Susan
Subject: Business Case for DFP - Northern Ireland Renewable Heat Incentive

Jill,

Please see attached business case and accompanying Annexes outlining the proposals relating to the introduction of the Northern Ireland Renewable Heat Incentive (to be administered by Ofgem) and the *Renewable Heat Premium Payment* Scheme. This follows on from the Casework Committee meeting of 9 March 2012.

Grateful if you would forward to DFP Supply for consideration.

Thanks,

Peter

Peter Hutchinson

Renewable Heat
Department of Enterprise, Trade & Investment
Netherleigh
Massey Avenue
Belfast, BT4 2JP
Tel: 028 9052 9532 (ext: 29532)
Textphone: 028 9052 9304
Web: www.detini.gov.uk



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BUSINESS CASE

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1. INTRODUCTION

- 1.1 This business case details the proposals for a Northern Ireland Renewable Heat Incentive (**RHI**) to be administered and delivered by the Office of Gas and Electricity Markets (**Ofgem**), the GB energy regulator. It also provides information on the roll-out of an interim grant scheme for the domestic sector in regards support for renewable heating technologies.
- 1.2 A RHI is a mechanism to support the uptake of renewable heat technologies (biomass, heat pumps, solar thermal, geothermal etc). The incentive works in a similar way to the Northern Ireland Renewables Obligation (**NIRO**) that supports renewable electricity installations, by providing regular incentive payments over the lifetime of the technology for actual energy generated. The level of tariff is dependent on the size and type of technology and are calculated to cover capital costs, operating costs and non-financial 'hassle' costs over the lifetime of the technology.
- 1.3 The RHI will be available to all non-domestic customers in the first instance. This is where the most cost-effective renewable heat solutions currently exist and will provide a primer for the market in advance of a further roll-out to domestic consumers. In the interim, it is proposed to provide capital support to domestic customers; this is similar to the situation in GB.
- 1.4 The Department of Energy and Climate Change (**DECC**) in GB has already launched a RHI in England, Scotland and Wales; this scheme did not apply in Northern Ireland because of the significant differences in the various heat markets. A separate assessment on the Northern Ireland RHI has therefore been made.
- 1.5 The RHI is expected to increase the level of renewable heat in line with targets set by the EU and by the Northern Ireland Executive.
- 1.6 It is also proposed that Ofgem act as the administrator of the Northern Ireland RHI. Ofgem has considerable experience in managing large scale renewable energy projects and currently administers the Renewable Obligation in GB, the NIRO, the Feed-in-tariff and the GB RHI. By appointing Ofgem as administrator DETI can enjoy the benefits of work already undertaken by Ofgem in the design and roll-out of the GB scheme.
- 1.7 Full details of the RHI, the support for domestic consumers and the administration process are detailed in this business case.

- 1.8 This business case is heavily informed by research carried out by Cambridge Economic Policy Associates (**CEPA**) and AEA Technologies into the potential design of the Northern Ireland RHI. CEPA and AEA initially carried out work between February – June 2011 on this issue, this initial analysis informed a public consultation on the potential design of the RHI. Following the consultation, CEPA and AEA carried out further analysis to address a number of issues raised by stakeholders.
- 1.9 In addition, comments related to the administration of the scheme by Ofgem have been informed by a feasibility study into the potential management arrangements, including a cost benefit analysis.
- 1.10 An internal DETI Casework Committee considered these proposals on Friday, 9th March 2012 and approved the Northern Ireland RHI, the RHPP scheme and the administration arrangements with Ofgem.

2. EXECUTIVE SUMMARY

Background

- 2.1 Heating energy accounts for around half of all total energy consumed within Northern Ireland with over 98% of our heating fuels coming from imported fossil fuels. Renewable heat is simply heat produced from renewable sources such as solar radiation, biomass materials, heat pumps, geothermal energy and waste materials.
- 2.2 The EU Renewable Energy Directive (RED) (2009/28/EC) set a binding target that 20% of the EU's energy consumption should come from renewable sources by 2020. The UK share of this target commits the UK to increasing the share of renewable energy to 15% by 2020 and Northern Ireland is expected to contribute to this share. The Department of Energy and Climate Change (DECC) has indicated that renewable heat levels of around 12%, coupled with 30% renewable electricity consumption are required for the UK to meet its requirements. £860million has been made available from central Government funding to support the introduction of a Renewable Heat Incentive (RHI) in GB over the period 2011-2015; HMT has notified the Northern Ireland Executive that £25million of funding is available for a NI RHI over the same period.
- 2.3 In 2010, DETI commissioned a study conducted by AECOM Ltd and Pöyry Energy Consulting (**Annex A**) – an Assessment of the Potential Development of Renewable Heat in Northern Ireland. The report concluded that a 10% target was achievable but would require significant Government intervention. The report also indicated that an incentive scheme specific to Northern Ireland would be required.
- 2.4 The Strategic Energy Framework (SEF) was agreed by the Northern Ireland Executive in September 2010. The SEF includes four key energy goals: building competitive markets; ensuring security of supply; enhancing sustainability; and developing our energy infrastructure. The development of the renewable heat market locally will support the delivery of these energy goals, specifically in regards to Northern Ireland's sustainability and energy security. A target of 10% renewable heat by 2020 was included within the SEF; this is a challenging target given that the current level is 1.7%.
- 2.5 In order to achieve the renewable heat target, DECC introduced a GB Renewable Heat Incentive for the non-domestic market in November 2011. Northern Ireland was not included within that scheme because of the differences in the two heat markets. In GB the natural gas market is prevalent and accounts for 68.8% of