

BUSINESS CASE TO EXTEND THE NI RENEWABLE HEAT INCENTIVE

1. INTRODUCTION

- 1.1 In its Programme for Government (PfG) the Executive has a target of achieving 4% renewable heat by 2015. This is an interim milestone to achieving 10% renewable heat by 2020 in line with the Executive endorsed Strategic Energy Framework (SEF). In pursuit of these targets, the interim Renewable Heat Premium Payment (RHPP) and the Non Domestic Renewable Heat Incentive (RHI) schemes were introduced in May and November 2012 respectively. The full Domestic RHI Scheme was introduced in December 2014 to replace the RHPP. The proposed tariffs for both RHI schemes were developed on behalf of DETI through an external consultancy exercise carried out by Ricardo-AEA. Copies of these reports are attached at **Annexes A & C**.
- 1.2 This Business Case seeks DFP approval to continue the Non Domestic RHI scheme for 18 months from 1 April 2015 to 30 September 2016 to provide time for RHI budget clarification to be secured from DECC/HMT and for improved budgetary controls to be introduced if the scheme is to be extended beyond September 2016. It also seeks approval to increase expenditure under the Domestic RHI scheme. This paper is structured as follows:

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2. BACKGROUND

The Northern Ireland Renewable Heat Incentive (RHI)

- 2.1 The EU Renewable Energy Directive (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.
- 2.2 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 heat produced from renewable sources such as solar radiation, biomass materials, heat pumps, geothermal energy and waste materials. The Executive's 2010 Strategic Energy Framework (SEF) includes a target of 10% renewable heat by 2020 against a 2010 base of 1.7%.
- 2.3 In order to achieve the UK renewable heat target, DECC introduced a GB Renewable Heat Incentive for the non-domestic market in November 2011. Northern Ireland (NI) 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 heating demand with oil only accounting for 10%. This is very different from the NI situation where refined oil products account for over 70% of the overall heat demand.
- 2.4 A separate assessment on the level of incentive (tariff) for the NI RHI was completed (**Annex A**) to inform the final business case (**Annex B**). This was approved by DfP in April 2012 and the interim RHPP (domestic) and Non Domestic RHI schemes were introduced in May and November 2012 respectively. A revised assessment was also completed in 2013 to inform the Phase 2 Review of the RHI (**Annex C**).
- 2.5 £860 million was made available from central Government funding to support the introduction of a Renewable Heat Incentive (RHI) in GB over the period 2011-2015. £25 million of funding was made available by HMT for a NI RHI over the same period. A further allocation of £11.6m was made available for 2015/16 in line with the Department's AME forecast submitted in November 2014. However due to a significant increase in uptake of the NI Non Domestic RHI scheme over the past 12 months, an increased 2015/16 AME forecast requirement of £23m was submitted in June 2015 which is now confirmed in our AME profile.

2.6 The RHI supports the uptake of renewable heat technologies (biomass, heat pumps, solar thermal) by providing regular incentive payments over the lifetime of the technology for actual heat energy generated. The level of tariff is dependent on the size and type of technology and is calculated to cover capital costs, operating costs and non-financial 'hassle' costs over the lifetime of the technology. To date, the NI RHI schemes have increased renewable heating to around 3½% and the Executive's interim target of 4% is expected to be achieved before the end of 2015. The RHI is expected to continue to increase the level of renewable heat in line with the longer term targets set by the EU and by the Executive.

Previous DFP Approval (Non Domestic RHI Scheme)

2.7 The interim domestic Renewable Heat Premium Payment (RHPP) and the Non Domestic RHI schemes were introduced in May and November 2012 respectively. The full Domestic RHI Scheme was introduced in December 2014 to replace the RHPP. The proposed tariffs for the Non Domestic RHI and RHPP schemes were developed on behalf of DETI through an assessment carried out by Ricardo-AEA (**Annex A**). This assessment informed the business case for both schemes (**Annex B**). This was approved by DFP in April 2012 on the basis that:

- *Whilst the scheme is envisaged to be open to new installations until 2020, approval is given for the period 1 July 2012 to 31 March 2015, representing the period for which HMT funding has been secured. Any decision to continue the scheme beyond 2015 would require further/separate DFP approval;*
- *As outlined in Section 7.53 of the Business Case, arrangements are put in place for scheduled reviews to allow the progress of the scheme to be monitored, assessed and if necessary, changes implemented. It is noted that the first review is scheduled to start in 2014 and that the reviews will be carried out by DETI.*

2.8 With low levels of uptake and under spends with both RHI schemes, the Department undertook a Phase 2 Review of the RHI in 2013 to improve scheme performance. This included proposals to:

- extend the Non Domestic scheme to further renewable heating technologies;
- introduce a full Domestic RHI Scheme with annual tariff payments (to replace the RHPP scheme);
- introduce biomass sustainability and emission standards; and
- introduce annual cost control measures.

The proposals were subject to public consultation in October 2013 (**Annex D**) and informed by a further detailed assessment carried out by Ricardo-AEA (**Annex C**).

2.9 Following the public consultation, the Department prioritised implementation of the domestic scheme over the non domestic phase 2 proposals. This involved securing EU State Aid and DFP approval and putting in the place the necessary Domestic RHI legislation.

Need for further DFP Approval for the Non Domestic RHI Scheme

2.10 Regrettably, with the focus on implementing the domestic scheme, the need to secure further DFP approval to continue the Non Domestic RHI scheme beyond 31 March 2015 was overlooked and not sought. DETI Energy officials had wrongly assumed that like the domestic scheme, approval for the Non Domestic RHI scheme had been secured until scheme closure in March 2020. Given this position on approvals for the non domestic scheme, the Department has been assessing options to prevent ongoing, irregular funding. This concerns committed expenditure for new non domestic applications approved from 1 April 2015. Committed expenditure (over 20 years) for applications approved prior to 1 April 2015 is covered by the original Business Case approval in 2012.

2.11 The basis for the scheme is statutory. It is therefore not possible to cease, suspend or otherwise delay applications. This has been confirmed by DSO (**Annex E**). Effecting legislative change requires affirmative resolution of the NI Assembly and can take many months to complete. The Department is taking work forward legislative proposals to reduce tariffs for new biomass installations (which make up 97% of all applications) from November 2015. This is covered in more detail in Section 4.

2.12 The Department is seeking DFP approval to regularise the position in relation to expenditure under the Non Domestic RHI scheme (both RHI payments and administration costs) both retrospectively from 1 April 2015 and prospectively to 30 September 2016 on the basis that expenditure is unavoidable and constitutes a binding legal commitment. Approval is also sought on the basis of the scheme's continuous and continuing provision of value for money which is assessed in Section 3. DFP approval is also sought for increased expenditure under both RHI schemes in light of increased uptake and committed expenditure over the past 9 months.

2.13 Before seeking further DFP approval for a longer scheme extension beyond September 2016, the Department needs clarification on the level(s) of future RHI allocations for NI and whether there will be any NI DEL consequences. Subject to clarification on availability of future funding, the Department will complete a review of the non domestic RHI and submit a further Business Case to either close or extend the scheme. A scheme extension would be predicated on ensuring effective budgetary controls are put in place to manage future expenditure. More information on this is covered in Section 4.

3. RHI SCHEME PERFORMANCE AND AFFORDABILITY (BOTH SCHEMES)

3.1 Both RHI schemes are demand led. It is therefore difficult to predict and manage future uptake and expenditure. For this reason HMT agreed to fund the RHI through Annual Managed Expenditure (AME). £25m of AME was initially allocated to the NI RHI for the 4 year 2011-15 period. This initial allocation was based on the Barnett formula with NI receiving 2.98% of the DECC allocation of £860m.

3.2 A delay in securing EU State Aid approval meant that the non domestic RHI scheme wasn't introduced until November 2012. This delay together with low levels of initial uptake generated an under spend of around £14m during the first 4 years. This is investment that the NI economy has effectively lost out on. The Department's focus over the past 12 months has therefore been on trying to improve the performance of the RHI to achieve the Executive's PfG target of 4% renewable heat in 2015 and ensure that the renewable heating sector and the wider NI economy benefits from this investment. This included introducing the full Domestic RHI Scheme in December 2014 and completing an extensive advertising campaign during 2014/15.

Non Domestic RHI Scheme Performance

3.3 Table 3.3 shows how the Non Domestic RHI has performed over its first 4 years in terms of application numbers, expenditure and the amount of renewable heat incentivised. Despite a sustained reduction in oil prices, the Department has successfully increased scheme uptake over the last 12 months.

Year	Average Application Nos		Committed RHI Expenditure			Incentivised Renewable Heat (GWhr)		
	Monthly	Total	Committed Monthly Expenditure (at year start)	Average Monthly Increase	Financial Year Total	Annual Increase	Total	% of total NI Heat Demand
2012/13	3	9	£0	£6k	£19k	3.5	3	2.04%*
2013/14	10	119	£19k	£21k	£650k	46.1	50	2.32%
2014/15	36	435	£267k	£75k	£6.5m	168.7	218	3.33%
2015/16* (Apr-Oct)	53	371	£1.3m	£110k	£21.5m	143.9	362	4.19%
2015/16*** (Nov-Mar)	40	200		£83k		77.6	440	4.65%

*Includes base levels of 300GWh (1.7%) in 2010 and 37GWh incentivised through Domestic RHI / RHPP by 30/9/15.

**Based on actual application numbers from April to Sep.

***Estimated figures for quarters 3 & 4 reflect proposed tariff changes in Autumn 2015.

3.4 The total number of renewable heating installations under the scheme has increased from 263 to 800 during the 12 months from September 2014 to August 2015. Over 50 applications are currently being received every month. If these uptake levels are retained, the PfG 4% target will be achieved before the end of the calendar year. This recent increase in applications has been driven by a move in the NI poultry sector away from LPG to biomass heating systems for its broiler houses. Table 3.4 shows the technology mix of applications received to date.

Technology	Banding	Tariff / kwh	Applications
Ground Source Heat Pump	< 20 kw	9.0p	3 (0.37%)
	20 – 99 kw	4.6p	3 (0.37%)
	> 100 kw	1.3p	0
Solar Thermal	< 200 kw	9.1p	3 (0.37%)
Biomass	< 20 kw	6.7p	3 (0.37%)
	21 – 99 kw	6.4p	775 (96.9%)
	> 100 kw	1.5p	13 (1.6%)
Biomethane Combustion & Injection	All sizes	3.3p	0
Total			800

3.5 Biomass heating systems in the 21-99 kw banding make up 775 (or 97%) of all applications received to date. Most of these current biomass applications are for 99kw installations for the poultry sector. Conversion to biomass heating not only provides the NI poultry industry with a cost effective, low carbon alternative to liquid petroleum gas (LPG), but more importantly keeps chicken litter drier, reducing ammonia levels, boosting bird growth and improving bird welfare. The Non Domestic RHI scheme has an important role to play in the future performance of the poultry industry which forms an essential part of the NI economy in terms of jobs and investment. However, it is essential that the Non Domestic RHI scheme remains affordable and provides the right level of incentive. It is also important that an appropriate mix of renewable heating technologies is incentivised for security of supply purposes. With just over 1% of applications received for technologies other than biomass, there is a need to increase uptake of the other technologies. **Annex D** outlines the Department's Phase 2 proposals for the Non Domestic RHI Scheme which include introducing a number of new technologies and tariffs.

Domestic RHI Scheme Performance

3.6 The Domestic RHI scheme provides an upfront capital payment towards the installation costs followed by 7 years of technology based tariff payments based on the deemed heat requirement of a property based on its Energy Performance Certificate. The scheme also includes an annual payment cap of £2,500. Therefore, unlike the Non

¹ Based on Ofgem figures at 27/8/15.

Domestic scheme, where tariff payments for a given installation can significantly change from quarter to quarter, annual domestic RHI payments for individual households are effectively fixed for the 7 years. This makes managing the Domestic RHI Scheme budget much easier than the non domestic scheme. A total of 1760 domestic renewable heating insulations have been incentivised under the Domestic RHI and RHPP schemes. Biomass is still the most popular renewable heating technology in the domestic scheme making up 43% of all installations. However, unlike the Non-domestic scheme, a mix of technologies are been installed as demonstrated in Table 3.7 below.

Technology	Banding	Upfront Payment	Tariff / kwh	Applications	%
Ground Source Heat Pump	< 100 kw	£3,500	8.3p	219	12%
Air Source Heat Pump	< 100 kw	£1,700	3.6p	245	14%
Solar Thermal	< 100 kw	£320	13.7p	541	31%
Biomass	< 100 kw	£2,500	5.7p	755	43%
Total				1760	

3.7 An average of 40 applications per month has been received since the Domestic RHI Scheme opened in December 2014. Table 3.8 shows how the Renewable Heat Premium (RHPP) and full Domestic RHI schemes have performed in terms of application numbers, expenditure and the amount of renewable heat incentivised. Despite a sustained reduction in oil prices, the Department has successfully managed to sustain scheme uptake over the last 12 months.

Year	Number of Installations	Committed RHI Expenditure		Incentivised Renewable Heat (GWhr)*		
		Capital Payments £	Estimated RHI Payments (7yr total)	Annual Increase	Total	% of total NI Heat Demand
2012/13	326	307,900	N/A	6.84	6.84	0.04
2013/14	588	1,033,680	N/A	12.34	19.18	0.11
2014/15 (Apr-Dec)	376	842,720	N/A	7.89	27.07	0.16
2014/15** (Dec-Mar)	151	255,440	12,104,400	3.17	30.24	0.16
2015/16 (Apr-Sep)	319	589,240	2,679,600	6.69	36.93	0.22
Total	1760	3,028,980	14,784,000		37	0.22

*Based on average domestic heat requirement of 21,000 Kwh / year

** Assumed average annual payment of £1,200 per installation.

***Domestic RHI Scheme started in Dec 14 and includes tariff payments for 1,231 installations transferred from RHPP.

RHI Scheme Affordability

- 3.8 The recent increase in uptake has seen committed monthly non domestic RHI expenditure rise by over £1m over the last 12 months. Forecast expenditure for both RHI schemes in 2015/16 is now over £23m. However with previous under spends total scheme expenditure during the 2011 to 2016 period is still within the 5 year AME allocation of £37m (£25m + £12m). The initial 4 year AME allocation of £25m (£2m/£4m/£7m/£12m) was profiled to reach £12m by 2014/15. The original 2012 business case (**Annex B**) then assumed that the 10% renewable heat target could be achieved by 2020 by continuing to increase the annual allocation by £5m to reach a maximum of £42m in 2020/21. However, the revised CEPA / Ricardo-AEA assessment completed in 2013 (**Annex C**) concluded that the 1,000 GWh of additional renewable heat needed to achieve the 10% target in 2020 could not be achieved within a £42m constraint in 2020/21.
- 3.9 To achieve 1,000 GWh within these assumed allocations, the average heat costs (tariffs) for both RHI schemes would have to be 4.2p/KWh or less for all technologies. Experience with both the GB and NI RHI schemes has shown that rates of 4.2p/KWh or less would not provide the investment returns necessary to attract investors into a new industry and generate sufficient levels of uptake to meet UK and EU targets. Apart from the sharp increase in biomass applications over the last 12 months, uptake of the Non Domestic RHI scheme for other technologies has been low even with rates significantly higher than 4.2p/KWh. Low oil prices make switching to renewable less attractive and have impacted on uptake. A fine balance therefore exists between providing an incentive/tariff that is high enough to attract applications and uptake but is low enough to be affordable and provide value for money. Section 4 provides an assessment of the scheme's continuous and continuing provision of value for money.
- 3.10 The Department's most recent AME forecast of RHI expenditure in October 2015 is set out in **Annex I** (first Tab). This assumes both schemes remain open until March 2020. Table 3.10 below compares this recent forecast against the profile approved by DFP as part of the Domestic RHI business case in September 2014. It also includes a profile based on the Barnett consequential (2.98%) of DECC's most recent forecasts for the GB RHI.

Forecast	14/15	15/16	16/17	17/18	18/19	19/20	Total
Domestic Capital	1,140,000	1,015,000	1,560,000	2,760,000	3,510,000	3,802,500	13,787,500
Domestic Resource	245,085	329,000	1,032,000	711,000	3,888,000	5,700,500	11,905,585
Non Domestic Resource	6,540,280	21,470,985	31,609,727	36,445,177	39,925,052	42,295,247	178,286,468
October 2015 AME Forecast	7,925,365	22,846,185	34,232,927	39,947,377	47,354,252	51,798,247	203,979,553
Included in Domestic RHI Business Case	6,500,000	9,500,000	13,500,000	18,500,000	24,500,000	31,000,000	103,500,000
Barnett's % of GB RHI Forecast	6,496,400	13,976,200	19,966,000	26,283,600	36,236,800	49,170,000	152,129,000

3.11 The October 2015 forecast factors in the Department's proposed legislation to reduce non domestic RHI incentives for biomass from the autumn 2015 and assumes that new application numbers and associated expenditure will reduce as a result. Total forecast RHI expenditure for the 6 year 2014-20 period is now £204m - almost twice the profiled amount (£103m) included in the Domestic RHI business case last year. This is attributed to the unprecedented increase in non domestic applications and committed monthly payments over the last 12 months.

3.12 Forecast expenditure is also significantly higher than the figure of £152.1m based on the "Barnett consequential" of the DECC forecast. In order to bring future RHI expenditure back down to within the Barnett envelope, it is likely that the Non Domestic RHI scheme (which currently accounts for over 85% of total forecast RHI expenditure) would have to close much sooner than the original planned closure date of March 2020. This of course will mean that the Executive's 10% renewable heat target will not be achieved. A strong reaction could be expected to such an announcement.

3.13 A case can be made for increasing NI RHI funding above the Barnett allocation. Despite the difference in populations, application numbers for the NI RHI scheme are currently running at 5% of the GB scheme. As highlighted in Section 2, the GB RHI and NI RHI are different schemes targeting significantly different heating markets with oil accounting for 70% of the NI heating market (unlike GB where natural gas is prevalent). Traditionally oil is more expensive than gas so there should be more scope for incentivising NI households and businesses to switch to renewable heating technologies. The rural nature of NI also makes it more suitable for renewable technologies such as biomass and Combined Heat and Power (CHP). In addition, the poultry sector in NI, currently the largest convert to renewable heating (biomass), with 800 broiler houses is four times the size of that in England (with 200 houses). Moy Park's current expansion will see the number of NI poultry houses (and biomass applications) increase even further.

- 3.14 Nonetheless, previous correspondence between DETI and HMT officials in 2012, indicated that RHI funding may not be treated as normal AME and that there may be NI DEL consequences / penalties of “overspending”. It is not clear what this means but one assumption could be expenditure above the Barnett levels. Clarification is therefore needed from DFP/HMT on whether there will be any NI DEL consequences of ongoing provision of an RHI scheme. If there are penalties or consequences for the NI Block of spending more than the Barnett allocation, both RHI schemes may need to be closed in 2016.
- 3.15 One option that we have explored with DECC is that HMT would only have concerns about the overall budget for UK RHI schemes. Should DECC find that available funding is not being fully utilised in GB they might agree that NI would come within an overall envelope. However, DECC do not anticipate a shortfall in 2015/16.
- 3.16 With the Department’s expenditure forecast, it estimated that 8% renewable heat can be achieved by 2020. It is hoped however, that the Department’s Phase 2 RHI proposals for the non domestic scheme will improve scheme uptake and increase the number of renewable heating technologies installed. **Annex D** sets out the Phase 2 proposals for the Non Domestic Scheme which include:
- introducing a number of new tariffs and technologies including Combined Heat and Power (CHP) and Air Source Heat Pumps;
 - increasing the tariffs for poor performing technologies such as biogas injection/combustion to stimulate interest; and
 - introducing a system of annual cost control (including the ability to adjust tariffs in year without legislation).
- 3.17 However, the Phase 2 proposals alone are unlikely to be enough to achieve the NI Executive’s current 10% target for 2020. Even with the Phase 2 proposals, it will be a challenge to achieve 10% renewable heat within the current AME forecast. It is likely that higher tariffs and increased expenditure will be needed to deliver the necessary levels of uptake. Achieving 8% renewable heat from a 2010 baseline of 1.7% would however, still be a significant achievement.
- 3.18 Therefore, once the future RHI budgetary position has been clarified by DFP/HMT, the Department will complete a more detailed review of the RHI to assess the levels of renewable heat currently in place and how much additional heat can realistically be afforded going forward.
- 3.19 To enable this review to take place, approval is sought to extend the Non Domestic Scheme to September 2016. Table 3.17 below provides a forecast of the additional expenditure associated with a further 18 months of Non Domestic RHI commitments. It is set out in detail in **Annex I** (2nd tab). Due to the long term nature of support provided

by the RHI scheme it should be noted that the 18 month extension generates an additional £97m of Non Domestic RHI expenditure over the 6 year 2015-21 period.

Table 3.17 – Non Domestic RHI Expenditure (for commitments up to 30 Sep 2016) £,000

Non Domestic Forecast	15/16	16/17	17/18	18/19	19/20	20/21	6 Year Total	<u>20 Year Total</u>
Previous Commitments (Nov12 – March15)	13,058,742	13,058,742	13,058,742	13,058,742	13,058,742	13,058,742	77,229,074	261,174,840
New Commitments (Apr15-Sept16)	8,412,243	17,433,545	17,838,035	17,838,035	17,838,035	17,838,035	97,197,926	355,789,389
Revised AME Forecast (Oct15)	20,646,533	27,775,514	28,180,004	28,180,004	28,180,004	28,180,004	161,142,063	616,964,229

3.20 Following the RHI review, the DETI Minister and NI Executive will then have to either agree a reduced 2020 RHI target (possibly 8%) or make a case to HMT / DECC for increased funding for the NI RHI. The Department's ongoing review of the Strategic Energy Framework (SEF) provides an opportunity for the RHI target to be revised and included in the NI Executive's next Programme for Government (PfG) in 2016.

To inform a decision on the future of the NI RHI, the Department will complete a review of both schemes to assess the levels of renewable heat currently in place and how much additional heat can realistically be afforded going forward.

To inform this Review, clarification is sought from DFP/HMT on whether:

- (i) future NI RHI expenditure can be increased as demand increases like traditional AME or whether it is restricted by the Barnett formula or some other measure constituting "overspending"; and**
- (ii) what are the NI DEL consequences / penalties of "overspending".**

Given support for the scheme, it should not be assumed that the Executive would be unwilling to contribute to its funding from DEL should that be necessary.

Approval is sought to extend the Non Domestic RHI Scheme for 18 months to September 2016 to enable this review to take place. The additional expenditure requirements are summarised in Table 3.17 above.

4. VALUE FOR MONEY ASSESSMENT (BOTH SCHEMES)

NPV Assessment - Non Domestic RHI Expenditure up to 31 March 2015

- 4.1 The Non Domestic RHI scheme provides financial support for renewable heat technologies for the lifetime of the installation (to a maximum of 20 years). Payments are made on a quarterly basis and determined by the actual metered heat output of the system. A cost benefit analysis of the non domestic scheme was undertaken in the original business case for the scheme by the consultants CEPA and Ricardo-AEA (**Annex A**). They developed an economic model which assessed the expected uptake of renewable heat together with the displacement of oil and gas that this implied. The analysis found that the NPV for the scheme was £-242m assessed against a do nothing approach.
- 4.2 CEPA and Ricardo-AEA also undertook an assessment of the development of Phase 2 of the Renewable Heat Incentive in 2013 (**Annex C**) which included development of the Domestic RHI Scheme and a number of new technologies/tariffs for the non domestic scheme. Quantifiable benefits identified again related to carbon emissions with the costs made up of the subsidy payments plus an allowance for administration costs. The consultants' conclusion was that none of the options had a positive NPV purely on a quantitative basis. They did conclude that the net effect of renewable heat on employment would be positive but did not attempt to quantify this. While concluding that the costs appear to outweigh the benefits for all options they calculated the cost-effectiveness of the options.
- 4.3 It was concluded that introducing a seven year tariff for the Domestic RHI together with a number of new non domestic tariffs / technologies (e.g. CHP, District Heating, large biomass, etc) was the most cost-effective option. The full Domestic RHI Scheme was introduced in December 2014. The Phase 2 Non Domestic proposals are outlined in **Annex D**.

NPV Assessment – Non Domestic RHI Expenditure from 1 April 2015

- 4.4 As mentioned in Section 2.11, the Department is legally bound to continue accrediting new Non Domestic RHI installations at the current tariff levels until legislative changes can be made. Expenditure for new commitments during this period is therefore unavoidable. However, to assess the scheme's continuous and continuing provision of value for money in achieving the Executive's sustainable energy objectives, we have calculated the costs and benefits of new installations accredited onto the scheme since March 2015. The costs of the scheme relate to the actual payments made or anticipated to be made for the projects assisted. In addition to the carbon benefits, we have attempted to quantify the employment benefits for the first time. This is more consistent with the approach taken in assessing the cost-benefit of other renewable schemes.

- 4.5 Three months of actual application data from April to June 2015 was used. This was doubled to give an estimate of scheme expenditure for the six month period from March to September 2015. Tariff reductions are proposed from November 2015. Total committed annual expenditure for the six months of new applications is estimated to be £7.16m. This expenditure is then forecast to be paid for 20 years. The total estimated costs and carbon benefits for the six months of applications provide a net present cost of £56.79m over 20 years.
- 4.6 The previous consultants' studies did mention positive employment benefits but did not attempt to quantify them. However, in a separate piece of analysis for the Department in relation to the costs and benefits of the Executive's 40% renewable electricity target, consultants Ricardo-AEA estimated the job-years created by different renewable technologies and the gross value added to the NI economy that this employment would bring. We have applied the same methodology to estimate the benefits of the RHI scheme to NI.
- 4.7 Using the estimate of 74.5 job-years per MW of biomass installed and an average NI gross value added (GVA) per job of £51,092, it is estimated that the six month tranche of RHI installations generates an annual benefit of £5.1m². This figure takes account of likely displacement of jobs from the home heating oil business. The Department's analysis has shown that GVA in the heating oil business is typically 5% of turnover in NI. We have estimated the volume of heating oil displaced based on the CO₂ savings identified and estimated the turnover displaced, this represents by using GCC's long term average cost of NI heating oil. The calculations show an annual GVA displacement from the home heating oil sector of £333k due to this six month tranche of RHI support
- 4.8 The overall NPV of the six months of Non Domestic RHI support, taking into account the subsidy costs together with the environmental and employment benefits, (including displacement offset), is **£1.85m**. An assessment was also completed on the same 6 months of data to demonstrate how the scheme's value for money improves after the Department's proposed tariff changes are made. The NPV increases to **£41.3m** once the changes are applied. The two assessments are summarised in the table below and detailed in **Annex F**.

² Source of figures: 'Ricardo AEA review of the Costs and Benefits of the Northern Ireland Executive's 40% Renewable Electricity Target'- Report for DETI, May 2015. With 74.5 job-years per MW, biomass is one of the highest energy employers. For example, Solar PV is estimated to create 16.7 job-years per MW. The higher biomass jobs figure is likely to be explained by ongoing cultivation of fuel and greater O&M needs. Ricardo has calculated the GVA figures based on NI average GVA published by NISRA. Ricardo's GVA estimate aligns with the estimate for Northern Ireland by the Centre for Economics and Business Research Ltd in their June 2010 report on "The economic value of the woodfuel industry to the UK economy by 2020" for the Forestry Commission.

Cost / Benefit Description	Current Tariffs Total (£m)	Proposed Tariffs Total (£m)
Cost of Non Domestic RHI for projects Apr-Sept 15	(150.38)	(73.87)
Carbon reduction benefits (£m)	50.22	50.22
Estimated Jobs GVA (£m)	107.16	107.16
Net Cost-Benefit (£m)	7.00	83.5
NPV (£m)	1.85	41.3

4.9 Previous studies have shown that the RHI has a net present cost to the economy and the most cost-effective tariff scheme was chosen for both sectors (Non Domestic / Domestic) to attempt to meet the 10% target for renewable heat delivered in 2020. The analysis for the six months tranche of assistance also shows a negative NPV. However when the employment benefits are quantified the cost-benefit analysis becomes positive. It was always anticipated that the RHI scheme would have to be 'pump primed' and have higher tariffs in the early years to generate sufficient uptake. As uptake levels grow and more businesses switch to renewable heating, it was expected that the capital and running costs of these technologies would reduce and that tariffs would be reduced accordingly. Although the NPV is relatively small at £1.85m, the higher tariffs have been needed to generate the current levels of uptake. Because of this, the Department can now reduce tariffs (and improve the NPV) going forward but still hopefully maintain uptake.

Rate of Return Assessment – Non Domestic RHI Scheme

4.10 The Non Domestic RHI Scheme's continuous and continuing value for money has been assessed in sections 4.4 - 4.8 above but it is also important that the rate of return that the scheme provides for investors is in line with its EU State Aid notification/approval and that it isn't overly generous. The vast majority of non domestic RHI applications are for biomass technology and most of these are for 99kW boilers in the poultry sector. To inform this assessment, the Department asked the Department of Agriculture and Rural Development (DARD) to complete an assessment of the heating needs of a typical poultry house. This is provided at **Annex H**.

4.11 The original biomass tariffs were based on providing a Rate of Return of 12% with the initial capital outlay for installing the renewable heating system paid back within 7-8 years. The DARD report shows that 388,000kWh of biomass heat is the upper limit of the expected annual heat requirement for a typical poultry shed. Taking the 99kW boiler as the main provider of heat in most situations and 90% efficiency, this equates to some 4,355 annual hours of operation (388000 / (99x0.9)). The DARD report shows that a maximum incentive of 1.5p/kWh is required over a comparable LPG heating system to

cover the difference in fuel and running costs. If fuel/running costs (1.5p/kWh) are deducted from the current tariff of 6.4p/kWh, this leaves a tariff of 4.9p/kWh for determining the Rate of Return. If 90% boiler efficiency is assumed, the maximum estimated annual payment for a typical poultry house is:-

$$\text{Total Annual Payment} = 388,000 \times 90\% \times 0.064 = \text{£}22,349$$

$$\text{Annual Payment (towards capital)} = 388,000 \times 90\% \times 0.049 = \text{£}17,111$$

4.12 The capital cost of a typical 99kW biomass heating system is £50,000. The current RHI tariffs are therefore currently delivering payback in around 3 years (or 33%). However, it must be emphasised that the Rate of Return for other sectors with different boiler sizes or lower operating hours will be much lower. For example, the Rate of Return for a 99kW boiler with 2,000 annual hours (typical for other sectors) is just under 6 years (or 17%). Given that the expected payback for capital investments of this nature would be 7 – 8 years (or 12%), the position above reflects the reduction over time in biomass technology costs.

Proposed Tariffs Changes in November 2015

4.13 The increased rate of return plus the issue of affordability going forward requires the biomass RHI tariffs to be reduced whilst still maintaining a sufficient incentive to ensure uptake of the technology. To address this, the Department is currently progressing legislation to reduce biomass tariffs for future applicants. The final policy for these changes has been approved by the Minister and ETI Committee and can be viewed on the DETI website via the link below³. Subject to Assembly clearance, it is hoped these initial changes can be implemented in November 2015. These changes are outlined below:

- **Proposed Changes to Biomass Tariff:** the current tariff banding, (20-99kW), has resulted in a large number of applications for 99kW boilers. It is proposed to widen this banding up to 199kW (as is the position in GB), to encourage larger more efficient installations.
- **Two Tier Tariff System:** a two tier tariff system will also be introduced. The standard tariff will apply to the first 1314 peak hours (15% of total possible hours). This is in line with the position introduced by DECC for the GB scheme. Hours over and above these peak hours will be paid at the reduced tariff rate of 1.5p/kWh. The rationale for introducing a tiered tariff is that the RHI uplift for the peak hours is towards the capital repayment, whilst the 1.5p/kWh is towards running costs. Using the example as quoted above the revised annual figures would be:-

³ http://www.detini.gov.uk/final_policy_paper_on_rhi_proposals__september_2015_.pdf

Tier 1: $1314 \times 99 \times 90\% \times 0.049 = \text{£}5,737$ (contribution towards capital)

Tier 2: $4,355 \times 99 \times 90\% \times 0.015 = \text{£}5,820$ (contribution towards running costs)

Total Annual Payment = $\text{£}11,557$

This example shows the total annual payment is effectively halved by the tariff changes and that capital payback (at $\text{£}5,737/\text{yr}$) would be achieved in 8.7 years (or 11.5%). The Rate of Return will be the same for all boilers of the same size if the operating hours are 1314 or higher. Evidence from the poultry industry would suggest that 99kW biomass boilers don't meet all the heating requirements of a poultry house during certain stages of chicken development or during periods of colder weather. LPG is used to meet the additional heating requirements during these periods. Extending the 6.4p/kWh tariff to biomass plants up to 199kW in size is therefore likely to incentivise the poultry industry to install boilers significantly larger than 99kW to meet all its heating needs and remove the need for LPG. Using 388,000 kWh as the maximum heat requirement of a typical poultry house and assuming 90% boiler efficiency, the annual incentives for a 150kW and 199 kW are shown below:-

Boiler Size	150 kW	199 kW
Assumed Capital Cost	£75,000	£90,000
Annual Operating Hours	$388,000 / (150 \times 90\%) = 2,874$ hours	$388,000 / (199 \times 90\%) = 2,166$ hours
Tier 1 Payment (capital return)	$1314 \times 150 \times 90\% \times 0.049 = \text{£}8,692$	$1314 \times 199 \times 90\% \times 0.049 = \text{£}11,531$
Rate of Return	11.6% (8.6 years)	12.8% (7.8 years)
Tier 2 Payment (towards running costs)	$2874 \times 150 \times 90\% \times 0.015 = \text{£}5,820$	$2166 \times 199 \times 90\% \times 0.015 = \text{£}5,819$
Total Annual Payment	£14,512	£17,350

- Annual Payment Cap:** the proposals to extend the 6.4p/kWh biomass tariff banding up to and including 199 kW boilers and to introduce a tiered tariff of 1.5p/kWh will provide a reduced Rate of Return of between 11.6% (8.6 years) and 12.8% for new applications from the poultry industry depending on boiler size. This would bring the Non Domestic RHI tariffs back into line with the 12% Rate of Return included in the EU State Aid approval. The introduction of the tiered tariff will also reduce the risk of 'gaming' and installations being operated over and above the required kilowatt hours just to generate RHI income. However, the Department also proposes to introduce an annual cap on eligible kilowatt hours above which no further incentives will be paid. DARD has determined the maximum annual heat requirement for a typical poultry house to be 388,000 kWh.

Allowing for 12,000 kWh of additional heat for exceptionally cold years, the Department proposes to introduce a cap of 400,000 kWh (or 2,233 hours for 199kW boiler). As shown below, the maximum possible annual payment under this cap would be £17,530.

Tier 1: $1314 \times 199 \times 90\% \times 0.049 = £11,531$ (capital return)

Tier 2: $2233 \times 199 \times 90\% \times 0.015 = £5,999$ (running costs)

Total Annual Payment = £17,530

The Department seeks DFP approval to regularise the position in relation to non domestic RHI scheme expenditure (both RHI payments and administration costs) both retrospectively from 1 April 2015 and prospectively to 30 September 2016 on the basis that:

- Expenditure is unavoidable (as accreditations during this period constitute a binding legal commitments);
- the scheme provides continuous and continuing value for money;
- legislation will be brought forward in November 2015 to introduce tariff tiers and an annual payment cap for all new biomass installations; and
- the Department will complete a review of the scheme to ensure effective controls are put in place to manage future expenditure.

NPV Assessment – Domestic RHI Expenditure to date

4.14 The economic assessment for Phase 2 of the RHI (**Annex C**) concluded that introducing a seven year tariff for the Domestic RHI together with a number of new non domestic tariffs / technologies (e.g. CHP, District Heating, large biomass, etc) was the most cost-effective option. The business case for the Domestic RHI Scheme was approved by DFP in September 2014 and introduced in December 2014 on the basis of the funding profile shown in Table 4.13 below.

Table 4.13 – Previous RHI Expenditure Forecast (included with Domestic RHI Business Case)

Forecast	14/15	15/16	16/17	17/18	18/19	19/20	Total
Domestic Capital	1,140,000	900,000	900,000	900,000	900,000	900,000	5,640,000
Domestic Resource	1,220,128	1,192,188	1,573,788	1,955,388	2,336,988	2,718,588	10,997,068
Total Domestic RHI	2,360,128	2,092,188	2,473,788	2,855,388	3,236,988	3,618,588	16,637,068
Non Domestic Resource	4,136,383	7,380,192	11,028,192	15,735,192	21,258,192	27,723,192	87,261,343
Total RHI	6,496,511	9,472,380	13,501,980	18,590,580	24,495,180	31,341,780	103,898,411

4.15 However, in light of experience with administering the Domestic RHI Scheme over the last 10 months, the Department's forecast of scheme expenditure has increased to the levels set out in Table 4.14 below. This is taken from the Department's most recent forecast which is included in **Annex I** (4th tab). The Department is therefore seeking DFP approval to increase Domestic RHI Scheme expenditure during the 6 year approval period from £16.6m to £25.7m.

Forecast	14/15	15/16	16/17	17/18	18/19	19/20	Total
Domestic Capital	1,140,000	1,015,000	1,560,000	2,760,000	3,510,000	3,802,500	13,787,500
Domestic Resource	245,085	329,000	1,032,000	711,000	3,888,000	5,700,500	11,905,585
Total Domestic RHI	1,385,085	1,344,000	2,592,000	3,471,000	7,398,000	9,503,000	25,693,085
Non Domestic Resource	6,540,280	21,470,985	31,609,727	36,445,177	39,925,052	42,295,247	178,286,468
Total RHI	7,925,365	22,814,985	34,201,727	39,916,177	47,323,052	51,798,247	203,979,553

4.16 To assess the Domestic RHI scheme's continuous and continuing provision of value for money we have calculated the costs and benefits of installations accredited onto the new scheme since it was introduced. The costs of the scheme relate to the actual upfront payments made together with committed future expenditure associated with the 7 years of annual tariff payments. The benefits include the monetary CO2 savings together with job creation. The same methodology was applied to calculate job benefits associated with biomass installations (section 4.6 above). No job benefits were included for either heat pump or solar thermal installations. Although it is expected that both renewable technologies would create added job benefits and improve the NPV.

4.17 The overall NPV of the first 9 months of the Domestic RHI scheme, taking into account the subsidy costs together with the environmental and employment benefits (including displacement offset), is **£5.96m**. The analysis is summarised in the table below and detailed in **Annex G**.

Cost / Benefit Description	Total (£m)
Cost of Dom RHI for approvals (Dec 14 – Sep 15)	(4.87)
Carbon reduction benefits	3.93
Estimated Jobs GVA (for Biomass only)	15.56
Net Cost-Benefit	14.62
NPV (£m)	5.96

Rate of Return Assessment – Non Domestic RHI Scheme

- 4.18 There is no evidence through the levels of uptake since the Domestic RHI Scheme was introduced 10 months ago to suggest that the RHI tariffs need reduced. Unlike the Non Domestic scheme, the annual payments are fixed and based on the individual heat requirements of a property as assessed through its Energy Performance Certificate (EPC). There is also an annual payment cap of £2,500.
- 4.19 The assessment below is based on a typical domestic biomass installation. Biomass is currently the most popular renewable heating technology under the Domestic RHI accounting for 43% of all accredited installations. The fuel figures in SAP 2009⁴ which is currently used for Energy Performance Assessments in NI are 5.45p/kWh for biomass pellets and 4.06p/kWh for heating oil. However, the biomass tariff of 5.7p / kWh has to cover the extra running (fuel/maintenance) costs of biomass over oil. Based on the DARD assessment (**Annex H**), this requires an additional 0.65p/kWh. This makes the running costs of biomass 2.04 p/kWh more expensive than oil. Deducting this 2.04 p/kWh from the RHI Biomass tariff leaves 3.66 p/kWh towards the capital costs. Based on these figures, the Rate of Return is 10.2% (or 9.8 years) which is line with the proposed Non Domestic tariff changes. No tariff changes are therefore proposed.

Assumed Capital Cost	£10,000
Upfront Grant	£2,500
Outstanding Costs	£7,500
Typical Annual Heat Demand	21,000 kWh
Annual Payment (towards capital)	21,000 x (0.0366) = £768.60
Rate of Return	7500 / 768.6 = 9.8 years (or 10.2%)

Subject to budget clarification, the Department seeks DFP approval to increase Domestic RHI Scheme Expenditure for the 5 year (2015/21) approval period to the levels in Table 4.14 above on the basis that the scheme's continuous and continuing provision of value for money has been demonstrated.

⁴ The Government's Standard Assessment Procedure for Energy Rating of Dwellings 2009 edition - http://www.bre.co.uk/filelibrary/SAP/2009/SAP-2009_9-90.pdf.

5. NEED FOR FURTHER BUDGET MANAGEMENT / COST CONTROL MEASURES

Background

5.1 As set out in Section 4, the Department is currently drafting legislation to reduce biomass tariffs for future applicants to address the recent surge in Non Domestic RHI applications and committed expenditure. However, making legislative changes can take many months to complete depending on the complexity. This makes it very difficult to react quickly to large increases in uptake. In the longer term, the Department therefore plans to legislate for an annual system of digression where tariffs for both RHI Schemes can be changed if in-year expenditure or application triggers are reached.

Need for More Flexibility to Make Tariff Changes

5.2 One of the biggest challenges with forecasting future Non Domestic RHI scheme expenditure is that uptake levels and individual payments fluctuate month by month. Estimated quarterly payments for accredited heating installations must be accrued until such time as the individual businesses submit their meter readings online to Ofgem. This can take many months. There can also be quite a variation on the payment amount depending on the type of business and of course the weather/temperature. This is what happened with the large increase in biomass applications from the poultry industry. Forecast payments for new applications had been based on the average operating hours of previously accredited installations which had typically been around 2000 hours / year generating a payment of around £12,700. The poultry installations subsequently proved to have average operating hours of over 4000 and annual payments of up to £30,000.

5.3 Similar variations can arise when forecasting expenditure for new Non Domestic RHI applications. The current forecast assumes £100k of additional monthly expenditure based on receiving 50 applications. If more or less applications are received in any given month, this can have a significant impact on financial year expenditure particularly if it occurs early in the year. For example, if expenditure associated with new applications proves to be £150k (i.e. £50k more) in April, this increases the annual expenditure by £600k (i.e. 12 x £60k). Tariff changes can also generate significant over/under spends. If new tariffs are too low, poor uptake will lead to under spends. If tariffs are too high, there could be over spends.

5.4 To provide assurance for potential investors, the RHI tariff changes are set out in legislation. This means that tariff changes can take 6 months or more to implement whilst ongoing over/under spends will continue to grow. Drafting and preparing legislation on the other hand requires a significant resource so any decisions around tariff changes must not be taken lightly and should be based on robust evidence and not on one or two months of high applications which could prove to be a blip. A balance therefore needs struck between having the flexibility to change tariffs quickly but still

encourage investment in renewable heating technologies. Investment decisions for larger renewable heating installations (>200kW) are often taken over a year before the installation is completed, by which time tariffs could have changed.

Proposals for Automatic Tariff Digression

- 5.5 DECC have introduced a system of automatic tariff digression for the GB domestic and non domestic RHI schemes where scheme expenditure is reviewed every 3 months and if budgetary triggers are breached for individual technologies, tariffs are automatically reduced by a certain percentage. The digression triggers and reduction (%s) are set out in the legislation. The GB non domestic scheme also includes a system of advanced preliminary accreditation where tariffs can be guaranteed for large scale installations that have completed a preliminary accreditation process with Ofgem. This ensures that the digression system doesn't prevent such installations coming forward.
- 5.6 To provide much more flexible in-year budgetary controls, the Department plans to introduce a system of automatic tariff digression for both RHI schemes as part of the Phase 2 proposals in 2016 where tariffs will automatically be changed to address low or high levels of uptake. Unlike GB, the NI Non Domestic RHI scheme has had very limited uptake from technologies other than biomass so introducing individual budgetary triggers for each technology is unlikely to be appropriate. A quarterly trigger based on additional overall scheme expenditure or applications might be more appropriate. However, this will be examined as part of the RHI review later this year and any proposals will be put out to public consultation. Advanced preliminary accreditation for large scale installations will also have to be considered.
- 5.7 In order for a system of automatic tariff digression to work effectively, the Department will need to set clear budgetary constraints for both RHI schemes which will inform the triggers for reduction. Therefore, clarity is needed from DFP/HMT around future RHI allocations before such a system can be implemented. The Department plans to consult on the digression proposals in the autumn so budget clarification will be needed before then. These AME allocations might also need to be included in the scheme legislation.
- 5.8 All the difficulties around Non Domestic RHI forecasting and cost control are why DECC produce 3 different forecasts (low / medium / high) for the GB RHI scheme. The Domestic RHI scheme on the other hand is much easier to predict with fixed upfront payments and annual payments determined by the Energy Performance Certificate (EPC) for the property. The domestic scheme also includes an annual payment cap of £2,500 per household. However, the Domestic RHI Scheme currently only accounts for around 15% of forecast RHI expenditure.
- 5.9 To manage the difficulties around forecasting non domestic expenditure, rather than seeking approval for a specific expenditure profile which will no doubt continue to increase or reduce to reflect inyear changes to scheme uptake, it would be much more

practical to forecast an expenditure range like DECC based on the future cost of incentivising renewable heat. Even with DECC's system of automatic tariff digression in GB, there can still potentially be 4 months of over spend before any tariffs can be reduced which could still generate a significant annual overspend. Similarly, a drop in scheme demand after a tariff reduction could generate under spends.

5.10 If DFP approval for the Non domestic RHI scheme could be provided for a future expenditure range rather than a fixed profile, a future system of automatic digression could be deployed to ensure expenditure stays within the range. Experience in GB suggests that monthly application numbers and new expenditure can significantly increase/decrease month by month. As an illustration Table 5.10 provides an example of a possible expenditure range for the non domestic scheme. It includes three different forecasts of the expenditure needed to achieve the 10% target based on incentivising new installations at average rates of 4p/KWh, 2½ p/KWh and 1½ p/KWh. The Department's October 2015 Non Domestic RHI expenditure forecast falls in between the medium and high range.

Year	Proposed Forecast Range			Incentivised Renewable Heat (GWhr)		
	Low (1p/KWh)	Medium (2.5p/KWh)	High (4p/KWh)	Annual Increase	Running Total	% NI Heat Demand
2015/16	£21,071,364	£21,071,364	£21,071,364	93.1	435	4.62%
2016/17	£25,908,467	£27,411,592	£28,914,717	185.0	620	5.73%
2017/18	£27,758,467	£32,036,592	£36,314,717	185.0	805	6.84%
2018/19	£29,608,467	£36,661,592	£43,714,717	185.0	990	7.94%
2019/20	£31,458,467	£41,286,592	£51,114,717	185.0	1,175	9.05%
2020/21	£32,306,384	£43,406,384	£54,506,384	-	1,175	9.05%
Estimated Future Domestic RHI Contribution				114	1,289	9.73%
Estimated NIRO (CHP) Contribution				50	1,339	10.03%

5.11 If expenditure increases towards the high profile, quarterly digression can be used to bring the profile back towards the middle range. Similarly, if low levels of uptake push scheme expenditure towards the low profile, tariffs could be increased for poorly performing technologies. The Department would continue to submit RHI AME forecasts within this range as part of the in year monitoring rounds.

Subject to budget clarification and DFP approval, the Department will develop a future system of tariff digression for the RHI scheme(s) based on a forecast expenditure range as part of the RHI Review over the next 12 months.

6. NON DOMESTIC RHI SCHEME ADMINISTRATION

6.1 Under Section 114 of the Energy Act 2011⁵, the Department can directly administer the RHI or outsource this function to either NIAUR⁶ or Ofgem⁷. The Domestic RHI scheme is currently administered inhouse within the Department's Energy Division. The Non Domestic RHI has been administered by Ofgem since 2012. Ofgem has considerable experience in managing large scale renewable energy grant schemes and in addition to the NI Non Domestic RHI currently administers: the Renewable Obligation in GB and the NIRO; the Feed-in-tariff in GB; and the GB commercial and domestic RHI schemes. An Administration Agreement is in place between the Department and Ofgem.

Value for Money

- 6.2 The Domestic RHI scheme calculates annual tariff payments based on a property's heating requirements set out in its Energy Performance Certificate (EPC), only a percentage of properties need to be checked for audit purposes. The Non Domestic RHI Scheme on the other hand requires that all installations to be metered and payments are calculated accordingly. Neither the Department nor NIAUR have the resource or expertise available to effectively carry out these functions. To outsource the scheme's administration to another private or public sector organisation (other than Ofgem or NIAUR) would require primary legislation which could take up to 12 months to put in place. In addition, Ofgem operates an online application and metering facility where owners of accredited plants record their quarterly metered readings. Developing a similar web based IT system specifically for the NI Non Domestic RHI scheme wouldn't be a cost effective use of public funding.
- 6.3 The Department is charged 3% of Ofgem's total administration costs for the GB and NI non domestic schemes. This is despite the fact that NI application numbers are currently running at 6% of the GB total. Any GB specific costs (legal, IT, etc) are removed before the NI costs are calculated. Similarly, any NI specific costs are added at the end and not charged to DECC for the GB scheme.
- 6.4 In 2015/16, Ofgem is expected to process over £23m of RHI payments for the NI scheme at a cost of £239k (or 1.1%). Administration costs for government grant schemes are typically between 8-10% of total grant expenditure. The Department therefore benefits from the economies of scale of being treated as a small addition to the much larger GB Scheme. Similarly, the Department also benefits from administrative changes already made by Ofgem for the GB Scheme. Whenever DECC make changes to the GB Scheme such as tariff changes, new technologies, etc, Ofgem have to upgrade their IT systems and processes. They charge DECC development costs for this work. Once these changes are made for the GB scheme, similar changes can be

⁵ <http://www.legislation.gov.uk/ukpga/2011/16/contents/enacted>

⁶ Northern Ireland Authority for Utility Regulation

⁷ Office of Gas and Electricity Markets

introduced for the NI scheme for much less cost. For example, to implement the administrative changes (IT, staff, etc) needed for the Phase 2 proposals set out in Section 5, Ofgem's development costs will be between £80k - £100k. DECC paid over £300k for similar changes for the GB scheme.

Future Administration Costs

6.5 It is proposed that Ofgem are given continued responsibility for the administration of the NI Non Domestic RHI. Ofgem were identified for this role because of their experience in effectively and efficiently developing and administering other government environmental programmes, including the GB RHI and the Northern Ireland Renewables Obligation, (NIRO). Ofgem would continue to administer the NI Non Domestic RHI alongside the GB RHI, and thereby provide significant savings to DETI. Ofgem's actual administration costs for the NI RHI scheme will continue to be based on 3% of the actual costs for administering both GB and NI schemes. An estimate of Ofgem's annual administration costs for the next 5 years is set out in Table 6.8.

Year	Forecast of Total GB/NI Scheme Costs (£)	NI Annual Administration Costs (3% of GB/NI Total)	Additional NI Specific Costs (£)		Total NI Costs	
			Admin ⁸	Development ⁹	(£)	(% of RHI Exp)
2015/16	7,300,000	218,700	5,350	15,000	239,050	1.1%
2016/17	9,735,921	292,107	30,000	100,000	422,107	1.5%
2017/18	13,897,931	416,980	30,000	-	446,980	1.4%
2018/19	14,564,850	436,989	30,000	100,000	566,989	1.7%
2019/20	14,840,815	445,269	30,000	-	475,269	1.3%
2020/21	14,983,831	449,560	30,000	-	479,560	1.3%
Total	75,323,348	2,259,605	155,350	215,000	2,629,955	

6.6 Total administration costs for the 6 year 2015-2021 period are estimated to be **£2.63m** and to remain at between 1 and 2% of forecast annual RHI expenditure. This includes £215k of development costs to allow for future changes to the scheme including the Phase 2 proposals and tariff digression. £155k / year of NI specific administration costs are also included to cover legal advice, additional audit checks and specific changes for the NI scheme.

The Department is seeking DFP approval to continue using Ofgem to administer the Non Domestic RHI Scheme for the period 1 April 2015 to 31 March 2021 on the basis that the NI administration costs will continue to be based on 3% of total administration costs for both the GB and NI Non Domestic RHI Schemes .

⁸ The NI RHI scheme has specific administration costs associated with legal advice, additional audit checks (where requested) and NI specific changes.

⁹ Development costs relate to any IT/system changes needed to implement any NI policy such as tariff changes.

7. WAY FORWARD

Non Domestic RHI Scheme Approval

7.1 The Department seeks DFP approval to regularise the position in relation to Non Domestic RHI scheme expenditure (both RHI payments and administration costs) both retrospectively from 1 April 2015 and prospectively to 30 September 2016 on the basis that:

- the scheme's continuous and continuing provision of value for money has been demonstrated (Section 3); and
- the Department will introduce legislation to reduce incentives for new biomass installations from November 2015.

7.2 To inform this Business Case, the Department completed revised forecasts of Non Domestic Scheme expenditure for previous commitments (pre April 2015) and new commitments from April 2015 to September 2016. These are included at **Annex I** and summarised in Table 7.2 below. Total estimated scheme expenditure (20 years) for new commitments over the 6 year 2015-21 period is £97m. Over the lifetime of the scheme, the additional expenditure for these commitments is estimated to be in the region of £355m. Previous commitments entered into before 1 April 2015 are covered by the original 2012 Business Case approval.

Table 7.2 – Non Domestic RHI Expenditure (<u>for commitments up to 30 Sep 2016</u>) £,000								
Non Domestic Forecast	15/16	16/17	17/18	18/19	19/20	20/21	6 Year Total	<u>20 Year Total</u>
Previous Commitments (Nov12 – March15)	13,058,742	13,058,742	13,058,742	13,058,742	13,058,742	13,058,742	77,229,074	261,174,840
New Commitments (Apr15-Sept16)	8,412,243	17,433,545	17,838,035	17,838,035	17,838,035	17,838,035	97,197,926	355,789,389
Revised AME Forecast (Oct15)	20,646,533	27,775,514	28,180,004	28,180,004	28,180,004	28,180,004	161,142,063	616,964,229

7.3 Subject to DFP approval to continue the scheme for 18 months, the Department will:

- (i) Complete a detailed review of the RHI to assess the levels of renewable heat currently in place and how much additional heat can realistically be incentivised within the current forecast - the NI Executive will then have to either agree a reduced 2020 RHI target or a case will have made to HMT / DECC for increased funding for the NI RHI;

- (ii) Subject to this Review / Decision, and budget clarification, the Department will approach DFP for further scheme approval beyond 30 September 2016; and
- (iii) develop and consult on proposals for an automatic system of tariff digression for both RHI schemes based on an expenditure forecast range (Low, Med, High) and implementation of the Phase Non Domestic proposals.

7.4 Non Domestic RHI payments will need to continue to be processed and audit requirements implemented even if the scheme closes to new applications from 30 September 2015. DFP approval is therefore sought to continue to use Ofgem to administer the Non Domestic RHI Scheme for the period 1 April 2015 to 31 March 2021. This is on the basis that the NI administration costs will continue to be based on 3% of total administration costs for both the GB and NI non domestic RHI Schemes (as set out in Section 7).

Domestic RHI Expenditure

7.5 DFP approved the Domestic RHI Scheme in September 2014 based on a total RHI expenditure profile of £103m for the 2014/15 – 2019/20 period. This was based on the Department's forecast of expenditure in early 2014 when uptake of both the Non Domestic RHI and RHPP scheme was low. This forecast is included in Table 8.5 below.

Forecast	14/15	15/16	16/17	17/18	18/19	19/20	Total
Domestic Capital	1,140,000	900,000	900,000	900,000	900,000	900,000	5,640,000
Domestic Resource	1,220,128	1,192,188	1,573,788	1,955,388	2,336,988	2,718,588	10,997,068
Total	2,360,128	2,092,188	2,473,788	901,955	3,236,988	3,618,588	16,637,068

7.6 In light of experience with administering the Domestic RHI Scheme since its launch in December 2014, the Department's forecast of scheme expenditure has increased. The Department is therefore seeking DFP approval to increase Domestic RHI Scheme Expenditure for the 5 year (2015/21) approval period to the levels in Table 8.6 below. These are based on the Department's June 2015 AME forecast. The Domestic RHI Scheme's continuing provision of value for money has been demonstrated in Section 3.

Forecast	14/15	15/16	16/17	17/18	18/19	19/20	Total
Domestic Capital	1,140,000	1,015,000	1,560,000	2,760,000	3,510,000	3,802,500	13,787,500
Domestic Resource	245,085	329,000	1,032,000	711,000	3,888,000	5,700,500	11,905,585
Total Domestic RHI	1,385,085	1,344,000	2,592,000	3,471,000	7,398,000	9,503,000	25,693,085

ANNEXES

- A. *Original CEPA Report (2011)* [DT1/15/0147730]
- B. *Non-domestic Business Case (2012)* [DT1/15/0147732]
- C. *Revised CEPA Report (2013)* [DT1/15/0147736]
- D. *Phase 2 Consultation Document* [DT1/15/0147773]
- E. *DSO Advice on Scheme Suspension* [DT1/15/0147740]
- F. *VFM Analysis: Non Domestic RHI Scheme* [DT1/15/0147720]
- G. *VFM Analysis: Domestic RHI Scheme* [DT1/15/0147725]
- H. *DARD Paper on Poultry Shed Heating Requirements* [DT1/15/0147750]
- I. *RHI Expenditure Forecasts (October 2015)* [DT1/15/0139328]

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