THE FUTURE OF THE NORTHERN IRELAND NON-DOMESTIC RENEWABLE HEAT INCENTIVE SCHEME - POLICY SUMMARY

Background

1. The Northern Ireland Non-Domestic Renewable Heat Incentive Scheme (NIRHI) was introduced in November 2012. The Scheme was designed to contribute to a reduction in carbon emissions by increasing the uptake of renewable heat technologies. This was to be achieved by providing ongoing payments to cover the projected difference in cost between renewable heating and fossil fuels, as well as providing a 12% rate of return on the additional capital cost of a renewable heat boiler. The NIRHI was based on the GB Renewable Heat Incentive Scheme but with different tariff rates and the absence of important cost control measures, including a tiered tariff structure.
2. In early 2015, the projections of the cost of NIRHI started to rise above the available budget for 2015-16 and future years. This led to the introduction of tiering and a heat generation limit for small and medium biomass installations for new participants from 18 November 2015. However, an unprecedented spike in applications prior to the introduction of the new tariff structure resulted in a further increase in the projected cost of the Scheme. Therefore further action was required and, as a result, the Scheme was suspended to new applicants on 29 February 2016.
3. However, after the NIRHI closed to new applicants in February 2016, expenditure on the Scheme was still expected to breach the available budget. In response, the Department for the Economy (DfE) introduced the Renewable Heat Incentive Scheme (Amendment) Regulations 2017 as an interim measure, extending the tiered tariff and cap to all small and medium biomass installations whilst a long term policy was being developed. DfE, in conjunction with the Northern Ireland Office (NIO) then extended the tariff structure introduced under the 2017 Regulations for a further 12 months through the Northern Ireland (Regional Rates and Energy) Act 2018.
4. Should we reach 1 April 2019 without further legislation, the Department for Economy would have no statutory basis for making payments to approximately 1,800 biomass installations accredited to the scheme before 18 November 2015.

Ricardo Tariff Review

5. In order to inform the development of the long term policy, DfE commissioned an independent consultancy, Ricardo Energy and Environment (‘Ricardo’), to undertake a comprehensive review of all the main elements of the tariff for small and medium sized biomass boilers and Combined Heat and Power (CHP) plants.

6. The Ricardo Report identified the extent to which the current NIRHI biomass tariffs are set at too high a level and suggested three main alternative tariff scenarios. Ricardo also estimated the projected cost to DfE and the rate of return to participants for each of the tariff scenarios compared with the current and previous tariff structures on the NI and GB RHI Schemes. Ricardo indicated that a subsidy was not required in respect of the CHP plants which applied to the NIRHI Scheme and suggested that it would now be appropriate to switch from the use of the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) when calculating the annual inflationary uplift of tariff levels.

Public Consultation

7. On 14 June 2018, the Department launched a public consultation on the future of the non-domestic NIRHI Scheme. The consultation ran for 12 weeks and ended on 6 September 2018. The options consulted on were:

<table>
<tr><th></th><th colspan="2">Tariff for 20-99kW boiler (p/kWh)</th><th rowspan="2">Tier 1 threshold (hours)</th><th rowspan="2">Annual usage limit (MWh)</th></tr>
<tr><th>Tariff Option</th><th>Tier 1</th><th>Tier 2</th></tr>
<tr><td>1. Tariff structure under the 2017 and 2018 legislation is not continued</td><td>0.0</td><td>0.0</td><td>None</td><td>None</td></tr>
<tr><td>2. Retain tariff structure under 2017 and 2018 legislation</td><td>7.2</td><td>1.6</td><td>1,314</td><td>400</td></tr>
<tr><td>3. Revert to tariff structure under 2012 Regulations</td><td colspan="2">7.2</td><td>None</td><td>None</td></tr>
<tr><td>4. Adopt the base case tariff structure from the Ricardo Tariff Review</td><td>2.3</td><td>-0.4</td><td>1,314</td><td>None</td></tr>
<tr><td>5. Adopt the base case tariff structure excluding fuel costs</td><td>3.4</td><td>0.5</td><td>1,314</td><td>300</td></tr>
<tr><td>6. Adopt the hybrid tariff structure from the Ricardo Tariff Review</td><td>2.8</td><td>0.0</td><td>1,314</td><td>None</td></tr>
<tr><td>8. Adopt the current GB tariff structure</td><td>3.14</td><td>2.20</td><td>3,066</td><td>None</td></tr>
<tr><td>8. Adopt the tariff structure for entrants to the GB Scheme in autumn 2015</td><td>4.66</td><td>1.24</td><td>1,314</td><td>None</td></tr>
</table>

8. The consultation also considered a compulsory buy-out option whilst a voluntary buy-out element was included as part of Options 4-8. In addition, the consultation document set out options in respect of the annual inflationary uplift to tariffs as well as the approach to CHP installations.

9. A total of 258 written responses were received. The responses provided the Department with a range of information and views, including evidence from Scheme participants on costs associated with biomass installations, the impact of tariff changes and data on capital costs. The Consultation Report was published on 31 January 2019.

Affordability

10. A critical factor when setting the future payment structure is whether it is affordable within the allocated budget from HM Treasury. The projected total cost for each tariff option, from 2019-20 to the end of the Scheme is shown in the following table depending on whether the RPI or CPI measure of inflation is used to uplift tariff levels. These figures do not include the cost of payments made to small and medium biomass installations to date (estimated to be £120 million by the end of 2018/19) or payments made in respect of the other technologies and the Domestic NIRHI.

Tariff Option	**Total payments (to nearest £5 million)**	
	CPI	**RPI**
1. Tariff structure under the 2017 and 2018 legislation is not continued	0	0
2. Retain tariff structure under 2017 and 2018 legislation	440	480
3. Revert to tariff structure under 2012 Regulations	945	1,020
4. Adopt the base case tariff structure from the Ricardo Tariff Review	65	70
5. Adopt the tariff structure from the Ricardo Tariff Review excluding fuel costs	160	170
6. Adopt the hybrid tariff structure from the Ricardo Tariff Review	120	125
7. Adopt the current GB tariff structure	330	360
8. Adopt the tariff structure for entrants to the GB Scheme in autumn 2015	290	315
Compulsory Buy-Out	35	

11. The total available budget available for the remainder of the lifetime of the Scheme will only be confirmed as part of future Spending Reviews. It is estimated that this will be under £500 million (undiscounted, in current prices). As the table demonstrates, Option 3 would cost far in excess of this amount. If the Scheme were to revert to the 2012 tariff structure, it would require substantial funding from the NI Executive block grant, based on current estimates. This does not include the cost of other elements of the Scheme and previous overspends. On this basis, Option 3 is not viable.

State aid

12. The Department has been in contact with the European Commission throughout the policy development process in an effort to ensure the future payment structure is compliant with State aid rules. Although the original State aid decision made reference to a range of 8-22%, in recent months the Commission has made it clear that its decisions adopted to date on the Scheme authorise an average rate of return of 12% rather than the tariffs themselves or the wider range of 8-22%.

13. This means that of the options consulted upon only Option 4 – the base case tariff – or a compulsory buy-out are considered compliant with State aid rules. All other options are anticipated to deliver a prospective return greater than 12%.

Impact on scheme participants

14. A key consideration in coming to the preferred option has been the impact on scheme participants. There are approximately 2,100 installations accredited to the scheme with just over half of these operating in the agriculture sector and the majority of installations within that subset are found in the poultry industry. Geographically, the installations are spread all across Northern Ireland.
15. Although it has previously been suggested that significant job losses would occur as a result of the 2017 Regulations none of the available statistics or the responses to the public consultation included substantive evidence to support this assertion.
16. Where specific information, particularly on costs associated with biomass installations and the impact of tariff changes on businesses, was identified through the consultation exercise, it has been reviewed as part of the development of the long-term policy in conjunction with data collected via the running of the Scheme, the Ricardo Tariff Review, and other information that has come into the public domain, for example, through court proceedings and the Public Inquiry into the RHI Scheme.
17. As part of the public consultation it was also highlighted that the negative Tier 2 tariff under Option 4 might result in participants switching back from renewable heat to a fossil fuel boiler once the Tier 1 threshold had been reached. Whilst the findings from the Ricardo Tariff Review suggested that this would not be rational, as the operating cost of a fossil fuel boiler is higher than for a biomass boiler, it was recognised that this was a potential issue.
18. Two key elements of the preferred option have been specifically designed to take account of the impact on boiler owners:
    - Scheme participants indicated that they overwhelmingly would prefer an ongoing tariff payment structure rather than closure and buy out; and
    - Scheme participants with very small load factors or higher-than-average capital costs could see low rates of return under any of the options. In addition, some participants indicated that they may experience short term cash flow problems because they have funded their investment in a biomass boiler through loans of significantly shorter duration than the 20 year period for RHI payments. This needs to be set in the context of the scale of over compensation received to date as well as the benefits that will accrue for the majority of the lifetime of the Scheme when loans have been repaid but RHI payments are still being received. However, both of these issues are mitigated by the inclusion of a voluntary buy-out option alongside to allow those participants to exit the scheme with a reasonable rate of return, or potentially, to address a short term cash flow difficulty.

Preferred Option

19. In terms of affordability and compliance with State aid rules the preferred option was assessed as being the Base Care tariff structure from the Ricardo Tariff Review. However, it was recognised that there were administrative issues with this option as well as the potential for an adverse behavioural response from participants to a negative Tier 2 tariff. In this context, a variant of Option 4 was developed with the Tier 2 tariff set at zero and the Tier 1 tariff adjusted so that the typical installation is expected to achieve a 12% rate of return. In particular, the Tier 1 tariff for Option 4 in the table above is reduced from 2.3p/kWh to 1.7p/kWh.

20. On this basis, the preferred option is to bring forward legislation which will:

- <u>Establish a new set of tariffs for all small and medium sized biomass boilers accredited to the Scheme.</u>

  The tariffs are set out in the table below and are designed to provide a prospective 12% rate of return. The tariffs are a variant of the originally consulted upon Base Case tariffs. This is in recognition of the difficulties that could arise from operating a negative Tier 2 tariff which would require users with higher load factors to receive incentive payments early in the year before then making payments back to the Department / Ofgem as they moved onto the (negative) Tier 2.

  The tariffs will be adjusted annually in line with inflation as measured by the Consumer Prices Index.

	Installation capacity	**Tariff (p / kWh)**
Small biomass	Less than 20kWth	Tier 1: 7.4 Tier 2: 1.8
Med biomass (lower capacity)	20kW and above, up to but not including 100kWth	Tier 1: 1.7 Tier 2: zero
Med biomass (upper capacity)	100kW and above, up to but not including 200kWth	Tier 1: 1.2 Tier 2: zero

- <u>Provide the Department with the power to offer a voluntary buy-out scheme to participants.</u>

  Whilst almost 90% of installations are expected to achieve a return of at least 12% under the revised tariffs, there will be a small group of participants that for whatever reason have higher capital costs or lower ongoing usage and will see a lower return. For this reason, we would wish to offer participants the possibility to be “bought out”. This voluntary buy out would offer participants a payment that would be calculated to provide a sum equivalent to a 12% return on the additional capital cost of their biomass boiler, less the amount of RHI payments received.

Legislation

21. Implementing the preferred option requires legislative change. In this context, DfE has written to the Northern Ireland Office to outline the proposals and request that the Secretary of State for Northern Ireland brings forward legislation in Westminster to implement the long-term payment structure.