RURAL NEEDS IMPACT ASSESSMENT

Organisation:	Department for the Economy
Title:	Continuation of Northern Ireland Renewable Heat Incentive cost control measures introduced in 2017 for a further 12 month period to 31st March 2019 to enable development of longer term policy.

Step 1: Define the Issue

Objective of Regulations

On 1 November 2012, DETI[1] launched the non-domestic Renewable Heat Incentive (RHI) Scheme. Following the announcement of proposed Regulations to introduce tariff changes in 2015, there was an enormous spike in applications. This, together with the lack of controls in the Scheme which gave rise to substantial overcompensation to scheme participants, resulted in the projected costs of the Scheme far exceeding the available budget and led to the decision to introduce the Renewable Heat Incentive Scheme (Amendment) Regulations (Northern Ireland) 2017[2] (the 2017 Regulations). Under the 2017 Regulations all small and medium biomass boilers moved to the same tiered tariff and annual cap structure introduced by the Renewable Heat Incentive Scheme (Amendment) Regulations (Northern Ireland) 2015[3] (the 2015 Regulations).

Further, DETI originally intended that the RHI Scheme would provide a rate of return of 12% (depending on boiler size) in line with State aid approval. However, the average rate of return, prior to the introduction of the 2017 Regulations, was substantially higher than 12%, particularly for those installations that were being operated intensively (load factor).

The 2017 Regulations will cease to have effect on 31st March 2018. Further analysis and consultation are necessary before long-term cost control measures can be put in place and this work will not be completed prior to 31st March 2018. In the interim, DfE intends to continue the cost control measures introduced in 2017 until 31st March 2019 through amendment of the Renewable Heat Incentive Scheme Regulations (Northern Ireland) 2012 via the Northern Ireland (Regional Rates and Energy) Act 2018.

---

[1] On 8 May 2016, DETI merged with the Department of Employment and Learning to form the Department for the Economy (DfE). References to DETI and DfE should be read relevant to the 6 May 2016 transfer.

[2] SR 2017 No.32

[3] SR 2015 No. 371

The proposed continuation of these cost control measures will assist DfE to balance its obligation to the Scheme beneficiaries with its wider obligation in respect of securing value for money for the taxpayer. The Northern Ireland (Regional Rates and Energy) Act 2018 allows the scheme to continue to provide a rate of return for typical RHI recipients of at least 12% and reduces the incentive (contrary to the policy intent) to produce unnecessary heat.

Urban/Rural Split

The Department compared postcodes provided on beneficiaries' application forms with the Northern Ireland Statistics and Research Agency's Postcode Directory (updated in November 2016) to ascertain the urban / rural split of the location of installations accredited under the Scheme.

The breakdown, which is set out in Tables 1 to 3, indicates that the majority of all accredited installations are in rural areas (88%). This figure is the same whether the installations were accredited before or after the 18 November 2015 tariff changes which first introduced the tiered tariff structure and annual cap.

The percentage of payments rises from 91% for rural installations accredited before 18 November to 94% for rural installations accredited after the November 2015 tariff changes. These figures indicate that the overwhelming financial benefit of the Scheme went to rural businesses with either pre or post 18 November 2015 installations.

Table 1: Pre 18 November 2015 Count & % of Installations and Count & % of Payments Split by Urban/Rural

	Number	%	Payments to 31 October 2017 (£ million)	%
Urban	212	12%	£7.1m	9%
Rural	1547	88%	£70.6m	91%
Total	1759	100%	£77.8m	100%

Table 2: Post 18 November 2015 Count & % of Installations and Count & % of Payments Split By Urban/Rural

	Number	%	Payments to 31 October 2017 (£ million)	%
Urban	39	12%	£0.3m	6%
Rural	274	88%	£4.2m	94%
Total	313	100%	£4.5m	100%

Table 3: Total Count & % of Installations and Count & % of Payments Split by Urban/Rural

	Number	%	Payments to 31 October 2017 (£ million)	%
Urban	251	12%	£7.4m	9%
Rural	1821	88%	£74.8m	91%
Total	2072	100%	£82.2m	100%

Impact in Rural Areas

The Department is aware that the continuation of the tiered tariff and annual cap will impact on the level of RHI payments to scheme participants in the rural community. However, this is in the context that the previous levels of payment provided substantial excess compensation to scheme participants, the continuation of which would have had a detrimental impact on the provision of public services for all the people of Northern Ireland, including the rural community. This is a policy driven by the need to manage pressures on budgets whilst developing longer-term cost controls.

The proposed continuation of the cost control measures introduced in 2017 will assist DfE to balance its obligation to existing scheme participants with its wider obligation to safeguard value for money and is intended to result in greater benefits to the general public including those in rural areas.

Funding for the scheme is provided through Annual Managed Expenditure (AME) calculated as a population based share (3%) of the funding available for the parallel scheme operating in the rest of the UK. The amount of payments in excess of the AME funding must be met from Northern Ireland's block grant. This will mean that less funding is available for other government schemes and services in Northern Ireland. It is very likely that any budget cuts to other Departments, as a result of RHI overspend, will have a negative impact on rural stakeholders as well as the public generally.

Further, State aid and scheme requirements mean that only 'useful heat' is eligible for payment under the RHI Scheme. In other words, only heat which would otherwise have to be met by fossil fuels would receive payment. The continuation of the cost controls will mitigate the incentive for generating heat to receive payments.

Outcome

The continuation of the cost control measures will allow rural RHI recipients to receive payments in line with the intent of the policy and will ensure the scheme remains compliant with State aid approval, whilst safeguarding public expenditure including monies which otherwise may not be available to support rural communities.

The Department considers that the continuation of the cost control measures, i.e, the tiered tariff and cap is justified, fair and proportionate. This is in light of the extent to which the Scheme was operating contrary to the original intention and assumptions and also in light of the serious financial consequences for the NI Block budget.

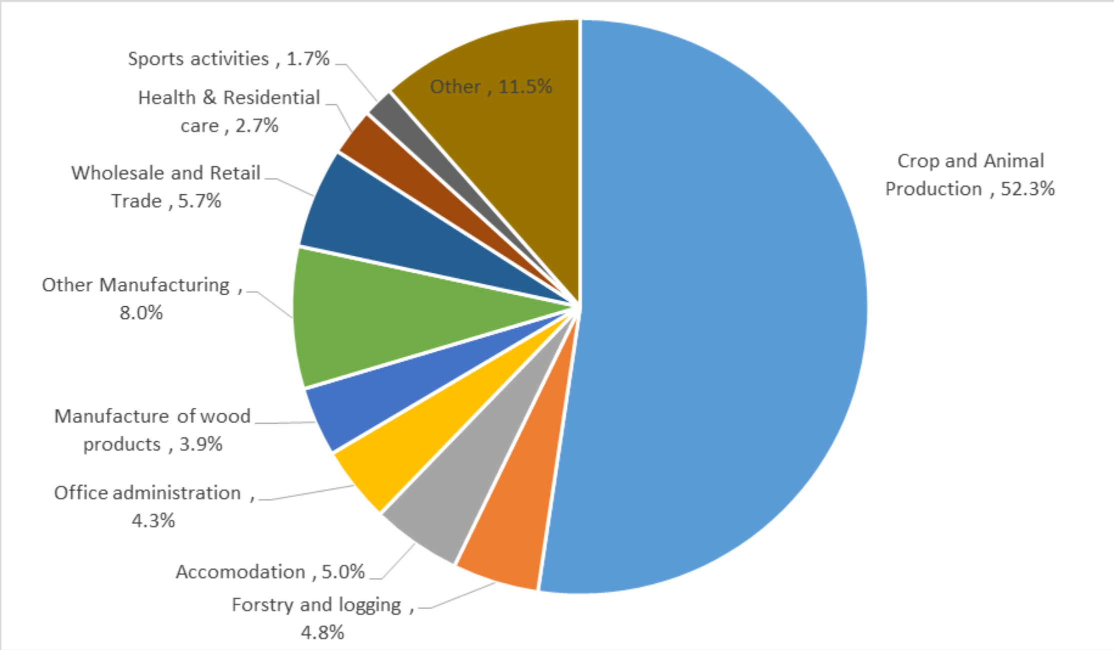
Step 2: Understand the Situation

Current Situation

The Northern Ireland Non-Domestic Renewable Heat Incentive (NIRHI) scheme provides a financial incentive to boiler owners across Northern Ireland including those in rural areas. On 1st April 2017, the Renewable Heat Incentive Scheme (Amendment) Regulations (Northern Ireland) 2017 introduced a tiered tariff structure to all small and medium biomass boilers accredited before 18 November 2017. These Regulations are time-bound and will cease to have effect from 31 March 2018. The Department requires more time to develop longer term proposals and proposes to continue the cost control measures introduced in 2017 through amendment of the 2012 Regulations via the Northern Ireland (Regional Rates and Energy) Act 2018 and so maintain the current level of subsidy for all small and medium biomass RHI installations.

As part of the accreditation process, participants were asked to specify the sector in which their business operated. The proportion of users within each sector is summarised in the chart below. The most popular sector was Crop and Animal Production (52.3%). Within that sector the predominant use was poultry farming. This was reflected in the sample selection of an audit by Price Waterhouse Coopers, where 38% of successful inspections were in the poultry sector. The Department’s analysis of responses to a question in the application form in which applicants describe how heat generated by their installation would be used suggests that potentially 847 (39.8%) accredited boilers operate in the poultry sub-sector.

Chart 1: RHI Boilers by Sector



Impact on Businesses

The scheme was never intended to provide enhanced economic benefits for individual businesses. The NIRHI tariffs were designed to bridge the gap between existing heating systems and the renewable heat alternative, with consideration given to the capital costs, operating costs and the non-financial 'hassle' factors that are involved in replacing existing heating.

The scheme was developed on the basis that the renewable heat eligible for funding would act as a replacement for heat previously generated by fossil fuels. However, in reality, only one third of participants indicated in their application that their boiler would be replacing an existing heating source. It is unclear whether the other two thirds of participants would have purchased a new fossil fuel boiler in the absence of the RHI.

In addition, there is evidence that participants were generating significantly more heat than required for their normal business needs, because the tariff rate was higher than the price of fuel. Whilst this was partly addressed by the introduction of a tiered tariff, there was a need for a further measure in respect of those installations which have access to biomass fuel at a very low cost. In response, the extension of the 400,000kWh usage limit under the 2017 Regulations is expected to significantly reduce the amount of heat generated unnecessarily under the scheme.

The annual usage limit of 400,000 kWh (equivalent to a load factor of 46%) applies only to accredited small and medium sized biomass boilers for heat generated on or after 1 April 2017. The extent of the impact will therefore depend upon individual usage levels and also the period of time during which the operator has already received payments under the 2012 Regulations.

Without the extension of the tiered tariff structure via the Northern Ireland (Regional Rates and Energy) Act 2018, additional unnecessary heat would continue to be generated as a result of the unintended incentives in the Scheme. This would be detrimental to the environment and does not help achieve the environmental objectives of the Scheme. The continuation of the 2017 cost control measures ensures these safeguards will continue to be in place while the longer-term policy for the scheme is developed.

NIRHI Funding & Costs

The increase in committed RHI payments associated with the influx in non-domestic applications meant that the NI AME allocations from 2016/17 onwards was exceeded. Even with scheme suspension for new applications, existing RHI commitments from 2016/17 onwards exceeded the available AME budget.

The projected cost of the subsidised heat under the Non-Domestic NIRHI, without the 2017 Regulations and without continuation of the tiered tariff and annual cap via the Northern Ireland (Regional Rates and Energy) Act 2018, would have been over £50 million per annum by 2020 (excluding CHP) compared with the budget of £29million per annum. Clearly this is not financially sustainable.

All this means that less funding would have been available for other government schemes and services in Northern Ireland. While it is not possible at this stage to identify the areas where budgets may be affected, it is very likely that any budget cuts to other departments, as a result of RHI overspend, would have a negative impact on rural stakeholders as well as the public generally.

Mitigations

DfE is considering a number of options as part of the long term approach for the scheme, which will be informed by the ongoing expert policy review of the tariff structure. In order to allow sufficient time for a longer term tariff structure to be developed and approved, it is necessary to continue the provisions of the 2017 Regulations until 31st March 2019.

The outcome of the consultation on longer term measures will clarify the financial impacts. The scheme will continue for the full 20 years to all those who have applied successfully, and a fair and reasonable rate of return will be provided to scheme participants over this period, depending on circumstances.

Step 3: Develop and Appraise Options

Barriers to Delivery

There are no barriers to delivery of this already established incentive scheme in rural areas.

Additional Costs

There is no additional cost to deliver the RHI Scheme in rural areas. The Scheme provides the same incentive to rural and urban RHI installations.

Achieving a Fair Rural Outcome

There is an equality of treatment for all NIRHI scheme participants as they are subject to the same ongoing obligations under the scheme. DfE considered four options to provide a more reasonable rate of return for scheme recipients and to mitigate the risk of the incentive to generate unnecessary heat. These were:

1. **Do nothing/minimum** – If the Department does not put in place a replacement tariff structure for the period commencing 1 April 2018, the legal advice is that there is no clear statutory authority to make payments for small and medium biomass installations accredited before 18 November 2015.
2. **Status Quo** - Continue the tiered tariff structure introduced under 2017 Regulations with inflationary uplift until 31st March 2019 or until an appropriate long term tariff structure can be implemented.
3. **Apply GB Tariff**- Apply the equivalent GB tariff from autumn 2015 when most applications were made to the NI Scheme, taking account of subsequent inflationary uplifts. This option would involve no usage limit being placed on the amount of heat eligible for RHI payments.
4. **Revert to 2012 Regulations**- Apply the previous single tier tariff to all small and medium biomass boilers.

Cost to the NI Block Grant

The UK Government provides funding to Northern Ireland for the RHI Scheme, calculated as a population based share of the budget for the Scheme across the UK as a whole. In the 2015 Spending Review it was forecast that the UK budget for the Scheme would increase by 15% in 2018-19, rising from £780 million in 2017-18 to £900 million.

Northern Ireland accounts for approximately 2.86% of the GB population, adjusted for VAT abatement factor, which implies that £25.7 million in funding will be available from the UK Government for the NIRHI Scheme in 2018-19, compared with £22.3 million in 2017-18. This funding will be used for both the Non-Domestic and Domestic NI RHI Schemes with the latter having a projected spend of £3.1 million in 2018-19, compared with £3.0 million in 2017-18. This leaves £22.6 million for the Non-Domestic RHI Scheme.

Under Options 1, 2 and 3 there would be no or minimal cost to the NI Executive as the level of payments is projected to be broadly the same or lower than the available funding. In contrast, reversion to the 2012 Regulations under Option 4 would impose a significant cost on the NI Executive in excess of £25 million.

This analysis shows that:

- Option 1 – 'Do nothing' - If the Department does not put in place a replacement tariff structure for the period commencing 1 April 2018, the legal advice is that there is no clear statutory authority to make payments for small and medium biomass installations accredited before 18 November 2015. Payments to most boiler owners may have to cease. This option would be legally complex and not in the interests of the Department or boiler owners. However, for many boiler owners the excess level of previous payments means that they will already have received sufficient RHI payments to achieve the target 12% rate of return over 20 years.
- Option 2 - the continuation of the cost control measures introduced by the 2017 Regulations would lead to expenditure moving closer in line with the available funding whilst at the same time still providing Scheme participants with a generous rate of return.
- Option 3 – applying the GB tariff - would reduce the cost even more, however this option would also require a new State aid notification to the European Commission.
- Option 4 - reversion to the previous single tier tariff inevitably means that the AME budget will be breached again with associated impact on the funding for public services. Option 4 also carries a material likelihood that most participants would be overcompensated and generate returns significantly in excess of the range previously specified in State aid approval. This would not represent value for money for the taxpayer or an effective use of the scarce resources available to Northern Ireland. Further, a significant proportion of the additional heat paid for under Option 4 would represent inefficient or ineffective generation inconsistent with the spirit of the renewable heat target. This option could also trigger the opening of a formal investigation by the European Commission and require a suspension of such payments until its investigation concludes.

State Aid

State aid approval from the European Commission has been secured for Option 2, the preferred option, as it is based on the continuation of the same cost controls approved earlier in 2017. In contrast, any change to the tariff structure could take at least 9 months.

Options 3 and 4 would also require State aid approval, for which State aid notifications would be required. The European Commission is likely to have major concerns about Option 4, a reversion to a single tier tariff structure, as this has been shown to not represent value for money, particularly in light of the potential for Scheme participants to use the over compensation from RHI payments to cross-subsidise their wider business interests.

Conclusion

The Department considers Option 2 – continue the cost control provisions introduced by the 2017 Regulations into 2018-19 – to be the preferred option. This option represents the lowest risk and highest non-monetary benefit. Whilst it has a forecast cost greater than Option 3, it has a significantly lower cost than Option 4. In addition, it is considered to be more closely aligned to the original intention of the Scheme and to deliver a rate of return to participants in line with the related State aid approval.

Funding from the UK Government for the purpose of the RHI Scheme is forecast to be in the region of £25.7 million in 2018-19. This funding will be used for both the Non-Domestic and Domestic NI RHI Schemes with the latter having a projected spend of £3.1 million in 2018-2019. This leaves £22.6 million for the Non-Domestic RHI Scheme. The forecast cost of the preferred option is £22.8 million which leaves a small projected shortfall to be funded by the Department. Therefore the preferred option is deemed affordable.

Step 4: Prepare for Delivery

There is an equality of treatment for all RHI Scheme participants as they are subject to the same ongoing obligations under the Scheme.

The proposed changes require mainly administrative mechanisms required to deliver the proposed extension of the tiered tariffs introduced by the RHI Scheme Regulations (Northern Ireland) 2017 are already in place. Therefore, the payment mechanism to maintain the current level of subsidy for RHI participants can continue to be delivered.

There is no need for flexibility for delivery bodies to find local solutions nor are different solutions required in different areas as this is a payment of incentive mechanism.

Step 5: Implementation and Monitoring.

The Department, in liaison with Ofgem, will continue to monitor the operation of the Northern Ireland Renewable Heat Incentive to assess if the elements of the scheme are having the anticipated impacts.

The Department is separately carrying out a long term tariff structure review with external policy advice having been commissioned, which will inform the consultation on the future of the scheme. It should be noted that the rates of return in this document have been calculated for the typical boiler at each load factor using the assumptions from the 2016 NIAO report. The ongoing tariff review will provide the latest position in respect of the main costs and other factors which determine the RHI tariff structure.

The Department has also embarked on a comprehensive audit of installations participating in the scheme, and this inspection and monitoring work will be ongoing over the scheme’s lifetime.

Step 6: Evaluation and Review

The fundamental elements of this policy (tariffs, bands, cap, etc.) are being reviewed as part of the wider scheme review, and a consultation will be held later in 2018 after which the Department will evaluate and implement any changes required to the scheme. It is intended to have this longer term policy in place by 1st April 2019.

Next Steps

The Department will be consulting on longer term future of the scheme during the period of operation of these new legislative provisions.

Rural Needs Impact Assessment Undertaken By:	Adele Willis
Position:	Deputy principal, RHI Taskforce
Signature:	
Date Completed:	30/03/18

Rural Needs Impact Assessment Approved By:	Jonathan McAdams
Position:	Grade 6, RHI Taskforce
Signature:	
Date Completed:	30/03/18