

Where's the Incentive in the Renewable Heat Incentive?

**THE CARBON
CATALYSTS
GROUP**

March 2011

The Renewable Heat Incentive (RHI) has just been published. It is almost a year late, will come into effect 16 months later than planned and gives every sign of being an interim arrangement with substantial work being left until next year.

The RHI is the method by which Government has chosen to ensure delivery of 73TWh of renewable heat by 2020. This heat target is 12% of the overall renewable energy target. It is a seven-fold increase on 2009 (it was then 1.6%) and is a *huge* increase.

Phase 1 of the RHI (this year) only applies to non-domestic heat installations. In Phase 2 (next year onward) domestic heat installations will be included and, perhaps, other fuels and technologies. The 'perhaps' is the clue to why there are two phases: many questions remain unanswered. Will Government support landfill gas? Yes; when it's worked out how to do it. Will it support solar thermal beyond 200KW? Perhaps, if after analysis the overall costs aren't too high. Will it support air-source heat pumps? Perhaps, if testing shows them to be value for money. And so on and so on.

At heart it seems these questions are about cost. In its September report, the Committee on Climate Change noted the Government's target of 12% heat as part of the overall 2020 target and, suggesting the costs were too high, that a drawback might be appropriate. Government rejects the drawback (it repeats the original 12% target) but shows all the signs of paring down any excess to least cost.

In general terms the RHI is intended to work in the same way as the Feed-in Tariff and the differences between this year and next lie in additions to what has already been established:

- ◆ a subsidy is paid per unit of renewable heat 'generated' against a published tariff;

- ◆ the tariff endures for 20 years with an annual RPI uplift;
- ◆ the regulator approves an installation and confirms its output, so enabling payment to be made on a quarterly basis (with the difference that payments are made to owners and not via suppliers or agents).

So far, the FIT has been successful. If the RHI is to deliver against its own targets, it needs to be as successful as the FIT before Government decided to limit its most successful parts.

Will it deliver? In principle the view seems to be that it will, surely, if the tariffs are set at the right level. But the RHI scheme is thin. Tariff levels are to be kept to the minimum and will provide compensation only for the *additional* costs of a technology over, primarily, gas heating and not for the full cost of equipment or fuel. The scheme thus incentivises small-scale decisions: where a heat installation was already due to be replaced, the RHI will incentivise its replacement by a renewable technology. What it won't do is provide a reason for replacing an installation that is perfectly adequate save for its technology.

The RHI also runs foul of another investment hurdle - regulatory certainty. If there is any chance that what has happened to the FIT scheme will happen to the RHI scheme, investment will be hesitant, at best. Yet intervention and chop and change is built into the model. In addition to reviews every four years, which are to be expected, there is to be provision for 'early' reviews and degression, i.e., intervention by Government to set tariff levels lower if there is a greater take-up than expected.

The RHI, then, is a scheme without attractive incentives and with regulatory risk. Wouldn't one expect Government to *expect* it to fail?