SUSTAINABLE ENERGY ASSOCIATION

The Future of ECO

Briefing note on the Government's Final Decision

Executive Summary

The Department of Energy and Climate Change (DECC) has announced today the Government's final decision on the Consultation for the Future of the Energy Company Obligation (ECO).

The Consultation on the Future of ECO followed on from the December Announcement in 2013 which proposed cuts and reform to the Carbon Emissions Reduction Order element of ECO in return for the Suppliers passing on £30-35 energy bill reductions to their consumers. The six week Consultation outlined the December Announcement changes in more detail and also included several other changes, notably around the Rural Sub-Obligation, off-gas households, and the Affordable Warmth (AW) obligation. The Government's final decisions are consistent with the December Announcement, which had been expected, although the outcome does refer to significant opposition from respondents to many proposals.

Outside of the key decisions, there were some changes which will impact individual technologies. For example, DECC are proposing the introduction of one year installation warranties for boilers coupled with a "deflator value" for the scoring of gas "qualifying boilers" which aims to reduce the number of replacements in Home Heating Cost Reduction Obligation (HHCRO). One significant change from the Government's Consultation, in terms of the Sustainable Energy Association's Consultation Response, has been the decision to include renewables in the scoring uplifts for the off-gas sector to give Suppliers the option to install these technologies and bring the ECO policy more in line with the Renewable Heat Incentive. Finally, it is worth noting that changes to the Green Deal Home Improvement Fund voucher payments were also announced.

Headline Changes:

- **ECO will continue to March 2017** with new targets for CERO (at the reduced level of ambition) and CSCO and HHCRO at a pro-rata target according to new 2015 levels
- **CERO will be cut for the March 2015 ECO target by 33%.** Loft and cavity insulation, and district heating1, will be eligible measures for CERO from 1st April 2014
- **Carryover** of March 2015 Overachievement will be allowed with no cap in place. For the AW obligation, only measures installed from January 2014 will be allowed, and they must be subject to an "exchange rate". CERT/CESP carryover will also be allowed.
- **Carbon Savings Community Obligation (CSCO) eligibility** will be increased from 15% to 25% of the lowest IMD areas, and qualifying criteria for the Rural Sub Obligation will be simplified so that Suppliers can reach the poorest 25% of rural areas and AW households in rural areas
- **Affordable Warmth** will have "uplifted" scores for insulation and non-gas heating and "deflated" scores for replacement gas boilers. 1year warranties will apply from 2015.

1 Members interested in Heat Networks should see Annex A: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/335002/future_energy_company_obligation_government_response.pdf

- **Renewable technologies** are eligible for the AW uplifts if they can be notified as a non-gas "qualifying boiler" with a 12 year lifetime (although this uplift will not be calculated separately). Householders may receive support from ECO and the RHI.
- **The installation standard for ECO** will remain that all measures carried out have to be explicitly carried out to the PAS 2030 standard.
- **The Impact Assessment** has also been released and suggests that overall (with the additional two years of ECO included) the proposed changes will have a net benefit. The DECC Economists remain uncertain about the assumptions used for costs on bills.
- **Green Deal Home Improvement Fund** vouchers have been reduced following the originally £50m budget being allocated through the issuing of vouchers in the first six weeks. SWI has been reduced to £4000; Flue Gas Heat Recovery is no longer eligible from 5 August 2014.
- **Update 12/08/14:** The GDHIF was closed two days after the announcement that voucher payments would be reduced due to a surge in uptake. DECC are currently in the process of auditing likely redemption rates in order to determine whether any "additional" expenditure could be found in this financial year.

For more information please contact:

Emma Pinchbeck
External Affairs Manager
+44 (0) 7920 571 885

Changes to Level of Targets (CERO)

CERO

It is notable that the Government response to the key question of the Consultation, which is whether the 2015 CERO target should be reduced by 33%highlighted that 68% of the respondents to the Consultation disagreed with the proposed reduction. The Government response states that their view is that, "it is right that the impact of environmental programmes on consumer energy bills should be reduced", however. It is their belief that the priority to reduce the cost of the levy on consumer fuel bills, in combination with the £540m of mitigation incentives (some of which makes up the Green Deal Home Improvement Fund), does justify a cut to the CERO target of 33%. In addition to the cut, the Government decision is that district heating, with loft and cavity wall insulation measures should be eligible for CERO.

SWI Minimum in CERO

CERO was originally targeted towards Solid Wall Insulation (SWI) delivery. Therefore the Government also proposed that they would set a minimum level of SWI delivery for the Suppliers alongside allowing more cost-effective measures into CERO. The decision has been to set the minimum level for Solid Wall delivery for CERO at 4Mtonnes of CO_2 delivery (roughly equivalent to 100,000 installations) which will be apportioned to Suppliers according to their market share. "Secondary measures" installed alongside an SWI job cannot count towards this minimum target, and changes to the way lots are listed on the ECO Brokerage system have already been made to reflect the Government's final decision on primary/secondary measures. DECC are also proposing to fix SWI lifetimes in legislation for the 2015-2017 obligation at 36 years (Park Homes are exempt).

Levelisation for CERO Delivery

The other consequence of allowing other measures into CERO was the proposal for a "levelisation" mechanism which would aim to ensure that amongst the Suppliers, those companies which had moved earlier to deliver their CERO obligation using more expensive SWI measures would not be commercially disadvantaged by the policy changes which proposed that the CERO target could be delivered through more cost-effective measures.
The December Announcement proposed to "uplift" the scores for the measures which had been delivered by Suppliers by March 2014 above a threshold of 35% of their delivery target; an uplift value of 1.75 applied to the usual score was proposed. However, delivery trajectories between December 2013 and March 2014 accelerated more quickly than anticipated by the December Announcement, with more Suppliers than initially proposed now qualifying for the scoring uplift.

The Consultation states that "given recent company delivery performance, maintaining the levelisation arrangements set out in the Consultation document might well lead to lower carbon savings and greater cost savings to the companies aggregate". However, the Government has chosen to keep its original Levelisation mechanism on the basis that the public announcement of this mechanism will have been available to all the Suppliers equally, and that subsequent delivery behaviours have been freely chosen by Suppliers in the light of this announcement.

DECC note, however, that they hope that Suppliers will pass on any additional savings that they make, by virtue of benefitting for greater uplifts than anticipated in December, to consumers. - Although this will not be a regulatory requirement at this stage. Finally, SWI will not be treated differently for the purposes of calculating levelisation; the original proposal to calculate a delivery profile for each Supplier in order to meet the minimum threshold for SWI by March 2017 has been dropped.

Carry Over: Excess and Surplus Actions

Carry over is the name given to allowing Suppliers to count excess actions over and above their targets, delivered under both previous energy efficiency schemes and ECO obligation phases, towards their present ECO obligation. There are two types of "carry-over" referred to with regard to the Future of ECO.

The first is allowing carry over from the previous Carbon Emissions Reduction Target (CERT) and Community Energy Saving Programme (CESP). The Government proposal is to allow optimum carry forward from CERT and CESP, and with CERT only to allow some Suppliers (those who were in the same group of companies on 31st December 2012) to make an application showing how excess CERT actions could be most effectively allocated between them. Some respondents to the Consultation indicated that this would mean more carry-over from CERT than originally consulted upon.

The second kind of carry-over refers to the Government's proposal to allow companies to carry over ECO activity from current phases to the March 2017 phase of ECO. These are called "surplus actions". This would be to ensure that as companies meet their current HHCRO and CERO targets (before the March 2015 deadline) they can continue to deliver measures without interruption before the next ECO obligation period. The difficulty in this approach is how to deal with measures installed between now and March 2015 to ensure that they meet (or are exempt from) any proposed new standards for March 2017.

The Government decision is that over-delivery against the current obligation period will be allowed, providing both the main target and any sub obligations such as the rural target have been met. The decision around standards is that any surplus activity will be scored using the version of the Standard Assessment Procedure (SAP) and Publically Available Specification (PAS) which is available at the time. For AW installations *only,* measures installed from 1st January 2014 and 31 March 2015 may be counted for surplus actions, and scoring will be subject to an "exchange rate". For surplus actions warranty standards are optional between 1st January 2014 and 31st December 2014 (reflected in different exchange rates) and thereafter ARE REQUIRED for 1st January 2015-31 March 2015.

Long Term Commitment to ECO

Elsewhere, it is interesting that the response states that the "obligation is intended to be both ambitious and long term, extending through until at least 2022", and that this ambition was partly behind the decision to announce the new phase of ECO out to 2017.

The response also restates this Government's commitment to a supplier obligation as the route for financing and delivery of energy efficiency: "we believe that involving the main energy suppliers in ECO as funders, rather than simply meeting the costs of the scheme from general taxation is an effective route for reducing carbon emissions and reducing fuel poverty by promoting domestic energy saving". The 2015-2017 Obligation will continue HHCRO and CSCO at a pro-rata level of the 2015 targets against the 2012 Impact Assessment for ECO; CERO will continue to 2017 at a reduced rate of delivery.

Changes to CSCO

The Carbon Saving Communities Order (CSCO) is currently under-delivered relative to the other two ECO components. The Government proposed several ways of making CSCO less administratively burdensome and ensuring that more consumers benefited than at present.

Increasing the number of CSCO Areas

Under the existing ECO rules, the eligible areas for CSCO are those that are in the bottom 15% of areas as identified in the Index of Multiple Deprivation (IMD). The Government decision is that measures delivered under CSCO, backdated to the 1st April 2014, will be eligible if they are delivered to areas which are in the bottom 25% of areas listed in the IMD.

Simplifying the Rural Sub Obligation

In a similar way, Government have also decided to extend the Rural Sub Obligation eligibility so that a measure installed in any household in the bottom 25% of rural areas, as determined by the "*CSCO eligible deprived rural areas (25 per cent)*" list will be eligible, as well as a measure installed in an AW household in one of the areas from the "*CSCO eligible rural areas*" list. Both these lists can be found in the "*Future of the Energy Company Obligation, Small Area Geographies Eligible for ECO CSCO Support*" document on the DECC website. Until April 2015, Suppliers will be able to install measures in the two groups above, and also in any household in the AW group which is in an area with a population of 10,000 inhabitants or less.[2]

Changes for Affordable Warmth & Boilers

- For AW installations only, measures installed from 1st January 2014 and 31 March 2015 may be counted for surplus actions, and scoring will be subject to an "exchange rate" and must meet warranty standards for 2015-2017."

- "It is worth noting that any target which remains undelivered will also be carried forward with a 1.1 penalty rate applied."
  This is only the CERO target. It doesn't apply to CSCO or AW.

It is clear from the Government's decision that they want to change the delivery patterns for Affordable Warmth away from boiler replacement towards packaged heating and insulation measures with more delivery in off-gas grid homes than at present. There were also concerns

2 https://www.gov.uk/government/publications/the-future-of-the-energy-company-obligation-small-area-geographies-eligible-for-eco-csco-support

about the price of Affordable Warmth on Brokerage, and the possible quality of installations in the Affordable Warmth sector which has resulted in the introduction of warranties for boilers.

Warranties

The Government have decided that any Affordable Warmth "qualifying boilers" installed for the 2015-2017 Obligation must have at least one year's installation warranty; electric storage heaters will require a warranty not an installation warranty. This will cover the costs of rectifying all problems which affect the boiler or the heating system it serves which relate to the installation of the boiler or its incorrect specification, and will not include an annual service. In recognition of the marginal price of the policy increasing in order to implement all the changes made to AW policy, the overall AW target has been reduced from £4.9bn to £3.7bn in the Impact Assessment which DECC believes will mean the overall policy costs remain constant. The cost of a boiler warranty from 2015 onwards has been assumed to be £130 per year, which has increased by £50 from the original Assessment of Impacts.

"Exchange Rates" for Carry-Over of Surplus Actions

The Government has decided that excess activity under the current ECO obligation period can be counted towards the 2017 targets if earlier obligations are met before March 2015. For Affordable Warmth "qualifying boilers", they have further determined that any installation installed between 1st January 2014 and March 2015 will be eligible for carry over (and none outside of this period). However, the proposed changes to the introduction of warranties and a "deflator value" on "qualifying boilers" for the 2015-2017 obligation means that there could be a difference in standards - and more importantly for DECC, the value of the measure - across both periods.

Therefore DECC will apply "exchange rates" to measures to equalise their value across both ECO periods. The exchange rates are shown below and will be applied to the lifetime notional bill savings achieved for measures installed since January 2014, against the 2017 AW target. There is no specific rate for electric storage heaters, because the 2015-2017 target will now include a "qualifying electric storage heater" and in the absence of compliance requirements which are yet to be determined, DECC will not incentivise their replacement.

Fig 1: Exchange Rates

<table>
<tr><th rowspan="2">Measure</th><th colspan="2">Installed 1 January-31 December 2014
Exchange rate</th><th>Installed 1 January-31 March 2015
Exchange rate</th></tr>
<tr><th>New warranty requirement not met</th><th>New warranty requirement met</th><th>New warranty requirement obligatory</th></tr>
<tr><td>Replacement gas ‘qualifying boilers’</td><td>0.75</td><td>0.8
(installation warranty)</td><td>0.8
(installation warranty)</td></tr>
<tr><td>Replacement non-gas ‘qualifying boilers’</td><td>1.40</td><td>1.45
(installation warranty)</td><td>1.45
(installation warranty)</td></tr>
<tr><td>Replacement boilers which are not ‘qualifying boilers’</td><td>0.95</td><td>1
(installation warranty)</td><td>1
(installation warranty)</td></tr>
<tr><td>Repaired non-gas ‘qualifying boilers’</td><td>1.45</td><td>1.45</td><td>1.45</td></tr>
<tr><td>Insulation measures in non-gas fuelled properties</td><td>1.35</td><td>1.35</td><td>1.35</td></tr>
<tr><td>All other measures</td><td>1</td><td>1</td><td>1
(warranty for replacement electric storage heaters)</td></tr>
</table>

Introduction of a “deflator” for gas boilers

The Government has decided to introduce a “deflator” value (the opposite to the “uplift” function being introduced elsewhere) which reduces the notional lifetime bill savings achieved by a replacement gas “qualifying boiler”. DECC state that they have taken this decision following concern from Consultation respondents around the domination of the HHCRO delivery by boiler replacements and because they wish to promote “fabric first” approaches. The aim is to reduce the delivery of replacement gas “qualifying boilers” towards the 207 target from 94% of all measures delivered (based on current trajectories with no policy change) to 75% of all measures (without including the impact of the proposed uplifts for non-gas fuelled households) which reaches 64% of the market once the proposed non-gas uplifts are taken into consideration. The Impact Assessment modelling for the “deflator” is shown in the table below.

Fig 2: Impact of “Deflator” Values

	No deflator	Deflator value: 0.9	Deflator value: 0.85	Deflator value: 0.8	Deflator value: 0.75	Deflator value: 0.7
% of delivery through gas boilers	92%	91%	82%	75%	75%	75%
% of measures delivered to non-gas fuelled households	99%	99%	89%	82%	82%	82%

Off-Gas Changes

Apart from the changes proposed by the December Announcement, the Future of ECO Consultation also made several proposals which sought to redirect ECO measure delivery to the off-gas grid sector, with its relatively high rates of fuel poor households. To incentivise delivery to this sector, the Government proposed a series of uplifts to make non-gas heating technologies and packaged measures more cost-effective for Suppliers to deliver. The biggest change from the consulted-upon proposals has been the decision to consider renewables (although not in their own right), which was a key point for the SEA response.

Introduction of uplifts for non-gas fuelled homes

DECC are introducing scoring uplifts for several measures when installed in non-gas fuelled homes. For the purposes of the uplifts, non-gas homes are those whose main space heating systems are non-gas and exclude households which use mains gas or district heating systems. Insulation measures have had the uplift they will receive increased; however qualifying non-gas boilers have had their uplift reduced because the "competition" from more competitively priced gas boilers will be reduced for ECO by the "deflator" value of 0.8 which has been introduced for gas "qualifying boilers".

- Insulation measures will benefit from an uplift of 1.35 (up from the 1.05 proposed)
- "Qualifying boilers" (non-gas) will receive an uplift of 1.45 (down from 2.0 proposed but mitigated by a 0.8 "deflator" value imposed on gas "qualifying boilers")

Renewables

Properties which already use renewables will be eligible for the AW uplift. In addition, where renewable measures may be notified as a non-gas "qualifying boiler" with a 12 year lifespan, Suppliers can choose to take advantage of the existing uplift for non-gas boilers and apply it to these installations. DECC do not intend to incentivise the installation of renewables in their own right, because they are less cost-effective than other options. Consumers will be able to benefit from both the Renewable Heat Incentive (RHI) and ECO providing the householder at least part-funds the installation. DECC also recognise that acknowledging renewables is sensible from the point of view of wanting aligned policy and states that they will look to further streamline these policies in future.

Storage Heaters as "qualifying boilers"

The Government will also introduce a new eligible measure under the Affordable Warmth target- a "qualifying electric storage heater". This will take the same approach to scoring as a "qualifying boiler" as it will use a (broken or inefficient) electric room heater as the baseline heating technology. The assumption is that this will lead to a much higher notional bill saving for the replacement storage heater than is currently the case, and encourage Suppliers to prioritise off-gas householders for heating replacements as well as gas-householders who have benefited from replacement gas "qualifying boilers" to date.

The replacement storage heaters must have a responsiveness rating of above 0.2 according to SAP 2012 for repair, and in the case of replacement must be operating below a SAP rating of 0.2 or be broken beyond use. For electric storage heaters operating below 0.2, a replacement is only allowed if there is a broken qualifying electric storage heater in the property. Savings for repair will be scored for one or two years depending on the warranty provided, and for a replacement will be scored for 20 years.

DECC hope that acknowledging that efficient storage heaters can make significant savings against electric stand-alone heaters will allow the ECO policy to target more effectively fuel poor and vulnerable consumers. A cap will be imposed on repairs to ensure that most AW activity remains delivered through other heating measures (replacements are not limited). The caps are 5% for boiler repairs and 5% for electric storage heater repairs (or 10% of overall AW activity).

Consumer Protection

DECC state that a key concern of many of the Consultation respondents was a need to improve and protect standards. Key outcomes for individual issues under the consumer protection category of proposed changes are summarised below:

Installer Standards: In future, Government are particularly keen to align the standards across policy. DECC will not mandate that all installers are Green Deal Installers, and will continue to require that all measures must be installed to PAS 2030 standards.

Warranties: Government are introducing one year warranties for boilers and replacement electric storage heaters (see above).

Ofgem Boiler Checklist: suggestions for future improvements will be passed to Ofgem.

Use of the GDAR & Lodged EPCs: both will be encouraged but will not be mandated. Lodged EPCs will also be encouraged for scoring purposes.

Green Deal Home Improvement Fund Changes

The mitigation for the cuts to the ECO CERO target was the introduction of £540m in the Autumn Statement for funding energy efficiency measures via several programs targeted at different sectors (public buildings, home movers, and private landlords). The scheme originally targeted at home movers was broadened from initial proposals to the “Green Deal Home Improvement Fund” package announced in May 2014. This allocated £120m in the 2014/2015 financial year for particular measures, with different grants per measure, and with rates for those measures guaranteed for the first £50m of expenditure.

In particular, changes to CERO, which could impact the SWI sector sought mitigation with a £6000 grant for SWI insulation, and up to £1000 for a householders who installed more than one measure; the “homebuyers” element of the original Autumn 2013 decisions were preserved with an additional £500 made available to homeowners who had moved within 12 months. A separate scheme operates in Scotland.

Alongside today’s ECO decision, the Government has announced that the Green Deal Home Improvement fund has seen more than £43million worth of vouchers issued in six weeks, and well over £50million of grant applied for. Changes have therefore been announced for the voucher amounts for several measures: solid wall insulation will now be reduced to £4000 from its original value of £6000. Flue Gas Heat Recovery will no longer be eligible as a measure from the 5th August 2014.

Update 12/08/14: The GDHIF was closed two days after the announcement that voucher payments would be reduced due to a surge in uptake. DECC are currently in the process of auditing likely redemption rates in order to determine whether any "additional" expenditure could be found in this financial year.

A Note on the Impact Assessment

The Impact Assessment suggests (versus the Assessment of Impacts published with the original Consultation) that the overall traded emissions savings from ECO are lower in the final package than against the status quo assumptions, but that non-traded emissions savings are higher. It is worth noting that this is currently based on modelling assumptions which assume that the Green Deal Golden Rule mechanism is functioning, and that many electrically heated households (traded emissions) will not be addressed through ECO but through consumer-led financing.

While the changes to ECO will reduce the carbon and measures delivered against 2015 projections, DECC have counted the additional two years of delivery confirmed by the decision to announce a 2015-2017 net benefit from the policy changes in the Impact Assessment. With regard to the impact on energy bills, the Impact Assessment remains agnostic: the DECC Economists state that "the exact impact on bills is uncertain and that further evidence is required on costs". Their net impacts table is published below:

Table 15: Monetised social impacts of final ECO package (targets from 1 January 2013 to 31 March 2017 (2013 prices) – impact net of the ECO counterfactual (ECO targets currently in legislation from 1 January 2013 to 31 March 2015)

£m (unless stated otherwise)	CERO	CSCO	AW	Total ECO
Installation costs	-164	194	487	517
Hidden/hassle costs[56]	-107	74	5	-28[57]
Assessment costs	-10	58	Captured in installation costs	48
Finance costs	6	10	N/A	17
Administration costs[58]	93	17	32	142
Green Deal mechanism costs	-6	35	N/A	29
Total costs	**-189**	**390**	**523**	**724**
Energy savings (Variable element)[59]	-35	359	814	1,139
Comfort benefits	-16	92	227	303
Air quality benefits	45	29	13	87
Lifetime non-traded carbon savings	-5	165	-115	46
Lifetime EU Allowance savings	-4	7	42	45
Total benefits	**-14**	**651**	**982**	**1,619**
Net Present Value	**175**	**262**	**459**	**896**

Figures may not add due to rounding

End of Briefing