Title: Warm Home Discount – Proposals to introduce greater flexibility **IA No:** DECC0153 **Lead department or agency:** Department of Energy and Climate Change **Other departments or agencies:** None	**Impact Assessment (IA)** **Date:** 16/12/2013 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Sam Jenkins - samuel.jenkins@decc.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
£0.34m	£0m	£0m	No	NA

What is the problem under consideration? Why is government intervention necessary?

The Warm Home Discount scheme began in April 2011 and provides assistance annually to around 2 million low income and vulnerable households in Great Britain. The scheme helps offset the impact of rising energy prices and helps households to heat their homes adequately at resonable cost. Revised estimates of the number of households qualifying for support under the scheme's 'Core Group' in 2013/14 mean that as things stand the support provided by the scheme will become unbalanced over the next two years. Government intervention is required to allow participating energy suppliers greater flexibility to smooth support across the next two scheme years, ensuring a continuity of support to qualifying households.

What are the policy objectives and the intended effects?

The objective of the amendments to the scheme's regulations is to allow participating suppliers greater flexibility to vary the level of support they provide to households under the scheme's 'Broader Group' in both 2013/14 and 2014/15 to offset the shortfall in 'Core Group' support in 2013/14. The total level of support over this Spending Review period is fixed overall, this relates to the timing of expenditure only. The intended effect is to avoid a significant shortfall in support to households in 2013/14, the shortfall being rolled over to the level of support provided in 2014/15, and that expanded level of support in 2014/15 proving unsustainable against the scheme's spending envelope for 2015/16.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Do Nothing - the current scheme regulations would remain unamended and support to households would be unbalanced over time;

Policy Option 1 - amend the scheme regulations to enable participating suppliers to offset the anticipated shortfall in support to 'Core Group' households in 2013/14 by varying their support to the 'Broader Group' over the 2013/14 and 2014/15 scheme years.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** No
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0.000	**Non-traded:** 0.003	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: ______ ***Date:*** 13 December 2013

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2013	Time Period Years 2	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	**High:** 1.3	**Best Estimate:** 0.34

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low		1		
High				
Best Estimate	0.004			**2.67**

Description and scale of key monetised costs by 'main affected groups'

Change in equity-weighted cost passthrough to energy bill payers: PV £1.87m; Value of change in fuel consumption: PV £0.56m; Value of change in greenhouse gas emissions: PV £0.21m; Value of change in Air Quality: £0.02m; Direct costs to business: £0.004m.

Other key non-monetised costs by 'main affected groups'

None identified.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low		N/A		
High				
Best Estimate	N/A			**3.00**

Description and scale of key monetised benefits by 'main affected groups'

Change in equity-weighted energy bill reductions for eligible households: PV £3m.

Other key non-monetised benefits by 'main affected groups'

None identified.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Recipients of support through bills increase their demand for heating fuels only;

The responsiveness of household energy demand to changes in energy bills are based on evidence from a published non-Government source.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 0.004	**Benefits:** 0	**Net:** -0.004	No	NA

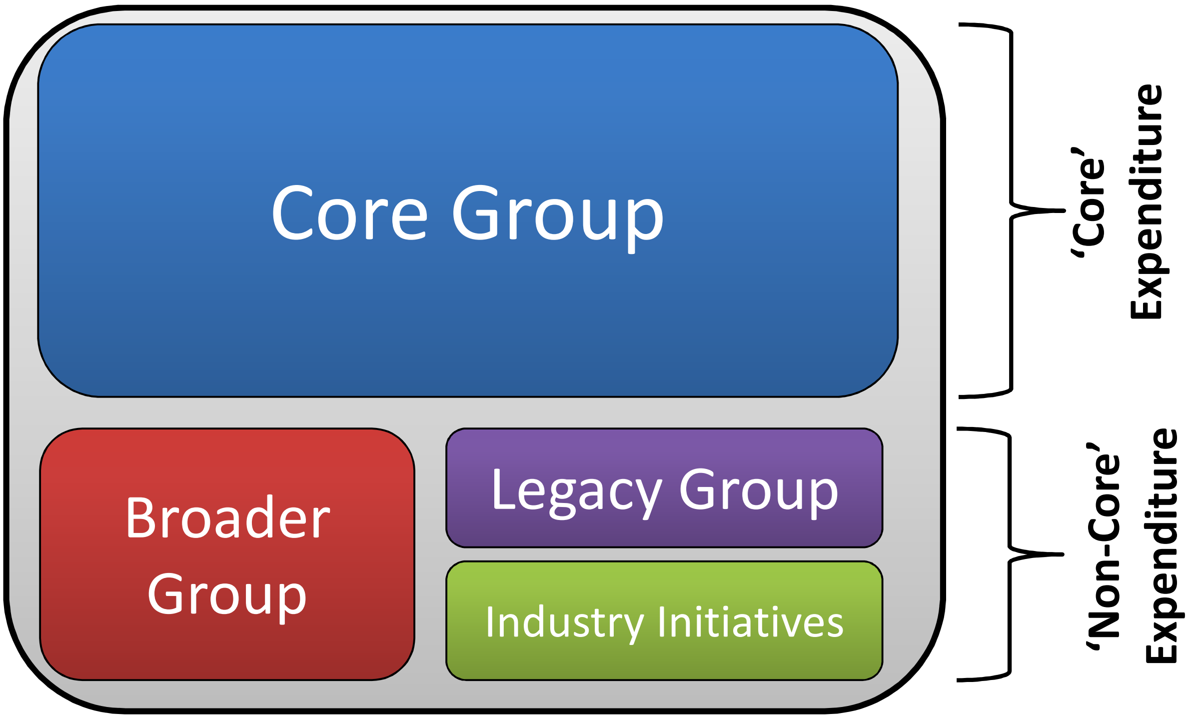
Evidence Base (for summary sheets)

Problem under consideration

1. The Warm Home Discount (WHD) scheme began in April 2011 and provides assistance annually to around 2 million low income and vulnerable households in Great Britain. The assistance is provided by the 7 largest energy suppliers each of which has over 250,000 domestic customers. The majority of spending by suppliers is on electricity bill discounts and last winter around 1.5 million households received £130 off their electricity bill.

2. The Warm Home Discount is a Government-led scheme, established in Regulations, and is a key component of the Government's commitment to tackle fuel poverty. The Government announced in June a commitment to continue the scheme beyond its current 31 March 2015 end date, with a £320m spending target for 2015/16. In total, that is a commitment by this Government of over £1.4 billion in 5 years to help those most at risk from fuel poverty.

Figure 1: Illustration of composition of Warm Home Discount spending envelope



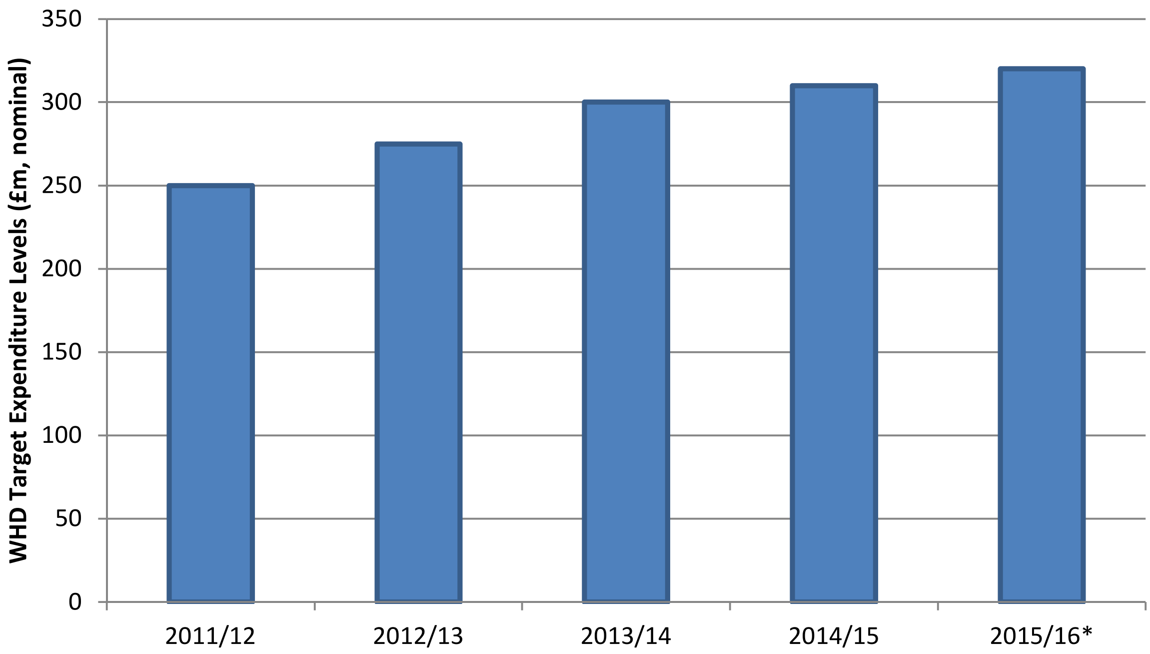
3. The scheme has an overall expenditure target for each financial year, which is divided into 4 sub-groups (Figure 1). The majority of spending each year is on automatic discounts made on the electricity bills of low income pensioners, those who are in receipt of a subset of Pension Credit; this is known as the **'Core Group'**. The level of expenditure on the Core Group each year is determined by the number qualifying households each year. The remainder, known as 'Non-Core' expenditure, is divided into three elements:
   - The **'Broader Group'** – the largest component of 'Non-Core' expenditure, under the Broader Group participating suppliers provide electricity bill discounts to a variety of low income and vulnerable households, including those of working age. Each year the Secretary of State for Energy and Climate Change sets a minimum level of expenditure that participating suppliers are required to undertake on the Broader Group within the required overall spending level on Non-Core activities in that scheme year.
   - **'Legacy Spending'** – this component captures a number of households to which suppliers began providing social and discounted tariffs under the Voluntary Agreement that preceded Warm Home Discount. Its inclusion under WHD is to provide for a smooth transition from the

Voluntary Agreement to the WHD scheme. The level of expenditure that suppliers can count under Legacy Spending is declining over time, reaching zero in the 2014/15 scheme year.

- '**Industry Initiatives**' – participating suppliers are permitted to count up to a collective maximum of £30m of expenditure per year on actions to support low income and vulnerable households that do not fall under the criteria of any of the scheme's other expenditure components. These include activities such as the targeting of available support or offering energy saving advice.

4. The scheme has overall expenditure targets set in regulations (Figure 2), rising from £250m in 2011/12 to £310m in 2014/15, with a commitment to increase the expenditure target to £320m in 2015/16. These expenditure targets are fixed in legislation, and no part of this proposal changes that. The regulations also specify that should the overall expenditure target not be met in any given year, for example if the number of households qualifying for the Core Group were lower than anticipated, Government has the power to add the shortfall to the following year's target level to compensate.

Figure 2: Overall WHD scheme expenditure targets by scheme year



* 2015/16 expenditure level committed to by Government but not yet set in regulations

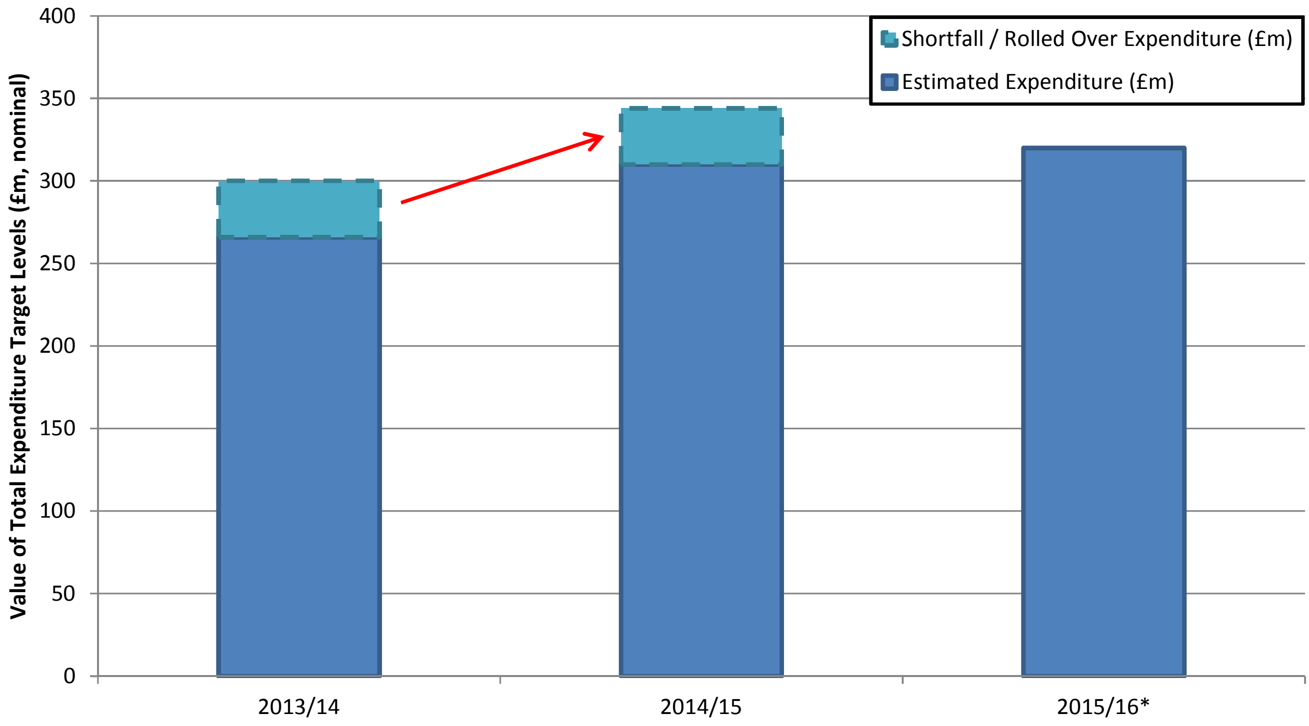
Rationale for intervention

5. The target expenditure level for the 2013/14 scheme year is £300m. Individual participating suppliers are required to provide discounts on the electricity bills of all identified members of the Core Group, and are also set a required level of expenditure on Non-Core activities – a minimum level of this must be on Broader Group discounts. Legacy Spending and expenditure on Industry Initiatives are discretionary subject to spending caps on each element. Where a supplier over or underspends against its Non-Core expenditure obligation – for example, by spending more on Broader Group discounts than the minimum level set by Government each year – they are currently permitted under the scheme regulations to 'bank' overspends or 'borrow' against underspends up to a maximum level that is equal to 1% of their overall Non-Core expenditure obligation.

6. The minimum level of expenditure on Non-Core activities is set by Government each year once an estimate has been made of the anticipated size of the Core Group in that scheme year. For example, this year it was estimated that the Core Group would require £200m of expenditure in 2013/14 against an overall target expenditure level of £300m, and Government therefore instructed Ofgem, the scheme administrator, that non-core spending should be £100m across all participating suppliers. Ofgem in turn instructed suppliers how much non-core spending they would each be required to carry out, based on their share of domestic customers. As required by the scheme Regulations, the suppliers were informed by 14 March of their Non-Core spending obligations.

7. Since participating suppliers were informed of their Non-Core expenditure obligations, Government estimates of the number of individuals in receipt of Pension Credit that would qualify for the Core Group reduced significantly, from around 1.8 million to around 1.5 million. Consequently the estimated required expenditure on the Core Group has been revised from around £200m to around £166m. In the absence of Government intervention this would result in a shortfall in expenditure to support low income and vulnerable households in 2013/14 of around £34m.

Figure 3: WHD overall target expenditure including rollover of estimated 2013/14 underspend



* 2015/16 expenditure level committed to by Government but not yet set in regulations

8. A further consequence of the estimated shortfall in Core Group expenditure in 2013/14 is that the estimated value of the shortfall, around £34m, will be added to the target expenditure level for 2014/15 (Figure 3). This would result in a target expenditure level in 2014/15 of around £344m – around £24m above the expenditure level for the following scheme year committed to in the 2013 Spending Review. The potential implication of this would be that, in addition to overall support under WHD being lower in 2013/14 than was intended, participating suppliers would be required to significantly increase their Non-Core spending in 2014/15, before *rolling back* Non-Core expenditure in 2015/16. This could potentially have the consequence of suppliers providing support to low income and vulnerable households in one year, and then withdrawing it the next.

9. Government intervention is required to enable a greater level of flexibility for suppliers, beyond the current 1% limit on banking and borrowing, to smooth the 2013/14 Core Group shortfall over their Non-Core spending obligations in 2013/14 and 2014/15.

Policy Objective

10. The objective of the change to the scheme regulations is to provide participating suppliers with the flexibility to, should they wish, increase their Non-Core spending in *both* 2013/14 and 2014/15. If Government did not intervene, then suppliers would simply be required to make up the shortfall through significantly higher Non-Core spending in 2014/15 alone. Table 1 provides an illustration of how greater flexibility could smooth the shortfall spending across the two years.

Table 1: Illustrative expenditure levels under policy scenarios

Scenario (£m, nominal)	***2013/14***	***2014/15***	***2015/16****
Target expenditure level in regulations*	300	310	320
Do Nothing – all shortfall rolled over to 2014/15	266	344	320
Central Flexibility Scenario – 70% of shortfall offset in 2013/14 through greater Non-Core expenditure	290	320	320
High Flexibility Scenario – 100% of shortfall offset in 2013/14 through greater Non-Core expenditure	300	310	320

* 2015/16 target expenditure level not yet set in regulations

Options under consideration

11. Two options are under consideration:

- **Do Nothing**: the current scheme regulations would remain un-amended and support to low income and vulnerable households would be unbalanced over time.
- **Policy Option 1**: amend the scheme regulations to enable participating suppliers to 'bank' a greater proportion of any expenditure in 2013/14 that goes beyond the level legally required of them. This would enable them to offset the anticipated shortfall in support to 'Core Group' households in 2013/14 by varying their support to the 'Broader Group' over the 2013/14 and 2014/15 scheme years. At present the share of any expenditure beyond the required level on the Non-Core spending is capped at 1% of each supplier's Non-Core obligation.

  The proposal under this Policy Option would be to increase this proportion to 34% of their £100m Non-Core obligation in 2013/14 - enabling suppliers the flexibility to make up the full shortfall of £34m this scheme year should they wish to. **This change would only apply to the current scheme regulations which expire in March 2015**, therefore the amendments would be effectively a 'one-off' change that would have no lasting impact on any future scheme regulations.

Do Nothing Option

12. To estimate the 'Do Nothing' baseline we assume the following:
    - That overall expenditure on the scheme in 2013/14 and 2014/15 would follow the profile set out in the 'Do Nothing' row of Table 1. This would mean a £34m shortfall in WHD expenditure in 2013/14, with the shortfall rolled over into an overall expenditure of £344m in 2014/15;
    - The split of total expenditure between the Core and Broader Groups, Legacy Spending and Industry Initiatives would be as set out in Table 2;
    - The estimates in Table 2 of spending on the Core Group in 2014/15, as well as Legacy Spending and the level of Industry Initiatives in both 2013/14 and 2014/15, are based on the assumptions made in the <u>February 2011 Warm Home Discount Impact Assessment</u>;
    - The remainder of the overall expenditure targets in each year are assumed to be spent on Broader Group discounts;
    - Electricity bill discounts paid under the Core and Broader Groups are worth £135 in nominal terms as set in the scheme regulations;
    - Legacy Spending assistance is worth £84 per household and no quantified impact of Industry Initiatives is included, in line with the <u>February 2011 Warm Home Discount Impact Assessment</u>.

13. The costs and benefits of both the Do Nothing baseline and Policy Option 1 are estimated using the same approach and model as in the <u>February 2011 Warm Home Discount Impact Assessment</u>, with the only updates made in relation to updates for energy price assumptions, income levels for the purpose of equity-weighting, and inflation.

Policy Option 1

14. To estimate the impact of Policy Option 1 we assume the following:
    - The overall expenditure on the scheme in 2013/14 and 2014/15 follow the 'Central Flexibility Scenario' expenditure profile in Table 1. Under this scenario participating suppliers are assumed to use the revised banking provisions for Non-Core spending to increase their <u>Broader Group</u> expenditure by £24m in 2013/14, and by £10m in 2014/15 to 'smooth' the shortfall across the two years. We also undertake sensitivity testing of a 'High Flexibility Scenario' to test the impact of suppliers making up the full shortfall in 2013/14 only. No 'Low Flexibility Scenario', where no increase to Non-Core spending is made in 2013/14, is modelled as this would give the same result as the Do Nothing baseline.
    - The split of total expenditure between the Core and Broader Groups, Legacy Spending and Industry Initiatives would be as set out in Table 2;
    - The estimates of spending on the Core Group would be the same as under the Do Nothing baseline;
    - The value of bill discounts and support per household under Legacy Spending are the same as under the Do Nothing baseline;
    - Each supplier incurs an additional administration cost in order to familiarise themselves with the changes to the regulations. This is assumed to be 2 hours incurred by 3 middle managers in each participating supplier, with a further 2 hours incurred for dissemination among 20 administrative staff per supplier.

Table 2: Assumed splits between expenditure components

Policy Option (£m, nominal)	*2013/14*	*2014/15*
Do Nothing	***266***	***344***
- Core Group	166	190
- Broader Group	47	124
- Legacy Spending	33	0
- Industry Initiatives	20	30
Policy Option 1 – Central Flexibility	***290***	***320***
- Core Group	166	190
- Broader Group	71	100
- Legacy Spending	33	0
- Industry Initiatives	20	30
Policy Option 2 – High Flexibility	***300***	***310***
- Core Group	166	190
- Broader Group	81	90
- Legacy Spending	33	0
- Industry Initiatives	20	30

Cost-Benefit Analysis Results

15. Following the approach taken in the February 2011 Warm Home Discount Impact Assessment, the only quantified benefits estimated are equity-weighted transfers from non-eligible households to those that are eligible. The costs quantified are:
    - The equity-weighted bill increases for those households not eligible for support;
    - The estimated increases in energy use from households in receipt of electricity bill discounts;
    - The value of the increase in greenhouse gas emissions resulting from these changes in energy use;
    - The changes in air quality resulting from the same changes in energy use; and
    - Administration costs. The only estimated change in administration costs estimated in this Impact Assessment is the cost to the 7 obligated suppliers of familiarising themselves with the amended regulations.

Table 3: Estimated costs and benefits options – central scenario (£m, 2012, discounted to 2013)

	Do Nothing		**Policy Option 1 (Central)**			**Policy Option 1 (High)**		
Benefits	**2013/14**	**2014/15**	**2013/14**	**2014/15**	**Net Change**	**2013/14**	**2014/15**	**Net Change**
Equity Weighted Bill Savings	655.3	748.2	697.9	708.7	3.00	715.4	692.0	3.84
Total Benefits	*£655.3*	*748.2*	*£697.9*	*708.7*	*3.00*	*£715.4*	*692.0*	*3.84*
Costs								
Equity Weighted Bill Increases	330.5	400.9	357.6	375.7	1.87	368.7	365.1	2.40
Resource Costs	52.1	58.7	56.8	54.6	0.56	58.8	52.8	0.75
Carbon Costs	19.9	22.6	21.7	21.0	0.21	22.5	20.3	0.28
Air Quality Costs	3.4	4.0	3.7	3.7	0.02	3.8	3.6	0.03
Administration Costs	13.9	16.2	13.9	16.2	0.00	14.9	15.3	-0.01
Total Costs	*419.8*	*502.5*	*453.7*	*471.2*	*2.67*	*468.6*	*457.1*	*3.45*
Net Present Value	***235.5***	***245.8***	***244.2***	***237.4***	***0.34***	***246.8***	***234.9***	***0.39***

16. Compared to the Do Nothing baseline, Policy Option 1 shows a small improvement in the net present value to society, both if suppliers made full use of the proposed flexibility provision (High scenario) or partial use of it (Central scenario). The improvement is driven primarily by the bringing forward of benefits under Policy Option 1 compared to the Do Nothing scenario, meaning a lower level of discounting is applied in the net present value calculation. This more than offsets the familiarisation costs of the changes to the regulations, plus the small changes in energy consumption that result from bringing forward more Broader Group discounts in 2013/14 (when energy prices are projected to be lower than in 2014/15). If suppliers did not make any use of the flexibility, there would be no change compared to the Do Nothing. It is uncertain the extent to which participating energy suppliers would make use of the proposed amendments to the scheme regulations, however this will provide for maximum flexibility to utilise the Core Group underspend in the most efficient way.

17. To test the sensitivity of the central estimates to assumptions in relation to fossil fuel prices, carbon prices, air quality damage factors, and elasticities of demand for different fuels, we have generated 'low' and 'high' scenarios, shown in Tables 4 and 5 respectively. The low scenario takes the 'low' values for each sensitivity variable from the Interdepartmental Analysts' Group guidance, while the 'low' elasticity assumptions are applied from the February 2011 Warm Home Discount Impact Assessment. The corresponding 'high' values from these sources are used under our 'high' scenario.

Table 4: Estimated costs and benefits options – low scenario (£m, 2012, discounted to 2013)

	Do Nothing		Policy Option 1 (Central)			Policy Option 1 (High)		
Benefits	**2013/14**	**2014/15**	**2013/14**	**2014/15**	**Net Change**	**2013/14**	**2014/15**	**Net Change**
Equity Weighted Bill Savings	655.3	748.2	697.9	708.7	3.00	715.4	692.0	3.84
Total Benefits	*£655.3*	*748.2*	*£697.9*	*708.7*	*3.00*	*£715.4*	*692.0*	*3.84*
Costs								
Equity Weighted Bill Increases	330.5	400.9	357.6	375.7	1.87	368.7	365.1	2.40
Resource Costs	9.4	10.8	10.3	9.9	0.08	10.7	9.6	0.11
Carbon Costs	3.3	4.0	3.7	3.7	0.02	3.8	3.6	0.02
Air Quality Costs	1.0	1.3	1.1	1.2	0.00	1.2	1.1	0.01
Administration Costs	13.9	16.2	13.9	16.2	0.00	14.9	15.3	-0.01
Total Costs	*358.2*	*433.2*	*386.6*	*406.8*	*1.98*	*399.2*	*394.7*	*2.53*
Net Present Value	***297.1***	***315.0***	***311.3***	***301.9***	***1.02***	***316.2***	***297.3***	***1.31***

Table 5: Estimated costs and benefits options – high scenario (£m, 2012, discounted to 2013)

	Do Nothing		Policy Option 1 (Central)			Policy Option 1 (High)		
Benefits	**2013/14**	**2014/15**	**2013/14**	**2014/15**	**Net Change**	**2013/14**	**2014/15**	**Net Change**
Equity Weighted Bill Savings	655.3	748.2	697.9	708.7	3.00	715.4	692.0	3.84
Total Benefits	*£655.3*	*748.2*	*£697.9*	*708.7*	*3.00*	*£715.4*	*692.0*	*3.84*
Costs								
Equity Weighted Bill Increases	330.5	400.9	357.6	375.7	1.87	368.7	365.1	2.40
Resource Costs	75.6	89.4	82.5	83.0	0.51	85.4	80.3	0.65
Carbon Costs	38.9	45.8	42.5	42.5	0.28	43.9	41.1	0.37
Air Quality Costs	4.5	5.3	4.9	4.9	0.03	5.1	4.8	0.04
Administration Costs	13.9	16.2	13.9	16.2	0.00	14.9	15.3	-0.01
Total Costs	*463.4*	*557.6*	*501.4*	*522.4*	*2.70*	*518.0*	*506.6*	*3.45*
Net Present Value	***191.9***	***190.6***	***196.5***	***186.3***	***0.31***	***197.5***	***185.4***	***0.39***

18. The sensitivity estimates show a slightly higher net benefit under the ‘low’ scenario compared to the central scenario, driven primarily by the lower estimated cost of the energy demand response to the discounts paid and the lower value of the subsequent resource, greenhouse gas and air quality impacts. The ‘high’ scenario shows very similar results to the central scenario, mainly as a result of the central assumptions being relatively closer to the ‘high’ assumptions than the ‘low assumptions’.
19. Overall, the sensitivity testing shows that under all scenarios Policy Option 1 will result in a small improvement in societal welfare, and should suppliers choose not to make use of the additional flexibility (i.e. effectively the same as the Do Nothing option), this would result in no change in societal welfare, other than the small familiarisation costs borne by suppliers.