CONSULTATION RESPONSE

Renewable Electricity Financial Incentives – Feed-In Tariffs 16 Oct 2009

Introduction

The Home Builders Federation is the principal trade association representing private sector house builders in England and Wales. Between them our members are responsible for about 80% of the homes built each year.

The Federation is responding to the consultation's proposals for the introduction of a Feed-in Tariff (FIT) from April 2010. The FIT will be important for home builders in helping them work towards the Government's objective that all new homes should be built to an agreed zero carbon standard from 2016. Our comments in this response therefore seek to suggest ways in which the FIT can best assist the achievement of this objective.

Summary of key comments

The HBF considers the following points are of the highest importance in implementing a FIT incentive successfully:

1 An effective FIT scheme will be critical to the successful implementation of the Government's zero carbon new homes policy. This policy prospectively involves significant up-front capital costs for renewable technologies that cannot be passed on to home purchasers. As developers seek to work out the best means for achieving necessary carbon reductions without adversely affecting project viability and their ability to increase output in order to tackle the growing shortfall in housing supply, therefore, the role of the FIT in offsetting additional development costs will be important.

2 Given this, it is essential that the income stream provided by the FIT can be accessed efficiently by home builders or their partners in providing smaller scale renewable electricity solutions for future residential development.

3 The Federation understands that since the householder would generally be envisaged as the recipient of the FIT the home building industry will need arrangements for the assignment of FIT income to other parties to be available and to operate effectively. (We would stress that we do not see evidence that the great majority of house purchasers would currently pay a price premium for properties benefiting from small scale renewable electricity generation and in any event the constrained availability of mortgages would limit their ability to do so.

4 It is also important that the FIT works successfully to help finance community-scale or community-owned renewable electricity facilities as well as those integrated in or placed on individual new homes. In the case of at least larger new residential developments, communal generation may well be used given its greater technical efficiency that that of very small scale installations.

5 The FIT should be available for all future new homes employing renewable electricity generation

to reduce carbon prior to the introduction of the full zero carbon standard from 2016.

6 We share the concern raised by the renewable industry and others that the proposed tariff levels in the consultation document are insufficient. If the wish is to promote the adoption of small-scale renewable electricity widely as part of the UK strategy to reduce greenhouse gas emissions, such investments need to be financeable on appropriate terms. Any investment that does not provide a suitable return will not attract finance against the competition for capital provided by alternative investments. In this context, returns of between 5 and 8% are insufficient to match the cost of capital for business and individuals.

7 We believe that a rate of return on investment of a minimum of 10% is required to ensure investment in small-scale renewable electricity is commercially attractive. In principle, technologies should benefit from the same rate of return to avoid any risk of trying to pick winners.

8 The return on investment proposed for PV is particularly low comparatively, yet this seems to be one of the technologies most likely to be useful in meeting the zero carbon homes objective. The proposed PV tariff would therefore reduce the viability of zero carbon home development and act as a barrier to increasing sustainable housing supply for the future.

9 We support the proposed tariff structure, which avoids the risk of potential perverse incentive effects. We believe the tariffs should, however, be index-linked to maintain their value and a predictable rate of return for investors.

10 In order to ensure returns on investment are sufficient, the FIT should also be exempt from income tax, including when assigned by a householder to another party. The tax implications of the FIT generally require further consideration in ensuring tariff levels are sufficient to be commercially attractive.

11 We consider there is a strong case for allowing the FIT to bed down for its first three years before commencing any arrangements for tariff degression to ensure effective introduction and avoid the possible risks of stranded investment and reputational damage that might otherwise arise.

12 For new residential development working towards – and in due course, meeting – a zero carbon standard it will be necessary to find means of securing FIT income to properties in ways that enable the full benefit to be effectively assignable to other parties and not tied to the initial purchaser of they move to another property. This is an area that needs more work to ensure that solutions are robust, easily manageable and legally sound.

13 The implementation of the FIT in the case of new development also needs to allow for the involvement of management companies to operate and maintain technologies integrated in individual homes. However, our analysis so far suggests that such arrangements may not be easy to reconcile with the requirements of landlord and tenant legislation. This is another area in which more work is necessary and should be facilitated by the Government.

14 The HBF further considers that the provisions of consumer law, including the Property Misdescriptions Act must be assessed in relation to the operation of the FIT and the sale of residential properties with small-scale renewable electricity generation that are receiving FIT payments.

15 We would propose the establishment of a working group involving Government, developers,

property professionals and others to analyse, assess and propose solutions to the legal and commercial issues mentioned in the 3 preceding bullet points.

Comments on the specific consultation questions on the FIT

We set out below our comments where we have them on the detailed questions raised in the consultation document.

Q35. Do you agree that FITs should be structured in order to recognise all generation, rather than just exports?

Yes.

Q36. Do you agree that the best way of delivering security for the investor is to set a long-term guaranteed price for exports?

Yes, although this should be set as a minimum not a maximum rate. For new residential development it will be important to reward export sufficiently as the high fabric efficiency standards that will apply will reduce conventional power requirements in such homes.

The tariff for export should also increase over time in line with energy inflation.

Q37. Do you agree that FITs generators should also benefit from on-site use of their generation?

Yes.

Q38. Do you have any other views on the basic structure of the FITs?

The tariff proposals in the consultation document make no allowance for general price inflation or, in the case of export, energy inflation. As a result, the real value of the tariff payments and the rate of return on investment would decline substantially over time. To ensure that the policy is effective the generation tariff should be index-linked to RPI.

The export tariff should be reviewed in line with movements in the wholesale price of electricity.

The issue of degression needs to be looked at further. We believe that degression should not be

introduced until the FIT has bedded down – say, after the first three year period of operation. In addition the rate of degression proposed for some technologies – notably PV – is too high and assumes over-optimistic levels of cost-reduction in delivering future installations. Such aggressive degression rates will deter take-up and adversely affect the viability of new residential development.

Q39. Do you agree with the proposed limits of 5MW for renewable technologies and

50kW for gas fired CHP for FITs installations?

Yes.

It is important to cover up to 5 MW for new residential development. Some larger development sites are likely to have opportunities to accommodate facilities well above 50kW capacity and the 5MW limit will also be relevant to making “affordable solutions” for off-site measures under the zero carbon homes policy effective and affordable.

Q40. If you disagree with the proposed limits, what lower limits would be more suitable and why?

Not applicable.

Q41. Do you agree that generators off the electricity grid should be eligible for FITs? If so, what safeguards should be put in place for these generators to ensure the electricity is being used?

Yes, we strongly support eligibility for such generators. This may well be the position for new development and we would want such sites to qualify for the FIT.

Q42. Do you agree with the selection of technologies for which we will be providing tariffs from April 2010?

There is a good case for making the FIT available to all known and emergent technologies to assist and promote innovation. We are not sure therefore that it is necessarily right to confine the FIT only to the list of technologies proposed.

Q43. Should technologies for which we do not propose to offer a specific tariff from April 2010 be handled by:

1 Providing a single tariff from April 2010 for all remaining technologies;

or:

1 Considered as a new tariff band as part of regular FITs reviews?

All technologies should in principle benefit from the same rate of return on investment unless there were specific additional costs of capital associated with particular technologies. Tariffs should be determined case by case on the basis of this principle.

Q44. Do you agree that the FITs should not require on-site generators to comply with any energy efficiency standards as a condition for eligibility?

Yes.

Q45. Are there any issues regarding eligibility that we have not foreseen here? If so, how should we address them?

No comment.

Q46. Do you agree with our approach not to offer up-front capitalisation to schemes as part of the FITs? If not, what alternative approach do you propose and why?

The view of our members is that up-front capitalisation is not essential provided that tariffs provide an adequate rate of return for investors and FIT income can be assigned to third parties. We are concerned therefore that the opportunity to develop innovative financing mechanisms and service offers based on the FIT will not be realised unless the rate of return is improved to at least 10%.

Q47. Do you agree with our approach that a generator may assign the rights to their FITs payments to a third party? If not what alternative approach do you propose and why?

Yes, this is essential for new build residential development seeking to work towards and then achieve the proposed zero carbon standard.

It is only through assignment to other parties that innovative ways can be found of mitigating the additional capital cost involved – which otherwise would either make new homes less affordable for consumers or reduce development viability and housing supply.

Assignment will also be necessary to establish effective arrangements – whether through an ESCO or otherwise – for communally owned renewable facilities on new development sites or provided as an “allowable” off-site solution under the zero carbon homes policy.

For all forms of installation that may be associated with the zero carbon policy and be eligible for the FIT it is also essential that should a property be sold, the benefit from the FIT is transferred to the new owner/nominated third party.

There should be full freedom to assign FIT income to all third parties, including to financial bodies such as banks who may then be able to develop innovative and efficient financing models for renewable electricity installations.

Q48. Do you agree with the proposed model for registration and accreditation of plant claiming FITs discussed in the Accreditation, Registration and Connection section?

In general, yes.

Q49. Do you agree with the principle that all generation should be metered to qualify for FITs? Do you foresee any issues with that approach?

Yes.

Some of our members have, however, pointed out that a net metering approach should be adopted as in other European countries for smaller installations. This may be particularly important for new residential development using technologies such as PV where a significant amount of generation may be exported and the export price may be considerably less than the retail energy price.

Q50. What are your views on regulating which suppliers should be required to offer FITs, and in what circumstances?

We are broadly content with the approach proposed.

Q51. Do you agree with the tariff levels, lifetimes and degression rates we have set out for the chosen technologies? If not, what evidence do you have for choosing alternatives?

Tariff levels

No.

The tariff levels are generally insufficient, particularly for PV.

In order to attract investment and finance providers and so as not to discriminate between technologies, all eligible technologies should in principle benefit from tariffs that provide a rate of return of at least 10%. Without an adequate return take-up will be insufficient and new low and zero carbon homes would either become less affordable for purchasers or development would become less viable, frustrating the objective of increasing housing supply.

The rate of degression needs to be consistent with the achievement of this level of return on investment for each technology and as argued above we see a strong case for not introducing degression until the FIT has settled down during its first three years. The level of degression proposed for PV is too high in the view of expert advisers among our membership.

In ensuring an adequate return for investors and finance providers, the tax position must also be considered. If tax were to be payable on FIT recieved by either individuals, businesses or bodies to whom the FIT had been assigned that would affect the rate of return achieved. The government needs to clarify the position and ensure that the final tariff levels are set to achieve the 10% return necessary after allowing for any tax payable.

As also indicated elsewhere in this response, the value of tariff - and rate of return - needs to be safguarded for both generation and export payments through index-linking. in the case of export tariffs there is a sound argument for considering linking the tariff to energy prices so that it retains meaning within the overall tariff structure. In the case of new build homes an export tariff that is meaningful in relation to wider energy prices would seem sensible given the potential for export.

Specifically, **on PV**, we believe the Government needs to think further about the rate of the FIT for building integrated PV systems. These are more expensive than roof-mounted systems to install and so should be considered as a separate banding within the tariff. The tariff for building integrated systems needs to be higher than for other PV installation bandings to achieve a suitable return.

On **biomass CHP**, there is a simailar issue. The technology for sub 1MW biomass CHP is currently immature and should be looked at as a separate element in the tariff banding. The tariffs for smaller scale biomass CHP installations need to be raised to levels higher than that for installations of more than 1MW.

Q52. Do you agree with our proposed guaranteed minimum price for the exported electricity? If not, what price would you propose and what is your proposal based on?

The principle of a minimum price is sensible, but to maintain the value of the tariff it either needs to be index linked to general prices, or to reflect changes in electricity prices. There is merit in looking at the latter option, particularly to ensure that export continues to be seen as desirable where possible to the generator. The need to ensure that there is seen to be value in the export tariff is felt by home builders to be important given the real potential that energy efficient new homes may well have for export.

Some members also feel the initial export tariff has been set at too low a level.

Q53. Does the proposed review structure provide the right balance between providing certainty and adapting FITs to the changing circumstances in which it operates?

Yes.

Q54. Do you have any initial views on the relationship between FITs and those in fuel poverty or on low incomes?

We do not have any strong views or expertise in this field. In principle, however, it seems best to address fuel poverty issues directly rather than seek to complicate the design of the FIT itself to mitigate fuel poverty. The additional impact of the FIT on the problem of fuel poverty would we also understand be fairly small.

Q55. Do you agree that the levelisation process described above provides the best system for redistributing costs amongst suppliers? If not, what other ways can we levelise costs across suppliers?

Yes.

Q56. How can the levelisation process facilitate participation in FITs for small suppliers?

No comment.

Q57. Should suppliers be able to include an administration cost in the levelisation process? If so, what should the level of that allowance be and how should it be determined?

Yes, this would seem fair provided this allowance is simply one that reflects actual costs.

Q58. Should the levelisation process include consideration of large and unforeseen price differences between prices paid to generators and the market value?

No comment.

Q59. Do you agree with the proposed approach to auditing, assurance and enforcement? If not, what alternative approach do you propose and why?

Yes.

Q60. Are there any issues regarding the role of suppliers that we have not foreseen here? If so, how should we address them?

We do not have any comments on this.

Q61. What do you think is the best way of defining an installation for the purposes of FITs?

The definition of installation needs to cover all types of renewables installation. Thiese will include installations in or on single dwellings, building mounted systems serving groups or blocks of flats or apartments, communal installations for all those living on a new development and larger community schemes (which may form part of "allowable measures" under the proposed definition of zero carbon).

In general our members seem content with the approach proposed. However, one specific question has been raised: how would the rules cover phases of development on a single development site?

In house building there are sites which are sufficiently large that they will be built out and sold in specific phases that might spread over a number of years. In such cases the provision of renewable electricity might also be approached on an incremental basis with new capacity of perhaps the same technology being added over time. In that event one suggestion made by our members is that a new output meter should be installed for each new phase of development, with the FIT rate applying being that for the year of installation in each case. We suggest that further discussion is probably required on this point.

Q62. Once an installation is defined, do you think further checks are required to verify this? If so, what would these checks be?

Guidelines to accredited installers could cover this.

Q63. How could we deal with installations at a single site installed in different years?

See above.

Q64. Do you agree with the proposed approach for the treatment of existing generating stations?

No specific comment.

Q65. Do you agree with the proposed approach for the treatment of generating stations that completed installation during the interim period?

No comment.

Q66. Do you agree that, for non-household installations built during the interim period, we should make access to FITs conditional upon repayment of any central Government grant received for such installations?

No comment.

Q67. Do you agree with the proposed approach for the treatment of new generating stations once the FITs scheme becomes operational?

Yes.

Q68. Do you agree with the decoupling of support for heat and electricity for new renewable CHP plants? What are the technical issues that need to be considered in implementing transitional arrangements towards the introduction of FITs and RHI for CHP installations?

This seems sensible.

Q69. Do you agree that FITs should not restrict access for those projects covered by other schemes?

Yes.

It is important that future low and zero carbon new homes should qualify for the FIT in respect of eligible technologies and that arrangments for assignment of the FIT should be practical and readily accessible by third parties. It would discriminate against new homes in the market for the benefits of the FIT not to be avialble in this way. Access to the FIT to mitigate the capital costs involved is essential in order to deliver the new homes of the future as affordably as possible in the greater volumes required to meet national needs.

Separately, we would also point out that there can be no case for excluding new homes subject to "Merton rule" planning policies from the benefit of the FIT. We were concerned to read in the consultation document the suggestion that "It will be up to local authorities to decide whether supported renewables may be counted in fulfilment of such [Merton rule] conditions". Such a discretionary approach would be grossly unfair to developers - and again discriminatory towards new homes in the market - nor do we believe it would be justified in planning policy terms.

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