Opinion: regulator EANDCB validation
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Regulatory Policy Committee

Heat networks

Regulatory Delivery Directorate (NMRO)

(Department for Business, Energy and Industrial Strategy)

RPC rating: validated

The assessment is now fit for purpose as a result of the regulator's response to the RPC's initial review. As first submitted, the assessment was not fit for purpose.

Description of proposal

The Heat Networks (Metering and Billing) Regulations 2014 implemented aspects of the Energy Efficiency Directive in the UK. In its original form, the implementation applied to any building that had a 'heat network' (a system that distributes heating or cooling from a central source to multiple final customers). This meant, contrary to the intention of the EU requirements, that a significant number of buildings were brought into scope of the requirements, most notably 'Houses in Multiple Occupation' (HMOs).

The owners of any building within scope of the requirements have to: notify the regulator at least every four years that the building has a heat network and assess the viability of installing heat meters or cost allocators if not already installed; and fit individual meters if technically and economically feasible.

The guidance implementing the requirements was amended in July 2015 to remove some forms of shared occupation building (such as HMOs) where the application of the requirements would have very limited or no scope to deliver energy savings, meaning that the cost of theteh requirements would be disproportionately expensive with very limited potential to reduce energy use

Impacts of proposal

Using local authority housing statistics and the Department for Communities and Local Government 2010 Private Landlord Survey, the regulator estimates the change would affect around:

- 570,000 HMOs, owned by around 259,000 landlords; and
- 2,500 buildings owned by around 900 universities, private boarding schools or businesses that provide student accommodation.

The regulator now uses an estimate of initial compliance with the requirements of 30% (based on the compliance levels of businesses remaining in scope of the regulation). Using evidence from other regulatory requirements that affect the same group of businesses in a similar way (the Energy Performance of Buildings Directive), the regulator estimates that compliance in the counterfactual would have risen to 85% by the end of appraisal period. In line with Better Regulation Framework Manual guidance on levels of compliance, these estimates are used to ensure that the benefits to business do not inappropriately include savings for businesses that would not have complied with the regulatory requirements. As initially submitted, the assessment assumed 100% compliance.

The regulator's assessment discusses impacts associated with removing requirements to notify and undertake appraisals, familiarisation, and installation of meters.

Notifications

Based on consultation and engagement, the regulator estimates that around 80% of businesses would have completed the notification process themselves, taking an average of 15 hours at a rate of £22.56 per hour (the mean wage for property, housing and estate managers, taken from the Annual Survey of Hours and Earnings uprated by 20% for non-wage labour costs). The remaining 20%, due to complexity or other factors, are likely to have used consultants at an average cost of £250 a day, for two days. The results in an average cost of £370 per building associated with the notification requirements.

Taking account of the estimated levels of compliance over the appraisal period, and four year notification cycle, this change is expected to save business around £474 million in present value terms over the ten year appraisal period.

Assessments of viability

Even though it is unlikely that heat meters would be feasible (technically, economically, or both) for the buildings affected by the change, the owners would still have been required to complete an assessment to provide the necessary evidence. Even given the availability of support tools for owners, feedback from those who have completed the process estimate it takes around 13 hours. Based on the same £22.56 per hour wage rate, and a similar proportion of owners engaging consultants to undertake the work, the regulator estimates that the viability assessments would have cost £321 per building.

As the requirement to undertake viability assessments would have come into force later (by end 2016), the total savings over the appraisal period are estimated to be £411 million, when adjusted for expected compliance levels.

Familiarisation

Based on feedback, the regulator estimates that familiarisation with the initial requirements took about one day, at the same wage rate (£22.56 per hour). Taking account of when businesses would be expected to become compliant under the counterfactual (assuming this correlates to when they familiarise themselves with the requirements) and assuming a continuation of the current 2% annual increase in HMOs and HMO-owning businesses, the regulator estimates around 207,000 businesses will avoid familiarisation costs of £169 per business (£36 million over the ten year appraisal period).

The regulator estimates that around 90,000 businesses (35% of those in scope) had familiarised themselves with the initial requirements. The regulator's assessment is that these businesses will face additional familiarisation costs of understanding the subsequent change. The regulator assumes this will cost £169 per business (£15.5 million in the first year).

Installation of meters

Prior to the change, district heat networks would have been required to install meters to measure individual customers' consumption, even if they shared a house. The regulator estimates that removing this requirement will result in the installation of 16,000 fewer meters. Installation of meters, depending on complexity, is estimated to cost between £960 and £3,420 per building (based on industry estimates), with a best estimate average of £1,265 per building. This results in an estimated saving of £20 million in present value terms over the ten year appraisal period.

Overall

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of -£90.7 million. This will be a qualifying regulatory provision that will score under the business impact target.

Quality of submission

As initially submitted, the assessment included several issues that meant that the RPC did not consider the estimated benefits to be robust. Following the RPC's initial review, the regulator submitted a revised assessment responding to the concerns raised. In particular:

- The assessment now provides a robust estimate and justification of compliance with the requirements under the counterfactual. As initially submitted, the assessment assumed 100% compliance with the requirements and assessed the benefits on this basis. However, the regulator did not justify this sufficiently, especially given evidence of limited compliance at the time of the change. While the change in requirements took place prior to the deadline for compliance, it did not appear reasonable to assume 100% compliance with the requirements. The additional background provided on the timing of the changes (which provides an explanation for the limited volume of notifications at that point) and evidence of changes in compliance for comparable regulatory requirements means that the estimates can now be considered robust.

- The assessment now provides further evidence supporting the unit costs and volumes of affected businesses. The assessment would benefit from providing further detail regarding some of the processes, for example providing further background on why the notification process will take two days. However, the regulator has now explained that the estimates are based on feedback and engagement with industry experts with experience of relevant processes. The estimates for the number of HMOs are now consistent with other appraisals and evidence.

The RPC notes that the estimated familiarisation cost for the 90,000 businesses that had familiairsed themselves with the previous requirements is likely to be an over estimate. This is because it would appear to take less time to understand that regulatory requiremetns no longer apply compared to understanding a new requirement will apply and the content of those requirements. However, in EANDCB terms, the overestimated costs are unlikely to have a material impact on the overall EANDCB.

The summary table in the assessment does not correctly transpose the totals from earlier in the assessment or from the EANDCB calculator. The sections in relation to each aspect of the changes are correct. The summary table needs to be corrected prior to publication.

The accessibility and transparency of the figures used in the assessment could be improved. While the figures, for example on numbers of HMOs, appear correct, the way in which they are presented is not transparent. For example, the assessment would benefit from presenting more clearly, such as through the use of graphs, expected trends in the numbers of HMOs and owners in each year. This would help to clarify the variation in the volumes of businesses that would have been compliant by that point.

The RPC notes that the benefits to business arise as a result of amending unintended errors in the implementation of the initial policy proposal. We note, the failure properly to account for the true costs of the initial proposal in the previous Parliament. The treatment of this measure serves to highlight once again that the Business Impact Target and previous regulatory accounts cannot be added together to provide an assessment of changes in the impacts of regulation on business across the two periods. Just as importantly, the RPC views the scoring of this measure as beneficial under the Business Impact Target, when the costs have not previously been accounted for, as a perverse outcome, and indeed one that risks creating the wrong incentives in the better regulation framework.

The RPC would welcome further detail on the review and monitoring plans for the requirements. Given that there appears to have been a number of significant errors associated with the design, appraisal and implementation of this policy, it would appear that the potential lessons learnt would justify a post-implementation review earlier than may be appropriate in other cases.

Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net cost to business (EANCB)	-£87.2 million (initial estimate) -£90.7 million (final estimate)
Business net present value	£782.6 million
Societal net present value	£782.6 million

RPC assessment

Classification	Qualifying regulatory provision (OUT)
EANCB – RPC validated[1]	£90.7 million
Business Impact Target (BIT) Score[1]	-£453.5 million
Small and micro business assessment	Not required (regulator assessment)
RPC rating (of initial submission)	Not fit for purpose

[1] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.

Michael Gibbons CBE, Chairman