

## Impact Assessment Form

<p>Title: Impact Assessment on potential change to Fuel Poor Network Extension Scheme (FPNES) eligibility criteria</p> <p>Division: Networks Team: RIIO Gas Networks</p> <p>Associated documents: Consultation on potential change to the Fuel Poor Network Extension Scheme.</p> <p>Coverage: Full coverage of policy in consultation document above, published alongside this IA</p>	<b>Impact Assessment (IA)</b>
	Type of measure: Price control
	Type of IA: Not Qualified under Section 5A UA 2000.
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### Summary:

**What is the problem under consideration? Why is Ofgem intervention necessary?**

The Fuel Poor Network Extension Scheme (FPNES) helps households that are not connected to the gas grid to switch to natural gas by offering funding towards the cost of connecting to the gas network. Gas is usually a cost-effective fuel of heating, once installed, so is a key way to tackle access to affordable energy and alleviate fuel poverty.

The FPNES is part of the current RIIO-GD1 price control with a target for number of connections under the scheme. The Gas Distribution Networks (GDNs) are expected to meet their individual outputs by the end of the price control period (March 2021).

Households wishing to access the FPNES must meet one of the pre-defined criteria. We are no longer confident that one of the eligibility criterion, that the household must "reside within the 25% most deprived areas, as measured by the government's Index of Multiple Deprivation" (the "IMD criterion"), effectively targets those in fuel poverty.

BEIS has changed the associated Energy Company Obligation (ECO) by removing the obligation that also targeted the 25% most deprived areas, as it was modelled as being a poor proxy for fuel poverty and not as well-targeted as other aspects of ECO. This change has prompted us to review use of the IMD criterion in the FPNES.

Having reviewed the available data on the targeting of this criterion, and further considered the options, we are proposing to remove the IMD criterion. This is so that the FPNES continues to align with other relevant schemes, as well as aims to ensure that connections under the scheme are going to those that are in fuel poverty and need them most. We consider this offers better value for money.

We have not considered the remaining criteria within the scope of this Impact Assessment (or consultation). These were established/updated as part of a detailed review of the FPNES from 2014-15. There has been no cause for us to review these again.

**What are the policy objectives and intended effects including the effect on Ofgem's Strategic Outcomes**

Ofgem has a duty to all current and future energy consumers, with a particular consideration for vulnerable consumers, including those in fuel poverty. The FPNES seeks to help households not currently connected to the gas grid to switch to natural gas by offering funding towards the connection. Gas is a cost-effective fuel for heating so helps households access affordable energy supplies and can contribute to alleviating fuel poverty.

We are proposing the change to:

- ensure the FPNES is effectively targeted at households in fuel poverty – the proposed change is to remove a criterion that is a poor proxy for fuel poverty.
- continue to align the FPNES criteria with relevant government schemes and wider policy – the aspect of ECO that employed the IMD criterion has been removed from 1 April 2017.
- ensure the scheme offers good value for money for all consumers - the scheme is covered by total expenditure allowance within the RIIO-GD1 price control which is recovered from network charges (i.e. consumers' bills). Better targeting will improve the use of this.

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

We have considered two main options:

**Option 1:** Do nothing – retain the current eligibility criterion

**Option 2:** Remove the IMD criterion

We are proposing Option 2. This option better meets the policy objectives of the scheme. Available data shows that the IMD criterion is a poor proxy for fuel poverty and other remaining criteria for the scheme will more accurately target households in fuel poverty.

Retaining the criterion would lead to a poorer-targeted scheme, go against related policy changes to ECO and likely be poorer value for money for energy consumers.

Further details are provided in the Evidence Base section.

The remaining criteria would be that the household must:

- Be eligible for measures under the Home Heating Cost Reduction Obligation (HHCRO) aspect of the Energy Company Obligation (ECO) (all), Nest (in Wales only) or the Home Energy Efficiency Programmes (HEEPs) (in Scotland only); or
- Be in fuel poverty based on the latest definition/indicator for the relevant area. The definition/indicator differs for England, Wales and Scotland.

**Preferred option - Monetised Impacts (£m)**

Business Impact Target Qualifying Provision	Non-qualifying
Business Impact Target (EANDCB)	N/A
<b>Net Benefit to Ofgem Consumer</b>	-
<b>Wider Benefits/Costs for Society</b>	-
<b>Explain how was the Net Benefit monetised, NPV or other</b>	
The impacts are hard to monetise	

### Preferred option - Hard to Monetise Impacts

#### **Describe any hard to monetised impacts, including mid-tem strategic and long-term sustainability factors following Ofgem IA guidance**

The impact on fuel poverty that the change will have is hard to monetise. We consider that the improved targeting means that the FPNES is more likely to reach those in fuel poverty and less likely to connect households not in fuel poverty, meaning the scheme is reaching those that need it most.

Ultimately, we consider that this will lead to a greater proportion of connections going to those in fuel poverty and a decrease in connections going to those not in fuel poverty, based on the information outlined in the Evidence Base section.

There will also be an impact on the GDNs. We acknowledge that the change in approach will require the GDNs change their approach and be more innovative in order to identify households that are eligible for a connection. This may increase their costs for delivering the scheme which will ultimately affect their total expenditure in RIIO-GD1. This will impact the revenue that goes through the RIIO sharing factor, i.e. how much cost/saving is passed onto consumers. There may also be fewer connections under the scheme, as discussed further below.

There will also be an impact on schemes currently in the pipeline or planning stage, given the proposed change. A sudden change to the criteria would stop a number of these schemes continuing. We propose to mitigate this impact by implementing the change with a transition period, as outlined in more detail in the consultation document.

#### **Key Assumptions/sensitivities/risks**

One key assumption is that the GDNs will still meet their connection targets under the scheme for RIIO-GD1. We recognise there is a risk that the GDNs may not meet their FPNES connection targets, particularly given they have stated that it would be more difficult to meet the targets if we change the criteria. If this risk materialises, it could lead to a decrease in the overall number of fuel poor households connected. However, we would have greater confidence that those who are connected under the scheme are in fuel poverty. We consider this risk will only materialise from this change if GDNs are unable to sufficiently adapt their approach to targeting and identifying FPNES eligible households. We will continue to monitor progress against the connection targets as part of our annual reporting process.

It is unclear how this change will affect GDNs' costs as it will depend on the number of connections they are able to deliver and what new approaches they develop to identify those eligible for connection.

Acknowledging these risks, we expect GDNs to take all reasonable steps to meet their individual connection targets under the FPNES.

If the targets are not met (or are surpassed), there is an existing review mechanism that is triggered at the end of the price control (as set out in Special Condition 4J of the GDNs' Special Licence Conditions). As set out in the mechanism:

- The GDNs are required to provide a report on performance under the FPNES.
- We will review this with regard to any justified over-delivery (against targets) or justified under-delivery.
- We will then determine whether adjustments should be made in the next price control period (RIIO-2).

There are a few other sensitivities that could affect our assessment of the options:

The targeting information has been based on modelled estimates from government analysis. This is the best available data to us. We have not been able to acquire data on the actual incidence of fuel poverty among those connected under the FPNES to date, although this data was requested from the GDNs.

<b>Will the policy be reviewed?</b> Yes	<b>If applicable, set review date:</b> We will review the criteria if any future changes to other schemes and fuel poverty policy are made. The FPNES will also be subject to review ahead of the next price control (RIIO-2).
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<b>Is this proposal in scope of the Public Sector Equality Duty?</b>	<b>No</b>
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**Summary Table for all options.**

<b>Summary of options</b>	<b>Main effects on Ofgem outcomes</b>	<b>Benefits</b>	<b>Costs</b>	<b>Key Considerations</b> (Risks, assumptions, distributional impacts etc.)
Option 1 – No change	Poorer value for money for energy consumers. Misaligned with government targeting	Processes in place and easier for GDNs to meet targets – potentially more total connections	Higher proportion of non-fuel poor consumers getting connected under scheme	Analysis assumes that IMD criterion is poor indicator of fuel poverty
Option 2 – remove IMD criterion <b>Preferred</b>	Scheme is better set up to target fuel poverty so better value for money for energy consumers	Better targeting of scheme. Better value for money for consumers	Change in identification approach - may result in fewer total connections. This may increase costs to GDNs	GDNs may have to work harder and innovate to meet targets. This may increase costs to GDNs. There is a risk that targets are not met.

## Evidence Base

### *Background and rationale for change*

The Fuel Poor Network Extension Scheme (FPNES) helps households that are not connected to the gas grid to switch to natural gas. It does so by offering funding towards the cost of connecting to the gas network. Access to gas, a cost-effective fuel for heating, is a good way to ensure fuel poor households can access affordable energy supplies.

To help ensure the scheme reaches those who need it most, access to the FPNES is based on eligibility criteria that reflect commonly used proxies of fuel poverty, and the criteria used by related measures and schemes such as Scottish and Welsh schemes to address fuel poverty. Doing so ensures that households that get a gas connection through the FPNES are more likely to also benefit from related assistance, such as first-time central heating or energy efficiency measures. This should further help alleviate fuel poverty and may provide wider benefits.

Under current rules, to be eligible for the FPNES the household must:

- Reside within the 25% most deprived areas, as measured by the government's Index of Multiple Deprivation (IMD) – the "IMD criterion". The IMD is defined separately for England, Scotland and Wales; or
- Be eligible for measures under the Home Heating Cost Reduction Obligation (HHCRO) aspect of the Energy Company Obligation (ECO) (all), Nest (in Wales only) or the Home Energy Efficiency Programmes (HEEPs) (in Scotland only); or
- Be in fuel poverty based on the latest definition/indicator for the relevant area. The definition/indicator differs for England, Wales and Scotland.

We are now proposing to remove the FPNES eligibility criterion that the household must "reside within the 25% most deprived areas, as measured by the government's Index of Multiple Deprivation (IMD)". We are proposing to remove the criterion from 1 April 2018.

We consider that there are two important reasons behind changing the FPNES criteria:

- they should align with the criteria for relevant government schemes
- the FPNES should be effectively targeted at households that are fuel poor.

### *Overview of options considered*

We have considered two options for the eligibility criteria for the FPNES:

**Option 1** – Do nothing – retain current criteria

**Option 2** – Remove the IMD criterion

We are proposing Option 2 as this results in a scheme that is better aligned with other government initiatives and is better targeted at fuel poverty, resulting in a better value for money scheme.

Below we first outline how the proposed change accords with the reasons provided above and objectives for the scheme, particularly looking at government analysis on estimated fuel poverty in deprived areas.

We then consider the relevance of this for the FPNES and compare to other criteria.

We then outline our consideration of the two options. This includes a consideration of the alternatives, should the IMD criterion be removed.

Next, we include an assessment of wider impacts and the materiality of the scheme and the change, to provide more context.

Finally, we look at risks related to the proposed change and how they will be mitigated.

### *Better alignment – changes to ECO*

In January 2017 the government decided to change to the Energy Company Obligation (ECO) scheme.<sup>1</sup> This included the removal of the Carbon Saving Community Obligation (CSCO), which focused on delivering insulation measures to any home within the 25% most deprived areas in Great Britain.

Our proposal to remove the IMD criterion from the FPNES ensures it continues to be aligned with criteria the government use for related schemes (i.e. ECO). This consistency enables households to access additional assistance for their home, such as energy efficiency measures and first-time central heating. The impact of this is difficult to assess, but the benefit of the FPNES increases as additional measures are adopted.

We also think that governments have the relevant expertise to develop criteria to effectively target fuel poor households. As seen below, we have predominantly used government analysis as our evidence base.

### *Effective targeting of fuel poor households*

In their analysis of ECO, BEIS compared CSCO to other areas of ECO, with a particular focus on England. We have expanded our approach to also consider Scotland and Wales.

Modelled data shows that the IMD criterion does not appear to be a good predictor of fuel poverty, since fuel poverty rates in those areas that meet the criterion are only marginally higher than the national average as set out in the table below.<sup>2</sup>

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<sup>1</sup> [The Government response to the ECO: Help to Heat Consultation](#)

<sup>2</sup> Note that the different fuel poverty rates between England, Scotland, and Wales are partly due to differing definitions used in each area.

**Table 1: Summary of government data on proportion of fuel poverty in deprived areas**

England	BEIS estimated that only 13% of households that meet the current IMD criterion are in fuel poverty. <sup>3</sup> This is compared to the national average fuel poverty rate of 11.0%. <sup>4</sup>
Scotland	Based on Scottish Government data, the proportion of households in fuel poverty in the 15% most deprived areas, according to the Scottish IMD, is estimated as 31%, which is the same as the national average for Scotland as a whole. <sup>5</sup>
Wales	Our analysis of data from Wales estimates that the average rate of households in fuel poverty in the 25% most deprived areas, according to the Welsh IMD (WIMD) is 25.70%. <sup>6</sup> This compares to a projected national level of 23%. <sup>7</sup> For reference, 10% of households in Wales were estimated to be in fuel poverty under the same definition of fuel poverty used in England.

Based on this poor level of targeting, we are concerned that the FPNES is not being sufficiently delivered to those in fuel poverty. In England the proportion is particularly low. Although there may be specific parts of areas that meet the IMD criterion that have high rates of fuel poverty, currently there is no guarantee that it is these fuel poor homes that receive a connection under the FPNES.

In contrast, the Home Heating Cost Reduction Obligation (HHCRO) element of ECO will remain as an eligibility criterion in Great Britain and has been shown as a better proxy for fuel poverty. The proportion of those in fuel poverty that are eligible for HHCRO is almost three times that of the IMD criterion, in England.

At the same time as removing CSCO, changes were made to the specifics of eligibility for HHCRO. This improved the estimated percentage of households in England eligible under this scheme that are in fuel poverty from 29% to around 35%.<sup>8</sup> Improvements are expected in Wales and Scotland, although similar analysis is not available.

#### *Consideration of options:*

##### **Option 1 – Do nothing – retain current criteria**

We consider that it will be easier for GDNs to meet their FPNES connection targets if the IMD criterion is retained.

Historically, around 70% of connections under the FPNES were qualified under the IMD criterion. It provides guaranteed eligibility in certain areas and does not require direct involvement with a household to determine eligibility as it can be assessed on location alone. This means engagement with potential connecting households is easier, particularly for community schemes.

However, the poor targeting of the IMD criterion, outlined above, means we are less confident that those who are eligible under the criterion are those that need a connection most.

<sup>3</sup> Page 8, [ECO: Help to Heat Consultation document](#)

<sup>4</sup> As outlined in the 2017 [Annual Fuel Poverty Statistics Report](#), based on 2015 data

<sup>5</sup> Page 74, [Scottish House Condition Survey: 2015, Key Findings](#)

<sup>6</sup> This is based on WIMD data from 2014 and fuel poverty estimates up to 2016.

<sup>7</sup> [The Production of Estimated Levels of Fuel Poverty in Wales : 2012-2016.](#)

<sup>8</sup> Page 19, [ECO: Help to Heat, Final Stage Impact Assessment](#)

**Option 2 – Remove the IMD criterion**

Under this option, the eligibility for the FPNES would be based on whether someone met the relevant definition of fuel poverty, or were eligible for a relevant government scheme. A household would no longer be eligible based on residing in the 25% most deprived areas.

As outlined above, the remaining criteria are better proxies for fuel poverty and, as such, would improve the targeting of the FPNES. We would be more confident that a greater number of connections were going to those in fuel poverty.

We have considered the difficulties that removing the IMD criterion will create in identifying eligible areas for connection and facilitating area-based delivery. This could particularly affect the delivery of community scheme connections.<sup>9</sup> These currently make up around 40% of connections under the FPNES.

However, the eligibility for HHCRO has recently been expanded which will flow through to FPNES eligibility and therefore enable new ways of targeting. For example, all social housing with an Energy Performance Certificate rating of E, F or G is now eligible for HHCRO, and therefore eligible for the FPNES, as well as the introduction of Flexible Eligibility through Local Authority declarations.<sup>10</sup> Both of these should continue to facilitate area-based targeting and delivery.

*Wider impacts and considerations of materiality*

The FPNES is an output under RIIO-GD1. In total, GDNs have a target of 91,203 connections under the FPNES, with individual targets for each network. Across the industry they are currently ahead of schedule in meeting this target, having made just over 52,000 connections under the scheme so far, although performance is more varied when broken down for each network.

In order for all GDNs to meet their connection targets in all network areas, they are required to make nearly 39,000 additional connections in the remaining 4 years of RIIO.

An efficient level of expenditure was calculated for this activity as part of their total expenditure under RIIO-GD1. This was then revised as part of a detailed review of the FPNES (2014-15), in which we increased targets under the scheme.

The allowance for this activity is around £129m.<sup>11</sup> Based on this, the value of the remaining connections under the scheme is around £56m.

*Risks*

There are a few factors that could affect our assessment of the options:

The targeting information has been based on modelled estimates from government analysis. This is the best available data to us. We have not been able to acquire data on

<sup>9</sup> Connections under the FPNES are divided into “community scheme connections” and “one off connections”. Community schemes require a new gas main to be laid, as well as individual service pipes to each property. A one-off connection under the FPNES is connecting a fuel poor household to an already existing gas main, and requires the installation of a gas service pipe only.

<sup>10</sup> Further detail on flexible eligibility can be found in Ofgem’s [ECO2t Guidance: Delivery](#) document, page 43 and BEIS’ [ECO: Help to Heat scheme – flexible eligibility](#) guidance documentation.

<sup>11</sup> Based on 14/15 price base.

the actual incidence of fuel poverty among those connected under the FPNES to date, although this data was requested from the GDNs.

However, we also acknowledge the change in approach required that may make identifying households that are eligible for the scheme more challenging. There is a risk that this may lead to fewer connections on the scheme if GDNs are unable to sufficiently adapt their approach to targeting/identification.

We will continue to monitor progress against the connection targets as part of our annual reporting process. In particular, we will review GDN performance at the end of the price control as part of the incentive mechanism that exists for the FPNES<sup>12</sup>. As set out in the mechanism:

- The GDNs are required to provide a report on performance under the FPNES.
- We will review this with regard to any justified over-delivery (against targets) or justified under-delivery.
- We will then determine whether adjustments should be made in the next price control period (RIIO-2).

We recognise that if GDNs do not meet their targets, it will lead to fewer connections under the scheme, which may mean that fewer households in fuel poverty receive a connection under the scheme than currently. However, we consider the benefits in improved targeting and, therefore, a better value for money scheme, still make this a positive change for the FPNES.

There is a risk that a sudden change to the criteria would stop a number of schemes continuing, particularly those that are currently in the pipeline. We propose to mitigate this impact by implementing the change with a transition period, as outlined in more detail in the consultation document.

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<sup>12</sup> As set out in Special Condition 4J of the GDNs' Special Licence Conditions, introduced in our [licence modification direction](#), made in December 2015