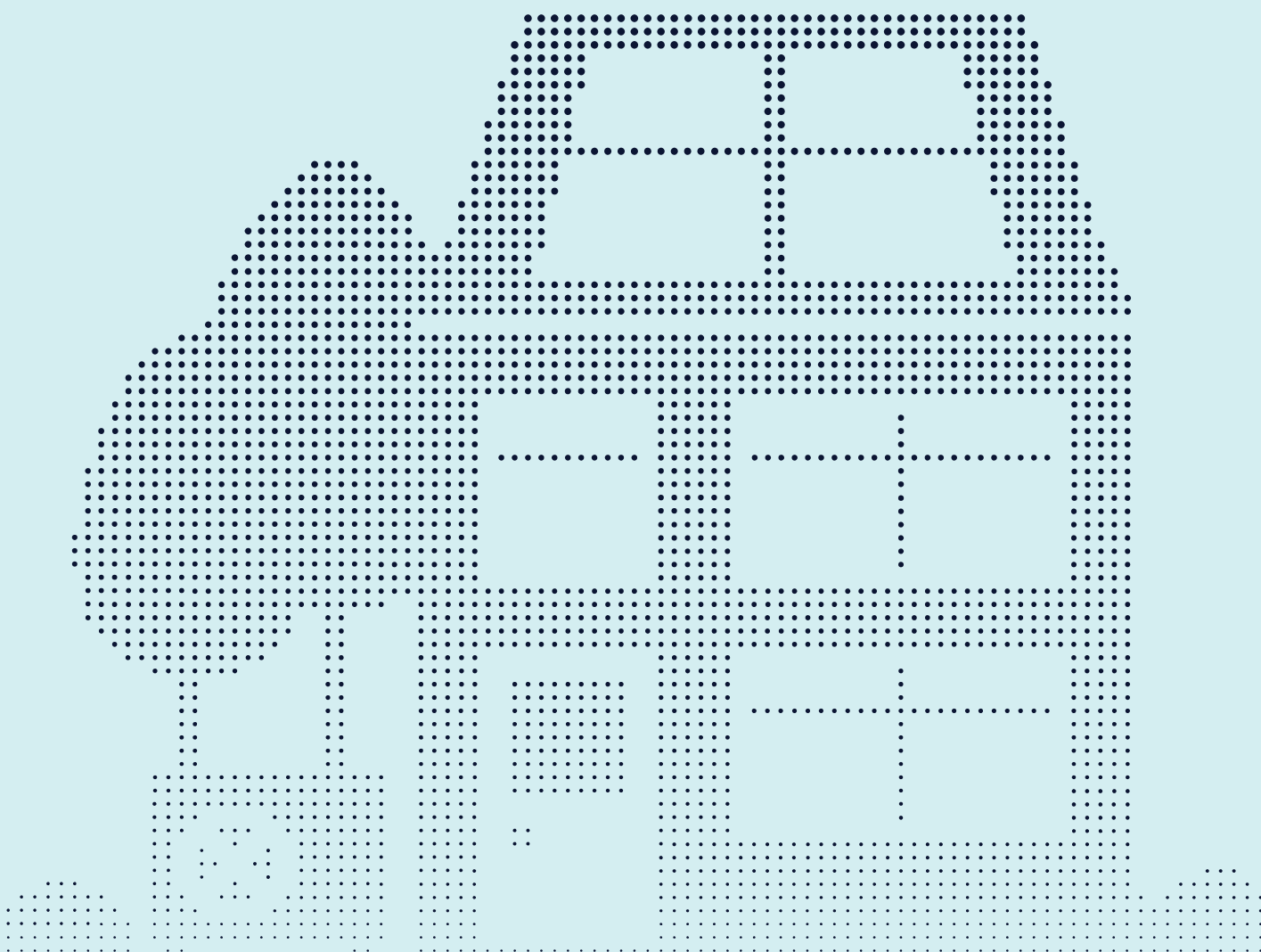


**THE CASE FOR FURTHER
LEVY REFORM:
IMPACTS ON ENERGY BILLS,
FUEL POVERTY AND THE
CLEAN HEAT TRANSITION**





The case for further levy reform:

Impacts on energy bills, fuel poverty and the clean heat transition

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About The MCS Foundation

Our vision is to make every UK home carbon-free.

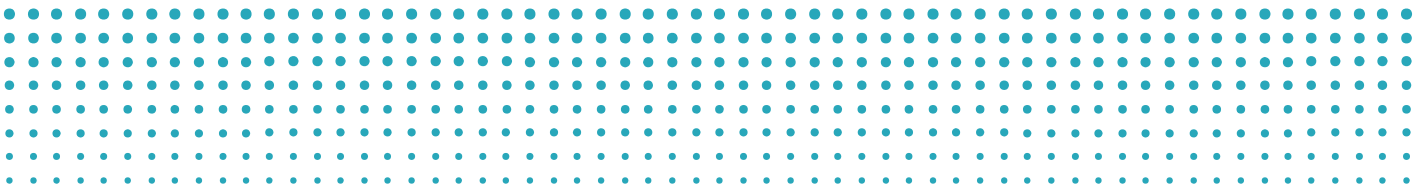
The MCS Foundation helps drive positive change to decarbonise homes, heat and energy through our programmes, grants, and advocacy work.

We support engagement programmes, fund research and facilitate innovative solutions to drive widespread adoption of renewables to help achieve a net zero future. In addition, the Foundation oversees the [Microgeneration Certification Scheme \(MCS\)](#) which defines, maintains and improves quality standards for renewable energy at buildings scale.

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Contents

Glossary	4
Foreword	5
Executive Summary	6
Introduction	8
Method	10
Results	12
Distributional impacts of the current levy framework	12
The benefits of full levy reform for households	14
The role of levy reform in supporting electrification and energy security	17
Conclusions and recommendations	21
References	23



Glossary

Consumer-led flexibility

An energy system approach where consumers actively adjust their electricity use, generation, or storage in response to prices, incentives, or grid needs, helping balance supply and demand while potentially reducing costs and supporting grid reliability.

Fuel poverty (official definition in England)

A household is considered fuel poor if, after energy costs are deducted, its remaining income falls below the poverty line, and the home has an EPC rating of D–G.

Fuel poverty (National Energy Action definition)

A household is considered fuel poor if it spends more than 10% of its net income on energy costs in order to maintain a satisfactory heating regime.

Heat pump

A low-carbon heating technology that uses electricity to extract heat from the air, ground, or water and transfer it into a building, delivering multiple units of heat for each unit of electricity used.

Net income

Household income after taxes and benefits, representing the amount available for spending on essentials such as energy, housing, and food.

Non-commodity costs

Components of energy bills that are not related to the wholesale cost of gas or electricity, including network charges, system operation costs, and policy-related charges.

Ofgem

The Office of Gas and Electricity Markets, the independent regulator responsible for protecting consumers and overseeing gas and electricity markets in Great Britain.

Ofgem archetypes

A set of representative household profiles developed by Ofgem to assess how different types of consumers are affected by changes in energy policy, prices, and regulation.

Price cap (Ofgem price cap)

A limit set by Ofgem on the maximum amount suppliers can charge households for energy under default tariffs, based on estimated costs of supplying a typical household.

Reformed National Pricing

A package of reforms proposed by the UK Government to improve the efficiency of the electricity wholesale market and reduce system costs, while retaining a single national wholesale electricity price.

Social and environmental levies / Policy costs

Charges added to energy bills to fund government schemes supporting decarbonisation, energy efficiency, renewable generation, and assistance for vulnerable households.

Spark gap

The ratio between electricity and gas unit prices, reflecting how much more expensive electricity is than gas per unit of energy.

Standing charge

A fixed daily cost paid by energy consumers regardless of how much gas or electricity they use, covering network and system costs.

Time-of-use (ToU) tariffs

Electricity tariffs where prices vary by time of day, encouraging consumers to use electricity when demand is lower or renewable generation is higher.

Unit rate (per MWh)

The variable cost paid for each megawatt-hour of energy consumed, excluding fixed charges (the standing charge).

Wholesale energy market

The part of the energy system where electricity and gas are bought and sold between generators, suppliers, and traders before being supplied to end users.

Foreword



By Garry Felgate, CEO, The MCS Foundation

In March 2026, The MCS Foundation published our report '*Rebalancing Electricity Levies in the UK*' which argued that the UK's approach to funding social and environmental programmes through electricity bills is no longer fit for purpose. The levy system is unfair, regressive, and acts as a brake on the transition to clean heating.

Since then, global and domestic events have only strengthened the case for electricity price reform.

The war in Iran and resultant fossil fuel price shock has sent gas prices soaring, with British households reliant on gas seeing their bills rise accordingly. Thanks to the increasing proportion of renewables in the energy grid, electricity costs have remained more stable. This demonstrates that increasing domestic renewables can shield electricity prices from global fossil fuel price shocks, while also reducing reliance on imported fuels.

However, while electricity costs have risen less than gas prices, the levy system in Britain continues to disincentivise the switch to cleaner electric heating such as heat pumps. Placing the vast majority of levies on electricity rather than gas drives up the cost of running a heat pump at a time when we should be ensuring renewable energy is affordable for all.

A fairer levy system is possible. In the 2025 Autumn Budget, the Government announced that 75% of one levy - the Renewables Obligation (RO) - would be taken off electricity bills and funded through general taxation, alongside the scrapping of the Energy Company Obligation (ECO). Although the scrapping of ECO has caused uncertainty in the sector, the funding of the RO by the Treasury has demonstrated that levies can be moved into general taxation. This step was welcome, helping to cut the cost of electricity for many households. However, the fundamental imbalance between gas and electricity prices remains.

This report revisits our earlier analysis using the latest data. The findings are striking. Despite the Government's interventions last autumn, some low-income households still spend more on levies on their energy bills than they do on fresh vegetables. Some of the most vulnerable pay over three times more on levies, as a proportion of their net income, than the more affluent. Moving levies would deliver the greatest proportional savings to these vulnerable households.

While rising gas prices mean heat pumps are now cheaper to run than gas boilers for all household at SCOPs of 3, we should not be relying on fossil fuel price shocks to improve the financial case for heat pumps. If levies were permanently moved off electricity and into general taxation, the savings for households switching to a heat pump would be maximised, with bills reducing by as much as £230 a year. That is the structural change in electricity prices we need to incentivise the transition to clean heating.

Levy reform alone will not solve fuel poverty or the challenge of decarbonising our homes. It must sit alongside targeted support for vulnerable households, wider electricity market reform and a commitment to clean heat that ensures all new heating systems installed from 2035 are zero-carbon. But moving levies into general taxation is one of the few measures available to government that can deliver immediate savings to struggling households. Increasing the proportion of renewables in the grid and delivering other reforms to energy markets will take time. Moving levies into general taxation can cut bills now.

Executive Summary

In March 2026, The MCS Foundation published *'Rebalancing electricity levies in the UK'*, demonstrating that the UK's energy levy framework is unfair, regressive and acts as a barrier to the transition to clean heat.

While the Government's Autumn Budget 2025 reforms reduced the percentage of policy costs on electricity bills from 17% in 2025 to 9% in Q3 (July – September) 2026, they did not fully address the underlying imbalance whereby electricity continues to bear a disproportionate share of social and environmental levies. Furthermore, these interventions are only temporary, with Treasury support for the Renewables Obligation due to end in Spring 2029.

Since then, rising wholesale gas prices have pushed household energy bills higher once again, highlighting the UK's continued exposure to volatile international fossil fuel markets. At the same time, high electricity prices continue to weaken the financial case for switching to heat pumps and other low-carbon heating technologies. This report updates our previous analysis, using the Q3 2026 Ofgem price cap data, to assess the impact of rising energy costs on households and examine the case for further electricity levy reform.

SUMMARY OF METHODOLOGY

We repeated the analysis undertaken in our March 2026 report using Ofgem's Q3 2026 price cap and policy cost data. Using Ofgem household archetypes, we modelled energy bills, policy cost contributions, fuel poverty impacts and heat pump running costs under both the current levy framework and a scenario in which all remaining electricity levies are removed from bills and funded through general taxation.



KEY FINDINGS

1. Despite recent reforms, policy costs on electricity remain around three times higher than those on gas.
2. Some low-income households continue to spend more than three times the proportion of their net income on levies than wealthier households.
3. Full levy reform would save households as much as £286 per year, with average savings of around £120. Low-income households using direct electric heating would see the largest proportional reductions in energy costs.
4. Rising gas prices have improved the economics of heat pumps, with all archetypes modelled achieving lower running costs than equivalent gas boilers at a seasonal coefficient of performance (SCOP) of 3. Full levy reform would mean households could save between £184 and £230 per year by switching from a gas boiler to a heat pump.

KEY IMPLICATIONS AND RECOMMENDATIONS

The findings reinforce the case for permanently removing the remaining social and environmental levies from electricity bills and funding them through general taxation. This would deliver immediate bill savings, reduce the disproportionate burden faced by low-income and electrically heated households, and strengthen the financial case for clean heat.

However, levy reform should be viewed as part of a wider package of measures. Targeted support schemes will continue to be needed to tackle fuel poverty, while broader reforms to electricity markets and pricing will be required to reduce electricity costs further and accelerate the transition away from fossil fuels.

We therefore recommend that the UK Government:

- **Permanently fund electricity levies through general taxation.**
This would remove regressive charges from bills, align costs with ability to pay, and reduce the spark gap, helping incentivise the switch to heat pumps.
- **Use levy reform to support electrification.**
Narrowing the electricity-to-gas price ratio is essential to give households confidence that switching to clean heat will reduce running costs.
- **Continue targeted bill support alongside structural reform.**
Levy reform alone will not eliminate fuel poverty; targeted schemes remain necessary while broader market reforms take effect.
- **Accelerate implementation of Reformed National Pricing and flexibility measures.**
Long-term affordability depends on reducing exposure to gas prices and better reflecting low-cost renewable generation in household bills.

Introduction



In March 2026, The MCS Foundation published the report *'Rebalancing electricity levies in the UK: impacts on electricity bills, fuel poverty, and the clean heat transition'*.¹ Using Ofgem household archetypes and price cap data across 2025, the report demonstrated how the UK's current energy levy framework is unfair and no longer fit for purpose.

Social and environmental levies placed on energy bills fund important schemes such as the Warm Homes Discount and the Feed in Tariff, but the way they are recovered is regressive. Our report showed that in 2025, some low-income households paid more on levies than they did on bread, rice and cereals. What's more, households using electricity to heat their homes, either via direct electric systems such as panel heaters, or via heat pumps, paid considerably more on levies compared to dual fuel households, despite using considerably less energy overall.

The report set out a case for why permanently moving social and environmental levies into general taxation would improve affordability for low-income households, reduce the burden on households using electricity for heating, and strengthen the financial case for transitioning to clean heat. Events since the publication of that report have only reinforced the importance of these issues. Following the energy crisis triggered by post-pandemic demand recovery and Russia's invasion of Ukraine in 2022,² renewed geopolitical instability and conflict in the Middle East have contributed to further increases in global fossil fuel prices.³ As a net importer of gas and oil, the UK remains heavily exposed to international fossil fuel markets and relies on overseas supplies to meet domestic demand.^{4,5} Rising wholesale gas prices have once again pushed up household energy bills in the UK.

Ofgem's energy price cap increased from £1,641 in April–June 2026 (Q2) to £1,862 in July – September 2026 (Q3),⁶ representing a 13% rise despite energy prices typically falling during the summer months.⁷ Notably, gas prices have risen at a higher rate than electricity prices under the latest price cap, unlike what was observed during the 2022 energy crisis;⁸ unit prices for gas and electricity have increased by 28% and 6% respectively.⁹ Ofgem notes that the growing contribution of domestic renewable generation has helped limit increases in electricity prices.¹⁰ Nevertheless, the Q3 price cap increase illustrates the consequences of the UK's continued reliance on fossil fuels.

Strengthening the UK's energy security will require a sustained shift away from fossil fuel dependence and towards domestically generated renewable electricity. Given that domestic heating accounts for the largest share of natural gas consumption in the UK,¹¹ as well as contributing to 15% of the UK's greenhouse gas emissions,¹² supporting households to transition to low-carbon heating systems must form a central part of that strategy.

And yet, high electricity prices in the UK act as a disincentive for households to switch to heat pumps. Analysis across European countries has shown there is a strong correlation between the spark gap – the ratio between electricity and gas prices – and heat pump deployment rates of a country.¹³ In the UK, social and environmental policy costs remain predominantly concentrated on electricity bills, creating a structural imbalance whereby non-commodity costs contribute to electricity being more expensive than gas.

In April 2026, the Government implemented measures announced in the Autumn Budget 2025 to reduce electricity costs, including the removal of the Energy Company Obligation (ECO) from bills and the temporary part-funding of the Renewables Obligation (RO) through general taxation. These measures reduced the share of the average electricity bill attributable to policy costs from around 17% across 2025 to 9% in Q2 2026. However, policy costs on electricity remain three times higher than those on gas. Furthermore, these reforms are temporary, with Treasury funding of the RO due to end in March 2029, and do not fully address the structural imbalance in how policy costs are recovered across electricity and gas bills.

This follow-up analysis updates our March 2026 report using the latest July–September (Q3) 2026 Ofgem price cap data. Because the Q3 2026 price cap covers a single quarter rather than a full year, it has been annualised to enable comparison with our previous modelling. While the Q3 price cap is not representative of energy prices across the whole year, it provides an illustration of household energy costs under the most recent price cap available at the time of writing and allows us to assess the implications of current market conditions using a consistent methodology.

This report examines the impact of the recent increase in energy prices on households across Great Britain and assesses the implications for affordability, fuel poverty and the clean heat transition. It explores the benefits of full levy reform, whereby all remaining social and environmental levies are removed from electricity bills and funded through general taxation.

In particular, it considers the extent to which further levy reform could address the remaining inequities in the current levy framework, deliver immediate bill savings to households facing rising energy costs, and strengthen the economics of clean heat as part of a wider strategy to improve energy security and reduce reliance on fossil fuels.

Wider reforms to electricity markets, including changes to wholesale market arrangements, and unlocking the value of consumer-led flexibility, will all play an important role in reducing system costs and delivering a more efficient energy system. However, it is likely to take years for many of these reforms to be implemented and for their benefits to be fully realised by households.¹⁴ Permanently funding electricity levies through general taxation represents one of the few policy interventions that can be implemented rapidly to reduce electricity costs.



Method



We repeated the analysis conducted for our original report using Q3 2026 price cap and policy cost data.¹⁵ Archetypes,ⁱ assumptions and modelling approach remain unchanged unless otherwise stated. The full method can be found in the original report.ⁱⁱ

The annual energy consumption for each archetype was converted to MWh for use in calculations to correspond with Ofgem price cap data, which uses MWh for average annual consumption.

Table 1 shows the breakdown of policy costs for both electricity and gas in Q3.ⁱⁱⁱ Policy costs are either added as a flat rate per customer (£/customer) or are dependent on energy usage (£/MWh). The total amount (£) spent on policy costs annually was calculated for each of the Ofgem archetypes, as well as the proportion of net income the different household archetypes spend on these charges.

Table 1 - Variable (£/MWh) and fixed (£/customer) policy costs for electricity and gas in Q3 2026.

	Policy costs (£/customer)	Policy costs (£/MWh)
Electricity	£3.41	£27.37
Gas	£7.23	£1.81

Table 2 shows the annual standing charge and the annual variable costs for gas and electricity under the Q3 price cap. The annual standing charge costs the same for everyone (£/customer), and the annual variable costs are the energy costs that change depending on how much energy a household uses over a year (£/MWh). These figures were used to calculate total electricity and gas bills for each archetype, with total energy cost being the sum of the two.

Table 2 - Variable (£/MWh) and standing charge (£/customer) costs for electricity and gas bills in Q3 2026.

	Standing charge (£/customer)	Annual variable costs (£/MWh)
Electricity	£198.81	£248.67
Gas	£100.94	£69.76

Under the full levy reform scenario, policy costs on electricity were modelled as £0 (Table 3), and the subsequent variable and standing charge costs for electricity under this scenario (Table 4) was calculated by subtracting the policy costs shown in Table 1 from the values in Table 2.

i. The same Ofgem archetype data was used (2024) www.ofgem.gov.uk/sites/default/files/2024-02/Ofgem_archetypes_update_2024_FinalReport_v4.1.3.pdf

ii. See 'Methodology' in mcsfoundation.org.uk/wp-content/uploads/2026/02/MCSF-Rebalancing-Electricity-Levies-in-the-UK-Report-Final.pdf

iii. This analysis explored the results using 'Other Payment' data, which is the price cap for direct debit customers, as the majority of households in the UK pay for energy bills via direct debit.

Table 3 - Variable (£/MWh) and fixed (£/customer) policy costs for electricity and gas in Q3 2026 under full levy reform.

	Policy costs (£/customer)	Policy costs (£/MWh)
Electricity	£0.00	£0.00
Gas	£7.23	£1.81

Table 4 - Variable (£/MWh) and standing charge (£/customer) costs for electricity and gas bills in Q3 2026 under full levy reform.

	Standing charge (£/customer)	Annual variable costs (£/MWh)
Electricity	£195.40	£221.30
Gas	£100.94	£69.76

→ IMPORTANT CONSIDERATIONS

1. Firstly, this analysis uses the Q3 2026 price cap to model a hypothetical scenario of full levy reform. To reflect the way household energy costs are commonly presented and assessed, the Q3 price cap has been annualised and applied across a full year. While this does not capture fluctuations in energy prices throughout the year, it provides an indication of household energy costs under the most recent price cap and allows the impacts of levy reform to be assessed consistently with our previous analysis.
2. Secondly, the modelling uses the annual energy consumption data from Ofgem's household archetypes. As a result, it does not account for seasonal variations in energy demand, including the lower levels of energy consumption typically seen during the summer months covered by the Q3 price cap. This approach has been adopted to ensure consistency with our previous analysis and to enable like-for-like comparisons across household types and policy scenarios. The results should therefore be viewed as an illustrative assessment based on the latest available data, providing an indication of how households could be affected under current market conditions.
3. Thirdly, as in our original report, total energy costs include 5% VAT.

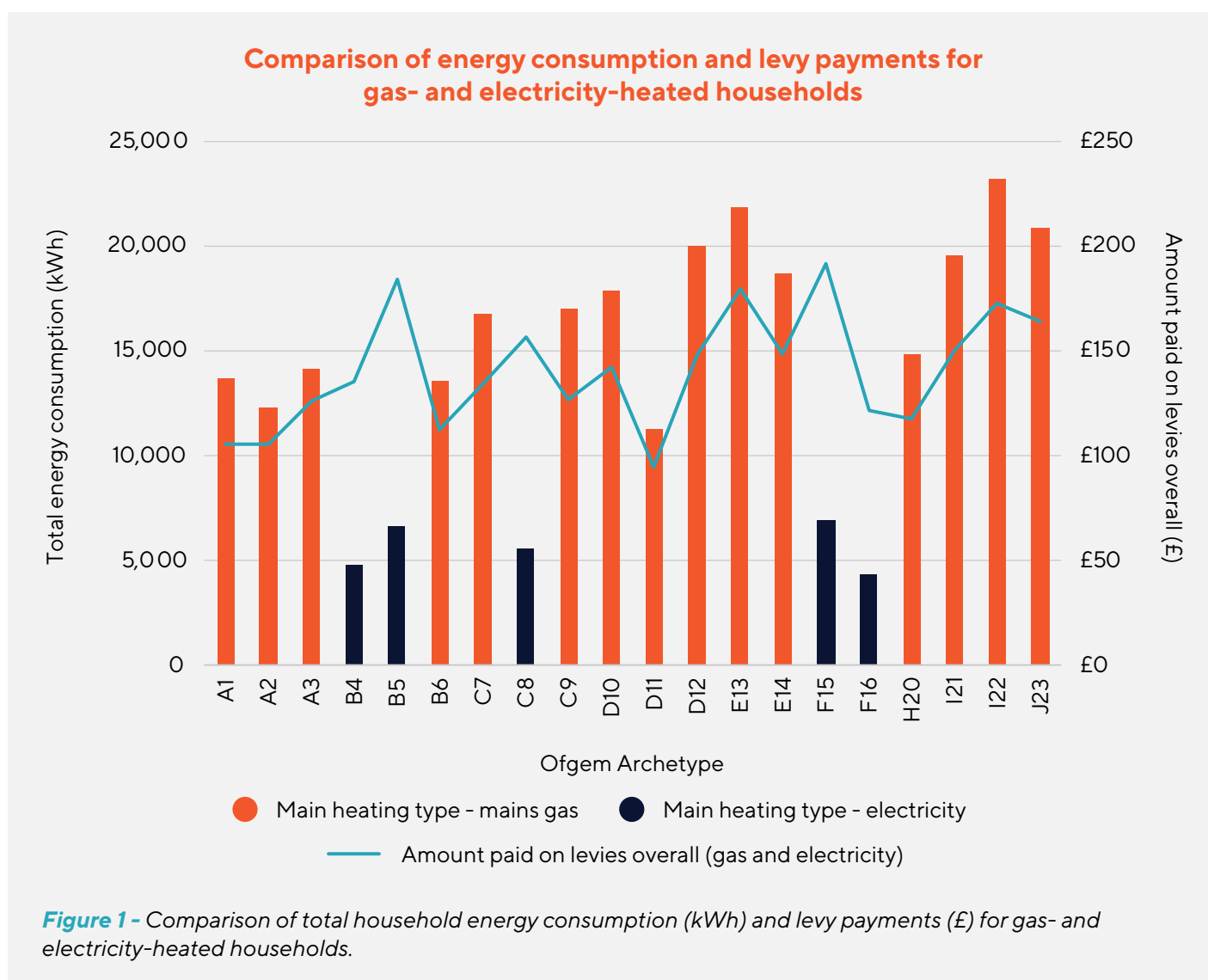


Results

→ Distributional impacts of the current levy framework

The measures announced in the Autumn Budget 2025 represented a welcome step towards reducing energy bills. Policy costs on the average electricity bill have fallen from 17% in 2025^{iv} to 9% under the Q3 2026 price cap, while policy costs on gas bills have fallen from 6% to 3%. However, these measures have not addressed the underlying unfairness in the current levy framework.

Despite the reductions in policy costs, the majority of levies continue to sit on electricity bills. As a result, households using electricity bear a disproportionate share of these costs. As Figure 1 shows, households using direct electric heating pay considerably more in policy costs than dual-fuel households, despite typically consuming less energy overall. Given that electricity-heated households are around twice as likely to be in fuel poverty compared to those connected to the gas grid,¹⁶ the current levy framework continues to penalise some of the households facing the greatest energy affordability challenges.



iv. As an average across the four price cap quarters

As well as disproportionately affecting households using direct electric heating, the current approach to funding policy costs is also regressive, with the burden falling unfairly on low-income households. Some archetypes spend more than three times the proportion of their net income on levies compared to wealthier households. This is particularly stark for archetypes A3 and B5. Virtually all of these households are in receipt of disability benefits, while more than half of A3 households are below the poverty line. For both archetypes, weekly spending on gas and electricity levies exceeds expenditure on fresh vegetables.¹⁷

These findings suggest that, while the Autumn Budget 2025 interventions represented an important first step, they have not gone far enough to address the underlying inequity in how social and environmental policy costs are recovered. With Government support for the RO due to end in March 2029, and receipts from environmental levies projected by the Office for Budget Responsibility to increase by around one-third by 2030–31,¹⁸ establishing a fair and sustainable approach to funding these costs will become increasingly important.^v

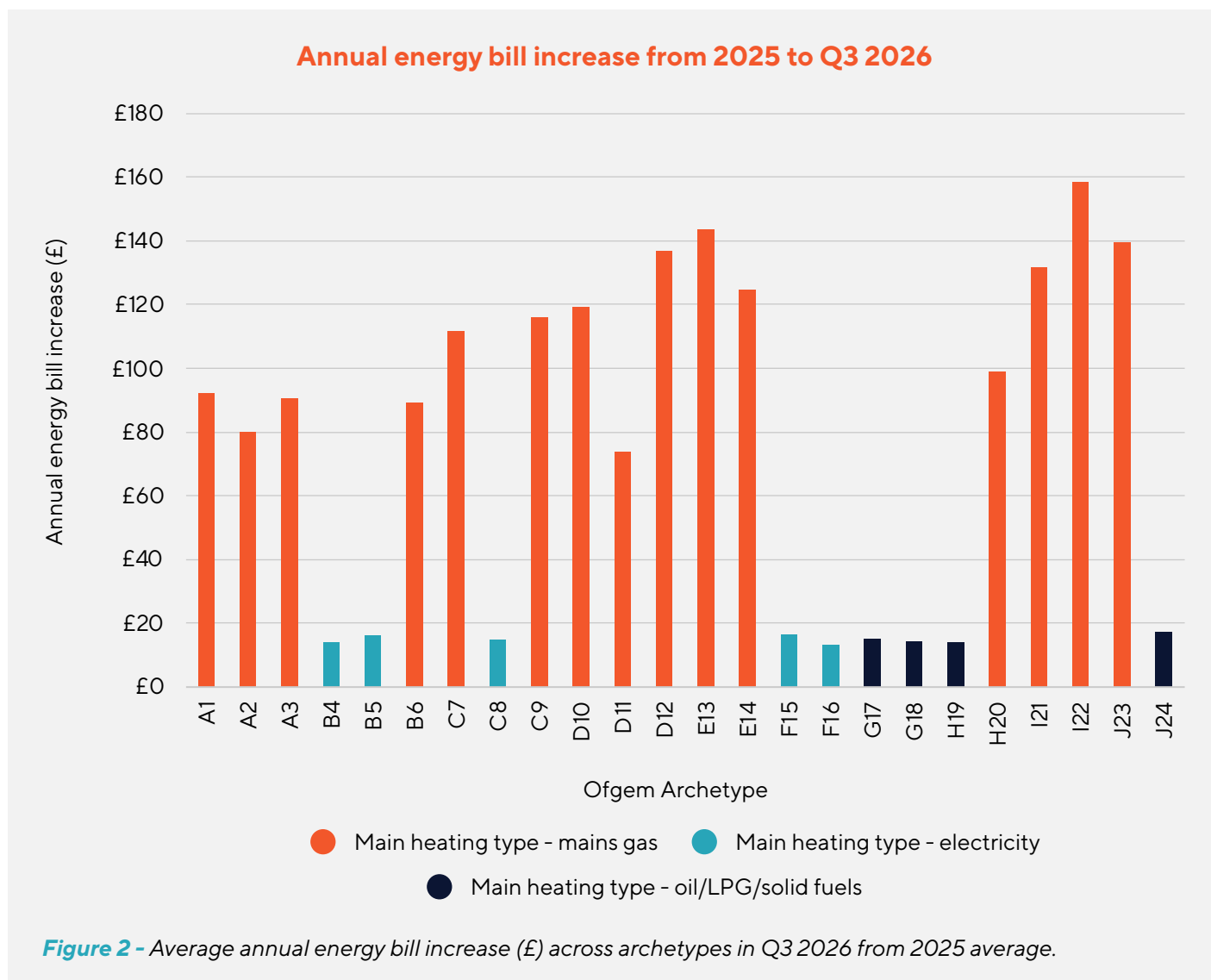


v. This rise is driven primarily by higher costs associated with the Contracts for Difference scheme, the Capacity Market and Nuclear Regulated Asset Base model.



The benefits of full levy reform for households

Figure 2 shows the change in modelled annual energy bills between the 2025 average price cap and the Q3 2026 price cap.



Across all Ofgem archetypes, annual energy costs have increased. Many dual-fuel households have seen annual energy bills rise by more than £100, with some archetypes experiencing increases of over £140 per year compared to 2025. For households using oil, liquefied petroleum gas (LPG), or solid fuels, the increases shown reflect non-heating energy use only. In practice, households relying on these fuels for space heating have experienced significantly larger increases in their overall energy costs than presented in this figure.¹⁹

The increase in the Q3 2026 price cap is particularly concerning for low-income households. Based on our modelling, the lowest-income archetype (A1) is now spending over 12% of net income on energy bills, significantly above the 10% fuel poverty threshold. Even after accounting for targeted support schemes such as the Warm Home Discount or Winter Fuel Payment, both the A1 and A3 archetypes remain above the threshold. This highlights the extent to which recent energy price increases are placing additional pressure on households that are already among the most financially vulnerable.

Figure 3 presents the modelled annual bill savings under a full levy reform scenario, where all remaining social and environmental levies are removed from electricity bills and funded through general taxation. Under this scenario, households would save between £75 and £220 per year. Based on the average electricity consumption across the Ofgem archetypes (3,955 kWh), the average household would save around £120 annually.

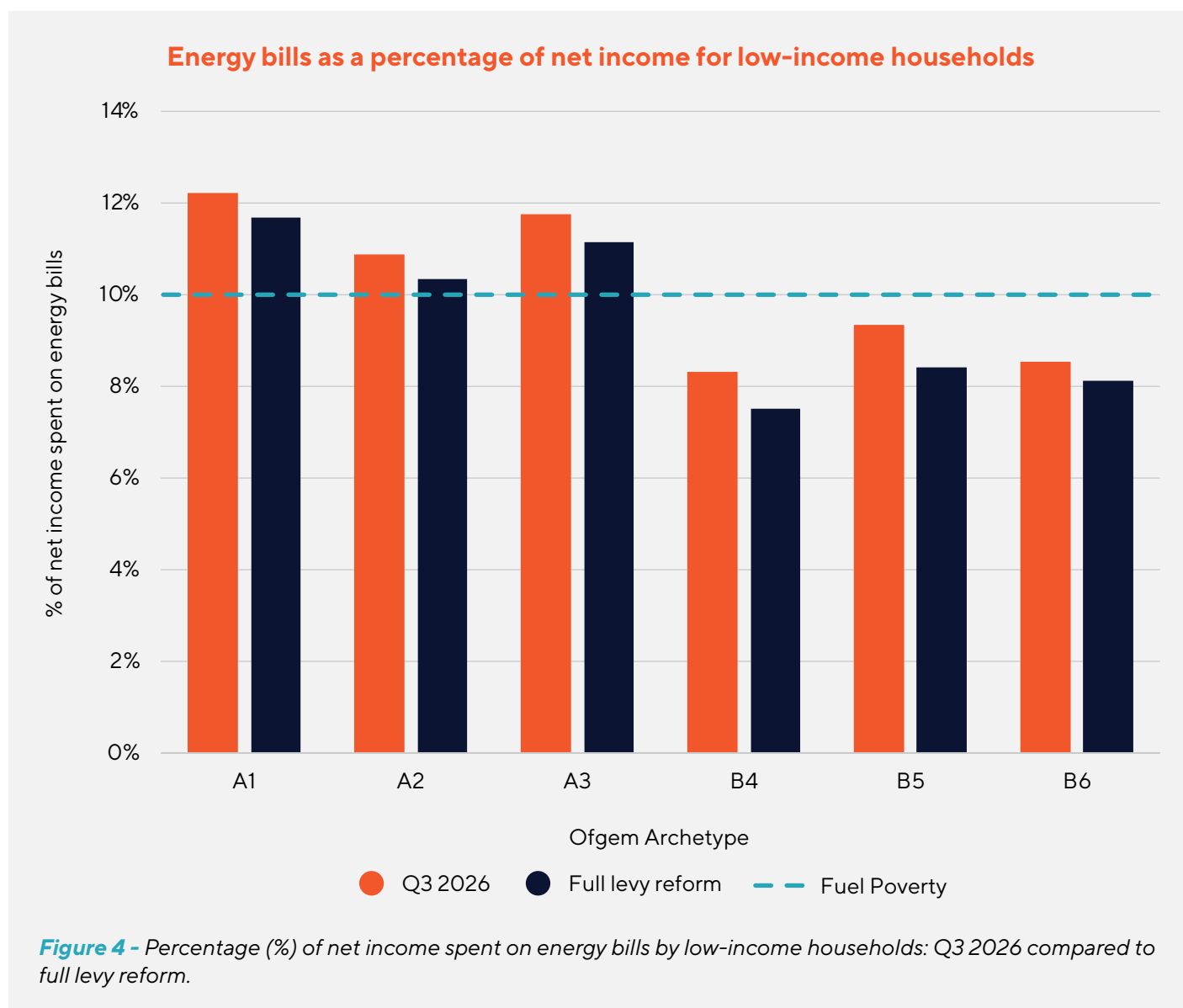


Figure 3 - Average annual energy bill savings (£) across archetypes under full levy reform.

These savings could help mitigate the impact of recent increases in energy costs. For example, households in the lowest income group (A1) have seen their annual energy bill rise by £92 under the Q3 2026 price cap compared to 2025 (Figure 2). Under a full levy reform scenario, almost all this additional cost would have been removed, with bills rising by just £10. Similar effects are observed across many of the low-income archetypes modelled.

Assuming the Q3 price cap data is applicable for the whole year, low-income households would save between £82 and £193 per year under full levy reform (Figure 3). Low-income households using direct electric heating, represented by archetypes B4 and B5, would benefit the most from the removal of electricity levies. These households could save £142 and £193 per year respectively, equivalent to 0.80% and 0.93% of net income. This represents the largest proportional reduction in energy costs across all Ofgem archetypes.

Despite these savings, full levy reform alone would not eliminate fuel poverty. Figure 4 shows that the archetypes currently spending more than 10% of their net income on energy bills (A1-A3) would remain above the fuel poverty threshold even under a full levy reform scenario. This underlines the continued importance of targeted support schemes, including the Warm Home Discount, Winter Fuel Payment and Cold Weather Payments. For example, full levy reform alongside the Warm Home Discount could help lift the equivalent of 868,191 households represented by archetype A2 out of fuel poverty. However, these findings demonstrate that full levy reform alone will not be sufficient to tackle fuel poverty, and additional support will be needed for the households facing the greatest affordability challenges.



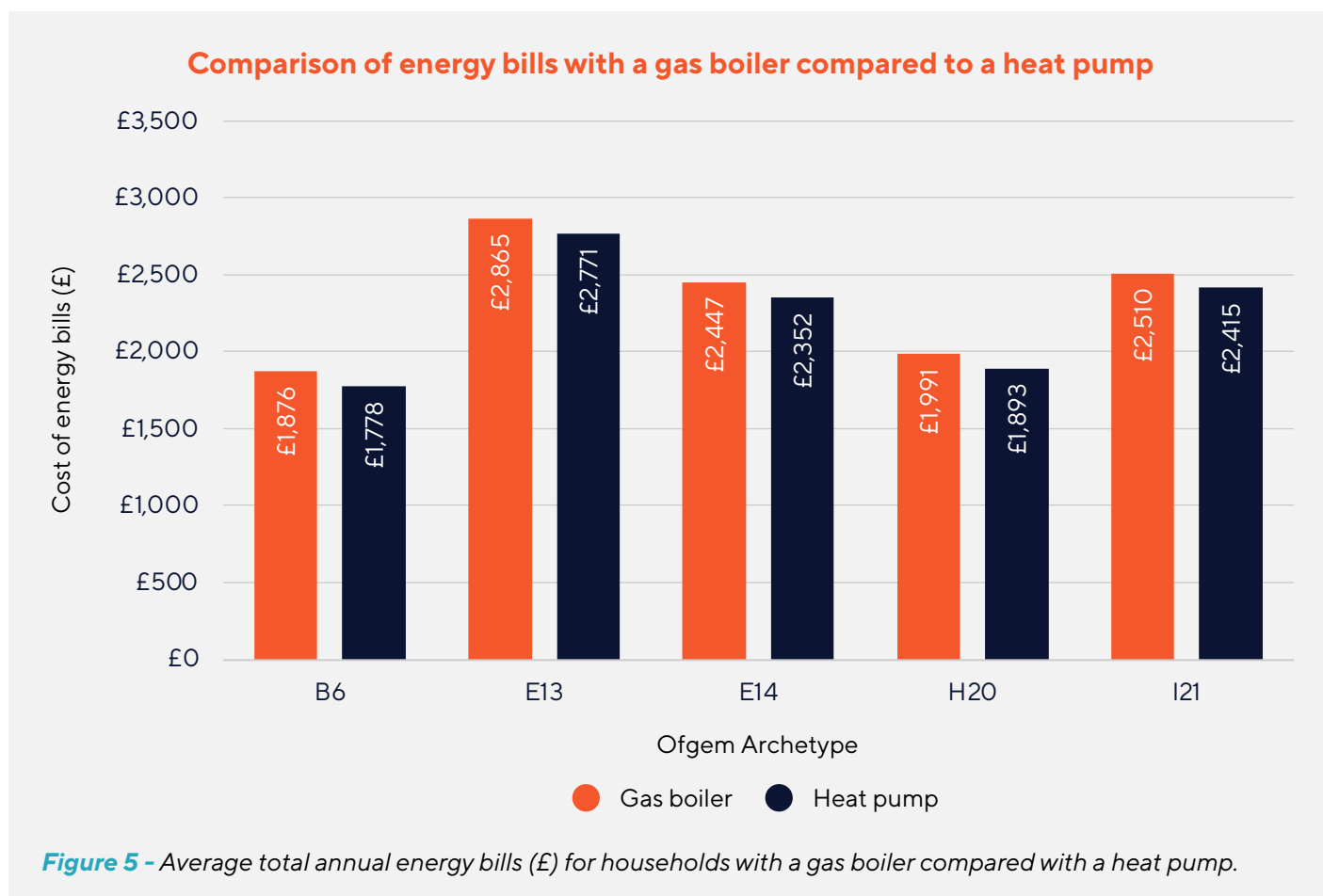
Removing the remaining levies from electricity bills and permanently funding them through general taxation represents one of the few measures capable of delivering immediate bill savings to households. Our analysis shows that every household archetype would benefit, with average savings of around £120 per year. At a time of rising energy costs, this would provide much-needed relief for households, helping to offset some of the recent increase in energy bills. We estimate that delivering this policy through general taxation would cost the Treasury just over £3 billion per year.

→ The role of levy reform in supporting electrification and energy security

Recent gas price increases show the importance of electrification for energy security and cutting bills

Despite the overall rise in the Q3 2026 price cap compared to 2025, this increase has not been felt equally across different household types. Households with higher gas consumption have experienced the largest bill increases, reflecting the fact that gas prices have risen more rapidly than electricity prices. The gas unit rate has increased by 13% compared to the 2025 average, while electricity unit rates increased by less than 1%. This is as a result of volatility in fossil fuel markets, whereas electricity, coming increasingly from domestic renewables, has remained more stable. This demonstrates that increasing domestic renewables can shield electricity prices from volatile global fossil fuel markets, while also strengthening energy security by reducing reliance on imported fuels.

Heat pumps in particular demonstrate the advantages of electrification at a time of unstable fossil fuel prices. Figure 5^{vi} compares the modelled annual running costs of a gas boiler and a heat pump using the current Q3 2026 price cap. Unlike in our previous analysis, where the archetypes modelled only reached cost parity or incurred slightly higher running costs when switching to a heat pump with a seasonal coefficient of performance (SCOP) of 3,²⁰ all archetypes now achieve annual bill savings. Savings range from £94 to £98 per year.



vi. Modelling assumes (1) a gas boiler efficiency of 85%, (2) a heat pump seasonal coefficient of performance (SCOP) of 3, (3) that household gas demand is used for space and water heating only, and (4) that the gas standing charge (and gas meter) is removed when switching to a heat pump.

Compared to 2025, annual energy bills for the heat pump archetypes modelled are only £15–£20 higher under the Q3 2026 price cap, compared with increases of more than £140 for some dual-fuel households. This demonstrates how electrification can help reduce households' vulnerability to rising gas prices.

However, the recent improvement in heat pump economics has been driven primarily by rising gas prices rather than falling electricity prices. Across 2025, the spark gap averaged just over 4, while under the Q3 2026 price cap it has fallen to 3.6. While this is encouraging, it should be interpreted with some caution, as it is uncertain whether this improvement will be sustained. Gas prices may fall in future as market conditions and geopolitical pressures change, as was seen following the 2021–22 energy crisis.²¹

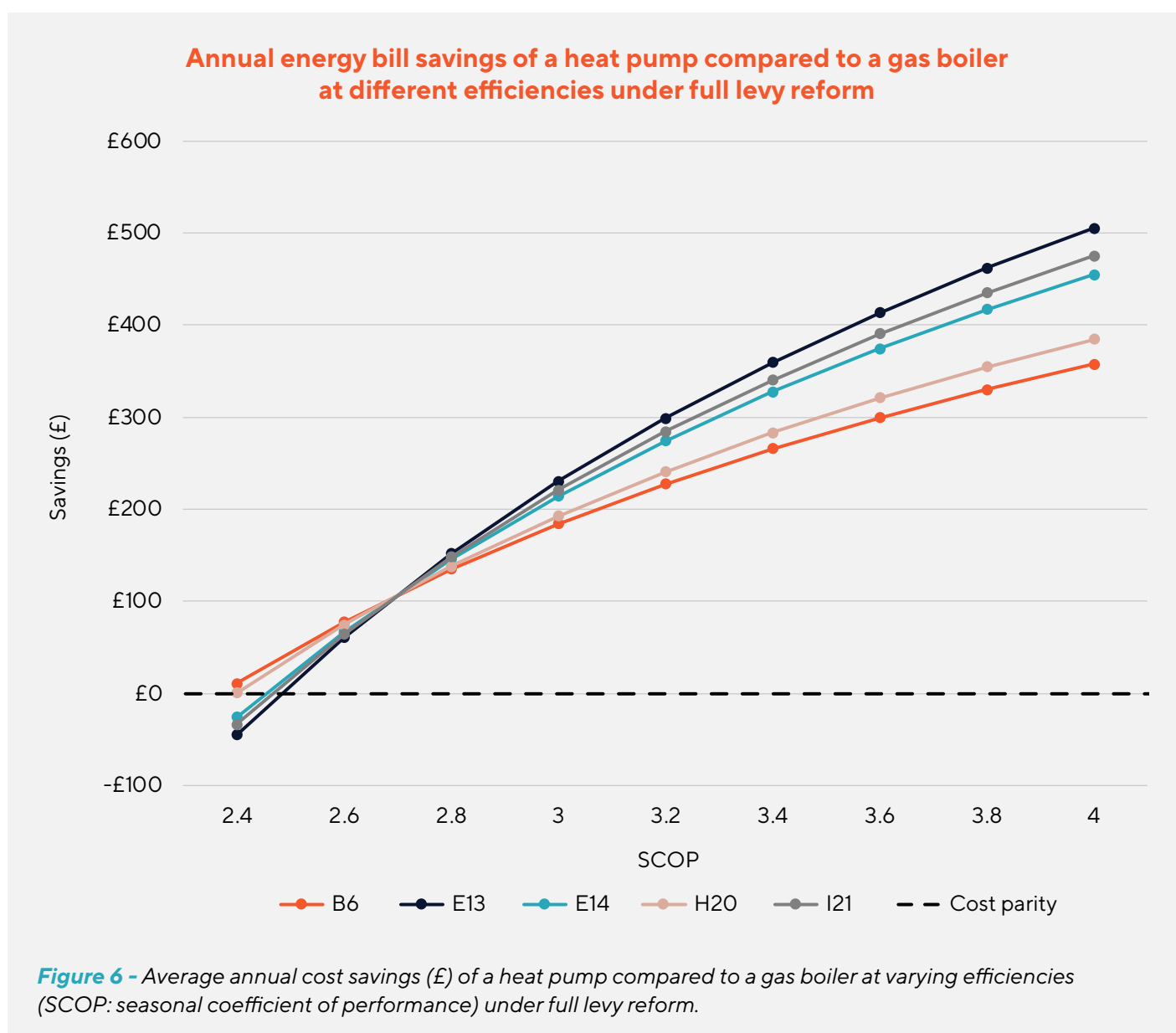
More fundamentally, the long-term economics of clean heat should not depend on periods of elevated gas prices driven by geopolitical events and volatility in global energy markets. Volatility in fossil fuel markets exposes households reliant on gas for heating to price shocks while electricity prices are more likely to remain stable, especially as the proportion of renewables in the grid increases. Nevertheless, a durable transition to low-carbon heating requires a sustained reduction in the cost of electricity relative to gas, allowing households to benefit from lower running costs regardless of fluctuations in fossil fuel markets. This is one of the key reasons why further levy reform remains necessary.



→ Full levy reform strengthens the case for clean heat

Unlike the recent improvement in heat pump economics, which has been driven primarily by higher gas prices, full levy reform would represent a structural intervention that permanently reduces the cost of electricity. Based on Q3 2026 price cap data, full levy reform reduces the spark gap from 3.6 to 3.2 and increases annual savings from switching to a heat pump from as gas boiler to between £184 and £230, assuming a SCOP of 3 (Figure 6).

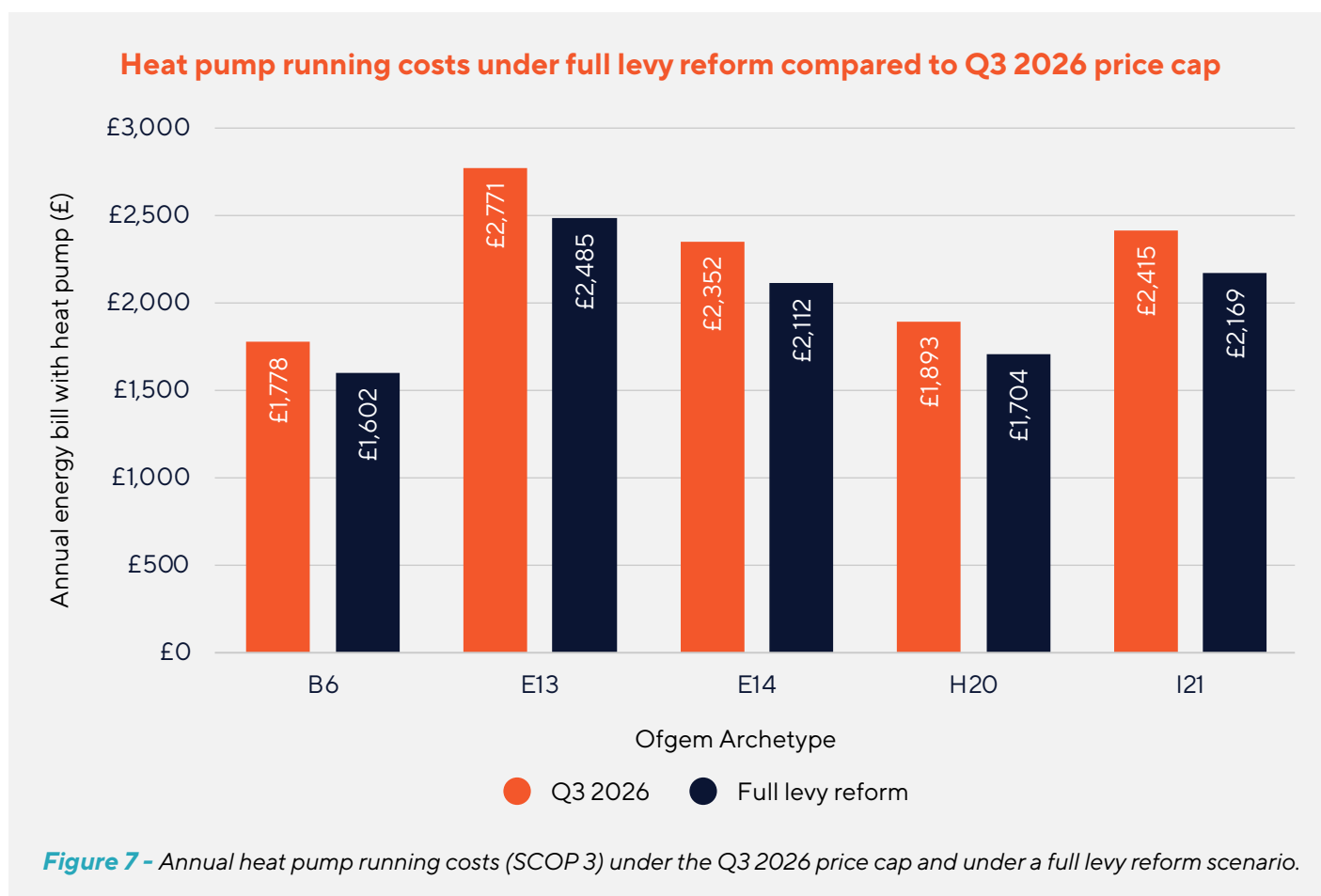
Furthermore, cost parity with gas boilers could be achieved at SCOPs as low as 2.4. At SCOPs of 4, annual savings could reach £357-£505, as shown in Figure 6.



Under current price conditions, these findings also highlight the potential for the transition to clean heat to form part of a wider strategy to tackle fuel poverty. Under a full levy reform scenario, archetypes A1, A2 and A3 would all fall below the 10% fuel poverty threshold following a switch to a heat pump, spending 9.92%, 8.81%, and 9.58% of net income on energy bills respectively. This is achieved without additional government support schemes, such as the Warm Homes Discount, being included in the modelling.

Furthermore, these estimates are based on a standard electricity tariff and do not account for the additional savings that may be available through time-of-use tariffs or by combining heat pumps with technologies such as solar PV and battery storage. Consequently, the savings presented here may represent a conservative estimate of the potential financial benefits.

Importantly, households that have already made the transition to clean heat would also benefit from full levy reform. For households with a heat pump, annual bill savings of between £176 and £286 could be achieved (Figure 7). In 2025 alone, 9,957 heat pumps were installed through ECO4, and heat pumps continue to be supported through the Warm Homes: Social Housing Fund and Warm Homes: Local Grant. With the Government committing to a new integrated low-income capital scheme from 2027/2028, ensuring that electricity prices are fair and affordable will become increasingly important.



Overall, these results illustrate the wider benefits that the transition to low-carbon heat can deliver alongside decarbonisation targets. When the spark gap is narrowed, heat pumps have the potential to improve energy affordability and reduce households' exposure to future energy price shocks.

However, even with full levy reform, the current spark gap remains above the level typically considered necessary to drive mass adoption. The European Heat Pump Association recommends a spark gap of 2 or below.²² This suggests that while this policy represents a significant step in the right direction, it should be viewed as part of a wider package of measures needed to improve the long-term economics of clean heat.

Conclusions and recommendations

This follow-up report builds on our work published in March 2026, using the latest July–September 2026 Ofgem price cap data. For the purposes of this analysis, the Q3 price cap has been annualised and applied across a full year, providing an illustration of household energy costs under the most recent market conditions. Importantly, although the Government's Autumn Budget 2025 interventions have reduced the proportion of policy costs recovered through energy bills, many of the conclusions remain unchanged, suggesting that the underlying inequities in the current levy framework persist and that the case for further levy reform remains as compelling as it was in the previous report.

Households using electricity for heating continue to shoulder a disproportionate share of policy costs, despite often consuming less energy overall. At the same time, some low-income households continue to spend more than three times the proportion of their net income on levies compared to wealthier households. For some of the most vulnerable archetypes, characterised by a high prevalence of disability and poverty, weekly spending on levies exceeds expenditure on fresh vegetables.

Our analysis shows that permanently removing the remaining levies from electricity bills and funding them through general taxation would deliver immediate bill savings for every household. Under the current price cap, households could save between £75 and £286 per year through full levy reform. At a time of rising energy costs, these savings could have significantly offset the impact of the latest increase in the price cap, providing some relief to low-income households who have been most impacted by the recent spikes. However, while full levy reform represents an important step, it would not eliminate fuel poverty entirely. Targeted support schemes and wider reforms to improve affordability will continue to be required.

The recent increase in gas prices has improved the relative economics of heat pumps, with all archetypes modelled now achieving lower running costs than a gas boiler at a SCOP of 3. Compared to 2025, annual energy bills for the heat pump archetypes modelled (SCOP 3) increase by just £15–£20 under the Q3 2026 price cap, whereas some dual-fuel households have experienced increases of more than £140. This highlights the potential for electrification to help shield households from energy price shocks.

However, these improvements have been driven primarily by higher gas prices rather than lower electricity prices. The long-term economics of clean heat should not depend on periods of elevated fossil fuel prices caused by geopolitical events and instability in global energy markets. Instead, a sustained reduction in electricity prices is needed to ensure that households can benefit from lower running costs regardless of fluctuations in gas prices.

Full levy reform addresses this challenge, helping to improve the economics of clean heat regardless of spikes in fossil fuel prices. Under a full levy reform scenario, households switching from a gas boiler to a heat pump could save between £184 and £230 per year, assuming a SCOP of 3. Cost parity with a gas boiler could be achieved at efficiencies as low as a SCOP of 2.4, while higher-performing heat pumps could deliver even greater savings.

Our findings also highlight the potential for the transition to heat pumps to form part of a wider strategy to tackle fuel poverty. Under a full levy reform scenario and Q3 2026 price conditions, the three lowest-income archetypes modelled would all fall below the 10% fuel poverty threshold following a switch to a heat pump, even without the inclusion of additional government support schemes.

These results should be interpreted in the context of current market conditions, and future changes in wholesale gas prices may alter the relative economics of clean heat in the future. Nevertheless, recent events have highlighted the wider benefits that electrification can deliver. As the cost of electricity falls relative to gas, heat pumps have the potential to serve not only as a decarbonisation technology, but also as a means of improving affordability and strengthening household energy security.

Overall, the findings of this report make a strong case for permanently funding the remaining electricity levies through general taxation. Although the Autumn Budget 2025 measures reduced the proportion of policy costs recovered through energy bills, the underlying inequities in the current levy framework remain. Full levy reform would help address this unfairness while delivering immediate bill savings to households at a time when many continue to face significant financial pressures. This reform would also strengthen the economics of clean heat and support the transition away from volatile fossil fuels.

However, levy reform alone will not be enough. Rather, it should be viewed as an important first step within a wider package of reforms. Alongside targeted support for vulnerable households, wider measures to reduce electricity costs – including wholesale electricity market reform and the implementation of Reformed National Pricing – and continued support for electrification will be required to improve affordability, strengthen energy security and ensure that the benefits of the clean heat transition are felt by all households.

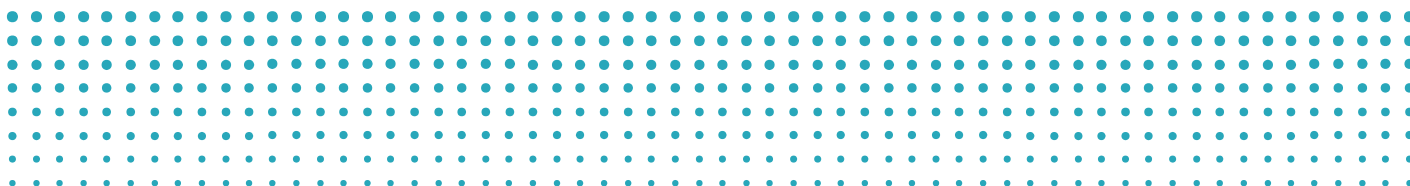
OUR RECOMMENDATIONS TO THE UK GOVERNMENT ARE UNCHANGED:

- **Permanently fund electricity levies through general taxation.**
This would remove regressive charges from bills, align costs with ability to pay, and reduce the spark gap, helping incentivise the switch to heat pumps.
- **Use levy reform to support electrification.**
Narrowing the electricity-to-gas price ratio is essential to give households confidence that switching to clean heat will reduce running costs.
- **Continue targeted bill support alongside structural reform.**
Levy reform alone will not eliminate fuel poverty; targeted schemes remain necessary while broader market reforms take effect.
- **Accelerate implementation of Reformed National Pricing and flexibility measures.**
Long-term affordability depends on reducing exposure to gas prices and better reflecting low-cost renewable generation in household bills.

Full levy reform represents one of the few measures capable of delivering immediate bill savings to households while supporting the transition to clean heat. Importantly, the Government has already shown that paying for policy costs through general taxation can be done. The Autumn Budget 2025 interventions established an important precedent. The opportunity now is to build on that progress and address the remaining inequities in the current levy framework.

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