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Creative financing can be a game-changer to accelerate return on investments from sustainable projects

by Grant MacFarlane

Investments in clean technology and net zero targets are being mandated across the board, at every level of government in Canada as well as within corporations. In March 2023, the Canadian government announced several major investment tax credits (ITCs) with the goal of accelerating decarbonization in Canada to meet its net-zero emissions goal by 2050.

Under the 2023 Federal Budget, eligible Canadian clean technology projects will receive a 30 percent refundable tax credit that taxable entities can be leveraged for eligible investments in clean technologies and materials. The ITC covers a wide range of zero-emission technologies. While legislation is still being finalized, in the interim, all investments in applicable technologies from the date of the Budget – March 28, 2023 onward – are eligible for the ITC. The credit will be phased out after 2034, with the credit rate reduced to 15 percent for 2034 and zero percent thereafter.

The Clean Technology Tax Credit holds tremendous promise to help accelerate the rollout of sustainable projects that previously may have been viewed as cost prohibitive. The ITC significantly improves project economics and allows more clean tech projects to become cash flow positive from day one, meaning the finance payments are less than the expected energy savings or revenue associated with the project.

Many clean technology vendors are focusing on this "cash-flow positive" model to go to market and increase their sales. Creative financing can provide a very strategic onramp, as these projects absolutely require flexible financing solutions to move forward. It also requires a lender that is knowledgeable about the industry and can offer flexible structures to achieve the lowest possible finance payments to allow more of these projects to become cash-flow positive.

Since Canada's ITCs are very similar to those used in the US, many American lenders are more comfortable with the structure and how to navigate the unique challenges. The biggest difference is that in Canada, the ITC is refundable, meaning recipients receive the full amount regardless of how much income tax they pay. This allows more recipients to take advantage of the credit and also removes many administrative and operational hurdles from a lending perspective, such as the need to find a third-party tax equity partner that has a big enough tax liability to leverage the ITC.

One example of how lenders can use structure to align with current demand is to structure a lump-sum payment, equal to the ITC in year one. Timing would depend on when the ITC is expected to be received, with the borrower using their ITC to make the lump-sum payment. Credit can get more comfortable with a rapid reduction in overall exposure, and the lump-sum payment will reduce all other payments, allowing the project a better chance of being cash-flow positive.

For many smaller clean tech projects, if a customer has borderline credit quality, or more importantly, if the finance amount is right up against their exposure limits, that rapid reduction in exposure can often be a make-or-break change in terms of credit approval.

While it seems every corporation touts the importance of ESG goals, at the end of the day, these projects and investments need to make sense financially – for all stakeholders. We are noticing that while some lenders are starting to really lean into increasing their ESG goals by growing their clean tech lending portfolio, some still aren't entirely comfortable with lending for many projects as they consider the underlying asset collateral to be weak, i.e., on solar projects where the re-sale value of the panels is not strong. These lenders often still view renewable energy and clean technology as an emerging industry in Canada and are approaching this economic upswing with caution.

It's imperative that the finance industry embrace the clean energy economic boom, utilize flexible structuring to incorporate the ITC's and align their lending products to allow more projects to move forward. Canada needs companies to embrace the Clean Technology Tax Credit, but to do this, we need lending partners that can be resourceful, flexible, and move quickly to meet this marketplace need to bring these projects to fruition.

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