Our ambitious foray into clean technology and its pursuit of net-zero targets have taken center stage, echoing through Canadian government and corporate corridors alike. In a defining move, the Canadian government, in March 2023, unveiled a suite of investment tax credits (ITCs) aimed at accelerating the nation’s decarbonization drive, with the goal of achieving a net-zero emissions status by 2050.

Budgets & Boons

With the 2023 Federal Budget, eligible Canadian clean technology projects are set to receive a 30 percent refundable tax credit, a financial boon that stands poised to reshape the landscape of sustainable innovation. This credit can be leveraged by taxable entities for investments in a gamut of clean technologies and materials. The ITC covers a wide range of zero-emission technologies. While legislative details are still being fine-tuned, all investments in eligible technologies, initiated from the Budget’s proclamation on March 28, 2023, stand eligible for the ITC. The credit, however, is slated for a gradual phasing-out process, with rates reducing to 15 percent in 2034 and eventually tapering off to zero.

The Clean Technology Tax Credit holds tremendous promise, transforming up to now cost-prohibitive sustainable projects into financially viable ventures, and paving the way for clean tech projects to become cash-flow positive right from their inception. In essence, the financial outlay for these projects becomes offset by the expected energy savings or revenue generated.

For these ventures to succeed, creative financing proves crucial. It demands financial institutions that have a deep understanding of the industry’s nuances, capable of crafting flexible structures that minimize finance payments and maximize the potential for projects to become cash-flow positive.

US and Canada

Interestingly, Canada’s ITC framework bears a striking similarity to its American counterpart, which gives a sense of comfort to would-be American lenders that are already acquainted with the structure and intricacies of the system. 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 for the lender. An example is 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.

Tempered Enthusiasm

Yet, in the excitement that surrounds environmental, social, and governance (ESG) goals, these projects and investments need to make sense financially – for all stakeholders. While some lenders are enthusiastically expanding their cleantech lending portfolio to bolster their ESG credentials, others have reservations as they consider the underlying asset collateral to be weak, (i.e., on solar projects where the resale 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.

About the Author

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