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# Energy Transition Series: Going Green – Finance Companies See The Green Light

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**Welcome to the final installment of a three-part Energy Transition Series that examines the changing legal and industry trends behind the emergence of the new renewable energy market.**

Over the past few weeks many of the large Canadian banks and commercial finance companies have made announcements as to either the establishment of, or enhancement to, their green lending programs.

## What is a Green Loan?

While each lender utilizes different criteria in determining what is a qualified green loan, there are similarities amongst all of the lenders. The underlying theme is to encourage and finance projects and commercial activity that will reduce our carbon footprint and lower the rate of climate change. The following is a non-exhaustive list of some of the initiatives that would qualify for a green loan:

- Renewable energy projects - including production, transmission, and related appliances and products.
- Energy efficiency initiatives in new and refurbished buildings, energy storage, district heating, smart grids, and related appliances and products.
- Pollution prevention and control - including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy/emission-efficient waste to energy.
- Environmentally friendly management of living natural resources and land use - including environmentally sustainable agriculture, environmentally sustainable fishery and aquaculture and environmentally sustainable forestry.
- Clean transportation - such as electric, hybrid, public, rail, non-motorized, multi-modal transportation, infrastructure for clean energy vehicles and reduction of harmful emissions.
- Sustainable water and wastewater management.
- Climate change adaptation - including information support systems, such as climate observation and early warning systems.
- Eco-efficient products, production technologies and processes.

## How Does a Green Loan Differ from a Traditional Loan?

A green loan must satisfy certain basic requirements identified by the lender or adopted from standards set by independent third parties, including:

1. **Use of Proceeds.** The proceeds must be used for an eligible green project.
2. **Process for Project Evaluation and Selection.** Borrowers must explain how their initiative meets or satisfies environmental sustainability objectives by describing its environmental objectives, the process whereby the borrower determines how its projects are considered Green Projects, and any related eligibility criteria (including standards or certifications).
3. **Management of Proceeds.** Borrowers are expected to track how the loan is being used for the eligible project.
4. **Reporting**. Borrowers are required to report on the annual use of the proceeds and the impact of the project until the financing has been fully drawn. Certain lenders require third party certification while others provide for self-certification by borrowers. The preference is to set objective standards that can be measured and benchmarked. Also encouraged is the use of quantitative performance measures (i.e. greenhouse gas emissions reduced).
5. **Covenants**. Certain green loans contain specific covenants that the borrower must comply with for the loan to remain in good standing or to benefit from some of the aspects which the lender is making available under the specific loan program.

## Structure of the Green Loan

As most of the loans will finance projects that require the acquisition of capital equipment, the structure of green loans will typically be most akin to the following:

1. **Construction and Project Financing.** Many of the large green projects take years to build and require long time-frames for completion and final funding. These projects will utilize the concepts and structures developed for both the construction and mining industry.
2. **Term Loans – Traditional Equipment Financing.** To the extent that the project can acquire the required assets relatively quickly (or could acquire such assets utilizing existing cash flow and credit facilities), a borrower would apply for a loan to finance the specific project which would, to the extent possible, amortize over the life of the loan. As will be discussed in future e-alerts, this may be one of the greatest challenges as the life of some of these projects may be longer than banks traditionally desire to have the term loans outstanding.
3. **Asset/Equipment Finance.** Lease payments will be tied to future revenue streams or cost reductions and/or carbon credit. Much like a term loan, this structure finances the acquisition of assets which would qualify for a green loan. The difference with this structure is that the repayment

of the loan is tied to either future revenue structures or defined cost savings. For example, if the project is renewable energy production, then the payments would be tied to the energy that is produced. This can be particularly important if there is seasonality in energy production. In addition, and this is an area that is not yet fully defined, many of the projects will qualify the borrower for carbon credits which can then be sold to repay the advance.

## Benefits of a Green Loan

From the lender's standpoint, the benefits are assisting the lender to meet its commitments to ESG principles and fighting climate change. The benefits to the borrower vary. Certain lenders may provide for an expanded credit criteria and approve loans that may not otherwise meet their underwriting standards. Other green loans provide for reduced costs and fees if the green covenants are adhered to. In almost all cases, there is a greater demand to provide these loans to borrowers which should increase liquidity and as such, reduce costs which may result in the reduction of the payments due from the obligor.

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*Cassels provides strategic legal advice to clients across the country on Canada's transition to a low-carbon economy. Our lawyers have experience advising clients in the financial services, mining, oil & gas, renewable energy, and cleantech industries on energy transition matters. Energy transition opportunities for companies include carbon credits, green loans, building retrofits, battery metals, electric vehicles, carbon capture, use and storage (CCUS), low carbon fuels, and power purchase agreements for renewable energy. Our energy transition team has deep experience with the financing (debt and equity) of these projects and industries.*

*Over the course of the upcoming months our firm, through our energy transition and financial services teams, will be focusing on this market from both a lender's and borrower's perspective to provide background as to what is a "green" loan and what are its key aspects and limitations. Future comments will delve into these loans in greater detail.*

*This is the third of a three-part Energy Transition Series that examined the changing legal and industry trends behind the emergence of the new renewable energy market. Topics include:*

- *Energy transition overview*
- *Legal and regulatory trends in the Canadian energy industry*
- *Energy transition in the financial services industry*

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