



The State of Blended Finance 2018



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Executive Summary

The Sustainable Development Goals (SDGs) target a range of development challenges, from combating climate change to ending poverty and hunger. To achieve the SDGs in developing countries, a significant scale-up of investment is required. Blended finance – the strategic use of catalytic capital from public and philanthropic sources to mobilize additional private sector investment – is one important approach to financing the SDGs. The United Nations (UN) member countries reached consensus on the importance of blended finance at the Third International Conference on Financing for Development in 2015. Since then, blended finance has entered the mainstream. Over the past year, blended finance has found its way into international development policy and strategies, made news headlines, and become a central theme across major global conferences.

This report uses Convergence data and insights to provide an updated analysis of the blended finance market, including SDG alignment, blending approaches, sectors, and regions. This report also highlights the top investors in the space, provides an overview of key events in blended finance, and reflects on progress that has been made on previous action items and issue areas outlined in the inaugural State of Blended Finance published in 2017. Established out of the Addis Ababa Action Agenda, Convergence generates blended finance data, intelligence, and deal flow to increase private sector investment in developing countries and sustainable development.

Deal Trends

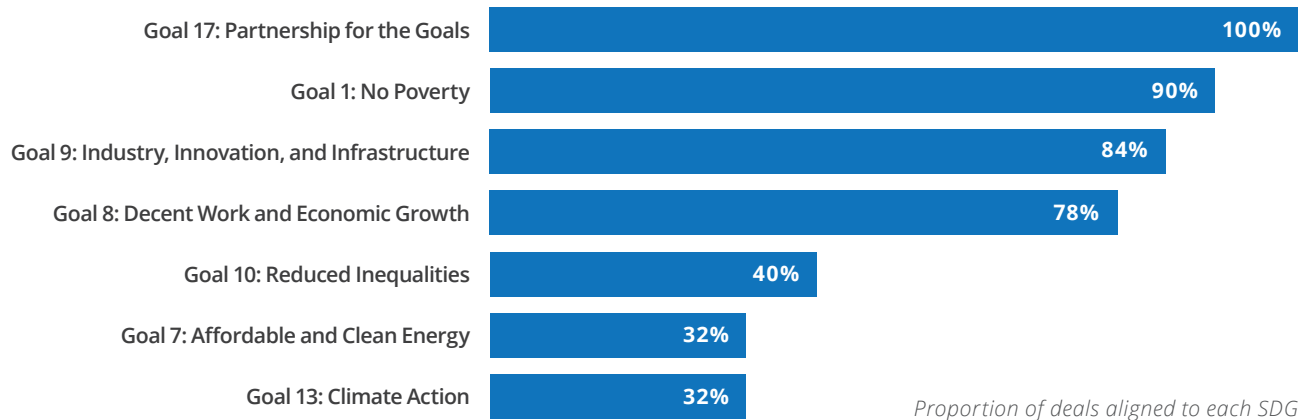
Convergence's database captures over 2,500 financial commitments to over 300 closed blended finance transactions, with an aggregate deal size of over \$100 billion. The size of the blended finance market is almost double our estimate from last year, and we are confident that this is still a conservative estimate. Blended finance deals range in size from less than \$5 million to over \$1 billion, with a median deal size of \$56 million. Funds are still the most common deal type, representing 55% of deals in the database. Sub-Saharan Africa is still the most popular target region, representing 42% of blended finance deals, and with an average deal size of \$125 million. Blended finance deals have primarily focused on financial services and infrastructure (together, 62% of all deals), particularly microfinance (50% of financial services) and renewable energy (60% of energy).

Blended finance continues to be strongly aligned to four SDGs: Goal 17 (Partnerships), Goal 1 (No Poverty), Goal 9 (Industry, Innovation, and Infrastructure), and Goal 8 (Decent Work and Economic Growth), with growing momentum around Goal 7 (Affordable and Clean Energy) and Goal 13 (Climate Action).

Investor Trends

Convergence's database identifies over 800 organizations that have made a financial commitment to a blended finance deal, with approximately 20% of these institutions active blended finance investors (invested three or more times). In 2017, there was a significant uptick in development agency

FIGURE 1 BLENDED FINANCE DEAL ALIGNMENT WITH THE SDGS



interest in blended finance and efforts to mobilize private sector investment more broadly. While blended finance “trailblazers” (which include the International Finance Corporation (IFC) and the Dutch Development Bank (FMO)) continue to refine and grow their blended finance practices, there are also a number of multilateral development banks (MDBs) and development finance institutions (DFIs) that are actively scaling up their blended finance activities (e.g., the Group of Seven (G7) 2X Challenge adopted in June 2018). Philanthropic organizations, particularly private foundations (e.g., the Rockefeller Foundation), continue to play a small but catalytic role, especially in seeding large-scale and ground-breaking initiatives. Impact investors are important blended finance investors because of their ability to bridge the gap between fully concessional and fully commercial returns. Institutional investors have demonstrated an increasing awareness of and commitment to the SDGs, but in practice there has been an insufficient number of attractive investment opportunities.

Ecosystem Trends

In late 2017, both the Organization for Economic Cooperation and Development (OECD)-led donor group and the IFC-led DFI working group agreed upon

principles for blended finance as it relates to their development activities. The two sets of principles both sought to improve the effectiveness and efficiency of blended finance in contributing towards achieving the SDGs, as well as encouraging transparency and information sharing among practitioners. These groups are now seeking ways to coordinate and harmonize their principles.

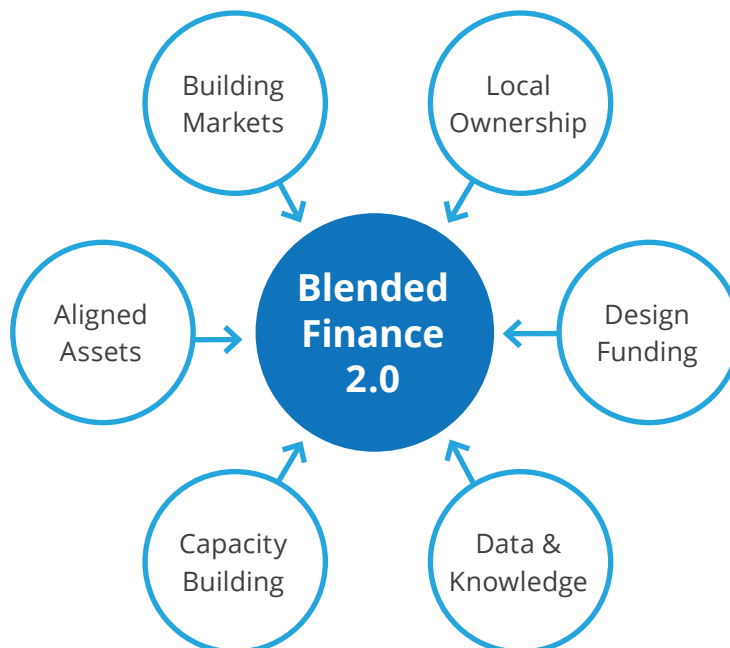
Other multilateral organizations and networks that progressed blended finance knowledge and practices over the past year include: The Blended Finance Taskforce’s Programme of Action summarized the diverse areas of activity driven by leading organizations in the blended finance space, the United Nation’s Financing for Development follow-up (FfD Forum) continues to drive policy dialogue, the European Commission’s External Investment Plan (EIP) started disbursing funding with a focus on private capital mobilization, and finally, the Global Impact Investing Network’s (GIIN) Blended Finance Working Group started a community of practice among impact investors to share lessons from designing and deploying blended finance structures.

Reflections

Blended finance is now mainstream; but this does not mean that it is universally accepted or even broadly understood. The UN, OECD, G7, Group of Twenty (G20), donors, DFIs, and MDBs have articulated meaningful, positive positions on blended finance, while philanthropic foundations and private investors are showing increasing interest in the space. Yet, healthy skepticism still exists. Policymakers and traditional grant-making agencies question both the effectiveness and opportunity costs of blended finance. Certainly, blended finance is not a panacea for the substantial gap in financing required to achieve the SDGs by 2030. These are important considerations and emphasize the value of establishing principles and best practices for deploying concessional capital to mobilize private investment.

Now that principles and good practices are starting to take root, it is time for a blended finance vision to (i) accelerate the evolution from fragmented activities to a common blended finance agenda, (ii) promote collaboration and investment in successful blended finance approaches that have the potential to achieve the scale required to achieve the SDGs, (iii) increase knowledge, data sharing, and transparency and (iv) demonstrate development impact. Convergence identifies six next steps for enhancing and scaling blended finance market to mobilize greater volumes of private sector capital towards the SDGs in developing countries (Figure 2): (i) capacity building and training, particularly for public and philanthropic funders, (ii) assets aligned to investor requirements and preferences (e.g., investment grade debt and capital market instruments), (iii) building markets to allow project sponsors, investors, and donors to connect, (iv) ensuring developing country participation, (v) early-stage design funding, and (vi) data and knowledge.

FIGURE 2 NEXT STEPS FOR ENHANCING AND SCALING BLENDED FINANCE



Introduction

Blended Finance

The Sustainable Development Goals (SDGs) are a set of 17 Global Goals set by the United Nations (UN) to tackle a range of development challenges, from combating climate change to ending poverty and hunger. Not only do the SDGs aim to create a world that is more sustainable, they also offer real business opportunities.

To achieve the SDGs, a significant scale-up of investment is required. The UN estimates that the annual funding needed to achieve the SDGs by 2030 is nearly \$4 trillion – much greater than the current aggregate SDG-focused funding of \$1.5 trillion from domestic and international sources. The \$2.4 trillion gap dwarfs official development flows and philanthropic commitments; the Organization for Economic Cooperation and Development (OECD) reports total official development assistance (ODA) from the 30 OECD Development Assistance Committee (DAC) members at \$147 billion in 2017, while Development Initiatives estimates that private development assistance (e.g., development assistance from non-public sources like foundations, corporations, and non-governmental organizations (NGOs)) is around \$45 billion annually.

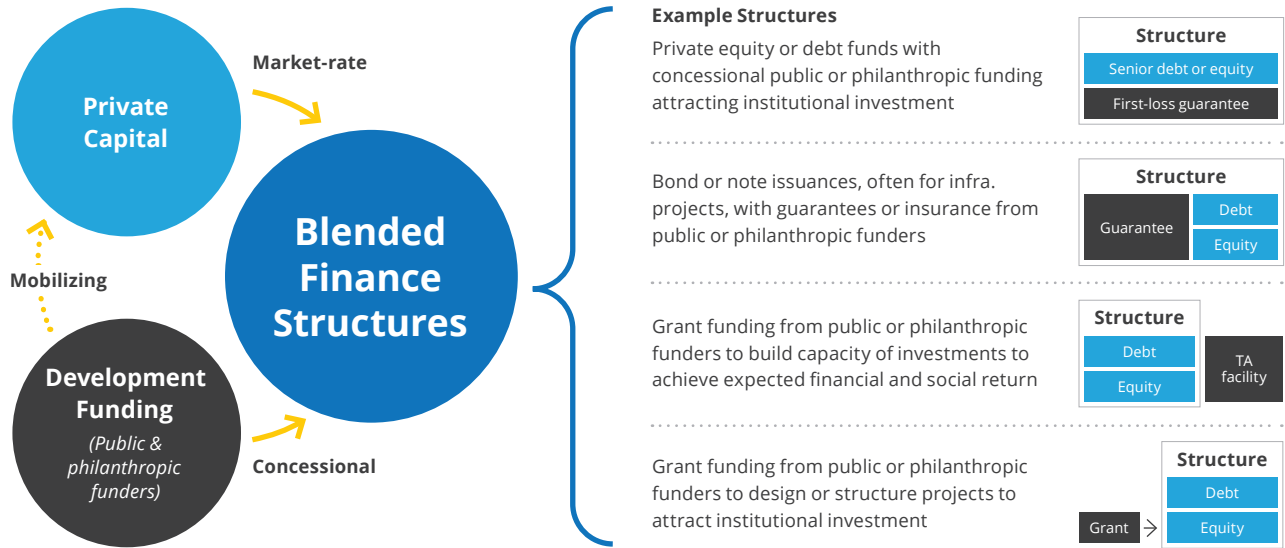
Blended finance is one critically important approach to mobilize new sources of capital for the SDGs. This is evidenced by the UN member countries' consensus on the importance of deploying public funds to attract private investment at the Third International Conference on Financing for Development in 2015 in Addis Ababa. Convergence was established out of

the Addis Ababa Action Agenda to build the blended finance market to attract significantly higher amounts of private capital to the SDGs.

In 2018, blended finance has entered the mainstream, it was a central theme to major global conferences including the 23rd United Nations Climate Change Conference (COP 23), the world's leading impact investing forum (SOCAP), the United Nations General Assembly (UNGA), the World Economic Forum Annual Meeting (Davos), the World Bank Spring Meetings, and the United Nations High-level Political Forum (UN HLPF).

Blended finance is the use of catalytic capital from public or philanthropic sources to increase private sector investment in developing countries to realize the SDGs. Blended finance allows organizations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social impact, or a blend of both). The main investment barriers for private investors addressed by blended finance are (i) high perceived and real risk and (ii) poor returns for the risk relative to comparable investments. Blended finance creates investable opportunities in developing countries, which leads to more development impact.

FIGURE 3 TYPICAL BLENDED FINANCE MECHANICS AND STRUCTURES



Blended finance is a structuring approach. Blended finance is not an investment approach, instrument, or end solution. Figure 3 highlights four common blended finance structures:

- i. Public or philanthropic investors provide funds on terms below market within the capital structure (referred to as concessional capital in this document)
- ii. Public or philanthropic investors provide guarantees or insurance on terms below market (referred to as guarantee / risk insurance)
- iii. Transaction is associated with a grant-funded technical assistance facility (referred to as technical assistance funds)
- iv. Transaction design or preparation is grant funded (referred to as design-stage grants)

Concessional capital and guarantees / risk insurance are deployed by the public or philanthropic sector

to create an investment opportunity with acceptable risk-return profiles for the private sector by (i) de-risking the investment or (ii) improving the risk-return profile relative to market norms. Concessional funding includes scenarios where the public or philanthropic investor takes a higher risk profile for the same or lower rate of return, as well as the same risk profile but accepts a lower rate of return. Technical assistance funds and design-stage grants are not direct investments in the capital structure, but improve a transaction’s probability of reaching bankability and financial close.

To illustrate the potential of blended finance, an allocation of 10% of total development assistance to blended finance structures with an average leverage ratio of seven could crowd-in over \$105 billion per annum of private investment to developing countries and sustainable development. This is three times the combined annual multilateral development bank (MDB) and development finance institution (DFI) financing to the private sector in developing

countries. Further, well-designed blended finance structures could attract new investors to a sector or region, who over time become more comfortable with the sector or region, and ultimately require less catalytic capital.

It is important to note that blended finance can only address a subset of SDGs that are investable. According to analysis conducted by the Sustainable

Development Solutions Network (a global initiative of the UN), approximately half the funding required to achieve the SDGs in developing countries can be in the form of private investment. For example, blended finance is highly aligned with goals such as Goal 7 (Affordable and Clean Energy), Goal 9 (Industry, Innovation, and Infrastructure), and Goal 13 (Climate Action), while less aligned with goals such as Goal 16 (Peace, Justice, and Strong Institutions).

About Convergence

Convergence is the global network for blended finance. Convergence generates blended finance data, intelligence, and deal flow to increase private sector investment in developing countries and sustainable development. Convergence works to make the SDGs investable through transaction and market building activities:

- **A Global Network:** We have a global membership of over 280 public, private, and philanthropic organizations like United States Agency for International Development (USAID), Credit Suisse, and the Bill and Melinda Gates Foundation. We create many opportunities for Convergence members to connect, including through the Convergence deal and investor match-making platform and exclusive networking events.
- **Data & Intelligence:** We curate and produce original content that builds the evidence base for blended finance and supports practitioners in their efforts to execute blended transactions, including (i) data on deals and investors, (ii) case studies, intelligence briefs, and market reports, (iii) workshops and trainings, and (iv) webinars.

- **Deal Flow:** We have built an online deal match-making platform for investors and those seeking capital to connect. As of July 2018, there are credible opportunities seeking to raise over \$1.7 billion, representing over \$3 billion in aggregate deal size. All deals are screened by our team to ensure fit within our mandate and credibility criteria.
- **Market Acceleration:** Our Design Funding program offers grants for the design of innovative blended finance vehicles that aim to attract private capital at scale. As of July 2018, grantees have raised over \$200 million of investment, a 40x multiple on the \$5 million Convergence has awarded.

Convergence focuses exclusively on blended finance to catalyze private investment. Other important stakeholders and initiatives, such as the DFI Working Group on Blended Concessional Finance for Private Sector Projects, focus on a broader scope of blended finance that includes the use of development funding to mobilize commercial-orientated public capital (e.g., capital from MDBs and DFIs). Convergence works closely with the OECD, DFI Working Group, and other key stakeholders to coordinate blended finance activity.

Report Methodology and Overview

The State of Blended Finance 2018 builds on Convergence's inaugural State of Blended Finance report released in July 2017¹. This report outlines key blended finance trends and developments in the past year and provides an updated analysis of the blended finance market based on Convergence's continuous data and intelligence collection efforts. The report includes input from Convergence's 280 member institutions and other key blended finance practitioners.

Convergence maintains the largest and most detailed database of historical blended finance transactions in the market. Given the current state of information sharing, it is not possible for this database to be fully comprehensive, but it is the best depository there is to understand blended finance scale and trends. Convergence continues to build out this database to draw better insights about the market and disseminates this information to the development and finance communities to improve the efficiency and effectiveness of blended finance to achieve the SDGs. The data in this report reflects Convergence's collection efforts as of July 2018.

Information is collected from i) credible public sources such as press releases, ii) information sharing agreements with key data aggregators like the OECD, and iii) validation exercises with Convergence members and partners. To be included in Convergence's database, a deal must meet three main criteria:

1. The transaction attracts financial participation from one or more commercial investors that would otherwise not have invested in the opportunity
2. The transaction uses catalytic funds in one of the following ways:
 - Public or philanthropic investors provide catalytic and concessional capital, bearing risk at below market returns to mobilize private investment, or provide guarantees or other risk mitigation instruments
 - Transaction design or preparation is grant funded
 - Transaction is associated with a technical assistance facility (e.g., for pre- or post-investment capacity building)
3. The transaction aims to create development impact related to the SDGs in developing countries

This report has four main sections:

1. **Deal Trends** provides an updated analysis of deals in the market, including blending approaches, sectors, regions, and development impact
2. **Investor Trends** highlights the top investors in the space, and key developments from important investors
3. **Ecosystem Trends** provides an overview of key events in blended finance being led by policy and advocacy organizations, think tanks, and other stakeholders
4. **Reflections** looks back on progress that has been made on the previous action items and issue areas outlined in the inaugural State of Blended Finance

¹ The State of Blended Finance was jointly produced by Convergence and the Business & Sustainable Development Commission's Blended Finance Taskforce (BFT). The purpose of the working paper was twofold: i) to expand the evidence-base around the potential of blended finance to help close the SDG funding gap and ii) to inform the recommendations the BFT intends to deliver to unlock systemic barriers in the blended finance ecosystem that are currently preventing the flow of mainstream capital into blended finance transactions at scale. Based on the work of Convergence and others, the BFT produced an Action Programme in early 2018.

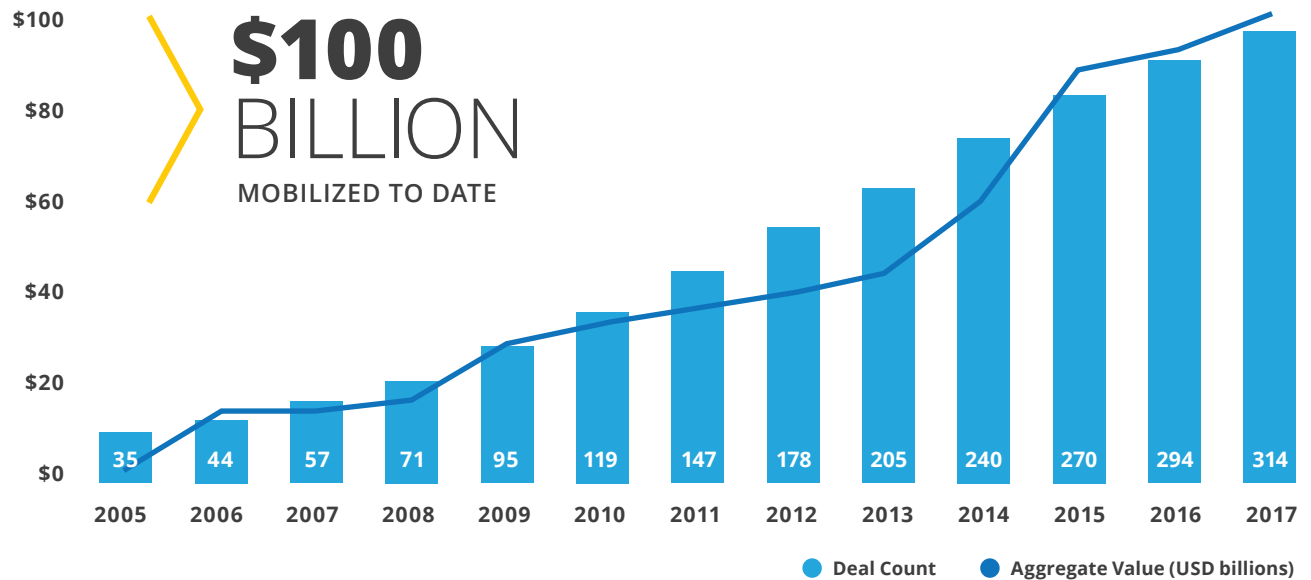
Deal Trends



Convergence has developed and maintains the largest database of historical blended finance transactions that mobilize private investment towards the SDGs in developing countries. The deal trends section and the following investor trends section present an updated market analysis, identifying prevailing practices, developments, and lessons learned, as well as providing benchmarks to help practitioners who are considering or evaluating new blended finance transactions.

Overall Market

FIGURE 4 AGGREGATE DEAL COUNT AND DEAL SIZE, 2005-2018²



Convergence's database captures over 2,500 financial commitments to over 300 blended finance transactions, with an aggregate deal size of over \$100 billion. The size of the blended finance market is almost double our estimate from last year, and

we are confident that this is still a conservative estimate. The majority of blended finance deals in the database were launched after 2005 (87% launched 2006-2018) and particularly after 2009 (69% launched 2010-2018).

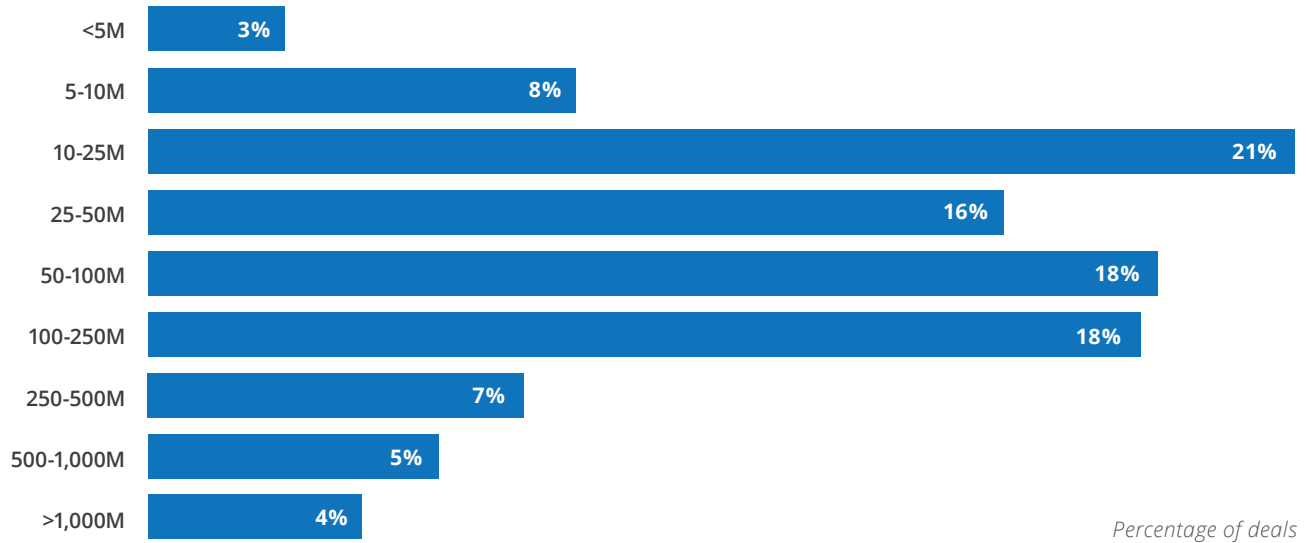
Deal Sizes and Types

Blended finance deals range in size from less than \$5 million to over \$1 billion, with a median deal size of \$56 million. The typical blended finance deal size

reflects the investment size preferences of private investors, who often require larger ticket sizes given the large amounts of capital they need to invest.

² Due to the nature of data collection, there can be a time lag in capturing recently closed deals. Therefore, we anticipate that the 2017 figures are higher than captured in this figure – both in terms of deal count and aggregate value.

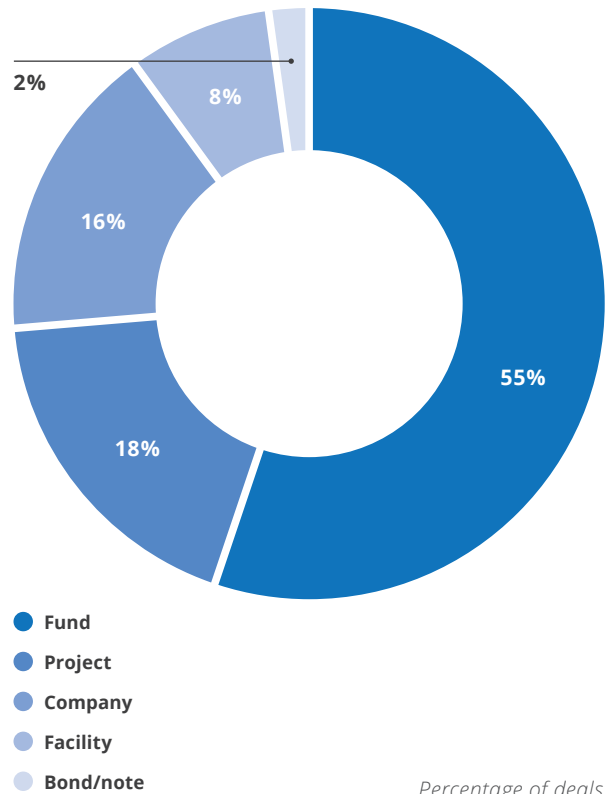
FIGURE 5 DEAL FREQUENCY BY DEAL SIZE



Percentage of deals

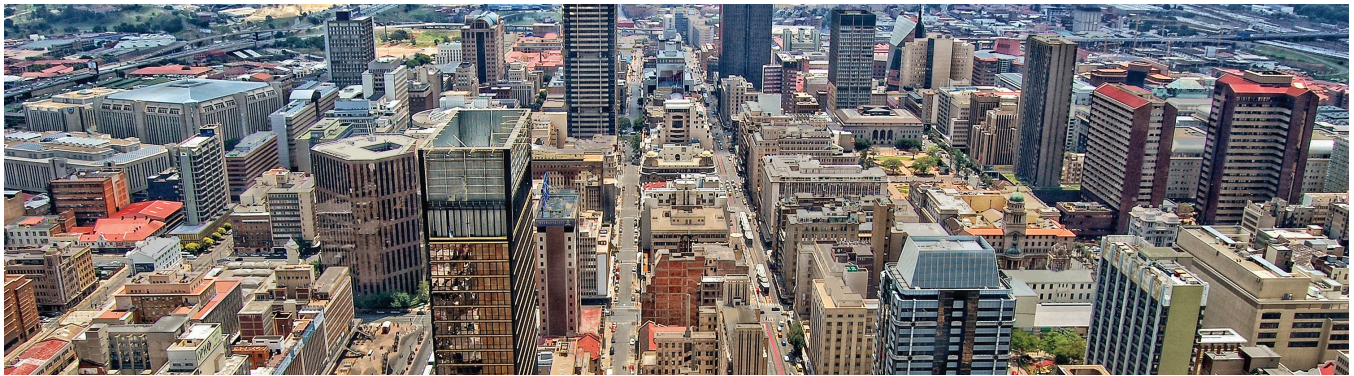
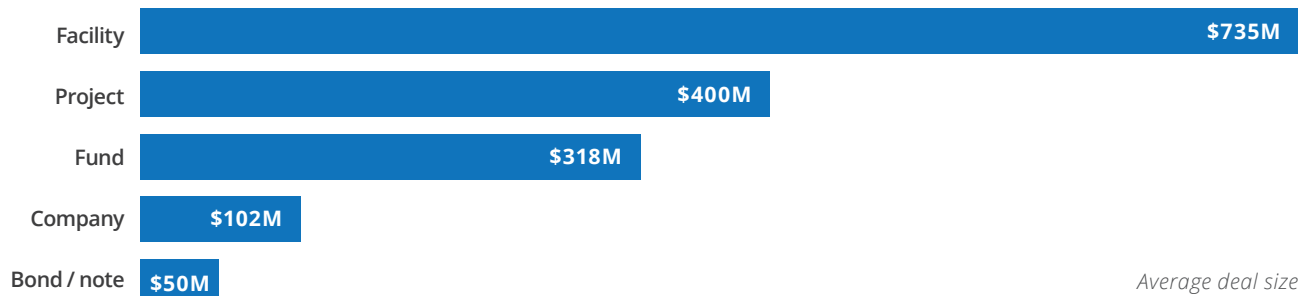
Convergence collects data on five common deal types: bonds / notes, companies, facilities, funds, and projects. Funds are still the most common deal type, representing 55% of deals in the database. Funds include equity funds, debt funds, and funds-of-funds. Companies and projects are the next most common deal type, representing 16% and 18%, respectively, of data collected. On average, projects and funds are much larger than companies. Projects are most commonly infrastructure projects. On the other hand, companies are most commonly social enterprises or small- and medium-sized enterprises (SMEs), which require either early-stage grant funding or capacity building alongside commercial capital. Eight percent of blended finance deals captured in our database are facilities. There is a much larger number of facilities – essentially pooled capital instruments – that are dedicated to blending at the project level (e.g., providing catalytic funding into blended structures), but they are not included in this analysis. Convergence’s database only captures vehicles that are blended at the facility level. The remaining 2% of blended finance deals in the database are bonds / notes.

FIGURE 6 DEAL TYPE FREQUENCY



Percentage of deals

FIGURE 7 AVERAGE SIZE BY DEAL TYPE



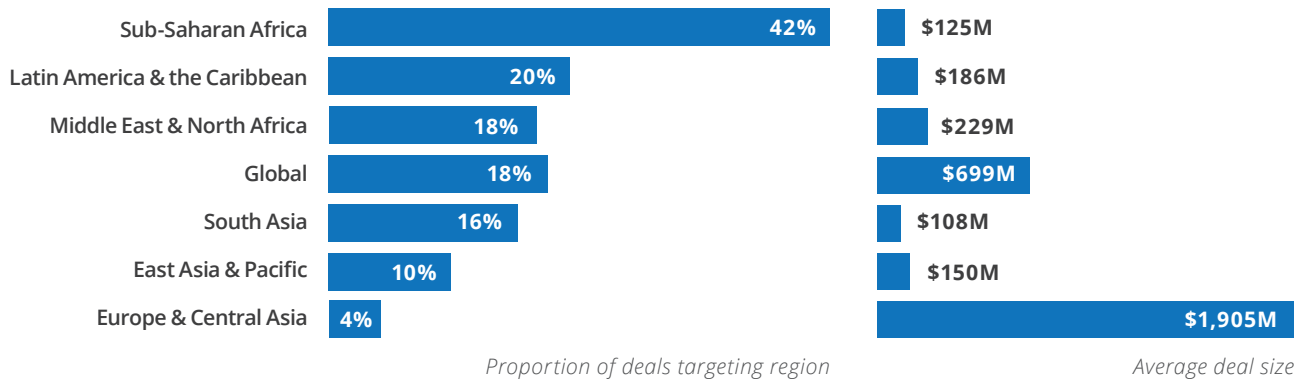
Regions and Countries

Sub-Saharan Africa is still the most popular target³ region, representing 42% of blended finance deals, with an average deal size of \$125 million. Within Sub-Saharan Africa, 73% of blended finance deals target countries in East Africa, which produced the continent's best economic performance in 2017. West Africa and Southern Africa are the next most common target sub-regions in Sub-Saharan Africa, and Central Africa receives the least blended finance, which likely reflects underdeveloped local capital markets as well as political instability. The outsized focus on Sub-Saharan Africa reflects the significant needs of the continent as it relates to the SDGs.

Latin America and the Caribbean is the second most frequent region, followed by the Middle East and North Africa and then South Asia. Latin America and the Caribbean is the target region for 20% of blended finance deals, with an average deal size of \$186 million. Middle East and North Africa and South Asia account for 18% and 16% of deals, respectively, and have average deal sizes of \$229 million and \$108 million, respectively. Global blended finance transactions that do not have a regional focus account for around 18% of deals and have an average deal size of \$669 million. Larger deal sizes for globally focused transactions should be expected, but it is interesting to note the large average deal size in the Middle East compared to other regions.

³ Convergence tracks country data by stated region of focus, not actual investment flows.

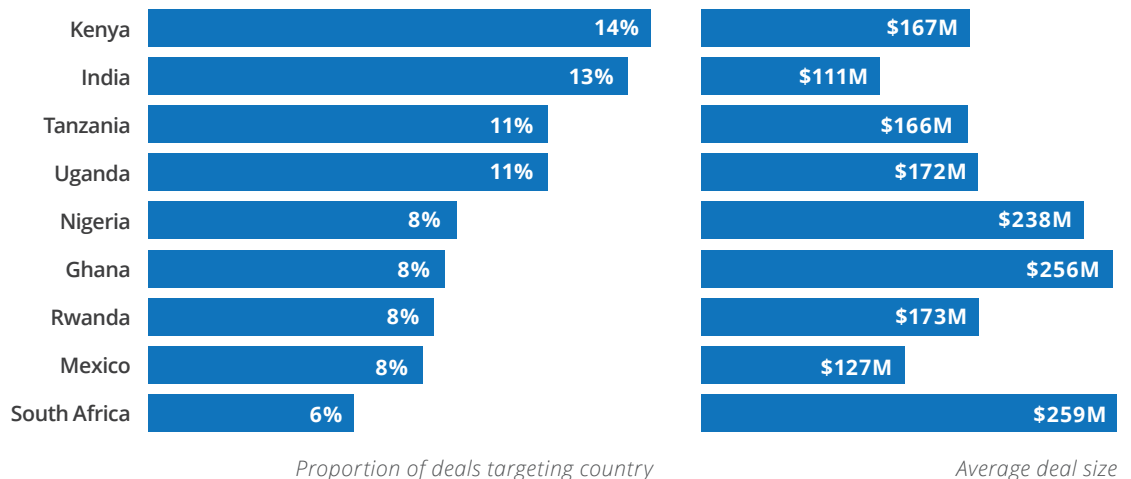
FIGURE 8 NUMBER OF DEALS AND AVERAGE DEAL SIZE BY REGION FOCUS



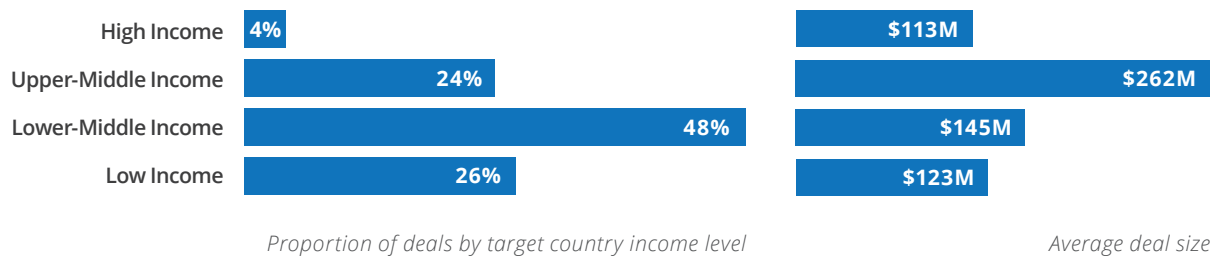
Blended companies and projects disproportionately target Sub-Saharan Africa; both deal types are nearly twice as frequent in the region as compared to the next most common region for companies and projects (South Asia). Approximately 28% of facilities are global, often focusing on a single development challenge / market intervention (e.g., vaccinations, microfinance). There is diversity among deal types in Latin America and the Caribbean, while the Middle East and North Africa most commonly benefit from blended finance funds and facilities. South Asia is a relatively less common target region for funds and a more common target region for projects.

Middle income countries are most commonly the target recipient⁴ of blended finance deal flows. Approximately half (49%) of the target countries in blended finance deals are lower-middle income, and 24% are upper-middle income. Only 26% of blended finance deals target low income countries. In terms of aggregate capital flows, lower-middle income countries are also about half (48%) of the committed capital and upper-middle income countries reflect a slightly larger share (26%). Low income countries represent 25%. The top countries for blended finance deals are Kenya (14%), India (13%), Tanzania (11%), Uganda (11%), and Nigeria (8%), with Tanzania and Uganda the only low income countries in the top five.

FIGURE 9 NUMBER OF DEALS AND AVERAGE DEAL SIZE BY COUNTRY FOCUS



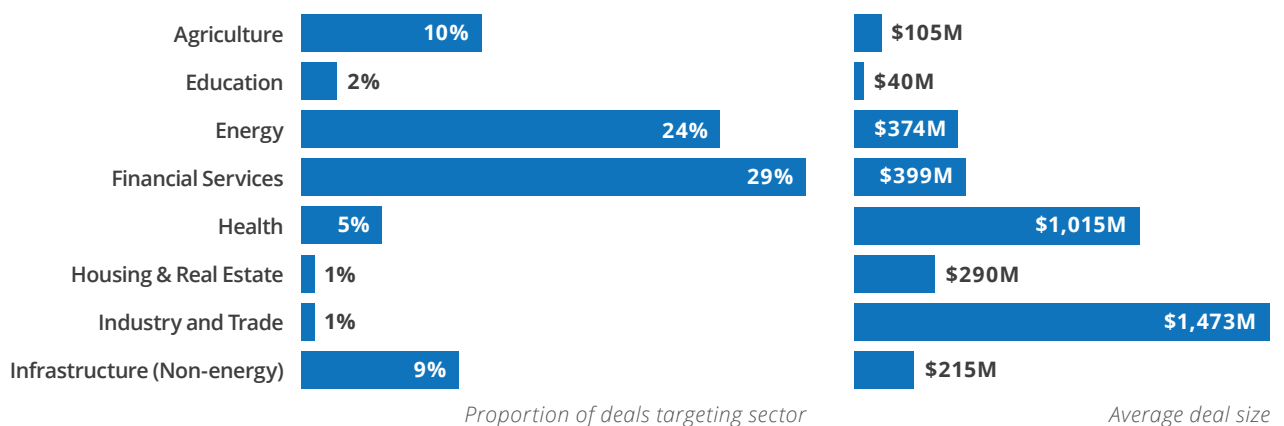
⁴ Convergence tracks country data by stated countries of focus at the time of financial close, not actual investment flows. Often, countries of eligibility are broader than those explicitly stated.

FIGURE 10 NUMBER OF DEALS AND AVERAGE DEAL SIZE BY COUNTRY INCOME LEVEL

Sectors

To date, blended finance deals have primarily focused on financial services and infrastructure (together, 62% of all deals). Financial services account for 29% of blended finance deals and include deals focused on microfinance / retail banking (50%) and small business / corporate banking (26%). These two sub-sectors broadly reflect the key development theme of financial inclusion – the pursuit of making financial

services accessible and affordable to all individuals and businesses. Financial inclusion is widely acknowledged as a key approach to reduce poverty and boost shared prosperity and has been identified as supporting seven of the 17 SDGs.⁵ Other financial services sub-sectors include capital markets (31%), insurance (8%), and green finance (3%).

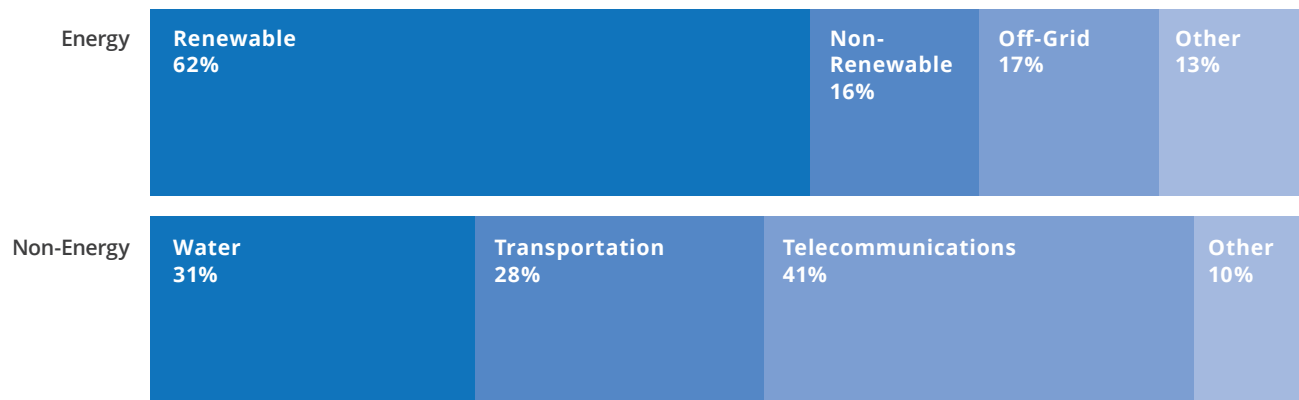
FIGURE 11 NUMBER OF DEALS AND AVERAGE DEAL SIZE BY SECTOR FOCUS

⁵ World Bank. (2018). "Financial Inclusion". Washington DC, World Bank. Accessed August 13, 2018. <https://www.worldbank.org/en/topic/financialinclusion/overview#1>

Blended finance deals focused on infrastructure can be divided into two groups: energy and non-energy. It should be noted that energy may include some projects / funds that are focused on adjacent themes such as carbon credits or energy efficiency. Energy is the focus sector for 24% of blended finance deals, primarily vehicles that finance and/or develop renewable energy (60% of energy deals). Renewable

energy is one of the most effective tools we have in the fight against climate change, and therefore benefits from the significant momentum and multinational commitments to clean energy. In addition, blended finance deals in the energy sector also include large-scale power generation (17%) and off-grid energy (11%). The median deal size for a blended finance deal in the energy sector is \$90 million.

FIGURE 12 INFRASTRUCTURE DEALS BY SECTOR AND SUB-SECTOR



Proportion of infrastructure deals targeting sub-sector

Nine percent of blended finance deals are focused on non-energy infrastructure, including telecommunications, transportation, and water and sanitation. The median deal size for non-energy infrastructure deals is considerably smaller compared to the energy sector at \$52 million. Given the close relationship between blended finance and project finance, as well as public-private partnerships, it is likely that there are a greater number of blended infrastructure deals that are not captured comprehensively in this database. Nonetheless, blended finance holds the potential to play a greater role in addressing the estimated \$1.3 trillion annual financing gap for infrastructure development in developing countries.⁶

Agriculture is a critical issue in many developing countries but has only been the focus of 13% of blended finance deals. The majority of agriculture deals (61%) focus on agricultural finance. Agricultural finance refers to financial services ranging from short-, medium- and long-term loans, to leasing and insurance. These products and services are key to a strong agriculture sector and have the potential to generate income growth, employment opportunities, and improved livelihoods. More than half of blended finance deals focused on the agriculture sector are in the form of funds – mirroring broader blended finance trends – and the remainder are relatively equally divided between projects (17%), companies (15%), and facilities (12%).

⁶ World Bank. (2018). Infrastructure Finance. Washington, DC: World Bank. February 2, 2018. Accessed August 13, 2018. <https://www.worldbank.org/en/topic/financialsector/brief/infrastructure-finance>

While more commercially oriented sectors like financial services and energy draw a large proportion of blended finance, social infrastructure sectors like healthcare and education also benefit from private investment mobilized through blended finance. Healthcare accounts for 5% of blended finance deals, but these deals are often significant in terms of total size, therefore healthcare reflects 16% of total capital flows from blended finance in developing countries. There have been many notable pharmaceutical and vaccination-focused blended finance structures, including the Global Alliance for Vaccines and

Immunization (GAVI) and the Global Health Investment Fund (GHIF), which can be considered early market-makers. While blended finance deals focused on health have become less frequent in recent years, health remains a critical development challenge with a significant financing gap. Finally, there is growing attention on the use of blended finance for education. Education currently accounts for 2% of blended finance deals, with a number of the projects and companies (i.e., social enterprises) established over the last five years.

Blending Approaches

The financial instruments that are most commonly deployed in blended finance structures are concessional capital and technical assistance funds. Forty-six percent of blended finance transactions in the database benefit from concessional capital, 42% from accompanying technical assistance funds, and 12% from both concessional capital and technical assistance funds. Concessional capital is a broad category encompassing many forms of catalytic participation from development funders – with the core characteristic of bearing risk at below-market financial returns to mobilize private sector investment. The most common forms are repayable grants, first-loss capital, and concessional debt and equity (junior or subordinate in the capital structure). Technical assistance funds are deployed pre- or post-investment, often to improve the investment readiness of underdeveloped sectors or markets.

Guarantees / risk insurance are growing in importance in the blended finance market. Guarantees / risk insurance are present in 21% of blended finance deals. A Climate Policy Initiative

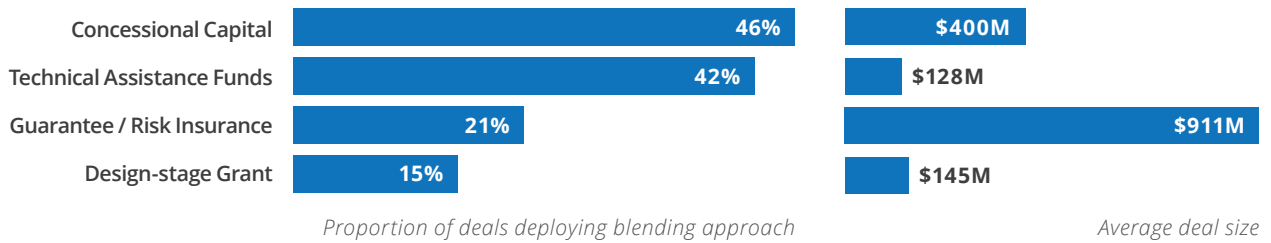
study found that guarantees represent only approximately 5% of financial commitments, but generate nearly 45% of private sector mobilization in their portfolio.⁷ Similarly, the 2016 OECD-DAC Survey found that guarantees account for 44% of total amount mobilized from the private sector in 2012-2015 (\$81.1 billion).⁸ However, there are a number of key challenges that prevent the wide use of guarantees for private capital mobilization, including i) international rating agencies' conservative policies on partial guarantees, ii) equal capital weightings for loans and guarantees at MDBs and DFIs, and iii) limitations on guarantees qualifying as ODA within OECD guidelines.

Design-stage grants have been present in 15% of blended finance deals. Many social enterprises have received grant funding for business model proof of concept or improvement, and subsequently raised commercial funding. However, capturing this data is difficult and therefore this number is likely an underestimate. There are a small number of programs focused specifically on providing design-

⁷ Climate Policy Initiative. (2018). Blended finance for risk mitigation. San Francisco: CPI. April 2018. Accessed August 13, 2018. <https://climatepolicyinitiative.org/2018/04/18/blending-finance-for-risk-mitigation/>

⁸ Organisation for Economic Co-operation and Development (2017). Amounts Mobilised from the Private Sector by Official Development Finance Interventions. Paris: OECD. July 2017. Accessed August 27, 2018. <https://www.oecd-ilibrary.org/docserver/8135abde-en.pdf?expires=1535467031&id=id&acname=guest&checksum=BD09D6530542B2A8E4992AF2980A462A>

FIGURE 13 BLENDING APPROACHES



stage grants to innovative finance and blended finance vehicles, including Rockefeller’s Zero Gap initiative and Convergence’s Design Funding program. These programs have proven to be catalytic and successful, but at present there are not enough sources of design funding to structure blended finance vehicles that support the SDGs at scale.

Different types of deals require different blending approaches. Funds most commonly benefit from concessional capital and technical assistance funds. Technical assistance can be particularly effective alongside investments in SMEs, as is the case for many debt and equity funds focused on low-

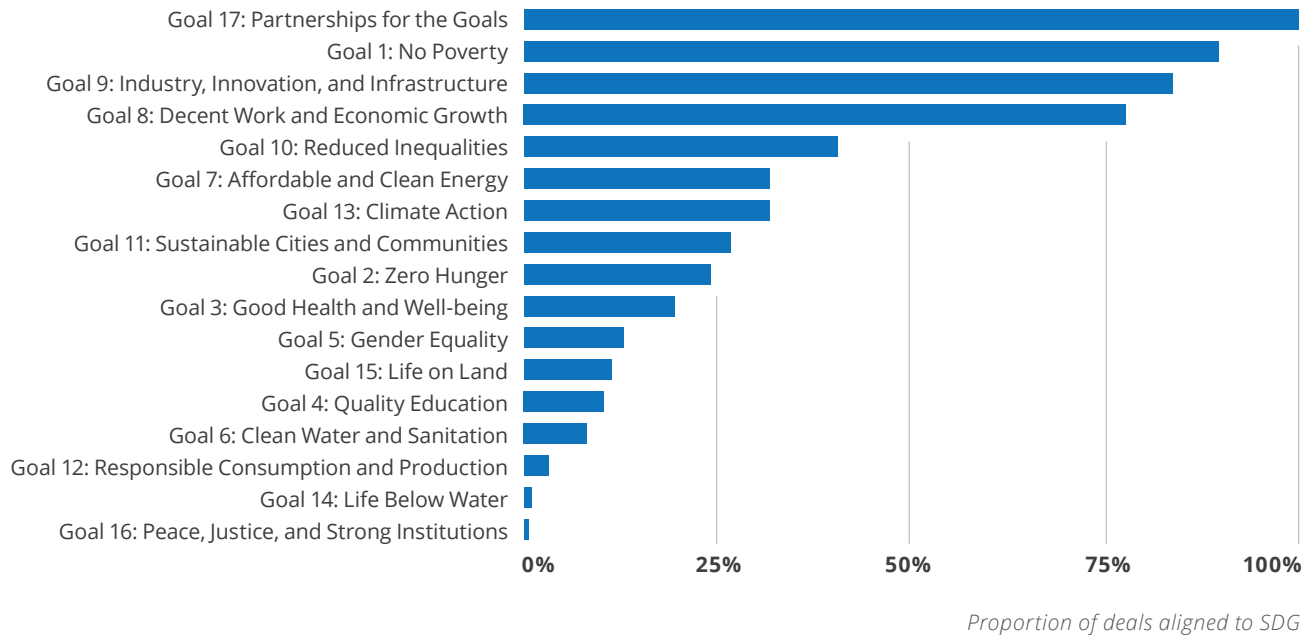
and lower-middle income countries. Projects, in particular when financing is debt-based, are most likely to receive a guarantee, often complemented by technical assistance. This reflects the significant number of infrastructure projects, as well as the existence of several important guarantee providers, such as GuarantCo, Swedish International Development Cooperation Agency (Sida), and United States Agency for International Development Development Credit Authority (USAID DCA). Companies are most likely to receive concessional capital, which is often early-stage investment capital provided to social enterprises aligned to a pre-identified set of priority development objectives.

SDG Alignment and Development Impact

As illustrated in Figure 14, analysis of the alignment of blended finance transactions with the SDGs illustrates very strong alignment with four goals: Goal 17 (Partnerships), Goal 1 (No Poverty), Goal 9 (Industry, Innovation, and Infrastructure), and Goal 8 (Decent Work and Economic Growth). Naturally, blended finance is highly aligned to SDG 17, in particular to target 17.3 “mobilize additional financial resources for developing countries from multiple sources” and indicator 93 “private net flows for sustainable development at market rates as share of high income country gross national income (GNI), by sector”.

There is strong alignment with another six goals: Goal 10 (Reduced Inequalities), Goal 13 (Climate Action), Goal 7 (Affordable and Clean Energy), Goal 11 (Sustainable Cities and Communities), Goal 2 (Zero Hunger), and Goal 3 (Good Health and Well-Being). These broadly align with some of the target impact themes of blended finance deals: financial inclusion, SME finance, income growth, employment opportunities, climate change, and food security.

FIGURE 14 BLENDED FINANCE DEAL ALIGNMENT WITH THE SDGS



There is growing momentum around Goal 7 (Affordable and Clean Energy) and Goal 13 (Climate Action). In 2017, the Green Climate Fund (GCF) launched a \$500 million global campaign to catalyze private capital to climate action by deploying concessional grants, loans, equity, and guarantees to the best business ideas addressing climate change mitigation and adaptation in developing countries. GCF received ~350 concept notes, amounting to a total demand for around \$18 billion in GCF resources. Relatedly, the Development Bank of Southern Africa’s (DBSA) new Climate Finance Facility (CFF) will deploy a blended finance approach to increase climate-related investment in the Southern African region. The CFF will focus on infrastructure projects that mitigate or adapt to climate change and utilize two main instruments to catalyze commercial bank financing into these projects: subordinated debt / first-loss and credit enhancements, such as tenor.

Successful blended finance transactions have clearly identified development impact objectives, outputs, and outcomes. However, blended finance is not a panacea; it has not yet demonstrated that it is a good development tool for all the SDGs. Blended finance can only be deployed for activities that produce cash flows that can generate a financial return for private sector investors.⁹ The suitability of blended finance also varies significantly within goals, particularly areas where both investment and policy action are required, such as education, health, and conservation. Nonetheless, blended finance is also increasingly being deployed for niche themes, including in response to the refugee crisis (e.g., Refugee Investment Network¹⁰, Kois Invest’s Syrian Refugee Bond¹¹), as well as Goal 14 (Life Below Water), following growing concerns around the state of the world’s oceans (e.g., Althelia’s Sustainable Ocean Fund.)

⁹ United Nations Sustainable Development Solutions Network. (2015). Investment Needs to Achieve the Sustainable Development Goals. New York: SDSN. November 12, 2015. Accessed August 13, 2018. <http://unsdsn.org/wp-content/uploads/2015/09/151112-SDG-Financing-Needs.pdf>.

¹⁰ The Refugee Investment Network (RIN) is the first blended finance investment collaborative dedicated to creating long-term solutions to global forced migration. Read more here: <https://www.refugeeinvestments.org/>

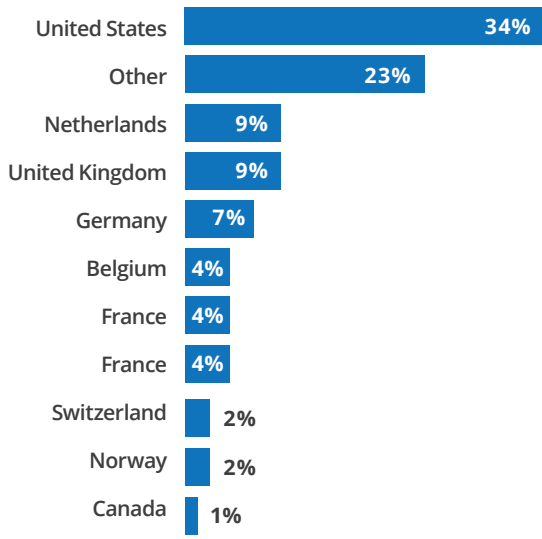
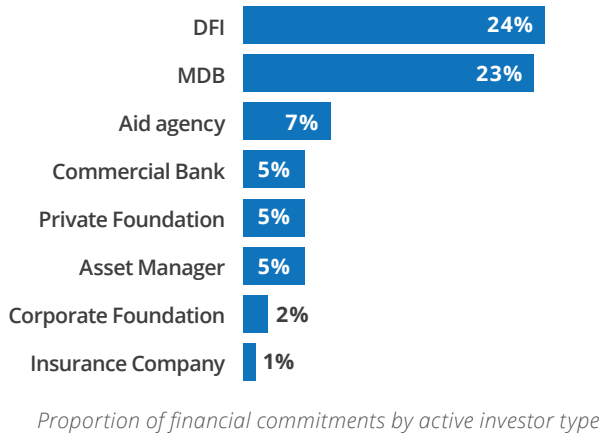
¹¹With support from Convergence and others, Kois Invest is currently designing a development impact bond targeting Syrian refugees in Jordan. Read more here: <https://www.koisinvest.com/>



Investor Trends

Convergence's database identifies over 800 organizations that have made a financial commitment to a blended finance deal, with approximately 20% of these institutions active blended finance investors (invested three or more times). Fifty-five percent of active blended finance investors are private investors, including businesses, financial institutions, and investment management companies. Philanthropic organizations – including endowments, foundations, and non-governmental organizations (NGOs) – account for nearly 25% of financial commitments by count to blended finance deals. Public organizations account for 20% of financial commitments to blended finance deals by count, but account for a far greater share of total capital committed to blended finance (i.e., public organizations' commitments are large on average). Public organizations can be classified as those with a pure development mandate (i.e., development agencies) and those with a commercial development mandate (i.e., DFIs and MDBs).

FIGURE 15 TYPE AND DOMICILE OF ACTIVE BLENDED FINANCE INVESTORS BY NUMBER OF INVESTMENTS



Development Agencies and Multi-Donor Funds

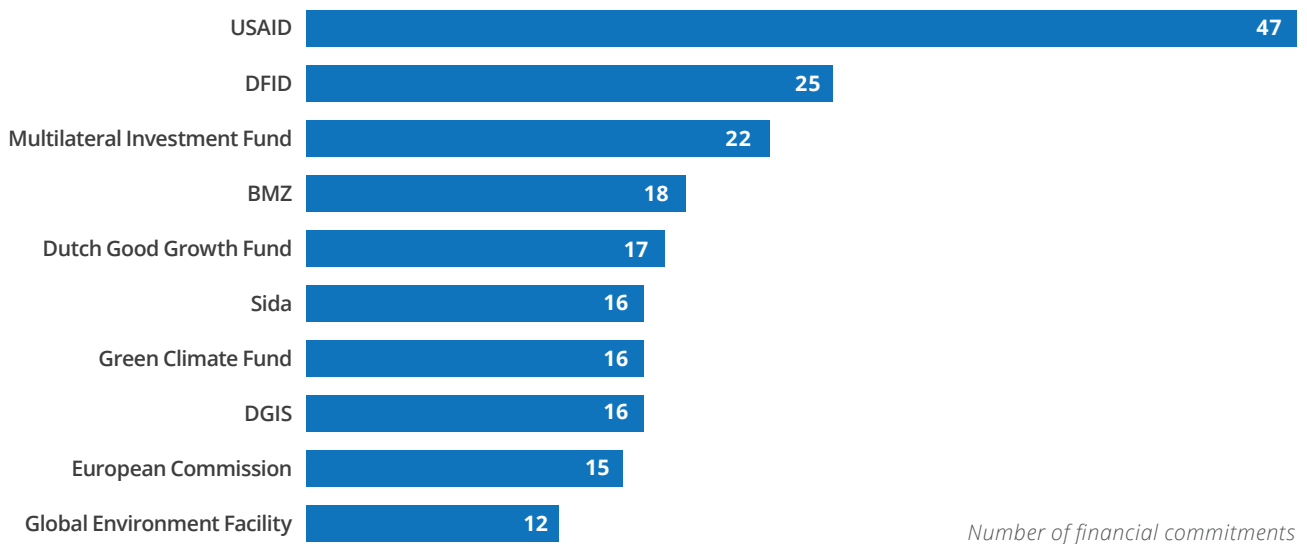
The most catalytic role of development agencies in blended finance is to provide risk capital – including guarantees, insurance, and concessional debt or equity – to create acceptable risk-return profiles for private investors and lower the cost of capital to a reasonable level for beneficiaries in developing countries. These institutions also play an important role in providing grants for technical assistance.

To date, the top public investors with development mandates (e.g., development agencies), measuring by frequency of appearance, have been USAID, the UK Department for International Development (DFID), the Multilateral Investment Fund¹², the German Ministry of Economic Co-operation and Development (BMZ), and the Dutch Good Growth Fund. As a market leader, USAID primarily provides grants – for design-stage funding (e.g., through the Partnering to Accelerate Entrepreneurship (PACE) Initiative) and technical assistance – as well as guarantees through the DCA. In 2017, USAID established The Invest Project to research, develop, and build blended finance vehicles for development challenges. Convergence, DAI, CrossBoundary, and Timeline are core partners among a network of firms with the specialized expertise across industries and geographies needed to identify, develop, and execute on blended finance structures for USAID.

In addition to USAID, DFID, the Dutch government, and the European Commission (EC) are strong contributors to blended finance. DFID has historically provided multiple types of concessional capital

¹² The Multilateral Investment Fund (MIF) is an independent fund administered by the Inter-American Development Bank, created in 1993 to support private sector development in Latin America and the Caribbean. MIF, or FOMIN as the fund is known in Spanish, provides technical assistance, long-term loans, and equity investments, with a focus on microfinance and SME finance.

FIGURE 16 TOP PUBLIC INVESTORS WITH DEVELOPMENT MANDATES BY NUMBER OF DEALS



to blended finance deals, including grants and first-loss equity, and advocates for maximizing the effectiveness of blended finance approaches as well as prioritizing the measurement of impact outcomes. The Dutch Directorate-General of International Cooperation (DGIS), directly and through Dutch Good Growth Fund and FMO, is an important blended finance actor, deploying various types of capital and blending approaches via relevant specialized bodies. Finally, the EC has been an important advocate and leader in blended finance. While the EC has traditionally deployed large volumes of public-on-public blending¹³, it has put an increasing emphasis on mobilizing private sector capital, including in its current External Investment Plan (EIP).

Multi-donor funds have also played an important role as concessional capital providers for blended finance deals, as indicated by the ranking of Multilateral Investment Fund (third), GCF (seventh), and the Global Environment Facility (tenth). These funds and facilities are established with the explicit purpose of deploying concessional funding, including

design-stage grant capital, investment-stage grants, concessional capital, and guarantees. There are clusters of multi-donor funds around key development objectives and / or market barriers. Climate change is an excellent example, with GCF successfully mobilizing over \$10 billion during its initial resource mobilization in 2014. Other common themes include infrastructure, particularly renewable energy, and SME finance.

In 2017-2018, there has been a significant uptick in development agency interest in blended finance and efforts to mobilize private sector investment more broadly. The Canadian government made a significant commitment of C\$1.5 billion to blended finance over the next five years to support innovation in Canada’s international assistance.¹⁴ The new budget states that these new funds will give the government greater flexibility for financing arrangements and partnerships and allow it to explore new and innovative ways to achieve its objectives, including the use of financial instruments, such as guarantees, equity, and conditionally repayable contributions.

¹³ Some definitions of blended finance include ‘public-on-public’ blending, whereby concessional capital is deployed by a development agency (e.g., the European Commission) to encourage commercially-oriented public agencies (i.e., DFIs) to invest in higher-risk countries, markets, and/or projects.

¹⁴Disclosure: Global Affairs Canada is Convergence’s primary funder

Multilateral Development Banks and Development Finance Institutions

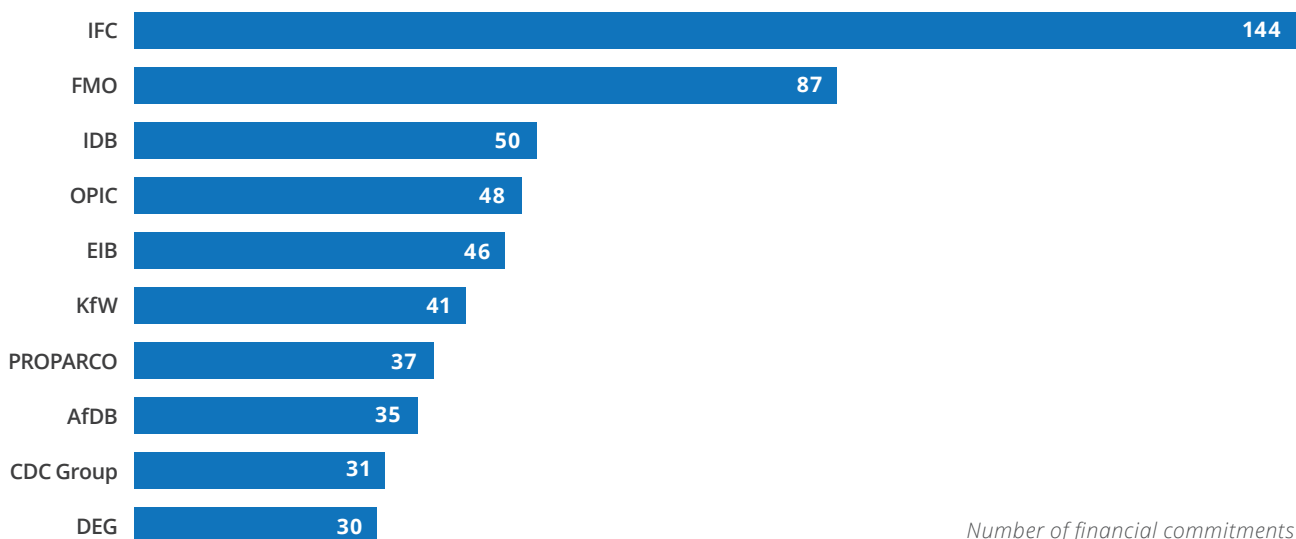
MDBs and DFIs are critical to the success of blended finance. One key role is as lead arranger and manager for debt and equity transactions that can be co-financed by private sector investors, with many subject to blended finance structures. In addition, MDBs and DFIs can provide guarantees and risk insurance to attract private investment. They are well-positioned to arrange larger amounts of financial assets that can be co-financed by the private sector through blended finance, with the presidents and shareholders of these organizations signaling this objective. This capacity is a great – but under-deployed – public resource to achieve the SDGs.

To date, the top public investors with commercial-development mandates, measuring by frequency of appearance, have been the International Finance Corporation (IFC), the Netherlands Development Finance Company (FMO), Inter-American Development

Bank (IDB), Overseas Private Investment Corporation (OPIC), and European Investment Bank (EIB). In 2017, IFC led the DFI Working Group on Blended Finance to revise the principles for deploying concessional finance in private sector projects. Further, IFC is currently leading a landmark blended finance deal – the Managed Co-lending Portfolio Platform (MCPPI). The MCPPI is a syndications platform that creates diversified portfolios of developing country private sector loans to infrastructure projects that institutional investors participate in. As of 2018, the MCPPI has raised \$7 billion from eight global investors, including Allianz Global Investors, AXA, Eastspring Investments (Prudential), Munich Re, and Swiss Re.

FMO is an active originator of and investor in blended finance deals. Blended finance deals account for approximately 16% of FMO’s entire portfolio of investments,¹⁵ and the organization is one of the most

FIGURE 17 TOP DFIS AND MDBS



Number of financial commitments

likely DFIs to deploy concessional capital. Most recently, FMO established Climate Investor One, which supports wind, solar, and hydro energy projects, deploying different forms of capital across the project lifecycle. Climate Investor One reached third close at \$535 million in June 2018. Similarly, German KfW, U.S. OPIC, and France's PROPARCO are well-established blended finance participants, although often on the same or similar terms to private investors. While KfW has deployed a diverse set of concessional and commercial investment instruments to blended finance deals (e.g., grants, debt, equity), OPIC has deployed predominantly commercial debt and PROPARCO has provided primarily debt and equity.

There are also a number of institutions that are actively scaling up their blended finance activities. Alongside the re-branding of its private sector arm, IDB has increased its capacity and activity in blended finance. IDB Invest – formerly the Inter-

American Investment Corporation (IIC) – aims to deploy nearly \$800 million of donor funds alongside its own commercial funding to pioneer, de-risk, and mainstream innovative business models and technologies in Latin America and the Caribbean. The African Development Bank (AfDB) is also increasing its private sector activities and leveraging blended finance to achieve strategic priorities. The CDC Group hired Nick O'Donohoe, former Senior Advisor on Blended Finance at Gates Foundation and Funding Committee member of Convergence's Design Funding program. Finally, the G7 countries adopted the 2X Challenge in June 2018, committing their seven national DFIs to mobilize their own funds alongside private capital to advance women as entrepreneurs, business leaders, employees, and consumers.¹⁶ The official communique from the G7 members stated explicitly, "We will work to implement the OECD-DAC blended finance principles including promoting greater transparency and accountability of blended finance operations."¹⁷

Philanthropic Foundations

Foundations in the blended finance space have most commonly played a small but catalytic role, either providing small amounts of financing to seed large-scale and ground-breaking initiatives or providing smart forms of subsidy and risk mitigation (e.g., interest rate reductions and/or concessional capital) to crowd-in the private sector.

To date, the top philanthropic investors, measuring by frequency of appearance, have been Omidyar Network, the Bill and Melinda Gates Foundation, Shell Foundation, DOEN Foundation, and the Rockefeller Foundation. These organizations represent leading private and corporate foundations globally, each with a set of innovative financing tools and development

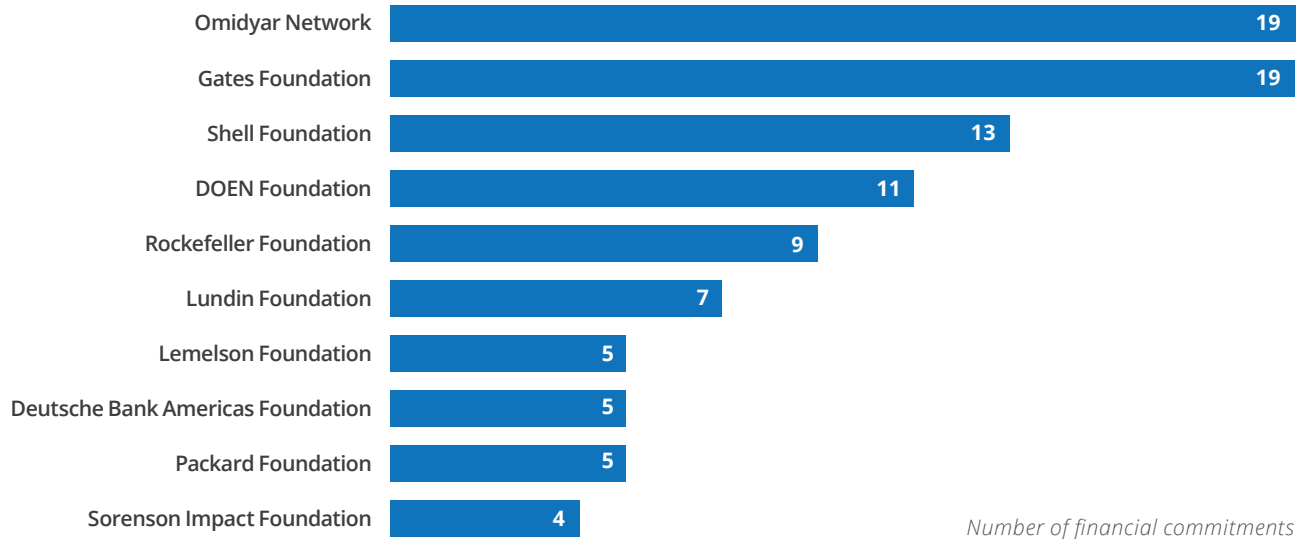
objectives. The Gates Foundation has actively pursued blended finance approaches since 2015, when it committed to allocate \$1 billion in first-loss capital and guarantees to catalyze private sector development. Shell Foundation co-creates businesses that can help achieve the SDGs, focusing on access to energy and sustainable transportation. It provides long term, patient, and flexible funding to early-stage innovators as well as extensive business support. The Rockefeller Foundation pursues innovative finance approaches through its Zero Gap initiative, which uses philanthropic risk capital – both grants and program-related investments – to develop and scale innovative finance and blended finance vehicles.

¹⁵ Estimation based on Convergence's historical deals database and the current size of FMO's portfolio of investments.

¹⁶ OPIC. (2018). "G7 DFIs Announce '2X Challenge' to Mobilize \$3 Billion to Invest in the World's Women." Washington, DC: OPIC. June 9, 2018. Accessed August 13, 2018. <https://www.opic.gov/press-releases/2018/g7-dfis-announce-2x-challenge-mobilize-3-billion-invest-worlds-women>.

¹⁷ Government of Canada (2018). Charlevoix Commitment on Innovative Financing for Development. Ottawa: G7 Charlevoix. June 13 2018. Accessed August 27, 2018. https://g7.gc.ca/wp-content/uploads/2018/08/InnovativeFinancingForDeveloppement_V2.pdf

FIGURE 18 TOP PHILANTHROPIC INVESTORS



Number of financial commitments

Impact Investors

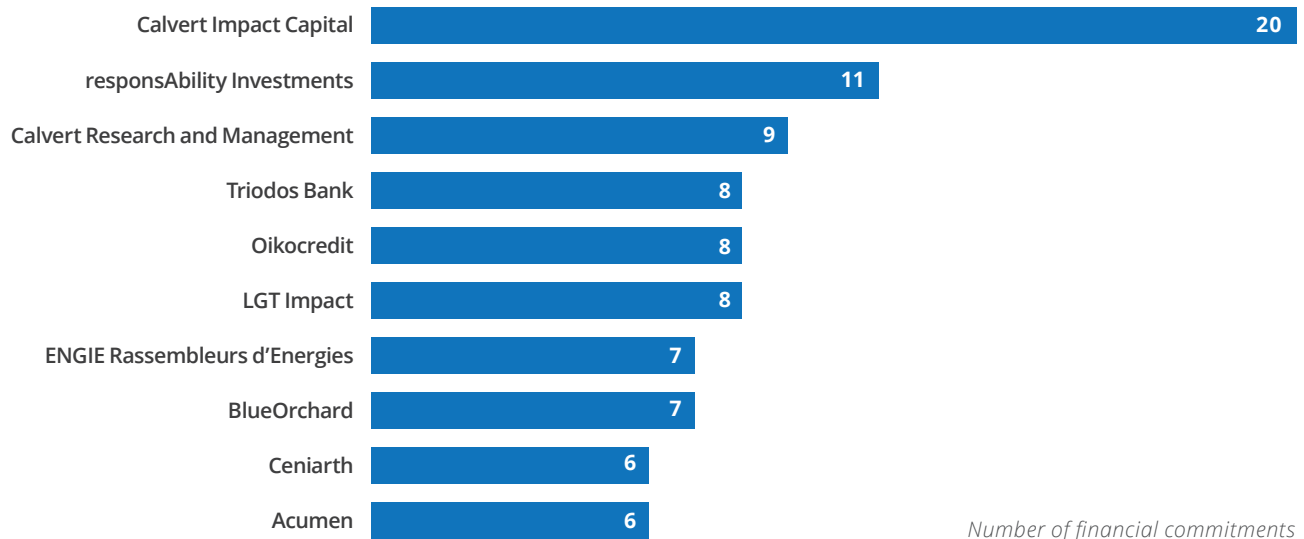
Impact investors have a dual mandate of seeking financial returns as well as social or environmental impact. Blended finance can benefit significantly from momentum and growth in the impact investment market. It is important to note, however, that blended finance is not synonymous with impact investing. While impact investment is a thesis behind investing, blended finance is a structuring approach. The purpose of a blended finance structure is to create one or more commercially investable tiers within an opportunity that, on an overall basis, may not have an attractive risk-adjusted return profile.

Impact investors are important blended finance investors because of their ability to bridge the gap between fully concessional and fully commercial capital. According to Convergence’s database, impact investors account for approximately 40% of private investors in blended finance deals, although these investors vary significantly in the degree to which they will prioritize social or environmental returns over

financial returns. The top impact investors in blended finance deals, based on frequency of participation, are Calvert Impact Capital, responsAbility Investments, Calvert Research and Management, Triodos Bank, and Oikocredit. These top investors demonstrate the diversity in approaches taken by impact investors. Calvert Impact Capital is a former private foundation turned impact investment firm, while ENGIE Rassembleurs d’Energies is a corporate impact investment fund for ENGIE.

There is growing interest among impact investors in blended finance, as demonstrated by the proliferation of the topic in industry associations and at conferences. In 2018, the Global Impact Investing Network (GIIN) established a working group on blended finance to provide guidance to their members. Further, blended finance was a key theme at the July 2018 Vatican Impact Investing Conference and will also be a theme at SOCAP 2018.

FIGURE 19 TOP IMPACT INVESTORS



Number of financial commitments

Institutional Investors

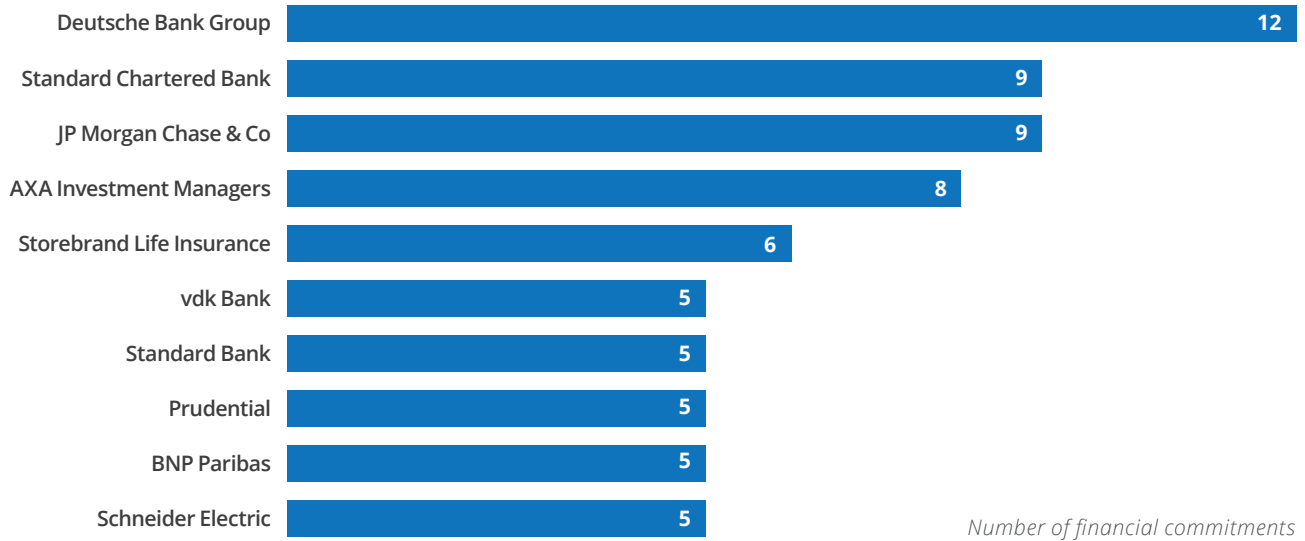
To date, commercial banks have been more involved than other institutional investors, with multiple banks investing in several blended finance transactions. The top institutional investors in blended finance deals are Deutsche Bank Group, Standard Chartered Bank, J.P. Morgan Chase & Co., AXA Investment Managers, and Storebrand Life Insurance. The level of blended finance activity among financial institutions has varied over time, reflecting significant movements in the global capital markets as well as changes in internal leadership and priorities. Institutional investor participation in blended finance is relatively more fragmented compared to other investor segments. Overall, there has been an insufficient number of attractive investment opportunities for institutional investors, based on transaction size and terms. Designing investment opportunities that

can attract institutional investors is critical if blended finance intends to materially contribute to closing the SDG funding gap.¹⁸

Nonetheless, there is growing momentum for blended finance and positive signals from the capital markets. In early 2018, Allianz became the first large commercial lender to commit long-term funding to the Emerging Africa Infrastructure Fund, with a \$110 million loan protected by a first-loss capital tranche committed from aid agencies / donors. The Tropical Landscapes Finance Facility, a partnership between UN Environment, World Agroforestry Centre, ADM Capital, and BNP Paribas, announced a landmark \$95 million 'Sustainability Bond' to help finance a sustainable natural rubber plantation on heavily degraded land in two provinces in Indonesia.

¹⁸ To read more on key considerations for mobilizing institutional capital through blended finance, read Convergence's report 'Who is the Private Sector?' here: <https://www.convergence.finance/knowledge>

FIGURE 20 TOP PRIVATE INVESTORS



Ecosystem Trends



Blended Finance Principles

In October 2017, the 30 OECD DAC members adopted a set of blended finance principles to improve and increase financial resources for the 2030 Agenda. These principles are the culmination of extensive research and engagement with a Senior Advisory Group that included representatives from the public, philanthropic, and private sectors. This is an important milestone for blended finance: an acknowledgement from the highest level of leading donor nations of the role that blended finance can play in closing the financing gap for the SDGs.

The OECD Principles provide a five-point checklist to ensure blended finance meets certain standards and achieves impact, covering the underpinnings of blended finance, including concessionality, additionality, and transparency—and highlight the critical steps required for blended finance to achieve scale and impact.

In parallel, the DFI Working Group, led by IFC, adopted the Enhanced Principles for Blended Concessional Finance for Private Sector Projects, building on and further strengthening the principles for the use of concessional finance in private sector operations previously agreed on by the DFIs in October 2013. The purpose of the enhanced principles is to ensure the effective and efficient use of concessional resources in private sector projects and avoid market distortion or crowding out private capital. The principles include how to promote

commercially sustainable vehicles using the minimum amount of concessionality, and also state the need for high social, environmental, and governance standards. In addition, the working group has agreed to exchange best practices, pilot a data-gathering exercise, and examine case studies to support the development of the enhanced principles.

There are now calls for harmonization among the sets of blended finance principles, including the OECD DAC Principles and DFI Working Group Enhanced Principles as well as individual principles and modes of practice established by other development finance providers. Harmonization would be particularly valuable in terms of measuring and reporting on development impact as well as establishing benchmarks around additionality, leverage, and impact outcomes.

Blended Finance Milestones and Convenings

The Green Climate Fund (GCF) launched a global campaign to tap private sector resources for tackling climate change in May 2017. GCF committed to leverage \$500 million to bring more private climate capital into developing countries, seeking business ideas that address climate change mitigation and adaptation. GCF received 350 responses and reviewed 258 concept notes, representing a total project cost of \$43 billion and targeting 50 developing countries. Although the GCF's recent board meeting ended in anticlimax as it failed to approve almost a billion dollars of funding for projects, GCF remains an important source of concessional financing for catalyzing greater private sector participating in climate change mitigation and adaptation efforts.

In late 2017, the Global Impact Investing Network (GIIN) established its Blended Finance Working Group, for a sub-set of its 260 global members, to address the complex nature of designing blended finance structures with the goal of decreasing costs and increasing the frequency and scale of blended finance transactions. The Working Group meets regularly to share lessons learned from designing and deploying existing blended finance vehicles, and endeavors to complement existing initiatives rather than duplicate efforts. This indicates the growing level of interest among impact investors in participating in and designing blended finance transactions.

In November 2017, the European Commission launched the External Investment Plan (EIP), a new EU initiative. It is designed to attract more investment, in particular from businesses and private investors, into countries near the EU ('EU Neighbourhood') and in Africa. It is expected to leverage €44 billion (\$50 billion) of investment through an initial EU input of €4.1 billion (\$4.7 billion). The EU has been a long-time advocate of blending developing capital with commercial capital, and this commitment reflects a renewed focus on mobilizing private sector financing.

The Business & Sustainable Development Commission's Blended Finance 'Taskforce' culminated its one-year mandate with a 'Programme of Action' delivered in April 2018 during the World Bank Spring Meetings in Washington, DC. The eight key initiatives outlined in the programme of action summarize the diverse areas of activity driven by leading organizations in the blended finance space and form a useful summary of the momentum in the market. The Taskforce worked with partners – Climate Policy Initiatives, Kois Invest, and Convergence – to produce a series of reports, which informed the summary report 'Better World, Better, Finance' and the programme of action. The Taskforce is a time-bound initiative led by the consulting firm SYSTEMIQ and will wrap up in 2019 (12-18 months after the release of the action programme).

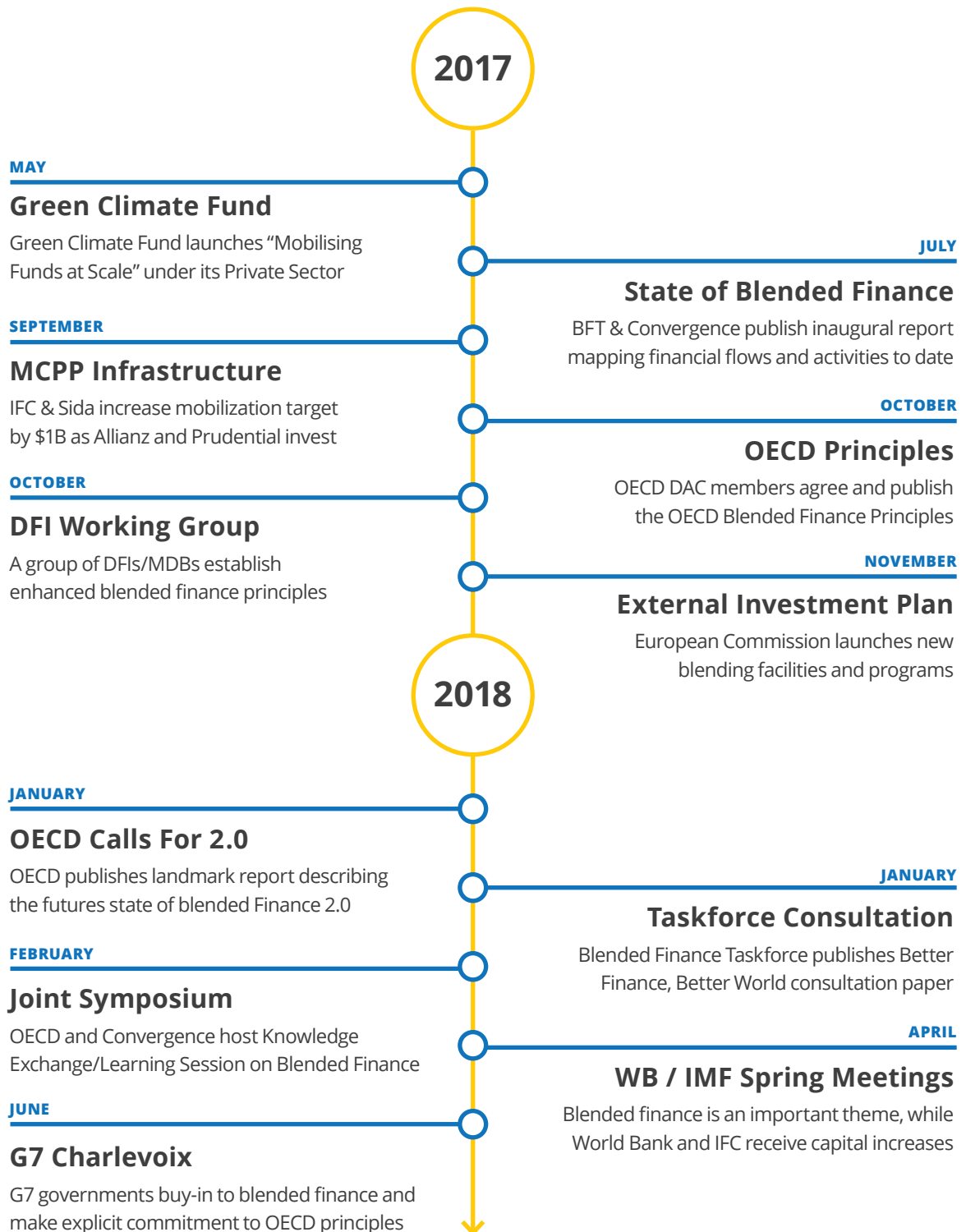
The OECD and Convergence co-hosted a Blended Finance Knowledge Exchange and Learning Session in early 2018 for OECD DAC members. The two-day session brought together approximately 23

OECD-DAC countries, partner and participant countries, such as Indonesia and the UAE, and over 30 experts from a wide range of development aid agencies, philanthropies, and private sector finance organizations, including the World Bank Group, European Commission, Citigroup, and the Gates Foundation. The purpose of the convening was to support the move from principles to practice of the OECD's Blended Finance Principles.

The 2018 ECOSOC Forum on Financing for Development follow-up (FfD Forum) was held in New York in April 2018. The FfD Forum is an intergovernmental process with universal participation mandated to review progress against the Addis Ababa Action Agenda. The FfD Forum, and accompanying progress report, 'Financing for Development: Progress and Prospects', highlighted both the potential of and the challenges to scaling blended finance, including important messages around the need for transparency and local ownership in blended finance deals and outcomes.

The Sustainable Development Investment Platform (SDIP) continued to grow its membership. SDIP is a growing membership of 41 institutions committed to closing the financing gap for sustainable infrastructure projects. In 2017, the Republic of Côte d'Ivoire and the Kingdom of Cambodia became the first two countries to formally announce their participation in SDIP. SDIP also announced a partnership with the Private Infrastructure Development Group (PIDG) to increase public-private finance for infrastructure projects in low income countries.

FIGURE 21 KEY BLENDED FINANCE EVENTS IN 2017-2018



Emerging Themes

Water, sanitation, and hygiene (WASH) has emerged as an area of strong interest for both investors and donors interested in blended finance. Meeting SDG 6 (Clean Water and Sanitation) will require significant financing – annual investments in water supply and sanitation need to increase threefold to \$114 billion per year, 63% of which will need to go to developing countries. There has been both an emergence of new blended finance investors in the WASH sector and a pivot towards the use of blended finance by existing investors focusing on the WASH sector. Water.org has piloted two iterations of a unique WASH-focused blended finance mechanism, WaterCredit and WaterEquity, with another mechanism to be launched in the near future. In addition, the Emerging Africa Infrastructure Fund, Climate Investor One, and other existing investment initiatives and funds are increasingly looking towards WASH projects.

Least developed countries (LDCs) have been a growing blended finance focus for public investors. Convergence and others have found that blended finance is mainly directed to middle income countries and targets a small sub-set of sectors. According to the OECD, of the \$81 billion in private resources mobilized by public development finance between 2012-2015, only 7% was in LDCs, with the lion's share (77%) being mobilized in middle income countries, and the rest targeting global or regional efforts.¹⁹ The United Nations Capital Development Fund (UNCDF), OECD, Convergence, and others are currently leading work on the current landscape of blended finance in the LDCs, with a forthcoming report anticipated later in 2018. Overall, blended finance is more aligned to financing in middle- and low-income countries;

however, blended finance approaches, including guarantees, may hold great potential for filling significant financing gaps in many LDCs.

There is rising demand for improved evidence around blended finance, particularly on its development impact outcomes. The successful scaling of blended finance will require a strong understanding of the best practices and lessons learned to date. However, there is a lack of evidence on blended finance, both in terms of financial flows going towards blending as well as impact of blended finance. Some argue that the current level of evidence is inadequate for donors and their partner countries to truly understand the impacts of blending, particularly on poverty reduction.

Gender equity and women's empowerment are increasingly recognized as a key enabler for sustainable development, as well as a central theme for blended finance. More and more development finance practitioners are 'mainstreaming gender'²⁰, focusing part or all of their portfolio on supporting Goal 5 (Gender Equality). Development agencies like Sida, have long-standing gender programs, while others, like Global Affairs Canada, have recently adopted ambitious feminist agendas. The 2X Challenge: Financing for Women is an initiative of seven DFIs – inspired by OPIC's 2X Global Women's Initiative – to deploy blended finance for women and girls. In parallel, there has been a growth in gender-lens investing in impact investing and philanthropic activities. Convergence recently announced a grant award to Women's World Banking Asset Management to design the Women's World Banking Capital Partners Fund II, and in particular to develop a pioneering methodology for assessing gender gaps among the staff and client base of the companies it invests in.

¹⁹ UNCDF. (2018). Blended Finance in the Least Developed Countries." New York: UNCDF. April 13, 2018. Accessed August 13, 2018. <http://www.uncdf.org/expert-meeting-on-blended-finance-in-the-least-developed-countries>.

²⁰ According to the European Institute for Gender Equality, "Gender mainstreaming has been embraced internationally as a strategy towards realising gender equality. It involves the integration of a gender perspective into the preparation, design, implementation, monitoring and evaluation of policies, regulatory measures and spending programmes, with a view to promoting equality between women and men and combating discrimination."

Reflections



- Blended finance is now mainstream
- Practitioners are coordinating to improve the market
- Healthy skepticism of blended finance still exists
- Blended finance is not a panacea for achieving the SDGs
- Convergence is leading a global vision for blended finance

Blended Finance Is Mainstream

Blended finance is now mainstream. While MDBs and DFIs have co-invested with the private sector for decades, there has been growing interest since the Third International Conference on Financing for Development in July 2015, where blended finance – and other innovative finance mechanisms – was recognized as one solution for addressing the SDG funding gap in developing countries. Since then, blended finance has become a key theme in global conferences, made news headlines, and found its way into international development policy and strategies. Now, the OECD and DFI principles represent widescale recognition and adoption of blended finance.

However, it is important to recognize that there is a history of deploying catalytic capital to mobilize private sector financing in developing countries, which can be used to distill best practices and lessons learned to date. Trailblazers, particularly the MDBs (e.g., IFC) and DFIs (e.g., FMO), should be leveraged; in particular, their portfolio, presence, and capacity to pool assets and risk transfer should be optimized. Efforts to identify best practices and lessons learned, through case studies and other research efforts, can advance the field towards more effective and efficient uses of blended finance approaches. Further, there is a great opportunity to scale existing approaches and solutions.

Coordination Is Improving the Market

Blended finance practitioners are coordinating to improve the blended finance market, including scaling existing approaches and solutions. In 2017, both the OCED-led donor group and the IFC-led DFI working group agreed upon principles for blended finance as it relates to their development activities. The two sets of principles seek to improve the effectiveness and efficiency of blended finance in contributing towards achieving the SDGs, as well as encouraging transparency and information sharing among practitioners. These groups are now seeking ways to coordinate and harmonize their principles. In addition, initiatives like the ECOSOC Forum on Financing for Development also support and inform the policy agenda around scaling best practice blended finance approaches.

Donor partnerships and multi-donor funds continue to be important tools for coordinating blended finance and private sector mobilization efforts, most commonly around specific themes such as infrastructure and climate finance. While there is certainly room to refine these models, the Multilateral Investment Fund, GCF, and the Global Environment Facility are valuable tools for deploying pooled catalytic funding in a coordinated and consistent way to mobilize private sector capital.

Healthy Skepticism Still Exists

There are still policymakers and development practitioners that hold earnest reservations about the potential and opportunity costs of blended finance. A non-exhaustive list of outstanding concerns includes:

- **Debt sustainability:** Developing country governments and organizations may take on unsustainable contingent liabilities or risks that cannot be adequately managed
- **National ownership:** There is a greater need to engage with host countries at the strategic level, to ensure that priorities in project portfolios align with national priorities
- **Extreme poverty:** Insufficient focus on least developed countries, including the need to design structures that respond to the specific needs of the most poor and vulnerable populations
- **Development impact:** There is limited availability of reliable evidence on the sustainable development impact of blended finance; blended finance project evaluations have not routinely been made publicly available
- **Aid effectiveness:** Any use of ODA should be held to the highest standards, including ensuring that aid is fully untied and effective in supporting private sector development in developing countries

These are important considerations and emphasize the value of establishing principles and best practices for deploying concessional capital to mobilize the private sector. Making progress on blended finance will mean moving from blended finance 1.0, where different forms of development capital are combined to increase efficiency and make projects more viable, to blended finance 2.0, where development

finance is used much more strategically to mobilize commercial capital at scale and target it towards a range of development issues and contexts. There is a strong and growing evidence base of blended finance transactions; the next step is to scale activities with data intelligence, adequate skillsets, harmonized benchmarks, and financial knowledge.

Blended Finance Is Not a Panacea

Blended finance is not a panacea for achieving the SDGs or eradicating poverty. Blended finance does not replace grant-based aid and humanitarian relief that have traditionally made up ODA, but complements aid to significantly increase financial resources for developing countries. Traditional grant-based interventions remain critical, particularly for the poorest and most vulnerable. These populations continue to be the costliest to reach and progress, where achieved, is fickle and at the greatest risk of reversal. Rather, blended finance holds the potential to mobilize additional sources of development finance to scale development impact and relieve public resources to be concentrated on interventions that address the poorest and most vulnerable.

It is important to note that blended finance can only address a subset of SDGs that are investable. Blended finance can play a critical role in stretching scarce resources for: i) development interventions with a proven track record, ii) private sector development interventions (e.g., microfinance, SME finance), and iii) transitioning and graduating countries across income levels. According to analysis conducted by the Sustainable Development Solutions Network, approximately half the funding required to achieve the SDGs in developing countries can be in the form of private investment. Blended finance can be leveraged where the recipient of the funding can generate cashflows to repay/remunerate the funding.



It's Time for a Vision

Now that blended finance is mainstream and practitioners are coordinating, it is time for a vision. The UN, OECD, G7, G20, and many MDBs and DFIs have articulated meaningful, positive positions on blended finance, with philanthropic foundations demonstrating an interest and ability to deploy catalytic capital. An increasing number of blended finance transactions are successfully attracting commercial capital, in part due to a rise in interest in blended finance from impact investors as well as large institutions with sustainable or responsible investing portfolios. While these transactions represent a drop in the bucket compared to global financial markets, it demonstrates the potential for commercial capital to be mobilized towards the SDGs in developing countries if the right opportunities are created.

A vision for blended finance would i) accelerate the shift from fragmented activities to a common blended finance agenda, ii) promote collaboration and investment in successful solutions that have the potential to scale, and iii) increase potential for knowledge and data sharing and transparency. Convergence intends to convene a group of practitioners to create this vision in the coming months.

Next Steps

Convergence identifies the following next steps for enhancing and scaling blended finance transactions to mobilize greater flows of private sector capital towards the SDGs in developing countries:

- 1. Capacity building and training:** Practitioners need to meet commitments with capacity. Donors are best positioned to deploy high risk capital (e.g., grants, concessional capital) to absorb risks or improve the financial returns for private investors. But it is important that these instruments are deployed effectively and efficiently to avoid negative effects, like market distortion, and to optimize the use of scarce aid dollars. To enhance and scale blended finance, public and philanthropic funders require i) greater knowledge and capacity to invest in blended finance transactions and ii) the tools and instruments (e.g., repayable grants, guarantees) to invest catalytically.
- 2. Assets aligned to investor requirements and preferences:** The best opportunity to achieve scale will be to create assets for which institutional investors have the largest allocations, which include tradable fixed income products. Blended finance structures should also focus on producing capital market instruments like investment grade

notes and bonds that are listed and provide sufficient liquidity. It is valuable to engage institutional investors early and continuously in the design process to ensure blended finance transactions are aligned to their investment requirements and preferences.

- 3. Building markets:** Blended finance is a temporary bridge to support sector development and the regular flow of private sector investment to developing countries. Over time, projects will become more operationally efficient and private investors will gain comfort with these regions and sectors. In the short-term, market intermediaries – or market builders – are needed to help coordinate – or ‘bridge the gap’ – between the project sponsors, development funders, and commercial investors at the transaction-level. Initiatives such as Sustainable Development Investment Partnership (SDIP) and the Refugee Investment Network (RIN), as well as Convergence’s efforts around match-making, can serve as valuable resources for connecting organizations, building institutional capacities, and disseminating trends and best practices.
- 4. Ensuring developing country participation:** Beyond donors, it is also important to build the capacity of developing country governments and organizations to participate in and originate blended finance transactions. Too many blended finance solutions have been implemented without sufficient local involvement from developing countries. Good blended finance transactions require strong local input to ensure against market distortion and maximize likelihood of sustainability. Further, there is an opportunity for blended finance to support local capital markets, encouraging domestic capital mobilization and local currency investments rather than the continued influx of foreign-denominated currency investment.

- 5. Early-stage design funding:** There is a continued need for early-stage concessional capital. Despite the significant potential of blended finance, the reality is that most transactions involving public, philanthropic, and private investors are complex, time intensive, and highly costly to structure and launch. Efforts like Rockefeller’s Zero Gap initiative have proven to be catalytic and successful in mobilizing private sector finance. Early-stage capital is also required for innovative businesses and projects, which may be able to attract commercial financing in the medium- to long-term but require highly concessional capital in the short-term.
- 6. Data and knowledge:** Deeper and more actionable blended finance data is still required for both donors and investors. For donors, there is a need to develop data-driven benchmarks and frameworks around additionality, leverage, and impact outcomes. More research is also needed to better understand the role of blended finance in certain sectors (e.g., education, smallholder finance) and countries (e.g., fragile and post-conflict countries). For investors, there remains a paucity of return data on blended finance transactions – in particular target or actual return data for commercial tiers of capital in blended finance transactions. There is a need for greater transparency in the blended finance market to build the evidence base for institutional investors to justify participation. Trusted industry intermediaries can play an important role in collecting return data and impact metrics as well as reporting trends and benchmarks out to the market.



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