UP2030 Green Finance Guide

Blending Strategies

Co-funded by the European Union

Funded by the European Union. Views and opinions expressed are however those of the author(s) only and do not necessarily reflect those of the European Union or the European Climate, Infrastructure and Environment Executive Agency (CINEA). Neither the European Union nor the granting authority can be held responsible for them. This project has received funding from the Horizon Innovation Actions under the grant agreement n° 101096405.

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1. Structured Funds and Facilities

How is it provided: The combination of concessional funding (public or philanthropic funds) with full return private capital or investments in companies regular equity or bonds.

Value proposition: Structured funds offer different asset classes and cater to the development objectives of public donors and Development Financial Institutions (DFIs) and the investment objectives of private investors. Private investors benefit from the waterfall structure's reduced risk, enabling them to invest in sectors and regions with high development potential and higher perceived risk. Publicly funded donor agencies benefit from revolving or continuously using their funds for sustainable development. Further, structured funds pool money from various sources to invest in many different countries and sometimes sectors, enabling risk diversification and reducing the risk of losses.

***Examples of financial instruments and mechanisms used in this type of blending*:**
- Debt Funds
- Climate & Green Funds
- Multi-Donor Trust Funds
- Blended Finance Funds
- Revolving Credit Facilities
- Regional Development Facilities
- Outcome-Based Facilities
- Liquidity Facilities
- Sector-Specific Facilities
- Risk-Sharing Facilities
- Public-Private Partnership (PPP) Facilities
- Impact Investment Facilities
- Guarantee Facilities
- Pooled Grant Facilities

Examples of blending:
EU Regional Investment facilities: They combine grants funded by the European Development Funds (EDFs) and the EU general budget with loans, mainly from European development finance institutions. In some cases, direct contributions are also made by EU Member States.

Link to example: https://international-partnerships.ec.europa.eu/funding-and-technical-assistance/funding-instruments/european-fund-sustainable-development-plus_en

2. Insurance

How is it provided: Public or philantropic investors provide credit enhancement through guarantees or insurance below market terms and subsized concessional loans through below-market terms.

Value proposition: Insurance as an instrument "can reduce specific types of risk in transactions by transferring the risk of loss to the provider for a predefined premium". Insurance is used extensively in infrastructure projects and for mitigating climate risk. Insurance enables private sector confidence in contexts of higher political insecurity or commercial risks.

***Examples of financial instruments and mechanisms used in this type of blending*:**
- Political Risk Insurance (PRI)
- Microinsurance
- Re insurance
- Parametric Insurance
- Currency Risk Insurance
- Weather Derivatives
- Risk Layering with Insurance
- Catastrophe Bonds
- Resilience Bonds

Examples of blending:
African Reinsurance Corporation, Nigeria

In 2014, the World Bank Group and the African Reinsurance Corporation (Africa Re) entered into a Global Index Insurance Facility (GIIF), an agreement to carry out a risk-sharing venture to decrease premium levels for insured farmers and encourage local companies to create affordable insurance products.

Under the agreement, the facility reimburse insurers who experience more than a 75 percent annual loss ratio, thereby decreasing the cost borne by primary insurers. As a result, insured farmers benefit from lower premiums and local insurers and reinsurers are encouraged to expand their agriculture insurance books.

Link to example: https://www.cfocoalition.org/blueprints/p3-3-3-mapping-examples-of-corporate-blended-finance

3. Grants

How is it provided: Grants are typically provided by public (national or international) or philanthropic funders as non-repayable capital to support early-stage development, de-risk investments, or fund specific project components. They may be disbursed directly to recipients or intermediaries and can be combined with other instruments such as concessional loans or equity to attract private investment.

Value proposition: Grants can be critically important for the development of a project pipeline, especially in less mature sectors and riskier geographies, creating significant crowding in of private capita. For example, loan products are often subsidised through the provision of technical assistance and margins for investors continuously decrease. The provision of small ticket sizes or favourable loan conditions can, however, lead to a high level of development additionality for the instrument.

***Examples of financial instruments and mechanisms used in this type of blending*:**
- Concessional Grants/ Interest rate subsidies
- Technical Assistance (TA) Grants
- First-Loss Grants
- Output-Based Aid (OBA) Grants
- Endowment Grants
- Project Development Facility (PDF) Grants
- Debt Buy Down Grants
- Innovation Grants
- Matching Grants
- Emergency Response Grants
- Pooled Grant Facilities
- Social Impact Bonds (SIBs) – Outcome-Funding Grants
- Convertible Grants

Examples of blending:
Sistema bio, Mexico

Sistema.bio is a Mexican company that develops biodigesters, which turn animal waste into biogas, a clean and renewable energy, as well as biofertilizer. Since its founding, in 2010, the company has maintained a blended capital structure, attracting grants, concessional debt and equity, and private investments to achieve international scale, including completing a bridge financing round in 2020.

Sistema.bio, Colombia: Capital Structure
- Grant: $3 million*
- Equity: $12 million
- Seed: $0.5 million
- Series A: $7 million
- Bridge: $4.5 million (convertible)
- Series B: $10+ million (target)
- Debt: $5.5 million

* Shell Foundation, both repayable and nonrepayable

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4. Loans and debt financing instruments

How is it provided: Debt instruments for blending finance offer efficiency by allowing the borrower to meet a unified set of requirements instead of dealing with multiple lenders individually. They enable large amounts of capital to be borrowed and reduce lenders' default risk by spreading it among multiple parties.

Value proposition: Debt instruments for blending finance aim at a more efficient sharing of risk, both in geographical as well as in institutional terms. In development finance, multilateral development banks often act as lead arrangers, aiming at encouraging private participation in the loan. The implicit assumption is that private investors would not participate without the involvement of a MDB or other sovereign entities. Private investors are assumed to benefit from a range of de-risking measures, better monitoring systems and the preferred creditor status of MDBs.

***Examples of financial instruments and mechanisms used in this type of blending*:**
Debt Instruments:
- Concessional loans
- Subordinated Debt
- Senior Debt
- Mezzanine Financing
- Local Currency Loans
- Bonds
- Syndicated loan
- Performance-Based Loans
- First loss debt (Catalytic Capital)
- Convertible Debt
- Debt -for- Nature Swaps
- Outcome -Linked Debt

Examples of blending:
In 2019, the European Investment Bank (EIB) made a EUR 490 million loan to Terna to improve the reliability and quality of the electricity grid in Italy. This disbursement brought the EIB's outstanding loans to Terna to EUR 2.15 billion.

The loan, which has a longer term and lower costs than those available on the market, is part of Terna's financial structure optimization policy and is in line with the EIB's main financing activities in the energy and environmental fields.

The loan was disbursed in two fixed-rate tranches, each with a maturity of around 22 years. The first tranche drawdown was made in June 2020 for EUR 147 million, with a fixed rate of 0.717 percent. The second tranche drawdown was made in March 2021 for EUR 343 million at a fixed rate of 0.78 percent.

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5. Loans and debt financing instruments (additional)

How is it provided: CLFC can be provided through four possible instruments: equity, wherein the provider takes the most junior equity position; grants, which may be converted into debt or equity; guarantees, to cover a set amount of the losses; and subordinated debt, wherein the provider takes the most junior debt position (Bouri and Mudaliar, 2013[10])

Value proposition: This instrument refers to a socially and environmentally driven credit enhancement provided by an investor or grant-maker who agrees to bear first losses in an investment in order to catalyse the participation of co-investors that otherwise would not have entered the deal. The value proposition to providers includes accelerating impact, optimising resources and achieving better terms for investees. CFLC can be a way to demonstrate to other investors the viability of a project for market development. It can also be a longer-term investment to gain leverage for impact. For their part, recipients benefitting from first loss capital can better meet their investment obligations and gain a competitive advantage over other funds or businesses.

***Examples of financial instruments and mechanisms used in this type of blending*:**
Catalytic First Loss Capital (From Public Sector)

Examples of blending:
In 2020, IDB Invest closed an equity investment in Cargo X, Latin America's largest trucking freight digital platform. Cargo X leverages technology and data to connect large shippers with small carriers in Brazil. IDB Invest invested $9.9 million on its own account and $4.5 million with blended finance resources from the Climate Investment Funds (CIF).

The CIF investment includes an incentive mechanism to give shares back to the company's stock option plan upon the achievement of certain milestones, supporting the company's commitment to the development of a robust methodology to measure the greenhouse-gas-emissions reductions derived from its business model through load consolidation and route efficiency.

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6. Guarantees

How is it provided: Credit guarantees are most commonly used for company-level blended finance, as they guarantee the repayment of principal and interest on corporate loans or bonds. Public or philanthropic investors provide credit enhancement through guarantees or insurance below market terms and subsidized concessional loans through below-market terms.

Value proposition: With guarantees, a guarantor agrees to pay part of or the entire value of a loan, equity, or other instrument in the event of non-payment or loss of value. By reducing risk, the instrument can attract more risk-averse investors. Guarantees are attractive blended finance instruments because they optimise the use of public funds, as these funds are only disbursed in the case of actual losses.

***Examples of financial instruments and mechanisms used in this type of blending*:**
Guarantees:
- Partial or full credit guarantee
- Partial Risk Guarantees
- Surety Bonds
- First Loss Guarantees
- Counter Guarantees
- Performance/ Outcome-based Guarantees
- Political Risk Guarantees
- Currency Exchange Guarantees
- Contingent Recovery Guarantees
- Liquidity Guarantees
- Guarantee Facilities

Examples of blending:
Mixta, Nigeria

Mixta Nigeria is a leading real estate development company in Nigeria, with operations in residential, commercial, retail, and leisure real estate. In 2016, to raise long-term financing for the development of its affordable housing strategy, the company issued a bond for NGN 4.5 billion.

GuarantCo provided a guarantee of NGN 4.5 billion to improve the credit rating of the bond to a local AAA rating. Without GuarantCo's support, Mixta Nigeria's local bond rating would have been below the minimum threshold required by local insurance companies and pension funds to invest in private corporate bonds. Subsequently, in 2018, the company issued another two bonds for a total NGN 3 billion and obtained a guarantee from GuarantCo for the same amount.

Link to example: https://www.cfocoalition.org/blueprints/p3-3-3-mapping-examples-of-corporate-blended-finance

7. Outcome funding/ Results-based financing

How is it provided: In outcome-based blended finance, public or philanthropic entities invest in fixed-income instruments in which the financial and/or structural characteristics are tied to predefined sustainability or environmental, social, and governance (ESG) objectives. The objectives are measured through predefined sustainability KPIs and targets.

Value proposition: In using performance-based instruments, "a funder makes payments conditional on achievement of pre-agreed outcomes. The full payment is only received if the agreed-upon outcomes – i.e., measurable and independently verifiable social or environmental impacts – are achieved. performance-based instruments can be used for project preparation to bring a project to bankability. This can increase, directly or indirectly, the return realised by other funders.

***Examples of financial instruments and mechanisms used in this type of blending*:**
Instruments:
- Thematic Bonds
- Performance-based Loans
- Results-based incentives
- Performance-based grants / Output-Based Aid (OBA) Grants
- Impact -Impact-linked loans
- Climate resilience Credits
- Social Success Notes
- Conditional cash transfers
- Program-for-Results (PforR) Financing
- Payment by Results (PbR) Contracts

Examples of blending:
In 2018, Quantum Terminals Group, a local fuel and energy infrastructure developer in Ghana, raised a local currency bond for $10 million to expand business operations. This bond received a partial guarantee from GuarantCo to help attract financing from domestic institutional investors.

GuarantCo's partial guarantee (75 percent), priced at 3.5 percent per annum, covered debt servicing amounts owed by Quantum Terminals to the bond investors. Capital structure:
- senior debt: $10 million
- partial guarantee: 75 percent on principal and interest
- target return: 22.25 percent per annum

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8. Equity Financing

How is it provided: Private equity provides companies with liquidity outside conventional finance and supports early-stage companies and innovative ideas through investments like venture capital.

Value proposition: Equity investments provide long-term growth capital that private enterprises in developing and emerging markets often lack. Equity financing is risk-absorbing, so it allows companies to pursue riskier, higher-growth strategies. Moreover, equity financing provides investors the opportunity to influence the investee firm and its decisions from inside. In this sense, equity instruments deployed directly in companies, or indirectly in financial institutions or investment funds, can be efficient tools for raising and blending capital and achieving high additionality.

***Examples of financial instruments and mechanisms used in this type of blending*:**
Instruments:
Private equity

Examples of blending:
In 2016, the Asian Development Bank (ADB), the Global Agriculture and Food Security Program (GAFSP), and the International Finance Corporation (IFC) made an equity investment in Mountain Hazelnuts, a private sector enterprise that promotes hazelnut production by contracting with small farmers across Bhutan. IFC and ADB each invested $3 million of equity, which was matched by a $6 million investment by GASFP. As a social enterprise, Mountain Hazelnuts is committed to supporting low-income farmers, providing them with trees and other critical resources and guaranteeing them offtake of all their nuts and a floor price.

Link to example: https://www.cfocoalition.org/blueprints/p3-3-3-mapping-examples-of-corporate-blended-finance