CONVERGENCE
BLENDING GLOBAL FINANCE

Designing Blended Finance Vehicles

Learnings from Convergence's Design Funding Program

April 2021

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Executive Summary

This report offers a selection of key learnings from grantees of Convergence's Global Emerging Markets Design Funding Portfolio, funded by Global Affairs Canada. Convergence's design funding program provides early-stage grants to develop innovative blended finance structures that look to mobilize private capital for sustainable development at scale. Since its inception, Convergence's Global Emerging Markets Window has supported over 18 solutions, awarding just over $6 million to vehicles that have mobilized over $650[1] million in total capital to date. Within this report, Convergence aims to provide guidance for blended finance practitioners seeking to develop and launch investment structures at scale. Key questions framing this report include:

i) What factors have contributed to the success of design funding recipients as they design, structure, fundraise, and launch blended finance vehicles?

ii) What are the primary barriers faced in bringing early-stage blended vehicles to market? What are the key pivots in the process?

iii) How can findings from Convergence's design funding grantees better equip blended finance practitioners to launch vehicles and support market-wide learnings?

This report summarizes learnings across four stages of the design process: Structuring, Fundraising, Investment Activity, and Impact Reporting. Key learnings are summarized below:

Structuring	Fundraising
• Engage with funders early in the design process to streamline structuring and avoid delays downstream • When transitioning from desk research to the field, feasibility studies can help to validate initial risk assumptions in the local context • New stand-alone blended finance structures are not always needed; seek partners where applicable • In the absence of market benchmarks, consider collecting data before structuring concessional capital in your financial model • Allocate time and resources to ensure structures fit the reglatory environment	• Intermediaries play a key role managing stakeholder engagement • To accelerate the fundraising process and demonstrate credibility, it is helpful to partner with brand name anchor investors • To simplify structuring and avoid delays, identify the non-negotiables of various parties early-on • Build buffer time into the design process and manage launch expectation accordingly
Investment Activity	**Impact Reporting**
• Where possible, tap into the networks of existing institutions • Establish a local presence • Identify pipeline during structuring activities	• To measure impact meaningfully, develop metrics and reporting practices alongside structuring activities

[1] All $ is in USD unless otherwise indicated.

Methodology

This report is supported by information collected through the following channels:

i) **Survey responses** from 15 Convergence grantees

ii) **Interviews** with a sample of 6 Convergence grantees, selected to reflect the diversity of Convergence's Design Funding portfolio, with grantees varying by stage of development (pre-launch vs. post-launch), region, vehicle type, and sector

iii) **Secondary research** using documentation gathered by Convergence over 2016-2020

iv) **Desk research**

Convergence grantees include a variety of organization types, including advisory firms, investment management firms, non-profits, and fund managers. Convergence grants are used to support the design and development of blended finance structures (e.g., funds, projects, facilities etc.).

Convergence does not invest directly in the blended finance structure (i.e., participate in the capital stack), and grantees can be, but are not always, the deal sponsor. To see the full list of grantees in Convergence's Design Funding Portfolio, please visit Convergence's website **here**.

Introduction

Convergence's design funding program provides early-stage grants to develop innovative blended finance structures that look to mobilize private capital for sustainable development at scale. Convergence's unique market acceleration program identifies, supports and helps launch innovative blended finance structures that are additional to the market, while also showcasing the potential for scale and replicability. Given the early-stage nature of these vehicles, Convergence's grantees are at various stages in the development process; while some have launched and are starting to scale, others are completing design, structuring, and fundraising activities. The process for launching blended finance structures can be lengthy, given their unconventional structures, focus on relatively new markets, and complex stakeholder negotiation processes.

This report aims to provide a selection of key learnings based on the experience of grantees from Convergence's Global Emerging Markets Design Funding Portfolio, in an effort to provide guidance for blended finance practitioners looking to develop and launch vehicles at scale. Key questions guiding this report included:

i) What factors have contributed to the success of design funding recipients as they design, structure, fundraise, and launch blended finance vehicles?

ii) What are the primary barriers faced by bringing early-stage blended vehicles to market? What are the key pivots in the process?

iii) How can key learnings from Convergence's design funding grantees better equip practitioners to launch blended finance vehicles?

Note to readers: This report has taken a holistic approach and does not reflect the unique challenges presented by COVID-19 to grantees.

Design Funding

In 2015, Convergence was established as an independent not-for-profit corporation to serve as a global network for blended finance. In 2016, it received operational funding support from Global Affairs Canada (GAC) as well as funding for its inaugural design funding window, now known as the Global Emerging Markets Design Funding Window. Through this window, Convergence supports the design of blended finance solutions across the UN Sustainable Development Goals (SDGs) and across all emerging markets. Since its inception, Convergence's Global Emerging Markets Window has funded over 18 solutions, awarding just over $6 million for the design of blended finance structures that have mobilized over $650 million in total capital to date. This includes both transactions that have launched and those currently undergoing design stage activities.

In November 2019, Convergence launched two additional design funding windows focused on blended finance solutions in Asia-Pacific: i) the Indo-Pacific Design Funding Window, funded by the Australian government; and ii) the Asia Natural Capital Window, funded by the RS Group, a family office in Hong Kong.

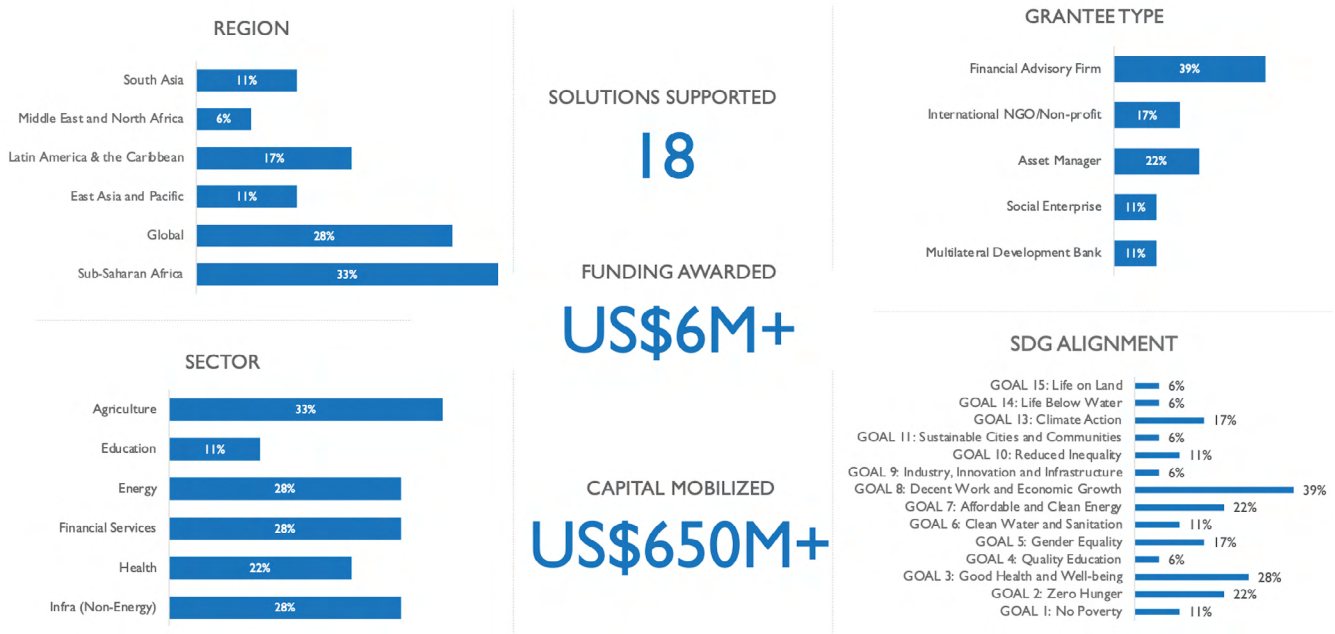


Figure 1: Convergence's Global Emerging Markets Design Funding Portfolio

39%

OF CONVERGENCE DESIGN STAGE GRANTS

have targeted the energy sector, mirroring overarching blended finance trends.

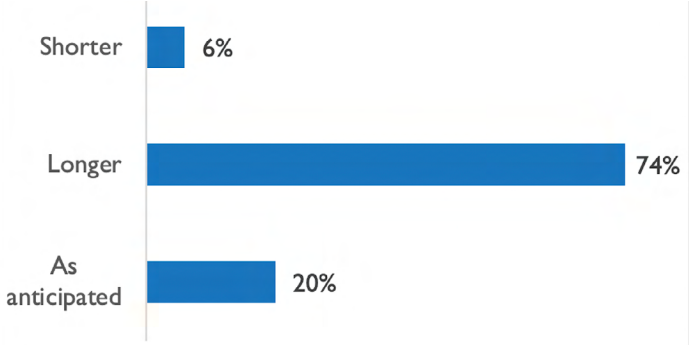
These windows are currently open for application. While Convergence has made grant awards through these two windows, these have not been covered in this report. Blended finance solutions supported by Convergence have ranged across a scope of sectors, vehicle types, and geographic regions (see Figure 1 of Convergence's Global Emerging Markets Design Funding Portfolio). Blended finance solutions funded through Convergence's Design Funding program have most commonly targeted the energy sector (39% of solutions supported), mirroring overarching blended finance trends. However, certain sectors, including agriculture (33% of solutions), health (22% of solutions), and education (11%), have been more prevalent in Convergence's Emerging Markets portfolio relative to the overall market, speaking to the benefits of early-stage funding in supporting underrepresented sectors. Convergence has most frequently funded solutions targeting Sub-Saharan Africa (33% of solutions), which reflects historical blended finance market trends.

Design funding has been used to address a broad set of objectives, both at the feasibility study level (22% of grantees) and at the proof-of-concept (67% of grantees) level, with 11% of grantees receiving both types of grants. While some grantees are further along in the design process and have used grant funding to support targeted activities prior to launch (e.g., sourcing legal and /or regulatory counsel to secure approvals), other grantees are earlier in the design process and have drawn on funding to conduct a broad range of activities. These have included market scoping (e.g., mapping target value chains, sourcing investee pipeline), developing and finalizing the financial model, establishing the legal and governance structure, and providing the necessary buffer time required when fundraising.

Section I: Structuring

Given the novel nature of blended finance vehicles, design funding grantees often undergo a lengthy process to complete design and structuring activities. Blended finance structures can be relatively complex, involving multiple types of investors from across the public, private, and philanthropic sectors, non-standard capital structures, and relatively higher risk profiles. This often results in longer and more unpredictable launch times compared to more traditional financial structures.

Has the design and structuring process taken shorter/longer than anticipated?



How long did design & structuring take (or is anticipated to take)?

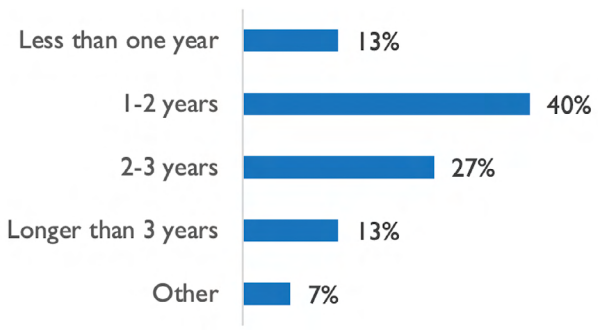


Figure 2: Design & Structuring Survey Results, 2020

Based on survey responses, the majority (70%) of grantees reported that structuring activities took longer than anticipated. Most respondents reported that structuring extended for time periods ranging from 1-3 years; 40% of respondents cited 1-2 years, while 27% cited 2-3 years. A further 13% noted that the time spent structuring transactions exceeded 3 years.

Factors Influencing Design and Structuring Timeline	% Responses
Market Assessment / Scoping	20%
Identifying Investment Pipeline	20%
Structuring Concessional Capital	60%
Navigating Regulatory Environment	27%
Identifying Legal Structure / Governance	27%

Figure 3: Convergence Survey Results, 2020 (Note: respondents could select multiple options)

Designing and structuring blended finance vehicles can include a variety of activities, including developing the appropriate use of concessional capital to mitigate risks, market scoping to assess demand, and establishing the appropriate legal structure and governance model.

According to survey respondents, the most salient factors influencing the design and structuring process can be separated into three activities:

1	Structuring Concessional Capital	2	Navigating Regulatory Environment	3	Identifying the Legal Structure

These activities are explored further below.

Structuring Concessional Capital

The cornerstone of a blended finance transaction is the presence of concessional capital, which is used to adjust the risk-return profile of an investment opportunity to an acceptable level for commercial investors. This includes, for example, concessional debt or equity in the capital stack, guarantees and / or risk insurance, and technical assistance funding. However, there is no one-size-fits-all solution for structuring concessional capital, which includes considerations such as: determining the use (e.g., what risks to cover, including political / country, liquidity, and FX risk), degree of subsidy (e.g., % of first loss), and type of instrument (e.g., concessional debt or equity vs. a guarantee). Moreover, concessional capital must be appropriate within the specific context of the transaction to ensure additionality and avoid market distortion (See Annex 1 for more information on how Convergence assesses for additionality).

Given the lack of transparency on levels of concessionality within the market, Convergence found that grantees often revisited the appropriate level of concessional capital needed, as the structure evolved over the design process. Determining levels of concessionality is also often dependent on donor appetite. For example, while one grantee revealed that a transaction was originally structured with a 20% layer of first loss protection, the subsequent fundraising experience indicated that the availability of that kind of capital was extremely limited in the market, and the structure was revised to require a smaller proportion (5%). Meanwhile, another structure aimed at fundraising from primarily institutional investors initially targeted a 9:1 leverage ratio of commercial to concessional capital, but this ratio was later revised to 4:1 which was deemed more feasible.

Key Learnings:

- **Engage funders early in the design process to streamline structuring and avoid delays downstream:** Blended finance practitioners should engage with funders during early concept development, well before producing term sheets. Survey responses and interviews with design funding grantees emphasized that structuring concessional capital is often an iterative approach and must be designed with the terms and requirements of funders and investors in mind. Investors and donors alike are governed by specific mandates, including risk appetites, geographic limitations, and the types of investment instruments deployed. Discussions with grantees demonstrated that it is often easier to develop structures in line with these initial considerations than to amend the structure later in the fundraising process. As an instructive example, Women's World Banking Capital Partners II (WWBCPII), a tiered blended fund, was structured early on to include an equity-participating debt tranche to accommodate one of its anchor funders, U.S. International Development Finance Corporation (DFC, formerly OPIC). At that time, DFC did not have the authority to invest equity; as a solution, WWBCPII was structured to incorporate a debt tranche that ranks pari passu to the Class A equity tranche.

- **When transitioning from desk research to the field, feasibility studies can help validate initial risk assumptions in the local context:** Feasibility studies can help to test theoretical blended finance models, including the applicability of the type and size of concessional financing to its target market. As shared by one grantee, "We had a theoretical concept in place. Design funding allowed us to evolve our blended finance solution into something concrete that is tested in the market." Clean Energy Work's PAYS for Clean Transport model, which aims to scale the deployment of electric public transportation, serves as an instructive example here. The model is based on the **Pay As You Save mechanism** first used for energy efficiency upgrades in buildings, but in this case, it aimed to leverage utility companies' lower cost of capital relative to that of bus service providers, to raise money and purchase electric buses. Bus service providers would then deploy the buses and pay tariffs to the utilities for their provision of electricity as fuel. Design funding provided by Convergence allowed Clean Energy Works to conduct a **feasibility study** which revealed market barriers to implementing the model in Lima, Peru. As a result, the PAYS for Clean Transport would need to amend the structure to include access to concessional capital given the insolvency of bus services providers and local utilities. Drawing on these initial findings, Clean Energy Works continues to look to implement its model in a market that is better positioned given the above barriers.

- **New stand-alone blended finance structures are not always needed; seek partnerships where applicable:** Where possible, blended finance practitioners should leverage existing partnerships and capabilities of other blended vehicles to reduce structuring time. For example, the Climate Finance Facility (CFF) was housed within the Development Bank of Southern Africa (DBSA) to benefit from institutional support and access existing concessional capital. This arrangement also simplified the fundraising process; one of the Facility's core funders, the Green Climate Fund, could only provide funding to **Accredited Entities**. Given DBSA is an Accredited Entity, CFF was able to circumvent a fundraising barrier. Likewise, the Facility for Agriculture Finance in Africa (FAFINA), led by the African Development Bank (AfDB) and IDH (The Sustainable Trade Initiative), will partner with Farmfit to leverage its technical assistance facility, effectively reducing the need to create an additional technical assistance fund.

Key Learnings:

- **In the absence of market benchmarks, consider collecting data before structuring concessional capital:** A lack of market benchmarks may make it difficult to determine how much concessional financing is appropriate your blended model. Here, data collection can serve a vital purpose. **Aceli Africa**, a catalytic market facility that offers financial incentives to lenders who provide financing to agricultural SMEs in East Africa, is an instructive example. Given the lack of data on the economics of lending to agricultural SMEs, it was challenging to identify appropriate blended finance interventions to incentivize lending. Aceli Africa conducted significant financial benchmarking with partner lenders, collecting data from over 31 lenders to date. This data enabled Aceli Africa to tailor its use of concessional financing to address three purposes: i) first loss coverage for partner financial lenders, ii) financial subsidies in the form of origination incentives, and iii) technical assistance funding. As Aceli Africa shared with us: "Whenever possible, blended finance initiatives should be informed by market data. Where there is a lack of existing benchmarks, data collection can be a useful tool to inform design, create a level playing field, and reduce the risk of market distortion." Similarly, the lead implementers of **FAFINA** drew on design funding to calibrate the appropriate level of technical assistance needed for its facility based on other providers in the market.

Case Study Summary: Aceli Africa

Description: Aceli Africa ("Aceli") is a catalytic market facility offering concessional financing in the form of financial incentives to lenders that then provide commercial financing to agricultural small- to-medium enterprises (agri-SMEs) in Sub-Saharan Africa.

Market Barrier: Aceli Africa was conceived to address the mismatch between the risk-return hurdle of lenders and the demand for capital among agri-SMEs; while lenders are looking for larger loan sizes with a more attractive risk-return profile, demand for financing largely comes from smaller SMEs that are riskier and costlier to serve.

Use of Design Funding: Convergence awarded Aceli a grant to help finalize the facility's design, including developing financial incentives criteria, legal costs, and developing data and research partnerships.

Key Stakeholders: Dalberg, Global Development incubator (GDI), IKEA Foundation, Swiss Agency for Development and Cooperation (SDC), and USAID.

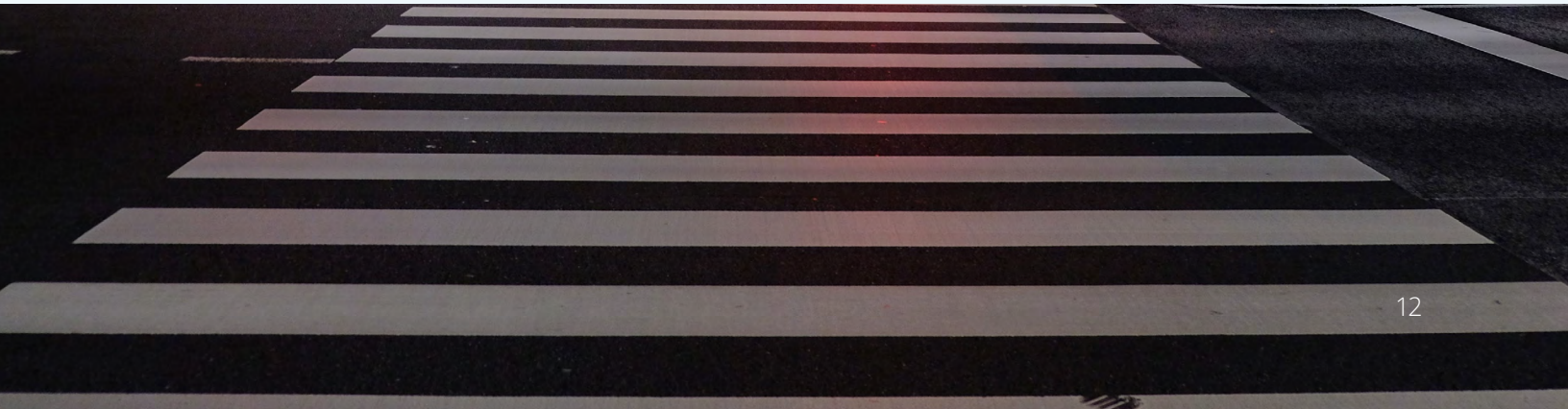
See Convergence's Aceli Africa Case Study **here**.

Navigating Regulatory and / or Legal Barriers

Blended finance transactions frequently involve the use of complex and new financial instruments, and innovative cost-sharing structures that may pose regulatory and / or legal challenges. Adapting to the local regulatory environment is a barrier, especially in sectors like WASH (water, sanitation and hygiene), health, and transportation, where products and services are most often delivered through public services. To address these barriers, grantees have typically drawn on design funding grants to consult with legal and / or regulatory experts to assist with contracting and to better understand the local regulatory environment. The processes for gaining regulatory approvals and structuring around local financial regulations can also be onerous and lengthy.

Key Learnings:

- **Allocate time and resources to ensure structures fit the local regulatory environment:** Grantees emphasized the importance of incorporating regulatory due diligence when selecting appropriate target markets and regions. This point is particularly salient for practitioners performing feasibility studies, where the operational context can look dramatically different on the ground compared to what was anticipated. For example, Clean Energy Works received a design funding grant to conduct a feasibility study for its PAYS model, which relies on the active role of local utilities and their regulatory framework (see Case Summary on next page). Though the PAYS program was structured as a utility investment, some still perceived it as a loan; consequently, PAYS could be subject to financial regulations rather than utility regulations. Regulatory fit should therefore be prioritized in line with other preferences, such as donor regional requirements. Grantees developing proof of concept have also benefitted from design funding to ensure blended finance meet local financial regulations, including hiring legal counsel where necessary. For example, as the first anticipated use of an Asset-Backed Security in Kenya, Total Impact Capital is using design funding to complete legal work, tax analysis and security documentation preparation to support the design of **IMFACT** (formerly known as SHIFT Kenya), a financial instrument that securitizes the invoices of major pharmaceutical distributors. Similarly, the **Green FIDC program**, managed by Albion Capital and Climate Policy Initiative (CPI), relied on design funding to ensure that the structure was ready for registration with the Brazilian Securities Commission and responsive to regulations in the Brazilian energy market. This was important given their innovative use of the FIDC (Portuguese for Green Receivables Fund); an existing capital market instrument traditionally used by companies in Brazil to raise capital by securitizing receivables. In a pivot from conventional practice, Albion Capital applied the FIDC instrument to raise capital for renewable energy projects.



Case Study Summary: Pay As You Save (PAYS) For Clean Transport Facility

Description: Clean Energy Works is designing a Pay As You Save® (PAYS®) for Clean Transport Facility. PAYS aims to reduce diesel emissions and combat climate change by accelerating the electrification of transportation – and is currently targeting an initial project for transit buses in a major Latin American city.

Market Barrier: PAYS aims to encourage the transition to electric bus fleets by capitalizing incremental upfront costs on the electric utility's balance sheet, thereby removing financing obstacles faced by local bus service providers in their transition to electric buses. PAYS aimed to attract private investment through a blended finance approach by using: i) first-loss capital to mitigate counterparty risk for investors, and ii) a reserve fund to cover any gaps in the utility's full cost recovery and bus service provider's operational savings (based on the transition from diesel to an electric fleet).

Use of Design Funding: Convergence awarded Clean Energy Work a feasibility study grant in 2018 to structure a PAYS Facility in Lima, Peru. Findings revealed market barriers in the Lima context, including the insolvency of bus operators and regulatory uncertainty. Going forward, Clean Energy Works is applying the learnings from its feasibility study to develop in the structure for a suitable market in Latin America, in partnership with the Zero Emission Bus Rapid-Deployment Accelerator (ZEBRA).

Key Stakeholders: Clean Energy Works (CEW), Inter-American Development Bank (IDB)

See Clean Energy Work's Feasibility Study **here**.

Section II: Fundraising

Blended finance transactions offer a path for investors from the public, private, and philanthropic sectors to work collaboratively to achieve their respective objectives. However, differing mandates, fiduciary requirements, and risk appetites can be a challenge when fundraising. Moreover, the novelty and complexity of blended finance transactions can cause delays in the fundraising process, as investors and donors require lengthier and more involved due diligence periods to become familiar with unconventional structures.

Design funding can play an essential role in supporting fundraising, by supporting operational costs for blended finance practitioners and providing the time needed to align different parties for long-term strategic partnerships.

How long did fundraising take (or is anticipated to take)?

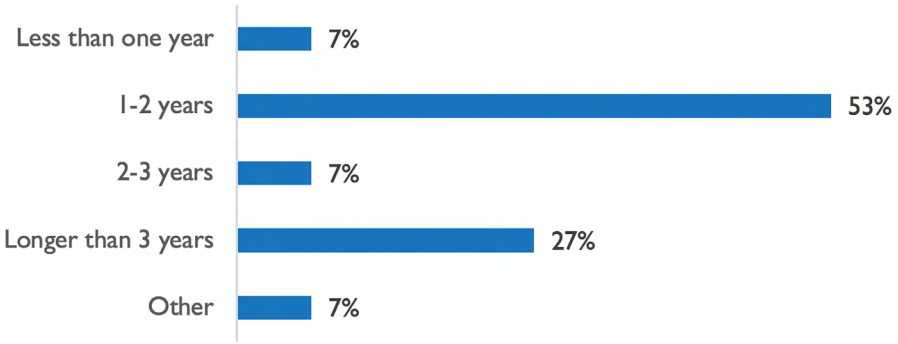


Figure 4: Convergence Survey Results, 2020

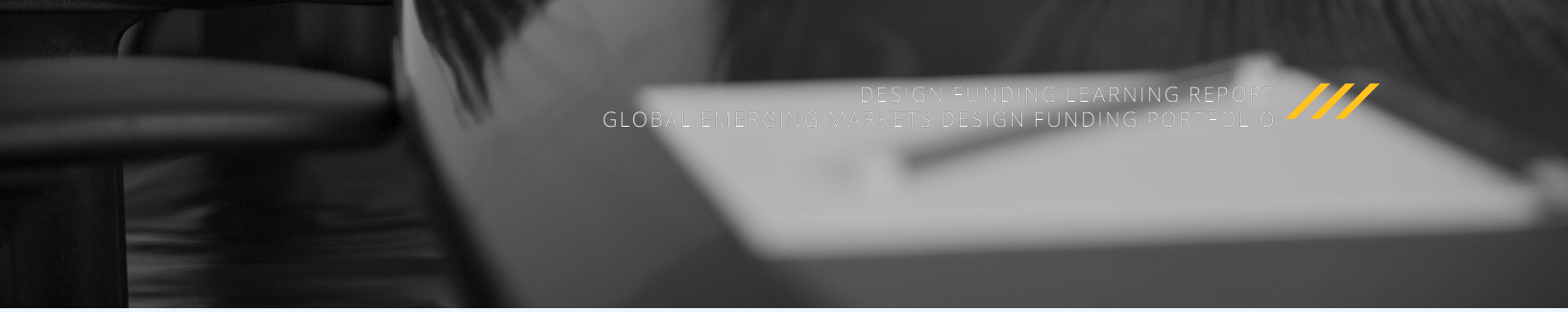
According to our survey, the majority of design funding grantees found that the fundraising process took 1-2 years (53%), while approximately a quarter (27%) said the fundraising period took longer than 3 years. This was the case for both traditional structures (e.g., funds) and more innovative, bespoke structures (e.g., development impact bonds). Moreover, 60% of respondents reported that fundraising took longer than expected, of which two factors were most salient:

i) Identifying anchor investors

ii) Negotiating terms / conducting due diligence

Factors Influencing Fundraising Timeline	% Responses
Identifying Investor(s)	20%
Due Diligence with Investor(s)	27%
Negotiating Terms with Investor(s)	27%
Other	26%

Figure 5: Convergence Survey Results, 2020



Attracting anchor (or first-in) investors was the main determinant of time-to-market, and grantees found this to be a major issue, whether they needed a commercial or a concessional anchor investor. Here, the processes for negotiating terms and conducting due diligence were particularly important, with 27% of respondents indicating either or both steps being particularly influential in the process.

Key Learnings:

- **Intermediaries play a key role in managing stakeholder engagement:** Blended finance structures often require continuous and extensive engagement with stakeholders. However, the human capital often required to manage the many relationships for launching a blended finance structure are sometimes difficult to find. A neutral third party such as an intermediary, who is not a direct funder or deal sponsor, can be uniquely positioned to support and align different parties. In this way, intermediaries reduce transaction costs and information barriers, and help support the gap between investor and investee to help structure and close deals. Services could include preparing financial, marketing, and legal documents, speaking to this significance, 38% of design funding grantees to date have been financial advisory firms. As shared by Aligned Intermediary, lead advisor to the **Climate Finance Partnership**, "to realize multi-stakeholder partnerships, it is necessary (but not sufficient) to assign and resource a trusted intermediary with the relevant financial and management skill sets".

- **Identify reputable anchor investors or partners; this lends legitimacy and can accelerate the fundraising process:** The presence of a known entity can be a powerful market signal for blended finance vehicles looking to attract follow-on funders. This is especially true for first-time fund managers without established track records. Examples of such partnerships include Aceli Africa and the Global Development Incubator (GDI), Climate Finance Facility and the DBSA, and Total Impact Capital and Cardano. For example, GDI was selected to incubate the design and launch of Aceli Africa. As a U.S.-based non-profit, GDI has extensive experience designing and incubating initiatives in blended finance and smallholder agriculture. In the latter case, Cardano partnered with Total Impact Capital to benefit from their expertise in new financial technologies and local capital markets. In addition to the advantages of name recognition, partnering with established partners can also yield access to developed institutional networks, development finance expertise, and advanced knowledge of local networks.

- **To simplify structuring and avoid delays, identify the non-negotiables of various parties early-on:** Core considerations and funding requirements like target country allocations or investment instruments, should be stated early and upfront. For example, WWBCPII revised its fund structure during fundraising to accommodate the geographic preferences of donors who were restricted to investing in certain regions. In this way, the Fund structure was adapted to include two subsidiaries for two different regional investment pools; one just for Sub-Saharan Africa investments, and one for Non-Sub-Saharan Africa investments. This complicated the structure of the Fund for the fund manager, WAM, and other investors with financial and legal implications. Likewise, blended finance structures should **account for key considerations** required by private investors within the structuring process.

Key Learnings:

- **Build buffer time into the design process and manage launch expectation accordingly:** Potential delays should be incorporated into the workplan given the lack of familiarity with blended finance structures and inevitable challenges in aligning diverse partners. Grantees spoke to the significant time required to explain aspects of the structures to potential funders. In addition to managing expectations amongst funders, investees are also impacted by the time of launch and should be communicated with accordingly. For example, investees in the agriculture value chain may need financing at a specific point in the season, such as during the harvest season. As one example, Convergence grantee ADM Capital Foundation invested a significant amount of time explaining the aspects of the blended structure that they were designing, the **Tropical Landscapes Financing Facility**, including the nature of USAID' Development Credit Authority (DCA) guarantee, to get private investors on board. Meanwhile Clean Energy Works found that more awareness, training, and capacity is needed for the PAYS model to succeed.

Case Study Summary: Tropical Landscapes Financing Facility (TLFF)

Description: TLFF aims to finance local projects and companies in Indonesia that are focused on green growth and sustainable rural livelihoods, in line with the Indonesian Government priorities, the Paris Agreement and the SDGs.

Market Barrier: The TLFF provides long-term financing for projects that improve access to rural electricity, reduce greenhouse gas emissions, and enhance smallholder farmers' livelihoods in Indonesia. In February 2018, TLFF completed its inaugural transaction, a landmark $95 million long-dated sustainability bond to finance sustainable natural rubber production across heavily degraded concession areas in the Jambi and East Kalimantan provinces. Michelin, the global tire manufacturer, will act as an offtaker of at least 75% of future production, and USAID's Development Credit Authority (DCA) provided a partial credit guarantee. The transaction is Asia's first corporate sustainability bond, with an innovative multi-tranche class structure that appeals to investors with diverse risk-return and tenor requirements. Class A notes, comprising $30 million, were rated Aaa by Moody's and subscribed by institutional investors from Southeast Asia, such as life insurance companies.

Use of Design Funding: Convergence awarded a proof of concept grant to ADM Capital and ADM Capital Foundation to help design and structure the initial TLFF deal pipeline.

Key Stakeholders: UN Environment Programme (UN Environment), World Agroforestry Centre (ICRAF), BNP Paribas, ADM Capital

See Convergence's Tropical Landscapes Financing Facility (TLFF) Case Study **here**.

Section III: Investment Activity

Many blended finance vehicles, including funds, facilities and bonds pool capital together for underlying investments, including investments in financial institutions, SMEs, and entrepreneurs. Overall, while most (57%) of respondents noted that identifying pipeline was as expected, 21% stated that identifying pipeline was more difficult than expected, and of these, 29% cited a lack of bankable opportunities as the key factor.

Was identifying pipeline (investible opportunities) easier / more difficult than expected?

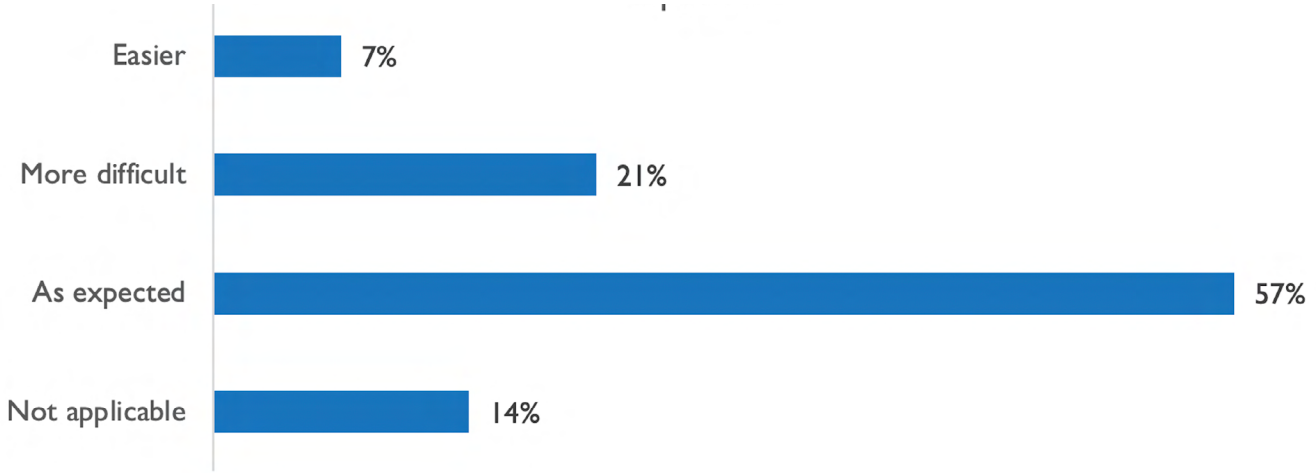


Figure 6: Convergence Survey Results, 2020

To address such challenges, design funding grantees have employed several strategies for sourcing investment opportunities, including working with partner commercial banks and development finance organizations. Grantees that experienced greater ease with market scoping and sourcing investment pipeline included those that either i) partnered with existing institutions (e.g., Climate Finance Facility partnered with DBSA), ii) were preceded by earlier structures (e.g., WWBCPII was preceded by WWBI), or iii) spent considerable time conducting market research early in the design process.

For most design funding grantees, sourcing investment pipeline was aided through either the support of a local office / investment team (71% of respondents), partner institutions (50%), or from existing deals (36%). In contrast, only 14% of respondents employed an open application process; likely due to the prevalence of funds (38% of grantees), which tend to use a closed process.

In general, the support provided through local teams and partners allowed has allowed design funding grantees to manage expectations when sourcing investment pipeline. In situations where prior blended finance solutions already exist, ensuring additionality by moving beyond existing investment-ready projects can require additional work. For example, during the design of the Climate Finance Facility, DBSA and the Coalition for Green Capital (CGC) benefited from partnerships with local commercial banks in South Africa (including all five major commercial banks - Standard Bank, Nedbank, ABSA Capital, Investec Bank, and Rand Merchant Bank) to source existing climate -friendly infrastructure projects. However, according

How were (or will) investment opportunities / pipeline (be) sourced?

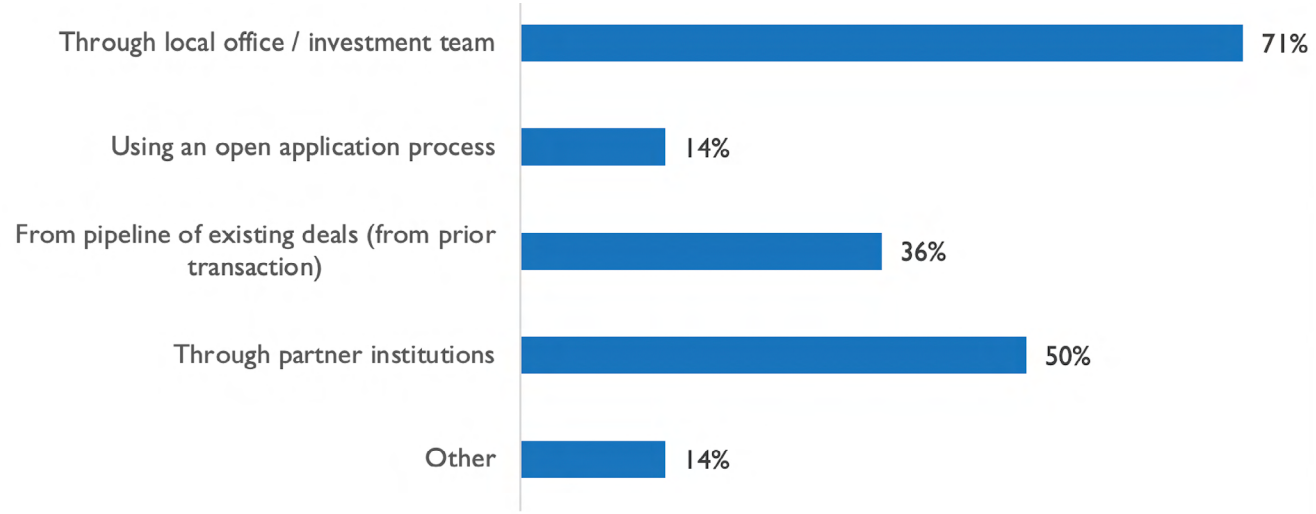


Figure 7: Convergence Survey Results, 2020

to CGC, it has been more challenging to replicate the green bank model in countries where commercial banks have constrained green lending capacity and project pipelines, and where potential deal flow is less developed. Similarly, another survey respondent shared that diversifying project pipeline beyond their first cohort of selected projects would be critical for fully implementing their broader mandate. This point was also made by a grantee in the agriculture sector, who noted that: "We know what type of entities we need to look for and what they need to be doing in order for us to reach our asset class – smallholder farmers and agri-SMEs. We will be increasing our niche to include the major players in the value chains (anchor buyers and anchor providers), to increase the ease and strength of the pipeline and ultimately service smallholder farmers." Other respondents highlighted how instruments like technical assistance can be used to increase investees' bankability and capacity, thereby boosting addressable demand while increasing their ability to conduct due diligence on investment opportunities.

Meanwhile, others raised related difficulties stemming from a lack of bankable underlying projects: while donors desire country diversification, the financial institutions and businesses in their respective sector(s) are concentrated in a small number of countries. More sophisticated commercial banking sectors with greater capacity and information on specific projects make the process of identifying pipeline easier, noted another survey respondent. Other considerations raised by survey respondents when sourcing pipeline included ensuring enough time to explain the structure of blended finance solutions to potential borrowers and prioritizing partner stakeholders with a track record and good governance pedigree. The COVID-19 pandemic has also surfaced a host of challenges in launching blended finance transactions, including difficulties traveling for on-site due diligence.

Key Learnings:

- **Where possible, tap into networks of existing instititions:** For example, blended finance vehicles like Climate Finance Facility, Aceli Africa, and FAFINA have partnered with local financial institutions to tap into existing investment pipelines. Deploying blended finance interventions across a market of existing financial institutions can increase competition and help catalyze market growth. Follow-on funds, which build upon the success of earlier structures, can target existing microfinance institutions (MFIs) already within their portfolio, effectively reducing the need for market scoping activity prior to launch.

- **Establish a local presence:** The majority of our survey respondents (71%) leveraged a local office or investment team for sourcing pipeline. A local team can deliver other advantages as well, including when fundraising. As one grantee shared: "The networks of local operators and dedicated country officers can be useful not just in sourcing underlying project pipeline, but also in sourcing local institutional capital."

- **Identify pipeline during structuring activities:** Grantees experienced fewer delays in sourcing investment pipeline for blended structures when these activities were incorporated into design funding activities. This allowed practitioners to adequately tailor risk-return profiles, design appropriate investment instruments, and ensure that there was sufficient demand for the vehicle amongst target beneficiaries. This is particularly necessary for newer vehicles that do not depend on an existing portfolio of deals or partner networks for pipeline. As shared by one grantee: "Pipeline is key when designing your financial products; you do not know what you can do unless you know the investment barriers."

"The networks of local operators and dedicated country officers can be useful not just in sourcing underlying project pipeline, but also in sourcing local institutional capital."

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Case Study Summary: Climate Finance Facility (CFF)

Description: The Development Bank of Southern Africa's (DBSA) Climate Finance Facility (CFF) is a specialized lending facility designed to increase private investment in climate-related infrastructure projects in the Southern African Development Community (SADC) region. The CFF is the first time the "green bank" model has been applied to an emerging market.

Market Barrier: The CFF will deploy capital to fill market gaps and crowd in private investment, targeting projects that are commercially viable but cannot attract market-rate capital from local commercial banks at scale without credit enhancement. The Facility will start by utilizing two main credit enhancement instruments: (i) long-term subordinated debt and (ii) tenor extension.

Use of Design Funding: Convergence awarded a Design Funding grant to the Coalition for Green Capital (CGC) in 2018 to support the DBSA with the design and launch of the Climate Finance Facility (CFF), including to support key business planning, market assessments, institutional design, pipeline development, capital recruitment from the GCF and other sources, and other activities prior to launching.

Key Stakeholders: Development Bank of Southern Africa (DBSA), Green Climate Fund (GCF), Coalition for Green Capital, Standard Bank, Nedbank, ABSA Capital, Investec Bank, and Rand Merchant Bank

See Convergence's Climate Finance Facility Case Study **here**.

Section IV: Impact

As indicated in **The State of Blended Finance 2020**, as donor governments, multinational development banks (MDBs), and development finance institutions (DFIs) increasingly look to blended finance as a tool for financing the SDGs, they are demanding improved impact measurement, reporting and standardization. Within the design funding survey, most respondents noted that they do, or plan to, collect impact data either on a quarterly (36%) or annual (36%) basis. None collect impact data on a monthly basis, nor do any plan to skip collection outright. Public disclosure findings from our survey match historical trends; 40% of the blended transactions captured within Convergence's historical deals database between 2014 and 2019 did not, at the time of financial close, intend to disclose impact reporting, and a similar proportion of survey respondents (36%) do not have plans to make impact reporting publicly available.

Frequency of Impact Reporting	% Responses
Monthly	0%
Quarterly	36%
Annually	36%
Not Determined	14%
None	0%
Other	14%

Figure 8: Convergence Survey Results, 2020

Most survey respondents chose to select impact metrics pre-launch (64%). This is often donor-driven as impact outcomes are a prerequisite for most funders. As relayed by one survey respondent, the impact potential of their initiative was key in securing interest from various stakeholders, including grant funders, investors, host government stakeholders, and regional bodies. Meanwhile, 14% of the survey respondents built out impact metrics during negotiations with capital providers or pipeline development. None waited until after the launch of the transaction. Respondents also expressed facing challenges in establishing impact

64%

OF CONVERGENCE SURVEY RESPONDENTS

chose to select impact metrics pre-launch; this is often donor-driven as impact outcomes are a prerequisite for most funders.

reporting processes for blended structures alongside other design considerations, and, consequently, the benefit of hiring impact consultants to support this process. "During the design process, we focused on establishing the viability of the structure first, rather than on reporting and monitoring. Now, as we're finetuning the structure, we're thinking of hiring a consultant who will be working with us on impact reporting."

The most frequent key impact metrics tracked and measured were the number of beneficiaries served (71% of respondents), the number of women served (64%), the number / amount of loans disbursed (64%), the number of jobs created (57%), and the amount mobilized / leveraged (50%). While these trends largely map onto historical blended finance trends, we saw an outsized focus on the number of women served amongst design funding grantees (64% amongst grantees compared to 15% in the market overall). Convergence has **previously advocated** the benefits design funding can provide in promoting gender equality, including through: i) aligning incentives, including linking financial returns and gender outputs ii) building good investment pipeline, iii) developing better gender methodologies, and iv) supporting transactions in markets with an underrepresented gender focus. Less prominent impact metrics captured by design funding grantees included sector-specific metrics like the number of smallholders financed (29%), the amount of clean energy generated / carbon offset (29%), and activity in low-income or frontier markets (29%).

Finally, as noted in the State of Blended Finance 2020, collecting gender-disaggregated data is a key step in developing evidence-based approaches for equitable development and assessing the impact of the blended finance market on women and girls; approximately one-third of all transactions (34%) in Convergence's database have reported gender-disaggregated data, suggesting that most transactions that report impact data also disaggregate findings by gender. Within the survey, most respondents (64%) stated that they do (or plan to) collect gender-disaggregated data post-launch. Meanwhile, 14% do (or plan to) collect gender-disaggregated data prior to launch, while 21% shared they do not (or plan to) collect gender-disaggregated data outright.

What key metrics are (or will be) measured?

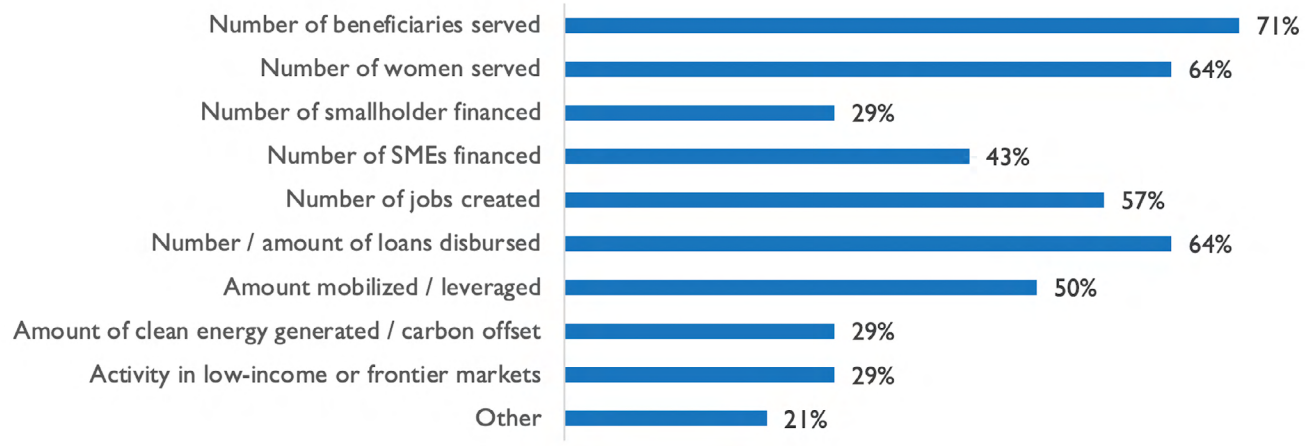

Figure 9: Convergence Survey Results, 2020

Key Learnings:

- **To measure impact meaningfully, develop metrics and reporting practices alongside your structuring activities:** As discussed above, grantees have made good progress in integrating impact measurement and gender considerations within blended finance structures to date. However, more work is needed to intentionally and comprehensively track impact. For example, grantees noted that certain impact metrics such as gender were not explicitly targeted in blended structures but were implicitly promoted by the nature of the sectors targeted (i.e., where women and girls are traditionally highly represented). Findings here included perspectives such as "We don't have a gender lens as we know the sector is gender sensitive and that a gender lens is embedded in the sector that we've targeted." Meanwhile, other respondents noted the difficulty of effectively encouraging gender targets within supported enterprises, particularly where the blending occurs where there is no direct contact with end beneficiaries: "The difficulty is that you cannot dictate to underlying investees that they hire a particular percentage of women. You can only assume that an increase in sales will mean that they hire more staff and more salespeople." One way in which grantees have addressed this is through tapping into grant funding. As one example, WWBCPII and Women's World Banking leveraged Convergence's design funding in part to develop their flagship **Gender Assessment Methodology** ("GAM"). An online self-assessment tool and outline of the GAM are publicly available to other investors and financial institutions to support market -wide learning on how to improve services to women and develop gender-diverse talent. A similar point was made by another survey respondent, who noted that due to the requirements of Convergence's design funding, impact metrics were considered throughout the investment process: during due diligence, during the investment decision-making, within the legal agreements negotiated with investees, and during the monitoring phase. Early-stage blended structures should take advantage of key opportunities presented during the design stage to better integrate gender considerations from the start.

Case Study Summary: Women's World Banking Capital Partners Fund II (WWBCPII)

Description: Women's World Banking Capital Partners Fund II (WWBCPII) is a blended fund that benefits from a layered capital structure, using first-loss equity, quasi-debt and technical assistance grants to attract commercial capital at scale. The Fund aims to close the 9% gender gap in women's access to financial services in the developing markets by enhancing women's access to financial services in order to build secure livelihoods. The Fund achieved a first close of $75 million in March 2020 and aims to raise a target final close of $100 - $150 million.

Market Barrier: WWBCPII was launched following the success of its predecessor fund WWBCPI, a traditional private equity fund. WWBCPII's fund manager, WAM, chose to create a blended finance structure for its second fund to fulfill two goals: i) expand its geographic presence to lower-income and fragile countries, especially in Sub-Saharan Africa; and ii) diversify its portfolio by investing in more products and services (e.g., specialty finance companies, digital financial products), as well by investing in earlier-stage companies.

Use of Design Funding: In April 2018, Convergence provided WWBCPII with design-stage funding to finalize its financial model and business plan, as well as to refine and further develop its existing gender assessments.

Key Stakeholders: DFC, Dreilinden, European Commission, European Investment Bank (EIB), German Federal Ministry for Economic Cooperation and Development (BMZ), Japan International Cooperation Agency (JICA), KfW Development Bank, Open Society Foundations, and USAID.

Conclusion

There are clear benefits of design funding to the development of innovative blended finance solutions, especially tied to increasing private capital investment at scale in emerging markets. By funding the completion of proof of concept and feasibility studies, design stage financing can support transactions that may otherwise be too risky or complex to pursue, particularly in nascent sectors in frontier markets, and can also be used to bolster impact objectives in blended finance solutions. This review has shown that, amidst the various challenges faced by design funding grant recipients – from developing investment pipelines to longer-than-expected structuring and fundraising processes – there are practical steps that practitioners can take to improve how their blended solutions are structured and launched.

As design funding grantees continue to operate in underfunded sectors and navigate the challenges brought forth by the COVID-19 pandemic, we hope that the learnings presented in this report can serve as an important reminder and resource for how design funding can be better deployed to support the design and launch of market-ready financial structures that have been developed to mobilize private capital at scale.

Annex I

Convergence's Evaluation Criteria for the Global Emerging Markets Window

Convergence considered the following factors when evaluating proposals for its inaugural design funding window:

- **Scalability and/or replicability:** How much private capital does the vehicle aim to catalyze? If the vehicle is successful, can other practitioners use a similar approach?
- **Demonstration effect:** Is the vehicle testing a never-before-tested design? Is it replicating an existing approach in a new market? Is the vehicle attracting partners that have not participated in the blended finance space before?
- **Development Impact:** How much social, economic, or environmental impact will the vehicle drive if successful?
- **Additionality:** Does the vehicle aim to deploy financial instruments that are under-supplied and will therefore catalyze financing with a high degree of additionality? Does the vehicle have strong potential to address a market failure in the short term, and catalyze broader market financing in the long term?
- **Stakeholder support:** Does the vehicle have the support of key stakeholders in the target region / country (e.g., government)?
- **Likelihood to achieve financial close:** Is the vehicle likely to attract investors and close within the short or medium term?
- **Contributions to portfolio and development risk-return:** How does the vehicle contribute to our mission and grant portfolio? Does the vehicle represent a strong development risk-return for Convergence (i.e., high risk vehicles should have the potential to achieve significant development impact)?

Convergence's Design Funding Application Process

Convergence employs an open-application process for its Design Funding Windows with applications accepted on a rolling basis. Practitioners are able to apply for two types of funding: feasibility study or proof of concept.

Convergence is currently accepting applications to the following Funding Windows: the Indo-Pacific Design Funding Window, funded by the Australian Government, and the Asia Natural Capital Design Funding Window, funded by the RS Group. To learn more about the focus areas of these windows and how to apply, please visit Convergence's website **here**.

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. This report offers a selection of key learnings from grantees of Convergence's Global Emerging Markets Design Funding Portfolio.

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