RESEARCH NOTE

SCALING BLENDED FINANCE FOR THE SDGS

DECEMBER 2019

EXECUTIVE SUMMARY

- It is well-known that to achieve the Sustainable Development Goals (SDGs) by 2030, a significant scale-up of financing is required. Blended finance is one important development tool for mobilizing additional financing for the SDGs.
- This Research Note identifies the SDGs for which blended finance solutions can be deployed in the short-term to mobilize additional investment at scale. The analysis considers the track record, standardization, and mobilization of blended finance transactions to date as well as the appetite for SDG projects across key stakeholder groups (e.g., donor governments, institutional investors).
- There are four SDGs that are "ready to scale" given more strategic coordination and use of concessional capital: Goal 7 (Affordable & *Clean Energy*), Goal 8 (*Decent Work & Economic Growth*), Goal 9 (*Industry, Innovation & Infrastructure*), and Goal 13 (*Climate Action*). There are additional SDGs with the high potential to scale.
- Ultimately, a nuanced view of scaling is required, which considers (i) the existing flows of capital for the SDGs, (ii) the role of an enabling environment in attracting private sector investment, and (iii) better coordination of public resources.

INTRODUCTION

It is well-known that to achieve the Sustainable Development Goals (SDGs) by 2030, a significant scale-up of financing is required. While additional financing is required from multiple sources, the SDGs present significant opportunities to leverage the expertise and resources of the private sector. However, private investors commonly cite (i) high perceived and actual risk and (ii) perceived low returns for the risk as barriers to investing in developing countries. Blended finance is a critically important approach to address these two barriers, and others, and mobilize greater volumes of private sector investment in the SDGs. Blended finance is a structuring approach that allows organizations with different objectives to invest alongside each other while achieving their own objectives (whether financial returns, social impact, or both).

Blended finance has emerged as a recognized development tool over the last decade. Convergence has compiled the largest database of blended finance projects implemented to date: around 500 blended finance transactions that represent $140 billion in aggregate financing. Certainly, blended finance to date has only scratched the surface of its potential to mobilize significant amounts of finance for the SDGs. The approximate $15 billion in annual blended finance flows to developing countries is a drop in the bucket compared to the potential resources available from global financial markets and capital markets (approximately $350 trillion and $220 trillion, respectively).

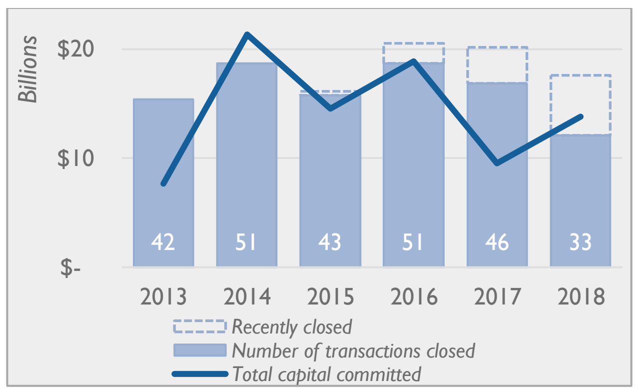

Figure 1: Growth of annual blended finance activities (2013-2018)

There has never been a more important time for blended finance. Official Development Assistance (ODA) from donor governments, development finance from MDBs and DFIs, and blended finance have all plateaued over the past five years. Meanwhile, the private sector has a growing appetite for sustainability and impact. The amount of assets under management seeking a positive outcome (e.g., impact investment, sustainable finance, responsible investing) is on the rise. The Global Impact Investment Network (GIIN) estimates that its members have $550 billion in AUM and the International Finance Corporation

(IFC) estimates that global demand for impact investment assets is close to $32 trillion. Blended finance can be strategically deployed to create investment opportunities in developing countries that are attractive to mainstream investors – mobilizing them to invest outside developed countries.

The key question is where can blended finance approaches be used to scale development impact and private sector mobilization? First and foremost, it is critical to understand that blended finance can only address a subset of SDG targets. Blended finance can only be used to finance development activities that generate revenues with which to repay investors an acceptable market-based return on capital. According to the Sustainable Development Solutions Network (SDSN), revenue-generating projects can account for approximately half the funding required to achieve the SDGs. Beyond basic compatibility to private sector investment, there is the key question of "scale". Increasing annual flows of blended finance to developing countries will require an increase in allocations of development capital and a higher level of coordination amongst development organizations.

This Research Note seeks to identify the SDGs for which blended finance solutions can be deployed to achieve development impact and mobilize private sector capital at scale. There are three parts to this analysis. The first part reviews historic and current alignment and trends in blended finance for the SDGs. The second part reviews similar SDG alignment mapping exercises to consider where there is greatest appetite from key blended finance stakeholders. The third part proposes four levels of alignment between blended finance and the SDGs: (i) those SDGs for which blended finance is ready to scale; (ii) those for which blended finance has high potential to scale; (iii) those for which blended finance solutions need additional innovation and/or evidence building; and (iv) those for which blended finance is not well aligned.

PART I: BLENDED FINANCE TRENDS

CURRENT ALIGNMENT & SCALE

To understand where blended finance has the greatest potential to scale, it is important to first understand where blended finance has been deployed to date. According to the Convergence database, alignment between blended finance and the SDGs, by number of blended finance transactions aligned to each SDG, is strongest for Goal 17 (*Partnerships for the Goals*), specifically Targets 17.3 (*additional financial resources*) and 17.17 (*effective partnerships*). Beyond Partnerships for the Goals, blended finance transactions have been most concentrated on Goals 9 (*Industry, Innovation, & Infrastructure*), 8 (*Decent Work & Economic Growth*), and 10 (*Reduced Inequalities*). This largely reflects sector trends: these three SDGs are broadly aligned to two sectors, financial services and infrastructure, where blended finance is most prominent. Notably, 62% of blended finance transactions have addressed Goal 1 (*No Poverty*), including Targets 1.2 (*reduce poverty*), 1.4 (*equal access*), and 1.5 (*build resilience*).

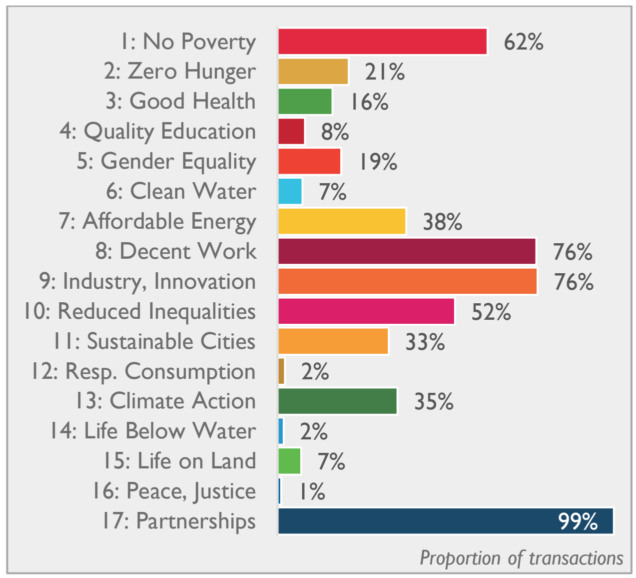

Figure 2: Alignment between blended finance and SDGs (2013-2018)

Current alignment suggests blended finance holds strong potential to support another two additional subsets of SDGs. First, blended finance has been demonstrated to be a good development tool for climate- and environment-related SDGs, including Goals 7 (*Affordable & Clean Energy*), 13 (*Climate Action*), and 11 (*Sustainable Communities*). Approximately one-third of transactions have focused on each of these three goals. Blended finance has also been demonstrated to be a potential development tool for Goals 2 (*Zero Hunger*), 5 (*Gender Equality*), and 3 (*Good Health & Well-Being*). Blended finance is still in innovation phases for Goals 4 (*Quality Education*), 6 (*Clean Water & Sanitation*), and 15 (*Life on Land*).

We can also look at aggregate financing (i.e., volume of capital) to each SDG (Figure 2). Between 2013-2018, aggregate financing has been greatest for Goals 9 (*Industry, Innovation, & Infrastructure*), 8 (*Decent Work & Economic Growth*), and 7 (*Affordable & Clean Energy*). Goals 13 (*Climate Action*) and 11 (*Sustainable Cities*) also account for a notable portion of aggregate financing from blended finance transactions. The smallest portion of aggregate financing is earmarked for Goals 16 (*Peace, Justice & Strong Institutions*), 12 (*Responsible Consumption*), and 14 (*Life Below Water*). Nonetheless, it is important to note that there have been a limited number of smaller-scale solutions for these goals (e.g., Sustainable Ocean Fund, Media Development Investment Fund).

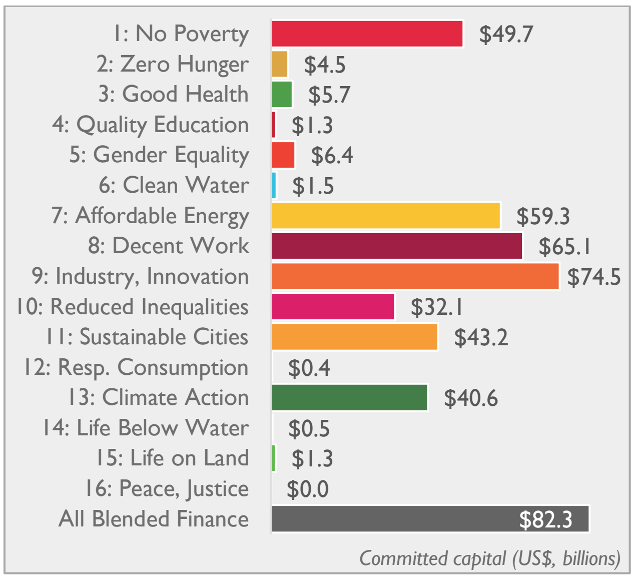

Figure 3: Aggregate blended financing by aligned SDGs (2013-2018)

SCALE & REPLICATION

The second consideration for determining scalability is where blended finance holds the potential to scale or replicate, particularly in terms of total size. Figure 3 presents the median blended finance project / transaction size, with median size across all SDGs at $60 million. Climate- and environment related solutions – including Goals 11 (*Sustainable Cities*), 7 (*Affordable & Clean Energy*), and 13 (*Climate Action*) – have been associated with larger total transaction sizes. This may reflect the volume of concessional and commercial capital earmarked for climate finance. It is also notable to see that blended finance transactions aligned to Goals 14 (*Life Below Water*), 15 (*Life on Land*), and 1 (*No Poverty*) have been relatively large in size versus the overall median, although the number of transactions has been limited.

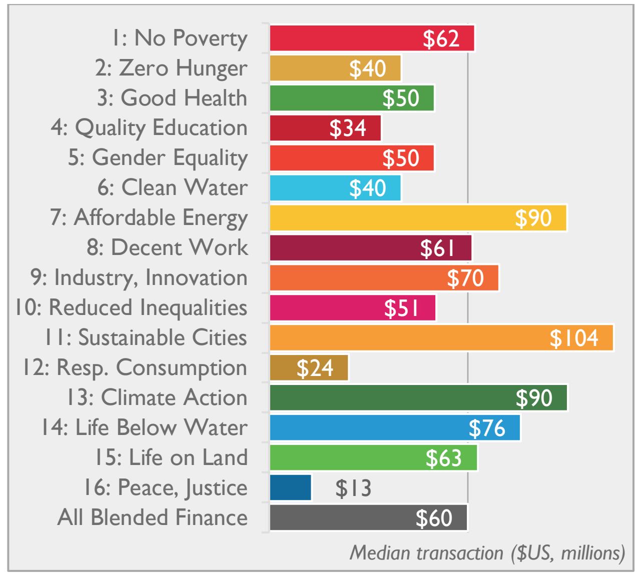

Figure 4: Median transaction size by aligned SDGs (2013-2018)

Standardization will also play a critical role in scaling SDG finance, facilitating the replication of smaller investments through pooling and/or lowering incremental transaction costs. Approximately half of blended finance transactions have been pooled vehicles (e.g., funds, facilities) that mobilize financing for multiple projects or companies. Figure 4 outlines the proportion of blended finance solutions for single companies / projects versus multiple companies / projects (i.e., pooled vehicles) by SDG. Blended finance transactions aligned to Goals 16 (*Peace, Justice, & Strong Institutions*), 14 (*Life Below Water*), 2 (*Zero Hunger*), and 4 (*Quality Education*) have been the most likely to be in the form of pooled instruments.

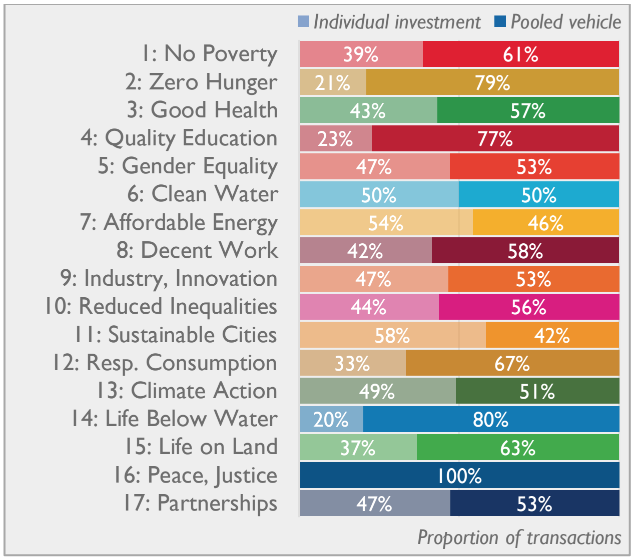

Figure 5: Proportion of commitments by aligned SDGs (2013-2018)

PRIVATE SECTOR MOBILIZATION

The third and final consideration for scalability is the degree to which blended finance has successfully mobilized mainstream investors. To date, blended finance transactions have most commonly mobilized private sector capital from corporates and financial institutions (see The State of Blended Finance 2019). Figure 5 describes the private sector segments mobilized through blended finance by each aligned SDG. Corporates have been most commonly mobilized to transactions aligned to Goals 6 (*Clean Water & Sanitation*), 14 (*Life Below Water*), and 3 (*Good Health & Well-Being*), while financial institutions to Goals 12 (*Responsible Consumption*) and 7 (*Affordable & Clean Energy*). It is also critical to mobilize institutional investors and tap the potential of global capital markets. The transactions that have most commonly attracted institutional investors have been aligned to Goals 2 (*Zero Hunger*), 1 (*No Poverty*), 8 (*Decent Work & Economic Growth*).

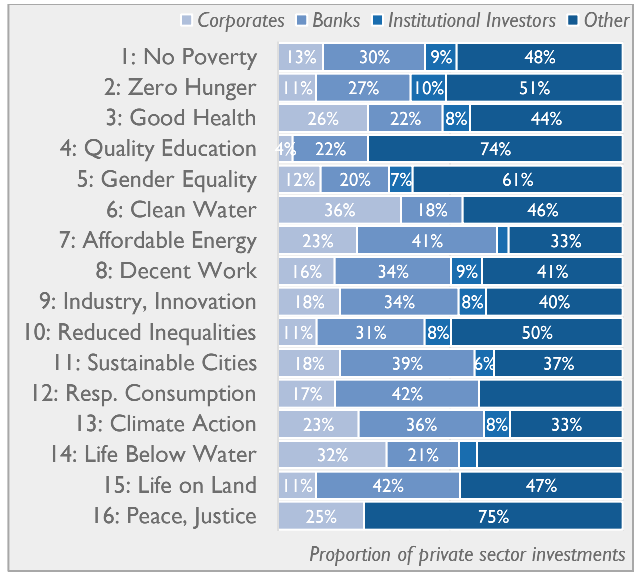

Figure 6: Private sector investors by aligned SDGs (2013-2018)

Leverage ratios can be used to measure the relative success of private sector mobilization through blended finance. Here, leverage is measured as the amount of commercial dollars mobilized by each dollar of concessional capital. It is important to note that mobilization ratios that measure the amount of private sector dollars mobilized is lower overall – since MDBs and DFIs act as commercial investors in many blended finance transactions. Initial analysis suggests that there is only minor variation in the average leverage ratios of blended finance across most SDGs. Figure 6 demonstrates that blended finance solutions aligned with Goals 14 (*Life Below Water*), 16 (*Peace, Justice, & Strong Institutions*), and 15 (*Life on Land*) have had slightly lower average leverage ratios compared to more cross-cutting goals like Goals 11 (*Sustainable Cities*), 5 (*Gender Equality*), and 1 (*No Poverty*).

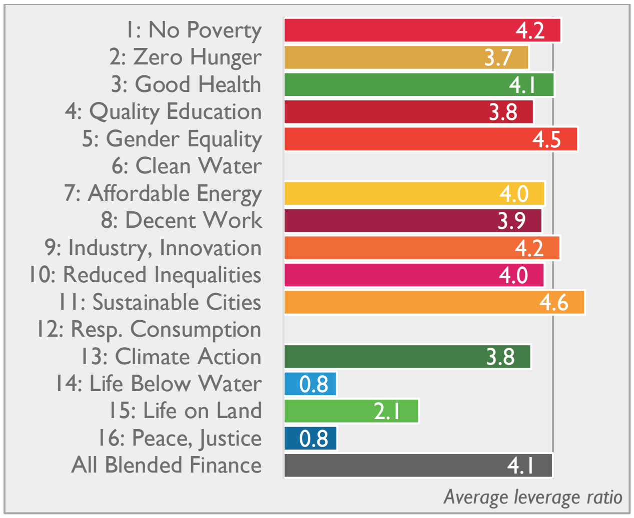

Figure 7: Average leverage ratios across transactions by aligned SDGs

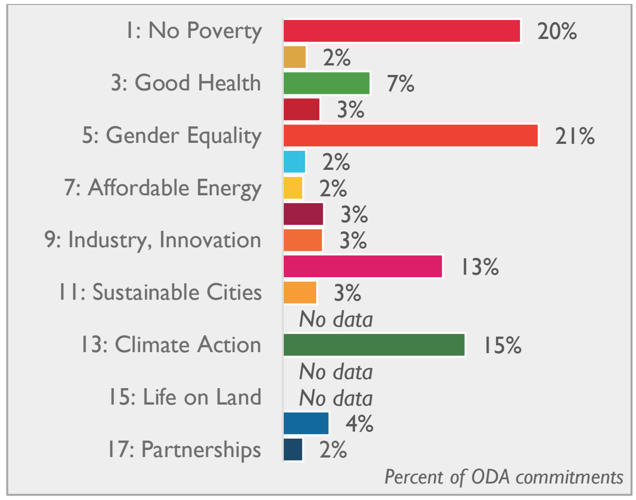

Figure 8: ODA commitments mapped to aligned SDGs (Source: EWB)

PART II: SDG ALIGNMENT TRENDS

OFFICIAL DEVELOPMENT ASSISTANCE

Official development assistance (ODA) is and will remain at the core of financing for the SDGs in developing countries, particularly the least developed countries (LDCs). The OECD Development Assistance Committee (DAC) members allocate approximately $150 billion per annum to developing countries.[1] According to analysis by Engineers Without Borders (EWB), ODA committed by the OECD DAC members in 2017 was most commonly aligned with Goals 5 (*Gender Equality*), 1 (*No Poverty*), 13 (*Climate Action*), and 10 (*Reduced Inequalities*). It is particularly notable to see the focus on Goal 5 (*Gender Equality*) in contrast to the above analysis on blended finance trends (*also see Blended Finance and Gender Equality*). A UNEPFI report (2015) found that ODA is most concentrated on the following sectors: economic infrastructure, health, and education. Blended finance has strong potential to leverage up, at scale, ODA dollars for Goals 9 (*Industry, Innovation, & Infrastructure*) and 11 (*Sustainable Cities*).

IMPACT INVESTORS

As noted above, the SDGs present a real opportunity for private sector investors to support high-impact projects that address critical global challenges. "Impact investors" have the intention to generate social and environmental impact alongside a financial return – and may even accept below-market financial returns to achieve their social mandates. Unsurprisingly, impact investors have embraced the SDGs, creating products, raising capital, and making new investments that directly target progress toward the SDGs. The GIIN's 2017 annual survey found that impact investors reported primarily tracking the performance of their investments with respect to Goal 8 (*Decent Work & Economic Growth*). Other commonly tracked goals include Goals 7 (*Affordable & Clean Energy*), 1 (*No Poverty*), and 5 (*Gender Equality*). These results are fairly aligned with the blended finance trends outlined above, although there is again an increased emphasis on Goal 5 (*Gender Equality*).

[1] The OECD DAC members can allocate ODA and non-ODA resources to blended finance. Convergence estimates that current allocations to blended finance are around 3-5% of ODA.

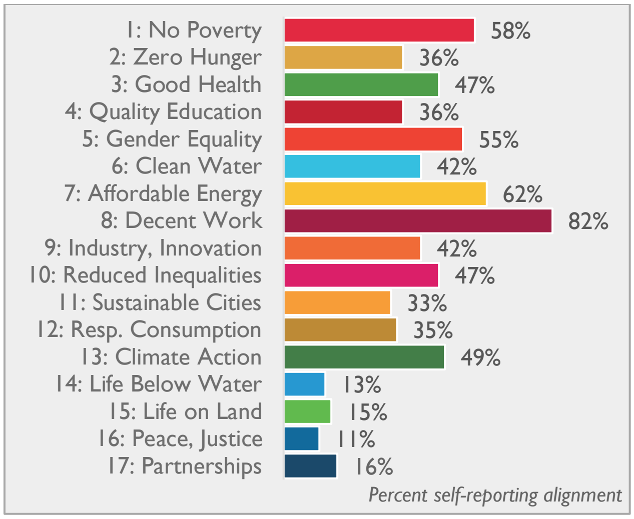

Figure 9: SDGs to which impact investors track (Source: GIIN)

COMMERCIAL INVESTORS

Beyond impact investors, blended finance holds the promise of tapping into global capital markets vis-à-vis mainstream investors. ShareAction examined how institutional investors perceive their alignment with the SDGs. 75% of institutional investors self-reported taking action towards the SDGs, with the largest proportion of respondents focused on Goals 13 (*Climate Action*), 5 (*Gender Equality*), and 7 (*Affordable & Clean Energy*). Similarly, a KPMG report found that corporates are also paying the most attention to Goal 13 (*Climate Action*), followed by Goals 8 (*Decent Work & Economic Growth*) and 3 (*Good Health & Well-Being*). This analysis does not capture investments in developing countries, but it can indicate the appetite of investors to SDG projects.

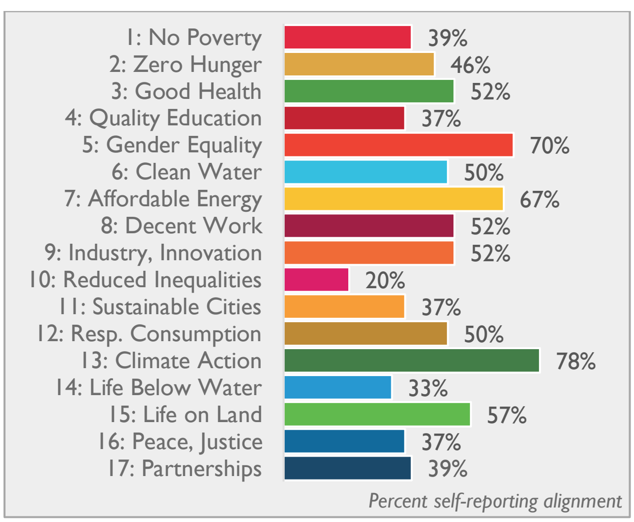

Figure 10: Perceived alignment to the SDGs (Source: ShareAction)

PART III: SCALING FOR THE SDGS

Blended finance practitioners across the public, private, and philanthropic sectors are increasingly coordinating to identify and scale blended finance solutions that have attracted additional private capital and achieved measurable development impact. There are broadly two ways to scale blended finance: increase the size or number of blended finance transactions. To date, there has been too much fragmentation across blended finance activities, especially in key areas such as infrastructure. There is a need to invest more in existing solutions; concessional capital providers should be careful to identify existing solutions before setting up new blended finance deals or initiatives. In some cases, new solutions will be required. Concessional capital providers should also consider where and how to replicate blended finance solutions for higher-impact sectors and countries.

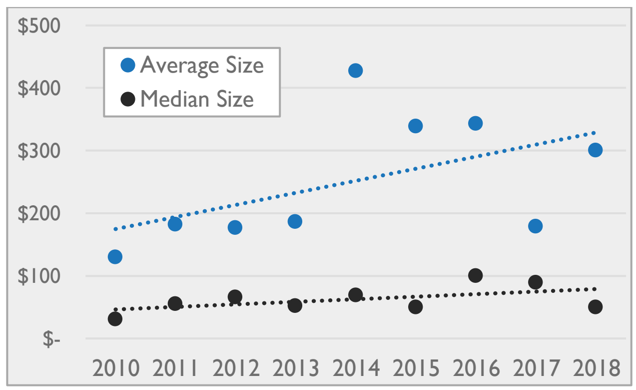

Figure 11: Average and median transaction size over time

Ultimately, the potential to scale blended finance varies across the 17 SDGs, according to (i) the pipeline of financeable projects and (ii) the existence of scalable models. This Research Note proposes four levels of alignment between blended finance and the SDGs in terms of the potential to scale in the short-term:

i) SDGs for which blended finance is well-aligned and there are "ready-to-scale" solutions,
ii) SDGs for which blended finance is well-aligned, but there is a need for more "ready-to-scale" solutions,
iii) SDGs for which blended finance has potential, but more innovation and/or evidence building is needed, and
iv) SDGs for which blended finance is not well aligned, especially for scale.

The scalability of blended finance for each of the SDGs is determined through analysis of historical blended finance trends and forward-looking attitudes around SDG financing. The first step (Part I) was to identify the SDGs where blended finance has established a track-record, potential for standardization, and mobilized private investors. Across these considerations, blended finance is best poised to scale for Goals 7 (*Affordable & Clean Energy*), 8 (*Decent Work & Economic Growth*) and 9 (*Industry, Innovation & Infrastructure*). The second step (Part II) was to identify where there is greatest appetite from key blended finance stakeholders for SDG projects. Goals 5 (*Gender Equality*) and Goal 13 (*Climate Action*) are high priority SDGs across a diverse set of organizations, including donors, impact investors, and commercial investors.

Ready to Scale	7 AFFORDABLE AND CLEAN ENERGY	8 DECENT WORK AND ECONOMIC GROWTH	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	13 CLIMATE ACTION
High Potential for Scale	1 NO POVERTY	3 GOOD HEALTH AND WELL-BEING	5 GENDER EQUALITY	11 SUSTAINABLE CITIES AND COMMUNITIES
Medium Potential for Scale	2 ZERO HUNGER	6 CLEAN WATER AND SANITATION	10 REDUCED INEQUALITIES	15 LIFE ON LAND
Low Potential for Scale	4 QUALITY EDUCATION	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	14 LIFE BELOW WATER	16 PEACE, JUSTICE AND STRONG INSTITUTIONS

Table 1: Alignment between blended finance and the SDGs by scalability

Based on the track record of blended finance to date and the appetite of capital providers, there are four SDGs that are "ready to scale": Goals 7 (*Affordable & Clean Energy*), 8 (*Decent Work & Economic Growth*), 9 (*Industry, Innovation & Infrastructure*), and 13 (*Climate Action*). For these SDGs, it is critical to focus on scaling, and replicating, existing blended finance solutions as well as tailoring these solutions for lower-income contexts. Importantly, there are another four SDGs where there is high potential to attract blended finance at scale: Goals 1 (*No Poverty*), 3 (*Good Health & Well-Being*), 5 (*Gender Equality*), and 11 (*Sustainable Cities*). Here, mainstreaming gender and impact measurement will be prerequisites to scale.

CONCLUSION

There has been a visible scale-up in blended finance activity over the past year. This is an important signal: increasing the volume and effectiveness of financing for the SDGs in developing countries will require greater allocations of development capital and a higher level of coordination among development organizations. Scale is one important consideration for progress towards "better blending" (also transparency, impact, etc.). This Conclusion offers several recommendations to concessional capital providers on actions for mobilizing additional private sector investment for the SDGs in developing countries *at scale*. These recommendations focus on actions that support scale in the short- to medium-term and are not universal recommendations for all blended finance activities.

1. Focus on portfolio approaches: Portfolio approaches are more effective for mobilizing additional private sector investment at scale because (i) only a small number of stand-alone projects are large enough and (ii) diversification across projects reduces risk for investors. Indicatively, rating agencies often provide a two-notch upgrade for a portfolio of well diversified investments (e.g., a portfolio of "B-" projects is enhanced to a "B+" through diversification).

2. Prioritize vehicles operating at scale: The median blended finance vehicle has been around $60 million in total size, disbursing an estimated $15 million per annum. To narrow the SDG financing gap, development organizations should allocate a healthy portion of catalytic funds (e.g., 50%) earmarked for blended finance to vehicles that have the capacity to disburse at scale (e.g., $100 million per annum), with the remaining blended finance budget allocated to smaller, more targeted interventions.

3. Support solutions that can attract institutional investors: Institutional investors represent the largest potential pool of additional capital for the SDGs, representing approximately $220 trillion in assets under management (AUM). Blended finance solutions that include a senior debt tranche at investment grade (e.g., "BBB") or strong non-investment grade (e.g., "BB+") are best able to appeal to the largest universe of prospective investors.

4. Collaborate and scale proven solutions: To date, the median blended finance vehicle has raised small and inefficient levels of concessional capital (albeit vehicles should be right sized to their target markets). Instead, catalytic capital providers interested in scale should shift away from creating new solutions and towards scaling up or refining existing solutions towards the two-fold objective of achieving development impact and mobilizing private sector capital at scale.

5. Identify "ready to scale" SDGs, sectors, and countries: Blended finance is not a panacea for achieving the SDGs, but rather a good development tool for a subset of development activities. The analysis in this Research Note suggests that there are at least four SDGs that are "ready to scale": Goals 7 (*Affordable & Clean Energy*), 8 (*Decent Work & Economic Growth*), 9 (*Industry, Innovation & Infrastructure*), and 13 (*Climate Action*).

In conclusion, a significant scale-up of financing is required to achieve the SDGs by 2030, blended finance has emerged over the last decade as one important tool for mobilizing additional sources of capital for sustainable development. And there has never been a more important time for blended finance, with plateauing levels of development assistance and a growing appetite from the private sector for sustainability and impact. Therefore, a key question is "where blended finance can be deployed at scale?" Ultimately, a nuanced view of scale is required; one that considers (i) the existing flows of capital for the SDGs, (ii) the role of an enabling environment in attracting private sector investment, and (iii) better coordination and maximization of scarce public resources.

METHODOLOGY AND NOTES

1. Convergence's database. Convergence maintains the largest and most detailed database of historical blended finance solutions 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. This Brief analyzes the alignment of 273 blended finance transactions launched between 2013-2018 with the 17 SDGs.
2. Calculation of SDG alignment: During data collection, Convergence codes the alignment of each transaction to one or more SDGs. This is based on qualitative assessment using keywords and the SDG sub-goals / targets.
3. Note on growth of annual blended finance activities: The dotted lines capture blended finance transactions that have recently achieved financial close but for which there is insufficient publicly available information to include in the Convergence database. Convergence continues to monitor these transactions and will add them to the database as soon as practical.
4. Note on leverage analysis: The data and methodology for Convergence's leverage calculations and analysis is outlined in our first data brief here. Note that this figure contains data beyond the five-year focus of the rest of the piece.
5. Comparative analysis: Part II reflects on additional mapping efforts in regard to financing for the SDGs. In most cases, the analysis describes different research parameters and cannot be directly compared. Rather, the analysis seeks to provide additional context on the positioning of blended finance and the appetite of some of its key stakeholders.
    a. Alignment of ODA: Figure 8 on the alignment between ODA and the SDGs is based on analysis by Engineers without Borders (EWB) Canada in *Canadian Aid & the SDGs: Prioritization, Resourcing & Influence* (October 2019). Read the report for additional information on alignment between ODA and the SDGs.
    b. Alignment of impact investing: Figure 9 on the alignment between impact investors and the SDGs is based on a survey of Global Impact Investing Network's (GIIN) members in 2017. Read *the Annual Impact Investor Survey 2017* for additional information on this survey and the resulting analysis.
6. Alignment of institutional investors: Figure 10 on the alignment between institutional investors and the SDGs is based on a survey of institutional investors by ShareAction. Read *Transforming Our World Through Investment* for additional information on this survey and the resulting analysis.
7. Additional analysis: This Brief builds on "Blended Finance & SDG Alignment", published in November 2018. Read the brief here for broader analysis on the alignment between blended finance and the SDGs.

ABOUT CONVERGENCE

CONVERGENCE is the global network for blended finance. We generate blended finance data, intelligence, and deal flow to increase private sector investment in developing countries.

BLENDED FINANCE uses catalytic capital from public or philanthropic sources to scale up private sector investment in emerging markets to realize the SDGs.

Our GLOBAL MEMBERSHIP includes public, private, and philanthropic investors as well as sponsors of transactions and funds. We offer this community a curated, online platform to connect with each other on blended finance transactions in progress, as well as exclusive access to original market intelligence and knowledge products such as case studies, reports, trainings, and webinars. To accelerate advances in the field, Convergence also provides grants for the design of vehicles that could attract private capital to global development at scale.

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