DATA BRIEF | DECEMBER 2024

Blending with Foundations

HIGHLIGHTS

- Within the past decade, foundations have played an important role in blended finance; since 2014, an average of 18% of blended transactions annually recorded in Convergence's Historical Deals Database (HDD) have included capital from at least one foundation.
- Convergence has recorded 236 blended finance transactions to date funded in part by foundations, totaling $24.2 billion in aggregate financing.
- Two-thirds of foundation investment commitments are concessional, indicating that foundations are largely using financial tools within the blended finance structure as a means of mobilizing commercial investors.
- Foundations also account for 15% of all concessional financing in deals where they are investors, which is equal to contributions by development finance institutions (DFIs) and multilateral development banks (MDBs).
- Funds are the preferred blended vehicle for foundations, accounting for 51% of all blended transactions partly funded by foundations.
- Transactions partly funded by foundations have a median deal size of $34.5 million, compared to $54.4 million for those transactions that do not have a foundation investor.
- The Shell Foundation (32 commitments), the Bill & Melinda Gates Foundation (31), and The Rockefeller Foundation (22) have the most concessional financial commitments, while the Omidyar Network (10), Shell Foundation (9), and Fundacion Netri (6) have the most commercial financial commitments.
- Challenges to foundations participating in blended finance include regulatory barriers, a lack of transaction standardization, and issues surrounding scalability.
- Opportunities to encourage foundation participation in blended finance include increasing the proportion of Sustainable Development Goal (SDG)-aligned investments in endowment portfolios; creating standardized investment frameworks; and focusing on high-impact areas to increase capital additionality.

CONVERGENCE
BLENDING GLOBAL FINANCE

Introduction

Within the past decade, foundations have played an important role in blended finance; since 2014, an average of 18% of blended transactions annually recorded in the HDD have included capital from at least one foundation. In the past three years, however, foundations have been proportionately less active, averaging 12% participation annually. One potential reason for this reduced activity is that since the COVID-19 pandemic, foundations may have begun shifting their focus to more local, rather than international, causes. However, given their ability to provide flexible capital, their focus on achieving impact, and their mission to catalyze big solutions to global challenges, foundations have the potential to play a larger role in blended finance.

In the HDD, there are examples of how foundations can be grant providers, catalytic concessional investors, and commercial senior investors. Overall, Convergence has recorded 236 blended finance transactions that include at least one foundation as an investor, totaling $24.2 billion in aggregate financing. Just over half of these transactions (122) have two or more foundations as investors (see Figure 1 below).

As shown in Figure 2, most foundations active in blended finance within the HDD (62%) are domiciled in the United States of America (U.S.). Therefore, while the analysis within this brief incorporates all foundations, the discussions on foundation structure and legal frameworks are mainly based on U.S. law.

To analyze how foundations invest in blended finance transactions, it is important to understand their investment strategies. Foundations start with a pool of capital called an endowment, which can be funded through donations from corporations or individuals. Most of the foundations investing in blended finance in the HDD (76%) are considered private, meaning they are funded through a single family or a small group of high net-worth individuals (HNWIs), such as the Bill & Melinda Gates Foundation (the Gates Foundation). Only 24% are the philanthropic branch of a corporation, like the Shell Foundation.

The funding within endowments can be risk-tolerant or risk-averse. The former is the means through which foundations provide concessional finance, by way of grants or through program-related investments (PRIs). A PRI is a type of

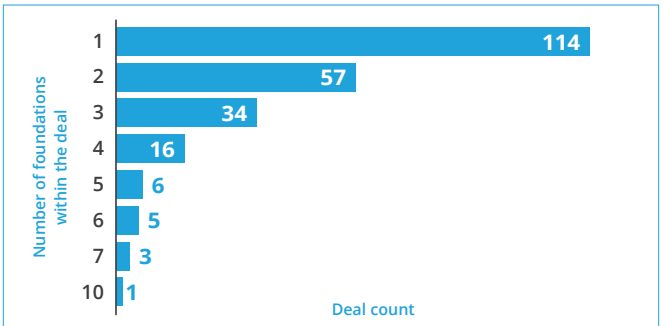

Figure 1: Number of foundation investors within blended finance transactions

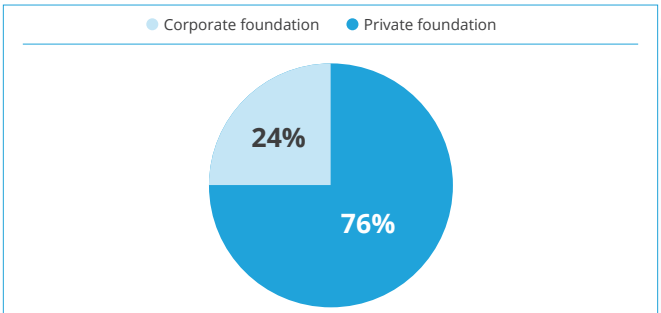

Figure 3: Breakdown of foundations that invest in blended finance by type

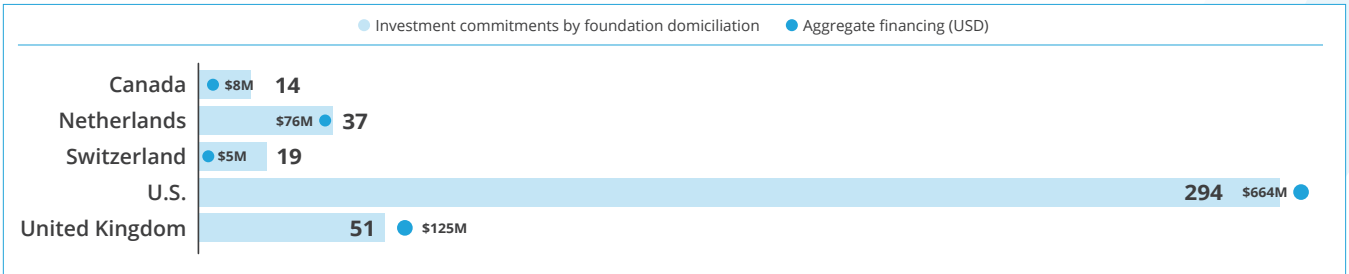

Figure 2: Foundation investment commitment count and aggregate financing by domiciliation

1 Data snapshot as of August 2024.

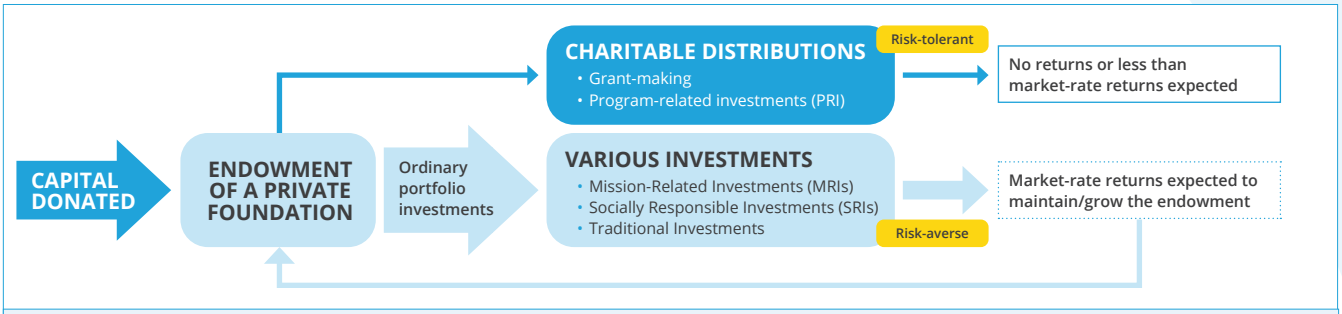

Figure 4: Typical structure of a foundation

financial instrument that is explicitly invested to further the impact mandate of the foundation, with all potential financial returns or value appreciation considered ancillary. The U.S. Internal Revenue Code (IRC) treats PRIs similarly to grants, in that they count against the foundation's minimum charitable allocation requirement to maintain their 501(c)(3) tax-exempt status, which is 5% of their endowment per year.

In contrast to other investments within their endowment portfolio, foundations do not expect PRIs to provide market-rate returns.

The other ordinary portfolio investments can take the form of mission-related investments (MRIs), or socially responsible investments (SRIs), which do not have legal definitions but can account for a significant proportion of a foundation's investment strategy. MRIs are typically investments in publicly traded companies with activities that are aligned with a foundation's charitable mission. Meanwhile, SRIs are investments in companies that adhere to good environmental, social, and corporate governance (ESG) practices. The final type of investment strategy within an endowment is traditional, commercial investments that are intended to earn market-rate returns. The combination of these return-seeking investments fund the foundation's PRIs and grants.

Foundations can therefore participate in blended finance by supporting different aspects of a transaction, whether through non-return seeking grants, concessional return-seeking investments such as debt or equity, or commercial investments. This brief analyzes how foundations have participated in blended finance transactions to date, presenting insights from an analysis of transactions within the HDD and interviews conducted with industry stakeholders.

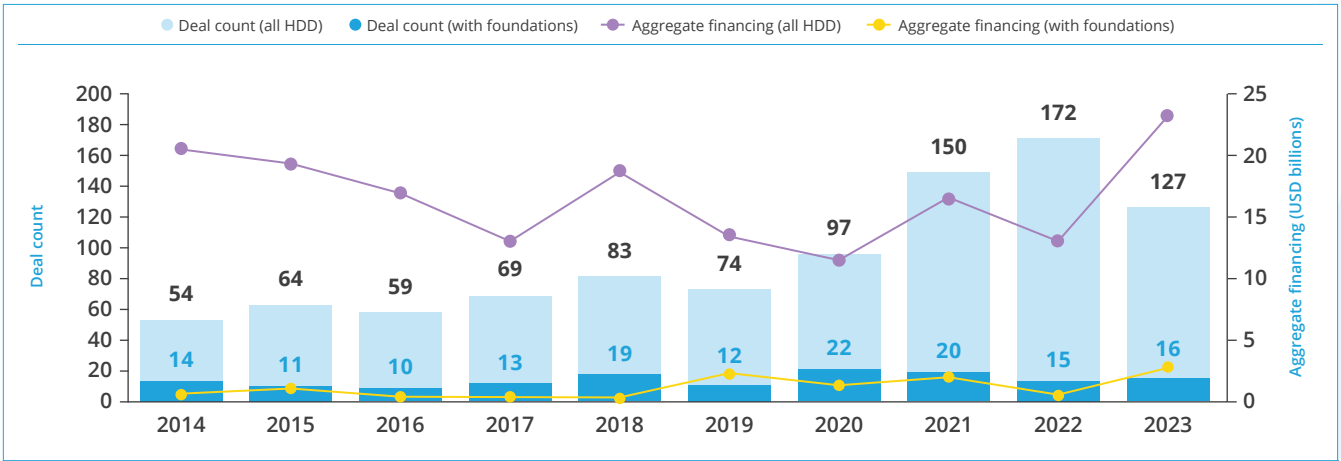

Figure 5: Annual deal count and aggregate financing of transactions with foundation investors and all transactions within the HDD, 2014-2023

Blending with Foundations: Analysis

TWO-THIRDS OF FOUNDATION INVESTMENT COMMITMENTS ARE CONCESSIONAL

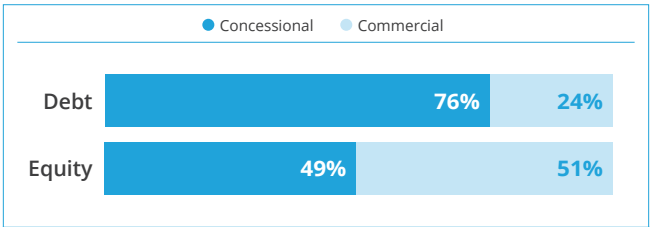

Figure 6: Percent of concessional vs. commercial debt and equity used by foundations in blended finance transactions

When looking at all foundation investment commitments to blended finance transactions within the HDD, 66% are provided on concessional terms and 34% on commercial terms. This indicates that foundations are largely using financial tools within the blended finance structure as a means of mobilizing commercial investors.

Foundations also account for 15% of all concessional commitments in deals with at least one foundation investor. This is behind development agencies, which account for 69% of concessional commitments, and on par with DFIs/MDBs. In terms of instrument usage, foundations prefer the use of concessional debt over commercial debt (76% vs. 24%), while equity financing is more equal between the two investment strategies.

Under the IRC, foundations are subject to excise taxes if underlying investments jeopardize the completion of any of its core mandates. Such investments are termed imprudent and explain the incentive for foundations to invest on commercial terms.

Beyond grant-making, should a foundation seek to make concessional investments, it must meet three tests to classify as a PRI:

- The primary exempt purpose test: The investment i) must forward the foundation's mission and ii) would not be deployed except for its potential to forward the mission.
- The no significant investment purpose test: The aim of the investment must prioritize impact generation, with expected financial returns considered an ancillary outcome. This test is automatically satisfied if the PRI is provided on concessional terms.
- The no political purpose test: The investment cannot influence legislation or intervene in any public office.

While some foundations, such as The Rockefeller Foundation, primarily operate using PRIs, the administrative burden may mean others choose to use them infrequently, if at all. Debra Schwartz, Managing Director of Impact Investments at the John D. and Catherine T. MacArthur Foundation ("the MacArthur Foundation"), suggests that some of the burden can be relieved by seeking legal counsel prior to using a PRI:

> *"If we support a blended finance transaction with a funded first-loss investment or unfunded guarantee, we need to determine whether this commitment would constitute a PRI or an MRI under applicable rules governing U.S. private foundation investing. This can affect the financing activities we can support and the type of reporting*

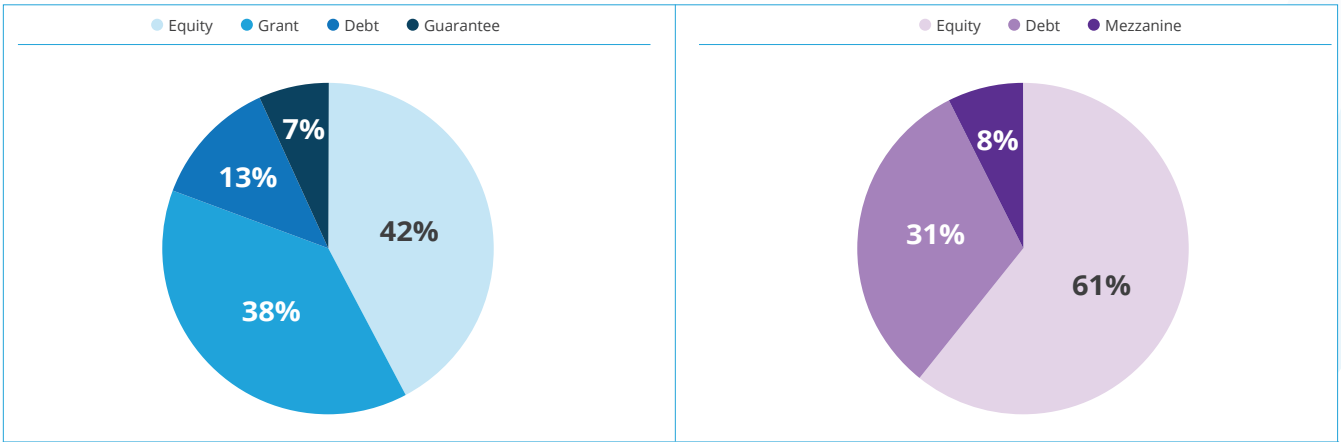

Figure 7: Percent of concessional financing (left) and commercial financing (right) used by foundations in blended finance transactions by investment instrument

2 While there were concessional investments made through mezzanine financing, these accounted for only 0.01% of total financing and are therefore not shown in Figure 6.

required. Our practice is to have a legal opinion on file at the time of closing, whether the commitment is funded or not. Our many reasons for doing this include having a clear classification of the investment in the event that a guarantee is drawn upon in the future."

Removing the ambivalence around the classification of an investment could aid foundations that may otherwise hesitate to use concessional financing.

Within the pool of concessional capital provided by foundations, grants account for 38% of the financing, while return-seeking investment instruments, including equity, debt, and guarantees account for 62%. This suggests that while the administrative burden may cause some foundations to hesitate to use PRIs, PRIs still account for over half of foundations' risk-tolerant capital within blended transactions.

Commercial investments, like concessional investments, see higher financing levels for equity (61%). Equity investments may allow foundations to have more influence over the strategic direction of a project or company, ensuring their values and mission align closely with the investment's outcomes.

FUNDS ARE MORE THAN TWICE AS FREQUENTLY USED IN TRANSACTIONS WITH FOUNDATIONS THAN WITHOUT

Funds are the preferred blended vehicle for foundations, accounting for 51% of all foundation-investor blended transactions. Funds are likely a popular vehicle choice because foundations lack the operational or regulatory flexibility to make numerous, smaller direct investments, such as through projects. Foundations may have fewer staff, or lower capacity for administrative overhead, and managing a direct investment into a project can be resource intensive. This is clearly shown within the HDD, as projects account for only 5% of transactions funded in part by foundations, compared to 34% of those that are not.

Meanwhile, funds offer a centralized investment vehicle, simplifying monitoring and due diligence. Maria Kozloski, Senior Vice President of The Rockefeller Foundation's Innovative Finance team, explaining the high use of funds, states,

"The Foundation often invests through intermediary or pooled vehicles (e.g. funds, platform structures, etc.) as these structures enable us to support and invest through local investment teams that are on-the-ground and have the capabilities to identify and advance a portfolio of high-impact investments. We can reach more companies through intermediary vehicles, assuming such vehicles exist that align with our goals and target strategy. We also make a handful of direct investments. These are typically a bigger lift for the Foundation and must be closely linked to the core of our goals, because we want to be good stewards of capital and best leverage the resources of our small team."

One of the largest funds supported by a foundation is the SDG Loan Fund, a $1.1 billion blended private debt fund launched in 2023 designed to increase institutional investor exposure to specific SDG-aligned investing. The fund benefits from multiple layers of risk protection, including a $111 million first-loss investment from the Netherlands Development Finance Company (FMO), which is credit-enhanced with a $25 million unfunded philanthropic guarantee provided by the MacArthur Foundation as part of the Catalytic Capital Consortium (C3) Initiative. The MacArthur Foundation's triple-A rated guarantee enabled FMO's first-loss investment by resolving key risk and technical factors.

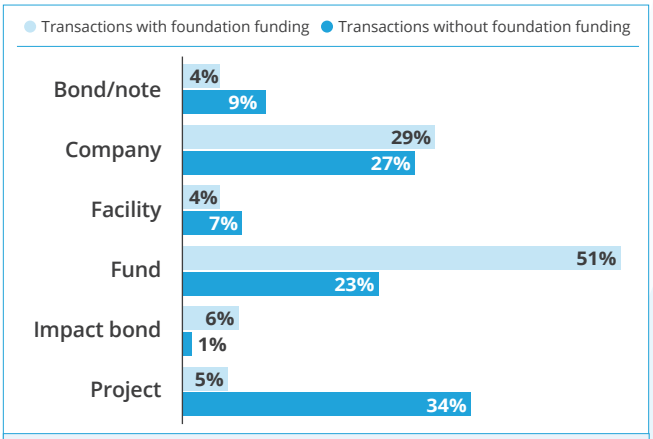

Figure 8: Transactions with foundation funding vs. those without by blended vehicle type

TRANSACTIONS WITH FOUNDATIONS AS INVESTORS TEND TO BE SMALLER THAN THOSE WITHOUT

Transactions with foundations as investors have a median deal size of $34.5 million, compared to $54.4 million for those that do not. While foundations prefer to invest in aggregation vehicles, such as funds, they also have a greater presence in impact bonds, which are less scalable, albeit with a higher focus on social outcomes. In an impact bond, private sector investors provide upfront capital toward a development outcome, and donor governments or philanthropic organizations commit to reimbursing them with additional returns, contingent on the achievement of pre-determined impact outcomes over the life of the program. The bespoke nature of each transaction means scaling up can be difficult, while transaction costs are high; the median size of impact bonds is $4.6 million. Foundations are present in over 63% of impact bonds in the HDD, either through providing outcome funding or technical assistance (TA) grants. Their popularity among foundations may be due to the structured nature of impact bonds, with their emphasis on measurable outcomes. This provides foundations with valuable data and insights to align with their mission and priorities.

The median size of an investment from a foundation to a blended transaction is $2 million, and these investments make up on average 9.3% of the total transaction size.[3]

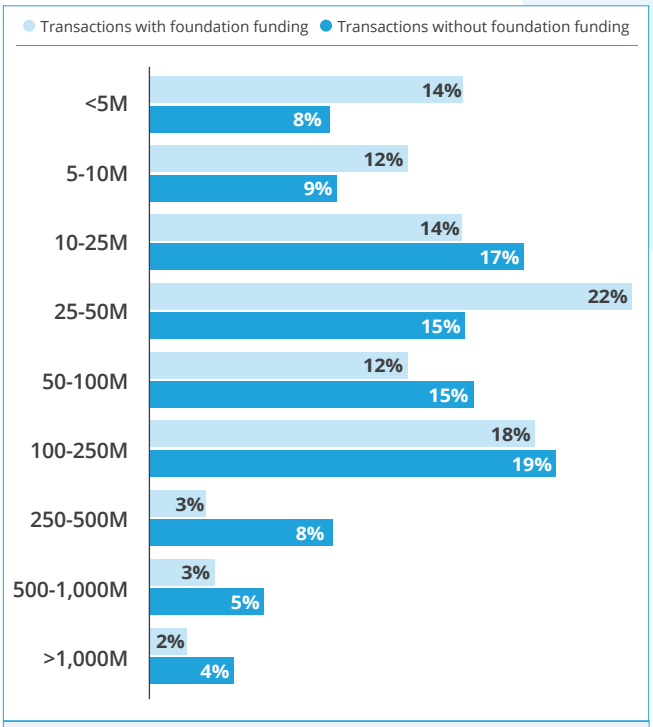

Figure 9: Transactions with foundation funding vs. those without by transaction size (USD)

TRANSACTIONS THAT ARE PARTLY FUNDED BY FOUNDATIONS ARE FAR MORE LIKELY TO CONTAIN DESIGN-STAGE GRANTS THAN THOSE THAT ARE NOT

Unsurprisingly, given the prevalent use of grants by foundations, design-stage grants are found in a far higher proportion within deals funded by foundations than in those that are not, while TA funds are present in 32% for the latter and 23% for the former. Design-stage grants can be integral to the creation of bankable projects that attract private commercial capital. For example, Redavia is a company that implements containerized modular solar farms in East and West Africa and that benefitted from an early-stage grant.

Beginning in 2014, the Shell Foundation provided project-preparation funding to assist Redavia in establishing operations in Sub-Saharan Africa. The grant financing was also used to streamline the supply chain for significant cost reductions, in addition to guiding the company through the fundraising process.

Following the foundation's investment, Redavia received concessional debt financing from public investors including InfraCo Africa, the Nordic Development Fund (NDF) and European Development Finance Institutions (EDFI) to further prove the company's model. The concessional backing mobilized debt and equity commitments from a diversity of private investors between 2018 and 2020.

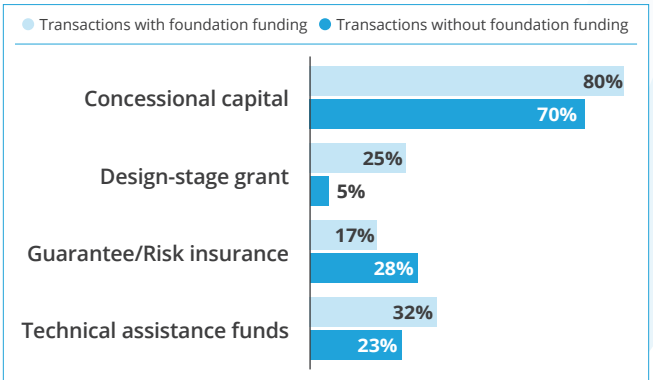

Figure 10: Transactions with foundation funding vs. those without by archetype

3 This does not include investments in guarantees or outcome funding, which Convergence does not count towards the overall transaction size.

KENYA IS THE TOP TARGET COUNTRY FOR TRANSACTIONS PARTLY FUNDED BY FOUNDATIONS, FOLLOWED BY INDIA AND UGANDA

By both deal count (53 transactions) and aggregate financing ($4.8 billion), Kenya is the most targeted country for blended transactions with foundation funders. Seven out of the top ten countries are within Africa. Many foundations strategically invest within certain geographic locations, which enables them to focus their impacts. Foundations may choose to approach their investment strategy by identifying "high needs" areas, where the foundation's resources can make a significant impact.

For example, the Bill & Melinda Gates Foundation ("the Gates Foundation") focuses on areas of overlap between its expertise and the Kenyan government's priorities under the Kenya Vision 2030 development blueprint and the country's SDGs, which include primary health care and gender equality.

To this end, in 2023, the foundation invested equity on commercial terms in a company called Access Afya, a Kenya-based social enterprise that provides localized healthcare services to low-income markets around the world, via health-tech and local clinics. The UBS Optimus Foundation extended a convertible grant to Access Afya, which was complemented by impact investments from not only the Gates Foundation, but also the Philips Foundation, and private sector investors.

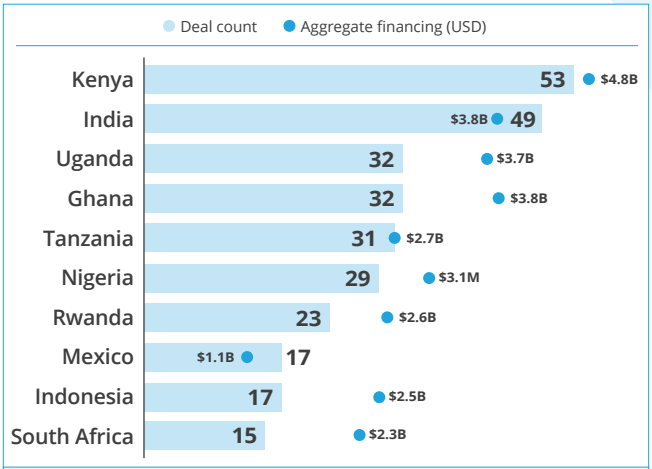

Figure 11: Transactions with foundation funding by count and aggregate financing by country, top 10 by deal count

EDUCATION, HEALTH AND GENERAL SECTORS ARE ALL TARGETED FAR MORE FREQUENTLY BY DEALS FUNDED BY FOUNDATIONS

Aligned with their dual objectives of fiduciary responsibility and mission-focused investments, foundations tend to invest more heavily in social sectors than other investor types. Foundations can be particularly additional in these sectors, where returns may not be high or where private investors may not typically invest. For example, looking at the leverage ratios[4] for each sector, the education sector ratio is 2.1, which is less than the average for all HDD deals of 3.9. There is therefore an opportunity for foundations to fill financing gaps in sectors that traditional investors may not prioritize.

Meanwhile, foundations focus their investments significantly less than other investors on sectors like infrastructure (1% for the former vs. 11% for the latter), energy (20% vs. 30%), and industry and trade (1% vs. 9%). These sectors tend to be supported through vehicles that are less appealing to foundations, such as projects, and have proportionately less representation in funds than other sectors.

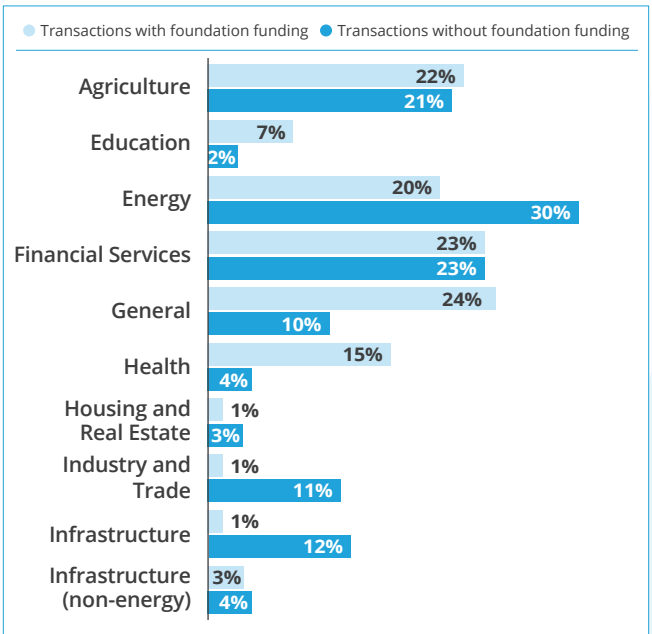

Figure 12: Transactions with foundation funding vs. those without by sector

4 Leverage ratios are defined here as the amount of commercial capital mobilized by each dollar of concessional capital, where commercial capital includes capital deployed by private, public, and philanthropic investors at market rates.

MOST DEALS FUNDED BY FOUNDATIONS FOCUS ON LOW-INCOME POPULATIONS

Foundations tend to invest in transactions that target specific population sub-groups as end beneficiaries; low-income (72% of deals funded by foundations vs. 39% of deals that are not) and rural populations (34% vs. 17%) are more highly represented in deals with foundations as funders, while the general population is far less represented (30% vs. 57%). Given that most financing from foundations within the HDD is provided on concessional terms, foundations based in the U.S. especially need to be intentional in directing their capital towards end beneficiaries that directly align with their specific missions to fulfill PRI obligations.

Transactions can target more than one end beneficiary. For example, 74% of transactions with foundations as funders that target women and girls also benefit low-income populations. Given a foundation's mandate to seek out the largest impact with its given fiscal capacity, transactions with foundation investors have a much higher proportion of deals that target two or more end beneficiaries than those without (75% for the former vs. 58% for the latter).

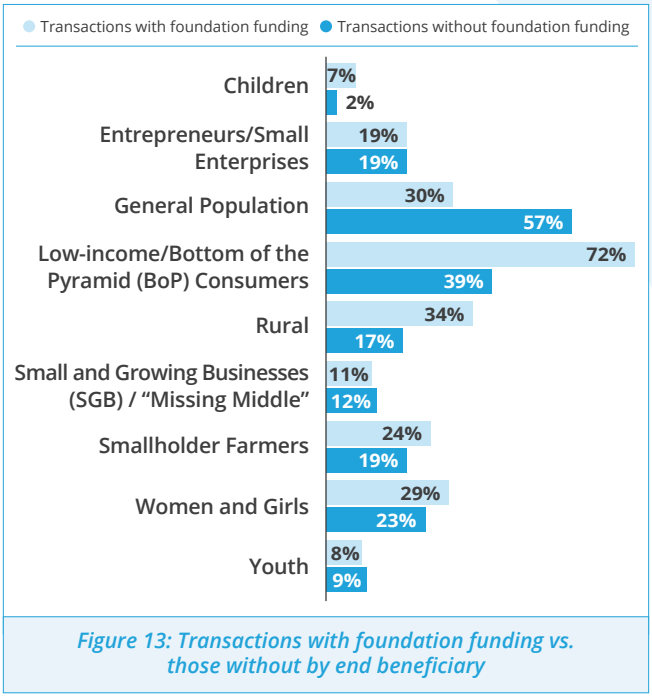

Figure 13: Transactions with foundation funding vs. those without by end beneficiary

FOUNDATION INVESTOR FOCUS ON GENDER TRANSACTIONS MOSTLY ALIGNS WITH OTHER INVESTORS

Compared with other investors, foundations have invested in a slightly higher proportion of deals that have some gender focus, but overall, they are fairly aligned. Recently, the Organization for Economic Development and Cooperation (OECD) released a report finding that private philanthropy is emerging as a major actor in the pursuit of gender equality in developing countries. International philanthropic contributions targeting gender equality objectives have tripled from 2017 to 2022, reaching on average $3.4 billion per year in 2021 to 2022, up from $2 billion in 2019 to 2020 and $1.3 billion in 2017 to 2018. The report also found that the increase in gender-related cross-border giving was primarily driven by programs where gender is one of several objectives. This suggests that there is an appetite for foundations to increase their consideration of gender within blended finance transactions beyond their current levels.

The Shell Foundation (14 commitments), followed by the Gates Foundation (11), and The Rockefeller Foundation (11) have the highest number of investment commitments towards transactions that either have some gender focus or are gender-focused transactions. As part of its investment strategy, Shell Foundation applies a gender lens across all areas of its operations to increase access to products, resources, and finance for women and entrepreneurs. This has been shown to improve commercial performance while delivering a better impact for women.

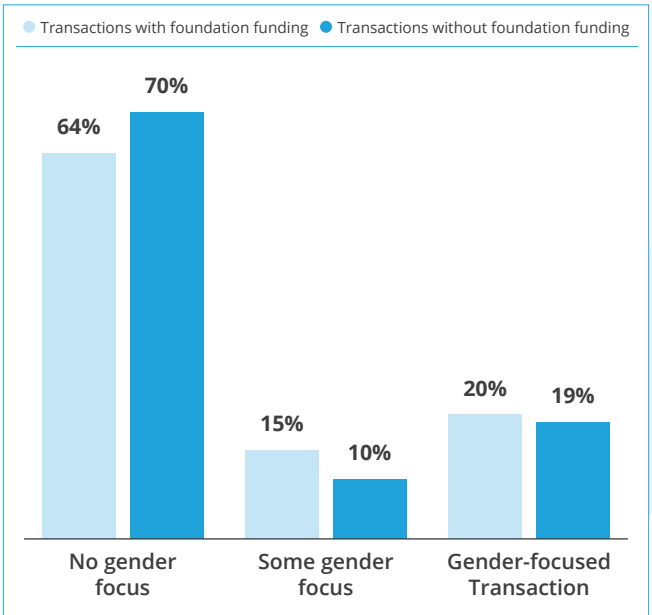

Figure 14: Transactions with foundation funding vs. those without by gender focus

FOUNDATIONS INVEST PRIMARILY IN SDGS 8 (DECENT WORK & ECONOMIC GROWTH) AND 1 (NO POVERTY)

Aligned with the highest target end beneficiary being low-income populations, most transactions funded by foundations target poverty reduction and greater economic opportunities. The former, SDG 1 (No Poverty), is represented far higher in these deals (56%) than in deals with no active foundations (33%), again likely reflecting the intention of many foundations to seek out transactions that support the most vulnerable populations. Likewise, the focus on the health sector is apparent in Figure 15, with 24% of transactions partly funded by foundations targeting SDG 3 (Good Health & Well-Being), vs. only 8% of other transactions.

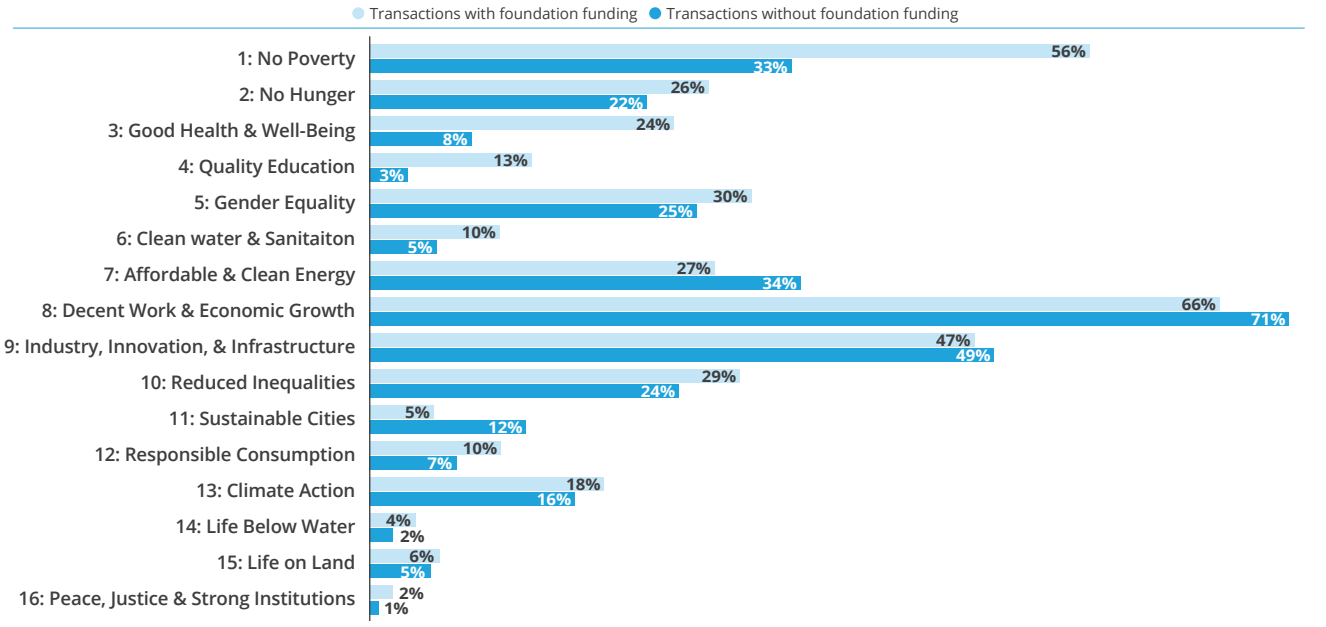

Figure 15: Transactions with foundation funding vs. those without by SDG focus

IMPACT INVESTORS ARE THE HIGHEST PROPORTION OF DEAL SPONSORS IN DEALS PARTLY FUNDED BY FOUNDATIONS, COMMERCIAL INVESTORS ARE LESS ACTIVE

Given that impact investors have similar dual goals of fiduciary responsibility and positive social impact, it is unsurprising that they play an outsized role in sponsoring deals where foundations are investors (47% in deals funded by foundations vs. 16% in deals not funded by foundations). Likewise, commercial investors prioritize returns over impact and are less likely to sponsor deals that fully align with a foundation's mandate (20% vs. 56%).

Other non-governmental organizations (NGOs) are also more likely to sponsor deals that appeal to foundation investors, again due to their orientation towards impact-first transactions.

In some cases, foundations themselves act as deal sponsors. One example is the responsAbility Energy Access Fund, launched in 2015, which was sponsored by the Shell Foundation. It provides debt financing to manufacturers and distributors of off-grid renewable energy solutions in Asia and Sub-Saharan Africa. The fund is a multi-layered debt vehicle, comprising three risk tranches, financed by both commercial and concessional investors.

DFIs/MDBs also act less frequently as deal sponsors for deals funded by foundations than deals not funded by foundations (4% vs. 13%), potentially due to their governance rules that discourage them from taking risks to provide financing that would otherwise not be available from commercial lenders.

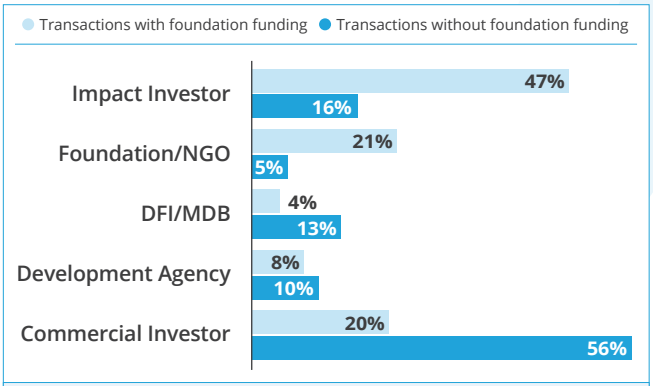

Figure 16: Transactions with foundation funding vs. those without by deal sponsor organization type

SHELL AND THE GATES FOUNDATIONS HAVE THE MOST CONCESSIONAL INVESTOR COMMITMENTS

The Shell Foundation has the top number of concessional capital investment commitments (32 commitments), followed by the Gates Foundation (31) and the Omidyar Network (22). The Shell Foundation has a specific strategy aimed at unlocking capital into commercially viable solutions by deploying risk capital. This capital is intended to leverage funding from other capital providers and improve the risk-return profiles of the transaction, with the aim of reducing poverty.

Other foundations have partnered together to increase the impact of their concessional capital, such as the Omidyar Network, The Rockefeller Foundation, and the MacArthur Foundation. These foundations founded C3, which uses catalytic capital strategically to enable impacts that would not otherwise be possible. The partnership also acts as a critical resource for addressing urgent global challenges related to climate, health, poverty and injustice. The consortium uses catalytic capital within various stages of a transaction's lifecycle, focusing on "seeding, scaling, and sustaining".

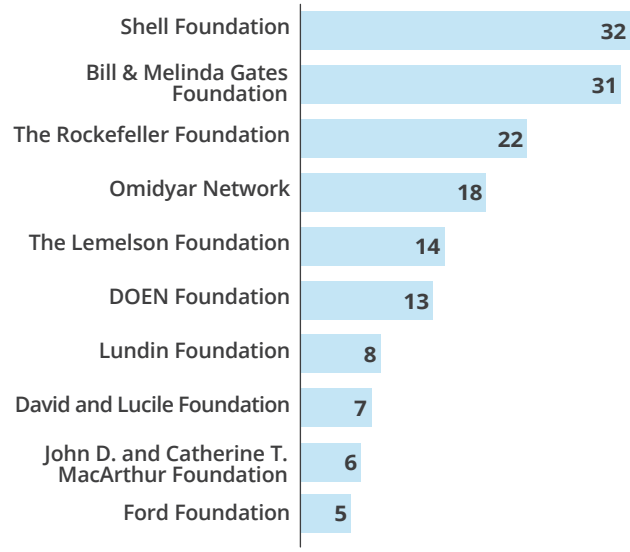

Figure 17: Top 10 foundations by concessional capital commitments

OMIDYAR NETWORK AND SHELL FOUNDATION HAVE THE MOST COMMERCIAL INVESTOR COMMITMENTS

Omidyar Network, a member of C3, is the foundation with the highest number of commercial investor commitments (10 commitments), followed by the Shell Foundation (9) and Fundacion Netri (6). While Fundacion Netri also provides grants, a large focus of their strategy is investing in critical sectors to improve the quality of people living in poverty in developing countries.

For example, the foundation provided senior financing in the form of equity to the Transform Health Fund (THF), launched in 2022. THF is a blended finance fund that provides debt and mezzanine capital to health enterprises across Sub-Saharan Africa in need of scale and growth capital, and operating in supply chains, care delivery, and digital solutions. It received grants and concessional equity from Financial Sector Deepening Africa, which helped increase private-sector investor confidence and perceived risk-adjusted returns. Senior financing was also provided by other foundations, DFIs such as Swedfund and the U.S. Development Finance Corporation (DFC), and corporate commercial investors.

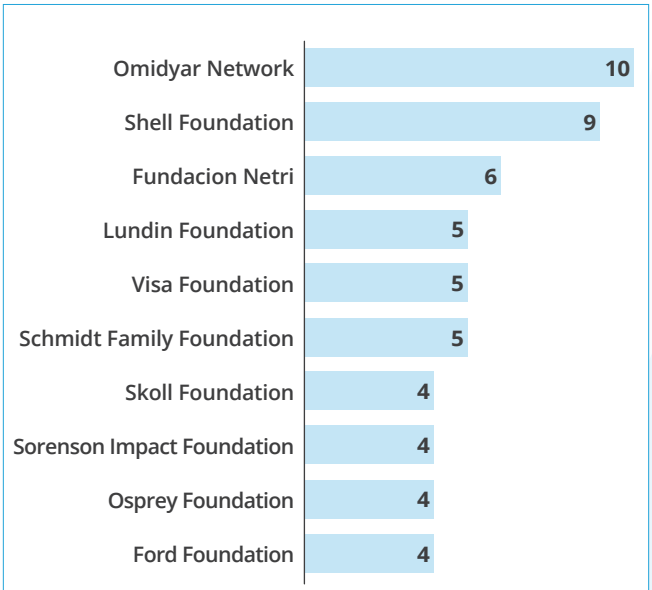

Figure 18: Top 10 foundations by commercial capital commitments

Reflections

In our conversations with various blended finance practitioners, several themes became apparent regarding the challenges and opportunities for foundations investing in blended finance transactions.

CHALLENGE

Balancing mission and financial returns

Foundations must continuously balance their fiduciary responsibilities of ensuring sustainability within their operations and investing in mission-related transactions. In the U.S., regulations governing PRIs can make the legalities around return-seeking concessional investments difficult to navigate. If a foundation does not have the historical knowledge base and in-house legal team to advise on PRI classifications, it can create additional barriers. According to one foundation investor:

> *"If a family office or a foundation didn't have that advisory capacity internally, that would probably add fees to an already low yielding deal, and that could probably be something to hold someone off."*

Schwartz notes that some foundations may find the work involved in making PRIs challenging, particularly if this is a new practice for the organization.

> *"For example, making a PRI does require specialized expertise regarding charitability and PRI-specific rules related to returns, risk, ordinary investor preferences and other issues."*

In other, non-U.S. jurisdictions, regulations have also historically created challenges for foundations that want to participate in innovative financial structures that help balance their goals more efficiently. For example, in the Netherlands, previous regulations all but prohibited charitable funds from partaking in investment activity beyond grant-making. This made it difficult for Dutch foundations to access the full range of financial tools to effectively achieve their mission.

There are also instances where foundations are governed by a board of directors that is averse to using PRIs or return-seeking investment instruments to forward their charitable goals. Rather, these boards may push to exclusively use grants. Matt Onek, President & Chief Executive Officer of Mission Investors Exchange suggests that this is even more of a challenge than the regulatory environment:

> *"I'm not sure that is as much a regulatory issue at this point as it is a challenge with the education of boards and investment committees. Getting impact investing expertise and diversity on to boards and investment committees is a big focus of ours. Because I think there remains a perceived hurdle to doing certain things around PRI and MRI investments. So increasing education and diversity is a critical part of this work."*

Likewise, other foundations have noted that their boards do not accept low returns and are more focused on the preservation of capital.

OPPORTUNITY

Increasing impact-based investments

With global interest in impact investing growing quickly, changing regulations and greater opportunities to use return-seeking catalytic capital can increase the proportion of endowments that are being used to support SDG-aligned transactions. While PRIs can be difficult to implement from a legal perspective, they also provide the opportunity to create higher levels of impact while still generating returns. According to Kozloski,

> *"PRIs enable blended finance because, with them, we have this primary charitable purpose, but we bind it with return, and we have a lot of flexibility with that capital. PRIs provide scarce patient capital that, when deployed prudently, can reduce risk and catalyze more traditional investment dollars toward impact without distorting the market."*

There are also opportunities to align higher levels of a foundation's endowment with MRI and SRI investments, rather than committing financing to commercial investments with no impact. For example, in 2023, The Rockefeller Foundation announced that its $6 billion endowment would target net zero transactions by 2050. Another example is the Ford Foundation, which in 2017 made a commitment to invest $1 billion of its endowment over a 10-year period in MRIs.

In the Netherlands, there has also been an encouraging regulatory change that now allows foundations to use impact investing to support its mission, which means higher levels of financing can flow to transactions with a positive social impact.

CHALLENGE

Structural complexity of blended transactions

For many foundations, blended finance creates a layer of complexity that is difficult to overcome. While some foundations have tapped into models that have scaled up to become deals worth over a billion dollars, such as the SDG Loan Fund, there are no standardized models that are easily replicable and that also show high levels of impact and appropriate returns.

Foundations may particularly benefit from research into standardized models, given the oftentimes small operational capacity of their investment teams. Creating bespoke transactions can therefore create a prohibitive barrier.

OPPORTUNITY

Standardizing models and building confidence in strategic investment methods

The creation and execution of standardized, replicable models can reduce the overall load on small foundation investment teams and minimize transaction costs. It may also encourage using concessional capital through PRIs, which can draw in higher levels of private capital mobilization.

Recognizing this challenge, The Rockefeller Foundation, the MacArthur Foundation and C3 have jointly launched the Zero Gap Fund. The fund deploys flexible, patient, and risk-tolerant capital to catalyze private investment into strategies that address the SDGs. Its mandate is to support innovative products and structures that are replicable and scalable, and to demonstrate how new solutions may drive needed financing for the global good.

Another means of reducing complexity is through becoming familiar with a particular investment strategy. For example, Ceniarth's investment strategy for the Isenberg Family Charitable Foundation is very targeted. According to Ames,

> *"We don't make grants or guarantees. We deploy capital to funds, financial intermediaries, and social enterprises that support marginalized and vulnerable populations. We invest with non-profits, for-profits, and hybrid organizations with an emphasis on sectors such as agriculture, affordable housing, financial inclusion, and climate justice. We prioritize investments that are catalytic in nature and may require flexibility on risk and return parameters such as modest returns expectations or more acceptance of risk than other impact investors."*

Meanwhile, The Rockefeller Foundation has built confidence investing with PRIs through decades of experience, while the MacArthur Foundation gained comfort deploying guarantees. Much in the way that private investors develop expertise within specific financial instruments, foundations can effectively create strategies using certain investment tools and methods.

At the same time, Onek cautions against picking a tool before the challenge is thoroughly understood:

> *"We wouldn't want to pick the tool before the solution. Rather, we really want to make sure that foundations are figuring out what the right solution is for the issue they're addressing."*

CHALLENGE

Smaller investment ticket sizes and limited additionality

While the average investment size of a foundation in blended finance transactions is $4.7 million, this is partially driven by a few large deals from major foundations. For example, in 2009 the Gates Foundation contributed $50 million in grants to the Advance Market Commitment (AMC) for Pneumococcal Vaccines, which guarantees the price for pneumococcal vaccines once they are developed; and in 2008, $40 million in junior equity to Immunore, a company that researches and develops biological drugs and therapies for the treatment of cancer, infectious diseases and autoimmune diseases.

The median foundation investment size, however, is $2 million, better representing the fact that 40% of the investment sizes are $1 million or smaller. These smaller amounts of capital means foundations may face challenges associated with scaling impact.

One practitioner sees the impediment this causes in trying to tackle massive global challenges:

> *"There are not many foundations big enough or serious enough about impact investments, who will also do something major in emerging markets."*

Onek also sees scalability issues on the mission-related side of a foundation:

> *"Scale can be a problem. For some foundations, there's a need to keep things narrowly tailored to the foundation's mission. If you think that impact investing must be narrowly tailored to your mission – and cannot include broader impact-oriented goals, then a foundation is even more circumscribed."*

Dario Parziale, Managing Director, Program and Operations at Toniic, likewise discussed how many foundations struggle to use their capital in junior tranches to catalyze private investors. He explains that large foundations may be able to provide the junior capital needed to establish a transaction and bring in senior capital, but more often with smaller commitments, foundations are approached in the later stages of fundraising.

OPPORTUNITY

Using catalytic concessional capital in high-impact areas and catalyzing DFI financing

Throughout the interviews, the idea of focusing investments on high-impact areas and seeking out specific challenges where foundation capital can be additional was consistently discussed. As mission-driven organizations, foundations should seek out areas of market failure and use their endowments to mobilize investment into those sectors.

Kozloski explains The Rockefeller Foundation investment strategy as follows:

> *"When you think of where we best contribute to private capital mobilization, it is when we see tipping points and deploy our capital to support nascent market segments. We find where investor interest is in a particular category, but also where investors are not yet ready to commit dollars. They want demonstration vehicles that deliver on their impact and return expectations. So our main driver is the mobilization number. We look at where tipping point opportunities are for private capital right now."*

At Ceniarth, Ames similarly starts with an impact-first mindset, noting that it is important for them to know they have a level of impact:

> *"We have three levels of impact which we assess from: beneficiary, enterprise or fund level and capital additionality. All the investments that we make are impact first and this is assessed from the beginning of our origination process. This is complimentary to our impact levers which categorise different roles that Ceniarth can play in a transaction such as providing catalytic junior capital or investing in new funds and emerging managers"*

Schwartz emphasizes this need to focus first on identifying specific capital gaps and to use foundation impact investment to address them:

> *"To provide meaningful support for a given transaction, you must understand the capital gap that you are trying to deal with. What is stopping the capital from flowing in a sufficient or workable form? Be very clear about why capital from a more conventional source isn't flowing, and then try to target your blended finance structure and your support for that structure in a way that is really going to solve that issue."*

By clearly targeting the areas where private capital will not flow, but where there are opportunities for a demonstration effect in high-impact sectors, foundations can have large additionality even with small investment sizes.

One way foundations can work together to overcome small investment sizes and catalyse higher levels of private investment is through jointly contributing to higher risk syndicated tiers within blended finance transactions. Syndicated tiers refer to the different layers or "tranches" of capital that investors can participate in, each with distinct levels of risk, return expectations, and impact targets. This structuring allows investors with varying risk appetites and investment motivations to be part of the same financing package and maximize overall funding.

This method was effectively used in the American South Real Estate Fund (ASREF). Launched in 2015, the ASREF is a $58 million blended private equity fund investing in real estate projects in low- and moderate-income communities in the southern states of the U.S. ASREF's mandate targets the persistent effects of certain discriminatory policies and lending practices of mainstream financial institutions in the American South since the 1930s.

The fund was launched by SDS Capital Group, a California-based impact fund manager, and Vintage Realty, a commercial real estate firm operating across several states in the southern U.S. SDS Capital structured the ASREF as a blended fund, adding a subordinated PRI tranche to allow for private foundation investment. Given the MacArthur Foundation's experience with PRIs, it played a key role in the fund's design.

By creating tranches for Class A shares and Class B shares (the PRI tranche), the fund was able to accomplish multiple outcomes. First, it created an investment vehicle tailored to the needs of private foundations that deploy PRIs in smaller amounts. Second, it enabled private foundations to participate without jeopardizing market risk-adjusted returns for Class A shareholders, thereby playing a highly catalytic role; and third, it enabled ASREF to raise more capital by creating a fund that would generate attractive returns for investors seeking both impact and market rates of return.

Foundations can also specifically provide comfort for DFIs to enter a transaction. According to Parziale,

> *"We often hear the narrative that DFIs crowd in other capital. But by looking at recent blended capital investments featured on the Toniic deal-flow program, we can see there are cases where DFIs are crowded in by foundations."*

DFIs are capital providers that also seek sustainable development opportunities and address global challenges. More often, DFIs are less risk-tolerant, but Kozloski sees greater opportunities for alignment between foundations and DFIs:

> *"I think there should be a very symbiotic relationship between the DFIs and philanthropic organizations. All these pools of capital are very needed in the world right now where funding flows, especially in emerging markets, are very challenging."*

Conclusions

Foundations have already shown their ability to play a catalytic role in blended finance transactions using flexible capital and impact-driven investment strategies. Through grants, catalytic concessional investments, and commercial investments, foundations have contributed to blended finance transactions in a myriad of ways throughout the past decade. There are, however, barriers that impact foundations' ability to participate at even higher levels. Regulations around PRIs and how foundations can use return-seeking catalytic capital may hinder their participation as concessional capital providers. Moreover, the complexity of blended transactions can create prohibitive costs for small investment teams with low operational capacity. Small investment sizes can also create challenges around additionality in blended transactions.

These challenges, however, also present opportunities. While PRIs can enable blended finance, if using them is legally too complex, foundations can choose to direct a higher proportion of their endowment to target MRIs and SRIs. Standardized models of blended transactions coupled with building confidence in certain investment strategies can also help lower transaction costs. Finally, focusing investments on high-impact areas and targeting solutions to specific and clear problems, while coordinating with DFIs, can help overcome the problem of small investment size and lead to greater additionality.

If given the proper tools, foundations can become an even more powerful force for blended finance.

Methodology & Notes

1. **Convergence's database:** Convergence maintains the largest and most detailed database of blended finance transactions that have reached financial close. Given the current state of information sharing, it is not possible for this database to be fully comprehensive. We have made efforts to capture all relevant blended finance transactions; however, there are likely more transactions that have not been captured.
2. **Scope of available data:** This brief analyzes 236 blended finance transactions that contain at least one investor classified as a foundation. This brief also draws upon stakeholder interviews conducted with Alexandra Ames, Investment Associate at Ceniarth; Debra Schwartz, Managing Director, Impact Investments at the John D. and Catherine T. MacArthur Foundation; Matt Onek, President & Chief Executive Officer of Mission Investors Exchange; Maria Kozloski, Senior Vice President, Innovative Finance & U.S. Economic Opportunity at The Rockefeller Foundation; and Dario Parziale, Managing Director, Programs and Operations at Toniic.
3. **Target regions and countries:** Convergence tracks region and country data by stated region(s) and countries of focus at the time of financial close, not actual investment flows. Often, regions and countries of eligibility are broader than those explicitly stated.
4. **Convergence considers a transaction to be blended based on three criteria:**
   1. It attracts financial participation from one or more commercial investor(s) that would otherwise not have invested
   2. The transaction leverages concessional capital
   3. The transaction intends to create development impact related to the Sustainable Development Goals. Other organizations, such as the India Impact Investors Council, may use different criteria when establishing whether a transaction is blended. This may lead to differences in overall data trends between the Convergence HDD and other regional data sources.

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CONVERGENCE
BLENDING GLOBAL FINANCE

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.