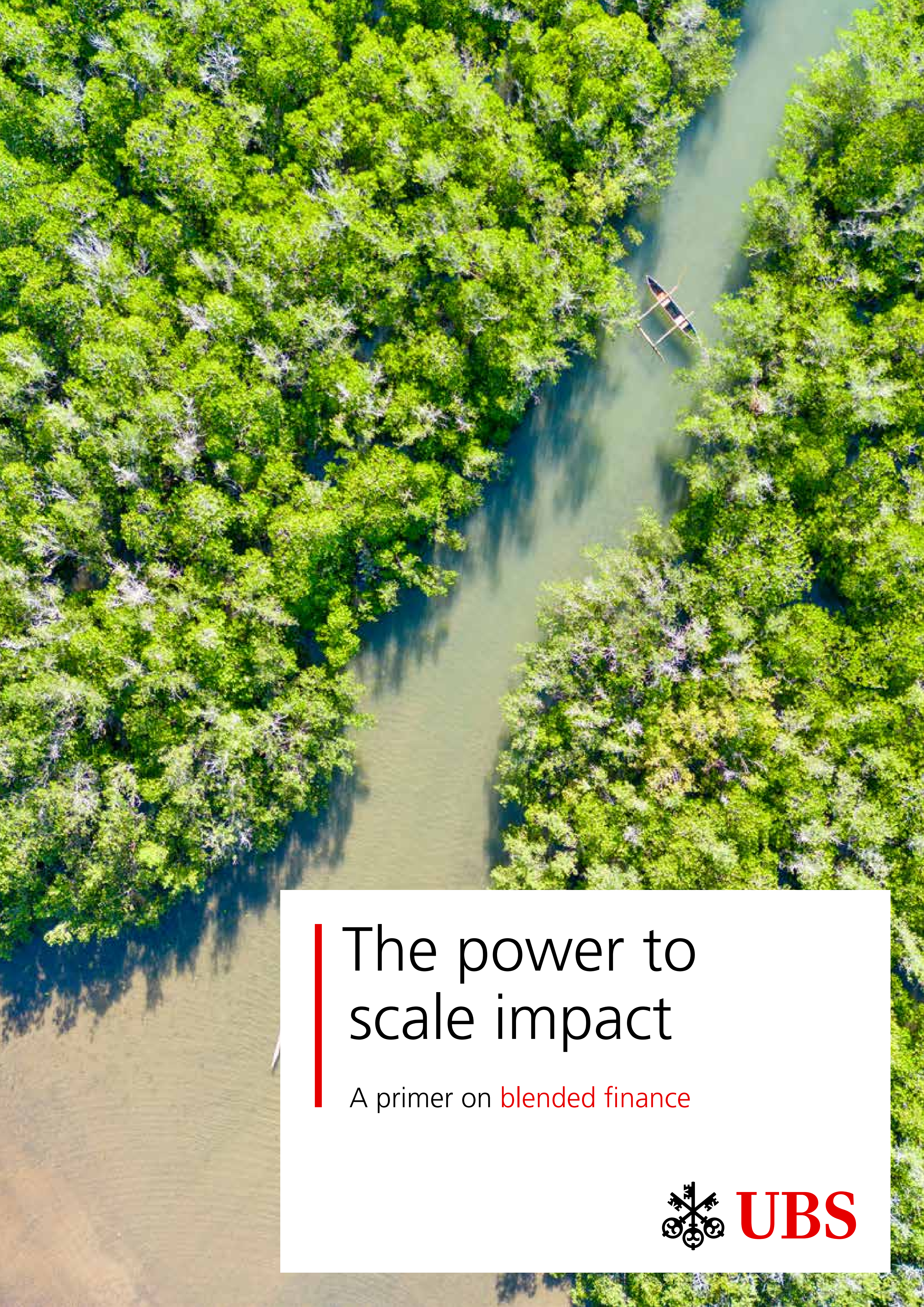

The power to scale impact

A primer on blended finance

Special thanks to all of our UBS experts and partners who have contributed to the publication of this primer.

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Executive summary

Mobilizing more capital for more impact
Blended finance can bring scale to financing social and environmental development. By combining philanthropic or public funding with private capital, it bridges the gap between ambition and action to enable transformative development outcomes.
As the UN highlights, the sustainable development goals (SDGs) face a USD 4 trillion annual funding shortfall. Blended finance has the potential to help close this gap.

What is blended finance?
Blended finance uses philanthropic and public funds as catalytic capital, improving risk-adjusted returns to make investments in social and environmental projects commercially viable. This approach seeks to align goals for the diverse stakeholders involved – financial returns, social and environmental impact, or both – through suitable financial structuring.

Scaling development impact
From climate resilience to healthcare, education to infrastructure, blended finance can raise funds to drive change at scale where it's needed most. It can help to address market failures and fill financing shortfalls by leveraging the multiplier effect to catalyze investment in emerging markets. By engaging a blended finance structure, every dollar of catalytic capital can mobilize up to USD 5-10 in private investment for development, increasing the pool of funding available.

With an approach that makes sense for a spectrum of stakeholders…
By using their capital as a catalytic tool, philanthropists can attract private and public funding, address critical funding gaps and significantly increase the scale of financing available for the SDGs. For investors, blended finance offers a pathway to achieve measurable social and environmental outcomes alongside financial returns. Potential risks can be mitigated through structured approaches, such as guarantees, or first-loss capital from public or philanthropic sources, incentivizing investors to engage in markets or sectors they might otherwise consider too risky. Blended finance's alignment of impact and risk-adjusted returns allows investors to balance purpose with profitability.

..and for society in general
Blended finance drives societal progress by enabling the funding of essential initiatives that might otherwise remain unaddressed. These investments lead to better access to services and strengthened community resilience, while fostering inclusive growth. Even more beneficial is the collaborative nature of blended finance. It promotes shared responsibility among governments, businesses and nonprofits, ensuring societal needs are met in a sustainable and equitable way.

Creating transparency and trust

While the potential is immense, challenges remain in designing the right blended finance structure that meets all stakeholder objectives. Improved frameworks and governance, impact transparency and better visibility are all critical to unlocking more involvement, turning perceived risks into real opportunities. We're seeing progress in these areas every year as the field advances.

Set for growth

There is increasing demand for greater impact with sustainable development efforts. Tools such as blended finance are opening the door for new ways of financing development investments. With greater philanthropic, government and institutional support, as well as a growing track record, the stage is set for blended finance to bring more funding to address environmental and social challenges.

Ready to dive deeper?

This summary offers a glimpse of the potential of blended finance. In the pages ahead, we'll unpack the concept, explore real-world examples and provide proven actionable insights to help you navigate the opportunities it offers.

Section 1

The time is now

"We are seeing more and more cases where blended finance has created viable investment opportunities that concurrently address the SDGs. To deliver on the full potential blended finance offers, mainstream financial institutions like UBS can play an important role in folding blended finance into their operations to move large amounts of capital into risk-adjusted investments outside of their ordinary boundaries. Time is short to meet the SDGs, and the need and opportunity to act are before us."

Joan Larrea, CEO, Convergence

Why we're excited about blended finance

More than half of the world's population are still not covered by essential health services.[1] Over 600 million youth globally lack basic mathematics and literacy skills.[2] And new high records continue to be set for global GHG emissions and atmospheric concentrations of carbon dioxide (CO_2).[3] Yet, we're not seeing the levels of funding needed to solve these issues or the many others targeted by the UN Sustainable Development Goals (SDGs).

Development and climate finance clearly need more funding. If we can find a way to engage the deep and vast capital markets better for social and environmental projects, there is an opportunity to bridge this development and climate finance gap.

That's where blended finance comes in.

Convergence, a global network for blended finance, defines it this way:

> "Blended finance is the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development."[4]

What is catalytic about this capital? Philanthropists and public funders are interested in seeing impact returns in the form of positive social and environmental outcomes. In some cases, their resources can be used to sufficiently de-risk projects to the point where it becomes viable for commercial investors to join in. That makes it catalytic: for every public or philanthropic dollar spent on development, additional commercial capital can be added in so that social and environmental solutions can be scaled to increase impact.

We're encouraged by the increasing global recognition of the role blended finance can play in closing the SDG funding gap. Organizations such as OECD and major development finance institutions are cooperating with large fund managers in the launch of sizable blended finance funds.

1 World Health Organization and International Bank for Reconstruction and Development / The World Bank, Tracking universal health coverage: 2023 global monitoring report, 2023.

2 UNICEF, Education, accessed September 3, 2024.

3 UN Environment Programme, Emissions Gap Report 2023, 2023.

4 Convergence, Blended Finance, accessed September 3, 2024.

Blended finance has the potential to meet the goals of all stakeholders involved: scaling social and environmental impact for catalytic funders, delivering market-rate financial returns for investors and driving powerful outcomes for communities. The key to unlocking its full potential is engaging more catalytic capital as well as seeing a higher volume and/or scale of initiatives. The former will require more evidence of impact and the latter will take deliberate effort to create an enabling environment for blended finance.

We've created this primer in response to interest expressed by our clients, peers and strategic partners to learn more about blended finance's power to scale impact. Certain innovative solutions to social and environmental issues simply need a leg up to eventually become investible opportunities. We hope that sharing some general principles about how blended finance works – and how it can meet the respective objectives of diverse stakeholders – will help advance its use in areas where it might truly scale impact.

> "By subsidizing and de-risking private capital investments through various de-risking mechanisms and hereby improving the risk-return profile of private capital, blended finance can serve as a catalyst and open up new investment opportunities for investors from across the entire spectrum – philanthropists, family offices, impact and sustainable investors, institutional investors – who may want to learn more about the potential and limitations of how their investments could yield the financial and societal returns they seek while investing in the long-term human, economic, and planetary health and well-being of the future generations to come."
>
> Prof. Dr. Caroline Flammer, A. Barton Hepburn Professor of Economics, Columbia University

Section 2

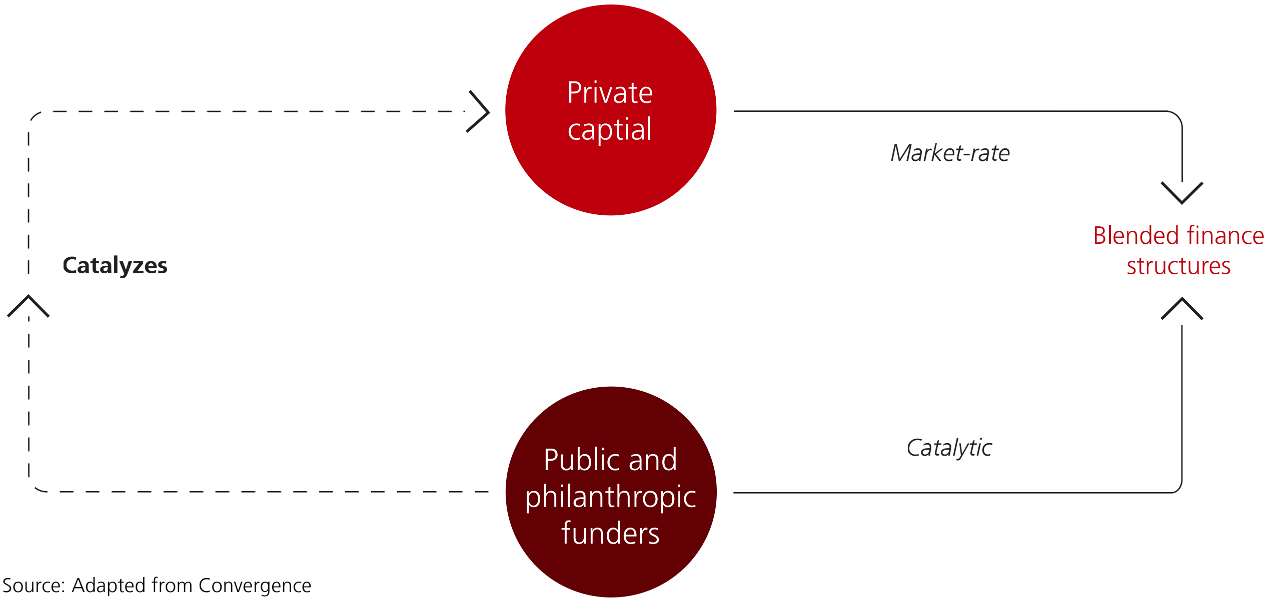
What is blended finance?

With growing investor interest in having greater positive impact with their capital, philanthropists and public funders have a unique opportunity to help bring new players into development finance.

Using catalytic capital to attract private investment

Blended finance is a structuring approach that allows diverse parties to invest alongside each other while achieving their own objectives (whether financial returns, social and environmental impact or a blend of both)[5] using common financial market structuring techniques. The structure harnesses philanthropic or public funding to catalyze commercial investment in development. This catalytic capital attracts commercial capital by lowering investment risk and/or enhancing target returns to the point where the financial risk-return profile may be comparable to commercial projects.

Effectiveness depends on the specific structure and project – a blended finance structure is not necessarily conducive to all projects. When effectively done, catalytic capital providers can achieve impact objectives on a significantly larger scale, while at the same time investors can participate in transactions where they otherwise might not have. As such, both impact objectives as well as differentiated financial return objectives can be achieved.



Source: Adapted from Convergence

[5] Convergence, Blended Finance, accessed September 3, 2024.

Closing the SDG funding gap

In late 2023, the United Nations (UN) reported that between USD 5.4–6.4 trillion is needed annually to achieve the UN Sustainable Development Goals (SDGs) by 2030. But because of underfunding, the annual investment gap in developing countries is estimated to be about USD 4 trillion – almost the size of Japan's economic output – up from the USD 2.5 trillion estimated in 2014, just before adoption of the SDGs.[6]

Foreign direct investment in developing countries stood at about USD 841 billion in 2023.[7] Official development assistance (ODA) from OECD countries stood at about USD 204 billion in 2022.[8] And although it's challenging to get a full picture of the total amount of philanthropy going toward development, the 2023 Global Philanthropy Tracker estimated that total cross-border philanthropic flows in 2020 were about USD 70 billion.[9]

Ultimately, sustainable development requires more than the capital available from governments, civil society and philanthropists. We need private sector commercial investment in development.

[6] UNCTAD, SDG Investment Trends Monitor, Issue 4, September 2023.

[7] UNCTAD, Global Investment Trends Monitor, Issue 46, January 2024.

[8] OECD, Bottlenecks to Access Sustainable Development Goals Finance for Developing Countries, 2023.

[9] Indiana University Lilly Family School of Philanthropy, 2023 Global Philanthropy Tracker.

Making sustainable development investible

Blended finance addresses two of the main barriers for commercial investors: (i) high perceived and real risk and (ii) poor risk-return relationship. The figure below shows how the use of catalytic capital can make certain projects that are currently not attractive to commercial investors investable for them. Investments to the right of or below the market line are poorer investment alternatives than others in the market.

It would not be rational for a commercial investor to invest in a project with a risk-return combination like the one seen in point A, which has high risk and low expected return relative to alternative investments available in the market. This kind of investment may still be socially desirable and boost development, thereby appealing to investors with a strong impact orientation. But it would be unlikely to capture the interest of mainstream commercial investors, thereby making it difficult to scale.

Source: Adapted from Convergence

Blended finance can change the relative risk-return relationship, effectively moving the private investor's expected return to a point on the market line (that is, between points B and C).

- A»B: In the case of risk mitigation, a first-loss protection or first loss provision (for example) may move the investment's risk-return profile to point B on the market line, reducing the associated risk for investors and accordingly lowering their required rate of return.

- A»C: In the case of return enhancement, catalytic capital raises the expected investment return to meet investor requirements for taking equivalent risk, thus moving the investment's risk-return profile to point C.

In both cases, this will make the project attractive enough to trigger investment on regular commercial terms. Most blended finance solutions aim to move a project from point A to B – that is, mitigate the risk – but essentially both approaches achieve the same result.[10]

In addition to financial risk-return profile adjustments, philanthropic or development capital may also mitigate risk at the project level through funding technical assistance or extending grants aimed at improving the successful delivery of cashflows and gains to support the distribution of returns.

[10] Paul Wade, "How Can Development Cooperation Mobilise Private Investment in Developing Countries to Achieve the Sustainable Development Goals?" Norad, January 2022.

Evolving through the years

> Blended finance has evolved over time, integrating various financial mechanisms to address development challenges. While the actual term 'blended finance' was coined relatively recently, many concepts and versions of blended finance have been around since the end of World War II (and possibly much earlier).

1950s–1980s Early origins
The concept of blending public and private finance emerged after the 1944 Bretton Woods Agreement. International development institutions like the World Bank and regional development banks began pooling funds from governments and international organizations to finance development projects in low- and middle-income countries.

1990s–2000s Emergence of PPPs
Public-private partnerships (PPPs) gained traction in the 1990s as a mechanism to leverage private sector expertise and investment for transportation, energy and water infrastructure projects.[11]

2010s Shift toward blended finance
As development challenges became more complex and the financing gap for achieving the SDGs widened, there was a growing recognition of the need for innovative financing solutions to mobilize private capital alongside public resources to address development needs.

2010s Rise of impact investing
The rise of impact investing, which seeks to generate social and environmental impact alongside financial returns, invited increased dialogue on the interplay of impact, risk and return, as well as demand for impact measurement and management. Such practices – alongside increased investor attention on thematic issues such as healthcare, education, renewable energy and affordable housing – also contributed to a more enabling environment for blended finance.

2010s–2020s Institutional support and frameworks
Multilateral development banks (MDBs), governments and philanthropic organizations started creating dedicated facilities and frameworks to support blended finance initiatives. These efforts aimed to de-risk investments, provide technical assistance and create conducive environments for private sector participation in development projects.[12]

[11] Grahame Allen, "The Private Finance Initiative (PFI)," House of Commons Library Research Paper 01/117, 2001.

2010s–2020s Scaling up
Blended finance gained momentum as a key tool for scaling up investment in sustainable development with the launch of Convergence at the 3rd International Finance for Development conference in 2015 in Addis Ababa, Ethiopia. Furthermore, initiatives like the Global Impact Investing Network (GIIN) and the UNDP's SDG Impact initiative worked to standardize metrics, improve transparency and build capacity within the blended finance ecosystem.

2020s COVID–19 pandemic response
The COVID-19 pandemic highlighted the importance of blended finance in addressing global crises. Efforts were made to leverage blended finance to support healthcare systems, small and medium-sized enterprises, and social safety nets in developing countries impacted by the pandemic.[13]

Present
In The State of Blended Finance 2024, Convergence reported an annual average of 85 blended finance deals over the previous decade, with median annual financing of USD 15 billion. From 2021 to 2023 that average was 122 transactions. Of note, 40% of deals recorded in 2023 exceeded USD 100 million in ticket size.

Future outlook
Efforts to strengthen collaboration between public, private and philanthropic sectors; improve measurement and reporting of impact; and address systemic barriers to investment in developing countries will be crucial for the future of blended finance. International efforts to mobilize climate finance for emerging markets and developing economies (EMDEs) will increasingly involve blended finance solutions.

[12] World Economic Forum and OECD, Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders, September 2015.

[13] OECD and United Nations Capital Development Fund, Blended Finance in the Least Developed Countries 2020: Supporting a Resilient COVID-19 Recovery, December 16, 2020.

Section 3

What does it look like in practice?

Blended finance is an approach that can be leveraged across a whole spectrum of topic areas – with developing and emerging markets in focus. Blended finance always utilizes catalytic capital to lower investment risk but there are several ways to do that.

Following best practices

The OECD DAC Blended Finance Principles[14] have been embedded into the international development architecture and recognized as the *de facto* practice for countries, donors, organizations and actors to follow when applying blended finance.

Principle 1:
Anchor blended finance to a development rationale.

Principle 2:
Design blended finance to increase the mobilisation of commercial finance.

Principle 3:
Tailor blended finance to local context.

Principle 4:
Focus on effective partnering for blended finance.

Principle 5:
Monitor blended finance for transparency and results.

Finding the best opportunities

What kinds of development projects are possible candidates for using blended finance? In most cases, the project must itself generate cashflows that would support distribution of some financial return, even if catalytic capital is required to provide a leg up to de-risk or enhance returns. Areas where we see opportunities for blended finance to play a role include climate resilience, nature conservation, energy transition, infrastructure, healthcare, education, agriculture and financial inclusion.

Different structuring methods can drive the effectiveness of catalytic capital to varying degrees. While not always financial return–seeking, using philanthropic and development capital still carries opportunity cost – even if participation is only in the form of a first-loss protection, this still locks up capital for the duration of the blended finance structure. When used effectively, blended finance can attract private capital and simultaneously free up valuable philanthropic or development capital to be used where it’s most needed.

Blended finance structures necessarily require extensive stakeholder engagement and transparency. Structuring projects takes time, and fees can be considerable (legal, structuring, impact measurement and management). While projects often benefit from pro bono support, it’s important to consider the opportunity cost of such resources to ensure that a blended finance structure is the most efficient or effective solution.

Choosing the right structure

Do all blended finance structures look the same? Not at all. There are a variety of ways for philanthropic and public funding to catalyze private investment. The four most common approaches, based on those identified by Convergence, are illustrated below and include providing i) concessional terms, ii) a first-loss protection or risk insurance, iii) technical assistance or iv) a design-stage grant.[15] These approaches can also be combined in individual transactions, which tend to be highly bespoke in nature.

Concessional capital
Public and philanthropic funders provide concessional (catalytic) capital on below-market terms to lower the cost of capital or provide a layer of protection for commercial investors.

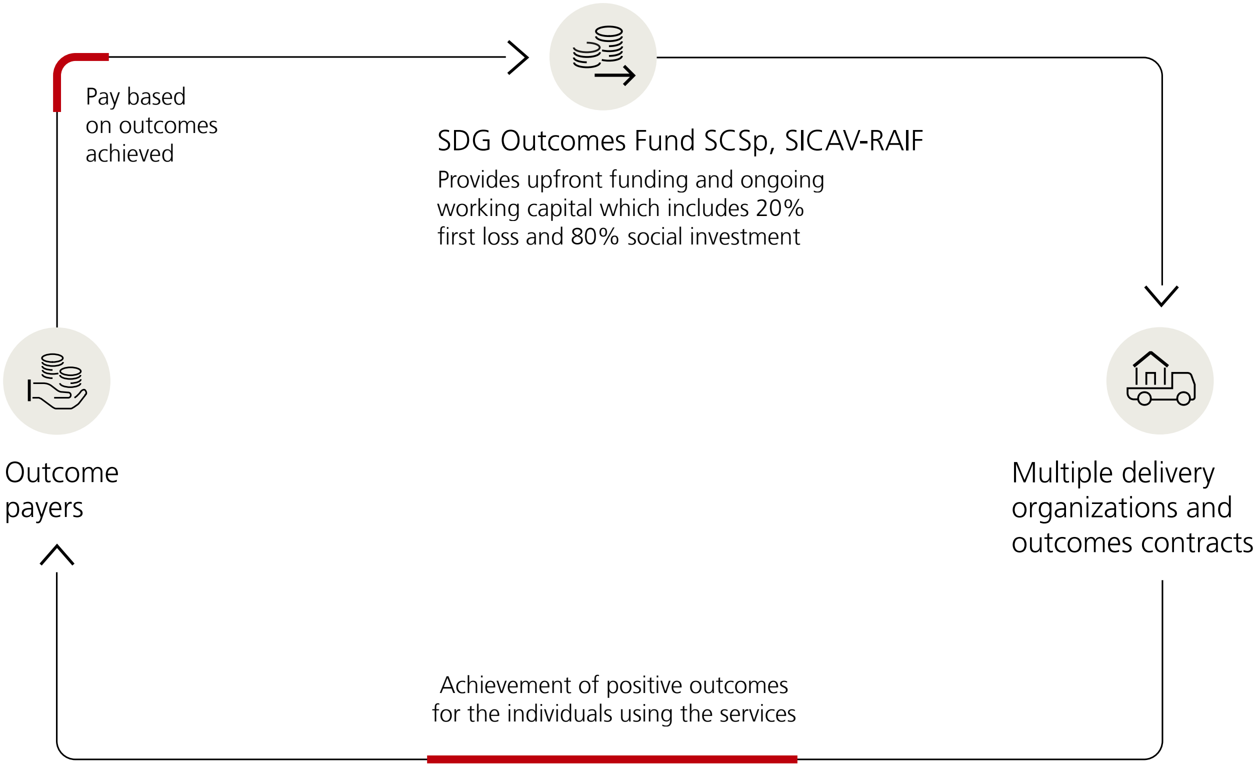
Technical assistance
Public and philanthropic funders provide a grant-funded technical assistance facility to use pre- or post-investment to strengthen commercial viability and developmental impact.

Guarantee/risk insurance
Public and philanthropic funders provide credit enhancement with guarantees or risk insurance on below-market terms.

Design-stage grant
Public and philanthropic funders provide grants for project preparation or transaction design.

[14] OECD, The OECD DAC Blended Finance Guidance, September 2020.
[15] Convergence, State of Blended Finance 2024, April 30, 2024.

Exploring some recent examples



> "The SDG Outcomes Fund is a first-of-a-kind fund to invest in underlying pay-for-results programs. It is a landmark initiative as it both drives more capital to solve pressing social and environmental issues by leveraging a blended finance structure, and at the same time promotes better use of development funding by supporting outcomes contracts."
>
> Dhun Davar, Head of Social Finance, UBS Optimus Foundation

SDG Outcomes Fund

Concessional (catalytic) capital

The SDG Outcomes Fund is designed to direct commercial capital and catalytic capital toward projects that achieve better outcomes for the world's most vulnerable people in developing countries. The fund brings together supranationals – including the European Investment Bank (EIB), the US International Development Finance Corporation (DFC) and the UK's British International Investment (BII) – governments, philanthropists and investors to fund programs aiming at achieving better social and environmental outcomes through outcomes-based finance approaches that enable flexible delivery and clear accountability.

The SDG Outcomes Fund is focused on the thematic areas of education, health, employment and environment. Launched by the UBS Optimus Foundation and managed by Bridges Outcomes Limited, one of the world's leading specialists and innovators in outcomes-based projects/investments, it targets financial returns based on the achievement of verified social and environmental impact, using 20% philanthropic first-loss funding to unlock USD 80 million of commercial capital.

Size	USD 100 million
Investments	Outcomes contracts (also known as impact bonds or pay-for-results programs) for social and environmental impact in developing countries
Blend	Catalytic capital: USD 20 million Commercial investment: USD 80 million

> "Blended finance structures like FWF drive innovation by using philanthropic funding to attract private investment into high-impact social enterprises. This strategy boosts overall funding and amplifies impact while establishing a track record that encourages further private sector participation and replication. By mitigating risks through capital layering, blended finance turns challenging opportunities into viable ventures."
>
> Batya Blankers, CEO, Chancen International

Future of Work Fund
Concessional Debt/Equity

Chancen International's Future of Work Fund (FWF)[16] is an example of how blended finance can drive transformative change in education, youth employment and livelihoods across Africa. By partnering with local educational institutions and using income share agreements (ISAs), FWF allows underserved and marginalized students to access job-market relevant post-secondary education without upfront costs.

Graduates repay through a percentage of future income, aligning repayment with their future financial success. This model removes financial barriers and aligns incentives between education providers, funders and beneficiaries – promoting sustainable impact. FWF aims to support around 15,000 underserved youth, emphasizing female empowerment with gender targets in every cohort.

Size	USD 40 million
Investments	Income share agreements (ISAs) for students to attend colleges, universities, and vocational training programs in Africa
Blend	Catalytic capital: USD ~15 million Further funding: USD ~25 million

UBS Optimus Foundation is an investor in the Future of Work Fund.

[16] Chancen International.

> "Blended finance allows institutional investors to become more familiar with asset classes or types of investments they would traditionally shy away from. The theory of change is that through such experiences, the gap between perceived and actual risk will be reduced over time. Start with your journey, even if small."
>
> Nadia Nikolova, Allianz Global Investors

SDG Loan Fund

Concessional Debt/Equity and Guarantee/Risk Insurance

The SDG Loan Fund[17] aims to advance the UN Sustainable Development Goals (SDGs) in emerging and frontier markets. Investors in the fund – including Allianz, FMO and Skandia – are providing catalytic capital for high-impact, SDG-aligned loans to small and medium-sized enterprises (SMEs) in low- and moderate-income countries (LMICs) across Latin America, Asia, Africa and Eastern Europe in three target sectors: energy sector, financial institutions and agribusiness.

Allianz Global Investors is managing the SDG Loan Fund and has delegated portfolio management to FMO Investment Management, a 100% owned subsidiary of FMO (the Dutch Development Bank). The John D. and Catherine T. MacArthur Foundation (MacArthur) has committed a USD 25 million guarantee for credit enhancement. The SDG Loan Fund's large-scale and multi-sector reach are enabled by a first-loss investment from FMO, coupled with MacArthur's guarantee on the first loss. Together, these catalytic contributions are unlocking USD 1 billion in private capital for affordable energy, financial inclusion and sustainable agriculture in emerging and frontier markets.

Size	USD 1.1 billion
Investments	Loans to SMEs in LMICs
Blend	Catalytic capital: USD 111 million Commercial investment: 1 billion

[17] Allianz SE, "SDG Loan Fund mobilizes USD 1.1 billion of investor capital," Press Release, December 1, 2023.

> "Catalytic capital, in whatever form it comes in, is typically a scarce resource. We are grateful to philanthropists and concessional investors who have concentrated their investments in a few funds, which enables those funds to truly execute on their strategy. While all ticket sizes are welcome, it is the larger catalytic commitments that can make or break the success of fundraising. Making fewer, larger commitments also allows catalytic investors to have greater influence – particularly through sitting on advisory committees, having a larger percentage of shareholding for key voting matters related to the fund and exerting soft influence on the fund."
>
> Noorin Mawani, AfricInvest

Transform Health Fund

Concessional Debt/Equity

The Transform Health Fund[18] is an impact fund with a focus on making healthcare more accessible and affordable across the African continent. The blended capital structure is transformative, enabling the fund to invest in a pipeline of businesses that address the most fundamental needs in healthcare in Africa, including the poorest populations and most remote rural communities outside of the traditional investment hubs for the continent. The structure allows the fund to invest in the healthcare supply chain, healthcare delivery (like clinics and hospitals), and enabling healthcare technologies that bring improvements in quality, access, innovation and affordability to some of Africa's most vulnerable communities.

The Transform Health Fund is well-positioned to capture these opportunities through its patient and flexible investment instruments. Investments are made primarily using self-liquidating instruments, to allow for early liquidity for investors. Furthermore, the fund's longer-term life allows for a longer-term tenure of the investments, a longer investment period as well as the ability to recycle capital. The latter aspect not only allows for additional investments and/or follow-on investment but enhances returns of the overall fund.

Size	Target of USD 100 million
Investments	Health enterprises in Africa

UBS Optimus Foundation is an investor in the Transform Health Fund.

[18] FSD Africa, Transform Health Fund, updated February 2024.

Section 4

What are the benefits for stakeholders?

Success of blended finance is predicated on finding alignment between catalytic capital providers and commercial investors – allowing each to achieve their respective objectives. As a result, more communities benefit than would have been the case with philanthropic and public funding alone.

Bringing social and environmental impact to scale

Public and philanthropic funders are looking for impact, not financial returns. Participating in blended finance initiatives offers public and philanthropic funders an opportunity to catalyze additional funds from investors by de-risking transactions or providing relative return enhancement.

With blended finance, catalytic capital allows investment to take place that would not otherwise happen. With these additional resources, public funders and philanthropists benefit by getting more impact for their resources than they would otherwise.

Powering up impact

Between 2019 and 2021, multilateral development banks (MDBs) and development finance institutions (DFIs) were able to mobilize only 13 US cents of additional private finance for every US dollar invested by them. But when using blended finance instruments during that timeframe (less than 2% of their total commitments), they were able to mobilize 50 US cents per dollar invested.[19]

[19] Institute of International Finance (IIF), Scaling Blended Finance for Climate Action – Perspectives from Private Creditors, June 26, 2023.

Providing financial returns to commercial investors

Historically, development aid and climate funding has been given in the form of direct grants from philanthropists or governments. Involving commercial investors looking for risk-adjusted financial market returns – such as asset owners, asset managers, family offices or private individuals – unlocks larger amounts of capital while providing them with a new investment opportunity.

Commercial investors seek market-rate financial returns. At the same time, these investors – particularly institutional investors – may be motivated by diversifying their investment portfolios. The reduction in systemic risk is a key consideration for them to improve long-term returns and studies show consistently that diversifiable risk is a small portion of a portfolio's risk.[20] While institutional investors on behalf of their principals are often very keen on impact, they are subject to various restrictions that limit their room to maneuver – for instance, in relation to a sub-market rate of return in comparison to equivalent investments or asset classes and/or emerging market risks.[21] So, reducing risk for any given rate of return through the use of blended finance can allow them to engage.

Pursuing multiple objectives

Can catalytic funders also be commercial investors? Of course.

Family offices, for example, frequently pursue impact from a variety of angles, taking a broad view of returns that includes impact, financial returns and the creation of future investment opportunities. The Tsao Family Office, for example, pursues financial, social and environmental returns through impact investing and philanthropy.[22]

Family offices have the opportunity to participate in blended finance structures in two ways: taking positions on both catalytic and investment tranches. Guess who Convergence registers as the top private investor for blended finance since it began tracking transactions? A single-family office.[23]

[20] James Hawley and Jon Lukomnik, “Beyond Modern Portfolio Theory: How Investors can Mitigate Systemic Risk through the Portfolio,” RI Quarterly, vol. 12, UNPRI, 2017.

[21] Frederic de Mariz, Laura Aristizábal and Daniela Andrade Álvarez, “Fiduciary duty for directors and managers in the light of anti-ESG sentiment: an analysis of Delaware Law,” Applied Economics, 2024.

[22] Indira Vergis, “Tsao Family Office busts myths on impact investing, philanthropy,” Asian Investor, May 2, 2024.

[23] Convergence, Blended Finance, accessed September 3, 2024.

Benefitting more communities

By leveraging private sector capital alongside philanthropic and public resources for development, blended finance initiatives can have a profound impact on marginalized communities and developing regions by offering additionality – that is, funding projects that otherwise would not have happened.

Blended finance initiatives can prioritize inclusive and sustainable development practices, with a goal of benefitting the most vulnerable populations. Communities can benefit from improved healthcare, better education, clean energy and other outcomes that enhance quality of life.

The communities benefitting from blended finance can be large, including sovereign nation states benefitting from investment in climate resilience. Or they can be more discreet, such as individual villages in a particular country benefitting from better education through investment in an early-childhood education social enterprise.

Catalytic investors

- Philanthropists
- Multilateral development banks (MDBs)
- Development finance institutions (DFIs)
- International Development Agencies (USAID, DFID, SDC, etc.)

Communities

Commercial investors

- Asset owners
- Asset managers
- Family offices, foundations, endowments
- Private individuals

How blended finance can help with climate mitigation and adaptation

> "EMDEs [emerging markets and developing economies] are confronted with significant funding gaps to finance their transition to a net zero economy. Public resources for climate investments in EMDEs are often limited, with governments constrained by high public debt amid increased borrowing costs from elevated interest rates. Private capital is constrained by the unattractive risk-return profiles of many transition projects.
>
> Blended finance can play an important role in synergising public and private capital for climate mitigation and adaptation. It entails the use of public resources at concessionary terms to catalyse private financial flows."[24]
>
> Network for Greening the Financial System

[24] Network for Greening the Financial System, Scaling Up Blended Finance for Climate Mitigation and Adaptation in Emerging Market and Developing Economies (EMDEs), December 2023.

Section 5

What are the challenges to scaling?

While blended finance is seen as a promising approach to turn billions of development finance into trillions, several challenges impede realization of its full potential. Addressing these in the coming years is critical to scaling impact.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Appealing to catalytic capital providers

Blended finance does not work without catalytic capital. The main sources of catalytic capital are governments and development banks, but increasingly philanthropists and foundations are considering engaging their funding. The challenge in engaging catalytic funders is linked to real and perceived issues. Real issues, of course, exist when the net impact of the blended finance structure is not bigger than the pure philanthropic alternative. But perceived issues can come into play when, for example, a large net positive impact can be achieved but a catalytic capital provider hesitates to participate due to the presence of commercial investors requiring risk-adjusted market rate returns in the same blended finance structure.

Furthermore, philanthropists often have specific themes and geographies they would like their funding to support. This can be a challenge as such highly country- and/or theme-specific allocations may not always be feasible. This is especially the case when the blended finance structure is investing in relatively new and innovative programs and social enterprises.

Addressing commercial investment barriers

Blended finance structures fund projects that involve higher risk and or lower aggregate returns due to their innovative nature or challenging operating context. While blended finance structures aim to remove some of these risks or enhance returns, investors may still be reluctant to invest. This reluctance is often based on investors' inability to accurately gauge the risks involved or expected returns. This could be due to the lack of a track record, early stage or innovative nature of the underlying investments.

Apart from risk/return considerations, interested parties may also struggle to invest due to the restrictive nature of their investment policies. In these cases, a blended finance structure – despite providing risk reduction or return enhancement – may not meet certain conditions, such as those related to tenor, geography (developed vs. emerging or developing markets), or thematic limitation.

Improving visibility for viable projects

Blended finance is most effective when it can bridge risk gaps to crowd in private capital. Ideally, projects that sit at the cusp of commercial returns – for example, a revenue-generating project in emerging markets where returns exist but are insufficient to meet risk/return requirements of institutional investors in those markets – could be the most efficient projects to support through catalytic capital.

Technical assistance and verification may go some way in improving project visibility for investors. Many catalytic capital providers do recognize the importance of and are willing to provide technical assistance, but transparency on how and where resources get spent is important to drive credibility and scale. Meanwhile, project verification is a greater challenge to achieve and is currently mainly underwritten by non-government organizations where standardization and oversight is relatively low. Improved data and governance structures will go a long way towards bridging perceived and real underlying project risks.

Creating strong impact measurement

The key motivator for catalytic capital providers is impact. Blended finance initiatives must therefore be designed with an impact framework that clearly articulates the intended impact, the timeline to achieve this impact, how impact will be measured and disclosed, who will measure it and how often. This framework should follow from an underlying theory of change that is, in essence, a comprehensive description and design of how and why a desired change is expected to happen and would generate positive impact.

The feasibility of credible impact measurement and management, consistently applied throughout the lifecycle of the project, acts as another effective constraint on the viability of projects for the blended finance structure. A solid impact framework is indispensable for building and increasing trust among all stakeholders involved: philanthropists, public sector investors, commercial investors, program partners and communities.

Section 6

A future with opportunities

The potential for blended finance is immense. It presents opportunities for philanthropists, public funders, investors and communities alike.

Potential for great impact

Opportunities exist across a wide range of sectors, including climate resilience, nature conservation, energy transition, infrastructure, healthcare, education, agriculture and financial inclusion – areas where there is an underlying investment thesis to be built on. The potential for leveraging private capital to address global development challenges is substantial.

A 2024 report[25] by Convergence provides insight into the current market for blended finance:

- Financing totals grew to USD 15 billion in 2023, reaching a 5-year high.
- There were 25% fewer deals in 2023 compared to the year prior, but a greater frequency of deals with ticket sizes over USD 100 million than in the previous two years.
- The use of concessional guarantees and risk insurance is increasing, with the value of concessional guarantees up by over 40% in 2023 from 2021.
- 2023 saw the launch of a series of substantial coalition-led blended finance initiatives deploying official development assistance (ODA) instruments for deal pipeline development and catalytic capital efficiency.

What trends do we see?

More nature, more climate finance
A surge in climate blended finance deals is expected in the coming years, particularly in Asia.

Measurement will be king
Calls for accountability will grow, including increased standardization and transparency.

More philanthropists seeking efficient leverage
Catalytic philanthropic capital will bring in more private investments, multiplying impact both quickly and more efficiently.

Designing for local needs
Success relies on a greater focus on local contexts, market conditions and legal and regulatory frameworks.

Find out more here: **ubs.com**

[25] Convergence, The State of Blended Finance 2024, April 30, 2024.

About UBS Social Impact and Philanthropy

> Changing the world needs leadership. As one of the world's largest wealth managers, at UBS, we want to lead the way to a better future – for ourselves and generations to come.

We believe people's desire to make the world a better place will keep growing. People will increasingly seek to do good by choosing sustainable investments and philanthropic solutions. We're here to help you have more impact with your wealth. Together, we'll explore your purpose and help you make a difference through giving, investing,[26] connecting and leading the change you want to see.

We're recognized globally for our philanthropy services and expertise. With 25 years' experience, we can help you and your family maximize your impact locally, nationally and globally. And we're proud to be among the founding signatories of the Principles for Responsible Banking of the United Nations Environment Programme Finance Initiative. We were also among the first banks to shine a light on the United Nations' Sustainable Development Goals and what it takes to make them investable for clients.

Today, we're always seeking to develop solutions that direct investments towards those goals. Our philanthropic grant-giving foundation, the UBS Optimus Foundation, focuses on education, health, social protection, and environmental and climate issues. We've also launched UBS Collectives to help you connect with other philanthropists and take your solutions to the world. We cover the costs of running the collective, match donor funding and provide a deep learning experience over two years.

[26] As with any investments, the value may fall as well as rise, and you may not get back the amount you originally invested.

Glossary of terms

Additionality
A hallmark of blended finance in generating private capital investment, funding projects that otherwise would not have happened.

Blended finance
An investment structuring approach that utilizes philanthropic or public funding to catalyze commercial investment in development.

Catalytic capital
Sometimes called concessional capital, this funding comes from philanthropists or public funders to enable the blended finance structure by de-risking the investment to attract commercial investors.

Concessional capital
One blended finance structure where catalytic funders provide funds on below-market terms to lower the risk of the investment for private investors.

Development finance institutions (DFIs)
DFIs, or development banks, are government-backed institutions that make investments in underserved geographies and sectors where commercial funding is unavailable.

Impact investing
An approach to investing with explicit intentions to generate measurable, verifiable, positive sustainability outcomes, in addition to targeting market-rate investment returns.

Loan guarantee/risk insurance
One blended finance structure approach where the catalytic funder provide credit enhancement through guarantees or insurance, thereby lowering the risk for commercial investors.

Multilateral development banks (MDBs)
MDBs are international financial institutions chartered by two or more countries – like the World Bank – that encourage economic development through loans and grants.

Sustainability-focused investing
An approach to investing with explicit intentions or objectives that drive the strategy, in addition to targeting market-rate investment returns.

Technical assistance
Funding that is not part of the blended finance structure used to pay for expertise and information intended to increase the quality and, therefore, attractiveness of the blended finance investment.

Further resources

Convergence –
Blended finance primer >

Global Impact Investing Network (GIIN) –
What you need to know about impact investing >

International Finance Corporation –
DFI Working Group >

European Corporate Governance Institute –
Blended Finance >

OECD –
Leveraging private finance for development >

SDG Impact –
UNDP flagship initiative >

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