

GEF

Innovations in Blended Finance: A Summary



GLOBAL ENVIRONMENT FACILITY
INVESTING IN OUR PLANET

TRANSFORMING THE WORLD'S ENERGY SYSTEMS, CITIES, AND LAND-USE SYSTEMS TO BECOME LOW-CARBON AND RESILIENT WILL REQUIRE A LARGE-SCALE CHANGE IN GLOBAL FINANCE FLOWS.

The magnitude of financing is in the order of trillions of dollars per year, of which a large amount comes from the private sector. It is therefore critical that scarce public resources are deployed in a way that catalyzes the required redirection of finance. Blended finance aims to achieve exactly that, and therefore has attracted significant interest in recent years.

Blended Finance for Climate Change

Blended Finance refers to structured transactions in which development finance and private capital achieves climate impact—or other environmental impacts—while at the same time delivers adequate risk-adjusted financial returns for the private investor. The most commonly used financial instruments in blended finance are (i) guarantees, which provides protection from various forms of risks of capital loss for investors; (ii) debt, typically in the form of subordinated or concessional debt (or both); and (iii) equity, typically in the form of junior equity accepting higher risks for lower financial returns.

Adapted from OECD/World Economic Forum "Blended Finance Vol. 1: A primer for Development Finance and Philanthropic Funders."

The GEF experience shows that blended finance is a potent instrument. During 2013-14, the GEF provided a total of \$1.4 billion in climate finance (as defined by OECD-DAC's "Rio Marker"), equivalent to 68% of total funding from the GEF in that period. This finance mobilized about \$800 million from the private sector, implying that GEF climate finance, on average, mobilized about 60 cents from the private sector for each dollar from the GEF. The contrast with the GEF's smaller sample of blended finance operations is sharp: the \$175 million that GEF provided for blended finance operations mobilized \$1,098 million from the private sector, equivalent to a leverage ratio of 6.3—that is, a mobilization rate that is several times higher than our "regular" operations. The GEF experience shows that Blended Finance can be an effective instrument to redirect private sector finance towards investments that benefit the climate.

GEF Climate Finance Private Sector Mobilization

	Total Project Financing (US\$ million)				Leverage (\$ co-financing per \$ GEF Grant)		
	GEF Grant	Total co-financing	Private Sector co-financing	Other co-financing	Total	Private Sector	Other
Climate Finance	1,426	11,292	795	10,497	7.9	0.6	7.4
Of which Mitigation	514	5,286	660	4,626	10.3	1.3	9.0
Of which Adaptation	415	2,649	63	2,585	6.4	0.2	6.2
GEF Blended Climate Finance	175	1,603	1,098	505	9.2	6.3	2.9

Table data sources can be found on the back of the document



The GEF has experimented with Blended Finance for several years, initially mostly focusing on renewable energy and energy efficiency. As sustainable energy technologies began achieving significant cost-reductions and countries put in place enabling policy environments (e.g., feed-in-tariffs, power purchase agreements) the opportunity for private sector investment expanded greatly. The use of GEF funds to support equity investments proved especially attractive for supporting small scale clean energy projects.

GEF Blended Finance Operations in Renewable Energy and Energy Efficiency

Junior Equity for Renewable Energy. The GEF has provided \$4.5 million to the Africa Renewable Energy Fund (AREF), managed by the African Development Bank (AfDB) in the form of Class A shares with return capped at 4 percent. \$25 million is provided AfDB and other donors. By accepting a capped return, the GEF enables net returns to other investors to increase by 2-3%, which will expand the range of potentially investable projects and reduce the need for enhanced policy incentives to make projects bankable. The equity funding provided by the GEF and other development partners is expected to attract at least \$150 million from public, institutional, and commercial partners and significant additional private sector finance, primarily debt, for the actual projects, with a pipeline already worth half a billion dollars.

Junior Equity for Renewable Energy. The Equity Fund for the Small Projects Independent Power Producer Procurement Program managed by the Development bank of South Africa (DBSA) will promote renewable energy supply in South Africa by small and independent power producers. Similar to AREF, GEF funds are invested with the expectation of below-market return. DBSA will also create a securitization platform to help resell initial investments after the projects have begun power production. These two interventions help reduce capital costs for small-scale producers and attract private sector capital. The proposed investments will result in installation of close to 100MW of renewable energy, reducing approximately 260,000 tons CO₂e per year, resulting in an estimated 5 million tons CO₂e over an assumed average project lifetime of 20 years.

Subordinated, Concessional Debt for Energy Efficient Transport. The Green Logistics Program managed by the European Bank for Reconstruction and Development (EBRD) will improve efficiency and productivity of freight transport in the Black Sea Region by enhancing access to finance. GEF funding will provide subordinated loans at a concessional rate and security for investments made by the EBRD that promote energy efficiency and lower GHG emissions in the logistics sector. The availability of junior funding from the GEF will allow the EBRD to invest its own funds in projects that otherwise would be priced excessively, thus leveraging the EBRD's capacity to deliver energy efficiency solutions in the logistics sector in the region and to help clients to introduce energy efficient practices. With the GEF funding, co-financing investments should be well over \$155 million during the project period. Subsequent follow-on investments are expected to rise to \$250 million after the project is completed. Estimated greenhouse gas emissions reductions are 9.1 million tCO₂e.

Recently, the GEF has supported Blended Finance operations focused on the frontiers of natural resources management and climate. An encouraging trend in the GEF's Blended Finance program is the increasing interest in transactions and funds aiming to mobilize private finance to achieve a broader range of environmental objectives. For example, land restoration projects can deliver both improved soil health and enhance carbon sequestration; agro-forestry projects can help protect biodiversity, and enhance global carbon sinks. The GEF now has several innovative projects with this focus.

GEF "Frontier" Blended Finance Operations

Guarantees and Subordinated debt for Land Restoration. The Risk Mitigation Instrument for Land Restoration project, managed by the Inter-American Development Bank (IADB) combines a GEF investment of \$15 million with \$120 million in co-financing to deploy innovative risk mitigation instruments to support public and private sector investment to restore degraded lands in Latin America. The private sector is increasingly seeking investments in the restoration of degraded lands as a means of bringing low productivity land into production. Such investments however, have longer payback periods and represent various types of high financial risk making them difficult to finance. GEF funds will be used to provide guarantees and subordinated loans, helping catalyze additional public and private sector investments by reducing perceived risk. The project will support land restoration and integrated natural resources management activities such as sustainable management for increased eco-system services; landscape regeneration; intercropping; shade-grown systems; high-value forest products; and silvo-pastoral systems yielding benefits on at least 45,000 hectares. The enhancements to carbon stock in these investments are estimated to yield emissions reductions of 4.5 million tCO₂e.

Junior Equity for Agro-Forestry. The Moringa Agro-forestry Fund for Africa, managed by the AfDB, will promote sustainable land management in production landscapes in Burkina Faso, Cote d'Ivoire, Kenya, Mali, Tanzania, Zambia, and Congo DR. The Fund will invest in 5-6 scalable, replicable agroforestry projects that combine plantation forestry with agricultural elements to capture most of the value chain. The GEF has taken a junior equity position in the fund with an expected return of 6 percent. GEF's position helps lower risks for private sector investors who may be reluctant to consider land management projects on purely commercial terms due to for example long payback periods, lack no track record and uncertainty over product prices. The project also targets 79,000 hectares to maintain significant biodiversity and associated ecosystems goods and services, and more than 200,000 hectares of production systems under sustainable land and forest management. The project is expected to yield GHG emissions benefits of 9.5 million tons CO₂e.

Debt Aggregation for Energy Efficient City Lighting. The International Energy Efficiency Facility (iEEF), managed by the World Bank, is an example of a targeted intervention aimed a bridging the gap between institutional investors seeking exposure to real asset classes and the idiosyncratic investment needs related to increasing efficiency and bringing down carbon emissions in cities around the world. The iEEF will help aggregate energy efficient investment projects in cities around the globe, focusing first on conversion of traditional urban street lighting technologies to more efficient lighting emitting diodes (LEDs). Without aggregation, many projects would be too small for consideration by investors. Aggregation also helps cities with lower credit ratings to participate in a package that spreads the risk. Cities stand to not only reduce greenhouse gas emission benefits, but realize budgetary savings. Once up and running, this facility could expand aggregation approaches to broader types of efficiency investments, such as building retrofits. Estimated emissions reductions are 1 million tCO₂e.





By design, blended finance is a way to establish multi-stakeholder platforms around specific issues. An important emerging lesson from the GEF's experience is that blended finance transactions often bring together a broad coalition of stakeholders around a particular issue, including multilateral development agencies, private commercial investors, impact investors, civil society and others. This approach not only allows each partner aim for specific investment outcomes, but also enhances knowledge sharing and exchange of ideas, which are important additional benefits from these operations.

Blended Finance—Selected Partners in GEF Operations

Impact Investors: Calvert Foundation, Oiko Credit Ecumenical Development, Hivos-Triodos, Blue Moon Fund

Multilateral and Bilateral Development Institutions: KfW, European Investment Bank, Netherlands Development Finance Company (FMO), African Development Bank, Development Bank of South Africa, European Bank for Reconstruction and Development, Inter-American Development Bank, Sustainable Energy Fund for Africa, World Bank/IFC,

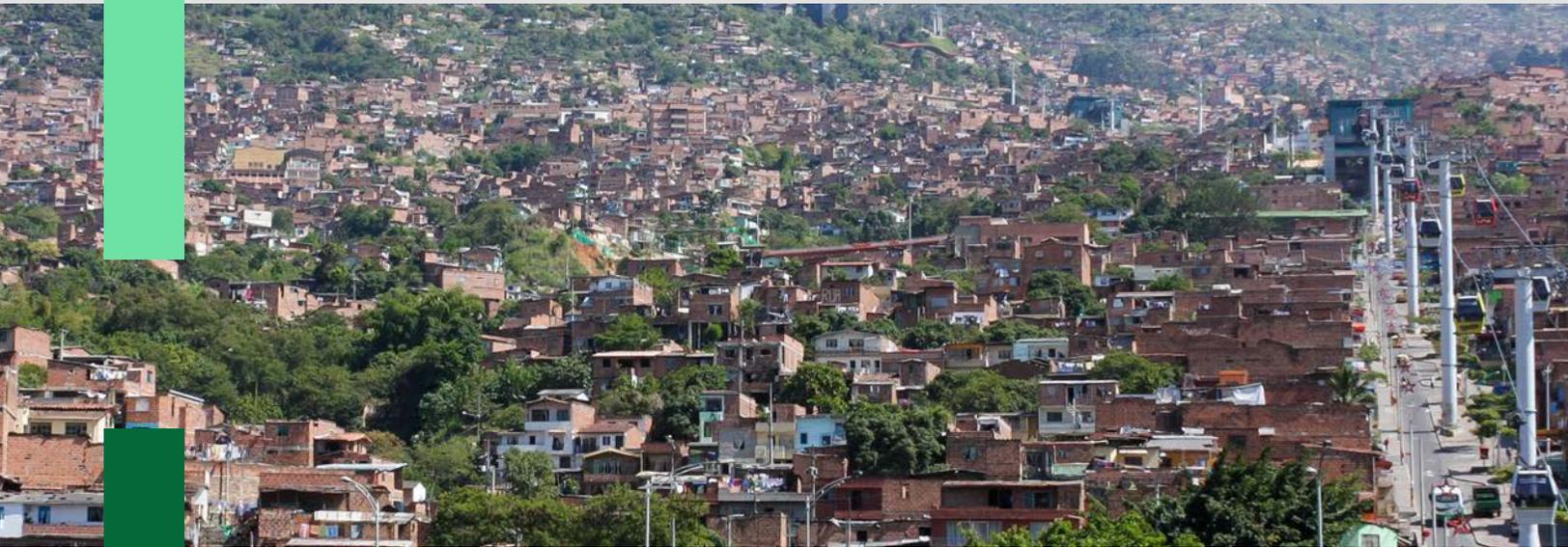
Private Funds and Investors: EcoEnterprises Fund, La Compagnie Benjamin de Rothschild, Moringa Fund

NGOs: The Nature Conservancy, ONF International

Blended finance is not a panacea that can be exclusively relied upon to drive the needed transformation in global economic systems, but it is an important element in package of available instruments. Broader support for appropriate policy frameworks that can help improve predictability and support low-emission investments are critically important, as are support for institutional strengthening and targeted capacity building in both the private and public sectors. At the same time, there are many opportunities to expand use of blended finance. To do this will require continued innovation on the ground to help countries and private sector partners match the right types of financial instruments to specific projects goals and objectives, including in "frontier sectors." Support for project preparation, along with aggregation and bundling of projects that can attract large scale investors will also be needed in many cases.

Data Sources

Data includes all GEF funded projects from the following GEF-managed trust funds (GEF Main Trust Fund, Least Developed Countries Fund, Special Climate Change Fund and the Nagoya Program Implementation Fund) that were endorsed or approved by the GEF CEO during calendar year 2013 and 2014. "CEO Endorsement or Approval" in the GEF project cycle is the final step before start of implementation. Excludes agency fees and project preparation grants. "Climate Finance" includes GEF funded projects that had climate change mitigation or adaptation as a "principal" or "significant" objective (as defined by OECD's "Rio Marker"). Note that this may include projects funded from GEF focal areas other than climate, it could, for example, be a forest restoration project funded from the GEF's biodiversity focal area which nevertheless has significant climate change mitigation objectives. "Climate Change Mitigation" finance includes projects with climate change mitigation as a "principal" objective, as defined by OECD's "Rio Marker". "Climate Change Adaptation" finance includes projects with climate change adaptation as a "principal" objective, as defined by OECD's "Rio Marker". Note that the definition of "climate-related" finance, following standard OECD practice, is broader than mitigation and adaptation as a "principal" objective, which is why "Total Climate Finance" exceeds the sum of Climate Mitigation and Climate Adaptation Finance. GEF Blended Climate Finance includes a total of 12 projects funded by the Main GEF Trust Fund starting from the end of GEF-4 and including the GEF-5 "Private Sector Set-aside" and programming to date under the GEF-6 Non-grant Instrument Pilot. Data is preliminary and should be treated with caution as data for a number of the projects are based on approved project concepts, not endorsed projects.



ABOUT THE GEF

The Global Environment Facility (GEF) was established on the eve of the 1992 Rio Earth Summit, to help tackle our planet's most pressing environmental problems. Since then, the GEF has provided \$14.5 billion in grants and mobilized \$75 billion in additional financing for almost 4,000 projects. The GEF has become an international partnership of 183 countries, international institutions, civil society organizations, and private sector to address global environmental issues.

The GEF's 18 implementing partners are Asian Development Bank (ADB), African Development Bank (AFDB), Development Bank of Latin America (CAF), Conservation International (CI), Development Bank of Southern Africa (DBSA), European Bank

for Reconstruction and Development (EBRD), Foreign Economic Cooperation Office - Ministry of Environmental Protection of China (FECO), Food and Agriculture Organization of the United Nations (FAO), Fundo Brasileiro para a Biodiversidade (FUNBIO), Inter-American Development Bank (IDB), International Fund for Agricultural Development (IFAD), International Union for Conservation of Nature (IUCN), United Nations Development Programme (UNDP), United Nations Environment Programme (UNEP), United Nations Industrial Development Organization (UNIDO), West African Development Bank (BOAD), World Bank Group (WBG), World Wildlife Fund Inc.. (WWF-US).



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