

HIGHLIGHTS

- Concessional capital is financing provided on more favourable (e.g., lenient) terms to mobilize commercial capital, and could include grants, debt at below-market rates, and equity with asymmetrical returns.
- Leverage ratio measures the amount of commercial capital mobilized by concessional capital, where commercial capital includes capital deployed by private investors at market rates and by public and philanthropic investors (mostly DFIs & MDBs) at market rates.
- Blended finance funds in the [Convergence database](#) have had an average leverage ratio of 1:4. For every \$1 of concessional capital, \$4 of commercial capital has been mobilized.
- Leverage ratios vary significantly across sectors and geographies according to perceived and real risks – e.g., average leverage has been greater for Latin America compared to Sub-Saharan Africa.
- Larger blended finance funds – between \$250-\$500 million in total size – have leveraged the greatest volumes of commercial capital per dollar relative to other deal sizes, on average.
- Of the \$4 of commercial capital mobilized by \$1 of concessional capital, only a fraction has come from private sector investors. Blended finance funds have attracted \$1.10 in private capital for \$1 of concessional capital. This highlights blended finance’s historic focus on partnering with DFIs and MDBs, rather than mobilizing private investors.
- Blended finance transactions should seek to maximize impact and leverage, but always according to the conditions of the transaction. Ultimately, leverage is just one measure of success for blended finance transactions.
- Given the size of the investment gap to achieve the SDGs, Convergence, along with many other stakeholders, pushes for blended finance approaches that focus on private capital mobilization.

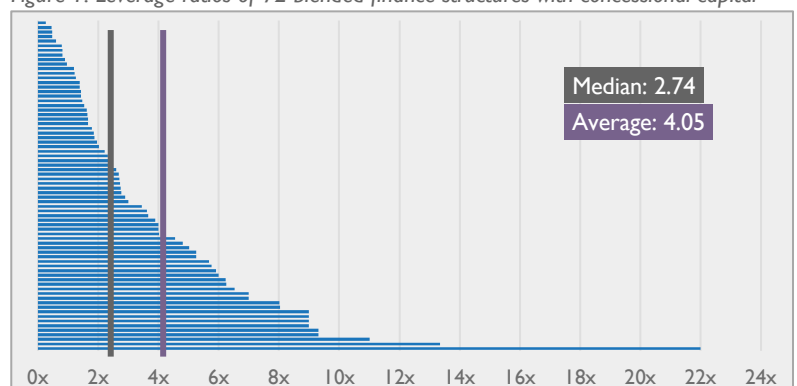
Each dollar of concessional capital deployed to a blended finance fund has mobilized on average \$4 in commercially-priced capital.

More than 40% of blended finance transactions have used concessional capital in a junior position – typically provided by public or philanthropic funders – to mobilize additional private investment to developing countries aligned to the Sustainable Development Goals (SDGs). Concessional capital refers to financing that offers more favourable terms than commercial capital, from grants (100% concessional) to debt at below-market rates or equity with asymmetrical returns. Concessional capital improves the risk-return profile of an opportunity to an acceptable level for commercial investors (e.g., by taking on additional risk).

Leverage ratios can be used to evaluate the effectiveness of concessional capital in blended finance transactions. While there are many ways to calculate leverage, this Brief analyzes overall leverage as measured by the amount of commercial capital mobilized by each dollar of concessional capital, where commercial capital includes capital deployed by private investors at market rates and by public and philanthropic investors (e.g., DFIs and MDBs) at market, or near market, rates. This Brief analyzes trends in leverage ratios of 72 blended finance funds or fund-like structures with concessional capital, using data from Convergence’s [database](#).

The average leverage ratio for blended finance funds with concessional capital has been 4.0. Leverage has ranged from a minimum of 0.3 to a maximum of 22.0, with a median of 2.7. This analysis mirrors other estimates published to date. For example, a World Economic Forum [study](#) found that the majority of deals studied leveraged ~\$5 per \$1 of development funding. Convergence’s estimates are modestly lower because, in part, our sample does not include blended finance transactions with guarantees at below market rates or grant funding for transaction design, which may have higher leverage.

Figure 1: Leverage ratios of 72 blended finance structures with concessional capital



ANALYSIS

Average leverage has been larger for transactions targeting Latin America compared to Africa

The average observed leverage ratio in Latin America and the Caribbean has been twice that of Sub-Saharan Africa. Blended finance funds targeting Latin America and the Caribbean had an average leverage ratio of 5.1, while those targeting Sub-Saharan Africa had an average leverage ratio of 2.4. Blended finance funds targeting Middle East and North Africa had a slightly higher average leverage ratio of 3.9. This aligns with expectations: Africa has the largest concentration of low-income countries, which tend to have higher perceived and real risks for commercial investors and therefore require more concessional capital dollar-for-dollar.

Health services and agricultural finance have had higher average leverage ratios compared to other sub-sectors

Overall, higher leverage ratios were achieved by blended finance funds targeting the financial services and infrastructure sectors (Figure 7). However, there was notable variation in average leverage ratios by sub-sector. For example, within financial services, blended finance funds focused on microfinance have historically attracted, on average, a greater volume of commercial capital (1:4.6) compared to those focused on SME finance (1:3.5). Concessional capital has leveraged relatively more commercial capital, on average, for funds targeting health services, renewable energy, and agricultural finance.

As expected, larger ticket sizes have, on average, attracted more commercial capital

Larger blended finance funds have tended to leverage more commercial capital per dollar. Blended finance funds valued between \$250-500 million in total size have leveraged, on average, the greatest volume of commercial funding for each dollar (1:4.5). Relatively smaller blended finance funds have leveraged less commercial capital, on average, for each dollar of concessional capital. This observation may reflect the investment preferences and requirements of commercial investors, who often require larger ticket sizes given transaction costs, portfolio size, and investment mandates.

Blended finance funds with commercially-oriented deal sponsors have had higher average leverage ratios

Initial analysis suggests that blended finance funds originated or led by commercially-oriented deal sponsors (e.g., impact-driven fund managers, DFIs, and MDBs) have had higher average leverage ratios, while those originated or led by development agencies have had lower average leverage ratios. Development agencies likely place a stronger emphasis on development impact and the poorest regions, and may also have less experience working with private sector investors. Commercially-oriented fund managers may have specialized skillsets (e.g., emerging markets, asset management) and more experience working with private investors.

Figure 2: Average leverage ratio by target region

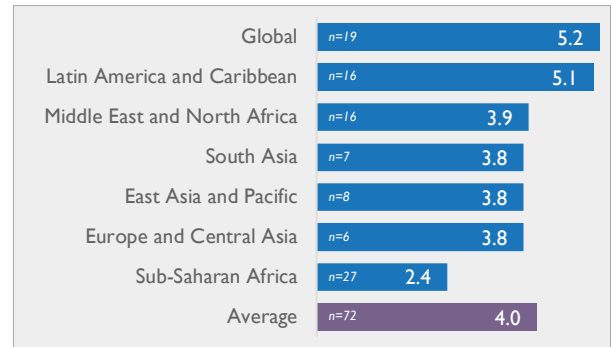


Figure 3: Average leverage ratio by target sub-sector

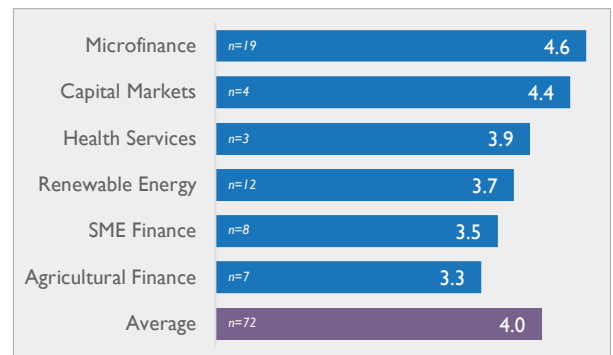


Figure 4: Average leverage ratio by deal size

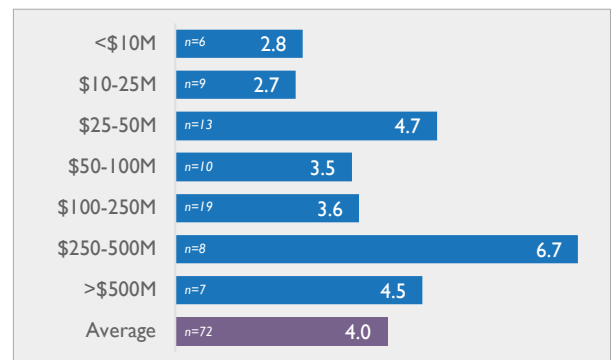
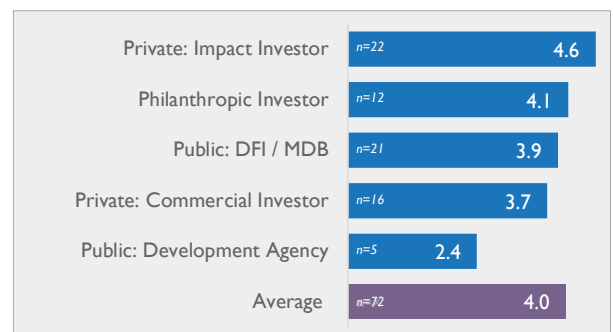


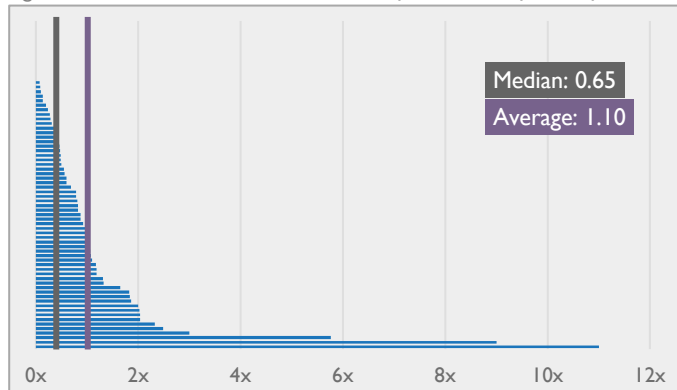
Figure 5: Average leverage ratio by deal sponsor type



Private sector investment has represented a fraction of commercial capital leveraged

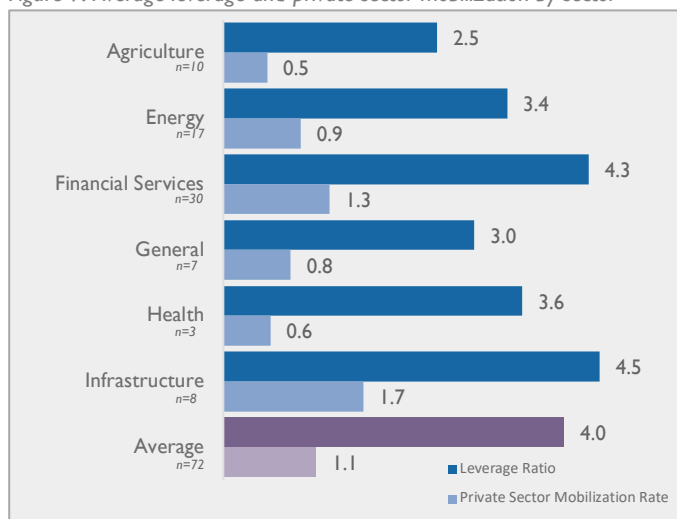
Of the \$4 of commercial capital mobilized by each \$1 of concessional capital, only a fraction has been from private sector investors. This Brief uses 'private sector mobilization' to indicate the amount of private sector capital leveraged by concessional capital. The average private sector mobilization rate has been 1.10, with minimum leverage of 0 (note: these deals raised commercially priced capital from only DFIs, MDBs, or philanthropic funders) and maximum of 11. This estimate is slightly higher than similar analysis completed by the OECD.

Figure 6: Private sector mobilization rates of 72 blended finance funds



Geographically, higher average private sector mobilization rates have been achieved through diversification: the average mobilization rate for global blended finance funds is 1.9, followed by East Asia and Pacific. As with overall leverage, the highest observed levels of private sector mobilization have been in the infrastructure (1:1.7) and financial services (1:1.3) sectors. Looking at private sector mobilization rates across sub-sectors, private investors have been, on average, more likely to invest in microfinance, renewable energy, and SME finance, and less likely, on average, to invest in agricultural finance and health services.

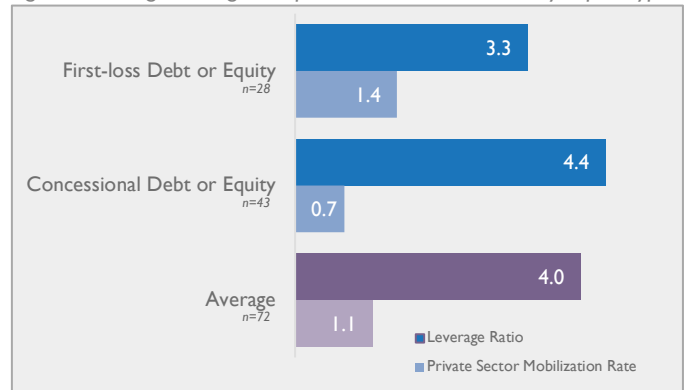
Figure 7: Average leverage and private sector mobilization by sector



First-loss capital has been the most effective tool to catalyze private sector investment to blended finance funds

Concessional junior and subordinate debt and equity deployed in tiered capital structures have been effective tools for attracting commercial capital from DFIs, MDBs, and impact investors to senior investment tiers. First-loss capital is even more risk-tolerant than concessional junior and subordinate capital, accepting negative returns as necessary. Initial observation suggests that first-loss debt and equity has mobilized more private investment than concessional debt or equity, with an average private sector mobilization rate of 1.4.

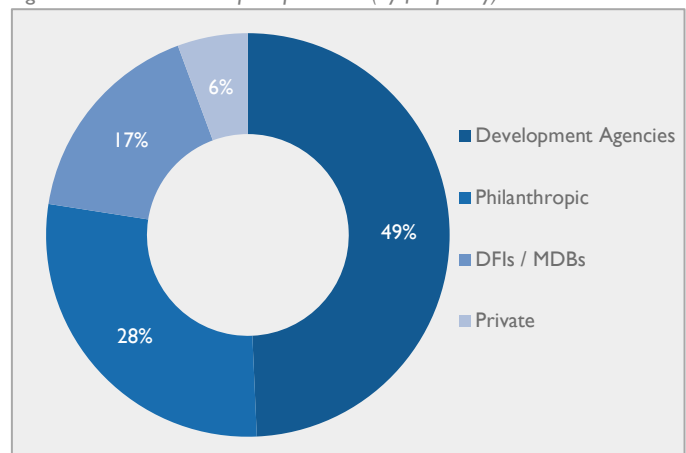
Figure 8: Average leverage and private sector mobilization by capital type



Development agencies are the top concessional capital providers

Concessional capital has been most frequently provided by development agencies, including multi-donor trust funds. Development agencies have deployed concessional capital to blended finance funds to leverage additional capital from DFIs and MDBs as well as private investors for lower-income countries or higher impact sectors. While DFIs and MDBs are sometimes criticized for insufficient focus on mobilizing private investment, certain DFIs and MDBs (e.g., FMO) have a strong and growing track record of deploying concessional capital to blended finance transactions to mobilize the private sector.

Figure 9: Concessional capital providers (by frequency)



REFLECTIONS

This Brief is a preliminary effort to benchmark leverage ratios for a sample of blended finance funds. Leverage ratios across blended finance funds have varied significantly, from a minimum of 0.30 to a maximum of 22 in this data set. Any effort to benchmark leverage ratios must be differentiated according to the conditions of the transaction, including the target sector, country, and impact outcomes. For example, deal sponsors have seen larger leverage ratios, on average, for blended finance funds targeting Latin America and the Caribbean, compared to Sub-Saharan Africa.

On average, blended finance funds have leveraged \$4.10 of commercial capital for every dollar of concessional capital. However, only a fraction of this commercial capital has come from private sector investors. This may highlight blended finance's historic focus of blending concessional capital with commercial capital from DFIs and MDBs, as opposed to mobilizing private sector investment. Given the size of the investment gap to achieve the SDGs, Convergence, along with many other stakeholders, urges practitioners to design and scale blended finance approaches that focus on private sector mobilization.

While leverage is a key component of blended finance, leverage ratios are just one indicator of the success of a blended finance transaction. Leverage ratios, if a desired metric, should be considered alongside other conditions (e.g. instrument, geography, region, and target outcomes), so as not to shift undue focus on commercial viability over development outcomes. Blended finance transactions should seek to mobilize additional sources of financing for projects aligned to the SDGs in developing countries, but only as suitable for the specific context of each project.

METHODOLOGY AND NOTES

1. **Convergence's database.** Convergence maintains the largest and most detailed database of historical blended finance transactions in the market. Given the current state of information sharing, it is not possible for this database to be fully comprehensive, but it is the best depository there is to understand blended finance scale and trends.
2. **Deal selection:** 72 deals were selected for this analysis from Convergence's Historical Deal Database based on the inclusion of concessional funding within the capital structure. This includes concessional capital that takes on additional risk or is priced below-market rates. Other forms of blended capital such as technical assistance funding, design-stage grants, and guarantees were not included in this analysis.
3. **Calculation of leverage ratio and mobilization rates:**
 - i) Leverage ratios are calculated as the ratio of commercial capital to concessional capital, including commercial (i.e., non-concessional capital) from public, philanthropic, and private sources.
 - ii) Private sector mobilization rates are calculated as the ratio of private commercial capital to mobilized by each dollar of concessional capital.
4. **Valuation of concessional and non-concessional capital:** All concessional capital referred to in this report is recorded at the face value of commitments from public sources. Non-concessional capital is recorded as the sum of non-concessional private and public reported investment or, when specific data is unavailable, derived from deal size.
5. **Analysis:** While as comprehensive as practical, this analysis is based on a limited sample size. The sample size (n) is noted where applicable. Observations discussed are based on historical data and are intended to identify trends, rather than to be predictive or prescriptive. Analysis highlights directional trends; the quantum of differences (e.g., regional differences) is not statistically significant given practical limitations in the data set.
6. **The word concessional used in this report implies bearing a non-market risk-return.** It does not imply concessionality in the traditional World Bank context of X% NPV discount.

ABOUT CONVERGENCE

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

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

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

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