

Blended finance for clean energy
1st technical workshop, 7 April 2022

SUMMARY

Background and context

Meeting the Paris goals of limiting global warming to 1.5°C by the end of the century, while pursuing climate-resilient development, will require an unprecedented mobilisation of all sources of finance, public and private. The financing needs to meet these goals are particularly acute in emerging and developing economies. The scale and complexity of the challenge is compounded by Covid-19 recovery needs, as well as longer-term development needs under the 2030 Agenda for Sustainable Development. Meanwhile, there remain myriad long-standing barriers to infrastructure investment and the mobilisation of wider climate finance, and the use of scarce public finance to effectively mobilise commercial capital remains far below its potential.

The scale of the challenge is such that all sources of finance – public, private, domestic and international – need to be mobilised at scale. In particular, the huge stocks of global capital need to be mobilised at scale towards more productive uses. Blended finance – the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries – has a critical role to play in this endeavour. In light of these challenges, the OECD’s Development Assistance Committee (DAC) has agreed a set of comprehensive principles to support development actors to most effectively leverage commercial capital through public development finance¹.

There is now a renewed need to develop bespoke guidance for the deployment and mobilisation of blended finance for clean energy. This guidance will build on the existing OECD DAC Blended Finance Guidance and Principles, in particular on Principle 2: designing blended finance to increase the mobilisation of commercial finance, whilst recognising the interdependencies of the wider principles.

General observations

- Though the risks facing commercial investment in clean energy were well-understood, the blended finance instruments that are commonly deployed to overcome them are not always tailored to the specific risks and barriers. There is therefore scope for the more efficient use of public resources by more carefully calibrating blended finance to project- and sector- specific features and risks.
- The OECD’s existing Blended Finance Principles provide a strong foundation to shape the use of blended finance for clean energy projects. Given the unique challenges facing the clean energy sector, and the scale of commercial investment needed to close the clean energy gap, blended finance tools need to be looked at afresh with specific reference to the sector. This includes the need for practical guidance that can help support beneficiary countries, donors, and the private sector to more effectively design blended finance interventions that are tailored to country, sector, and project specific risks.

¹ [The OECD DAC Blended Finance Guidance | Best Practices in Development Co-operation | OECD iLibrary \(oecd-ilibrary.org\)](https://oecd-ilibrary.org/)

Ensure additionality for crowding in commercial finance

Discussion questions

- *What other clean energy risk “add-ons” exist on top of the baseline risks for infrastructure investment?*
- *In which clean energy sub-sectors or geographies is there the highest potential for financial and development additionality, and for which the use of blended finance should be prioritised?*
- *How can blended finance be used to secure wider social benefits, including greater participation of women in clean energy projects?*

- Many clean energy investments, particularly in emerging economies, and the risks surrounding them are increasingly well-understood and managed by commercial investors. The greatest additionality gains are therefore at the frontier, both geographically, in low/low-middle income countries, and technologically, in newer sectors. But achieving scale, particularly in light of the huge financing needs for clean energy, is also important, so an objective of blended finance could also be to mobilise greater leverage in more mature sectors.
- Securing greater additionality gains also requires the more efficient use of scarce public (including donor) resources. Direct subsidies and grants could often provide a much greater leverage impact than cheaper or subordinated debt, with the same or similar financial cost to donors. This reinforces the need to more carefully tailor the nature of blended finance instruments to the specific challenge in a particular context.
- Development finance institutions such as MDBs that receive the bulk of donor funding and are the leading developers of blended finance mechanisms, lack the financial engineering expertise necessary to develop the innovative financing solutions necessary to access investors at the higher end of the risk spectrum, and therefore take on riskier projects. Current MDB mandates and practices may create disincentives to moving away from traditional concessional lending to more de-risking and structures that can help refinance and free up capital for riskier projects.

Seek leverage based on context and conditions

Discussion questions

- *What institutional and local financial market considerations are needed in beneficiary countries to design effective blended finance mechanisms?*
- *Which blended finance instruments should be used to maximise mobilisation in riskier projects and project phases?*

- Local stakeholders – financial institutions and project developers – often have a more sophisticated understanding of risk; their expertise should be drawn upon when considering the use of blended finance, and to help tailor instruments to address risk. Parallel efforts to improve the regulatory frameworks and deepen local capital markets, are also critical.
- Effectively responding to local conditions requires a comprehensive approach to blended finance by beneficiary governments, donors, and the private sector. New coordination mechanisms are emerging, which can help root specific interventions in governments’ longer-term decarbonisation strategies, thereby linking specific interventions to wider climate objectives.

Deploy blended finance to address market failures, while minimising the use of concessionality

Discussion questions

- *How can the need or degree of concessionality be determined in the clean energy sector?*
- *What other blended finance instruments (i.e. technical assistance for project preparation and project structuring) should be prioritised over concessional finance?*

- Concessionality of blended finance interventions in clean energy are not always well-targeted. Donors need to better tailor instruments to specific risks and market failures, and to risks at different stages of the project cycle. For example, concessional debt over the life of a project distributes concessionality over the life of a project, despite the risk profile often being heavily skewed towards the early stages. As well as the targeting of instruments to risks, risks need to be considered dynamically, and blended finance interventions tailored over time. Flexibility is key.
- Barriers to the mobilisation of commercial finance are often structural. Blended finance is not always the answer, and efforts to improve the underlying policy and investment environment are often needed, while blended finance is left to address specific risks and market barriers.
- Blended finance for clean energy is heavily skewed towards the use of concessional debt, rather than guarantees, which could be much more effective at mobilising commercial capital. Guarantees could be especially useful in addressing off-taker risk in renewable power projects. Guarantees and first-loss structures are not used widely enough in part due to a lack of capacity in donor organisations, as well as due to accounting rules that meant that guarantees eat into donors' capital space, without using direct resources. This could create a disincentive to the use of guarantees.
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Focus on commercial sustainability

Discussion questions

- *How do we assess clean energy sub-sectors for their long-term commercial sustainability, and determine the level of public support, including the use of concessional finance, accordingly?*
- *What level of technology maturity is needed before the use of blended finance should be considered?*

- Analysing commercial sustainability needs to happen at the sector and project levels, as well as with reference to local circumstances, including the ability of consumers to pay for services.

² OECD (2021), "Converged Statistical Reporting Directives for the Creditor Reporting System (CRS) and the Annual DAC Questionnaire: Reporting methods for private sector instruments (Annex 23)", Converged Statistical Reporting Directives for the Creditor Reporting System (CRS) and the Annual DAC Questionnaire: Reporting methods for private sector instruments (Annex 23), [https://one.oecd.org/document/DCD/DAC/STAT\(2020\)44/ADD3/REV2/en/pdf](https://one.oecd.org/document/DCD/DAC/STAT(2020)44/ADD3/REV2/en/pdf).

Commercial sustainability needed to be considered holistically, with reference to project development focusing on productive uses, for example investment in solar irrigation.

- Often there may not be a commercial solution to a clean energy problem, for example for energy access in remote areas without adequate growth outlook to achieve financial sustainability in a reasonable period. In such cases, well design subsidies may be a more targeted use of public resources than blended finance.
- With regards to newer clean energy technologies, often what is perceived to be technological risk is actually market risk: investors do not have certainty about how investments in newer, untested business models and cost inputs, for example hydrogen, may evolve in the long-term with the route to market difficult to predict. Blended finance therefore needs to be combined with efforts to establish market fundamentals.

Next steps

- The OECD continue to refine its analysis of blended finance for clean energy in the coming months, drawing on the expert inputs from workshop participants, as well as wider stakeholders. In particular, it will deepen consultation with private sector actors, including project developers and financial institutions.
- The OECD welcomes continued written and verbal input, including on the scope and structure of the planned blended finance guidance for clean energy. Development and clean energy practitioners are also invited to provide case studies setting out both challenges and best practice surrounding blended finance in the sector.
- Based on these consultations and inputs, the OECD will build on its existing work to develop more concrete guidance for the use of blended finance for clean energy. This will include deeper analysis of the financing challenges in clean energy sub-sectors, and the appropriate blended finance instruments that can be deployed to address those challenges.
- The OECD will convene a second workshop, tentatively scheduled for 25 May 2022.