

**Blended finance for clean energy  
2<sup>nd</sup> technical workshop, 25 May 2022**

**SUMMARY**

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**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 finance<sup>1</sup>.

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.

This workshop brought together stakeholders from beneficiary and donor governments, international financial and development finance institutions, and the private sector, to deepen participants’ collective understanding of the use of blended finance for clean energy. It built on an earlier workshop, held on 7 April 2022, which helped to identify gaps in understanding. In particular, this workshop helped identify and deepen understanding of clean energy sub-sector specific risks and barriers to commercial investment, and the specific blended finance instruments that can be used to help address and overcome them. The perspectives shared will be drawn upon during development of the OECD’s forthcoming guidance on blended finance for clean energy.

**General observations**

- The workshop was opened by Susanna Moorehead, Chair of the OECD’s Development Assistance Committee. She stressed the importance donors placed on private capital mobilisation for climate action in general, and blended finance specifically. She noted the difficulty of this challenge, and the importance of robust understanding of underlying barriers to investment, as well as a more sophisticated understanding of specific blended finance structures and instruments to help overcome them.

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

## Blended finance for clean energy in lower income countries

### *Discussion questions*

- *What specific barriers to finance and risks facing energy access need to be addressed to unlock greater scales of commercial capital?*
- *Which blended finance instruments can best address these barriers/risks?*
- *What indicators should be used to assess commercial sustainability?*

- **The development impact of clean energy access is huge.** Relatively small sums of public finance towards blending can potentially have an outsized impact on wellbeing, livelihoods, and wider economic and social development. These and other wider indirect benefits should all be accounted for when deciding where and how to deploy blended finance, and actively measured and monitored as projects are underway. This could help inform better decision-making on where best to deploy blended finance for the greatest development additionality (for example a relative shift away from utility-scale renewables and towards distributed generation, including for productive end-use).
- **Though a number of blended finance structures exist for utility-scale renewables in lower income countries, distributed and off-grid renewables remains an underserved sector.** Climate finance for renewables investment disproportionately benefits lower-middle and middle income countries, rather than lower income countries. There is also evidence that the share of funding requests from low-income countries for off-grid renewables is shrinking, due to other development needs and economic pressures. There is therefore a need for more innovative financing solutions targeted at more locally-suited solutions, including off-grid renewables, to close this gap. De-risking instruments for debt were more readily available than those for equity; the latter can be more important for development of off-grid projects.
- **Project risk is often lower than country risk in lower income countries.** Project aggregation and management by dedicated funds can help address this discrepancy. But it often requires a higher degree of concessionality. Given the very high potential development impact of off-grid renewables, a relatively high degree of concessional finance can be justified.
- **Blended finance needs to be used to target interventions by different development partners along different parts of the value chain.** For example, grant-funded technical assistance can be used to support project pipeline development and standardisation, whilst equity can be used to de-risk fund managers to aggregate small projects into investable products.

## Governance and coordination

### *Discussion questions*

- *Who are the key stakeholders that need to be involved designing, delivering, and monitoring blended finance transactions?*
- *How can in-country governance be designed to best facilitate the effective and efficient deployment of blended finance?*

- **Blended finance cannot be deployed in a vacuum** and needs to form part of a wider package of support measures. Some of the most significant barriers to clean energy investment are structural, and can only be addressed by concerted policy reforms. Clear long-term plans, including sectoral

decarbonisation pathways, are critical to investor confidence. Project level decisions often need to be taken alongside wider reforms, for example strengthening clean energy policies and regulation.

- **Private sector partners – including commercial finance and project developers – need to be brought in early.** This can inform a more nuanced understanding of barriers to commercial investment, and help shape public and blended finance interventions early in the process. This requires having a suite of blending tools ready to be deployed to respond to varied risks. Local capital markets development is also needed, including support for local financial institutions to improve their understanding of blended finance.

### **Sector deep dives: tailoring blended finance instruments to clean energy investment barriers and risks**

#### *Discussion questions*

- *What specific barriers to finance and risks need to be addressed in each clean energy sector?*
- *Which blended finance instruments can best address these barriers/risks?*
- *What indicators should be used to assess commercial sustainability?*

#### **Energy efficiency**

- **As with other sectors, a system-wide approach can support the efficient allocation and optimisation of blended finance interventions for energy efficiency.** Blended finance can be used to support the development of local solutions, for example through technical assistance and grant finance to support the development of locally designed building standards tailored to specific country weather conditions. Grant finance can also be used to support national and local governments to develop wider energy efficiency plans.
- **Standards and regulation are key to investments in energy efficiency.** Blended finance interventions need to be underpinned by, and can support the development of, clear guidance on the latest, most efficient available technology. These assessments need to reflect availability in and applicability to local markets. This can facilitate pre-approval of investments by the private sector, streamlining due diligence and investment decision-making.
- **Public finance interventions and concessionality need to be monitored over time.** As the costs of investment in efficiency fall, and the scope for commercial sustainability improves, blended finance should entail reduced concessionality over time. This further reinforces the need for close sight of the latest available technologies and their cost and availability in local markets. Levels of concessionality are typically higher for innovation, and lower for market penetration.

#### **Utility-scale renewables**

- **Utility-scale renewables are more susceptible to context- than technology- specific barriers to investment.** The scale and complexity of projects exposes them simultaneously to a number of long-standing risks that apply to large infrastructure projects in emerging and developing economies. This requires de-risking to be multifaceted, and targeted to individual risks. This, in turn, requires a diverse range of stakeholders to be involved in blended finance interventions, potentially providing multiple blended finance solutions simultaneously, and as part of wider efforts to de-risk investment, for example through enabling environment reforms.
- **Decisions on investment in renewables, including the deployment of blended finance, need to be considered as part of wider decarbonisation efforts.** Blended finance should form part of

a wider suite of tools to address the many challenges in energy transitions, including coal and other fossil fuel generation phase out strategies, efforts to mitigate the impact on vulnerable groups, and fossil fuel subsidy reform.

- **Projects and wider market conditions will mature over time, but some wider macro risks will remain.** In some situations, blended finance is needed at the early stage to get projects off the line, and concessionality can be reduced rapidly once they are operational. Some risks, for example foreign exchange risk, however, are more difficult to manage, and may require blended finance to persist for longer-periods of time.
- **Utility-scale renewables are already commercially viable and competitive with incumbent technologies in many geographic contexts.** This implies a need for discipline surrounding decisions to use public finance, especially concessional public finance. For existing projects with a public finance component, development partners should consider strategies for reducing concessionality and exiting blended finance interventions, to allow recycling of scarce public finance into more marginal projects.

#### ***Other clean energy and integration***

- **Energy storage is critical to the wider clean energy transition.** Infrastructure development, deployment, and financing strategies therefore need to be intimately linked to wider strategies for generation and transmission, which will impact the value proposition for investment in storage. Blended finance strategies should also be considered in a holistic manner, and with reference to the wider market, rather than on a project-by-project basis. Blended finance can help address uncertainties around demand and pricing, and technological performance, for example through viability gap funds and warranties protecting against physical asset degradation. Non-financial tools can also help mitigate technological risks, for example through clauses in power purchase agreements that protect battery and other storage asset owners against breach of contract in the case of non-performance due to technological failure.
- **Wider market conditions remain a barrier to investment.** Uncertainty around the future of certain technologies, including around the volume and distribution of global and local demand, poses risks for investment in some newer technologies, including green hydrogen. Such technologies may therefore require a higher degree of concessionality up-front, in the form of equity investment or direct subsidies. Contracts for difference can also help to address uncertainty around future market conditions, for example in the case of green hydrogen.
- **Clean energy supply chain risks can also be tackled by blended finance, for example through concessional support for investment in mining of critical minerals for batteries.** Instruments include grants supporting project development. Projects should be subject to sustainability criteria, both for development and financial purposes.
- **Investment in carbon capture, utilisation, and storage (CCUS) in fossil fuel generation infrastructure is likely restricted by wider sustainability and Paris-alignment criteria.** Paris alignment rules may be subject to greater flexibility, allowing investment in CCUS, if this was part of a wider strategy to decarbonise hard-to-abate sectors, including industry, for example.

## Using blended finance to scale institutional investment towards clean energy

### *Discussion questions*

- *How can blended finance be used to support the development of secondary markets?*
- *What financial products and instruments can be used to attract larger scales of global institutional capital towards clean energy?*

- **There remains a huge gap between the demand for clean energy finance in emerging and developing economies, and the investable products that commercial finance can be channelled towards.** International investors face a number of barriers to investment that blended finance can help address: small transaction sizes can be addressed through large aggregation platforms; a lack of institutional capacity to conduct due diligence among commercial investors can be addressed through technical assistance for project preparation; and high-risk transactions can be de-risked through first loss instruments and guarantees.
- **Different projects with different characteristics should target commercial capital providers accordingly, based on their expertise and investment objectives.** Pension funds, for example, look for stable, long-term returns, which could be well-suited to large utility-scale generation projects. At the same time, the nature of finance needs to be tailored to the needs of those demanding it. Concessionality also needs to be limited in order not to distort markets; this can be addressed through greater use of guarantees, rather than concessional loans. The leverage potential of the former is higher, given guarantees do not involve an automatic disbursement of public funds.