

# Blended Finance

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# What is blended finance?



Blended finance uses development (and government) finance to mobilize commercial finance to achieve different SDG goals

# What is blended finance?

## Investors in blended finance transactions targeting water and sanitation



Number of financial commitments

Source: Convergence Historical Deals Database, Nov 2020

# BLENDING FINANCE FOR THE SUSTAINABLE DEVELOPMENT GOALS

BRINGING DEVELOPMENT AND COMMERCIAL FINANCE TOGETHER

Blended finance could help bridge the investment gap for the Sustainable Development Goals in developing countries. Donor governments need to ensure blending approaches attract commercial sources of finance and directs these to development outcomes.

**MORE FINANCING NEEDED TO MEET THE \$2.5 TRILLION INVESTMENT GAP FOR SDGs IN DEVELOPING COUNTRIES**

Sources of external finance to developing countries



...BLENDED FINANCE COULD HELP BRIDGE THE INVESTMENT GAP...

## What is blended finance?

Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries.

**Additional finance = commercial finance**



BLENDED FINANCE CAN SHIFT THE RISK-RETURN PROFILE OF PROJECTS IN DEVELOPING COUNTRIES TO ATTRACT COMMERCIAL INVESTMENT.

BLENDED FINANCE IS GAINING TRACTION AMONG DEVELOPMENT FINANCE PROVIDERS



**17** of the OECD Development Assistance Committee members now engage in blending

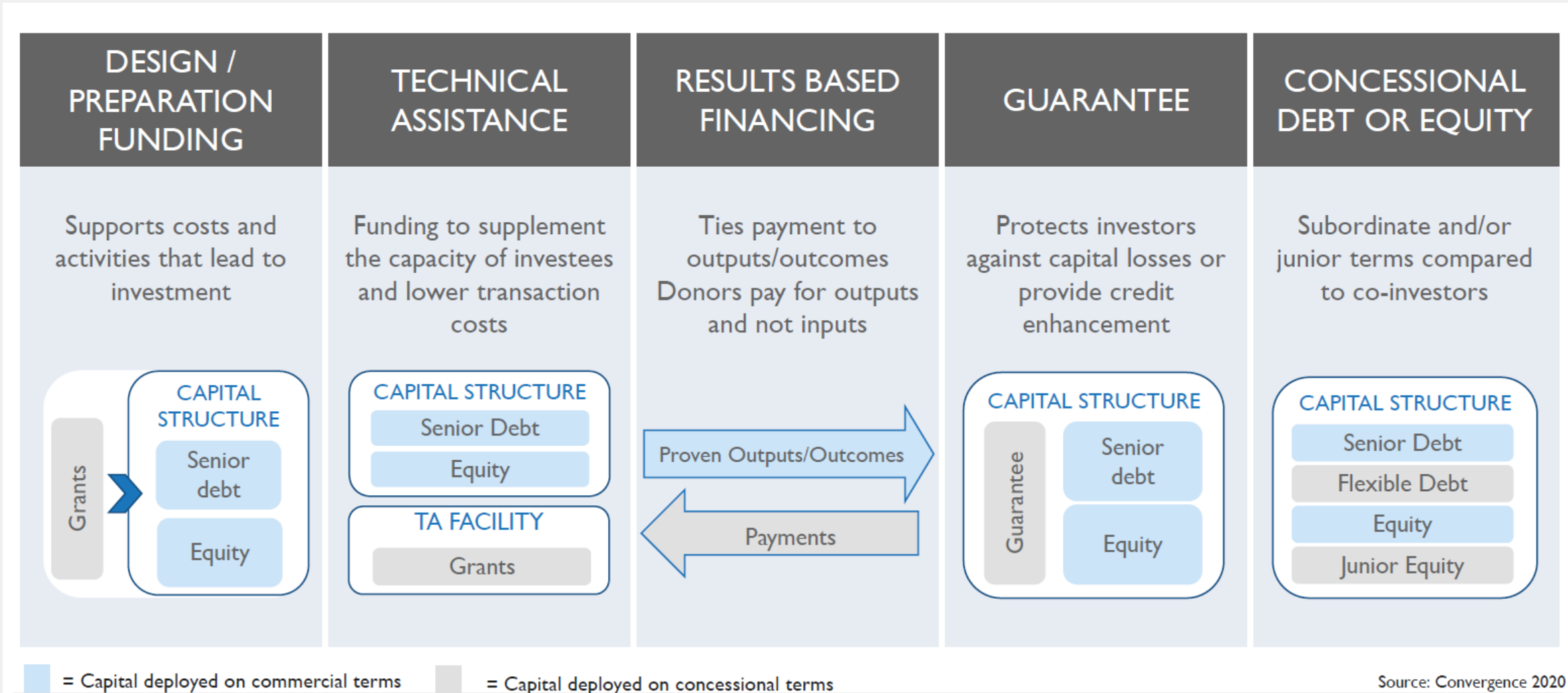
**167** facilities launched, 2000 - 2016, to pool finance for blending

## What is blended finance?

OECD describes it as “the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets”

Blended finance can help risk-return profile of projects to attract private and commercial finance to project and activities that help achieve SDGs in different sectors

# Common types of blended finance



Source: Convergence 2020

# Blending instruments to leverage private/commercial finance

## BLENDING: smart public finance to leverage private finance

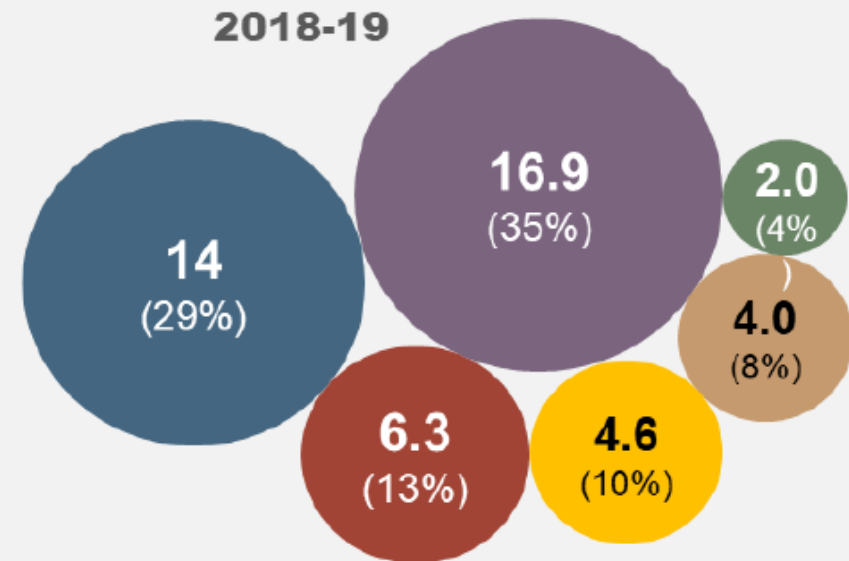
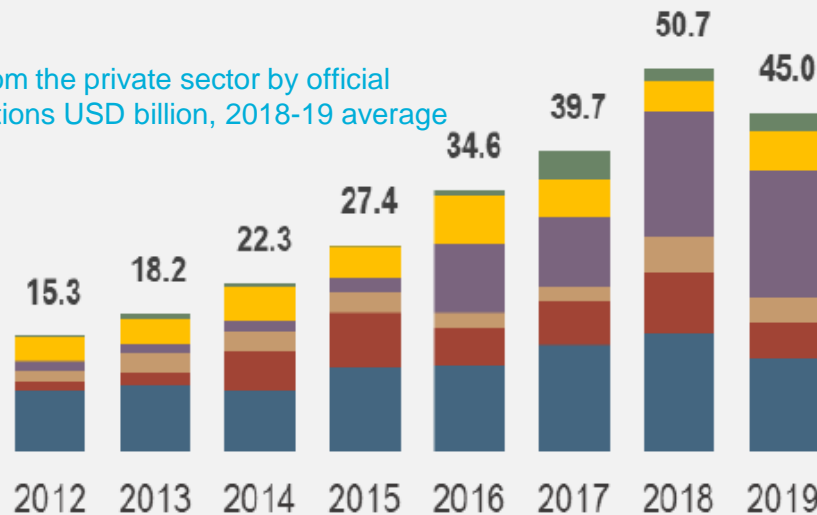
Grants / subsidies	Concessional loans / public finance	Credit enhancements
<p>Results-based subsidies, e.g. to support access extension</p> <p>Capacity-building and training e.g. training of borrowers and lenders</p> <p>Technical assistance e.g. sensitize banks to market opportunities, assess water investment projects, project preparation, shadow credit ratings</p> <p>Support water sector pooling / grouping to access larger commercial finance providers</p>	<p>Provide liquidity to commercial finance providers</p> <p>Blend concessional with commercial finance to soften lending terms</p> <p>“First loss” agreements</p> <p>“Patient capital”: equity participations at below market-rate return expectations can signal commitment</p>	<p><b>Guarantees:</b> reduce risk perception, leading to lower interest rates and longer tenors</p> <p><b>Revenue intercepts, escrow accounts:</b> to secure access to funds and reduce risk of non-payment</p>

Tools and instruments for blending to attract commercial finance

In recent years, development finance providers have ramped up their efforts in mobilizing private finance for the SDGs, including from institutional investors.

**Private mobilization generally followed an upward trend since 2012, with direct investment, guarantees and syndicated loans being the main leveraging instruments in recent years**

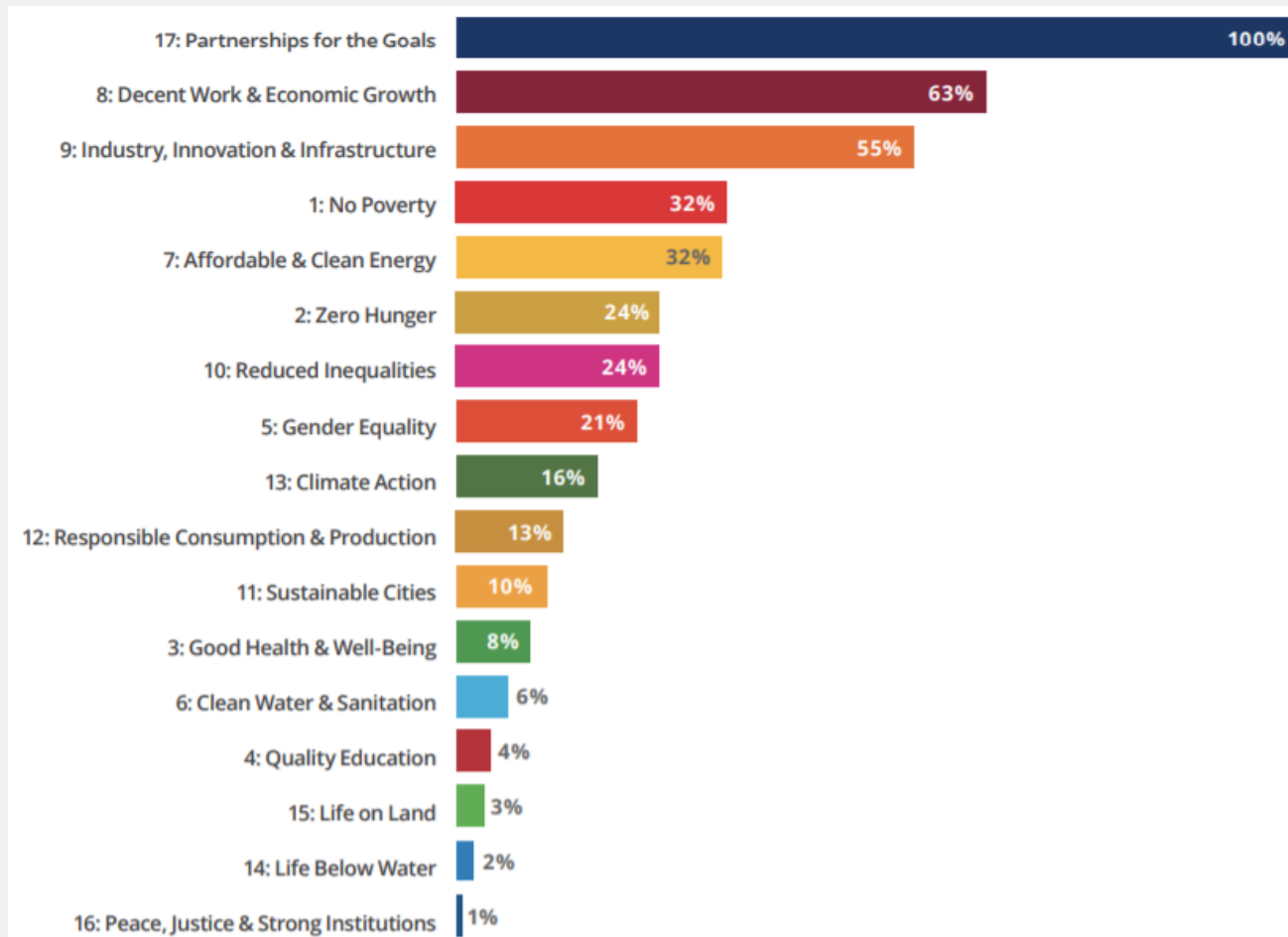
Amounts mobilized from the private sector by official development interventions USD billion, 2018-19 average



- According to OECD statistics, official development finance interventions by bilateral and multilateral development finance providers mobilised approximately **USD 253 billion of private finance** for development outcomes between 2012 and 2019 (OECD, 2021)
- The private investors mobilised do not only include banks and other financial institutions, private companies, asset managers but also institutional investors

# Blended finance addresses a subset of the SDG targets that are investible

## Alignment between blended finance transactions and the SDGs (2018-20)



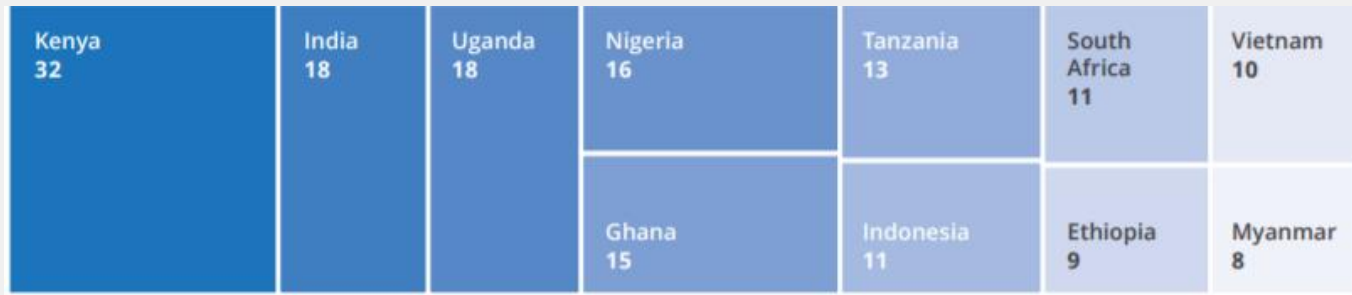
- According to analysis conducted by the Sustainable Development Solutions Network (SDSN, a global initiative of the UN), approximately **half the funding required to achieve the SDGs in developing countries** can be in the form of investment.
- Blended finance is **highly aligned** with goals such as **Goal 8 (Decent Work and Economic Growth)** and **Goal 13 (Climate Action)**, while **less aligned** with SDGs such as **Goal 16 (Peace, Justice and Strong Institutions)**.

Note: Convergence is the global network for blended finance. Convergence generates blended finance data, intelligence, and deal flow to increase private sector investment in developing countries and sustainable development

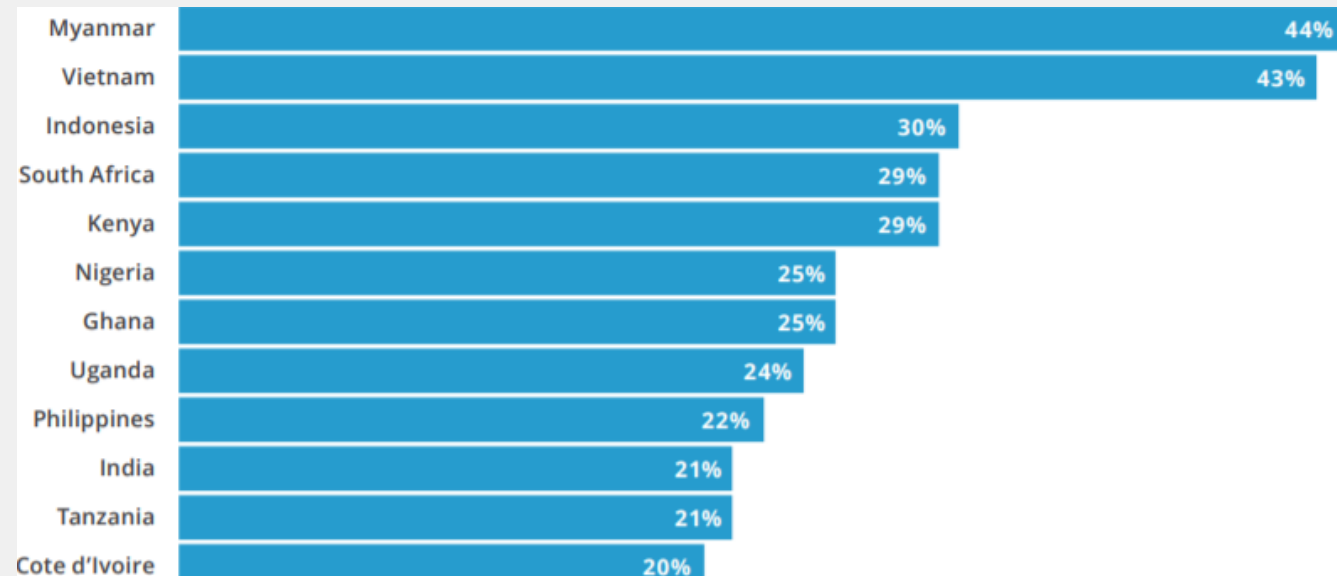


# Blended finance addresses a subset of the SDG targets that are investible

## TOP COUNTRIES FOR BLENDED FINANCE, BY NUMBER OF TRANSACTIONS (2018-20)



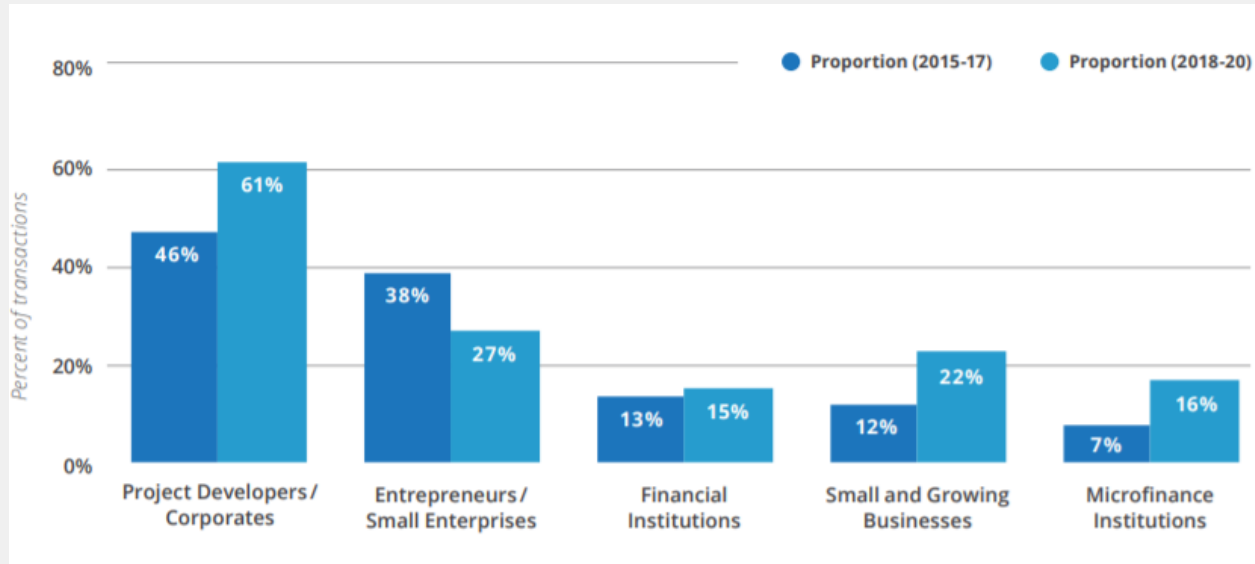
## TOP COUNTRIES FOR BLENDED FINANCE: PROPORTION OF DEALS BY TARGET COUNTRY LAUNCHED BETWEEN 2018-2020



- Kenya continues to be the most frequent recipient country of blended capital in recent years (32 transactions between 2018-2020), in line with historical trends.
- This can be attributed to a number of factors, including an enabling policy framework for private sector investment and a range of geographical and logistical advantages.
- The participation of special purpose financial intermediaries like GuarantCo and InfraCo Asia (both subsidiaries of the PIDG Group of companies) are common in transactions in Vietnam, Myanmar, and Indonesia, signaling their role in growing the presence of blended finance in new markets.

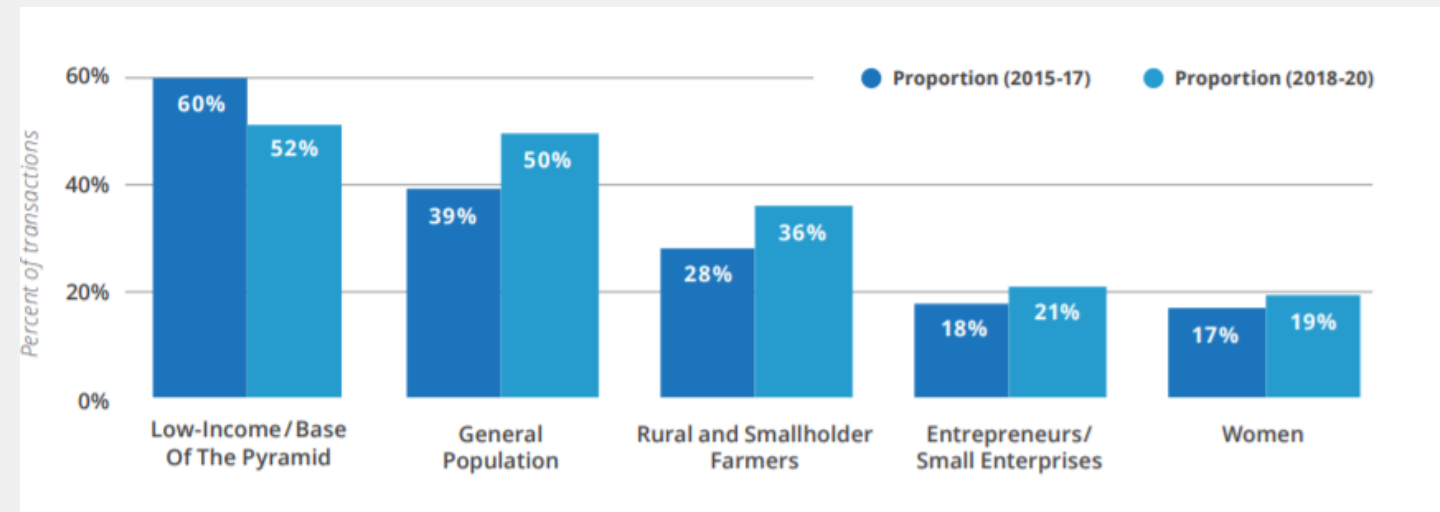
# Direct and end beneficiaries

## Proportion of closed transactions by direct beneficiary



- Micro-, small-, and medium-sized businesses (MSMEs) and small and growing businesses (SGBs) also continue to be common direct beneficiaries of blended capital, with nearly 50% of all transactions between 2018-20 directly targeting one or both groups.

## Proportion of closed transactions by end beneficiary

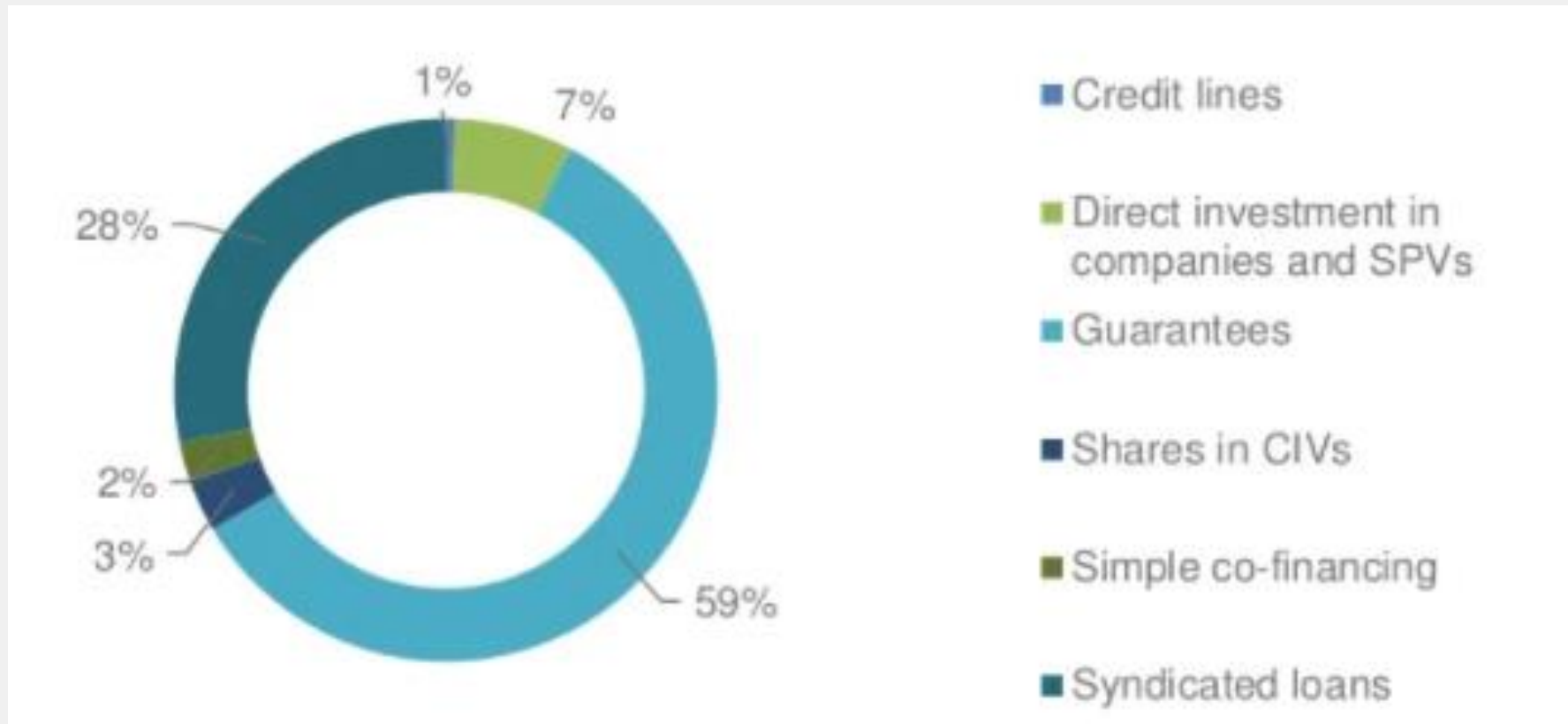


- The proportion of blended finance transactions with a clear intention to support women and girls has remained stable in recent years.

# Achieving scale in the blended finance market: recommendations

- **Donors** should **implement a strategy** where a **known amount of development funds can be allocated annually** to blended finance transactions. They must make private sector mobilization an essential pillar of their strategy and make it a key performance indicator for the recipients of their financing.
- **MDBs and DFIs** must put in place strategies to engage with institutional investors on a radically different scale.
- Host country governments can **create an enabling environment for blended finance** by:
  - a. **Leveraging limited public funding** strategically to attract private investment
  - b. Using **regional and national MDBs / DFIs** as deal originators
  - c. Focusing on blended finance projects for **local investors that are appropriately structured**.
  - d. **Establishing domestic institutional investor** consortia to mobilize local currency financing.
- **Practitioners should support scale** by focusing **on proven and replicable blended finance structures**. They should also fund standardized simplified fund structures and look to launch aggregation vehicles.
- Convergence advocates for innovation in blended finance that is additional to the market, yet familiar and replicable to investors. Incremental innovations, and not icebreaker transactions, will be the pathway to scaling blended finance to meet the SDG financing gap.
- All **practitioners, but particularly donors, should publicly disclose blended finance data** at the transaction level.

# Mobilisation of private finance in the water sector



- From 2012 to 2017, USD 2.1 billion (1.4%) of the six year total of private finance mobilized targeted the water and sanitation sector.
- Guarantees account for almost 60% of private finance mobilized, followed by syndicated loans mobilizing 28% of private finance.

# The potential of blended finance in water and sanitation



## Policy level

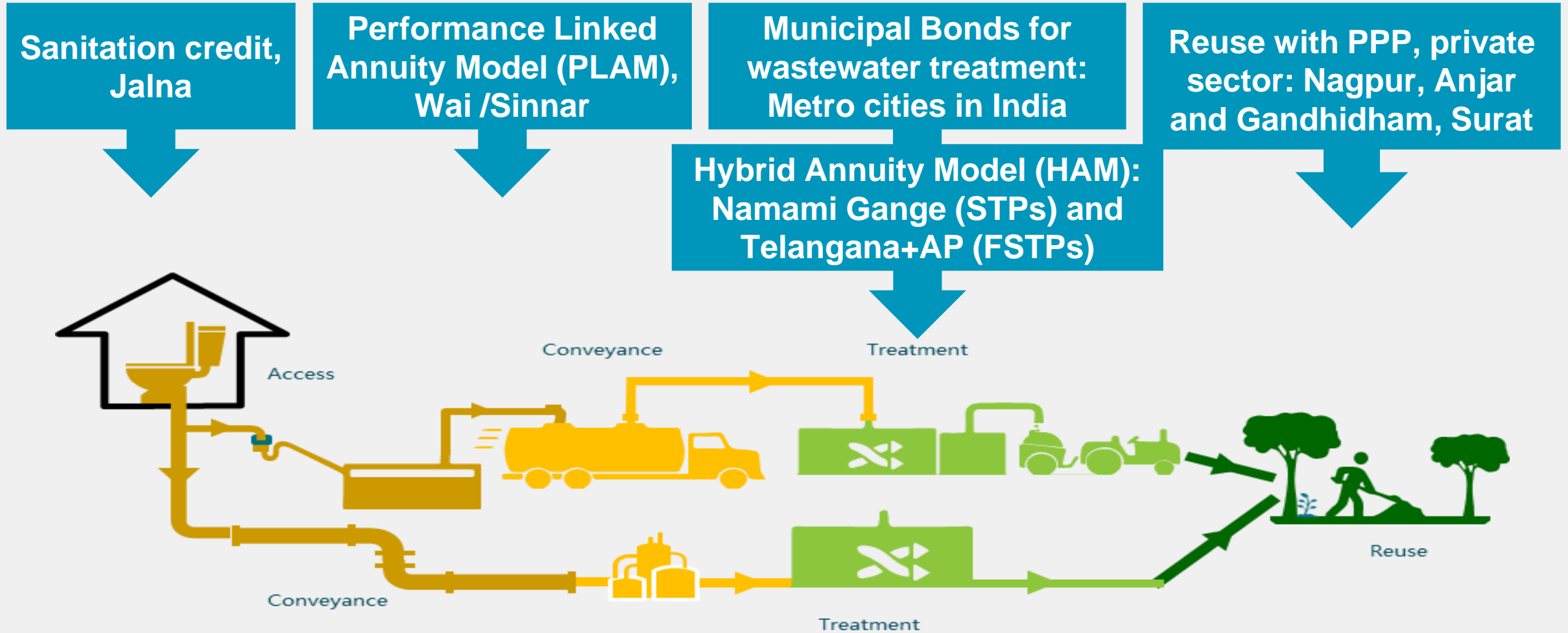
- Design blended finance in conjunction with efforts to **improve enabling environment**
- **Increase transparency** to make a valid business case to commercial investment
- **Establish co-ordination and co-operation processes** for blended finance

## Operational level

- Harness the opportunity to **mobilise local commercial actors**
- **Understand business models and revenue streams across the supply chain** and develop matching blended finance approaches
- **Explore development of portfolio of projects** to address unfavorable project attributes
- **Design blended finance to build markets** and incorporate a phasing out subsequently

# Blended finance to support public-private-partnerships (PPPs) for financing across sanitation service chain

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# The Climate Finance Partnership

In January 2019, the **Climate Finance Partnership (CFP)** was announced, which aims to direct capital into climate-related projects in developing countries. The Partnership brings together **BlackRock**, the world leader in asset management, **Agence Française de Développement (AFD)**, the **German Ministry for the Environment and the Hewlett and Grantham foundations**.

## Development Finance

- The fund consists of the first loss tranche of **USD 100 million** which will be financed by France and Germany each contributing USD 30 million. The Hewlett Foundation and the Grantham Foundation, will also contribute.
- **AFD Group** has been identified as the **operator capable** of implementing this partnership for France. Knowledge of climate issues in emerging countries and expertise in the field: environmental and social expertise, tools for measuring the impacts (carbon footprint assessment) as well as climate taxonomy (project eligibility will be determined based on the Common Principles adopted by multilateral development banks).

## Commercial Finance

- **Investment fund and decisions** to be managed by **BlackRock** in accordance with the established investment policy
- To **mobilize at least USD 400 million** from institutional investors

## Challenge

- Need to **increase the number of climate-related projects in low and middle income countries** and to increase the amount of private financing for these projects

## Solution

- The **CFP plans** to invest between USD 500 million and USD 1 billion in climate change mitigation projects in emerging countries.

### Impact:

For public donors, including France and AFD, this an opportunity for the large-scale mobilization of private savings and the chance for a significant global asset manager to handle investment projects for climate action and to benefit Africa

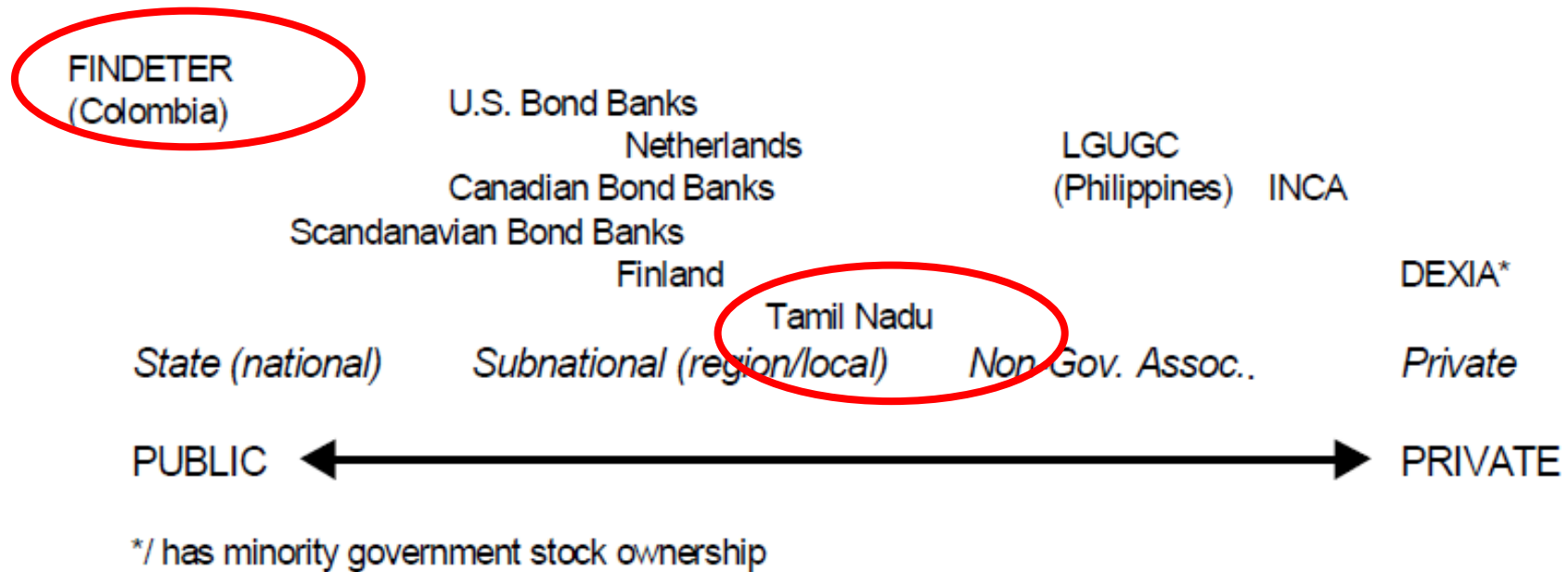
# Municipal Development Funds - examples of blended finance

- Municipal Development Funds can provide a much needed **link between civic infrastructure financing needs and domestic capital markets**.
- MDFs usually start as an **intergovernmental approach to municipal credit supply, structured as parastatal organizations**, but then evolve to become **financial intermediaries focusing on municipal credit**



# MDF Ownership Structures – A review

**Figure 2: MDF Ownership Structures**  
Arrayed by Nature of Ownership:

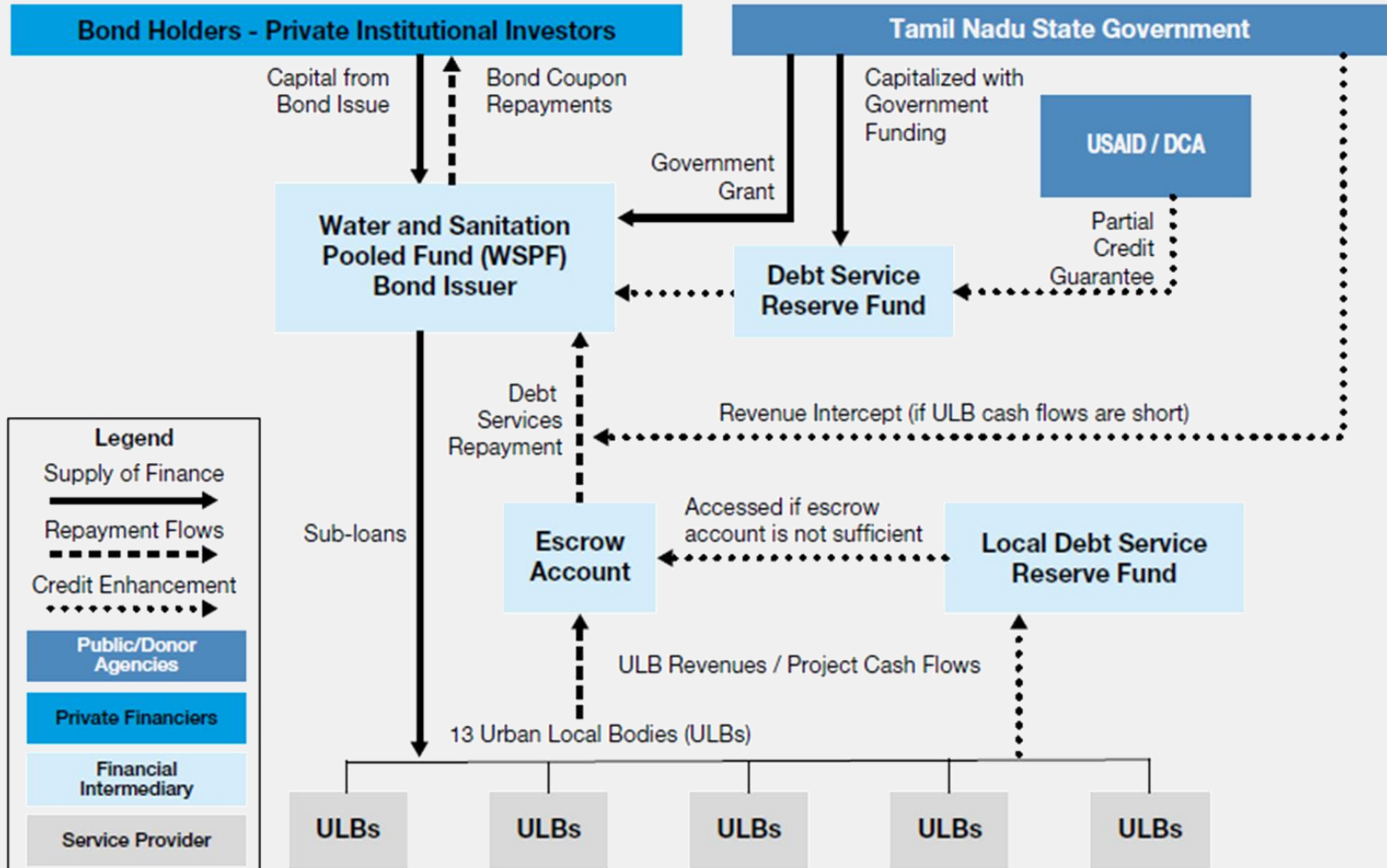


# Case of TNUDF

- Under the **World Bank credit** of Rs.167 crores, the **Municipal Urban Development Fund (MUDF)** was set up in **1988** to fund urban infrastructure needs
- TNUDF was established in 1996 as a **trust** under the Indian Trusts Act 1882, and is managed by an **Asset Management Company**, Tamilnadu Urban Infrastructure Financial Services Limited (TNUIFSL)
- **GoTN's equity in the venture is restricted to 49%**, based on the motivation to facilitate private sector management in investment decisions.
- Other shareholders of TNUIFSL are **ICICI (21%), HDFC (15%) and IL&FS (15%)**. ICICI, the lead institution, took up management responsibility, putting in place appraisal systems and key personnel.

# Pooled bond funds from capital market in TN, India

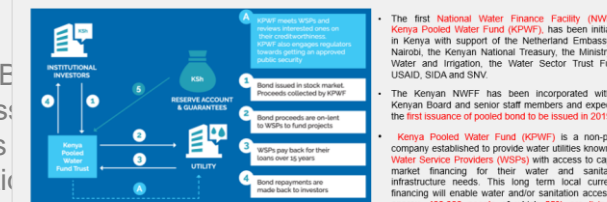
FIGURE 1 Pooled Municipal Bond Issuance in Tamil Nadu, India: Financial Structure



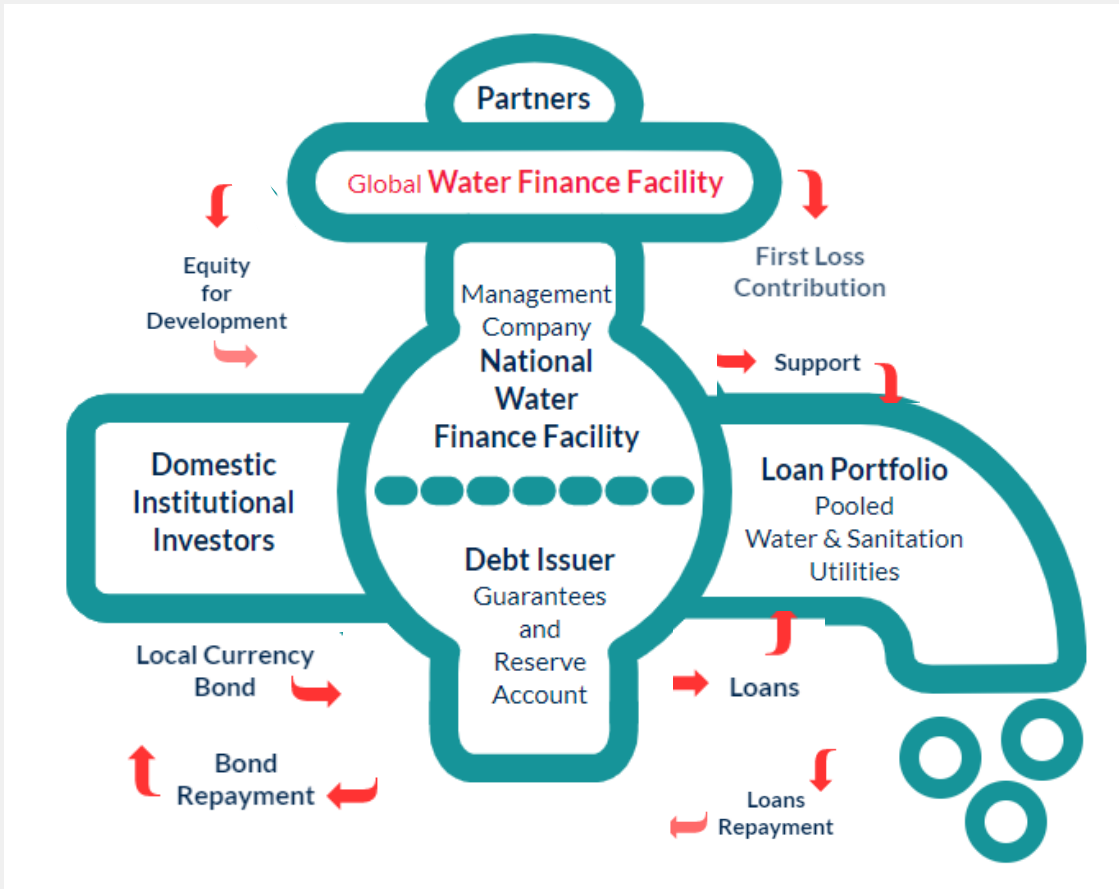
WSPF has been successful in mobilizing funds from the capital markets through 5 successive issues .

This approach can be used for pooling sanitation fund requirements for small towns

Pooled bond funds from capital market in Kenya by WFF

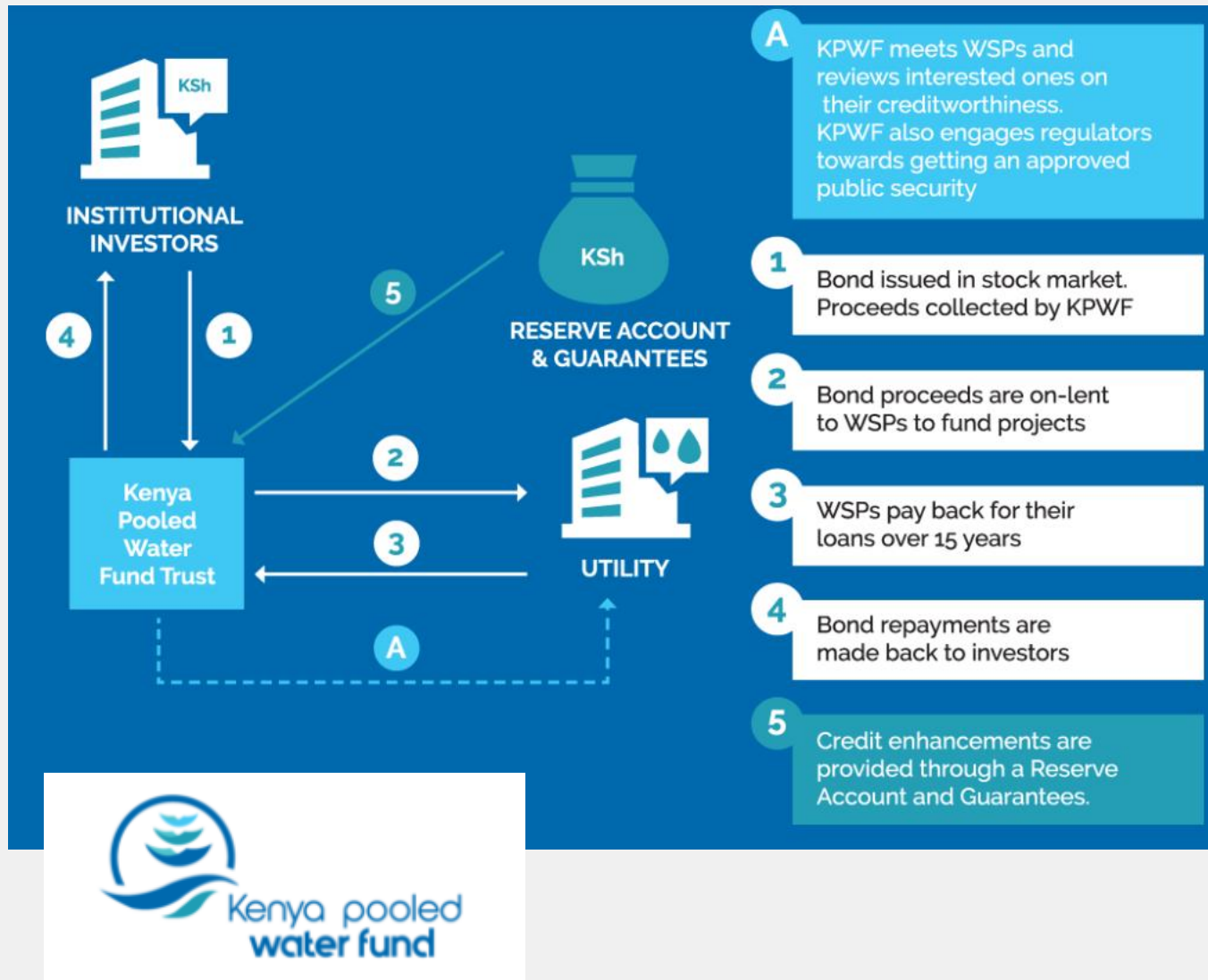


# Pooled bond funds from capital market in Kenya by WFF



- The **Water Finance Facility (WFF)** mobilises **large-scale private investment** from domestic institutional investors, such as pension funds, insurance companies and other qualified investors, by issuing local currency bonds in the capital market in support of their own country's national priority actions on water and sanitation service delivery.
- **Aim:** To **develop several country level water financing facilities**, which can issue **bond in their capital markets** to provide long-term loans to public or private water utilities that have little or no access to commercial finance or that have access at unfavorable terms, such as short tenors.
- Through the **pooling of projects of credit worthy water and sanitation companies**, the bonds will have lower risk.
- This **risk can be further reduced**, if **reserve funds, guarantees, soft loans or grants for blended finance** can be incorporated into the capital market structures.
- WFF **unlocks local capital market development** by providing alternative, credit worthy long term investments opportunities for the local pension funds and other investors of the domestic capital market.

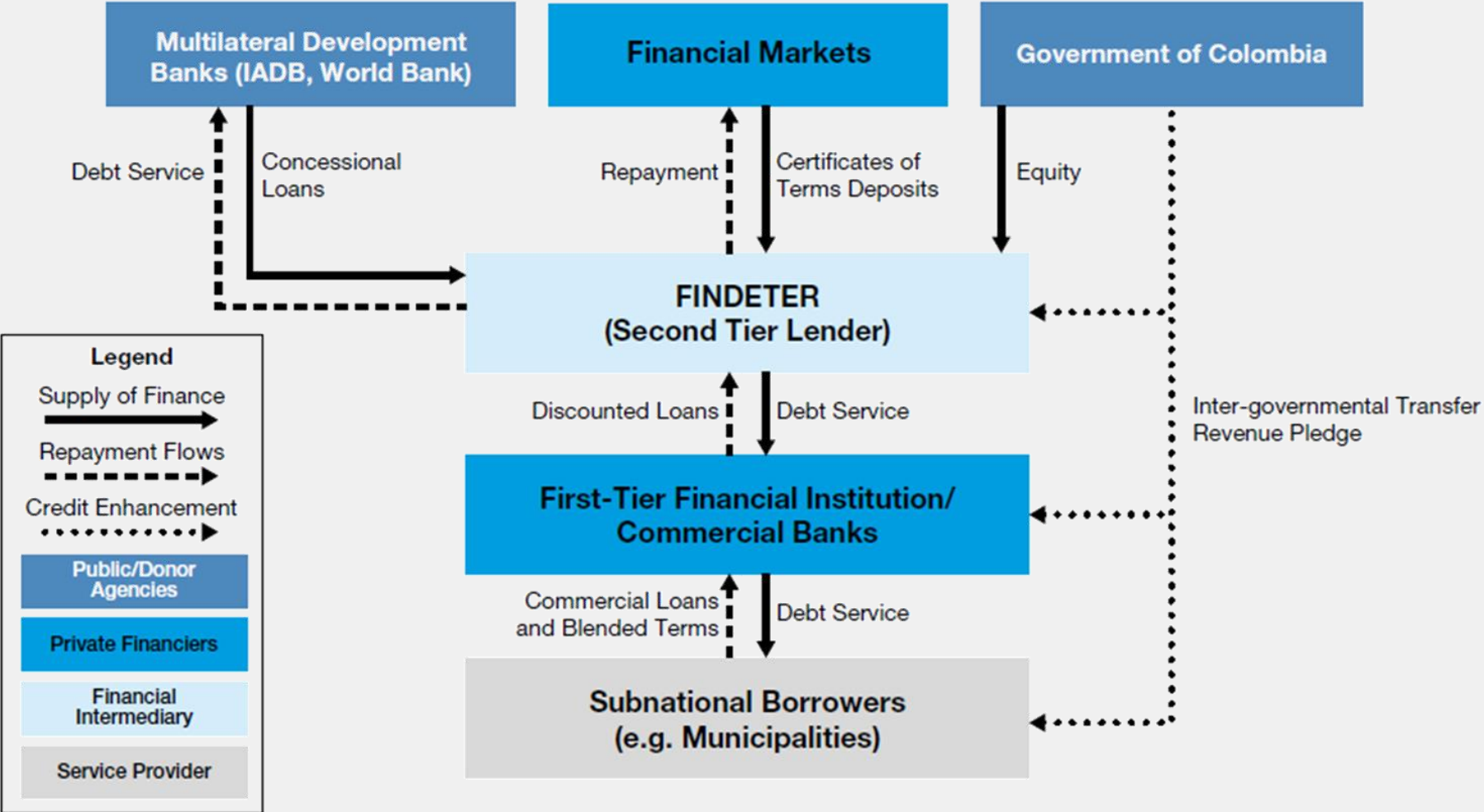
# Pooled bond funds from capital market in Kenya by WFF



- The first **National Water Finance Facility (NWFF)**, **Kenya Pooled Water Fund (KPWF)**, has been initiated in Kenya with support of the Netherland Embassy in Nairobi, the Kenyan National Treasury, the Ministry of Water and Irrigation, the Water Sector Trust Fund, USAID, SIDA and SNV.
- The Kenyan NWFF has been incorporated with a Kenyan Board and senior staff members and expected the **first issuance of pooled bond to be issued in 2019**.
- **Kenya Pooled Water Fund (KPWF)** is a non-profit company established to provide water utilities known as **Water Service Providers (WSPs)** with access to capital market financing for their water and sanitation infrastructure needs. This long term local currency financing will enable water and/or sanitation access to approx. **400,000 people** of which **25% are living in designated Low Income Areas**.
- **KPWF** creates an opportunity for government of Kenya, **Development Partners and International Finance Institutions** to achieve multiple leverage of their sectors financial contributions (grants, concessional loans, guarantees, etc.)

# Funding through Second-Tier Lender – FINDETER in Colombia

**FIGURE 1** Institutional Blending via Second-Tier Lender FINDETER, Colombia: Financial Structure

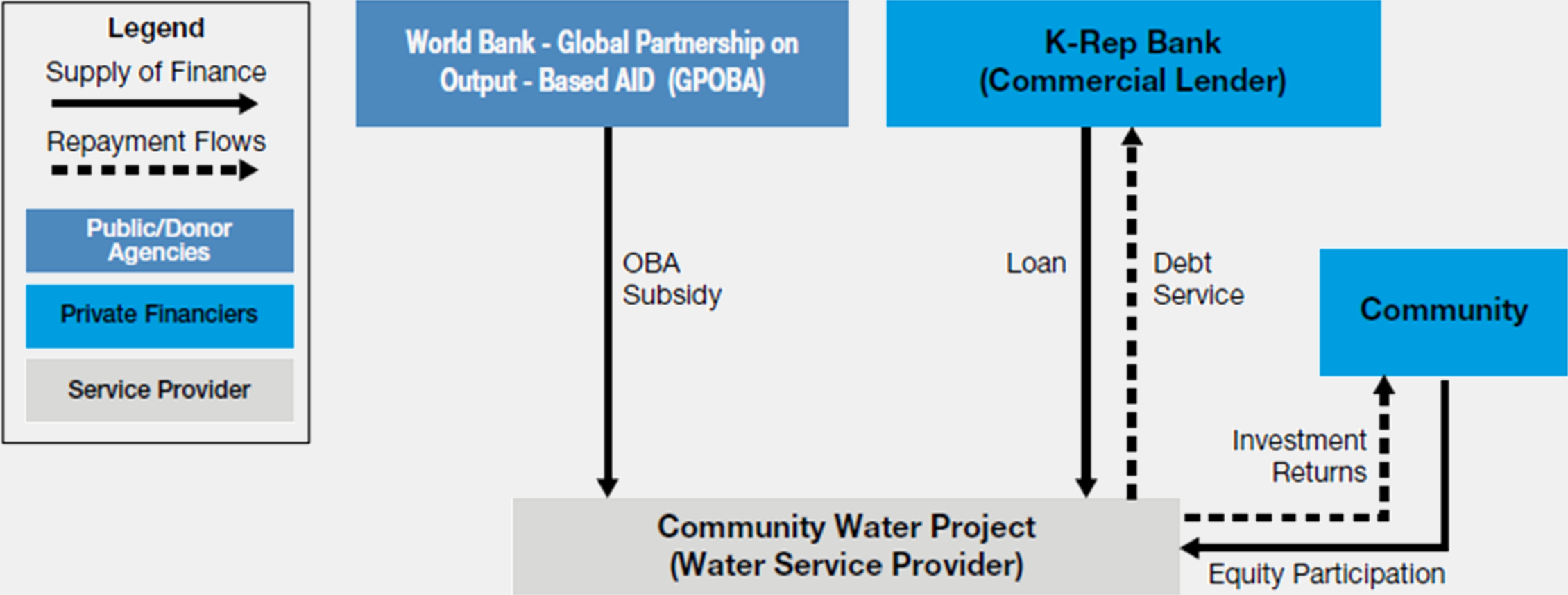


FINDETER has helped connect local municipal governments with commercial banks in Colombia

World Bank Group (2016), "Institutional lender via second tier lender FINDETER in Colombia" in Case studies in blended finance for water and sanitation", p. 2

# Mobilizing commercial finance with partial subsidies

**FIGURE 1** Scaling Up Blended Financing for Water and Sanitation in Kenya: Maji ni Maisha Financial Structure



World Bank Group (2016), "Scaling up blended finance for water and sanitation in Kenya" in "Case studies in blended finance for water and sanitation", p. 2.

# Annuity and Hybrid-annuity models to leverage private funding

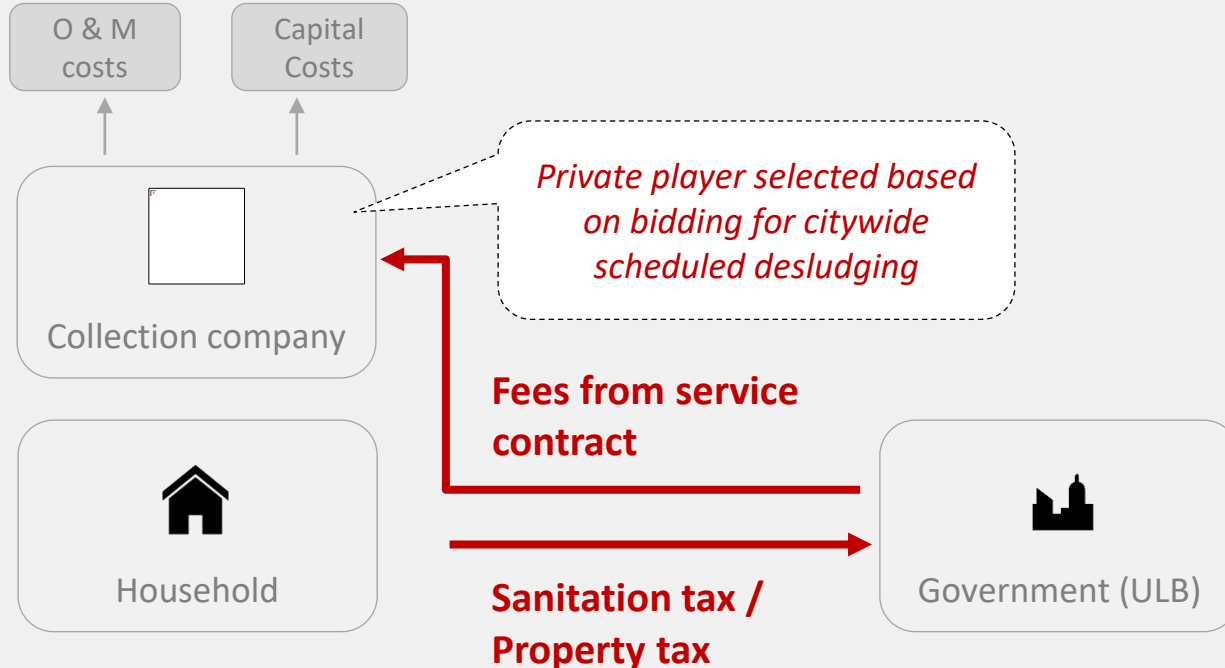
- Using annuity models across the service chain – conveyance to treatment
- Annuity payments by the government to be made using a recognized source over a defined time period
- Performance based annuity models for citywide scheduled emptying services – examples from India, Philippines and Vietnam
- Hybrid annuity models for treatment facilities – examples from India which draw on the transport sector experience



# Performance linked annuity models for conveyance, India

## 1. Scheduled emptying

- Private company selected through bidding process
- All septic tanks in the city to be emptied once in 3 years – 1/36 each month



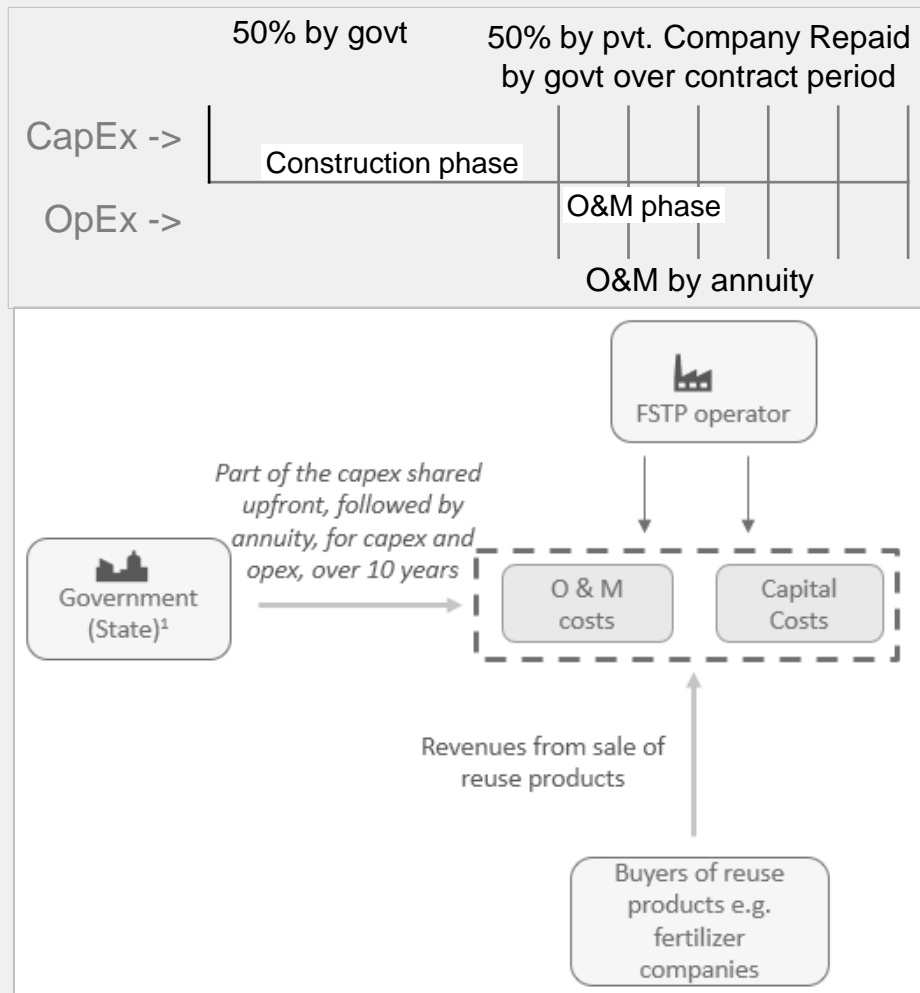
## 2. Performance based fixed monthly payments

- Penalties deducted for non-compliance
- Payment linked to number of tanks emptied – Receipts signed by households
- Ensuring safe emptying – receipts signed by FSTP official
- No spillage
- Use of safe methods – e.g. PPE for workers

## 3. Sanitation Tax

- Each household pays a small fixed amount as sanitation tax, and Sanitation tax + property tax used to pay private company
- Emptying provided without “per-emptying” fee
- Sanitation tax much less than the cost incurred per household previously for emergency emptying

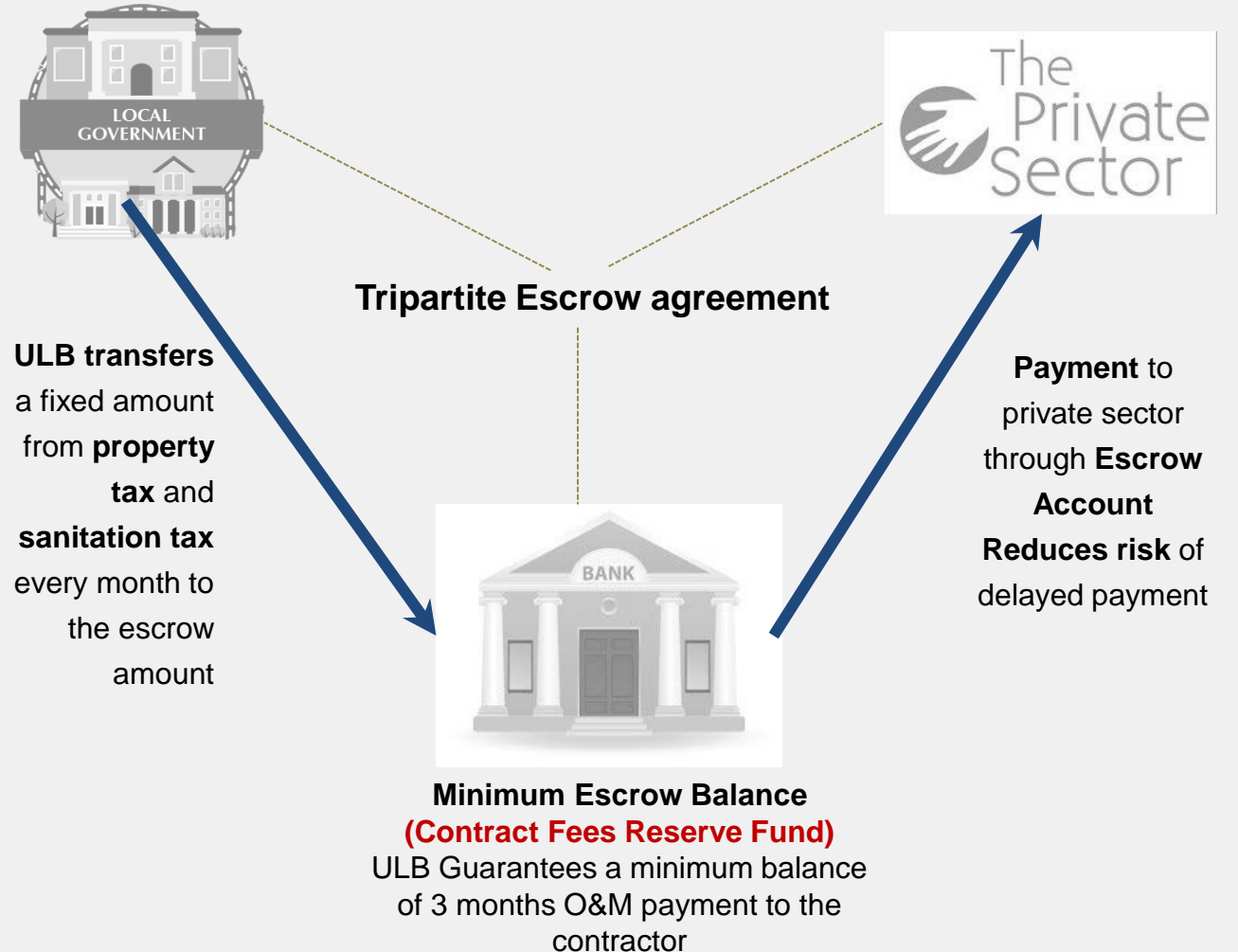
# Hybrid Annuity Models for FSTPs and STPs in AP and NMCG



- Private companies - undertake construction, operation and maintenance on a DBOT basis. Cost determined by bidding
- CapEx – 50% by government , 50% by private company
- Annuity payments cover a) CapEx by private company repaid through annuity payments over contract period, b) and OpEx
- Funding by State government alleviates concerns around individual ULB financial capacity and payment risks
- Private player clustering approach (multiple ULBs per partner) to achieve scale economies and a large contract
- Private player responsible for selling soil conditioner/bio-fertilizer/biogas and recycled wastewater. In the long term, part opex recovery planned through user charges

# Escrow mechanism to mitigate Payment Risk

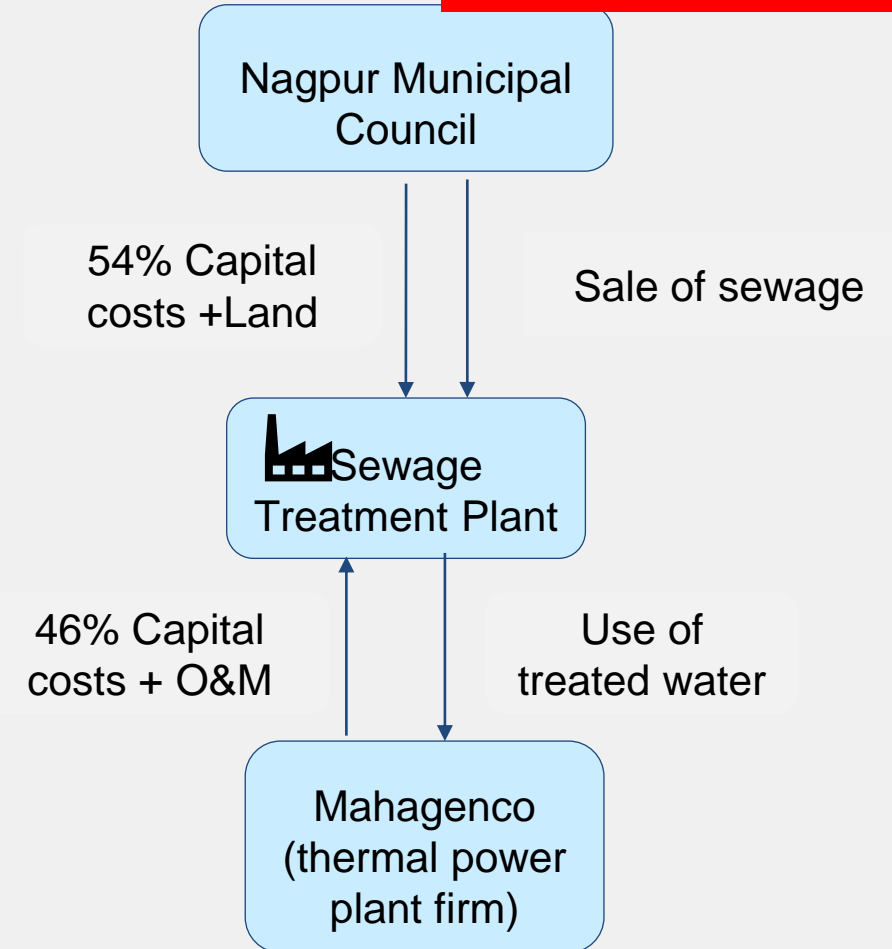
- Tripartite Escrow agreement between government, private sector, bank
- Payments to private operators made through an Escrow account by the Government
- Government to maintain 3 months' payment in account at all times
- Mitigates late payment risk for private operator
- Escrow will be funded by sanitation & property tax



# Reuse for thermal plant using a PPP Model – Nagpur, Maharashtra

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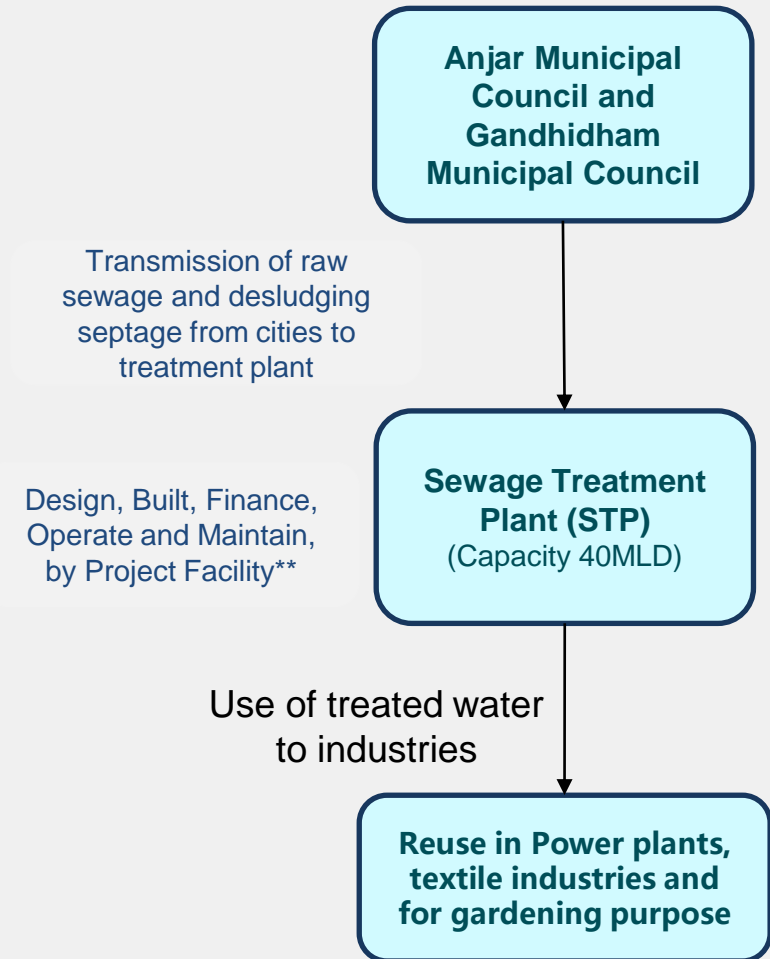
- Mahagenco – a thermal power plant firm in Nagpur, purchases sewage water from the Nagpur Municipal Council. The STP along with secondary and tertiary treatment are constructed, operated and maintained by private provider.
- Capital cost - US\$28 million: Private provider- 54% of capital cost and O&M cost, Local government gave 46% of capital cost and land for STP. Private provider pays local government a fixed amount US\$ 2.25 million a year for 110 million liters a day of raw wastewater.



Source: MOHUA, "MAHAGENCO- Nagpur Municipal Corporation WasteWater Reuse Project at Nagpur",

# Reuse by private industry - Anjar and Gandhidham

- A private industry partner, 'Welspun' reuses treated wastewater from the cities of Anjar and Gandhidham in their power plants, textile industry and gardens. It used a Design, Build, Finance and Operate (DBFO) model for this Sewage Treatment Plant.
- Cities receive a revenue of Rs. 62 lakhs per year at the rate of Rs. 0.4/KL for the raw sewage by Wellspun industries.



\*The respective ULBs ensure that Sewer generated by citizens is free from Industrial waste, hazardous material, prohibited and restricted material

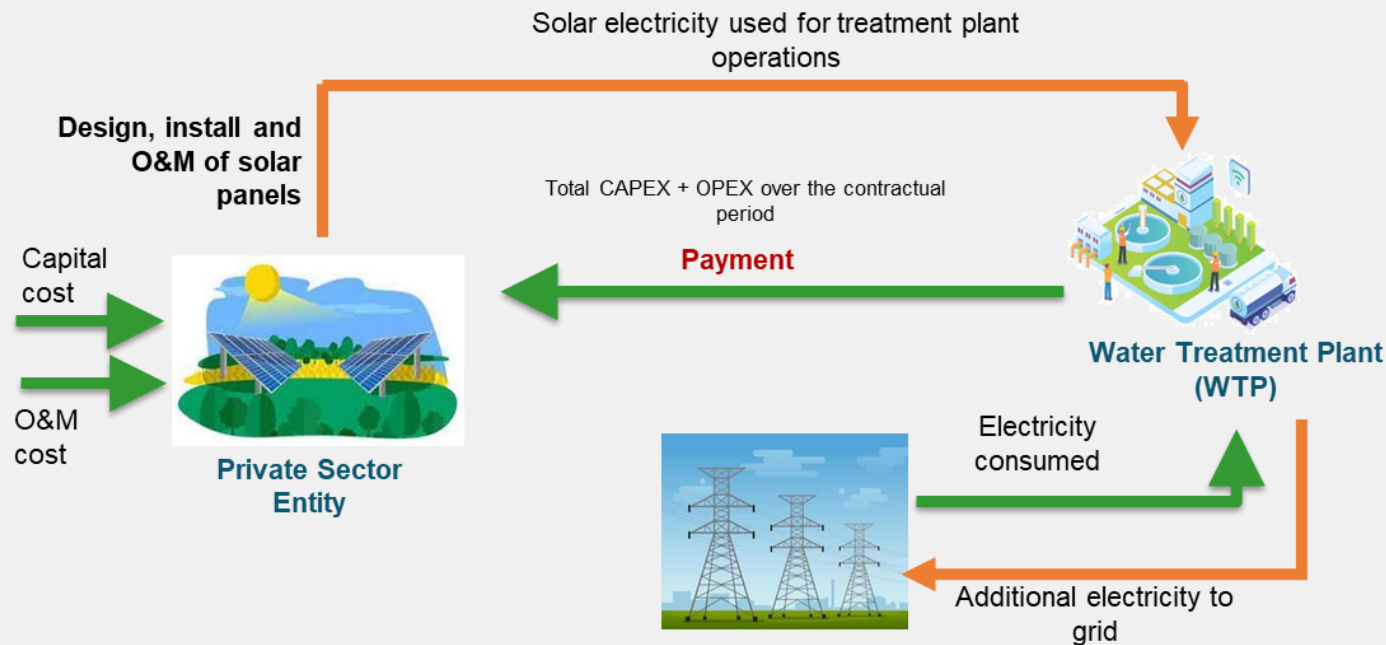
\*\*Welspun Infrastructure Ltd and Technology Providing Partner Ion Exchange Ltd (Concessionaire).

\*\*\* Sewage Pumping Station other than GNP Facility, network of bulk transmission of sewage from Designated location to STP is operated by Concessionaire.

# Public Private Partnership for solar power plant at Water Treatment Plant (WTP)

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## Key features

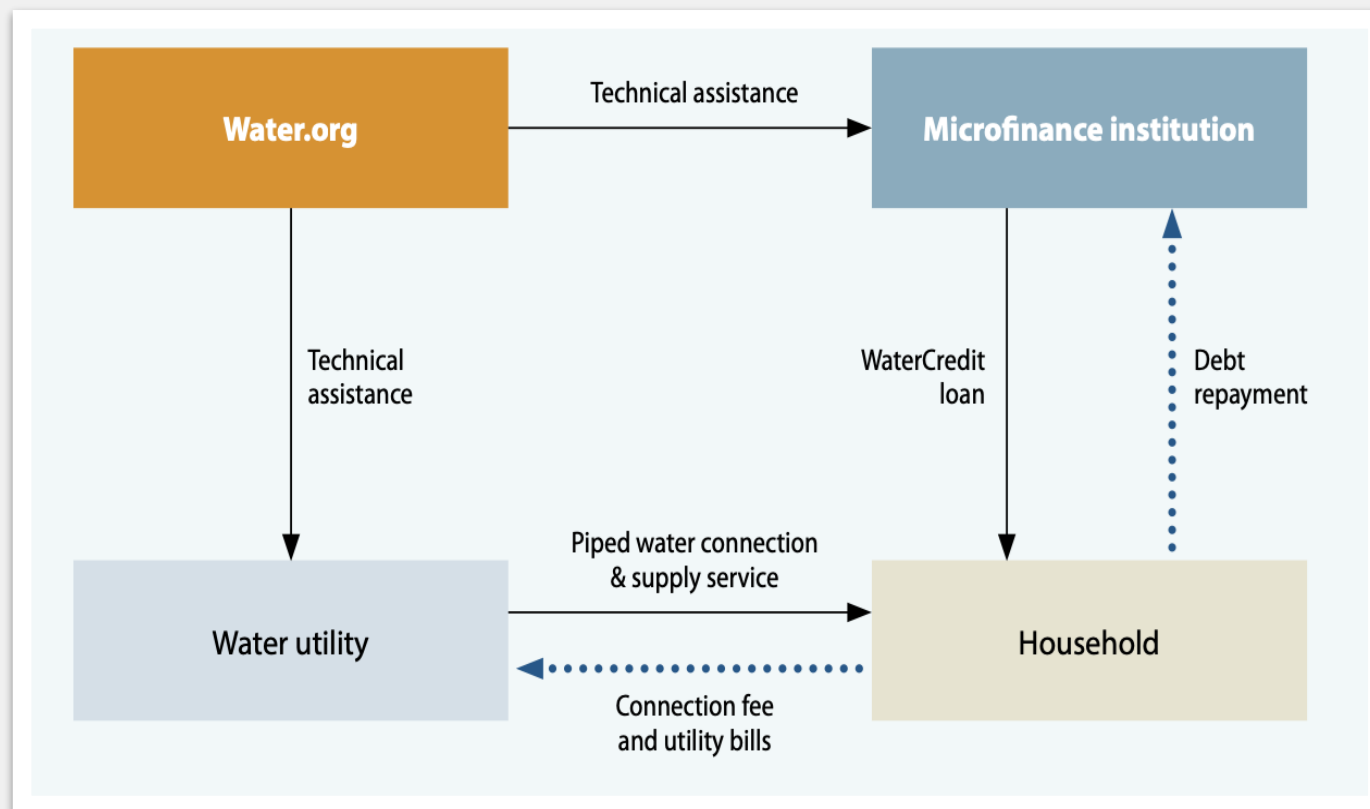


**This is the first of its kind innovative PPP model for solar system setup at city level.**

- It is a performance-based Public-Private Partnership (PPP) model that aims to set up a solar power plant at any public infrastructure of a city.
- The city will not have to pay upfront capital cost and will pay only against units of electricity produced by the solar system.
- In this PPP model, a private operator will undertake the financing of both capital expenditure (CAPEX) and operational expenditure (OPEX) costs.
- Additionally, they will handle the design, installation, and operations & maintenance (O&M) responsibilities for a period of 15 years or whatever the city decides.

# Case study: Water credits by water.org

*Loan program that enables affordable financing for WASH assets, by extending financial and technical support to local financial institutions*



## Interventions:

- *Flexibility for Financial Institutions*
- *Leveraging existing lending solutions*
- *Financing contextualised to local demographics*
- *Tailored WASH Loan Products*
  - *Water Access financing*
  - *Sanitation Access Financing*
- *Ecosystem Development*

# Chandigarh's 24x7 Water Supply Project



## Stakeholders

**Chandigarh Municipal Corporation**

**French financial institution - Agence Française de Développement (AFD)**

**European Union**



## Objective

**Citywide 24\*7 water supply**

**Smart water metering for ~ 1.77 lakh connections .**



## Other Objectives

**Water resource augmentation through leakage reduction**

**Limited dependence on groundwater**

**Installing energy efficient pumps**



## Structure

**Project Cost: ₹578 crore**

**AFD Funding: ₹412 crore loan (15-year repayment)**

**European Union Grant: ₹98 crore, Technical Assistance**

**Chandigarh Smart City Ltd. Contribution: ₹68 crore**



# Lessons from Case Studies of Blended Finance

- There are only **limited examples of use of blended finance so far** to leverage private and/ or commercial resources for urban and WASH sectors
- When designed properly, there are **opportunities for scaling up** as illustrated by the K-Rep case in Kenya. For this, it is important **to align these approaches with the prevailing institutions** in both urban water and sanitation as well as in the finance sector
- The level of development of the financial sector and capital markets will determine the extent of opportunities for urban infrastructure. **Strengthening links to financing institutions and capital markets** is critical.
- Special **measures such as escrow account** will help mitigate risks for the private sector and help bring down costs

# How to mobilize additional funding and financing for rural water maintenance services?

## 1. Use design and preparation-stage grants to support data collection and harmonization of performance metrics.

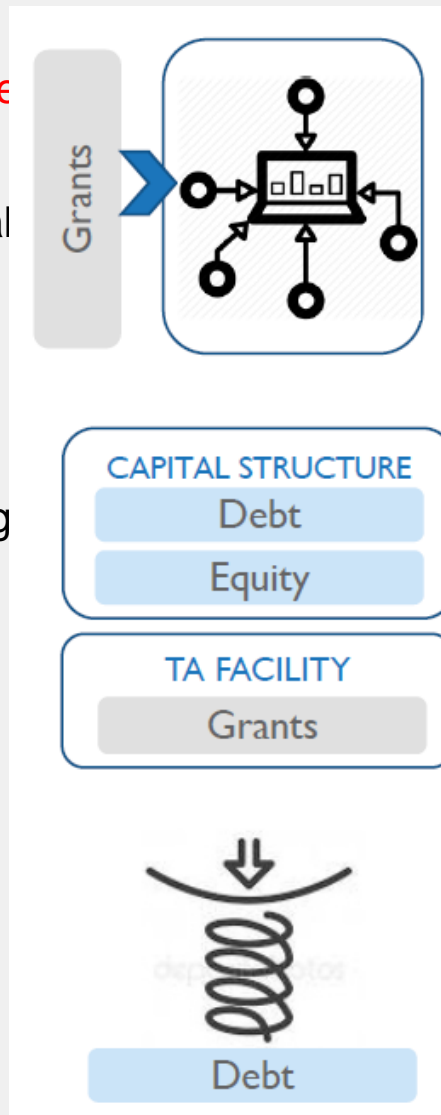
- Potential funders need performance data to assess investable opportunities and analyze the financial and operational viability of business models within that sector.

## 2. Use Technical Assistance to develop capacity and de-risk investments.

- TA is crucial to (i) improve the financial viability of the business/project; (ii) support financial modelling and loan applications; (iii) standardize credit assessments of borrowers.
- Example: Azure (El Salvador), initiated by Catholic Relief Services, managed by Total Impact Capital

## 3. Deploy flexible debt to account for seasonal variations in operations.

- Revenue-based loans, where repayments are linked to a revenues rather than determined by a fixed rate, are one viable approach.
- Example: Cambodia Revenue Finance Facility (Stone Family Foundation, BIDC)



# How can blended finance instruments be deployed to mobilize investment for rural water infrastructure maintenance?

1. Results-based financing is one step towards mobilizing additional private sector investments for water infrastructure maintenance.

- Examples: Turkana Water Outcomes Finance Facility; UPTIME.

2. Outcome funds, blended debt and/or equity funds and facilities can overcome the ticket size constraint many investors face.

- Examples: Take-a-stake Fund; Water Access Acceleration Fund.

3. Credit enhancement mechanisms are crucial to introduce unfamiliar lenders to the water sector and to tap into local capital markets.

- Examples: Philippines Water Revolving Fund; InfraCredit Nigeria.

# Pathways to scale for businesses and programmatic approaches in the on-site sanitation sector..

1. **National and regional government** need to create the institutional and legal environment for effective FSM, and make adequate budget allocations. The government is the key funder of FSM.
2. **Development agencies and development finance institutions** provide concessional loans to support capital expenditure (backbone infrastructure). They should make more use Technical Assistance to support the long list of responsibilities of the government and make enterprises/projects investor-ready.
3. **Foundations** providing grant funding for advocacy and technical assistance as well as grants and patient capital to sanitation enterprises and projects. This allows enterprises to scale, raise their first round of equity, and bring on board other funders and investors.
4. **Impact investors** have shown increased interest in the WASH sector. Their risk-return expectations are often well beyond what FSM business models can deliver - but blended structures can help bridge the gap. Patient capital is in high demand.

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# Thank you

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## About us

The Center for Water and Sanitation at CEPT University carries out various activities – action research, training, advocacy to enable state and local governments to improve delivery of services.



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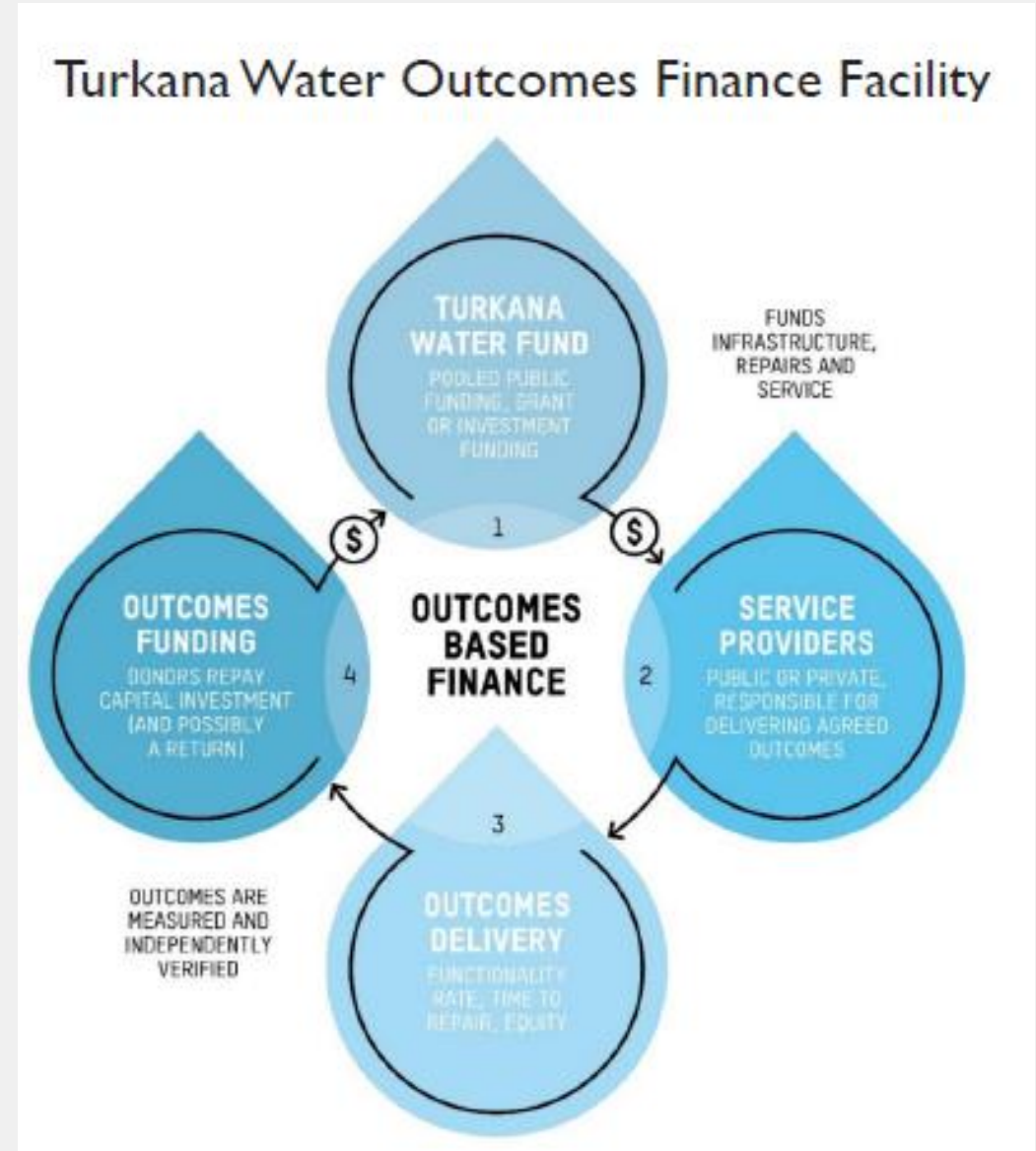
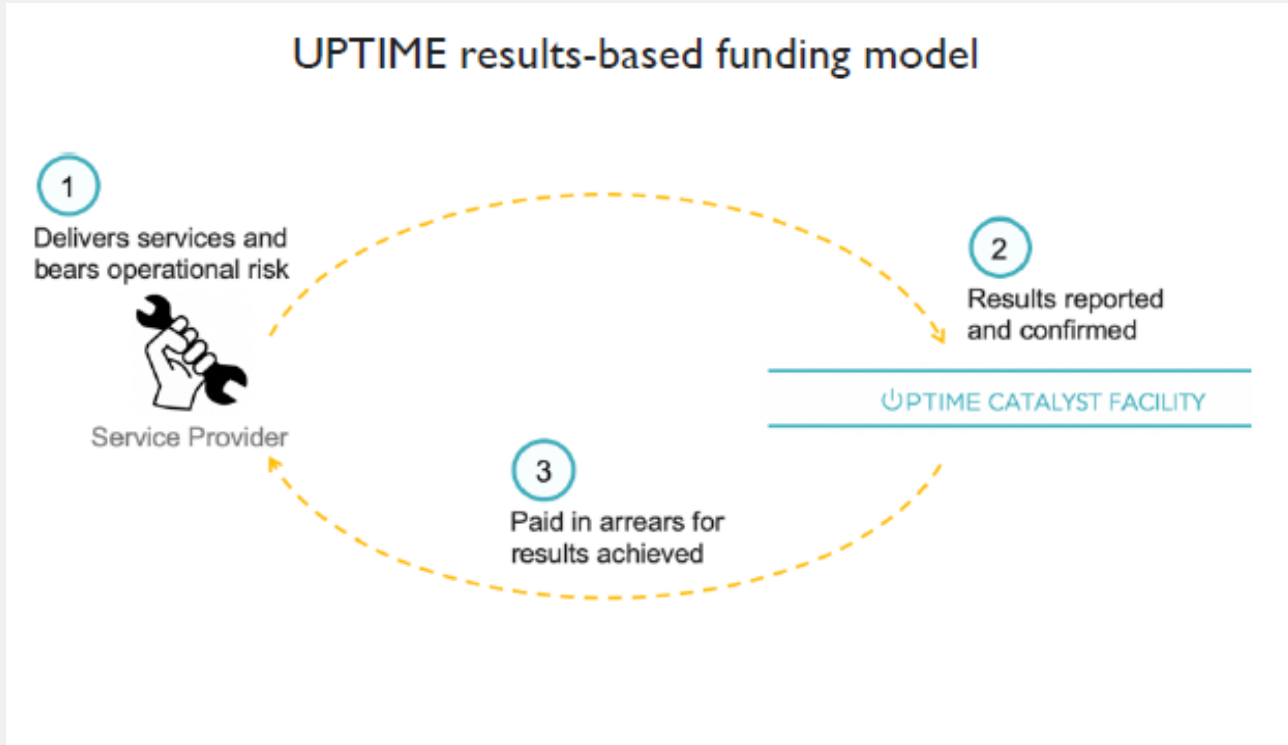


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# Examples in water sector



# Blended Finance Solutions for Various WASH Sectors

Instrument	Grants	Concessional Capital	Risk Mitigation	Results Based Financing
<b>Description</b>	Grants for technology development or testing markets can make companies investment ready and enable new solutions to come into the market.	Lower interest, zero collateral and flexible debt that helps enterprises to and build credit history and investor confidence and attract commercial debt.	Credit Guarantees can reduce loan risk and thereby induce more investments in targeted areas.	Payments are released on achievement of certain pre-determined outcomes.
<b>Type</b>	Technical Assistance Grants, possibly returnable in case of financial success.	Junior or subordinate Equity/Debt, impact-linked loans. Investor returns can step up in the case of strong success.	FLDGs, Pari-Passu Guarantees, insurance mechanisms, Working Capital	SIINC (Social Impact Incentives), Social or Development Impact Bond. Bill Discounting Facilities for government invoices to help working capital in face of payment delays.
<b>Use Cases and Sub Sectors</b>	All sectors, but especially those where need for innovative products and business models is greatest.	Especially useful for capital-intensive businesses across all these sectors	Any sector with unpredictable cash flows, which reduces credit flows	As part of Government schemes. To promote systemic and holistic thinking and solutions by focusing on multi-dimensional outcomes.
<b>Examples</b>	<ul style="list-style-type: none"> <li>• <a href="#">Water.org</a> provided grants and TA to MFIs to scale up HH sanitation loans.</li> <li>• Donors can pool funds, or work with investors who can ensure market-oriented use of grants.</li> </ul>	<ul style="list-style-type: none"> <li>• <a href="#">Spring Health Safe Drinking Water</a> raised concessional capital to provide clean water to villages in Eastern India.</li> <li>• Particularly useful for asset-building ventures like building toilets or waste treatment facilities.</li> </ul>	<ul style="list-style-type: none"> <li>• <a href="#">USAID and USDFC partnered with impact NBFCs</a> to provide partial guarantee to unlock credit for WASH enterprises.</li> </ul>	<ul style="list-style-type: none"> <li>• <a href="#">Roots of Impact and Aqua for All</a> have provided Social Impact Incentive payments to <a href="#">WASH enterprises</a> for achieving additional social outcomes (targeting BOP, rural populations, with a gender focus).</li> </ul>