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Blended Finance Explained: How It Works for Development Projects

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Key Takeaways

Blended finance can bring private money into development projects, but only when it is used for the right projects, with the right instruments and no more subsidy than needed.

- A definition - blended finance uses public or philanthropic development money to attract private investment into projects with development goals.
- Many instruments - guarantees, first-loss capital, concessional loans, equity and grants for preparation are the main tools.
- Modest subsidy - IFC reports an average concessional level of 4.7 percent of total project cost across a sample of its deals from FY2010 to FY2025.
- Below expectations - the OECD notes blended finance has mobilised relatively limited private finance and has not scaled as hoped.
- Preparation decides - bankable, well-prepared projects attract private finance; weak ones do not, whatever the subsidy.

Introduction

Blended finance is the strategic use of public or philanthropic development money to attract private investment into projects that serve development goals, such as clean energy, water, small business finance or climate adaptation. The development money takes on a part of the risk or cost that private investors would not accept on their own, so that the project becomes investable and private capital can follow.

For ministries, development banks and project teams, blended finance is attractive because public budgets alone cannot pay for the investment countries need. It is also easy to misuse: subsidies can go to deals that would have happened anyway, or projects can be structured in ways the public sector cannot manage. This guide explains how blended finance works, what the evidence shows and how governments can prepare for it.

How Blended Finance Works

A typical blended structure has three groups of participants:

- Development finance providers: donors, development finance institutions and philanthropic funds that provide concessional money or risk protection
- Private investors and lenders: banks, funds and companies that provide most of the capital on commercial terms
- The project or borrower: a company, utility, financial institution or public-private partnership that uses the money

The concessional part improves the risk-return balance for private investors. For example, a guarantee may cover some losses, or a first-loss tranche may absorb the first defaults in a loan portfolio, so commercial lenders are willing to lend at terms the project can afford.

The Main Blended Finance Instruments

How Much Subsidy Is Typical?

IFC publishes data on its own blended concessional finance portfolio. Across a sample covering FY2010 to FY2025, the average concessional level was 4.7 percent of total project cost. IFC describes this as a sample with limits, and it is not a rule for other deals, but it shows an important point: in many transactions, a relatively small concessional share supports a much larger total investment.

The principle behind this is minimum concessionality: using only as much subsidy as needed to make the deal work, so that public money is not wasted and markets are not distorted.

Why Blended Finance Has Fallen Short

The OECD's 2025 DAC Blended Finance Guidance notes that blended finance has mobilised relatively limited private finance and has not scaled as rapidly as hoped. Common reasons include:

- Too few well-prepared, bankable projects
- Small, one-off deals with high transaction costs
- Limited standardisation, so each deal is negotiated from scratch
- Weak transparency on terms and results
- Currency and country risks that instruments do not fully address

Blended Finance, PPPs and Ordinary Development Loans

Blended finance is often confused with other forms of finance. A public-private partnership is a long-term contract under which a private party delivers and often finances a public service or asset; it may or may not use blended finance. An ordinary development loan finances a government directly, without aiming to mobilise private investors. Blended finance is defined by its purpose: using development money to bring in private capital that would not otherwise come.

How Governments Can Prepare Projects for Blended Finance

- Start with the development goal. Be clear what the project must achieve and how it will be measured.
- Prepare the project properly. Feasibility, environmental and social studies, and a clear revenue model are what investors look at first.
- Identify the real barrier. Is it risk, cost, currency, tenor or market size? The instrument should match the barrier.
- Allocate risks clearly. Decide which risks the public sector, the development partner and private investors each carry.
- Use the least subsidy needed. Test whether the deal would happen with less concessional money.
- Plan the public sector's obligations. Guarantees and contingent liabilities must be recorded and managed.
- Measure and publish results. Track both the private money mobilised and the development outcomes.

A Simple Example

Consider a municipal water utility that needs to replace leaking networks. The investment would reduce water losses and improve revenue, but lenders see the utility as risky. A development bank provides a partial guarantee on a commercial loan, a donor grant pays for the feasibility

study and a performance-based contract, and the utility commits to tariff and collection improvements. The guarantee lowers the lenders' risk, the grant makes the project bankable and the utility's commitments give lenders confidence. Each party knows exactly which risk it carries.

Who Does What Inside Government

Blended finance deals touch several parts of government, and weak coordination is a common reason they stall.

Agreeing these roles early, and naming one lead institution for each deal, saves months of negotiation.

Blended Finance for Climate and Adaptation

Climate projects are a frequent use of blended finance because many have clear public benefits but uncertain or slow revenue. Renewable energy with a reliable buyer can often attract private lenders with modest support. Adaptation projects, such as flood protection or resilient water supply, are harder: they protect value rather than create new revenue, so they usually need a larger public or grant share, or a revenue source such as a tariff or a public payment linked to performance.

For governments, this means being realistic. Not every climate project can be made attractive to private investors, and forcing a commercial structure onto a project without revenue can create hidden costs for the public budget later.

Skills Governments Need for Blended Finance

- Project preparation: feasibility studies, environmental and social assessment and financial models
- Risk analysis: understanding which risks are being transferred and what they could cost
- Negotiation: working with lenders, investors and development partners on term sheets
- Fiscal risk management: recording and monitoring guarantees and contingent liabilities
- Contract management: monitoring performance over the life of the deal
- Results measurement: tracking development outcomes, not only money mobilised

Common Mistakes to Avoid

- Starting with the instrument. Choose the guarantee or loan only after the real barrier is clear.
- Underestimating preparation. Rushed studies lead to expensive renegotiation later.
- Hiding contingent liabilities. Guarantees that are not recorded can become sudden budget costs.
- Measuring only money mobilised. A deal that attracts investors but does not improve services has failed its purpose.
- Relying on advisers alone. Government teams need enough expertise to question advice and own decisions.

Key Terms

- Concessional finance: money provided on terms better than the market, such as lower interest or longer repayment.
- Mobilisation: private finance attracted into a project because of the development finance involved.

- Minimum concessionality: using only the subsidy needed to make the deal happen.
- Contingent liability: a cost the government may have to pay if a specified event occurs, such as a guarantee being called.
- Bankable project: a project prepared well enough that lenders are willing to finance it.

Questions to Ask a Development Partner About a Blended Offer

- What exactly is the concessional element, and why is that amount needed?
- Which risks does the instrument cover, and which remain with the government or the project?
- Are there fees, conditions or reporting duties that add cost or delay?
- How will the private finance mobilised be measured and reported?
- What happens if the project underperforms or a guarantee is called?
- Can the structure be repeated for similar projects, or is it a one-off?

Clear answers to these questions help the government compare offers, avoid hidden costs and build a pipeline of deals that can be replicated rather than negotiated from scratch each time.

Building a Pipeline, Not Single Deals

One of the reasons blended finance has not scaled is that many deals are small and unique. Governments can help by preparing groups of similar projects, such as several solar plants or several municipal water utilities, using standard documents and agreed risk-sharing terms. This lowers transaction costs for everyone and gives investors a reason to build expertise in the country.

Transparency and Public Trust

Because blended finance uses public money to support private returns, transparency matters. Publishing the main terms of each deal, the subsidy involved, the risks the public sector carries and the results achieved helps parliaments, auditors and citizens judge whether the money was well used. It also helps other agencies learn from each deal, which supports the standardisation that blended finance needs to grow. Governments that agree disclosure rules with development partners at the start avoid difficult questions later and build the trust that future deals depend on.

Critical Questions Government and Project Leaders Should Be Asking

Would this investment happen without the subsidy?

If yes, the concessional money is not needed. If no, check that the subsidy is the minimum required.

Do we have bankable projects ready?

Preparation is the most common bottleneck. Invest in feasibility and structuring before seeking investors.

Which risks are we taking on?

Record guarantees and other contingent liabilities, and assess them as part of public debt management.

How will we measure development results?

Agree indicators for both mobilisation and outcomes before the deal is signed.

Do our teams have the skills to negotiate?

Structuring and negotiating blended deals needs finance, legal and sector expertise inside government.

How Risalat Can Help

Risalat supports ministries, utilities and project units on climate finance, PPPs and investment preparation through its programmes and in-house assignments. Teams preparing proposals can start with the free climate finance proposal readiness check, or request a tailored proposal.

Frequently Asked Questions

What is blended finance?

The use of public or philanthropic development money to attract private investment into projects that serve development goals, usually by taking on some risk or cost that private investors would not accept alone.

What instruments does blended finance use?

Common instruments include guarantees, first-loss capital, subordinated or concessional loans, equity, grants for project preparation and technical assistance.

How much concessional money do blended deals use?

IFC reports that across a sample of its blended concessional finance portfolio from FY2010 to FY2025, the average concessional level was 4.7 percent of total project cost. It is a historical average for that sample, not a rule.

Has blended finance mobilised as much private money as expected?

No. The OECD notes that blended finance has mobilised relatively limited private finance and has not scaled as rapidly as hoped.

Related Risalat programmes

- Accessing Climate Finance: GCF and Adaptation Fund Proposals in Nadi, Nadi (11 Jan 2027)
- Accessing Climate Finance: GCF and Adaptation Fund Proposals in Nairobi, Nairobi (18 Jan 2027)
- Climate Finance Access & Proposal Development Training, Geneva (8 Feb 2027)
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