



---

# First and Second Loss Facilities

First and second loss facilities are credit enhancement tools where a provider commits to bear initial losses without equivalent return compensation, with the amount of loss covered typically agreed upfront.

- First-loss facilities absorb the earliest layer of losses incurred on a loan or investment (through donor capital, concessional equity, or subordinated debt) to reduce risk for senior lenders and investors, thereby encouraging co-investor participation that might not otherwise occur. First-loss capital can substantially alter the risk-return profile of a transaction. It may cover only lost returns on a loan or investment, or both returns and principal, and is often structured as grant funding or subordinated fund interest.
- Second-loss facilities provide an additional protective layer (through mezzanine equity, guarantees, or subordinated debt) that absorbs losses after the first-loss tranche is depleted. This further enhances investor confidence and broadens participation in high-risk or underdeveloped sectors.

## RISKS ADDRESSED

- **Credit risk:** De-risks investments in early-stage borrowers, high-risk sectors, or unproven technologies.
- **Market risk:** Encourages investment in sectors with uncertain demand or limited historical performance by improving perceived investability.
- **Liquidity risk:** Mitigates investor concerns in long-dated, illiquid, or small-scale climate and adaptation projects.

## SECTORAL RELEVANCE

- Climate-resilient infrastructure (e.g., water, transport).
- Distributed renewable energy and clean technology ventures.
- Nature-based solutions (NbS), land-use, and adaptation projects.
- Smallholder agriculture and agri-SMEs.

**Sector-specific considerations:** First- and second-loss facilities are particularly relevant for adaptation and resilience, where projects typically face challenges due to variable returns, limited track records and smaller project sizes. While many of these sectors offer indirect or long-term benefits (e.g., avoided losses, productivity gains), first- and second-loss capital buffers protect senior investors where even partial or uncertain revenue streams exist, for example, through blended payments, user fees or aggregated portfolio returns.

## TYPE OF INSTRUMENTS AND PROVIDERS

### A. Commercial instruments and providers

- [Mirova Sustainable Land Fund 2 \(MSLF2\)](#): A blended finance vehicle (target size EUR 350 million) bringing together commercial investors, development finance institutions, and philanthropic partners. Uses first-loss capital from entities such as the SDG Impact Finance Initiative to support sustainable land use and resilience investments across EMDEs, including Africa and Latin America.
- [Infrastructure Climate Resilient Fund \(ICRF\)](#): Managed by AFT Capital Partners; uses first-loss capital from the Green Climate Fund (GCF) and Africa Finance Corporation. The GCF's junior first-loss equity investment (USD 253 million) is its single largest equity investment in Africa to date.
- [BlackRock's Climate Finance Partnership](#): Mobilized more than USD 250 million from global institutional investors, governments, and philanthropies. Focused on climate infrastructure in EMDEs, using blended structures with first-loss layers to de-risk private participation.

### B. Concessional/public instruments

- [Climate Investor One \(Netherlands Development Finance Company, FMO\)](#): A three-tier blended finance facility that deployed donor capital in a first-loss position to de-risk infrastructure investment. With USD 412 million in commitments at first close, it is designed to mobilize at least USD 2 billion in private finance for renewable energy projects in developing countries.
- [GCF First-Loss Tranche \(USD 150m\)](#): Channels concessional equity to de-risk adaptation and mitigation projects in secondary cities and municipalities, crowding in private capital at the fund level.
- [Acumen Resilient Agriculture Fund \(GCF-PSF\)](#): Uses concessional first-loss equity under the GCF Private Sector Facility to unlock commercial investment in early-stage agribusinesses across East and West Africa, supporting resilience for smallholder farmers.
- [Dutch Fund for Climate and Development \(DFCD\)](#): Blends first-loss grants with DFI capital (via FMO and SNV) to de-risk adaptation and NbS investments in EMDEs.

### C. Key technical assistance providers

- MDBs (World Bank, IDB, AfDB): Support structuring, legal guidance, and pipeline development alongside capital provision.
- [GCF](#) and [CIF](#): Provide TA facilities and readiness programs linked to concessional tranches.
- [Convergence Blended Finance](#), [OECD-DAC](#): Produce knowledge products, transaction templates, and policy frameworks to guide governments.

## DEBT SUSTAINABILITY

- **Direct effect:** Generally off-balance-sheet; does not directly reduce sovereign debt stock. If governments or SOEs provide first-loss capital, this creates contingent liabilities that would reduce fiscal space and must be reported.

- **Indirect effect:** Crowds in private capital, reduces reliance on sovereign guarantees, and mobilizes finance for resilience infrastructure. First and second loss can improve fiscal space over time by enabling governments to meet investment goals without incurring additional sovereign debt. By de-risking transactions, they reduce the need for sovereign guarantees and attract the private sector to high-risk sectors like adaptation.

## INTERNAL CAPACITY REQUIREMENTS

### A. Minimum requirements:

- Ability to evaluate tranche structures and implications for concessionality.
- Identify/report contingent liabilities when public capital is at risk.
- Review term sheets and engage with DFIs/fund managers.

### B. Requirements for full integration:

- Portfolio-level modeling of risk exposure and catalytic leverage.
- Negotiating multi-party agreements (DFIs, donors, commercial).
- Managing contingent liability reporting under IMF/IFRS frameworks.

### C. Pathways:

- Embed advisors via GCF/CIF/MDBs.
- Develop climate investment units in MoFs or NDBs.
- Use donor-funded TA and pilot transactions to build experience.

## REGULATORY CAPACITY REQUIREMENTS

### A. Minimum requirements

- Legal/procurement frameworks permitting public entities to assume subordinated positions.
- Transparent fiscal reporting of first-loss investments.

### B. Requirements for full integration

- Rules for fiscal risk classification/disclosure of subordinated positions.
- Clear treatment of contingent liabilities in debt sustainability frameworks.

### C. Pathways

- Conduct fiscal risk guidance and legal gap analysis.
- Collaborate with IMF and rating agencies on treatment of subordinated capital.
- Use MDB/GCF pilots to establish precedents.

## FINANCIAL MARKET READINESS

### A. Shallow markets

- **Characteristics:** Limited investors, no blended funds, climate investment is mostly grant-funded.
- **Constraints:** High structuring costs, legal/regulatory uncertainty, FX volatility.
- **Solutions:** MDB-/DFI-led pilots, donor-backed TA, multi-country platforms (e.g., [Climate Investor One](#)).

### B. Emerging markets

- **Characteristics:** Presence of DFIs, some institutional investors, growing platforms.
- **Constraints:** Currency/credit risk, weak domestic coordination.
- **Solutions:** Local-currency risk mitigation (e.g., TCX, IFC), donor-backed sovereign climate funds with first-loss tranches.

### C. Mature markets

- **Characteristics:** Deep capital markets, ESG-oriented investors, experienced intermediaries.
- **Constraints:** Limited concessional capital, fiduciary complexity.
- **Solutions:** Market-competitive mezzanine and first-loss structures; SPVs backed by governments or blended platforms (e.g., [GARI](#), [GEAPP](#)).

## PRICING CONSIDERATIONS

- **Cost drivers:** Sector/geography risk profile, tranche seniority, leverage ratio, expected loss rates, FX exposure.
- **Role of concessional support:** Donor capital in first-loss improves the risk-return profile for senior investors by absorbing early losses and enabling return compression on senior tranches. In many blended finance facilities, this can lower required returns by several percentage points.
- **Examples:** [GCF PSF \(FP078\)](#) provided concessional first-loss equity, crowding in DFIs and impact investors.

## AVERAGE TIMEFRAME TO DEPLOY

- Existing blended funds: 6-12 months.
- New national funds or green banks: 12-24 months.
- MDB/DFI-supported platforms: 6-18 months.

## KEY CHALLENGES TO UPTAKE

- **Technical:** Limited MoF/NDB expertise in layered structures and modeling.
- **Market:** Few investable adaptation projects, high transaction costs.

- **Legal:** Restrictions on subordinated public investments; unclear fiscal treatment.
- **Institutional:** Fragmented governance, lack of blended finance units.

## HOW TO ADDRESS KEY CHALLENGES

### A. Practical steps for Ministries of Finance (MOFs):

- Develop internal guidance on subordinated investments.
- Build MoF/NDB blended finance units.
- Use TA to support risk modeling and legal reviews.

### B. Role of donors/DFIs:

- Provide concessional first-loss tranches and guarantees.
- Offer TA and readiness programs ([GCF Readiness](#), [CIF TA](#)).
- Anchor new vehicles with concessional funds to crowd in commercial capital.

## EXAMPLES

- **High-income:** Used in sustainable infrastructure funds managed by global asset managers.
- **Middle-income:** [Climate Investor One](#) (USD 412m commitments; >USD 2bn mobilization).
- **Low-income:** [Acumen Resilient Agriculture Fund](#) (GCF-backed, supporting smallholders in Africa).

## RELEVANT SOURCES

- [OECD \(2025\). DAC Blended Finance Guidance](#)
- [Convergence \(n.d.\). Blended Finance knowledge products](#)
- [GCF \(n.d.\). Private Sector Facility project documents](#)

## KEY TERMS

<b>First-loss tranche</b>	Most junior capital absorbing initial losses
<b>Second-loss tranche</b>	Additional subordinated/mezzanine capital providing further risk protection
<b>Concessional capital</b>	Philanthropic/public capital with non-commercial return expectations
<b>DFI</b>	Development Finance Institution
<b>FMO</b>	Netherlands Development Finance Company
<b>MDB</b>	Multilateral Development Bank
<b>NDB</b>	National Development Bank
<b>MoF</b>	Ministry of Finance
<b>TA</b>	Technical Assistance
<b>SPV</b>	Special Purpose Vehicle
<b>OECD-DAC</b>	Organisation for Economic Co-operation and Development - Development Assistance Committee
<b>CIF</b>	Climate Investment Funds
<b>GCF</b>	Green Climate Fund
<b>IFRS</b>	International Financial Reporting Standards