Forbes Middle East

Building For Good Times And Bad Times

When crude prices started dropping in the latter half of 2014, the Gulf countries had infrastructure projects worth millions of dollars at various stages of development. But as oil prices began a nosedive that lasted well through 2015, the deep pocketed governments of the GCC started to look for alternative sources of funding to build the roads and other major transportation projects. But their woes are far from over. A report from Standard and Poor's (S&P) earlier this year predicted that falling revenues from commodity exports and a dip in bank deposits across the region will constrain the amount of funding needed to sustain the Gulf's substantial infrastructure bill.

"We estimate that Gulf government spending on projects alone including infrastructure contracts awarded over the period 2016-2019 could be about $330 billion," the S&P report says. "We note that with some sovereigns, such as Saudi Arabia, the 2016 budget includes a capital spending allocation of about 9% for what they define as 'transport and infrastructure.' Taking this and other research into account, we estimate that about $50 billion out of the $330 billion that we think will be spent on projects will be allocated specifically for infrastructure (including transport-related projects). This compares with our estimates of about $604 billion in projects (including $100 billion of infrastructure projects) that will need funding through 2019. The difference between our estimates of capital spending on projects and project contracts awarded is as large as $270 billion through 2019."

The ratings agency forecasts that in order to close this funding gap, the governments could either borrow or turn to "innovative" financing solutions such as Public Private Partnerships. As the name alludes, PPPs are agreements through which a government agency and the private sector could collaborate to finance, build and operate projects. The concept of PPPs is not alien in the Gulf as this model has been widely used in the power and utilities sector for years. But in a region where most infrastructure projects were funded by oil money, such a model was also not the preferred one until recently.

Mouayed Makhlouf, director of Middle East and North Africa at International Finance Corporation (IFC) is well versed with the difficulties of getting institutions interested in the concept. His organization began pitching this model to governments years ago but did not meet with much success. "About 12 years ago when we started (the PPP unit) we went around and spoke to officials and ministers and this was really not on their mind. The model of the public sector financing everything was the only model that existed," he said during a roundtable discussion in Dubai. Although PPPs were not widely adopted then, IFC did have a few successes in the last few years. Expansion work on Jordan's Queen Alia International Airport and Saudi Arabia's Medina Airport were both PPP projects, showing that such partnerships could be successful when used prudently.

Experts agree that the current time is as good as any to start seriously considering PPPs as there are a number of projects looking at being implemented this way. "There is a robust pipeline of PPP projects in the market," notes Villiers Terblanche, Partner, Latham & Watkins. "Kuwait has five or six multi-billion dollar PPP projects ranging from waste water projects to energy. In Dubai, you have Hassayan coal fire power project and Abu Dhabi is in the market for a 350 megawatt solar project." The power generation sector in the region has its own laws governing PPP deals but now new regulations are being introduced to enable more PPPs in other sectors. In November 2015, Dubai introduced a law to govern PPP projects while Kuwait updated its PPP law to make it more investor friendly. In addition, Terblanche forecasts that economic demand brought on by Saudi Arabia's National Transformation Plan and mega events such as FIFA World Cup 2022 and Expo 2020 could spur demand for PPPs in certain industries such as hospitality and leisure.

Not Easy Finance

PPPs could be in the spotlight now due to a finance crunch but there is an inherent risk that abounds, industry professionals warn. "A lot of times governments think that it is a proxy for financing but it is not. If you do that then it is a disaster" says Muneer Ferozie, PPP Manager for the Middle East and North Africa at IFC. It is also a concern echoed by Terblanche who notes that there is a rush to do such projects right now partly due to this appeal. "PPP is not a substitute for government investment and it is not to be used by the governments to make money. Of course these may happen to be incidental byproducts of a good PPP, but if the starting point is to save investments and make money then PPP is probably not the right tool." He also notes that PPP is not the best way to complete projects if governments want to push all the risk to the private sector.

So when and why should governments consider PPPs? Terblanche says that the model can provide cost efficiency and improve service delivery if done for the right reasons. Aside from all else, such projects could help fully utilize the knowledge of the private sector in the right way. "PPP is a combination of not only getting private sector financing but also benefitting the public sector from their technical expertise on time procurement and on time delivery," explains Ferozie.

With such benefits to PPPs, interest in this model is picking up with many governments looking at using it in sectors like real estate and especially in social housing. Last year, Bahrain's Ministry of Housing signed a $1 billion deal with property developer Diyar to build 3,100 homes in an effort to address the country's affordable housing shortage. As per the agreement, the government will buy the housing units and the supporting infrastructure from Diyar upon completion, minimizing the risk for the developer while ensuring delivery on time. This comes at the heels of another $550 million PPP deal that Bahrain's government signed with developer Naseej in 2012 to build around 3,110 units of social housing. With most countries in the MENA region facing an affordable housing shortage, PPP projects could help bridge this gap. But experts say that the success of such deals will depend on various other factors as well.

"For the social housing PPPs in the MENA region, it is critical to ensure that the projects that are developed actually appeal to the private sector, are not over specialized and actually help solve the social housing issue. Furthermore, the availability of mortgage as well as foreclosure law are key ingredients that will determine the success of real estate PPPs. In the MENA region, this is still a work in progress," says Ferozie.

Regardless of these challenges, as Gulf countries enter a period marked with lower public revenues and widening budget deficits, PPPs are bound to increase as the region's infrastructure needs remain a top priority for the governments.

https://forbesmiddleeast.com/building-for-good-times-and-bad-times