



It takes two

PPP in infrastructure in the Middle East

Infrastructure development, as has been demonstrated in other parts of the globe, is crucial in meeting a region's social challenges. However, infrastructure investment in the GCC has not kept pace with the region's rapid economic and population growth. Unless infrastructure spending surpasses other planned investment, GCC countries will be unable to effectively meet their economic growth targets.

Gulf Cooperation Council (GCC) countries have demonstrated that it is imperative to continue investing in infrastructure. Take Dubai, for example, which, having experienced one of the most dramatic economic impacts in recent history, is exhibiting strong signs of recovery due largely to an infrastructure that is significantly more advanced than in any other part of the GCC.

Infrastructure investment in the Middle East

There is an increasing realization across the Middle East region that infrastructure needs cannot be met by the public sector alone. Countries with few natural resources and strained public finances must attract private investment for infrastructure projects as an alternative source of funding. Other countries with strong sovereign wealth also need to benefit from international management, with its proven track record and proprietary knowledge. The search for these benefits have led even the region's wealthiest countries to seek private sector participation in infrastructure projects. With the perceived capability to more readily provide government-backed subsidies, it also creates competition in this sector.

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Current infrastructure investment stands at over USD 200 billion in the region and with liquidity coming back into the market and the continued desire to invest within the region, over USD 400 billion spend in infrastructure projects (out of almost USD 1 trillion of planned construction projects) are expected to be undertaken within the next five years. Whilst Saudi Arabia's plan of spending USD 400 billion over the next five years has been approved and Abu Dhabi is budgeting USD 68 billion for the transportation sector alone, countries such as Syria are planning to disburse USD 50 billion over the next several years.

PPP in infrastructure in the Middle East

More and more Public Private Partnership (PPP) models to build or operate infrastructure projects in the region are being established, with nine public-private partnerships already active according to the International Finance Corporation (IFC). The Organization for Economic Cooperation and Development (OECD) projects USD 100 billion of PPP investments over the next five years.

In addition to leveraging commercial expertise and attracting private investment and resources, PPPs in other countries have already demonstrated their ability to create jobs in the private sector, provide higher quality services and facilities for citizens and stakeholders and lift much of the burden of development from the already over-extended public sector. PPPs can also implement commercial concepts to assist governments in dealing with distressed or failed projects by re-launching projects under a different structure without compromising the planned services originally envisaged.

The basis of PPP is the effective sharing of project risk and in many cases, asset ownership. However, in order to promote and encourage the use of PPP for the development of infrastructure, which is necessary for the region's long-term growth, governments must reduce the bottlenecks in terms of legal and regulatory frameworks. Under the right conditions, PPPs can represent "win-win" schemes, combining the respective strengths of both the public and the private sectors. Despite there being many cases of PPP success globally, there are also many failed partnerships, mostly when the original plan or strategy is not adhered to, and when prior mutually-accepted interests become unaligned. Below are some of the challenges of PPP transactions in the GCC:

Government decisions are not always financially driven

Social enhancement and other public policy initiatives play a key role in government decisions to invest in infrastructure – more so than in developed markets – creating bankability challenges in capital markets. Additionally, the pressure for essential services to be delivered as soon as possible puts additional pressure on the risk-sharing mechanism and weakens the chance of success under an alternative procurement/ financing strategy.

Returns may rely upon future demand

Some large-scale projects are being built based on forecast usage levels. Private investors, however, require immediate, proven and stable revenue projections in order to invest. Governments may not be in a position to mitigate risk by offering subsidies or the required guarantees.

Few PPP projects have been completed in the GCC

Many failed or delayed PPP tenders have proven that current PPP implementation in the region is still in its infancy. Without a bold advisor who is willing to tailor their global methodologies, or government commitment to modify policy and regulations, successful financial close is still at risk.

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Closing the funding gap in the Middle East infrastructure finance market

Around the world as in the GCC, there has been a tremendous loss of liquidity in the markets, which has had a major impact on high-profile projects. This has created challenges, as well as opportunities, for infrastructure finance.

Although the GCC countries combined earned an estimated USD 500 billion from oil exports, resulting in a total GDP of USD 850 billion in 2009, they are still challenged to meet the growing need for capital to fund infrastructure projects whose costs are running into the billions (USD 723 billion of public and private resources required within the next five years.)

This has resulted in the need for alternative funding sources. Although numerous private equity infrastructure funds (e.g. Abraaj, HSBC, Macquarie and ABCB) have raised financing over the last three years, very little of it has actually been deployed in terms of investment. Traditionally, the majority of infrastructure projects in the Middle East have been financed by the public sector and international and regional commercial banks, but decreasing petrodollars, the high volume of infrastructure needs and liquidity constraints have

created a funding gap and have ultimately created a focus on alternative funding sources, leading governments to seek alternative finance methods for infrastructure development.

Alternative finance can unlock value for infrastructure investment in the GCC

The region is driven by an ambitious expansion plan and is looking to continue to diversify its economy. Partnering is on the rise, especially in the healthcare and education sectors where a number of hospitals and schools have hired private firms to build and maintain their facilities and infrastructure.

A well-structured PPP is an effective way to accelerate and finance development by unlocking the value hidden in assets and providing profit incentives to stakeholders. The successes of PPP models in infrastructure delivery in Europe, Canada and elsewhere have spread a sense of confidence among private equity investors, hedge funds and commercial banks. PPPs in the Middle East can be financed through equity, Islamic financing and long-term debt, as is accepted for other investments. But in order to further stimulate private sector finance for infrastructure, the principles outlined below must be accepted and/or adhered to:

Bring construction forward driven by the incentive of realizing revenue	Reduce public sector burden due to lower upfront capital requirements
Deliver projects on time and on budget	Transfer risk to the private sector (design, build and operations) which is more experienced in mitigation strategies
Closely monitored strong customer service and performance incentives driven by the revenues linked to users	Preserve capital by acting as an investor and generate a return on investment
Innovations in design due to alignment between design, maintenance and operation	Spread costs over life of asset, focus on value for money over life of asset and reduce life cycle costs

Looking ahead

The decrease in confidence in the regional real estate sector will see a significant change in the type of projects that drive construction activity, with government-funded infrastructure and building projects set to provide the best opportunities for PPP. Efforts to develop schools, hospitals and affordable housing are expected to provide the strongest opportunities in the coming year, particularly in Saudi Arabia, Abu Dhabi and Qatar. With high-profile public sector projects around the GCC giving rise to new opportunities, as in major public transportation such as the Abu Dhabi surface transport program, other investments will continue in the development of power, water and wastewater projects, as well as other large-scale road and land transport projects. Risk will be reduced once the PPP model is clearly understood by the public and the private sectors in the region and greater regulation implemented as it becomes more commonplace, restoring, enhancing and further sustaining private investor confidence in the infrastructure development market.

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