On public-private partnerships, here is what Gulf economies must focus on

Matching government expectations and private sector capabilities is paramount

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On the infrastructure side, Gulf governments are opening the funding taps.
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As we move out of the pandemic-induced recession and look to renew growth, we see governments relying in part on tried and tested stimuli for their economies. Although the economic credibility can be questioned by some, governments are commencing the rollout of major infrastructure development policies to support and grow out of the major contractions in GDP seen in 2020.

When we look at the GCC, there is a significant need to correct the local economies and to continue to promote non-oil activity for GDP growth. In many respects, the recession represents an opportunity to provide further correction to the non-oil sector by focusing the minds of policymakers. The oil sector can see a recovery based on global demand rising again.

Ticket sizes get bigger

The fact is that real estate and construction are major contributors to GDP in the biggest GCC countries and represent a significant proportion of the population and salaries paid in these states, as well as having a $1.9 trillion pipeline of projects planned. In the UAE, which saw a 6.1 per cent GDP contraction in 2020 and a 4.8 per cent decline in construction contribution, the industry represents 8.1 per cent of GDP.

Laws and supporting networks are in place to smoothen out PPP-led projects.

As such, the GDP is expected commence growth and is forecast to pick up in 2021 to 3.1 per cent and with a continuation of 2.6 per cent per annum to 2026. In Saudi Arabia, the impact on the economy in 2020 was slightly less, although still significant, at 4.1 per cent contraction, with a forecast growth of 2.9 per cent in 2021, 4.3 per cent in 2022 and 3.3 per cent in 2023, and with construction making a 6.2 per cent contribution to GDP, although this grew in Q1-2021 to 6.4 per cent. Given the programmes across the Kingdom, this will maintain a significant CAGR (compound annual growth rate) as we see major programmes of work reach construction.

The question is, how do you commit to major infrastructure plans when debt-to-GDP has grown significantly over 2020? The UAE debt-to-GDP is up from 26.8 per cent to 38.3 per cent at start of 2021 (mostly due to the Dh395 billion - or 31 per cent of GDP - stimulus package) and Saudi debt-to-GDP from 22.8 per cent to 32.7 per cent at the start of 2021. Although still low by international standards, the major GCC nations have historically been cautionary in their borrowing.

There is obviously direct investment into infrastructure through wealth drawdown (by ADIA, Mubadala, ADQ and PIF in Saudi Arabia) and traditional borrowing and bond issuances. But the pandemic has presented a golden opportunity to enact PPPs (Public-Private Partnerships) effectively as a way of keeping states' balance-sheets healthier and engaging the private sector to continue the expansion of the non-oil sector in the region.

Private sector participants should not be fazed by build up costs and try and cut corners.

In the UAE, laws to enable PPP implementation were passed in 2015 in Dubai and 2017 at a Federal level, which were formally rolled out in 2019 and an advisory book published in 2020. In Saudi Arabia, there is now a PPP office to enable the continued roll out of such projects.

The Kingdom and UAE have already engaged in a variety of alternative financing option in the power and water sector, through Independent Water Projects (IWPs), Independent Power Projects (IPPs) and Independent Water and Power Projects (IWPPs), as well as in the renewables sector. However, in recent years, there has been developments in new sectors.

New sectors, new opportunities

This can be seen in with the Medina airport in the Kingdom, which was the first full PPP airport in the GCC, and with Tatweer awarding its first phase of schools to a private consortium. We also see in Abu Dhabi that the schools PPP programme has is now underway with the first project in market at present.

Clearly the commitment to move PPPs forward has started to gain traction. We see that Saudi Arabia has underway or in planning a pipeline of some 142 projects worth approximately $45 billion, while the UAE has 89 known projects with a combined value of $22 billion. We even see Qatar enacting a PPP law in May 2020 with a small pipeline of some 28 schemes in power, water, and schools, with a value of $1 billion. Indeed, Oman has a commitment to 28 current or underway schemes in the PPP sector as well.

Ways to get funds flowing

So, the next question is how to put this investment on the ground? Saudi Arabia has already committed SR99 billion in 2021 to infrastructure development at a direct funding level, which is the traditional route in the region.

There are a multitude of options available to regional governments. What works in each state is the key. There are significant challenges in the region to engage, administer and deliver on PPP models. Policy change has commenced, but time will be required to change and implement effectively and engage international experience to the level required by the visions of the nations.

Areas that need to be addressed to ensure that delivery is met include:

- Risk sharing: Historically the region operates in a 'push down' contract or master/slave style agreement, where the client party absolves as much responsibility as possibly. This model is not conducive to a partnership and provides little incentive to the private sector to meaningfully engage.
- Equitable contracts: Following on from risk sharing, the contracting methods need to ensure refinement of risk allocation and also of equitable terms and backstop arrangements for utilisation that the client must support and cover. To protect both parties, a ratchet arrangement can be applied, but this must be applied in both under and over expected utilisation.
- Tenure: 25 or 30 years, or longer? With most PPPs looking at rolling funding parameters over in a 5–7-year period, it is critical that the structure of the tenure is set to enable profitability to be achieved in a sensible timescale to avoid significant funding costs to the schemes. Without clarity on breakeven, or an unclear horizon as to how this will be achieved, the scheme will fail before it's started.
- Funders exit plans: For all financially liable parties, there needs to be a clear path to profit (if successful delivery is achieved), as well as the need to provide investor confidence in the long-term success and commitment to the project from the client body. Without that transparency, borrowing costs and investor interest will become challenging.
- Refinancing: Governments need to support the local development of finance institutional capacity and capability to engage in refinancing opportunities in 5–8-year horizon post-transaction closure to build a sustainable fiscal ecosystem in the region for PPPs.
- Refining delivery models: As with other regions that have rolled out PPP models, there is an inherent need to constantly refine the terms and scope of agreements to ensure a suitable balance of risk and return and delivery of products and services required is met. This 'lessons learnt' cycle is critical to maintain interest for both private and public sector.
- Lifecycle design, operations planning: In a region traditionally more focused on the delivery of the cheapest product possible for the specifications laid out, a mindset shift is required. Whole live-cycle thinking is required. The build cost of an asset is likely to be only 20-25 per cent of the whole life cost of that asset. The private sector has also to be aware of critical factors to be addressed when looking at delivery.
- Conceptualisation: At the earliest stages are the point where costs are most likely to be impacted up or down. Effective engagement with the client body and detailed planning and analysis will mitigate many risks and present opportunities to improve the asset and service delivery.
- Delivery methodology: As with the client entities, most regional private sector companies are focused on lowest cost delivery of an asset. The regional supply chain is broadly set up in this manner as well, which requires an education and management process which, whilst not untested in the region, is not widespread.
- Resources: As with supply chains, the professionals in region have a bias towards not administering delivery with a view to lifecycle costs and benefits. This challenge is being addressed, but a function of time and education still applies.
- Lifecycle operations: Careful planning through all phases of delivery will mitigate lifecycle operations costs, but as opposed to the status quo, it is vitally important to have the operations team involved from conceptualisation.

With the parameters to address the delivery under the leadership of the PPP office in Saudi Arabia and Ministry of Finance in UAE, the policy changes are clear. But time and education are the two critical factors to implementation.

If we note another example of policy change, the nationalisation programmes in the GCC have now had some significant successes. However, this process has taken several years to bear fruit, so whilst the opportunity is significant, getting a critical mass of schemes on the ground may prove to be a more mid-term ambition.