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DLA Piper

Gulf Affairs: How long has DLA Piper been operating in the GCC? What are some of your key achievements in the region?

DLA Piper: Having established our presence in the Middle East in 2005, DLA Piper has grown to become one of the largest international law firms in the region, with 27 partners and over 100 lawyers operating from nine offices across the GCC. Awarded International Law Firm of the Year in 2017 and 2018 by Legal Week at the Middle East Legal Awards, we are trusted by local, regional and international organisations, in addition to government bodies, across the full spectrum of legal services.

We bring particular strength in energy and infrastructure where our team has had a major role on most of the landmark and significant deals in these areas, helping to shape the region's public-private partnership (PPP) landscape. We are also taking strides in new energy technologies, including renewables. These include having advised on the largest renewables programme in the world, including Saudi Arabia's first commercial wind power plant; the first standalone water desalination projects in Saudi Arabia to be procured on an Independent Water Project (IWP) basis; Oman's largest water project; Oman's first utility-scale solar project; and the first International Sustainability and Carbon Certification (ISCC) project in Kuwait and only the second in the GCC (although unfortunately the project did not proceed).

DLA Piper is also unique for offering public policy advice and support to both private and public sector clients through our dedicated Middle East Government Affairs practice. We advise clients on policy issues in the context of legal and regulatory issues in both contentious and non-contentious environments across a number of sectors. On the project finance and PPP fronts, our government affairs advice typically involves articulating and helping clients navigate the political risks that impact the bankability of infrastructure projects. This is particularly critical in the context of public utilities, which typically involve large amounts of upfront investments and highly regulated sectors.

Gulf Affairs: How does the GCC market differ from other markets in terms of finance opportunities?

DLA Piper: The drivers in the GCC are quite different from those drivers in the Levant region, for example. There are different questions of resources and different questions of technical knowledge. In the Levant, it is more financially driven, and political risks are more pertinent as there are more such risks and greater volatility in policy implementation. Moreover, the security environment is a key differential, as the more uncertain picture in the Levant suppresses finance opportunities.

We are also beginning to see some of the International Finance Institutions (IFIs) assume a more active role in supporting PPP projects across the Gulf region. This is partly because, even in the Gulf, governments' finances have become more constrained as a result of falling oil prices. The attractiveness of IFIs for a number of GCC governments is their ability to provide wider advice on structuring PPPs and assisting governments in deriving long-term and sustained value from PPP initiatives.

Gulf Affairs: How is the outlook for project financing changing in the region in this time of economic reform and diversification? How is the GCC PPP market likely to develop?

DLA Piper: A broad theme has been the revisiting of PPP regulatory frameworks following a realisation that governments in the region should fully utilise their purchasing power by actively investing as governments. This will ensure that investments ultimately deliver targeted economic change across a variety of industries—from technology to natural resources—and in specific geographic areas so there can be job creation and economic security for those communities.

The focus on electricity and water projects is likely to continue and the critical question is whether PPPs will take hold in other sectors such as transport, health, education and other social infrastructure. With the exception of social housing, where a number of smaller projects have been developed on a hybrid PPP model, there is no equivalent track record of governments using project finance to develop this infrastructure. Whilst this is partly due to legal and regulatory challenges, there is also a fundamental economic issue in play, which is that governments seem largely unwilling to retain the demand and usage risk implicit in investing in a new hospital or metro system. In the electricity and water sectors governments are entirely willing to hold the demand risk and to pay the private developer a capacity (or availability) charge to meet his fixed costs, regardless of whether the plants are actually required to supply electricity or water. In the transport and social infrastructure sectors, there appears to be a greater imperative to transfer the demand risk to the private sector and this has historically impacted project viability.

In many of the most active and successful PPP markets around the world, the recognition that these transport and social infrastructure schemes are unlikely to be economically self-sustaining, but are nevertheless a critical public service, has led to the development of models that are similar to the capacity change models seen in the GCC electricity and water sectors. The acceptance of these 'availability' based schemes or hybrids between demand transfer models and 'availability' based schemes is an essential next step if the use of PPP is to expand. A number of major projects such as the Bahrain Light Rail Project, the new Saudi-Bahrain Causeway and the Saudi schools programme are currently exploring these issues.

Gulf Affairs: What regulatory changes are altering the outlook for project finance? What regulatory and other burdens are still meaningful obstacles?

DLA Piper: There is a long and successful history of the tendering and delivery of electricity and water projects in the GCC. These projects have typically been procured on the basis of a combination of existing procurement laws that don't quite work for a PPP (necessitating the granting of exemptions); sector specific laws that establish a framework for the sector and override other laws that would otherwise create obstacles; and overriding Royal Decrees and Orders.

Whilst this somewhat piecemeal approach has worked well enough for the occasional procurement of major projects, it isn't particularly conducive to the development of a pipeline of projects across a range of sectors, and it is this that has driven most of the GCC countries to look at implementing specific PPP laws that will work in different sectors. Progress has been mixed in this respect with Kuwait having been an early mover followed by Dubai. Oman, Qatar and Saudi Arabia have all prepared draft laws, but have delayed enacting them. We understand that Saudi Arabia's Private Sector Participation Law is expected to come into effect in the near future, which could be critical for local and foreign investment. Early enactment of the PPP laws and the implementing regulations remain important in order to both facilitate implementation and to demonstrate political commitment.

The establishment of a central PPP unit is generally considered best practice, but it is not necessarily a guarantee of success. Kuwait, for example, has a long-established central unit (Kuwait Authority for Partnership Projects), but this has not avoided project delays and cancellations. In Saudi Arabia, although the PPP law is not yet in force, there has been a rapid development of the institutional framework around PPPs with a series of ministry specific Supervisory Committees supported by the Ministry of Finance (through the National Center for Privatization & PPPs and the Vision Realization Office) beginning to prove effective in driving projects forward.

It is now generally possible to close project financings in all of the GCC markets and, other than the enactment of PPP laws to facilitate growth in sectors other than electricity and water, it is really now a matter of making changes to improve the processes rather than a requirement for wholesale change. For example, in Saudi Arabia, although LLCs are now legally able to grant pledges, the registry in which they need to be recorded is not yet operational, so in practice banks will not finance projects unless the borrower is a joint stock company. There are numerous similar examples of this around the region and it is important that these refinements are completed and a stable state is achieved as soon as possible.

One significant recent trend is that of governments seeking to limit their exposure under government guarantees that are given on PPP projects and, in some instances, to avoid providing any such guarantees. The desire to reduce guarantee exposure is entirely understandable from the government perspective but, depending on the project fundamentals, may make it more difficult to raise funding or lead to an increase in financing costs.

Gulf Affairs: What are the current prospects for PPPs across the GCC? How has the regulatory landscape evolved to better accommodate this mode of financing?

DLA Piper: The PPP market across the GCC is busier now than it has perhaps ever been and there is a view amongst some market participants that it is in danger of overheating. Electricity (especially renewables) and water (both desalination and wastewater treatment) are by far the most active sectors, with major utility scale projects in procurement in every one of the GCC markets. Saudi Arabia alone is planning to procure 27 Giga Watts of renewable electricity over the next 5 years. Project developers are now having to look critically at the different markets to work out where they want to deploy the human and economic capital needed to tender and deliver these projects.

Although the use of PPPs has its roots in the regional governments' need to identify alternative financing sources in the wake of the collapse of the oil price in 2014, it is being sustained by the growth of the renewables market and by photovoltaic solar projects in particular. As the price of solar power has reduced and the oil price has recovered, the solar resource rich countries of the GCC have reached the point where it makes economic sense to sell their oil and gas abroad while maximising the use of solar electricity in their home markets.

The economic and social reform agendas of the regional governments are also driving this trend with many regional PPPs now mandating high levels of local content (including workers and domestic inputs), encouraging tenders that will facilitate manufacturing in the local market and requiring that companies are subject to partial IPOs in the local markets once they are successfully operating.

We are also beginning to observe political risk issues feature more prominently for international investors supporting PPP projects in the Gulf region, where previously such considerations were muted in relation to other MENA countries. It is important that risks are fairly allocated and balanced in contractual arrangements to help protect the bankability and operational viability of projects (in particular where these are public utility projects) and to avoid a situation where the risk allocation in PPP contracts is not questioned over the lifetime of a concession.

Gulf Affairs: Which are the key institutions funding PPPs in the GCC?

DLA Piper: Smaller projects of up to $250 million (and perhaps higher in Saudi Arabia) are being financed by local banks (predominantly, in part or majority-owned by the state) lending in the local currency and this trend and deal value are increasing as liquidity improves in the local markets. The presence of these local banks strengthens the economic interest of the host governments in the commercial success and viability of these projects.

Larger deals are typically the preserve of a handful of European and Asian banks who are involved in the majority of deals in this market, often supporting multiple bidders: on one recent project with eight different developers bidding, the same group of four international banks (or some combination of them) supported all eight bids. On these deals, the local bank involvement is typically limited to the local currency tranche (if applicable) or the provision of equity bridge loans.

For major projects above $1 billion, it is common to see export credit agencies taking a central role, particularly those from Japan and Korea given the prevalence of major Engineering Procurement and Construction (EPC) contractors and equipment suppliers from those countries. Chinese EPC contractors and funders are beginning to play a larger role in the market.

The inclusion of a local state-owned bank, an IFI and/or an export credit agency in the composition of the lenders or investors consortium is generally helpful in mitigating political risks where they feature.

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