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PPP in the GCC

Jordan Bintcliffe

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Several Gulf Cooperation Council (GCC) countries are investigating ways of utilising more private finance to fund future infrastructure projects, as a reaction to depressed oil prices.

In the past month alone Dubai has brought its public private partnership (PPP) law into effect, Oman has appointed advisers to develop a PPP framework, and new plans for Saudi Arabia to privatise its airports in 2016 were revealed.

Countries in the region have previously expressed an interest in PPP projects, without any genuine PPP programmes being launched.

Umer Sultan, head of global business and transactions for the Middle East, Africa and Turkey at Italian bank Intesa Sanpaolo, said that cheap bank financing and high oil prices reduced these countries' need for PPP. Governments had plenty of surplus capital to guarantee construction projects and make up for any funding shortfalls, Sultan said. But a prolonged drop in oil prices has now dented government balance sheets.

A push for PPP

Oman appointed Ernst & Young, Squire Patton Boggs, Al Busaidy Mansoor Jamal & Co to explore options for PPP procurement in November this year. The consortium of advisers has been tasked with developing a first draft of a PPP framework by the first quarter of 2016. The short time scale is due to the country "aggressively" pursuing PPP development, a source said.

Sustained low oil prices means less revenues for GCC governments, which tend to be heavily reliant on oil exports for revenues. Even countries in the region that do not generate most of their funds from hydrocarbon and sales, such as Dubai, see government funds dented in a low oil price environment.

As well as reviewing delivery models, governments are likely to start prioritising which projects they push forward with, according to Iain Elder, a partner at Shearman & Sterling.

"As governments trim their annual budgets it's inevitable that, short term, we will see a rationalisation and reprioritisation of projects in the region; however the overall trend for the development of industrial and social projects in the region remains positive, with governments finding ways to push ahead with strategic investment", Elder commented.

"Inevitably, if governments move towards the adoption of a PPP structure for infrastructure projects that might otherwise have been financed by the public sector there will be a greater emphasis on how those projects are structured in order to ensure that they are attractive to potential sponsors and financiers."

The finances of GCC countries are far from dire however, at least for now. Many of these countries are sitting on massive reserves of capital that could potentially tide them over for decades. The GCC's move toward PPP is more like prudent

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risk management rather than a panicked response, Sultan commented.

Along with more PPP projects, reduced oil prices may also lead to more deregulation of GCC power markets. Oman has been unbundling and privatising its electricity market in recent years, and hopes to eventually introduce a spot market for power. Earlier this year Acwa and Mitsui reached financial close on the Salalah II independent power producer project, which entailed the privatisation of a state-owned generating asset as well as the procurement of a new power plant.

Saudi Arabia has long been planning deregulation of its own power sector that would see state-owned Saudi Electricity Company broken up, bringing in outside investors to separate generation, transmission, and distribution.

Higher cost of capital

While transport and social infrastructure deals have always traditionally been state-funded, GCC countries have for many years turned to private capital to fund greenfield power projects. Developers and governments had until recently been able to access cheap financing for these projects, according to Sanja Udovicic, partner in the project development and finance group at Shearman & Sterling.

“Developers have been really squeezing both international and local banks on pricing. But it seems the pendulum may be swinging in favour of the banks; liquidity is being squeezed and it’s going to be more difficult to get deals done at the competitive rates we’ve seen recently.”

Local banks, as reliant on oil revenues as local governments, now have less liquidity. Although the low oil price environment has been apparent for some time, the effect on local lenders will likely take some time to be seen, a senior executive at an Emirati bank commented. But international lenders are eventually expected to step in to fill the gap.

Given these shifts in the market, both international lenders and equity investors look likely to have increased opportunities in the region in the future.

“The desire to attract foreign investment and developers is twofold; to access new and additional sources of financing and to adopt international best practice and technical support,” commented Elder. “To some extent this is the natural progression of these markets but it’s also influenced by the fact governments are having to trim their budgets as a result of the reduced oil price.”

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