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Foreword



Cynthia Corby
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An uneasy economic environment prevails across the GCC oil exporter countries, which must adjust to the new reality of lower oil prices. Policymakers are implementing tough decisions, such as cuts in public spending and the introduction of economic reforms that will certainly impact the region.

Over the past decade, GCC countries have enjoyed large fiscal surpluses and rapid economic expansion supported by booming oil prices, which have delayed the development of other income-producing sectors and prolonged the implementation of a fiscal reform. With the oil prices plunging, surpluses have turned into deficits, reserves have been accessed and growth has slowed, raising concerns about economic and social development. Christine Lagarde, managing director of the International Monetary Fund (IMF), during a visit to the UAE, recommended taxes for the GCC states and said, “The likely persistence of low oil prices means that all oil exporters will have to adjust by reducing spending and increasing

revenue. This could be done through broad-based taxes, such as VAT and business profit tax.”

Gulf countries have similarities in terms of economic structure but differ in economic size, population, diversification levels and other factors. They have all been affected by the decline in oil prices in varying magnitudes, and reactions from each country have been different. Saudi Arabia, the UAE, Kuwait and Qatar benefit from more solid financial reserves and the progress made in diversification and integration with world trade, all of which has allowed them to confirm their visions for diversification as a priority.

Saudi Arabia, the biggest economy in the Gulf, approved in April 2016 its long-term economic transformation plan, Vision 2030, which sets out a number of structural reforms to advance economic diversification and creation of job opportunities, led by the private sector, for the growing number of young Saudi nationals. Kuwait will continue to invest, the UAE continues with its plans to becoming a global financial center and aviation and tourism hub, and Qatar continues to build towards its mega event and Qatar’s National Vision 2030.

We can expect to see a number of initiatives to tap private sector investment through alternative models in order for governments to fund project requirements. We may see the private sector involvement through public-private partnerships (PPP) in public projects and services. In parallel, governments might also consider other revenue measures, such as including energy price reforms, expanding non-oil tax revenues and privatization of state-owned entities.

Governments are taking significant steps to reconfigure their business models and measures are being adopted to move away from oil-based economies, create economic sustainability and continue infrastructure investment, a key element of the business environment and a generator of employment. Low oil prices will constrain the amount of funding available to regional governments that will have to innovate and find alternative funding sources to bridge the funding gap, hence the title of this year's publication 'The funding equation.' The private sector certainly has the appetite to participate and the announcement of recent PPP laws in Dubai, Qatar and Kuwait are all encouraging. The balance of risk and reward is the key to unloading the private sector's appetite to balance this funding equation.

We hope you will enjoy this year's edition and extend a thank you to all our contributors for their valuable insights. Despite the uncertainty and likely contraction in 2016, this region will continue to offer US\$2 trillion worth of opportunities and be an attractive market for businesses anywhere in the world.

Governments are taking significant steps to reconfigure their business models and measures are being adopted to move away from oil-based economies, create economic sustainability and continue infrastructure investment



GCC projects market outlook

Future market projections point to an average oil price of about US\$35 a barrel this current year and US\$40 in 2017 that will modestly recover to US\$50 a barrel by the end of this decade. Excluding Kuwait, the other countries in the region are expected to run fiscal deficits. According to the IMF, real gross domestic product (GDP) growth in the GCC in 2016 will slow down to 2.7% from 3.2% in 2015. Government spending will need to be better prioritized to ensure it meets social and economic development objectives, and options to enhance non-oil industries will have to be considered. So far, GCC oil exporters have sensibly used their cash reserves to limit the negative impact of lower earnings on growth, though this may not be sustainable in the long term.

Infrastructure investment in the GCC has remained high in the last three consecutive years and registered a record number in 2014 at US\$171 billion. There is a realization from governments of the dependence of their economies on public spending on projects and the necessity to maintain a certain level of spending and activity so as not to undermine future growth. Equally there is an awareness of demographic pressure, giving rise

to a growing need for infrastructure to be developed – involving power and water projects, roads, social housing, schools and hospitals – and the need for job creation for a young national labor force that is expected to drastically grow over the coming years.

The announced budgets for 2016 outline cuts on spending posed by low oil prices, but in a measured way, as well as the introduction of new earnings sources. Saudi Arabia is planning to reduce spending by 11% this year to US\$227 billion. As part of its Vision 2030 plan, the country aims to increase overall non-oil government revenue from SR163 billion (\$43.5 billion) to SR600 billion by 2020, and to SR1 trillion by 2030. Privatization of government services to encourage private sector investments – both local and international – in healthcare, housing, finance and energy sectors was announced as a key focus area for KSA. The country has gradually cut energy subsidies and increased energy prices to raise income as well.

According to the IMF, real GDP growth in the GCC in 2016 will slow down to 2.7% from 3.2% in 2015

The UAE, the most diversified economy among the Gulf countries, is set to register the first current account deficit in decades, and this is expected to widen to AED129 billion this year. The IMF has urged the Emirate to pursue growth-enhancing reforms and advance economic diversification. In 2015, fuel subsidies were eliminated, which has produced significant savings.

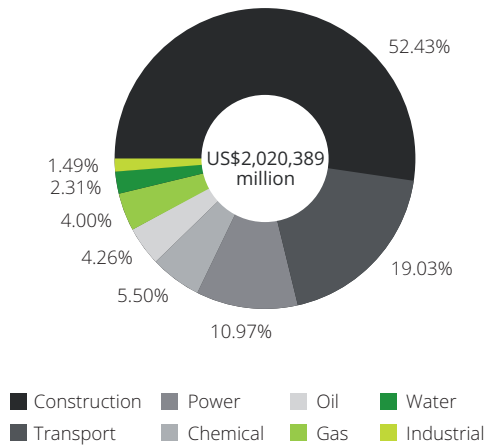
Qatar is intending to reduce its spending, prioritize projects and has also implemented subsidy reforms. All GCC countries plan to introduce a value-added tax by 2018 to raise non-oil revenues, and are considering taxes that are even more unusual to the GCC, such as corporate and income taxes, which may become more real prospects.

In an interview with Deloitte on the region's economic outlook, Tim Fox, Head of Research & Chief Economist at Emirates NBD, emphasized the necessity for governments to diversify their fiscal income streams, more efficiently allocate revenues and prioritize spending needs and said, "We see three fundamental approaches for governments across the region to address their fiscal challenges. First would be the development of a more comprehensive and sustainable revenue stream model. The gradual introduction of taxation is a complex yet sensible monetization tool to support government budgets, yet understanding the challenges this step implies from cost competitiveness to structural readiness is key. Second would be a reform of subsidies to cut government expenditures. The region accounts for some of the highest levels of energy subsidies globally, and reform could easily create much needed fiscal breathing space for government

budgets. Tapping bond markets through government issuances to fund rising public debt would have the combined benefits of allowing governments to fund long-term commitments without being constrained by volatile hydrocarbon markets, and support the development of more active domestic bond markets that could lead in the long run to more efficient allocation of credit in the economies."

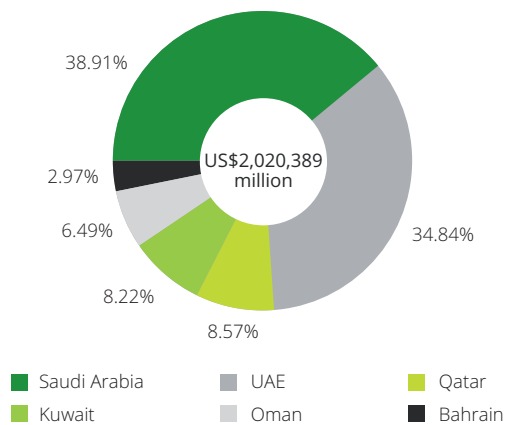
The pressing need to adjust budgets might have a negative impact on the projects market resulting in slower tender processes, slower decisions and payment procedures. The pipeline of projects planned in the GCC as of May 2016 amounts to US\$2 trillion, with Saudi Arabia and the UAE as the market leaders, and with construction and transport being the two leading sectors with shares of 52% and 19%, respectively. In third place is power with 11%. In order to maintain momentum in the project pipeline and in the face of austerity concerns, it will be necessary to innovate, perhaps with a drive towards privately financed solutions.

Net value of projects in pre-execution in the GCC, by sector



The pipeline of projects planned in the GCC as of May 2016 amounts to US\$2 trillion, with Saudi Arabia and the UAE as the market leaders

Net value of projects in pre-execution in the GCC, by country



Bill Smith, Partner at Pinsent Masons comments: "We are seeing a renewed interest in PPP as a delivery model for infrastructure in the MENA region. It is evident both from the market activity in the sector, and the new PPP laws that have been enacted, or that are being developed, across the region. The new Dubai PPP law takes an innovative stance by encouraging the private sector to approach government agencies with proposals for projects, leaving the way open for enterprising businesses to steal a march on their opposition. It will be interesting to see who will be among the first to exploit this opportunity."

MEED's forecast of contract awards for this current year is at US\$140 billion, about a 17% decline compared to 2015

Awards in 2015 across the GCC amounted to US\$165 billion, a good year when you consider historical trends. On a country level, KSA and the UAE did not perform as expected, whereas Qatar and Kuwait exceeded historical awards. In Qatar this was due to investments in infrastructure and the World Cup preparation, and in Kuwait primarily due to large oil and gas investments. The top sector was construction with over US\$70 billion of contracts awarded. Transport was the second largest sector in 2015, primarily as a result of major investments in railways and metros. Power and water sectors tend to be stable over the years reflecting demand driven by population growth.

MEED's forecast of contract awards for this current year is at US\$140 billion, about a 17% decline compared to 2015. Saudi Arabia has been the most affected market and the forecast is a US\$10 billion fall in contract awards to US\$40 billion, though it continues to be the largest project market and the biggest spender among the GCC countries. The forecast of contract awards in the UAE is set to be stable and mainly driven by the robust construction market in Dubai. There is a substantial amount of projects to deliver in Qatar,

such as stadiums, hotels, rail and roads in order to enable the World Cup, and the forecasted value of contract awards stands at US\$22 billion. Oman is expected to remain stable with values around US\$13 billion, and Kuwait – probably the most secure financially among all the states – has a strong amount of planned activity for this year in the construction and transport sectors.

As governments reviewed their spending plans for 2016, critical projects had to be identified. In Saudi, contracts close to being awarded are the construction of metro lines in Mecca, and metro and light rail networks in Jeddah. A rail network is also planned for Medina but it is at an earlier stage. Taif International Airport, which will have a capacity to handle 5 million passengers annually, is planned to be awarded this year and is due to be developed under a PPP model. The use of the private sector will be a more prominent feature of bids going forward in Saudi as a mechanism to fund the required infrastructure.

In Dubai, significant projects have been awarded during the first months of 2016 totaling US\$8,3 billion. The largest award is the Atlantis hotel expansion on the Palm Jumeirah, followed by the first tower at the Creek Harbour development and the Palm Gateway Towers, a three tower residential complex. Other major building schemes are the Burj 2020 development, a district that will include one of the world's tallest commercial towers, and the Route 2020 metro link developed by the Roads & Transport Authority (RTA), which will link the existing red line to the Expo site. In Abu Dhabi, some schemes that have been delayed and could be awarded this year are the second phase

of the national railway network by Etihad Rail, and the Sheikh Khalifa Medical City budgeted at US\$1.5billion.

Qatar's World Cup preparations are moving forward. The final number of stadiums has not been announced though a total of five has been confirmed so far; Al-Wakrah and Al-Bayt stadiums were awarded last year and are under construction. The major contracts for Doha's metro network and the expressway program are progressing, and another major project that has been postponed to 2017 is Qatar's long-distance rail that will link Doha to the regional rail network. The complexity of these large projects, and having seen recently a huge consortium terminated in Qatar, creates concern around the risks associated with mega projects.

The public sector dominates Kuwait's construction market. Two of the larger schemes planned are the national rail road and the metropolitan rapid transit system. The construction of new roads is also a key focus. Other relevant projects include the Mubarak seaport and a number of hospital developments. The biggest projects in Bahrain are the international airport expansion, which will increase its capacity to 13.5 million passengers annually, and the housing schemes that the Ministry of Housing is planning to develop, with a commitment to build around 25,000 units in the coming years. In Oman, over the past years the focus has been on the expansion of Muscat International Airport and the Batinah expressway, whilst for the coming years the focus is planned to shift to rail. The largest project is the national railway developed by Oman Rail, with a total length of 2,135km and a planned budget of US\$15.6 billion.

The public sector dominates Kuwait's construction market. Two of the larger schemes planned are the national rail road and the metropolitan rapid transit system.

There is a huge amount of project investment due to take place between now and the end of this decade. A growing population in the region will demand improved infrastructure for the cities to function and grow as planned. At a time when governments are facing budget deficits, their ability to adjust to the new environment, innovate and find alternative funding solutions to bridge the funding gaps required for ongoing investment will be key to the long-term diversification success.



Cynthia Corby
Partner
Middle East Infrastructure and Capital
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Building the aviation capital of the world

H.E. Khalifa Al Zaffin is the Executive Chairman at Dubai Aviation City Corporation. He is a leading figure and an expert in the aviation industry; he is specifically responsible for setting the strategic vision for Dubai South along with other major stakeholders.

The aviation sector is integral to the growth and success of Dubai. How are you responding to increased competition in the region and more globally?

Dubai's growth and success has always been tied to aviation, which supports the two strategic pillars of the economy: trade and tourism. To remain ahead of the increased competition, we continue to heavily invest in aviation. Dubai's expanding aviation ecosystem embraces Dubai South, Dubai Airports, Dubai Duty Free and Emirates Airlines Group – key players are working together to form a fully-integrated super system.

Dubai's aviation sector has seen a meteoric rise. In 2015, DXB retained the top position as the world's busiest airport with 78 million passengers and the projection for 2020 is 100 million passengers and over 4 million tons of air freight. Looking into the

future, a combination of factors, such as the growing tourism rates, Dubai's proximity to India and China, and the UAE's role as the gateway to emerging economies, will drive growth and further elevate Dubai's position as a global hub for trade, tourism and commerce.

How would you define the role of DACC to support the development projects of its affiliates and subsidiaries?

H.H. Sheikh Mohammad Bin Rashid Al Maktoum, Vice-President and Prime Minister of the UAE and Ruler of Dubai, said, "Our vision for Dubai is clear: we are not building the largest airport in the world. We are building the aviation capital of the world."

In line with His Highness' vision, we are not just building another airport, but an aerotropolis, "Dubai South." The planned 145km² city will have the capacity to accommodate one million people, generate half a million jobs and host companies of all sizes. A project of this scale will require a massive capital investment and coordination across the DACC group companies.

DACC has been mandated to be on the cutting-edge of Dubai's rapid rise in aviation. This includes boosting Dubai's position as global air cargo hub, as well as facilitating commercial, property, industrial and service investments related to aviation. DACC also works to create a suitable environment for attracting big aviation industry players to set up regional offices and maintenance, repair and operations (MROs) in Dubai South.

What is your view of the post-impact of oil prices on current market trends and on planned and anticipated projects?

Dubai actively started its diversification plans in the 1990s. Over the years, the reliance on oil has lessened. According to data released by the Dubai Statistics Center, the economy experienced 4.1% growth in 2015 and, though a slowdown is projected in 2016, it still shows positive growth. Low oil prices are thus expected to have a limited impact on the city's project pipeline.

Further, the IMF noted that the country's non-oil growth remained robust at 4.8% in 2014, driven by construction, notably owing to capital spending in Abu Dhabi, and services underpinned by Dubai's transportation and hospitality sectors.

What are some of the large projects DACC and its affiliates are focusing on? And how would this compare with the overall number of projects that are currently in the pipeline?

The most significant project is certainly the development of Dubai South, a 145km² city that will include Al Maktoum International Airport. This is an initiative of the Dubai Government to place the emirate as a leading international logistics and trade center. Dubai South is masterminded to be an economic platform, and designed to support every conceivable kind of business and industry, creating 500,000 jobs, with many of these created in and around aviation.

Launched as a government of Dubai project in 2006, Dubai South hosts the Al Maktoum International Airport, which will become the world's largest airport, handling 220 million passengers and 12.5 million tons of cargo annually. The development is well underway, with a terminal of 5 million passenger capacity to be expanded to 27 million passengers in 2017.

The most significant project is certainly the development of Dubai South, a 145km² city that will include Al Maktoum International Airport

Dubai South is composed of six integrated districts. In addition to others, the two most crucial for providing aviation infrastructure and services are the Logistics and Aviation Districts.

The Logistics District is an 18km² multimodal logistics platform. To date, 740,000m² of facilities have been built, with 3.1 million m² of land leased. The district includes free zone catering and a Dubai logistics bondless corridor connecting to the sea port. The Logistics District has attracted over AED1.8 billion investment by our customers.

Aviation District A is a 7.2km² aerospace ecosystem, one of its kind in the region. As well as being the permanent home of the Dubai Air Show, other components include an Emirates Flight Academy, Aerospace supply chain, STTS paint facility, fuel farm, Falcon completion center, VIP catering, VIP terminal, and build-to-suit facilities for MROs and major aircraft manufacturers.

In addition to these districts, the residential and commercial districts will provide serviced apartments, staff accommodation, luxury accommodation, hotels, and office and retail space for our residents and visitors.

In the current economic environment of reduced oil prices where we are seeing projects likely to experience delays, do you feel this has had an impact on any of the plans to expand the airports or has this provided you with an opportunity to start the project at a much more competitive price given the competition in the market between contractors for work?

Reduced oil prices have had little bearing on our current projects, as a result of a diversification policy under which the UAE's dependence on oil steadily decreases year after year. All of our planned activities are taking shape and being constructed with no deviation from our original plans.

Dubai South is composed of six integrated districts. In addition to others, the two most crucial for providing aviation infrastructure and services are the Logistics and Aviation Districts.

Business continuity planning is a focus for the Dubai government. Is this increasingly on your agenda and being incorporated into infrastructure design and delivery models?

For Dubai South, this is very much the case. We are working towards five-year business continuity plans, which are updated and assessed on an annual basis, specifically with regard to infrastructure requirements and any changes in market demand and technology.

How have you been able to create opportunities to raise the required funding for the expansion of AMIA and development of Dubai South, for example the build-to-suit model?

With the development of the aviation sector being the government's top priority, enhancing the facilities at airports to welcome tourists and business visitors is critical, and therefore the development of AMIA is financially supported by the government of Dubai, which has spent billions of dirhams to create the initial site infrastructure.

In terms of raising the required financing, there are a number of ways in which we are managing to do this. In the case of AMIA we have tapped into export credit funding from the countries who are major exporters of equipment and technology for construction of airports through respective export

Developing a smart city requires constant innovation and use of new technologies, and we are working to utilize and develop sustainable and smart solutions

credit agencies, which lend under significant long-term payment plans. For major components and systems to be built for AMIA, BOT models are being explored with major international players. We are also using the project finance model, where contractors are funded through the banks during construction. Other funding models under consideration include using the securitization of airport assets which directly generate revenue, and the issuance of long-term bonds and sukuks.

With regard to Dubai South, funding is being raised by creating build-to-suit facilities and providing serviced land as equity, through joint ventures by contributing serviced land and project management services, and by developing concession model agreements and revenue sharing models, as well as forward selling infrastructure.

How is DACC adopting technology to improve capital project delivery and whole asset lifecycle costing such as Building Information Modeling (BIM)?

Developing a smart city requires constant innovation and use of new technologies, and we are working to utilize and develop sustainable and

smart solutions. We are committed to using the latest technologies in the design, construction and operation of our projects in order to provide technologically advanced products to our customers. BIM plays an important role in our projects, however, this is only one of many platforms DACC uses to ensure our processes are efficient throughout the development cycle. Beyond BIM, we have spent considerable time developing a bespoke Primavera platform to assist our project delivery teams during design, construction and handover, as well as implementing PMWEB for project management and Maximo for our asset management and FM.

9. Is DACC investing in innovation such as partnering with technology developers?

DACC continuously invests in innovation and ground-breaking technologies. Taking Dubai South as an example, the idea of creating a purpose built, fully integrated and holistic city focused on the happiness of the individual is a ground-breaking vision in itself. In order to build “a smart and sustainable city” in line with His Highness’ vision, we are continuously initiating and developing relationships with technology providers – either directly with the technology developers themselves or through third parties. Our emphasis is on partners who specialize in sustainable development using alternative materials and systems as well as those that are environmentally friendly. We are working with the best available technology to reduce the carbon footprint of the development as a whole.

10. Has Dubai’s new PPP law assisted in this process of fund raising, and what other vehicles or structures have you been able to initiate to raise funding as and when

required? Do you believe this will place a new emphasis on measuring the ROI of each asset to ensure the level of investment is appropriate at the outset of the projects?

As a matter of fact, before any project is approved and undertaken, a detailed business model with sensitivity analysis is prepared and only those projects which bring in the ROI equal to or in excess of our threshold are allowed to be taken forward. We therefore ensure in each case that an appropriate ROI is planned and achieved. To date, we have only initiated one round of capitalization through syndicate funding brokered by DACC. In the future, we will be looking at PPP and options that will definitely impact the way we assess ROI.

11. Will DACC look to explore other models for its developments with the active participation of the private sector?

Dubai South is very much looking at actively involving the private sector. This will be done through potential joint ventures.

12. Are there initiatives in place to raise additional funds, such as the recent announcement to introduce a usage fee at the Airport as part of the strategy to generate additional returns on existing assets?

There are initiatives like this in existence related to real estate assets; however, these are initiated by other government partners or by the government of Dubai. We are primarily focused on asset returns versus creating supplementary incomes. Our key customers demand and value transparency and the simplification of cost structures, and we are very much guided by our customers' needs.

Other anticipated developments include the launch of an integrated staff village for the logistics and aviation sector

13. What is your vision for the roll-out of the developments planned for DACC and its affiliates, specifically Dubai South in the run-up to Expo 2020 and the role it is likely to play?

In the run-up to 2020 we will continue to invest in and grow the Logistics District, noting that its 2015 revenue was 45 times greater than its launch year of 2009.

Dubai South's contribution to non-oil GDP will increase significantly in 2020, by which time 85,000 professionals will be working here and we anticipate welcoming 10,000 residents. A growing business aviation sector means we project 15,000 VIP aircraft movements by 2020 and we also expect to have achieved 100% occupancy of the Business Park at Dubai South. Other anticipated developments include the launch of an integrated staff village for the logistics and aviation sector.



H.E. Khalifa Al Zaffin
Executive Chairman
of Dubai Aviation City
Corporation

The views expressed in this article/interview are those of the author, and do not necessarily represent the views of Deloitte.





Airport financing takes off

Challenges and opportunities for the region's transport hubs

Declining oil prices are posing a challenge to government budgets and have the potential to reduce the ability to raise necessary finance, while also placing the region's continuing expansion of its airport infrastructure in question. Yet at the same time the decline in revenue from this major economic contributor may accelerate the region's leaders towards their long-term vision to further leverage their geographically advantageous location and diversify their economies away from a reliance on oil.

Amid this backdrop of low oil prices, tourism is forecast to continue to contribute 8% of the Middle East's total gross domestic product (GDP) in 2016

Amid this backdrop of low oil prices, tourism is forecast to continue to contribute 8% of the Middle East's total gross domestic product (GDP) in 2016. This figure provides further validation of Dubai's (and others') proactive tourism strategy, which has helped travel hospitality and leisure (THL) currently contribute 28% of Dubai's GDP, a number that is forecast to grow to 37.5% in the coming five years (Oxford Economics). This forecasted increase is based on visitor numbers expected to increase to 20 million by 2020, representing a compound average growth rate (CAGR) of 6.9% per annum. Many countries are seeking to emulate Dubai's strategy. As a result, it is critical that the region's governments secure alternative forms of funding through alternative ownership structures together

with maximizing alternative sources of revenue or revenue share models, in order to deliver the required infrastructure.

Airport privatization and the appeal of (PPPs) have long been talked about in the region with varying application of PPPs as a financing solution. However, there is a broad spectrum of differing financing options across the risk, return and control considerations when tapping the PPP market.

Saudi Arabia has announced a pipeline of airport PPPs, building upon its recent announcement of granting an operate and maintain (O&M) concession for Riyadh Airport. Iran has recently announced a significant pipeline of opportunities to support the modernization of its airport infrastructure.

However, the track record of successful airport PPPs provides a cautionary tale and one that the region's governments and investors should consider. Some of the challenges witnessed include:

- Lack of regulatory clarity
- Optimism bias
- Weak dispute resolution

Critically, prior to undertaking a concession or PPP of government assets, it is important to truly understand the value of the assets in question, and to be clear regarding what the government wants to achieve aligned to the strategic objectives for undertaking the transaction(s) and the potential partial transfer of control of a service and its revenue.

Deloitte is seeing the region's governments and airport operators becoming more focused on

getting their “house in order” in preparing their airport’s assets and organizations to be positioned for external financing through tapping the capital markets. This is enabling them to enter into more advanced finance and ownership structures with low costs and greater returns.

Across the spectrum of privatization options there are varying models being applied to airports. The art and the science of structuring an optimal airport PPP centers around achieving the best value for money, which comes from carefully arriving at the appropriate risk allocation between the public and private sectors. It is also important that the required controls needed to protect the traveling public are in place whilst at the same time putting in place a pricing mechanism which maximizes financial returns. Typically the concession that identifies all risks and allocates these to the parties best placed to manage them, will thereby maximize the revenue, minimize costs and leverage the respective skillsets of the parties, which will result in an attractive proposition for all.

Increasingly, specific concessions are being granted for certain revenue streams, such as car parking, where concessionaires are responsible for significant upgrades of capital works for a future share of revenue. Critically, where airports are undertaking this for the first time it is important that there is detailed analysis of both who the counter party is as well as the due diligence of the future revenue potential.

Another important consideration is to assess the extent and type of revenue streams where the private sector can feasibly take commercial/ demand-based risks (and perhaps share some upside with the public sector) versus a reliance on demand guaranteed revenue streams committed

to by the public sector. These considerations are key to the ultimate type of finance and prospects of raising finance, some of which may be driven by any operational track record, compared to propositions that are largely greenfield in nature.

Airport corporatization is typically defined as the establishment of an independent legal airport entity wholly owned and controlled by a government or government-related entity. It is typically associated with seeking to establish an entity that incorporates a private sector discipline to its operations whilst remaining under the ownership of the government. In 2009 the Civil Aviation Authority of Singapore undertook the corporatization of Singapore’s government aviation entities. A number of reasons identified at the time included the benefits to raising funding, increasing the flexibility of the operational cost base (always a positive with airports) and enabling the entity to pursue international opportunities by leveraging its strong global brand.

The art and the science of structuring an optimal airport PPP centers around achieving the best value for money, which comes from carefully arriving at the appropriate risk allocation between the public and private sectors

The path to corporatization should not be underestimated, however, the direct and indirect benefits significantly outweigh the required investment. Specifically, benefits can include reduced financing costs, improved operational efficiencies, awareness of the true performance of the entity and sub-entities, and also being a catalyst for change and improvement.

There is a vast array of activities to be undertaken to prepare an organization for corporatization, including but not limited to creation of an asset register, valuation, international standard auditable accounts, a change in the management program and detailed business planning. This process can take between 18 months and three years.

Also there is a need for corporate change more at the business-process level (finances, back of house capacity) to demonstrate best-in-class operational and commercial capabilities. Becoming a standalone entity seeking to raise finance for operations and capital spend requires the operation to be able to stand up to granular and intrusive analysis from international banks, financiers and private equity with confidence. Becoming a standalone entity is a mammoth task. An interesting financing question for such corporatized airport entities is the applicability of project finance compared to hybrid infrastructure

finance models (which combine corporate finance techniques with project finance, examples of which have been seen in the UK and Europe).

Also within the region we are increasingly seeing airports seeking to better understand opportunities to generate additional revenue to improve overall profitability. A recent example of this is Dubai's introduction of a departure charge of AED35 for all passengers. We anticipate other airports in the region to implement similar charges to enhance the financial returns that airports deliver.

We are also seeing the need to drive improvements in performance through airport operators gaining greater insight into the true performance (ROI, ROE). This is through airports improving cost allocation, and the right asset stewards being responsible for all revenue streams associated with assets.

Prior to entering into alternative ownership and concession structures, with so much value at risk, we have been supporting organizations better understand the value of their assets, and the various structures and controls that are required to ensure alternative ownership structures maximize returns to stakeholders.

We foresee the continuing success of the region's airports, particularly Dubai, Abu Dhabi and Doha, enabling them in the future to seek to leverage their global brand and pursue international opportunities. A strong reflection of this is the current interest from leading global airport operators seeking to secure airport transactions or management agreements in the region, including Malaysian Airports, the Airport Company of South Africa, and Changi Airport Group's rumored interest in the O&M concessions in KSA currently in the market.

There is a need for corporate change more at the business-process level (finances, back of house capacity) to demonstrate best-in-class operational and commercial capabilities

Case study

In 2007 the government of Singapore announced that it would restructure its aviation industry citing the rising competition from Middle East airports and airlines. The restructuring, implemented in June 2009, redefined the responsibilities of the Civil Aviation Authority of Singapore (CAAS) and Changi Airport Group, including Changi Airports International (CAI), with the objective of building a quality portfolio of global airport investment. The three key objectives identified for corporatization were:

- a) Corporatization will provide Changi greater impetus to capitalize on new opportunities and face rising competition.
- b) A corporatized entity will have greater flexibility to attract and retain top talent to compete with global airport operators.
- c) Changi Airport will be able to better leverage its brand name to develop an international presence.

So how has Singapore fared since 2009 at a time of significant global upheaval? The airport has adopted a series of measures to support the continued operations of a number of airlines.

The Changi Airport Group chairman has stated: "Corporatization allows CAG to be more customer focused and gives it greater flexibility to respond and innovate in a rapidly changing aviation environment."

Changi has continued to be recognized as the global leader in airport service, retaining top ranking with over 490 industry accolades to its name. It has also continued to pursue international investment, recently acquiring Vladivostok International Airport in Russia.



Dorian Reece
Director
Head of Airports





Delivering Qatar's future today

What defines Ashghal and its culture?

Ashghal is Qatar's Public Works Authority responsible for the planning, design, procurement, construction, delivery and asset management of infrastructure projects and public buildings.

In line with Ashghal's mission to deliver and manage sustainable world-class public buildings and infrastructure to fulfil Qatar's National Vision 2030, the authority is committed to creating long-term, sustainable road and drainage networks that continue to support the growing social and economic development of Qatar beyond 2022.

Ashghal's corporate strategy sets a clear vision to develop a dynamic, responsive, and customer-centric organization.

"Qatar Deserves the Best" is the slogan that Ashghal believes in and has adopted as its approach. It is the promise and essence of all that it works towards achieving.

The authority is currently managing and coordinating five to seven year infrastructure and public building construction programs and projects to contribute to the country's future sustainability and growth.

What are the projects you are currently working on? And the projects in the pipeline?

Ashghal is managing and coordinating the 5-7 year development programs and projects to contribute to the future socio-economic sustainability of the country.

Ashghal's key infrastructure programs include the **Expressway Program**, which will deliver more than 30 major projects, about 1,000 km of new roads and an array of underpasses, flyovers and multi-level interchanges worth an estimated QR50 billion that will help create a sustainable future for the country.

There are many expressway projects currently under construction through 19 construction contracts, and additional projects are expected to commence in 2016 and beyond.

The Inner Doha Sewerage Implementation Strategy (IDRIS) is Ashghal's comprehensive drainage program being developed to upgrade and expand the sewage infrastructure, and to accommodate the projected population growth of an additional one million people in Doha's oldest areas, the south catchment. Enabling works are currently underway on site and we are expecting construction activities to gain momentum in the year ahead.

Another key drainage project under construction is the **Doha North Sewage Treatment Plant** – the first sewage treatment plant in Qatar to use advanced treatment techniques such as ultrafiltration and ultra-violet technologies to produce high quality reclaimed water for reuse in irrigation purposes. The project entered operational stage earlier this year and phase two of the project is expected to be completed by Q3 of 2017.

Ashghal's building master plan continues to focus on implementing **public building projects** covering a broad range of sectors including healthcare, education and a general sector covering municipal and recreational facilities. Currently we have 23 schools and kindergartens under construction with a total value of QR1.2 billion.

The authority is also working towards completing eight additional health centers spread across the country in 2016. Some of our general sector projects currently under construction include a comprehensive Aquatic & Fisheries Research Center, coastguard security headquarters and waste water separation plant, which are expected to be completed in 2016.

In fact, it is expected that additional projects with a total budget of about US\$20 billion will be tendered and awarded in preparation for 2022. These can be broadly classified under the following:

It is expected that additional projects with a total budget of about US\$20 billion will be tendered and awarded in preparation for 2022

Ashghal's **Roads and Integrated Infrastructure for Local Areas Program** aims to implement projects to completely upgrade existing infrastructure, in addition to building comprehensive infrastructure in new areas that are lacking these services. Works include buildings, roads and sewage networks, drainage networks, lighting and other infrastructure services. This is a dynamic program as new projects are added, expanded or merged to meet the requirements of the planning entities and the continuous development across the country. There are currently 30 projects under construction and more to come in the next few years.

- Expressways – Future construction contracts
- IDRIS – Future subcontracting works
- Drainage program – individual contracts for process engineering and pumping station upgrades
- Local roads and drainage – future framework opportunities
- Buildings – health and education sector facilities
- ITS supply and installations

In the current environment of economic downturn and reduced oil prices, projects are likely to experience delays. How will this affect the progress of major planned projects in Qatar?

Infrastructure development continues to be a key part of the country's economic agenda. The government is investing in a world-class infrastructure network across Qatar, which is now home to some of the largest and technologically advanced construction projects not only in the region but worldwide.

The government's high commitment towards this sector is reflected in Ashghal being allocated a higher budget for 2016. In fact, the current year's budget is more than 30% over the budget of last year. However, considering the current economic environment Ashghal is prioritizing some of its roads, drainage and buildings projects that will greatly impact the country's infrastructure development.

These include the construction of 11 major expressway projects currently under implementation such as Lusail Expressway, Wakra Bypass and New Orbital Highway.

As part of our Roads and Integrated Infrastructure Projects for Local Areas some of the important projects include Commercial Street in Al Khor, roads and infrastructure development of the Industrial Area and Rawdat Abal Heeran amongst others.

Ashghal is prioritizing some of its roads, drainage and buildings projects that will greatly impact the country's infrastructure development

Ashghal has numerous significant projects that are under construction, about to mobilize or in planning stages. Besides prioritizing some projects, our focus is on successfully delivering the essential infrastructure projects that are currently under construction on time, within budget and quality standards.

The question that you raised, however, continues to be a valid question, especially in today's global turbulent times. From the perspective of Ashghal, delaying priority infrastructure projects is not even an option, as these projects are essential to the overall strategic plan of the State leading to 2022 and then to the achievement of the 2030 Qatar National Vision. We look at rather challenging times as an opportunity for us to improve and optimize our processes and strategic drive rather than a cause of delays and business disruption.

What are some challenges you see when building projects in Qatar?

Qatar is implementing some of the largest and most technically advanced infrastructure projects in the region. With such a major infrastructure undertaking in progress there are various entities involved in implementation of these significant structures.

Our focus is to coordinate more closely and efficiently with the other peer entities involved in construction in order to plan and implement the projects with minimal disruptions.

The forthcoming commencement of operations of the New Doha Port will partially ease the pressure on the availability and cost of critical raw materials

Another challenge with implementing this scale of construction is to keep the country moving amidst all construction work. Ashghal continues to provide alternative roads where possible to ensure smooth and continuous traffic flow, however, we cannot avoid there being a degree of traffic flow slowing during works.

The disruption caused to residents and citizens during implementation of these projects is inevitable. However, we promise that the results of our work will be worth it. All of these projects are aimed at advancing our common aspiration – to build a stronger nation and improve the quality of life for our families and communities for years to come.

Finally, demand for resources including construction materials and labor is bound to rise as increased building activity spreads across the country. The authority continues to take necessary actions to ensure that constant supply of resources is maintained throughout the construction period. We closely monitor our supply chains to ensure that companies do not become over stretched at the risk of failing to deliver our programs within our pre-set quality standards. In addition, our procurement strategies are constantly evolving to minimize risk elements. We believe that the forthcoming commencement of operations of the New Doha Port will partially ease the pressure on the availability and cost of critical raw materials.

In considering and addressing strategic and operational issues, we equally look at the challenges facing the contractors, who – to us –

are key stakeholders in the process. There is a consistent message from the country's leadership and the senior executives at Ashghal emphasizing the importance of helping contractors succeed in executing their contracts on time and with the highest quality standards. This is demonstrated by an increasing involvement in addressing contractors' issues and timely positive responses to any request for meeting with the president, by any contractor working with the organization.

What are some important considerations foreign companies should take when bidding for projects in this market?

Companies bidding for projects should ensure they meet the conditions and criteria of selection that include important factors such as quality, safety, expertise, as well as the capability and commitment to implement these mega projects within the set schedule.

We urge foreign companies to explore the available and upcoming avenues in Qatar's infrastructure development and study the Qatari market environment. We also encourage them to enter into mutually beneficial cooperation with local Qatari firms, taking advantage of their knowledge and expertise in the local market.

One of the areas that foreign companies should take into consideration as and when they plan and execute projects in Qatar is the importance that the State continues to give to the wellbeing and quality of life of its labor force with significant improvements to the system, entered in the past few years. We believe this is a collective effort that all stakeholders take a part in.

Have you introduced any innovative procurement, project or program management systems?

Ashghal's process of selecting contracting companies is done based on certain conditions and criteria that take into account important factors such as quality, safety, expertise, as well as the capability and commitment to implementation within the set schedule.

The authority operates an open and transparent compulsory competitive tendering process whereby tenders are advertised on its website and in relevant publications.

With major projects, Ashghal also holds pre-tendering briefings to ensure companies are aware of the tender requirements for each stage of the project. Based on the value and scale of the projects, our tendering process includes clear categories for eligibility of companies who can apply.

Last year, Ashghal launched a new e-payment service to enable tenderers to buy and download the authority's tendering documents and circulars online through Ashghal's website. The new service aims to speed up and facilitate the tendering processes and mechanisms for all companies interested in participating in the authority's tenders.

One of the most important processes that will be automated in the future is the mechanism of issuing and awarding tenders, and activating the registration of contracting companies. This electronic platform is designed especially to include all contractors' information, in addition to offering them exclusive services such as sending tender alerts and allowing participating companies to review all updated information about open tenders.

Ashghal has adopted a framework of contract strategy that aims to expedite and ease the procedures of implementing projects through establishing conditions and general regulation, value rates, tendering and awarding procedures. The system also emphasizes the role of Qatari companies in local roads and infrastructure projects, and empowers and develops their capabilities.

Ashghal aims to deliver world-class projects while adopting best practices in infrastructure development and management. To that end, the authority has employed a powerful model of strategic outsourcing and partnership with the

world's leading organizations. Ashghal has on board leading program management consultants (PMCs) including Kellogg Brown and Root (KBR), Parsons Brinckerhoff, CH2M HILL, and MWH amongst others to assist in the timely delivery of its high profile infrastructure projects.

Do you envisage PPPs to be a likely option for infrastructure schemes in Qatar?

Where applicable PWA does explore the use of PPPs and/or Build Operate Transfer (BOT) as was used in the power industry in Qatar.

Any additional comments on the industry?

In Qatar we are looking forward to an enterprising and extremely busy year for the infrastructure industry. As always our focus will be on accelerating construction works on projects currently under implementation and delivering them on time. The pace and scale of construction across Qatar is expected to gain momentum in 2016 with more infrastructure projects moving into the implementation phase.

Our message is clear: our relations with other stakeholders – with contractors as key ones – is something we take very seriously. We continue to work on long-term win/win professional relationships with such stakeholders.

The authority will remain committed to ensuring that the country's roads and drainage infrastructure is upgraded to create a long-term, sustainable road network that continues to support social and economic growth beyond 2022.



**Abdulla Hamad
Al-Attiyah**
Technical Office
Manager of Ashghal

The views expressed in this article/interview are those of the author, and do not necessarily represent the views of Deloitte.





Rail infrastructure
Is it time for GCC
countries to consider
ramping up PPPs as
an alternate delivery
model?

On the back of a tighter fiscal environment, the GCC countries are, like many countries worldwide, facing significant challenges in maintaining expansion of critical infrastructure. The natural approach to these challenges is to come up with innovative and alternate solutions to funding and delivery of infrastructure. Currently infrastructure across the GCC is primarily government funded using a traditional model, which places mounting pressure on already strained budgets. Despite these challenges, during the Middle East Rail conference held in early March 2016, commitments to delivery of rail infrastructure were made. The funding required for this expansion into passenger and freight are staggering and whilst many sceptics may view the statements made at the conference as ambitious or unrealistic given the current economic climate, others would ask "is there a way?" On rail and roads alone, the total targeted expenditure is US\$306 billion, which when broken down into regions and projects, is a target that requires creative thinking around funding models.

On the back of a tighter fiscal environment, the GCC countries are, like many countries worldwide, facing significant challenges in maintaining expansion of critical infrastructure

History has not always been kind to the PPP project delivery model. Indeed there have been many examples worldwide where the silver bullet that was intended to solve cash strapped public entities' need for critical infrastructure has not delivered favorable outcomes. The key selling point - transfer of risk - that was supposed to balance the higher cost of private borrowing was not always achieved. Furthermore, the operation of key state assets serving the general public was not always optimized by private companies whose focus was their operating profit.

Past failures on projects do not necessarily point to the overall failure of a model. Much research has been done on the reasons for failures in different sectors and in different countries. This research and past experience should be used in the strengthening of future PPP models, not undermining them. The improvements must be seen in the value for money that is touted as a benefit of PPPs. This model in theory should bring the capital costs down through the control and alignment the private party has over the infrastructure supply chain. Right from design optimization to appropriate procurement, there are invariably opportunities to reduce the costs. The translation of this into real savings can offset partially the higher borrowing costs that private entities bear in comparison to government borrowing costs. Without efficiencies both in reduction of the capital cost and the timeframe, the model would be hard to champion.

The successes of the PPP delivery model should therefore not be ignored as the fundamentals are sound. Of particular note projects showing higher levels of success tend to be in roads and rail

infrastructure. There is ample data supporting the fact that there have been larger successes on PPPs on transportation projects over other infrastructure sectors, and particularly in Western Europe. The reasons for this are somewhat mixed and differ regionally, however it is believed that a primary underlying reason for the success in the transportation sector is the ability to transfer the risk successfully on these projects. Transferring the risk on a roads and rail networks is somewhat simpler than on a hospital for instance. Efficiencies of the PPP model are reduced when risk cannot be properly factored and transferred, as the premium paid to take on the risk outweighs the potential benefits. The less complex the project, the more suitable it is for PPP. ICT projects for example have been deemed inappropriate for PPPs in the UK. This is on the basis that fitting a PPP model around such risk and complexity is not advisable.

They may never become the exclusive delivery model, nor may it be suitable for all types of projects, but PPPs definitely have the capacity to deliver significant portions of the infrastructure budgets of the GCC countries.

Dubai passed PPP legislation recently in November 2015, and reflected the willingness to consider this model in a broader way in the future. There are already examples of PPPs in Dubai such as the redevelopment of Union Square, and the first phase of the Dubai Trade Centre District that was done using UK government funding via UK contractor Carillion.

With the total value of rail projects in pre-execution stage in the GCC countries sitting at US\$185 billion, the time seems right to look at opportunities to diversify the funding and delivery models. This

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allows for government resources, both financial and human capital, to be spread across several sectors and to deliver critical infrastructure in a broader way than they would be able to achieve through funding via government surpluses. The ideal situation is that PPPs, once implemented, require less input from the owner who requires that the contracted product (and service) be delivered on budget and on time.

Ensuring an efficient and transparent bidding process is an aspect of the PPP model that could form the basis of a lasting positive legacy that any public entity or government could be proud of. The bidding process has on previous PPPs been costly, lengthy and contested, to the point where bidders become disillusioned. The result of an inefficient and badly managed bidding process is that over time competition is reduced and the risk of monopolization and collusion increases. Value for money and optimization of capital costs are compromised with the overall process and model being devalued. Therefore a crucial role of public entities in the PPP partnership is to conceptualize,

package, and procure the infrastructure in a way that brings to the fore the innovative, cost effective and efficient solutions that the private sector is well equipped to provide. The private sector should be encouraged, through competitive processes, to offer dynamic funding and delivery models together with supply chain value that they are best placed to deliver.

The GCC are fortunate in that top local and foreign construction and engineering companies are already based within the region, and when linked to robust and established financial institutions and advisory services, this means that they are well placed to benefit from alternative funding models. It is true that the actual cost of the infrastructure projects is a reality and that the funding of it is either done via direct government funding or via a monthly payment over a defined period. Many critics have noted that the access, terms and cost of raising capital by governments is always preferable compared with private entities. Those critics surmise therefore that the PPP model is one that is flawed, and that the more traditional model of funding and project delivery is to be followed. The results speak for themselves though, and the

ability to deliver on future targets depends on the willingness to pursue alternative funding and delivery models, as well as strengthening of the current ones. No one model will ever be able to exclusively deliver the US\$306 billion roads and infrastructure budgets of the GCC countries. Instead, there is an opportunity for matching optimal solutions to unique challenges all through an open decision making structure and with a well-informed set of criteria this is surely the way towards maintaining momentum and delivering on government agendas for diversification.

Therefore, when considering the use of the PPP model to fund and deliver the planned projects, a significant portion of the infrastructure project budgets must surely be given priority. Around 10 to 15% of the budgets could be targeted for delivery by this model. This will allow for the different models to operate in parallel and allow for differing timelines. Projects funded under the different models should see traction at different stages and this provides the impetus required in delivery of the necessary infrastructure. The GCC countries have financial, regulatory, consulting, and contracting capacity to deliver efficiently and effectively under the PPP model – surely we will see PPPs rolling out large scale infrastructure before long.

Matching optimal solutions for unique challenges – all through an open minded decision making structure and with a well informed set of criteria – is surely the way towards maintaining the momentum and delivering on political manifestos



Kevin McGill
Managing Director of Loliwe
Integrated Rail Solutions





Steps to avoid financial duress during an economic downturn

A contractor's perspective

Despite the recent “bounce-back” in oil prices to over US\$40 per barrel, the regional economy is certainly feeling the effects of significantly lower oil revenues since their peak in mid-2014. It is estimated that real GDP growth slowed to 3.2% during 2015¹. As a consequence, governments have adjusted their fiscal policies, and this has translated into a slowdown in contract awards. It is further estimated that contract awards fell by 27% between 2014 and 2015², and this is likely to be even more pronounced in 2016 and beyond. Indeed, the sector outlook into 2016 does not bode well, as it is estimated that contract awards will fall even further, allied to a squeeze on liquidity by the region's banks.

Such economic turbulence typically impacts the construction sector first, and arguably hardest, which in turn translates into behavioral patterns that only serve to exacerbate economic distress. These include margin erosion through pricing, increasingly adversarial contract negotiations and contract claims, and, almost inevitably, cash flow issues.

So how does this impact project delivery and the construction sector as a whole? If we take pricing risk as a primary example, this means that margins will be reduced across the industry for two reasons: clients want more for less money, and contractors descend into a price “war,” resulting in an ever decreasing circle of lower margins to maintain competitiveness.

Simply winning new work becomes the greatest focus of contractors, driven by a desire to keep teams busy and maintain cash inflows from up-front payments. In turn, this presents a pricing risk to clients as the lower margins are unsustainable, meaning that contractors will then seek to recover a better margin on claims and variations. Indeed, a recent Deloitte survey³ noted that 53% of respondents believed that contractual claims had increased since the financial crisis, and it is likely this will increase further as economic uncertainty in 2016 and beyond, continues.

As margins are impacted, contractors are then faced with delivering projects on a like-for-like basis with less money and resources. This often results in cost cutting on materials or equipment hire, late payments to suppliers and staff, and increasingly adversarial discussions around contract administration such as claims, variations or interim payments.

In addition, the strategic and day-to-day risks associated with all construction work can often be inadequately considered and priced during the tendering process, leading to additional profitability pressures as the project moves into the delivery phase. A recent survey by Deloitte³ noted that 56% of respondent companies include contingency provisions in their forecast cost to allow for potential risks that could materialize.

Cash flow and operational underperformance typically go hand-in-hand, so as contractors face difficulties actually delivering the contract on time and on budget; the issues are then compounded by facing severe cash pressures. For example, delayed payment from the client coupled with a supply chain demanding payment for materials delivered to site, or works executed, is a typical source of stress for contractors. 74% of respondents to Deloitte’s survey³ indicated that monthly progress payment applications take anywhere between 31 to 180 days to be certified.

So how does the sector mitigate against such issues during an economic downturn? Simply put, delivering projects more efficiently, and more effectively, is the key. As humans, we are all driven by similar behaviors, so it would be naïve to assume that contractors will not attempt to “undercut” one another during times of financial distress. However, it is executing projects more efficiently during these periods of uncertainty that will provide a competitive advantage. Those with clear and effective plans and processes, and capable teams to deliver them, will likely survive.

Delivering projects more efficiently does not necessarily mean using less people, or using cheaper materials either. Efficient delivery is typified by three key actions: plan the project; manage risk; and manage cash.

Delivering projects more efficiently does not necessarily mean using less people, or using cheaper materials either. Efficient delivery is typified by three key actions: plan the project; manage risk; and manage cash.

If a contractor sets out a clear and realistic delivery plan (which includes a robust cost plan, program, manpower plan, unambiguous materials selection and a sound logistics plan), which is agreed with the client at the outset, then delivering exactly to this plan should result in a reasonably certain outcome. Projects that are planned appropriately lead to increased stakeholder confidence that the project will be successful.

If risk is then actively and timely managed throughout the contract, and suitably mitigated where this is possible, then deviation from the plan is even less likely. In addition to increased certainty of a project's outcome, managing contract risk is crucial in order to maintain tender margins. Frequent monitoring and comparison of contingency against actualized risks is essential.

Despite respondents to the Deloitte survey³ reporting that the level of contract claims has increased in recent years, 62% of respondents do not recognize uncertified/unapproved contract claims within contract revenue on their financial statements. Strong contract management processes (and personnel) can help ensure that contract variations and claims are processed sufficiently to enable potential profit to be realized.

Finally, if cash is managed through optimized cash flow planning that is aligned closely with physical activity; proactive and realistic invoicing; better resource planning and deployment; better linkage between project-based cash management and head office finance; pro-active risk management; and improved contractual knowledge of project based staff, then the net effect is efficient and effective project delivery on time, which may be the key differentiator between success and failure, and ultimately survival.

Projects that are planned appropriately lead to increased stakeholder confidence that the project will be successful

Endnotes

1. MEED Projects, 2016
2. MEED Projects, 2016
3. Deloitte C-Suite Survey, 2015



Ben Hughes
Director
Capital Projects





Alturki Group Adapting to a changing and uncertain external environment

What defines Alturki Group and its culture?

We believe deeply in the importance of culture for the sustainability of any organization. Moreover, we believe that we can only achieve sustainability through growing our businesses profitably while making a positive impact on people and the environment within our companies and the world at large. PERFORM is the set of values that form the backbone of Alturki's culture. It is in the DNA of Alturki Holding and its subsidiaries. We expect each member of the team to commit to PERFORM to create value every day; and promise each year to be better than the year before!

We are passionate about achieving excellence in every aspect of what we do. Excellence is not an option for us; it is the essence of our company. We act with utmost respect towards our people, customers, partners and the planet. Fun is an essential element in our company. Openness and transparency are vital in every activity we undertake.

Our partners and clients can rely on us to fulfill our promises and to take responsibility for our actions and decisions. We believe we must say what we do, and do what we say. We strive to do meaningful work that provides value to society at large.

What is the Alturki Group's strategy for the coming years?

I think you are referring to our corporate strategy as business strategies vary among our business units. Each has its own strategy based on business choices they make. Our job at the corporate level, is to ensure that whatever choices made by business units will create and capture value in a sustainable manner. Our corporate strategy is focused on what businesses to be in and how to allocate resources among existing businesses. Going forward, I must say that the focus has shifted from achieving diversity to managing our existing portfolio of businesses. Our priorities have also changed to:

- Risk management
- Preserving cash and ensuring liquidity
- Reducing debt
- Being closer to operating businesses
- Being fit: maintaining strong balance sheets and healthy cash reserves is critical in the coming years

Going forward, I must say that the focus has shifted from achieving diversity to managing our existing portfolio of businesses

Let me also clarify that managing and leading in an era of economic uncertainty requires having strategies that can easily adapt to the changing and uncertain external environment. It also requires boldness and making tough calls in order to ensure survival. This means that the overall size or distribution of the current portfolio may be different one or two years from now based on the situation at that time.

As far as the business units are concerned, most of our subsidiaries have changed their strategies from aggressive growth focus to (a) utilization, (b) profitability and (c) cash flow-focused strategy.

Finally, it is important to be realistic about the external environment and accepting external forces, yet staying positive in responding to the difficulties.

What are the obstacles related to operating in Saudi Arabia?

Let me start by saying that the Kingdom has made great achievements in the past years in terms of modernization of the overall business environment. The rapid changes that we have witnessed and continue witnessing is a sign that doing business in the Kingdom is on the right path to improve the overall environment.

Talking about the construction market in particular, we all know that government spending is the engine for economic growth. And as the government continues its fiscal tightening, the construction industry is expected to face difficult times ahead. As the project pipeline falls, competition will increase, putting pressure on margins and profitability. However, opportunities always arise in an era of economic turmoil. This pressure will help to overcome current shortfalls,

such as the need to upgrade performances and productivity. The construction market in the Kingdom is highly dependent on low skilled workers and low mechanization – which is leading to inefficiencies and low productivity. As per McKinsey, productivity in the construction sector is about one sixth that of the US. Construction companies that operate in the Middle East face a range of challenges that grow more complex year on year. As the GCC economies have grown rapidly in recent years, deficiencies in contractors' manpower management cycles have been exposed. Contractors were forced to hire thousands of unskilled workers to meet tight deadlines and massive work requirements. This has also led to implement performance management systems to monitor those workers. If we look at the ratio of blue-collar manpower to skilled manpower in ME contracting companies compared to their global peers we notice that the ratio is high and should be adjusted to become more efficient.

Therefore, the industry will have to adapt best practice improvements, such as:

- Effective manpower planning and performance management
- Training and retaining local talent
- Procuring more efficiently at lower cost
- Use of technology
- Investing in core construction capabilities such as project management and procurement planning

What are the factors that will drive growth in the mid-term?

Let me zoom in our portfolio and in specific building material-related businesses. Our flagship is Saudi Ready-mix Concrete Company (SRMCC), which is the largest in the region with a total yearly production capacity of 6 million cubic meters.

The construction market in the Kingdom is highly dependent on low skilled workers and low mechanization – which is leading to inefficiencies and low productivity

Without a doubt SRMCC will face various challenges in the coming two years for the reasons mentioned previously. Retaining market share will always be a priority for SRMCC and hence they continuously study options of domestic geographic expansions. The company has also recently launched a new product line (dry mortars) that will be used for plastering and masonry units. Other products are also in the pipeline. It is important to highlight that, despite all the initiatives to reduce cost, research & development and innovation remain to be key differentiators for SRMCC.

Other subsidiaries such as Masheed, a commodity trading company, and Arkaz, a building material company, are focusing on adding new commodities and building material product lines, leveraging SRMCC's strong customer base to continue increasing their market share.

We as a corporate are consistently focusing on improving the delivery of our products and solutions through initiatives that strengthen our sales force teams in every company.

Despite the budget cuts, we believe that some projects are critical and will launch in the near and medium future. These include power, water, hospitals, schools, defense and security projects.

What are the projects the group is currently working on? And the projects in the pipeline?

In terms of corporate projects and in addition to leading the overall development and upgrades of sales force teams, we at the corporate level are working on various initiatives to ensure smooth sailing through the storm. Such initiatives are focusing on people engagement, which is extremely important during tough times. Every leader must ensure continuance communication with people. We are also communicating with other stakeholders, such as customer, suppliers and bankers, ensuring that all stakeholders are aligned.

We are working closely with our oil and gas services company on various opportunities that could lead to increasing the size and offerings of businesses.

As far as projects backlog in our companies, they continue serving our regular reputable customers in the Kingdom. Our joint venture company Nesma and Partners is currently progressing in both SANG Hospitals and the King Abdul Aziz Road Development with a total value exceeding SR14 billion, plus other projects such as Kaust new

student housing, Jubail Bulk Plant and many other projects that will keep the company busy until 2018.

Is the new era of lower oil prices where governments announce cuts to infrastructure spending affecting the group? What is the way forward?

Most of our businesses are enjoying a healthy backlog that will support the revenue stream in the short term. However, despite the budget cuts, we believe that some projects are critical and will launch in the near and medium future. These include power, water, hospitals, schools, defense and security projects. Our businesses are targeting these projects, mainly with the aim of building a strong and healthy order book (backlog). We also expect significant growth in housing and commercial space over the next five years. The housing shortfall is widely estimated to be about 750,000 units. Therefore, with the reasonable prices of steel reinforcement bars and cement compared with their prices two or three years back (prices of cement and steel reinforcement bars fell by around 30% in the past three years), it is therefore expected that the housing industry will be boosted in the coming future.

However we remain to be cautious about the slowdown and we are working with our businesses on several initiatives that would allow them to sail through the turmoil. These include:

- Knowing your customer and credit management approach
- Segmentation of our projects and customers
- Manpower optimization
- Streamlining internal processes
- Capacity utilization

How is the group planning to deal with an anticipated project slowdown, financing and cash flow challenges?

In terms of any project slowdown I believe this has been addressed in previous answers.

We as a group strive to retain a very healthy leverage ratio that keeps our position with banks and suppliers very strong. This is something that the founders of the group have always stressed on and we as management always ensure compliance with this policy. Therefore, our ability to tap into additional financing is always an existing option due to our strong balance sheet.

As far as the financing challenges, we are closely monitoring the situation in the marketplace and ensuring frequent communication with our subsidiaries. In general, market conditions are creating an opportunity to finance working capital needs through suppliers. Also, recently we have started enforcing securitized credit lines with customers who are exposed to higher risk compared to others. We also encourage flexible offerings to early paying customers. We are pushing our subsidiaries to preserve cash by avoiding capital expenditures and to look for leasing options, which are expected to become more common. And finally we are working on linking our internal systems with SIMAH (Saudi Credit Bureau) to ensure that we obtain reliable credit information about our customers.

Do you envisage PPPs to be the most likely option for infrastructure schemes in Saudi? Any alternative methods of financing infrastructure investments?

As per a McKinsey report, around two trillion dollars in investments are needed in the next 15 years to be spent on infrastructure projects in the

Kingdom in order for the economy to achieve its full potential. Public investments alone will not be sufficient and therefore private partnership is necessary for this to materialize.

A perfect example was the railway network initiative taken by the government in 2003 to build what was at that time the largest railway network in the world on a Build Operate Transfer (BOT) basis, with the government providing the right of way to investors as an incentive. Today, the idea still exists but more on the operational aspect of the network rather than the construction aspect. We also see the partnership in King Abdulaziz Sea Port in Jeddah, where both the north and south terminals are being operated by two different operators in partnership with the Port Authority. Another example would be the Madinah International Airport, which got overhauled and expanded under a 25 year BOT concession. We expect more partnerships between the private and public sectors to deploy in the coming few years. This will create opportunities for long-term investors who manage to survive the economic turmoil.

Over the past years, has the group adopted innovative approaches to improve the business?

The group has invested a significant amount of time and resources in the past few years on strengthening infrastructure in operating businesses, mainly in processes, IT and policies as well as attracting talent in all lines of businesses to ensure sustainability. We have beefed up our strategy into action processes to allow the proper execution and monitoring of strategies across all businesses. We ensure alignment with stakeholders including banks. In fact, we have been unique in this sense, as we invited banks to our annual strategy review sessions to contribute

to our strategies across all businesses. Also, the group has adopted the highest standards of governance and operating models to organize and smooth the managing of businesses while ensuring the independence and flexibility at business units.

Any additional comments on the industry?

We define the potential of the construction sector in the Kingdom in one word: “unpredictable.” There are many projects in the pipeline in various stages. According to MEED these projects exceed one trillion dollars. Some of these projects are in the construction stage and many others are in the planning and design stages.

We do not expect that these one trillion dollar projects will all go ahead; many will be shelved, if not cancelled due to economic/feasibility reasons. Many will still go on, simply due to the genuine need – such as the SAR500 billion power projects that need to be executed in the coming decade or so.

It is important to note, though, that factors/risks, other than oil prices and government deficit, will determine much of what might happen in the coming months and years in the construction industry; these include the conflicts in the region,

the global economy, change in government policy and regulations, etc. That is why, we define the coming period as “unpredictable.”

What is your vision for the group in the next two years?

It is definitely going to be a challenging period of time. As mentioned above, planning can only be short- to medium-term and the focus will be on survival rather than growth. This will put more pressure on CFOs and they will have to keep running scenarios of pictures in the near future and ensure communicating those scenarios with various stakeholders to ensure alignment. We are lucky that the group has more than 40 years of business experience and therefore is well equipped to sail through this turmoil. We will see lots of changes in the marketplace: short-term players will leave the market and large players will stay. We might see mergers between companies and I think buyers will benefit from lucrative opportunities in the M&A market. Managing talent will be a priority as we expect to see migration of talent to other countries. Smart companies will implement various mechanisms to ensure retention of talent such as leadership retention programs and long term incentive plans.

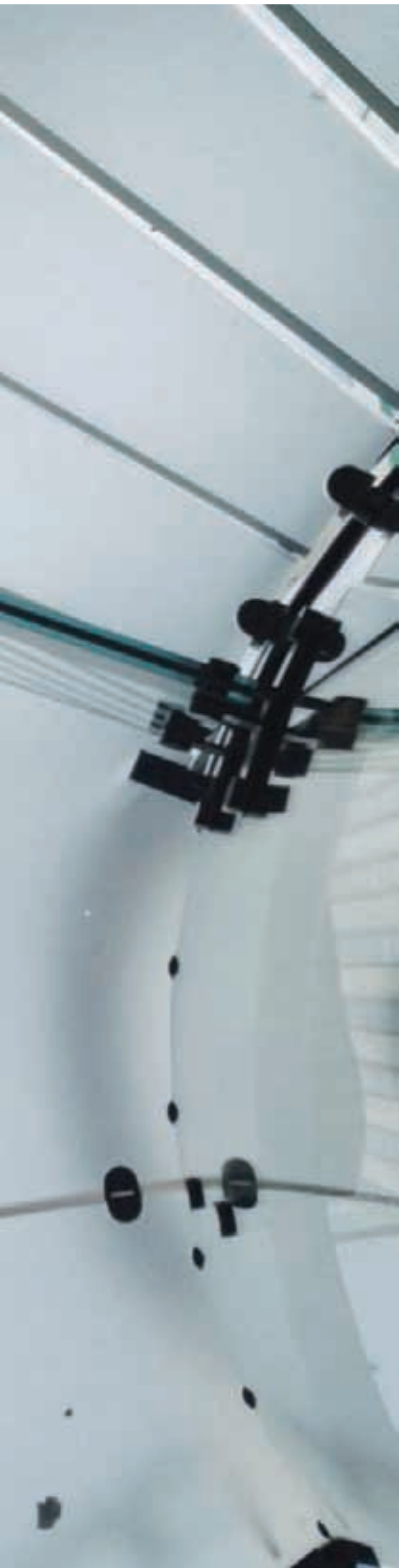
We define the potential of the construction sector in the Kingdom in one word: “unpredictable”



Eyad Ramlawi
Vice President and
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Fraud in construction projects

The potential for fraud to occur exists throughout the business world, and construction projects are no exception, particularly when there is a lack of governance and control. Indeed, there are more opportunities to commit fraud on a construction project than there are in business operations, where usually corporate policies and procedures are well enforced and internal or external audit is an ongoing requirement.

Actions that could be labeled as 'project fraud' are wide-ranging, and could relate to the project cost estimate, schedule, risk or procurement, among others. For example, each project needs to have a valid cost estimate to determine if it is viable or not. Under reported estimates of project cost could result in increasing the attractiveness for approving the project. In such a scenario the project investor would only know the true cost estimate once the project is at an advanced stage. The project owner would then have to decide whether to stop the project and lose what had already been spent, continue with the project and fund the additional cost, or try and understand what mitigation plans could be put in place to control the project cost and perhaps compromise the original design.

Another source of project fraud is known as 'unbalanced bids' for lump sum contracts and for which an award is made to the contractors who submit the lowest bid for the project. What potentially happens is that the bid price is based on the assumption that the project scope on certain items will change significantly and this can be due to knowledge that the design is incomplete. Accordingly, the pricing of individual bill of quantities (BOQ) items can be calculated to maximize the increase in price for items known to be linked to expected design changes.

Unbalanced bids can also occur when the contractor overprices items to be completed in the early stages of the project while underpricing items to be completed at the later stages. Should the contractor default, the project owner will find that the cost for completing the remaining scope of work far exceeds what was allowed for in the original contract agreement because of the imbalance of pricing for various stages.

Unsubstantiated change orders and over-estimated change orders are another common source of project fraud. In construction projects, changes will always happen, especially in the Middle East where projects experience a vast amount of change. A detailed risk assessment and response plan should be aligned with the contract agreements, project scope of work, professional indemnity and other insurance policies, procurement strategy, bidders' pre-qualification requirements, design reviews, claims and dispute resolution, among other actions; the absence of just such an assessment and plan could increase the project owner's likelihood of incurring costs for changes that will have a cost and time impact. Project owners should be able to assess the impact of changes they request to reasonably assess the cost and time impact and to evaluate these submissions by the contractors. These can be very complex with concurrency also needing to be fairly assessed and factored in. Equally the quality of the project site records and the cohesiveness of any claim for additional payment is important, as well as a clear understanding of the contract and the clauses that allow change.

Project owners should be able to assess the impact of changes they request to reasonably assess the cost and time impact and to evaluate these submissions by the contractors

In addition, the absence of a documented change management process with the appropriate approval levels could result in approving unsubstantiated change orders and/or over-paying change orders. This process should be aligned with other related processes, such as analyzing schedule delays and granting time extensions, as well as those relating to contract notifications, project communications and document management. The absence of the appropriate project documentation and communication might reduce the chances for voiding unsubstantiated changes. Often project owners will give verbal instructions for change orders and the written

instructions will only follow much later; this is an area where more discipline is required under contract administration from both parties.

Delayed and/or improper approvals by the appointed project consultant is another form of project fraud. As per the contract's terms and conditions, the project owner will become liable for those actions, which could result in additional cost as well as unanticipated delays.

Over-reported project performance to either over-invoice for work on site or hide project delays is another source of potential fraud on projects. Similarly, wrong forecasting for cost and time to complete the remaining project scope is also considered as project fraud. Both parties need to be conscious of certifying and valuing work completed to date accurately and be vigilant to ensure this is done as it may also affect compliance with real estate regulations for part payment of off-plan sales, bank financing drawdowns and the valuation of contractor's work in progress as well as the developer's capital work in progress/development in progress. The independence of the quantity surveyor/engineer in appraising claims and variation orders is therefore critical to safeguard the project owner and mitigate the chance of 'overpayment.'

The lack of capturing and documenting a project's data, communication and records could potentially also be misleading and therefore considered as a potential area open to fraud. With the absence of real-time and correct data, project owners and contractors risk making the wrong decisions, which could severely delay progress and harm the project.

The lack of capturing and documenting a project's data, communication and records could potentially also be misleading and therefore considered as a potential area open to fraud

Another source of project fraud is when lower-quality deliverables are accepted that do not comply with original specifications and these are certified as if they are compliant.

As we know, projects are complex, especially when mega projects like those witnessed in the GCC are underway. This unfortunately means all parties, contractors and developers alike, have to be aware of all of these potential fraud risks and should build risk mitigation plans to monitor these risks on a project-by-project basis but also at a board level as part of their overall governance and compliance monitoring functions.



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East meets Middle East Getting the recipe right

We are constantly being told the world is becoming increasingly homogeneous, from the familiar brand anchor store in our shopping malls, increasing global TV shows, music and movies. Starbucks are seemingly on every high street corner whether you live in the world from San Diego to Salzburg, Seoul to Sydney...

Whilst many things clearly do allow successful repetition across a global market, business practices and cultures often struggle across national borders where the complexity of operating is high or even just different.

Traditionally the media has talked about the clash of 'East Meets West' but what does this mean in the MENA region where increasingly 'East (Asia) Meets Middle East?' What are the opportunities of this increasing regional fusion with Asia and how should clients move forward to explore what the benefits are for them in their investment, development or infrastructure projects? Additionally, what myths or suspicions are needed to be addressed and overcome to fully understand whether looking East is right for them?

The opportunities

Firstly let us consider some of the 'big ticket' benefits that typify Asian market providers. These are in no particular order of significance:

- 1. Size, capacity and price** – Many Asian companies have generations of expertise, track records and significant manpower to dwarf the size of many US/European competitors. All traditionally at a lower cost.

The One Belt One Road (OBOR) initiative from China is one of a number of Asian country initiatives focusing specifically on increasing overseas investment in the delivery and operation of core assets and infrastructure

- 2. Quality improvements** – Product research, development and technology has seen a boom over the last 20 years with matching benefits to higher quality and reliability of manufactured products and systems for the construction industry. Whilst there is still a huge variance in cost and quality, effective procurement can yield significant benefits on both.
- 3. Supply chain integration** – Most companies are either vertically or horizontally integrated providing collaboration opportunities throughout the supply chain for MENA companies. Others on the other hand prefer more local integration (including joint venture's) as a way of reducing delivery risk.
- 4. Social infrastructure 'know-how'** – Many of the larger companies have grown through the delivery of national welfare agendas over many decades, in housing, health and education provision on a huge scale reflecting their high populations, budgetary constraints and geographical diversity.
- 5. Heavy infrastructure DNA** – As with social infrastructure many of these companies have grown and delivered to the industrialization agendas of their home and neighbouring countries from power and utilities, rail, road, aviation, bringing vast experience and expertise. Consider for instance, China's railways move more people by rail in a day than anywhere else on the globe!

- 6. Technology transfer/share** – The entering into strategic joint ventures to share and develop technology transfers such as one between the UAE and Korean governments to design, build and operate nuclear power stations. This epitomizes the 'share and transfer' model of Asian providers over and above more than their US, UK and European nuclear providers.
- 7. Increasing funding from Asian banks** – The One Belt One Road (OBOR) initiative from China is one of a number of Asian country initiatives focusing specifically on increasing overseas investment in the delivery and operation of core assets and infrastructure. The recent formation of the US\$100 billion UAE/Asian Investment Fund typifies this growing trend across the MENA region.

How to harness these Eastern benefits?

So recognizing the changing landscape and the scale and reach of many Asian organisations, how do clients engage and evaluate whether this model would work for them?

We recommend clients reflect and think about the following:

1. Recognize that the Asian markets and industries have matured significantly over the last 20 years and with appropriate procurement safeguards sourcing of high quality, technically advanced and reliable products is possible. The key is to be well informed and inquisitive.
2. Invest in effective and insightful advice of the Asian markets. This will allow a stronger appreciation and integration of cultural and technical differences from the outset. Remembering 'differences' can often yield innovative solutions by challenging preconceived norms thereby 'pushing the needle,' for example perhaps by reducing Capex investment without increasing Opex costs, or introducing new proven Asian technology into the MENA market.
3. Seek early advice to understand and map potential collaborations/joint ventures partner options. Focus needs to be more than just how

they might work from a legal perspective but also from a culture and operational perspective. For example - how will the combined delivery team work? Do business cultures align, compliment or potentially clash? Who will lead the joint venture? How will data be managed? What project controls will be adopted? How will each partner manage and satisfy all of its own company head office financial reporting, QA/QC requirements? You can see complexity quickly rises!

4. Identify and grow new relationships with an experienced advisory partner, familiar with the Asian markets who can locate, navigate and support (sometimes arbitrate) a new venture from the 'forming to performing phases' of any new joint venture/team formation. The advisor should act as the independent broker to defuse any differences and often cultural suspicions that sometimes arise purely from a 'lost in translation perspective.' Ensure you remain focused on successful solutions and aligned outputs at all times, not politics, as unfortunately happened too often.
5. Ensure early and strong governance, processes and procedures/project controls are developed and deployed. Ensure the new organization needs to be designed and supported by proven technology to underpin everything it does (within Deloitte we call this the 'Digital Capital Project').
6. Ensure that your advisory firm is used to interacting and dealing in the Asian and international business practices and culture. Overlaying this with MENA insight and experience can provide a potent and winning formula.
7. Research and understand the benefits of potential investment support or third party funding. What are the terms of the agreement? How does this benefit or complicate your own future strategic goals, including exit options? Does the funding also leverage potential benefits in lower construction costs through wider collaboration?

With the slowing of the MENA markets it seems inevitable that many clients, however you categorize them, will increasingly be under pressure to deliver more for less. To meet this new agenda we see re-appraising and embracing the potent Asian model opportunity as one response worth re-evaluating.

By redefining the relationship with Asia and taking a measured but collaborative approach, leading clients should be able to successfully access core capability, resources, strong supply chains as well as potential project finance via Asia's largest banks, developers and construction companies.

As I started this article, part of the secret to success in this complex fusion of business and cultures is appointing the right advisor to balance these undeniable but navigable differences and in doing so realize the synergies of this powerful 'East meet Middle East' fusion.

It is all about getting the recipe right.

Note

Deloitte Middle East has a permanent Asian Desk team consisting of national representatives from each of the major Asian markets connecting us to support and connect seamlessly to Asian banks, developers and contractor for clients within the MENA region as well as connecting MENA clients into Asian market opportunities. For more information contact the writer.



Andrew Jeffery
Managing Director
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A financier's perspective on the region

Market opportunities and strategy for growth

Over the past year, the increasing impact of low oil prices has been felt across the Gulf region, which, coupled with ongoing political instability in certain parts of the Middle East, has led to a challenging market environment in which builders and developers have had to come to terms with risks around liquidity and payment. All of this has served to highlight the important role financial institutions play in the built environment. With this in mind, we reached out to the Dubai-based regional general manager of the world's largest bank by assets, Zhou Xiaodong of the Industrial and Commercial Bank of China (ICBC), to hear his views on the GCC construction market from a financier's perspective, his strategy for the bank in this competitive market, as well as the challenges and opportunities he deems relevant for the bank and its financier peers.

ICBC is currently the world's largest bank by assets and deposits, while the Dubai (DIFC) branch of ICBC (ICBC Dubai) is the bank's key regional entity overseeing its overall business operations and growth across the Middle East. Since entering the region in October 2008, the bank has been a pioneer among the Chinese financial institutions in the Middle East, steadily expanding its branch network to Abu Dhabi, Doha, Kuwait and Riyadh. Currently backed by total assets exceeding US\$10 billion, ICBC Dubai has ranked top among all ICBC's overseas entities in terms of cost-to-income ratio.

ICBC considers Dubai an important logistic and transportation hub that is ideal for furthering its trade finance business

Speaking about ICBC's strategy in the Middle East, Zhou highlighted that the bank has a long-term vision. Having established its first presence via DIFC in 2008, since then the bank has gone through the process of converting its DIFC entity into a branch, which offers more flexibility around servicing customers in the region, and obtaining an onshore wholesale banking license in Abu Dhabi, which allows further access to the UAE local market. In a similar fashion, the bank has also set up its presence in Doha, Kuwait and, most recently, Riyadh, increasing its capability to serve client financing needs across the region. Armed with strong financial support from its head office in Beijing, the bank has since been a key financier to China's involvement in many of the region's large development/capital projects, while remaining at the same time active in what it does best, financing cross-border trade and investment between China and the Middle East. Its regional operation is also one of the bank's earliest overseas entities to have implemented a centralized management framework, ensuring consistency and flexibility in serving clients and projects in the region and beyond.

Looking back to when he first arrived in Dubai in 2009, Zhou noted that overall price points were significantly lower at that time while the margin was nearly three times higher than it is today, plus it was also much easier to conduct business. At that time ICBC was demonstrating its commitment to the region while other industry players were scaling

down as a result of the global financial crisis and subsequent credit shortages. Zhou was complimentary of the UAE government's efforts at diversification during the post-crisis years, and highlighted that the bank had been supporting sectors deemed critical to the Dubai economy – for example, ICBC Dubai has lent its support to aviation projects (such as Dubai Airport, Emirates Airlines), oil and gas sector (such as ENOC, DEWA) and hotel developments (such as Atlantis, Viceroy Palm Jumeirah).

We asked Zhou about his strategy for growing the bank's customer base in the region. He confirmed that the three main focus areas for the bank were trade finance, Money Market and corporate banking – ranked according to each segment's relative size of revenue contribution. ICBC considers Dubai an important logistic and transportation hub that is ideal for furthering its trade finance business. The offshore status of the bank's DIFC branch also allows convenience in serving other clients in neighboring countries. When it comes to expanding the bank's corporate client base, in particular in its largest regional market, the UAE, ICBC is focused on the following critical segments – Chinese corporations and investors, local small medium enterprises (SMEs) and government-related entities (GREs), as these are where they consider their competitive edge lies. For ICBC, Chinese corporations and investors are not limited to Chinese clients that have expanded their businesses to the Middle East; they also refer to regionally incorporated companies where Chinese entities are among the shareholders. In the case of the built environment, ICBC works with many Chinese contractors on project finance, and this has proven to be a mutually beneficial relationship given the current dynamic of the market – from the contractors' perspective, an ability to secure financing is increasingly known as the key differentiator that Chinese contractors bring to the table.

From ICBC's perspective, serving Chinese companies in the Middle East is a natural extension of the legacy relationship enjoyed with the head office level in China, which provides a stable client base and source of revenue in the region. ICBC considers both major public sector entities and other government-affiliated entities as their target GREs, a scenario that bears resemblance to what the bank was familiar with in China. As Zhou put it, "The UAE economy is very similar to that of China, and we are familiar with the scenarios." By this he refers in particular to the significant role governments and public sector entities play in driving economic growth, infrastructure and social developments in both regions.

With declining oil revenue over the past year, the pressure on local governments' budgets means that they now have stronger incentives to tap into alternative sources of financing when planning or launching large scale development projects; this is evident in the emergence of the recently launched PPP framework as one of the models for infrastructure developments across the region, with the UAE, Kuwait and Qatar all having announced their respective PPP laws in recent months. In such circumstances, banks are increasingly perceived as a significant source of funding and an important partner in the PPP model of shared risks and responsibilities. When speaking about the PPP laws' impact on ICBC and potential role for the bank, Zhou welcomed the recent market developments, yet remained cautious as to how the bank could help, noting that the model of developments which could be subject to PPP would inevitably affect the cost of lending. As a result, ICBC would naturally require more guarantees prior to providing funding. He added that PPP models imply that there is an expectation of risk sharing, and this has traditionally been applied mostly in the power and utilities sector, with a mixed track record of success in the

The Middle East, as is currently the case with China, still has to go through a learning curve of implementing and operating PPPs

developed markets. In this regard, he felt that best practices would likely be drawn from such experiences, whereas the Middle East, as is currently the case with China, still has to go through a learning curve of implementing and operating PPPs to identify how these could become an effective model for infrastructure developments in the region.

When asked how, in the current market environment, the ICBC prioritizes and selects projects to get involved in, Zhou confirmed that the ultimate decision would be aligned to the bank's regional business focus, and is mostly subject to the internal evaluation process. He did point out that the bank finds it less appealing when projects get divided into numerous pieces and phases, which happens fairly frequently in the region, as this poses additional challenge for the bank to properly evaluate a project and decide on a given size of investments. In his view, it would also be challenging to successfully deliver such projects, which "could last a long time and require lots of coordination throughout the process." When asked for his view on the role of export credit agencies (ECAs) in such a funding equation, Zhou noted that they can be better placed than commercial banks to provide direct support on project financing overseas, as some ECAs offer equity loans. A bank such as ICBC would be limited to the option of commercial loans, for example, if not backed by an ECA arrangement.

In a fast moving emerging market such as the GCC, it is not uncommon for project overruns to occur given the scale and complexity of the projects being undertaken; speaking of ICBC's approach in managing such cases, Zhou highlighted that the bank lends strictly on project feasibility, and is careful when assessing the risks involved in variations of projects they provide financing on. However, there are cases where the bank may adopt a slightly different view when evaluating the risk factors associated with a project. Given the strategic importance of the Middle East region to China's Belt and Road Initiative, the bank is fully aligned to its global head office in supporting the relevant Chinese outbound investments to the region. Therefore in cases where there is head office support on a particular project, the bank, as Zhou put it, would not be able to provide a high premium, "although we would be willing to consider some levels of support, taking into consideration the head office view."

Eight years on since ICBC entered the Middle East market, the competitive landscape has changed dramatically and, generally speaking, there are now more banks operating in the region than ever before, yet project growth momentum has slowed. In addition, many of these market players enjoy a relatively high level of capitalization, stable funding and sufficient liquidity, and are all formidable competitors for a limited pool of projects.

In a fast moving emerging market such as the GCC, it is not uncommon for project overruns to occur given the scale and complexity of the projects being undertaken

Responding to such a markedly different market of today, Zhou believes that ICBC is well positioned to continue differentiating itself from its local and international peers, both in terms of product focus and client focus; while local banks are dependent on retail banking for larger portions of revenue contribution, ICBC is dedicating its resources to corporate banking and trade finance; while international banks have been under pressure to reduce their regional exposure to seemingly high risk SMEs, and some have subsequently pulled out of the SME sector in the region, ICBC will not hastily move to fill the lending gap – instead it will focus on what it does best, Chinese corporations and GREs, leveraging its credentials as one of China's leading global banks and financiers to strategic development initiatives worldwide.

Historically, ICBC has successfully leveraged mergers and acquisitions (M&As) to expand its businesses to other regions, such as in the case of Hong Kong, where ICBC established a strong presence following a series of acquisitions. When asked whether this approach applies to ICBC in the Middle East, Zhou responded cautiously: on one hand, he acknowledged that ICBC acquired a bank in Turkey, Tekstilbank, to expand into the country via its 40 plus branches in the local market; on the other hand, he stressed that the deal was considered as offering great value for the investment, ICBC managed to launch its brand into Turkey, in addition to benefiting from the banking network's strong internet banking capabilities.

Rather than turning to aggressive M&As, Zhou emphasized a vision for the bank more in line with organic growth. Elaborating on his business and geographical priorities, Zhou stated that the bank will focus on wholesale banking, in markets including the UAE (Dubai & Abu Dhabi), Qatar, Kuwait, and Saudi Arabia. The Bank would also

be looking into other potential neighboring geographies, having already started negotiations on financing projects in Egypt and Jordan. Speaking of the Saudi market where the bank has recently opened a branch, Zhou shared that ICBC is actively pursuing lending opportunities to GREs in Saudi Arabia. However, he also described the market there as highly challenging. Given the Saudi government's current priorities following budget cuts, there are certainly promising opportunities in housing and healthcare sectors, as well as in railway projects, yet success in this market would require consistent long-term investments and patience, according to Zhou.

Speaking on the key challenges for ICBC's business operations in the region, Zhou perceives geopolitical risk, oil prices and understanding local laws and regulations as three main areas of concern. He does not foresee any government default issue, however there remain geopolitical risks and political instability associated with certain parts of the region. Oil prices would have a significant impact on the overall economic outlook of the region, where many governments are heavily dependent on oil revenue for large scale public/development projects; the resulting budgetary constraints could lead to a chain reaction on liquidity and payment that could subsequently put severe pressure on contractors and developers in the region, many of whom are among ICBC's key clients – the fast growing number of Chinese contractors and developers coming to the Middle East for project opportunities. Lastly, understanding local laws and regulations is critical to protecting the bank's collateral and is a challenge for the bank's legal team to consider in each jurisdiction in which they operate. Zhou was very complimentary when he spoke of Dubai/DIFC's regulatory framework for the financial services industry, citing its adherence to international best practices, its consistency in law enforcement and

Geopolitical risk, oil prices and understanding local laws and regulations are perceived as the three main areas of concern

independence of the DFSA Court as key factors to its current success. This was also the reason behind ICBC's decision to choose the DIFC as its first entry point to the region.

Looking forward, Zhou is optimistic in terms of what the Middle East market has to offer: the general momentum is still strong with the volume of opportunities growing steadily, and this is further supported by the enormous development needs of the region as a result of local governments' priorities and underlying demographics. Citing the growth estimates presented in DIFC's vision and strategy for the next decade, Zhou reiterated his commitment to this region, and his confidence that there would be scope for ICBC to play an important role as part of the region's vision for growth and development.



Zhou Xiaodong
General Manager of
the Dubai (DIFC)
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Public-private partnerships Global lessons learnt

Infrastructure is at the frontline of each GCC country's economic and social development plans, but the public sector alone, in the context of low oil prices, cannot fulfill every need in sectors such as water, power, transport, education, telecommunications and healthcare. In order to bridge the growing gap between the cost of needed infrastructure and available resources, PPPs are a growing element of interest.

The need to diversify economies in the region, through a combination of government investment and increased private sector participation, has intensified interest in alternative project finance. This has the potential to bring important benefits and it may be crucial to the region's ability to deliver its projects. PPP is seen as a way of bringing in specialist private sector expertise and efficiencies, as well as attracting international investment and local private sector involvement.

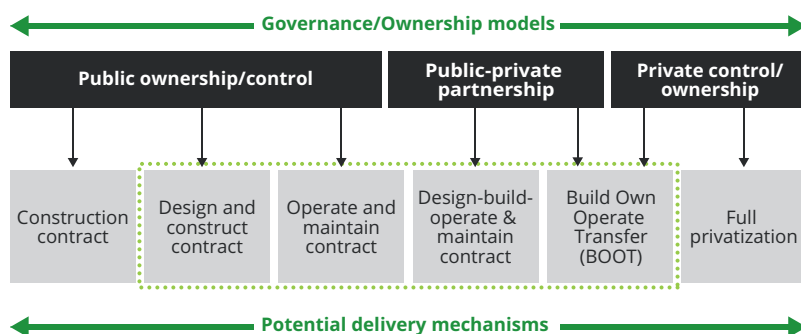
PPP projects have been long implemented in the Middle East, despite the lack of an adequate legal framework, and have proven to be very successful in some sectors, particularly power and water, which generally have their own sector-specific legislation.

GCC countries are taking significant steps to implement and strengthen national laws to provide a framework for PPP procurement, which can facilitate PPP projects beyond the successful power and water sector PPPs that have been prevalent to date. One example is the new PPP law that was introduced in the Emirate of Dubai in November 2015. Qatar is in the process of drafting a PPP framework that is anticipated to be introduced by the end of this year and is expected to accelerate infrastructure development in the country. Kuwait underwent a process of re-visiting its PPP laws and PPP procurement body (reframing the Partnerships Technical Bureau into the Kuwait Authority for Partnership Projects) up to 2015 and now has a renewed impetus to deliver its project pipeline. PPPs are one of several options for procuring infrastructure. Yet consideration must be given to whether a project is suitable for a PPP solution and whether there is political support for this.

What are PPPs?

There is a spectrum of infrastructure delivery models that may be used to design, construct and operate a significant infrastructure project. As illustrated in the figure below, moving left to right shows the role of the private sector increasing as the risk is transferred from the public to the private sector.

Infrastructure delivery spectrum



The term PPP covers a range of different structures where the private sector delivers a public project and involves the sharing of risks, finance, skills and expertise to deliver the desired outcomes.

PPPs are based on a contractual relationship between the public sector sponsor and the private partner. The private sector takes responsibility for the quality of design, construction, operation and long term maintenance of an asset, leaving the public sector to focus attention on the outcome-based public value they are trying to create.

With PPPs, the private sector returns are based on service outcomes over the life of the PPP contract, thus allowing governments to spread payments for large projects over their useful life, and those are made when services are delivered. The private sector is responsible for asset delivery, project management and implementation, and successful operation for several years after.

PPPs have been used to deliver many complex and significant public sector infrastructure projects. There are a number of reasons why governments adopt them.

PPP benefits

- PPPs make projects affordable. The private sector finances the construction of the project. This enables governments to spread the cost of infrastructure investment over the life of the asset.
- PPPs deliver better value for money. Transfer lifecycle cost risk to the private sector can deliver improved service at reduced cost.
- They provide budgetary certainty and on-time delivery. The private sector manages the overall delivery of the project on time and within budget. Public sector payments are aligned to the delivery of outputs at the required quality. This

incentivizes the private sector to deliver on time and at the expected quality levels.

- They transfer maintenance requirements to the contractor thus ensuring that assets are properly maintained over the life of the contract.
- PPP contracts set out fixed payments over the life of the contract that make it easier for governments to budget in their fiscal plans.
- PPPs enable the public sector to focus on outcomes, instead of inputs. The focus is on quality levels of outcomes and not on how these will be delivered.
- They encourage private sector investment.
- The successful use of the PPP model attracts international investors/contractors.

What are the key drawbacks to the model?

- PPPs imply a loss of management control by the public sector, which is passed to the private sector and which has control over the management of public sector services.
- Does the public sector have the core competencies, skills and capacity to adopt the PPP approach? The public sector should have the capability to formulate the project specifications and key performance indicators to manage the delivery of the process and achieve best value for money.
- The private sector has a higher cost of financing.
- PPPs tend to have high upfront transaction costs and are not suitable for low value projects.
- PPPs limit public sector future spending options, making it more difficult to pursue classic cost saving measures, i.e. deferring maintenance spend.

All major infrastructure investments have inherent risks related to their design, construction, operation and maintenance over their useful life. Treatment of risk is key. When identifying and assessing project risks, public sector sponsors need to be honest about where their strengths lie

with respect to risk management. This assessment and subsequent risk allocation is fundamental to the concept of PPP. There is recognition that the public and private sectors have different expertise in managing different risk elements, and therefore these risk elements should be allocated to the party best able to manage or absorb them.

The following is an example of risk allocation between public and private sectors.

	Definition	Ideal party to retain risk	Rationale
Design/ Technical risk	The risk of failures related to engineering or design	Private sector	This is a core skill of the private sector proponents
Land assembly risk	The risk that acquiring land will delay the overall project schedule	Public sector	The private sector may be unable to secure some land
Environmental approval risk	The risk that securing environmental approvals will delay the overall project schedule	Public sector	Environmental approvals are public sector approvals
Construction risk	The risk that cost escalation will occur due to faulty construction or delays	Private sector	This is a core skill of the private sector proponents

The public sector should have the capability to formulate the project specifications and key performance indicators to manage the delivery of the process and achieve best value for money

PPPs are currently more accepted worldwide and have enabled significant infrastructure projects such as airports, roads, water supply and others to be built. However, those are complex, and repeated issues continue to impede their development. The following provides a number of recommendations on PPP policy and project delivery from global lessons learnt with PPP projects implemented in more mature markets.

Recommendations on PPP policy

- A legal PPP framework should be established and political support is necessary.
- PPPs should only be used when suitable, typically for less than 20% of infrastructure projects.
- A contractual framework should be established, acceptable to all key stakeholders, that can be standardized and made replicable with risk to the party best able to manage and absorb it.
- The bankability of the commercial structure should be confirmed and in particular to domestic funders.

- Some assurance should be given that government will make the required funding available.
- There is a need to develop a sufficiently attractive project pipeline to attract and create a market.

Recommendations on PPP project delivery

- Establishing strong project teams with strong leadership is a critical factor.
- Understand and manage the stakeholder environment.
- Ensure the project can be specified for its lifecycle. If not, PPP should not be used.
- Ensure projects are appropriately specified.
- Ensure a competitive contractor market for each opportunity.
- Ensure realistic affordability tests are undertaken before launching the project.
- Develop a transparent and objective bid evaluation process.
- Establish ongoing project management both for government and contractors post financial close.

A contractual framework should be established, acceptable to all key stakeholders, that can be standardized and made replicable with risk to the party best able to manage and absorb it



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PPP Sentiment Survey

Recent surveys of the developer community in the UAE provide interesting pointers to the issues and factors that this key group sees as important to the success of the current drive for public-private partnerships (PPPs) in the Emirates and more widely across the region.

Introduction

As the region prepares for the much heralded acceleration of PPP as a mainstream option for governments seeking to address demands in areas like social infrastructure and transport, Deloitte has been testing the views of some of these sectors' key stakeholders on the features and attributes of this drive that will make it successful yet, if unaddressed, would trip it up.

It is our strong view that one of the principal elements to the success of a sustained PPP market in the region is the confidence of putative investors and partners in

the government. This is a key characteristic of international markets where PPP is a proven model and also in the power and water sectors in the Middle East, where a number of IPP, IWP and IWPP projects have been successfully financed and implemented by the private sector.

Over the coming months we will continue to develop the survey, both in terms of its coverage of wider stakeholder groups and the depth of the data collected. We hope it will become a valuable barometer of the overall sentiment of key market shapers and participants, and serve to support the articulation of their views in identifying the most pressing and important impediments to be addressed and success levers to be activated.

What we have seen to date

We have sought feedback on three main themes: firstly, with regard to elements of the enabling framework through which PPP will be promoted and undertaken; secondly, we asked the groups, drawn mainly from the development community, for their thoughts on the main impediments to the success of PPP in the region and how successful different jurisdictions within the region may be in addressing these, finally we sought to explore the views on the sectors wherein there was expected to be the greatest traction for PPP.

Transport and other infrastructure were strongly identified as the sectors which would benefit most from PPP

Briefly:

- The introduction of the PPP law in Dubai is considered an important but not singular influence on the views of market actors to potential involvement in future PPP projects.
- The PPP law is perceived to be as much about government signposting a commitment to PPP as it is a legal imperative.
- The establishment of a central unit or center of excellence to provide practical, specialist support to government bodies new to the use of PPP as a procurement and delivery tool was considered very important.
- It was thought that while the UAE would be effectively competing for PPP investment and best in-class partners with other countries in the region, there was confidence that the UAE would not be disadvantaged in this regard and, to the extent that there was competition, would be successful with regard to its peer group. Notwithstanding this confidence, around one in four respondents considered that these supply-side considerations represented a risk to the success of the program, even in the UAE.
- A further approximate 20% of respondents considered that extraneous factors such as regional instability posed a threat to the success of a wider drive to introduce PPP. The primary risks or impediments were identified by half of the respondents in one survey as those relating to factors associated with the commissioning bodies. These included adequacy of top level support and commitment, and also capacity and experience-related considerations.
- Transport and other infrastructure were strongly identified as the sectors that would benefit most from PPP. Social infrastructure such as health and education was the second sector identified, but more respondents considered that there was no

one single sector that would benefit disproportionately from the introduction of PPP as a mainstream option. Equally, there was a strong view that there was no single sector for which PPP would not be a potentially appropriate or value added option.

- With regard to the lessons that emerging PPP markets can draw from more mature sectors (such as power and water) or jurisdictions, themes around the assessment of bankable and optimum allocation of risk were considered most important. Managing the capacity and capability factors associated with PPP were also assessed as important areas from which learning could be taken. Very few respondents considered that there was no benefit to be gained from the experience of these other markets and early adopter sectors.

So what does it mean?

This short piece does not seek to unpack, validate or challenge these initial results; these steps come later.

For policy-makers and project commissioners some clear messages are already emerging. The developer and investor community, while positive on the overall drive for the use of PPP, see potential fragility in the capacity and experience of the project commissioners to deliver the scale and ambition of the program set out. They see limitations on the credible capacity of the supply side too, and while this may be a greater consideration in those markets in the region deemed less attractive than the UAE, it is still identified as a risk for the Emirates. The perception of these risks is expected to be compounded as governments move from transport and

The clear wish is for an appropriately resourced central body or framework to be established to support the commissioning entities

infrastructure projects to those in other sectors. The introduction of the PPP law is positive but not enough on its own. The clear wish is for an appropriately resourced central body or framework to be established to support the commissioning entities and to draw on and share best practices from within the region and more widely together with a clear pipeline of projects.

We will continue to expand and refine the PPP Sentiment Survey; its value and power will continue to increase as the deeper, richer understanding of the views and confidence of the key market actors emerges.

Footnote

The survey was carried out in Q1 2016 in invitee groups in the UAE, drawn principally from the resident and international development community. The survey findings to date are not being presented as statistically authoritative or representative. Further work is being undertaken to increase the coverage and depth of the survey.



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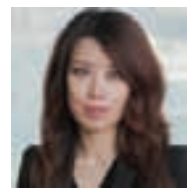
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