Adopting the Public Private Partnerships Model and its role in attracting Foreign Direct Investment

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In brief

Public Private Partnerships (PPPs) have become a popular tool for funding new infrastructure projects around the world. Using PPPs to develop infrastructure gives Governments the opportunity to move large upfront capital spending off their near-term financing commitments. PPP schemes can also play a further role in promoting economic diversification and foreign direct investment.

The announcement of a PPP law in August (published in September) is a clear indicator of Dubai's intention to widen this model for the delivery of infrastructure projects.

Dubai PPP Law

His Highness Shaikh Mohammed bin Rashid Al Maktoum, Vice-President and Prime Minister of the UAE, in his capacity as Ruler of Dubai, has issued Law No. 22 for 2015, regulating partnership between the public and private sectors in the Emirate of Dubai in August 2015. The new law aims at encouraging the private sector to participate in the development of projects and increasing investment in different fields in a way that serves economic and social development in the Emirate.

Key Benefits of Dubai PPP Law:

- Implement its strategic projects effectively and efficiently
- Harness financial, administrative, technical and technological expertise of the private sector
- Enable individuals in the community to have better access to services at less cost
- Increase productivity and improve the quality of public services
- Transfer of knowledge and experience from the private to the public sector
- Training and qualifying Emirati public employees in the areas of management and operation of projects

Why Government's turn to Public Private Partnerships

Public Private Partnerships (PPPs) have become a popular tool for funding new infrastructure projects around the world. States typically tend to turn to them when facing:

- Budget deficits;
- The need to protect against project delays and cost overruns;
- A desire to diversify the economy by stimulating private sector investment; and
- A desire to maintain the pipeline of projects when government funds are constrained.

Using PPPs to develop infrastructure gives Governments the opportunity to shift large upfront capital spending off their near-term financing commitments. For example, Oman's Energy Sector Law, in effect a PPP law, has removed billions of dollar of spending to develop power and water production facilities from the state budget. This cost is then spread across decades through a payment to a private sector company which has taken on the ownership, construction and financing of the plants. Because payments by the Government to the private sector are based on performance standards, it encourages competition and efficiency in the provision of services, and drives value for money. It also helps minimise project delays and cost overruns as these would eat into the profit margin of the private sector partner.

Terms and Conditions of Partnership

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Law No. 22 specifies the terms for partnerships between the public and private sectors as per a partnership agreement that follows the bylaws of this law:

- The project has to be economically, financially, technologically and socially feasible.
- A government body's director-general or their deputy can approve a project as long as the total cost that will be incurred by the body through the partnership agreement does not exceed Dh200 million.
- The Department of Finance will be responsible for approving projects that have a total cost above Dh200 million to Dh500 m.
- The Supreme Financial Policy Committee will approve projects valued at more than Dh500 m.

In addition to driving some element of competition into public services, it also has the potential to encourage knowledge transfer between some of the most sophisticated international private sector firms and the Government. When Dubai announced its PPP law in August (published in September) a key aim was transferring knowledge and experience from the private sector to the public sector and the training and qualifying of Emiratis in the management and operation of projects.

Dubai's history of funding infrastructure

Dubai has succeeded in turning itself into the undisputed business hub for the Middle East by creating a business friendly environment that welcomes investment from around the world. It has also spent heavily on infrastructure to create a physical working environment including modern office and residential space, a stable power supply, and transport infrastructure easing links within the city and between neighbouring cities.

To keep playing this role it has outlined plans to develop as a tourism, aviation and trade hub, but continuing to invest in these areas, as well as the supporting sectors of power, transport, utilities, health and Education will be challenging during a period of economic weakness in the region, and the Emirate needs to find new ways to fund its investment programme. It is only by doing so that Dubai will maintain its pre-eminence as the region's business hub.

Dubai wants to have 20 million visitors and add 35,000 new hotel rooms by 2020, while its population continues to expand. All this requires more to be spent on providing power, transport, and other infrastructure that makes Dubai a welcoming and attractive business and travel hub for the region.

Up until around 2010 Dubai financed the bulk of this on the Government balance sheet. This was done either directly by Government grants, or by borrowing in the loan markets and debt markets with an assumed Government guarantee. This mismatch between short-term borrowing and the long-term infrastructure that was being built caused financial problems for the Emirate when the ability to refinance loans disappeared during the financial crisis.

It also left the Government facing budget deficits as revenues dropped in the wake of the global economic slump. In response to the global liquidity crunch, Dubai focused on returning the budget to surplus, which it has achieved under the proposed spending plan for 2015, while continuing to allocate 13 percent of the 41 billion dirhams budget towards infrastructure spending.

This also comes against the current backdrop of weakening economic growth in the region. GCC Governments are starting to come to terms with the economic and social consequences of what we can expect to be an extended period of much lower oil prices. The financial impact of this has already manifested through budget deficits throughout the region. Qatar has just announced its first budget deficit in 15 years, expected to be 4.9% of GDP and goes on to state that this will continue through 2017 (3.7% in 2017). However despite this, Qatar still plans to continue its large scale investment plan ahead of the world cup. Saudi Arabia is currently facing a budget deficit in 2015 estimated to be up to 20% of its GDP. Policymakers across the GCC have been examining a variety of solutions and fiscal mechanisms that go beyond reducing subsidies and possibly introducing taxes. To this end, there has been an increase in interest in the PPP private finance model. Kuwait refreshed its PPP law earlier this year in a bid to streamline and improve its processes and Dubai has just announced a PPP law which aims to increase private sector investment in infrastructure and promote an increase in foreign direct investment.

The role PPPs play in attracting FDI

PPP schemes can also play a further role in promoting economic diversification and foreign direct investment.

The stability of revenue and long-term nature of PPP agreements with a sovereign Government, or Government body, is very appealing to the private sector. Well-structured PPP projects can attract interest and investment from firms around the world.

They also create private sector jobs, root foreign firms into the domestic economy and provide them with a platform to seek further contracts and expansion. This can create a mutually beneficial platform where the public sector gets a service provided to it by an efficient and experienced international operator, which in turn gets a long-term and stable source of revenue that can act as a base for expansion.

For Dubai in particular this could reap great rewards as it further enhances its value proposition as a regional hub if contracts in the Emirate are also a stable source of revenue. Already many businesses use Dubai as an operational base due to its quality of life and connectivity to the rest of the Middle East, North Africa and South Asia region. For example, French energy giant Engie (Gdf Suez) has established its regional head office in Dubai covering its investments in the Middle East, Africa and the Sub Continent.

The challenge for Dubai will be facing up to the initial learning curve that often comes with new PPP programmes as laws and procurement procedures are tested for the first time. This can result in the anticipated efficiency gains not arising until several projects have been delivered and the laws tested and perhaps even amended.

Why Dubai is turning to PPPs

As a result of this experience and the focus on returning the budget to surplus, Dubai has been seeking other innovative solutions to finance its continued infrastructure investment programme. The passing of a law for PPPs will give Dubai more fiscal flexibility and a useful tool to deliver on its infrastructure ambitions.

When the EU introduced fiscal deficit limits of 3% of GDP, countries such as Germany, The Netherlands and Hungary turned to PPPs as a fiscal tool to ensure that investment in the economy could continue and fiscal guidelines were not breached. This, in conjunction with an average efficiency and “whole of life” cost saving of around 20% compared to traditional procurement explains the phenomenal growth of PPPs over the last 20 years, and why Dubai is now looking to this model.

In some ways Dubai is mirroring the successful model of private sector cooperation that has been used in the rest of the Middle East for years, mostly to develop power and water projects. In other ways, Dubai is looking to be more innovative and push PPPs into industries and public services.

The development of an active PPP programme offers the Government the prospect of opening up long term foreign direct investment flows that can help achieve the Governments goals of continuing to develop and modernise its infrastructure, create jobs, and expand and diversify its economy.

Dubai has already demonstrated that it is an attractive destination for foreign investors in many sectors, and multiple successful bond issues by entities including the Department of Finance, to Government-owned or state backed corporations including Investment Corporation of Dubai and Emaar Malls, have shown that financial investors are comfortable with Dubai Government risk. These deals have helped to reinforce

Dubai's status and good reputation in the international capital markets.

Select recent Dubai government, or government-backed, bond/sukuk issues

Issuer	Amt $ m	Issue date	Maturity
Department of Finance	750	April 2014	2029
Dewa	1000	March 2013	2018
Investment Corporation of Dubai	1000	May 2014	Split between 2020 and 2024
Emaar Malls	750	June 2014	2024
Noor Bank	500	April 2015	2020
Dubai Islamic Bank	1000	January 2015	perpetual
DP World	500	May 2015	2020
Emirates Airline (with UKEF guarantee)	913	March 2015	2025
Flydubai	500	November 2014	2019
DIFC	700	November 2014	2024

The Department of Finance has even succeeded in issuing a 30 year bond that will mature in 2043, which provides an important guide for evaluating the price of long-term Dubai Government-backed risk. This will be a significant benchmark as the Government adopts the PPP model and private sector borrowers look to tap banks for long-term funding that carries sovereign backing.

PPP contracts are usually long term (up to thirty years) because the economic life of many PPP assets can extend well beyond this period. Financial instruments underpinning these projects can include commercial bank debt, sponsor equity, mezzanine loans and long term bond financing. Consequently, financing is usually long term and designed to match the duration of the service or offtake contract providing revenues for the project. The loans are often extended on a limited recourse or "project finance" basis by banks to project owners, and if a Government guarantee is provided, which is a typical PPP approach, the private sector company can benefit from a lower cost of funding

Looking further ahead, pension funds and institutional investors in Europe, Canada and Australia have increasingly participated in these structured finance deals, initially post construction and more lately even taking construction risk. This is because the steady revenue stream derived from their project financing loan assets can be easily matched against their long term balance sheet liability obligations. This would also allow Dubai to tap an investor pool that so far has little exposure to it.

Existing capital market debts are a useful pricing benchmark for the cost of raising that debt. Because these Government-guarantees are unlikely to all be called upon at any one time, it allows a state to lend its backing to more schemes than it could fund by itself. However, it is important for Dubai to understand and consider the financial implications of its portfolio of PPP projects before embarking on each new project.

In developing a PPP law Dubai is taking a mature approach to attracting long-term investment to the Emirate.

Dubai has already been making progress

Even without an overarching PPP law, Dubai had signed or was in the process of developing, several PPP deals, including:

- Dewa 100MW solar power project
- Dewa 1200MW coal power project
- Union Square metro station development

These projects have been tendered before the passing of the over-arching PPP law for the Emirate and instead have relied on legislation specific for the Government departments responsible for procuring them. Their success in attracting multiple world-class private sector bids demonstrates the appetite in the private sector for contracts with Dubai, even without the comfort of an overarching piece of legislation governing PPP processes.

The development of the PPP law builds confidence in Dubai's commitment to this programme and helps build legitimacy among private sector companies interested in bidding on these contracts. This ultimately will serve the Emirate well as the more confident the private sector is in Dubai's commitment to this process, the more bids they will receive for PPP contracts making the process more competitive and providing better value for money for the public purse.

Setting the right platform for PPPs

One of the key areas that Dubai will need to address to ensure that foreign investors find the regulatory landscape transparent and effective is which unit of the Government is responsible for delivery of PPP schemes.

There are many different models available that have been tried and are in use around the world to serve as examples. In some countries there is a centralised PPP unit responsible for all aspects of the tendering and procurement of these contracts, and these bodies can sit in several Government departments. Or the law can state that any contract over a certain value is assumed to be delivered through PPP unless the Government department procuring it can justify why it should not be.

Experience from the UK, the Netherlands and Australia points to the need for a strong PPP unit with a clear mandate. The European PPP expertise centre stresses the importance of PPP units which take the form of agencies created under the stewardship of the Ministry of Finance ("MOF") to monitor, and support activities. This is necessary in that there is a danger that once capital expenditure is made to appear less onerous in the short term, (the PPP Amortization Effect), there is a risk that too many projects are launched without due regard for priorities, value for money and the true benefits to society. When this occurs, distortions can arise when there is a mismatch between benefits and costs for projects over time. Lessons from a World Bank-PPIAF study show that countries with less effective PPP programmes tend to have less effective PPP Units and that a PPP unit may not be very effective without a high level of political support.

If PPP units are not properly managed this creates greater potential for several budgetary consequences:

a) Higher levels of capital can be funded than can be afforded over the longer term or "PPP over-leveraging" as seen in the UK.
b) The danger of lower-value projects being selected due to the lack of upfront budgetary recognition of full costs over time.

To mitigate this, the PPP Unit should be charged with ensuring that appropriate and essential capital projects are selected for PPP procurement by ministries or Government authorities. This will help maintain a balanced portfolio of public and private expenditure. The PPP Unit should regularly report to the MOF on matters relevant to setting future operating expenditure budgets and through this mechanism the MOF can mitigate any risks associated with "over leveraging" the economy. This is important in order for the Government to monitor any potential impact PPP accounting may have on the state's balance sheet and by extension it's Sovereign Rating.

PPP Units tend to work best when designed primarily as a powerful resource and sponsor to ministries, municipalities and Government departments. Each relevant arm of Government could then be directed to procure assets (above a certain investment threshold) under a PPP framework and draw on resources, capital, guidance, best practice and approvals from the Unit.

The Unit should also work with Government departments and municipalities to develop a catalogue of projects that are suitable for private financing. This is important as private developers will want to see a pipeline of bankable deals. Declared project pipelines help to justify the investment in bidding for projects competitively in specific markets. Additionally, PPP Units should monitor the number of PPP transactions in procurement on a national and international level at any one point in time in order to ensure that projects are phased and brought to the financial markets in a manner that do not create financing bottlenecks (ie. a finite amount of private capital chasing a growing number of projects giving rise to an increase in debt pricing).

In Victoria, Australia (Partnerships Victoria) regularly conducts PPP gateway reviews, ensuring that best practice developed in the state is shared nationally and internationally. Experience shows that by over-empowering a PPP Unit, there is a danger that an "ivory tower" is created without due consideration for stakeholder "buy in". This can lead to delays and stalled PPP programmes and tensions between different arms of Government.

Delivery bodies that do not have buy-in from other arms of the Government, or are viewed as working against other departments, will waste time and resources by weakening Government credibility through misaligned objectives.

Leveraging the PPP model to achieve strategic goals and attract investment

According to the latest figures from Dubai FDI, the top recipients of FDI are the real estate, financial services, hotels and tourism, renewable energy, business services, software and IT services sectors. Dubai's success at becoming a regional business, transport and logistics hub has helped attract investment into many of these sectors. But to continue to grow the volume of FDI attracted into Dubai it needs to offer more long-term investment opportunities.

Going forward, Dubai needs to determine a programme of implementation for PPP projects, identifying the easiest projects to procure first to test the efficiency of the law and build momentum for the wider programme. DEWA and the RTA have already started building momentum and each new project that closes successfully will further boost confidence in the Dubai regime.

Beyond some of the more standardised PPP schemes, such as those in the power and water sectors, there are still many untapped opportunities, capitalising on the rapid population growth and demographics of the Emirate, and the Government's plans to continue investing in new infrastructure. Key areas that the Emirate should consider using PPP models for include:

- Airport support services – e.g. Facilities management, baggage handling and logistics

- District cooling
- Metro rolling stock and trams
- Toll roads
- Waste to Energy BOT Concessions
- Waste Water BOT Concessions
- Bus concessions
- Facilities for military/police stations/worker camps/Municipal buildings
- Court houses/prisons

Ensuring a successful PPP programme

Dubai's PPP law is set to be enacted before the end of 2015 and although the full implementation method of the law is not yet clear, it does outline that above AED200m will need to create a special purpose vehicle overseen by a committee containing a project CEO and a representative from the Department of Finance. This implies that it is not just large infrastructure projects that Dubai is looking to develop through the PPP framework, but also smaller operation and maintenance contracts. Any contract above AED500m needs to be approved by the Supreme Fiscal Committee. These measures should help to ensure that Dubai does not become over extended through contingent liabilities and is able to maintain its standing with banks and international investors. The next step that Dubai needs to take is to start communicating with the market a prospective pipeline of PPP projects as soon as possible to demonstrate transparency in its plans and how the Government sees the infrastructure programme developing. This will help ensure that private sector firms who are not currently present in the Emirate have the opportunity to start their own due diligence processes ahead of potentially bidding for contracts. It will also give the public sector departments time to start digesting how upcoming projects will affect them and how they can ensure that every contract attracts a competitive bidding process.

Dubai has succeeded in becoming the Middle East's preeminent business hub, with the best infrastructure and one of the most investor friendly legal regimes in the region. Adopting the PPP model for future infrastructure spending will allow it to save valuable public finances as the regional economic outlook weakens, attract more foreign investment, create jobs, and encourage the transfer of skills to the public sector.

Dubai PPP Enabling Environment

Dubai PPP Law provides a framework and certainty for potential foreign investors, creating a friendly environment that would further spur PPP initiatives. Dubai Investment Development Agency (Dubai FDI), an agency of the Economic Development Department- Government of Dubai, is advocating a PPP sustainable enabling environment driven by international best practices and innovation.

Dubai FDI efforts to showcase the benefits of investing in PPPs in Dubai is evident in many infrastructure projects and government services. Initiatives to promote current and future project pipelines and develop channels to connect public and private officials to explore unsolicited PPPs were announced during Dubai Investment Forum held in October, 2015 and featured an Expert Panel on Dubai PPP Outlook.

Let's talk

For a deeper discussion of how this issue might affect your business in Dubai, please contact:

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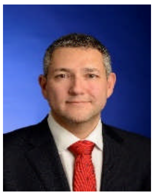

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