

## Saudi Arabia: Emerging Trends in Islamic Project Finance

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As one of the major project finance markets globally, the Middle East is the epicenter for innovative financing structures. Last year, US\$20 billion in debt financing was utilized for projects in Saudi Arabia, representing 55% of the total debt transactions in the Middle East and Africa. Landmark projects in both the public and private sectors have evolved as the new norms for financing structures.

With a growing need for diverse sources of funding, the demand for Islamic financing has been on the rise throughout the Middle East, especially in the oil, gas and petrochemical (OGP) sectors. Saudi Arabia has been the major driving force on this front and continues to attract major international financiers as well as export credit agencies (ECAs) in conjunction with local and regional financial institutions to meet growing market demands.

As the market matures, novel structures emerge with a trend towards foregoing conventional financing in favor of their Islamic counterparts. The growing scope and size of the transactions necessitate tailor-made and project-specific Shariah compliant structures. Despite the complexity of the structures, their flexibility sustains the innovative and vibrant nature of the market.

One of the more popular structures in use in Islamic financing besides Sukuk is the Ijarah Mausufa Fil Thimma (forward

lease) arrangement where, through a special purpose vehicle (SPV), investors can acquire an asset under construction and forward lease it to the project entity pending completion. In such a forward lease, investors are entitled to income during the construction phase, provided that all lease payments are refunded in the event the asset is not delivered upon completion.

### **Trend Setters**

#### • Rabigh (March 2005)

The US\$9.8 billion Rabigh refinery and petrochemical project, a joint project by Saudi Aramco and Sumitomo Chemical Company of Japan, represents the largest long-term Islamic project financing in the Middle East to date. It saw significant participation by 17 internationally renowned financial institutions along with the Japan Bank for International Cooperation (JBIC) and the Public Investment Fund for Saudi Arabia (PIF). Upon completion in 2009, Rabigh will be one of the world's largest export-oriented refinery and petrochemical complexes.

Along with conventional financing, this project entailed an Islamic tranche for US\$600 million spearheaded by APICORP, Islamic Development Bank, Bank Al Bilad and Gulf International Bank utilizing the Ijarah Mausufa Fil Thimma structure.

#### • IWPP Shuaibah (December 2005)

Thanks to the success of the Abu Dhabi

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independent water and power project (IWPP), the US\$2.5 billion in Shuaibah represents the first IWPP project of its kind in Saudi Arabia, as well as the largest greenfield power and desalination project to date.

This project comprised of three separate tranches with 23 banks involved in the commercial financing for US\$974 million on a limited recourse basis. Additional export credit facilities of US\$400 million and US\$455 million were arranged by Germany's Hermes and South Korea's Export-Import Bank (Kexim) respectively. The project also relied on a US\$210 million Islamic financing tranche.

As was the case with Rabigh, the Ijarah Mausufa Fil Thimma was used. The subsequent Shuqaiq, Marafiq and Ras Al Zour IWPP structures were based on the Shuaibah model.

Although the 20-year tenor for Shuaibah established the longest tenor for project financing in Saudi Arabia, future tenors are expected to stretch beyond 20 years. In addition to these characteristics, Shuaibah illustrates the increasing popularity of Islamic financing in mega projects in the region, with the gap between the two tranches diminishing.

### • Yansab (June 2006)

Yansab was the largest greenfield project in Saudi Arabia, requiring US\$5 billion in financing. It featured multi-tranche financing, including ECA-backed facilities provided by the official export credit agencies of

Italy (SACE) and the UK (ECGD) as well as an Islamic finance tranche of US\$846.8 million. Again, Yansab entailed unique characteristics representing the largest ever Islamic financing globally and the biggest single bank underwriting (ABN Amro) in the Middle East.

The Islamic financing component of the transaction improved overall pricing as well as enhanced the profile of future SABIC projects. The structure used with regard to Yansab was Ijarah Mausufa Fil Thimma.

### • Al-Waha (November 2006)

The US\$1 billion Al-Waha petrochemical project was financed through only Islamic vehicles representing the equivalent of US\$526 million in debt. As the first ever greenfield petrochemical project to be Islamically financed on a limited recourse basis without relying on commercial funding, the complexity of the transaction required a unique variation of the standard Islamic vehicles. This structure combined a procurement arrangement (a variation of an Istisnah contract) and a lease arrangement. The investors and the project company were involved in a co-purchase/co-ownership arrangement with respect to project assets.

The innovative structure and the sole use of Islamic financing for funding the project earned it the "Project Finance Deal of the Year 2006" award from *Islamic Finance news*.

### **Looking Ahead**

Projects currently underway in Saudi

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Arabia with a strong emphasis on Islamic finance tranches include Maaden Mining Co and Kayan Petrochemical Co in Jubail (which requires debt financing of US\$6 billion).

As the first project to be exclusively financed through Islamic products, Al-Waha acknowledges the potential of the Islamic finance market while introducing a new benchmark for complex structures. Despite estimates of market value ranging from US\$350 billion to US\$500 billion, the concept of Islamic finance is still evolving.

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Al-Waha is unique in that it utilizes a seminal Islamic financing vehicle in line with Shariah precepts; as such, it is likely to form the basis for forthcoming financings and promises to be a paradigm for future structures. As the market evolves, the related documentation will become more demanding to reflect the sophisticated nature of the structures.

### **Saudi Scenario**

Saudi Arabian corporate entities prefer Shariah compliant transactions. At present, local banks in Saudi Arabia offer Islamic financing products due to the high demand for Shariah products. Given the

size and scope of transactions in Saudi Arabia, especially in the OGP sector, the participation of international financial institutions is inevitable. However, Yansab clearly emphasizes the role of local and regional banks in conjunction with their international counterparts.

### **Emerging Trend**

Equity products and international investors are injecting additional liquidity into Saudi Arabia, the Sukuk market continues to thrive as illustrated by the SABIC Sukuk and the Saudi Electricity Co Sukuk.

Despite certain political concerns in the region, the flow of foreign funds is consistently increasing. Local lending institutions such as the Saudi Investment Development Fund and PIF, western banks and ECAs play an integral role in project financing in the Middle East by lending a hand to their local counterparts. While domestic and regional banks provide local expertise especially with respect to Islamic financing and the regulatory framework, international banks play a vital role in the syndication process. Although Islamic financing is still evolving, its increasingly important role in mega projects in the Middle East and beyond is becoming more pronounced.

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