

A photograph of several wind turbines against a sunset sky. The sky transitions from a deep blue at the top to a warm orange and yellow near the horizon. The turbines are silhouetted against the sky, with some showing the hub and blades in detail. The overall mood is serene and modern, representing clean energy.

Market
Intelligence

PROJECT FINANCE 2021

Global interview panel led by Milbank

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Middle East: Overview

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1 | What have been the trends over the past year or so in terms of deal activity in the project finance sector in your jurisdiction?

Both renewable and clean energy development remain key trends in the Middle East. Through the Kingdom of Saudi Arabia's (KSA) Vision 2030, the KSA continues to work towards an initial target of 9.5GW of renewable energy by 2030, with the UAE targeting a 50 per cent increase of clean energy contribution by 2050 and an overall reduction of its carbon footprint of power generation by 70 per cent through its Energy Strategy 2050. We have also seen other countries following suit with the implementation of ambitious and progressive clean energy focused strategies.

Despite low oil prices and concerns about the future of renewables, we have seen governments in the Middle East and North Africa (MENA) remain committed to diversifying their energy sources, including to lower the cost of renewables. The completion of the Dhofar wind farm in Oman, the first utility-scale wind farm in the Gulf Cooperation Council (GCC), has increased confidence among developers, governments and financiers. The agreed tariff for the Al Dhafra photovoltaic (PV) facility in Abu Dhabi is claimed to be one of the lowest in the world for a solar energy project.

Further, and in line with the megacity developments announced in 2019, we have seen the KSA continue to take steps to attract foreign interest in the region. The relaxation of guardianship rules and visa regulation will arguably make the KSA a more attractive proposition for international investors, with major development projects such as the Amaala project, which is anticipated to have its own regulatory structure and looks to create a tourist destination on the KSA's northwestern coast.

There has also been increased appetite by regional developers in North Africa, with the countries such as Morocco continuing to announce large-scale sustainable energy projects, presenting continued opportunities for Middle East-based investors and developers that share an approach to innovation and technology progression.

2 | In terms of project finance transactions, which industry sectors have been the most active and what have been the most significant deals to close in your jurisdiction?

The construction, transport and power sectors continue to remain the most active in the Middle East, with the UAE and Saudi Arabia taking great strides in this sector. With a reported 4,792 active projects, which accounts for 42 per cent of the UAE's ongoing and active projects, Dubai continues to drive growth in the construction and infrastructure sectors with projects such as Expo 2020, which, upon completion, will be one of the largest projects regionally to close, and other mega-projects such as



“While traditional construction sectors continue to be the most active, the breadth of sectors in which projects requiring financing are being developed is widening.”

the expansion of the Al Maktoum International Airport, Jebel Ali Port and the Dubai Metro Red line, which will connect the city centre to the Expo 2020 site.

While traditional construction sectors continue to be the most active, the breadth of sectors in which projects requiring financing are being developed is widening to encompass nuclear projects, desalination plants, aerospace developments and social infrastructure such as hospitals and schools.

The Shuqaiq 3 desalination plant in Saudi Arabia, with a value of over US\$600 million, will be one of the largest reverse osmosis desalination plants in the world and is scheduled for completion in the fourth quarter of 2021. The project is being developed under a 25-year build-own-operate contract model. Lenders include MUFG, SMBC, Samba Financial Group, Crédit Agricole Corporate and Investment Bank, the National Commercial Bank and the Norinchukin Bank.

The UAE government has also, in consultation with the International Atomic Energy Agency, developed a civil nuclear power programme. The UAE's first nuclear project, Barakah, which is projected to produce up to 25 per cent of the UAE's electricity requirements while preventing the release of up to 21 million tonnes of carbon emissions every year, is reportedly due to commence commercial operations in early 2021. By 2030, 12 per cent of Dubai's electricity supply capacity is forecast to be nuclear.

On the renewables side, Oman's largest solar PV power plant achieved financial close in April 2020. The consortium for the 500 MWac Ibrī-2 IPP consisted of ACWA Power, GIC and AEP and will be developed on a build-own-operate basis. ACWA Power also announced in May 2020 the completion of the transaction to introduce Silk Road Fund as a partner and a 49 per cent shareholder in ACWA Power Renewable Energy Holding Ltd (ACWA Power RenewCo). ACWA Power RenewCo currently owns ACWA Power's concentrated solar power, PV solar and wind assets in the United Arab Emirates, South Africa, Jordan, Egypt and Morocco. The deal highlights the strong relationship between Saudi Arabia and China and ACWA Power's renewables growth plans in MENA, Africa, Asia and Central Asia.

3 | Which project sponsors have been most active in driving activity? Which banks have been most active in providing debt finance?

Projects in the region are typically financed by syndicates of regional and international financiers, using a combination of sophisticated instruments including bonds, Islamic bonds, loans, syndicated loans, Islamic loans and initial public offerings.

Global political instability has prompted a more risk-averse approach to the region by international lenders and sponsors. However, regional financiers continue to actively support project development throughout the jurisdiction. Standard Chartered Bank is a key player in the market and was part of a consortium that raised

approximately US\$275 million to finance the construction and maintenance of the MWac Ibri-2 IPP in Oman. The mandated lead banks included Asian Infrastructure Investment Bank (AIIB), Bank Muscat, Riyad Bank, Siemens Bank and Warba Bank. This deal was the first renewable energy financing in the GCC region by AIIB, the Beijing headquartered international multilateral development bank.

The recent collapse of Arabtec, which was contracted to work of Dubai's Expo 2020, will no doubt place additional strain on the real estate sector and local banks operating in that space. Dubai's Mashreqbank is the most exposed bank, with an approximately US\$96.11 million loan. Banks have been generally reluctant to extend fresh credit to contractors considering the global downturn. Large UAE developers will likely also be impacted.

Government-backed infrastructure funds remain the most prevalent source of financing. For example, Masdar delivered the Dhofar wind project in Oman and funding for the project was provided by the Abu Dhabi Fund for Development, the UAE's leading national entity for development aid. The Oman Infrastructure Fund has also announced the establishment of its Rakiza Fund, which has a focus on core infrastructure and brownfield developments in Oman. The KSA's Public Investment Fund is also reported as having budgeted US\$270 billion for 2020 allocated towards increasing non-oil revenues.

Sponsors such as ACWA Power, Mubadala and Masdar remain active, with many of the government-related entities, such as the Abu Dhabi National Oil Company, the Abu Dhabi Water and Electricity Authority, and the Dubai Electricity and Water Authority, continuing to dominate the local sponsors or UAE-headquartered joint ventures list.

The post-flotation valuation of Saudi Aramco at US\$2 trillion is also noteworthy as the plans for the deployment of fresh capital in the KSA in 2020 are unveiled by Saudi Aramco. The listing in 2019 has spurred more initial public offerings in KSA, which has plans to deepen its capital markets under several reforms aimed at reducing its reliance on oil.

4 | What are the biggest challenges that your clients face when implementing projects in your jurisdiction?

The legal and regulatory framework in general continues to develop in the region, promoting foreign investment and local small and medium-sized enterprises, with many government authorities continuing to build on the progress of 2019 in respect of online and digital services and cross-government coordination in an effort that will continue to streamline the permitting and approval process to help support businesses. However, economic commentators continue to report the need for



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more robust investor protection schemes and a transparency rule, as well as stricter information disclosure requirements.

From a practical standpoint, construction risks remain a key concern in the region, which, in some instances, lead to high-value disputes and negative impacts project timelines. Late amendments to the scope of work (ie, contract variations) of ongoing projects lead to cost overrun and project delays, and the relevant national and municipal bodies often offer different approaches to, and standards of, procurement procedures, which can further lead to cost overrun and contract variations. Continued payment delays as faced by contractors, as well as diminished access to funding, have also placed extreme pressure on margins and, in some cases, led to financial distress. Recent casualties in the market are engineering group Drake & Scull International and Arabtec, whose shareholders voted in September 2020 to dissolve due to an untenable financial situation. This will likely affect local contractors and sub-contractors.

On the renewables side, regulatory reform is required in order to merge renewable energy, primarily PV solar power, into power grids. Policy adjustments and new regulations will also be required to integrate new technologies, such as battery storage for electric vehicles, to ensure the stability of the grid.

“There are some key changes underway in the landscape of foreign investment and public-private partnerships.”

Political tensions also remain a reality. Further to the withdrawal of the United States from the Joint Comprehensive Plan of Action (JCPOA) and the reimposition of US sanctions in 2019, tensions rose in 2020 as Iran reportedly exceeded the stipulated limitations on its nuclear programme. President Biden has pledged to return the United States to the JCPOA if Iran resumes compliance, although it is unclear whether and when new negotiations will commence. It remains to be seen whether ongoing projects in Iran, including Kermanshah-Khosravi railway in western Iran, Shiraz-Bushehr railway, Tehran-Qom-Isfahan railway and the Tehran-Hamedan-Sanandaj railway, which are awaiting international financing, will be negatively affected.

5 | Are there any proposed legal or regulatory changes that may give rise to new opportunities in project development and finance? Do you believe these changes will open the market up to a broader range of participants?

Traditionally, a foremost barrier to market entry in the UAE has been the restrictions on foreign direct investment. As previously prescribed by the UAE Commercial Companies Law (Federal Law No. 2 of 2015), restrictions were historically applicable to limit a foreign shareholder to holding a maximum of 49 per cent of the shares in a company incorporated onshore (that is, not within one of the many free zones in the UAE) (the FDI Restriction).

However, Federal Decree promulgating Law No. 26 of 2020 was passed in December 2020 (the Decree), repealing the FDI Restriction. Moving forward, the threshold required for local ownership will be determined by the Cabinet, as advised by a committee to be formed pursuant to the Decree, comprising members of various governmental departments (the Committee). The Committee will have the discretion to determine the activities that are considered to have a 'strategic impact' and thus are permissible for foreign investors to be entitled to hold up to 100 per cent of the legal interest in such companies. This opens the gateway for foreign ownership in construction companies generally and further, the Decree prescribes that entities partly (or wholly) owned by the government in certain sectors will be entirely exempt from the provisions of the Decree. This will be particularly interesting for project development companies that, by operation of law, are required to be partly government-owned.

There are some key changes under way in the landscape of foreign investment and public-private partnerships (PPP), with a broad trend of reforms across the region, in both the oil exporting and importing countries, to modernise legislation and enhance the business environment. Increased scope for participation and improved protections make it more likely that foreign investors might participate in PPP projects, which are also being facilitated by several dedicated laws. Egypt, Jordan and Kuwait started the trend, followed by Abu Dhabi, Dubai and Lebanon. A new PPP Law No. 12 of 2020

was published on 31 May 2020 in Qatar, and similar laws are expected in Saudi Arabia and Iraq this year. Although Oman introduced its long-awaited PPP laws in 2019, the Public Authority for Privatisation and Partnership (PAPP) was effectively dissolved in August 2020 as part of a wider government restructuring. This has caused some uncertainty in the market as bidders and investors consider the future of planned projects and ongoing tenders. PAPP was understood to have a healthy pipeline of projects in the education, healthcare, logistics and utilities sectors, and it will be important to ensure that confidence in the Oman PPP market is not undermined.

6 | What trends have you been seeing in terms of range of project participants? What factors have influenced negotiations on commercial terms and risk allocation? Are there any particularly innovative features?

The structuring of projects in the region generally means that the procuring government entity will also take the majority share of the project company. Liquidated damages, decennial liability and a robust security package comprising either a parent company guarantee or bond as performance security is typical and, due to the manner in which projects are competitively tendered in the region, it is usual to see bidders accept maximum risk transfer in order to submit competitive bids.

The procurer will typically pass off all construction risk, including interface, force majeure, site contamination risk and permitting requirements, to the developer. At the operational level, the backing-off of risk by developers through the use of sub-contracting is also common.

The use of sovereign guarantees often assists lenders with getting comfortable with the risk profile. However, as major infrastructure projects in the region are procured based on well-tested precedent legal documentation, project risk allocation does not often negatively impact the bankability of projects, such that no multinational lenders will be participate. This means that we are likely to see less use of the sovereign guarantee as a means to allocate risk in PPPs, for example. The use of other instruments, such as insurance, may in some cases offer a more efficient way to manage project risk. The sovereign guarantee is no longer a 'one size-fits-all' solution.

7 | What are the major changes in activity levels or new trends you anticipate over the next year or so?

The Gulf dollar peg came under extreme strain in 2020 with falling oil prices and the covid-19 pandemic. Despite this, some have argued that it is time for the Gulf to rethink the dollar peg given the diversification agenda in economies across the



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GCC and considering the realignment of trade and investment ties towards Asia. The options are not clear-cut, however, as unpegging will likely lead to significant currency devaluations, which will inevitably impact relevant economies. In the meantime, a weak dollar inevitably drags down the dirham against other major currencies. The Federal Reserve has promised not to raise rates through 2023 and so 2021 is likely to be a year of relatively low and stable interest rates.

Despite potentially bearish sentiment from foreign investors as a result of forecasted economic downturn following the twin impacts of low oil prices and covid-19 on the regional economies, there are still some promising signs. Saudi Arabia has recently announced that it would unilaterally cut a million barrels a day of crude production in a move to mitigate fears of a resurgent covid-19. The Al-Ula Accord was also signed on 5 January 2021, ending the three-year rift between Qatar, the UAE, Saudi Arabia, Bahrain and Egypt. The end of the Qatar blockade will be good for both the jobs market and the wider business climate in the region. We anticipate increased investment between the UAE and Qatar, particularly the UAE construction industry, which has recently put many projects on hold. The UAE has also opened its doors to Israel, promoting further trade opportunities. Furthermore, as we approach

Expo 2020 (in October 2021), the UAE has moved to relax a number of Islamic laws for personal freedom. These relaxations are designed to attract foreigners as well as to make the environment more conducive for business.

The region also continues to innovate and looks to foster the growth of new technologies. For example, Abu Dhabi renewables company Masdar has recently announced the funding of a £60 million graphene engineering invocation centre, which is reported to be more efficient and cheaper than traditional desalination and therefore presents an exciting prospect for the UAE.

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The logo for Simmons & Simmons, featuring the word "simmons" in red lowercase letters, a red plus sign, and another "simmons" in red lowercase letters below it.

The Inside Track

What three things should a client consider when choosing counsel for a complex project financing?

An in-depth knowledge and experience of PPP's and project finance, local regional knowledge and strong negotiation skills.

What are the most important factors for a client to consider and address to successfully implement a project in your country?

An understanding of local law and an appreciation of local culture is really important when structuring and executing projects in the UAE, so it is important to choose counsel on this basis. Given Simmons & Simmons has over 20 years' experience in the UAE, Qatar and Saudi Arabia, in addition to multi-language capabilities, we are well placed to assist our clients in this regard.

What was the most noteworthy deal that you have worked on recently and what features were of key interest?

- Advised Qatar-based Umm Al Houl Power QPSC (UHP) on the US\$389 million expansion of one of the largest and most eco-friendly power and desalination plants in the Middle East.
- Advising on the financing work for Mitsubishi Corporation (Diamond Generating) on their bid for a solar photovoltaic project in Qatar.
- Advising an infrastructure fund on its proposed investment in a submarine cable.

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