Funding tap: GCC margins dip

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State-owned Electricity Holding Co (EHC) - an umbrella entity for nine Omani electricity and water companies – has mandated JP Morgan and Bank Muscat to co-ordinate up to $2 billion of long tenor debt. The fundraising, the biggest by EHC to date, is the latest to be added to a growing list of state-owned Middle East borrowers attempting to tap the international loan market in a bid to top up government budgets constrained by low oil prices.

The 2014 oil price slump hit every aspect of the region's loan market. Sovereign ratings were downgraded, regional bank liquidity turned into a trickle and cost of local bank funding soared (Saudi Arabia's average three-month interbank lending rate went from below 1% to around 2.4% in the period 2014-16). Most significantly, loan pricing rose dramatically as the market dynamic changed from borrower to lender-driven.

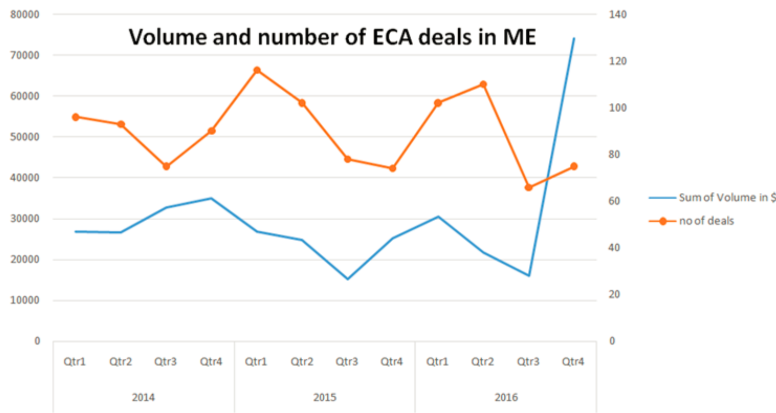
For SMEs cashflow has been particularly hard to raise. As Bruno Gremez, co-founder at Dubai-based CT&F consulting, tells *TXF*: "Local banks used to finance a very wide scope of local privately-owned businesses in the local economy." Now, regional banks have had to become much more selective, cutting credit lines to non-government companies.

But even major credits have felt the pinch. According to Pascal Martese, director of project finance at Saudi Arabia-based Acwa Power, "borrowers have been paying on average between 75bp and 100bp more for loans than before the oil price drop."

With the price of oil stable for the first time since 2014, loan pricing for the region's stronger credits is showing signs of tightening – albeit slightly. Crude oil rallied 16% in the final three months of 2016 to just under $60 a barrel, and that price increase is inversely mirrored in the Saudi interbank lending rate which dropped from 2.4% to 2% in the same period. "In terms of basis points, the fall in loan pricing has been around 25bp since oil prices went back up," says Martese.

Rise of ECA debt

Further tightening in the coming months looks unlikely – particularly with record numbers of state-owned borrowers competing for international bank appetite. But one of the upsides to the government budget deficits across the region, particularly in Oman and Dubai, is that even first-time borrowers have had to take a more sophisticated approach to fundraising. Project and corporate loans are no longer the only tools in the treasury toolkit. Pre-export finance and ECA-backed loans have been on the increase as treasury managers look to keep debt off the balance sheet whilst getting the best pricing possible.



The biggest volume jump has been in ECA-backed loans which, according to TXF Data, totalled $8.3 billion in Q1 of 2015, and doubled to $16 billion in the same period the following year. "The volume of ECA deals have grown recently," says Gremez. "And the volume of deals that will close in the Middle East over the next 12-24 months will continue to do so.

"Five years ago, most state-owned borrowers revelled in easy access to local funding. Of course, government-owned entities still have access to local funding, but when liquidity started drying up, alternative sources of financing became more attractive."

Although, over the past year regional bank liquidity has slowly begun to rebuild in tandem with increasing oil prices, "local and international lender liquidity is still tight," says Martese. But unless there is a reason for closing a deal quickly – for example, the majority of regional project financings closed in 2016 without ECA debt were linked to generating urgently needed non-oil export income – most regional borrowers appear content to add the extra time required to negotiate an ECA layer in a bid to make deals as attractive as possible to lenders, without sugaring the pricing too heavily.

Funding economic diversification

Although global rating agencies have either downgraded or assigned a negative outlook for most GCC countries, international bank appetite for sovereign risk across the region is still relatively strong. For example, despite Oman being rated just below junk, state-owned Oman Oil Company and Petroleum Development Oman (PDO) are both looking at new loans for 2017, with Oman Oil proposing a facility of up to $1 billion led by SMBC. Likewise, PDO's debut $4 billion pre-export financing (PXF) in 2016 - the first ever PXF facility in the Middle East to be backed by a Ministry of Finance guarantee - was ample proof of international lender appetite for Omani risk.

That is good news for the regions' governments, all of which have started giving non-oil-based economic diversification a sense of urgency, but have done so when, and for the first time, state budgets cannot foot the bill.

A key new area of investment across the region is solar power. Saudi Arabia, UAE and Jordan have all recently tendered solar schemes.

Starting this year, Saudi Arabia plans to develop almost 10GW of renewable energy by 2023, starting with wind and solar plants in its vast northwest. And in Jordan, a DFI-backed financing for the 61.3MW Al Risha solar scheme – a follow up to the 61MW Mafraq solar project financing in 2016 - is just weeks away from financial close

As Charles July, a renewable energy lawyer at Dentons, says: "All the Middle East countries are looking to solar. It is good news for the environment and the local economy because the countries have the immediate benefit of selling oil for $50 a barrel instead of burning it to make power." Furthermore, the latest UAE solar power farms produce power at a price that is competitive with oil-fired power, even if oil were at $10 per barrel.

Solar power is not going to radically alter the region's economies overnight – but it is a start.

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