

The Islamic project and infrastructure finance market



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According to the OECD, US\$71 trillion is required globally by 2030 to fund infrastructure projects, including road, rail, telecommunications, power and water infrastructure. A significant proportion of these projects will require private sector finance and, therefore, offer opportunities for Islamic investors and financial institutions globally.

While economic fluctuations, including low oil prices, have had an impact on the implementation of infrastructure projects, most governments have maintained their commitment to infrastructure development. This has led to greater incentive for many governments to tap into private sector financing, including through Islamic project finance, for developing large-scale infrastructure projects.

Review of 2019

The Islamic finance industry underwent a period of substantial growth in the past decade, but its growth has progressively declined in recent years, from 11.16% in 2013 to 6.58% in 2018. However, the Islamic finance industry remains an integral part of global financial markets with an aggregate value of US\$2.6 trillion at the end of 2018.

In recent years, most large-scale projects, particularly in the GCC, have featured one or more Islamic tranches alongside conventional debt finance.

The most frequently used Islamic project finance structures have been based on Istisnah-Ijarah and, in some cases in Saudi Arabia, Wakalah-Ijarah structures. This has been particularly the case for power, petrochemical and industrial projects, such as the US\$20 billion SADARA petrochemical complex, the US\$2.5 billion Shuaibah independent water and power project and Phase II of the US\$10.2 billion Emirates Aluminium smelter project.

While a more robust pipeline of infrastructure projects to be funded through Islamic project finance remains to be developed, there is wide market recognition that Islamic project finance can deepen the available capital pool for funding infrastructure projects through the inclusion of one or more Islamic tranches in a multi-sourced financing structure.

Although multi-sourced project finance arrangements lead to certain intercreditor issues between Islamic finance providers and conventional financiers, the success of various recent Islamic project financings has demonstrated that such issues can be overcome.

Notable projects recently financed through Islamic project finance alongside conventional finance sources include the US\$4.43 billion North Marmara Motorway private-public partnership (PPP) project in Turkey (September 2019), the US\$275 million 500MW solar photovoltaic independent power plant in Ibri, Oman (March 2020), the US\$1.85 billion Jambaran-Tiung Biru natural gas project in Indonesia, the EUR2.3 billion (US\$2.6 billion) financing

for the construction of Canakkale 1915 Bridge in Turkey (March 2018), the US\$4.61 billion Duqm Refinery project in Oman (October 2018), the AED1.2 billion (US\$326.7 million) 200 MW Phase II of the Mohammed bin Rashid Al Maktoum Solar Park in Dubai (March 2017) and the 800-MW Phase III of the Mohammed bin Rashid Al Maktoum Solar Park in Dubai (June 2017).

Preview of 2020

According to S&P Global Ratings, a “low-single-digit growth rate over the next two years is a fair assumption” for the Islamic finance industry – particularly as the growth of the industry will be hampered by the uncertain global economic impact of the coronavirus pandemic. However, the Islamic project finance industry is well placed to maintain a positive growth trajectory upon the recovery of the global economy from the coronavirus pandemic.

There is a large pipeline of infrastructure projects in the Middle East, Asia and Africa (including the projects in Saudi Arabia as part of Vision 2030) for which Islamic project finance could offer a viable financing option alongside conventional modes of finance. It is expected that projects comprised in the multibillion dollar Belt and Road Initiative and infrastructure projects in Africa will offer ample opportunities for Islamic project finance.

Moreover, according to MEED, approximately 151 PPP infrastructure projects, with a total value of approximately US\$185 billion, are planned or underway in the Middle East and Africa, which could offer ample opportunities for the use of Islamic project finance. This has elicited interest from governments and development finance institutions to mobilize Islamic project finance for financing PPP infrastructure projects.

However, questions remain as to whether Islamic financial institutions have the requisite capital-base to meet the increasing demand for Islamic facilities multi-sourced financings and, more determinatively for the sector, to independently finance large-scale projects.

To ensure the sustained development of the sector, reconsideration and adaptation of existing Islamic project finance structures to meet the current and developing needs of the project finance sector and the enhanced regulation of the Islamic finance industry continue to be desired.

Conclusion

Although the growth of Islamic project finance has recently been hampered by the global economic impact of the coronavirus pandemic and low oil prices, the future of Islamic project finance appears promising.

The continued development of Islamic project finance is a testament to its suitability for financing infrastructure projects and its growth is expected to continue in parallel with the recovery of the global economy from the coronavirus pandemic.

The position of Islamic project finance is expected to be further bolstered globally by the extensive pipeline of infrastructure projects which could be financed through Islamic project finance, the development of Islamic finance in traditional hubs and non-traditional markets, the increasing progress toward standardization and enhanced regulation of the Islamic finance industry and the growing interest of development finance institutions in promoting the use of Islamic project finance in the infrastructure development space. ☺