Time to fix contract financing woes in Gulf region

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GCC focus

The Saudi monthly Purchasing Managers' Index (PMI), a proxy for growth in the Saudi's non-oil sector, fell to 54.4 in December 2015 from 56.3 in November 2015 and recorded the weakest improvement in business conditions since the survey began in 2009.

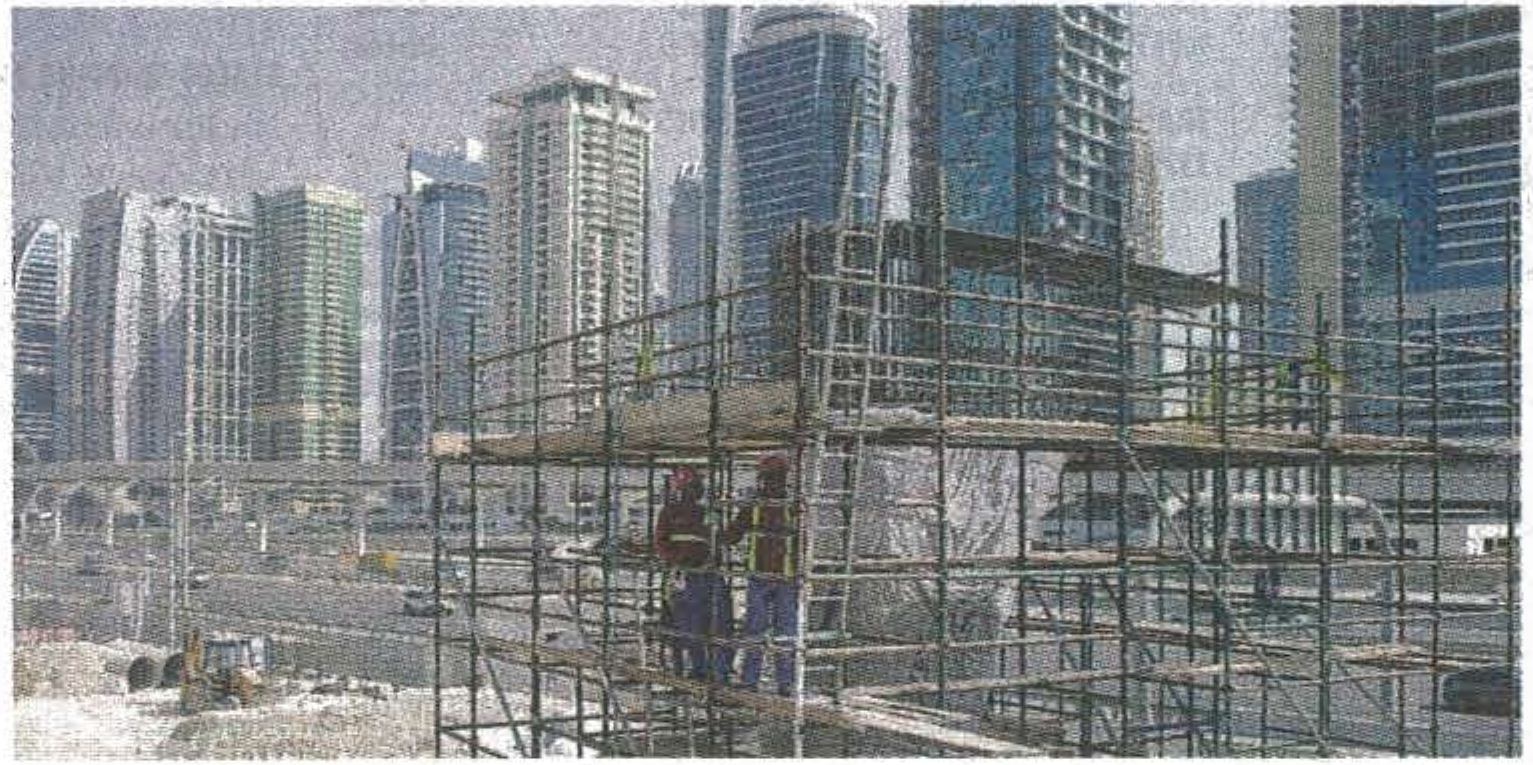
The non-oil sector in Saudi Arabia was affected by slower expansion in output and new orders as well as weak employment. Staffing levels last month stagnated, with the majority of respondents anticipating no change in employment.

Similarly in the UAE, the PMI dropped to a 40-month low of 53.3 in December 2015 from 54.5 in November. Slower growth in new work weighed on the sector, with the pace of expansion the weakest since August 2011. Output, employment and input buying also eased as firms competed to gain clients.

Despite the slowdown, the non-hydrocarbon sector is an area to focus on. As oil remains near $30 per barrel and with liquidity conditions getting tightened in GCC economies, banks will continue to focus on the contract sector as it will be an enabler for non-hydrocarbon diversification. The GCC contract sector will witness activity on account of the emphasis of non-hydrocarbon diversification by fiscal policies. Dubai's 2016 budget has approved Dh16.6 billion for infrastructure, transport and economics — as the city prepares to host Expo 2020. Dubai is planning to maintain the size of its investments in infrastructure over the next five years.

Qatar state spend

Qatar's 2016 budget has earmarked 25 per cent of total expenditure amounting to QR50.6 billion for infrastructure projects, which includes railways, the new Doha port, several large roadways and the expansion of electricity, water and sewage networks. The Bahrain budget has projects spending estimated at BD465 million for 2016.



Construction workers stand on scaffolding at a building site in Dubai. The city plans to maintain the size of its investments in infrastructure over the next five years. — *Bloomberg*

Banks have faced significant challenges from the contract sector. Payments are released to contractors beyond the agreed time, even against consultant certified invoices. This, in turn, affects payment to sub-contractors and impacts project profitability.

There is also a reluctance to assign proceeds or give irrevocable assignment letters to financing banks. Without this, banks have no certainty on project cash receipts to appropriate for settlements.

Contractors are given site instructions but not authorised variation orders or time extensions. Yet, they are expected to complete works, else will be found in breach of contract. Banks are put into difficult situations in such instances, not knowing whether the variations/time extensions are in order. The contractor will need continued bank finance to complete the job.

Dh16.6b

assigned for infrastructure, transport projects in Dubai's 2016 budget

Despite the slow issuance of variation orders and variations of time, there are expectations of banks to extend performance and/or advance payment guarantees. There may be instances where main contractors have called on performance and advance payment guarantees even where projects have been substantially completed.

When disputes occur

Interdepartmental dependence and issues sometimes cause payments beyond timelines. Banks are a partner in the projects. However, in certain instances, they are the last to know of any concerns and disputes between the owner and contractor.

Despite having an assignment of proceeds, payments are sometimes made directly to sub-contractors, without the bank's previous knowledge and approval. Payment under certified invoices is sometimes short of their approved value. This is conducted without the bank's previous knowledge.

The above challenges have resulted in various disputes such as variation orders, extensions or variations of time, changes in design; resulting in cost escalation and time variation.

Disputes tend to have an adverse effect on project efficiency and timeliness of project completion, with no forum to settle differences which tend to eventually build up to detrimental issues.

The writer is the group CEO of Doha Bank. Views expressed are his own and do not reflect the newspaper's policy.