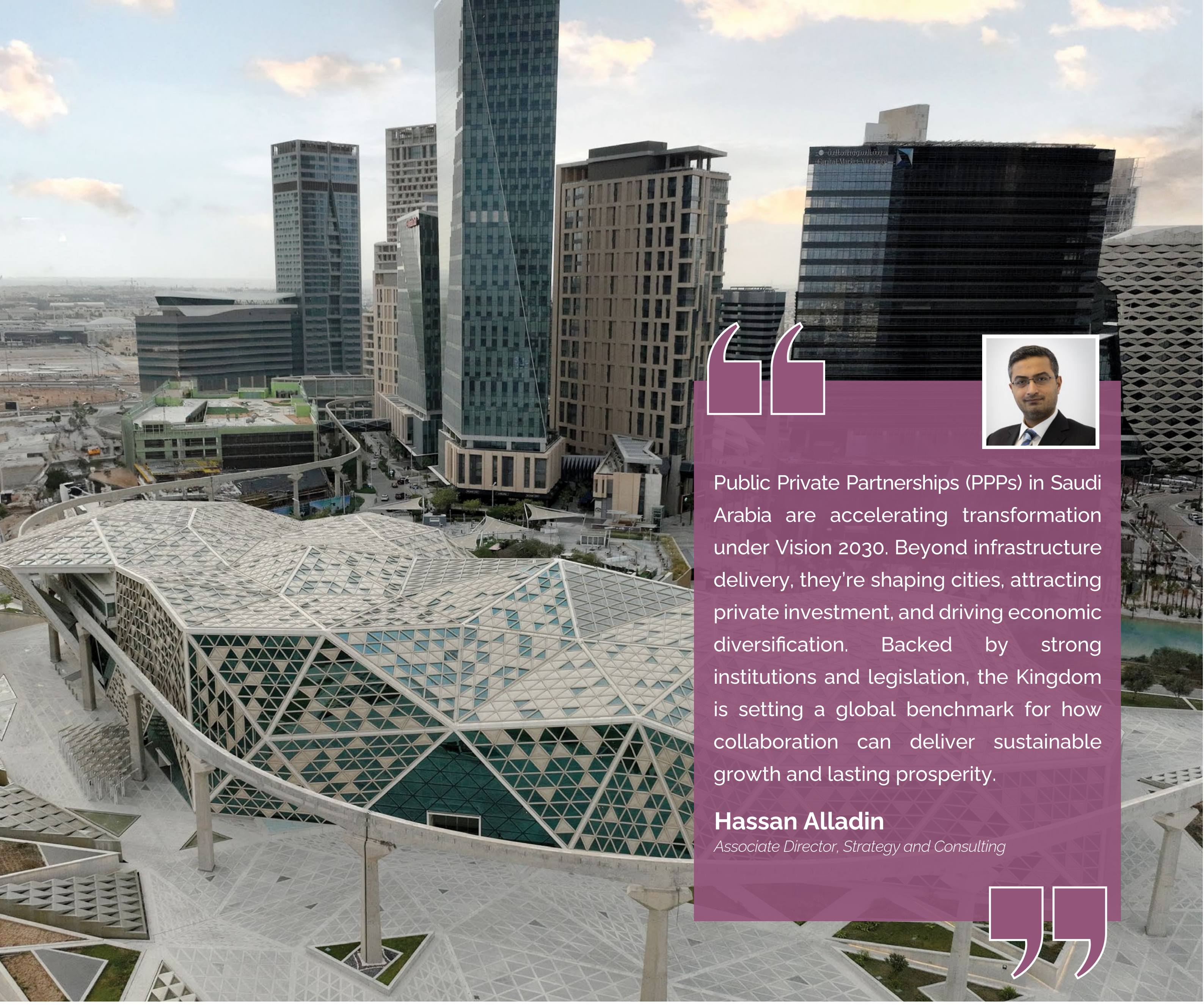
Cavendish Maxwell

Assessing the Role of Saudi Arabia's Public Private Partnership (PPP) Programme in Real Estate

OPINION



> Public Private Partnerships (PPPs) in Saudi Arabia are accelerating transformation under Vision 2030. Beyond infrastructure delivery, they're shaping cities, attracting private investment, and driving economic diversification. Backed by strong institutions and legislation, the Kingdom is setting a global benchmark for how collaboration can deliver sustainable growth and lasting prosperity.

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An immense commitment to Public Private Partnership (PPP)

There is no doubt that Saudi Arabia is now home to one of the world's largest and most successful Public Private Partnership (PPP) programmes. From early water and cogeneration projects (where gas-fired plants simultaneously produce electricity while capturing waste heat for industrial steam) launched in 2003, followed by electricity projects and the Prince Mohammad Bin Abdulaziz International Airport in Medina in 2011, there are now more than 200 projects active in sectors including water, healthcare, housing, energy and education.[1]

Institutional arrangements revolved around the creation of the National Center for Privatisation and PPP (NCP) in 2017 and, since 2021, have included specific procurement legislation, the Private Sector Participation (PSP) Law, which is under constant review.[2] Delivering infrastructure via PPP contracts with the private sector has become central to the diversification objectives of Vision 2030. This will no doubt remain key to future plans at the national level in the Kingdom.

Saudi Arabia is not employing PPP simply as a mechanism to push debt off the Government balance sheet, as it was in the past even in developed countries such as the UK before IFRS accounting standards for Government were tightened.[3] Nor is it being resorted to out of sheer necessity, as in the case of many developing countries with severely constrained budgets. Rather, PPP forms one aspect of an integrated programme of national development.

But, while this is part of a positive economic narrative, is it no more than background information? Or should real estate investors pay attention to specific projects? Yes, they should, because positive impacts on real estate markets are a specific objective of the Saudi PPP programme, the first time a Government globally has deliberately integrated PPP into a real estate and finance-driven diversification programme. So, what do investors need to pay attention to, and how should they go about it?

In what ways do PPP and real estate markets interact?

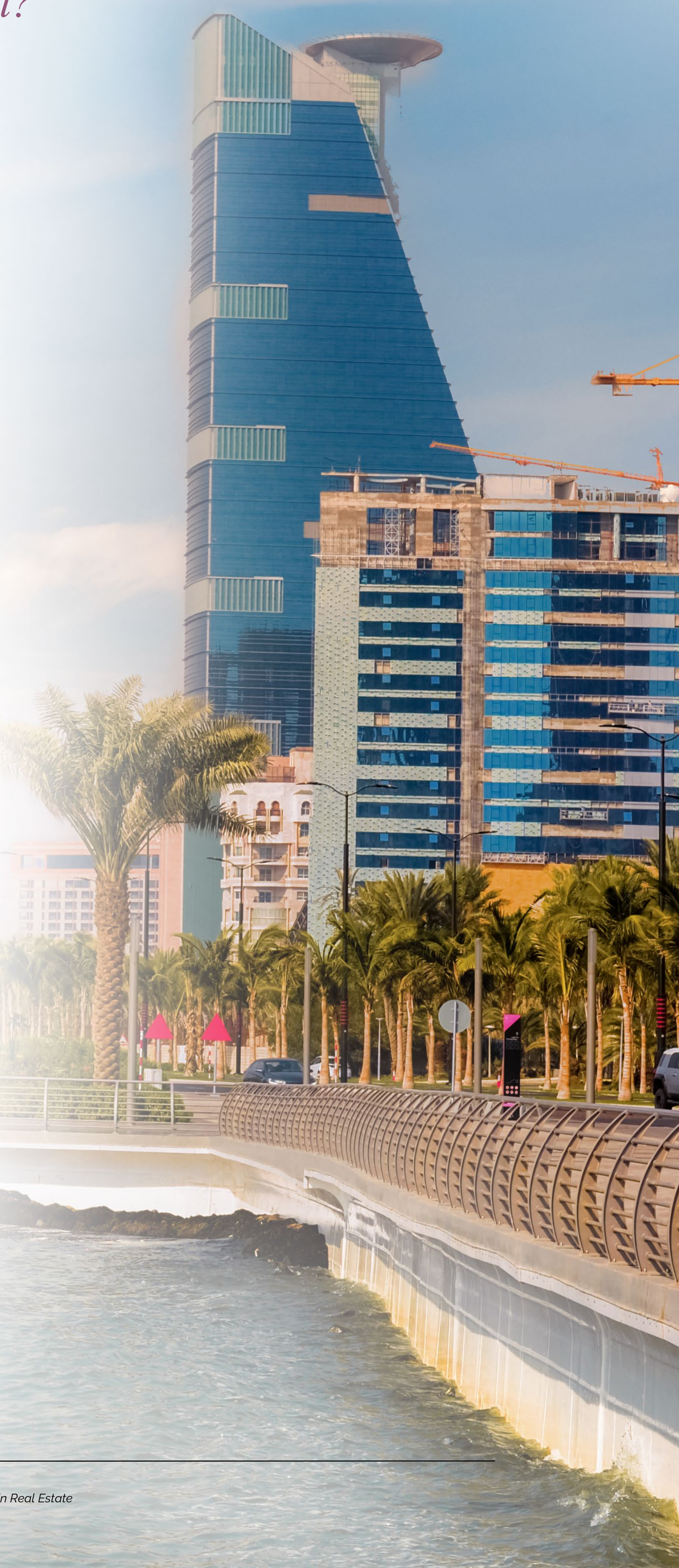
Most investors hold the intuitive conviction that infrastructure is essential for real estate markets to prosper. New cities, for example, need schools among a host of other requirements.[4] One would therefore expect infrastructure investment to be correlated positively with real estate market alpha (returns beyond the market benchmark, reflecting investment skill and strategy) and, indeed, there is evidence that it is, for example from China[5], where real estate investment near planned infrastructure has been shown to outperform market averages. The example of the Hong Kong metro extension is probably the most well-known: housing prices near stations rose 5–17%, and up to 30% with integrated design features like pedestrian access and retail connectivity.[6]

Beyond the impact of new transport links, however, there are three main reasons why quantifying the real estate impact of other PPPs is methodologically fraught.

- *Isolating the effect of the PPP from those of other variables (e.g. macroeconomic trends, zoning changes and demographic shifts) is problematic. While the construction aspect of PPPs is known to generate a multiplier effect in the context of overall employment,[7] the multiplier effect of specific PPP projects may not be sufficient to warrant separate modelling. Moreover, the effects may take a long time to materialise, even decades, by which time the causal link is blurred and the calculation of a multiplier effect problematic.*

- *Most available real estate data is not granular enough to highlight micro-market dynamics. Some researchers have attempted hedonic pricing models or difference-in-differences approaches, but results are often inconclusive or highly localised. This point is of especial importance given the highly localised impact of particular PPP projects.*

- *Some PPPs are themselves real estate projects. Urban real estate PPPs, such as those in Manchester in the UK, have already proved their capacity to deliver urban regeneration on a large scale. They help grow the economy and provide expanded opportunities for investors, as well as meeting the ever-growing demand for residential space in city centres, especially for young professionals and their families.[8] The multiplier effect of real estate PPPs is very real. On the other hand, such PPPs also require careful structuring such as joint ventures, eligibility criteria for owners and tenants, phasing and accurate pricing drawn up in consultation with private sector developers to avoid crowding out real estate investment by the private sector.*[9,10]



What then is the best approach to assess the dynamic of how the Saudi PPP and real estate markets interact?

Five points for investors to watch

Evidence suggests there are five main aspects of a PPP programme with which real estate investors need to be concerned.

• ***The question of scale.*** *For the most part, PPP projects can only influence real estate markets in line with their size and scale. A single waste-water treatment plant, such as the Juranah Strategic Water Reservoir PPP, exerts a positive influence over a local development and can enhance local content by increasing the localisation of business and human resources.[11] However, an entire port can play a decisive role in regenerating a city or even a region, as Saudi Arabia is seeing in the case of the Jeddah Islamic Port and the King Fahd Industrial Port.[12]*

• ***Geographical dispersion.*** *Because they are Government-driven, PPP projects can act as trailblazers for regional development. They can also contribute directly to development through the multiplier effects of their construction and operation. The Abha Airport PPP is an example of this effect. Investors can therefore look to regional PPP programmes as leading indicators of economic development. However, investors must recognise that the geographical and contextual variance of PPP projects affects their design and outcome significantly.[13] Blanket PPP budget data will not be useful for investors.*

• ***Project timing.*** *PPP projects can often take a long time to deliver the actual facility they are established to deliver. Investors must not make the mistake, however, of believing that the impact of a PPP project on real estate markets will only eventuate once the project comes on stream. On the contrary, the evidence points to the key benefits being concentrated around the time of the announcement of the PPP project – for example, in terms of private sector development announcements, price uplifts and lower capitalisation rates (often in that order).[14] The entire principle of value capture, where governments charge local landowners for price uplifts caused by the announcement of new transport routes and interchanges, using the funds raised as equity to inject into the projects, is based on precisely this timing lag.[15]*

• ***Types of project.*** *Not all PPP projects are created equal in terms of their impact on real estate markets. Transport infrastructure is known to be especially positive, with a greater effect shown in lower-income areas that exhibit greater reliance on public transport.[16] Moderate positive effects are observed with smart city projects, bonded warehouses and logistics and security centres. Others, although very necessary, such as prisons and water treatment plants are, if anything, disincentives to market growth through their effects on local markets, albeit only at the micro level. Finally, some PPP projects create real estate themselves, such as the Tanajib and NEOM housing PPPs which are delivering thousands of housing units for Saudi Aramco and the NEOM project itself, respectively.*

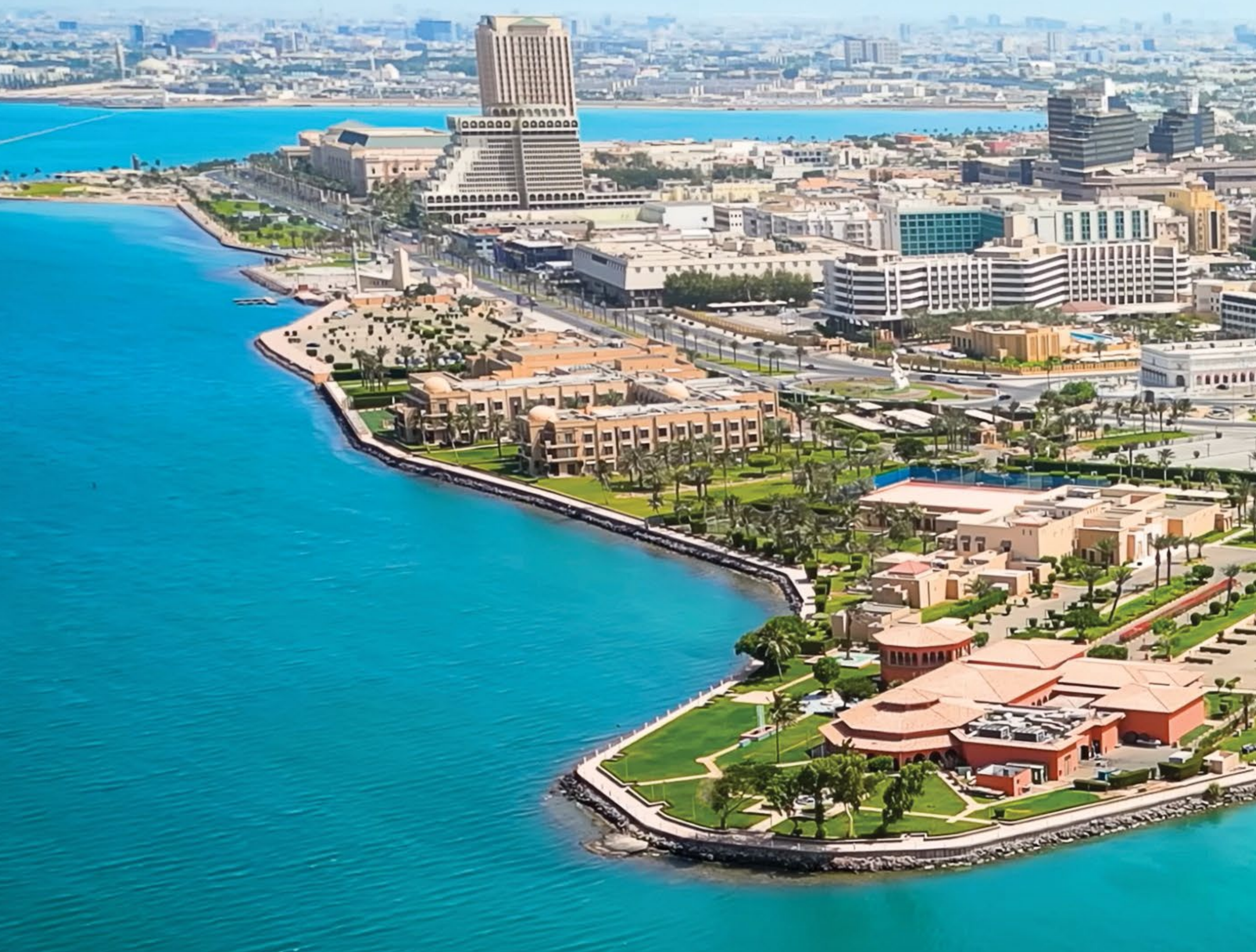
• ***Project structure.*** *It is easily forgotten amid the many successful PPPs in the Gulf that, worldwide, not all PPPs are successful. If they are poorly structured (as many early European PPPs were), especially in terms of risk allocation, then it is quite possible that they will not achieve their original objectives. Toll road risk transfer has proved especially problematic.[17] Government may even have to step in to take them over. Investors intending to hold physical property will always need to balance the prospect of immediate benefits at the time of the project announcement with the risks involved in delivery over the longer term.*

Each of these five analytical pillars can – and arguably should – feature in a market analysis of a city that features PPP projects. The role of the analyst or consultant is to decide upon the likelihood of the relevant PPPs achieving their goal within the stated timescale and the extent of the multiplier effect they will generate. Then, they need to take a view as to the practical facilitation the PPP permits (e.g. desalination plants and schools permitting population expansion, new train routes providing for commuting, or affordable housing PPPs opening the way to workforce deployment on related construction projects).

The result of the analysis may be presented quantitatively, especially if it is absolutely decisive, such as a bridge in relation to the value of island real estate, as has been suggested in the case of Abu Dhabi[18] or even, on a much larger scale, the potential of the Saudi Landbridge railway project connecting Riyadh and Jeddah.[19] However, this definitive and quantitative approach is rare: even in the case of the Hong Kong metro, forecasts were much more guarded than the most well-known analysis which, being retrospective, was able to ascertain the effect on real estate prices by comparison to other areas of the city through direct observation. More likely, however, the projected effect of the PPP is part of a broader market analysis in which it plays a part, such as in the case of the current wave of PPPs covering such sectors as hospitals and care homes in Riyadh and Jeddah.

Conclusions

Most real estate investors recognise in general terms that infrastructure projects are integral to fulfilling delivery of Saudi Vision 2030 in the Kingdom. This, in turn, is necessary to drive national economic success and, in turn, buoyant real estate markets. Experienced investors and the consultants such as Cavendish Maxwell who serve them go further, however, recognising that only by engaging in market research at a much more detailed level is it possible to acquire market knowledge at the required level of granularity for a specific real estate investment. The additional insights they gain demonstrate the benefit of including analysis of the nature, size and timing of PPP projects in the infrastructure piece of their overall real estate market analysis.



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