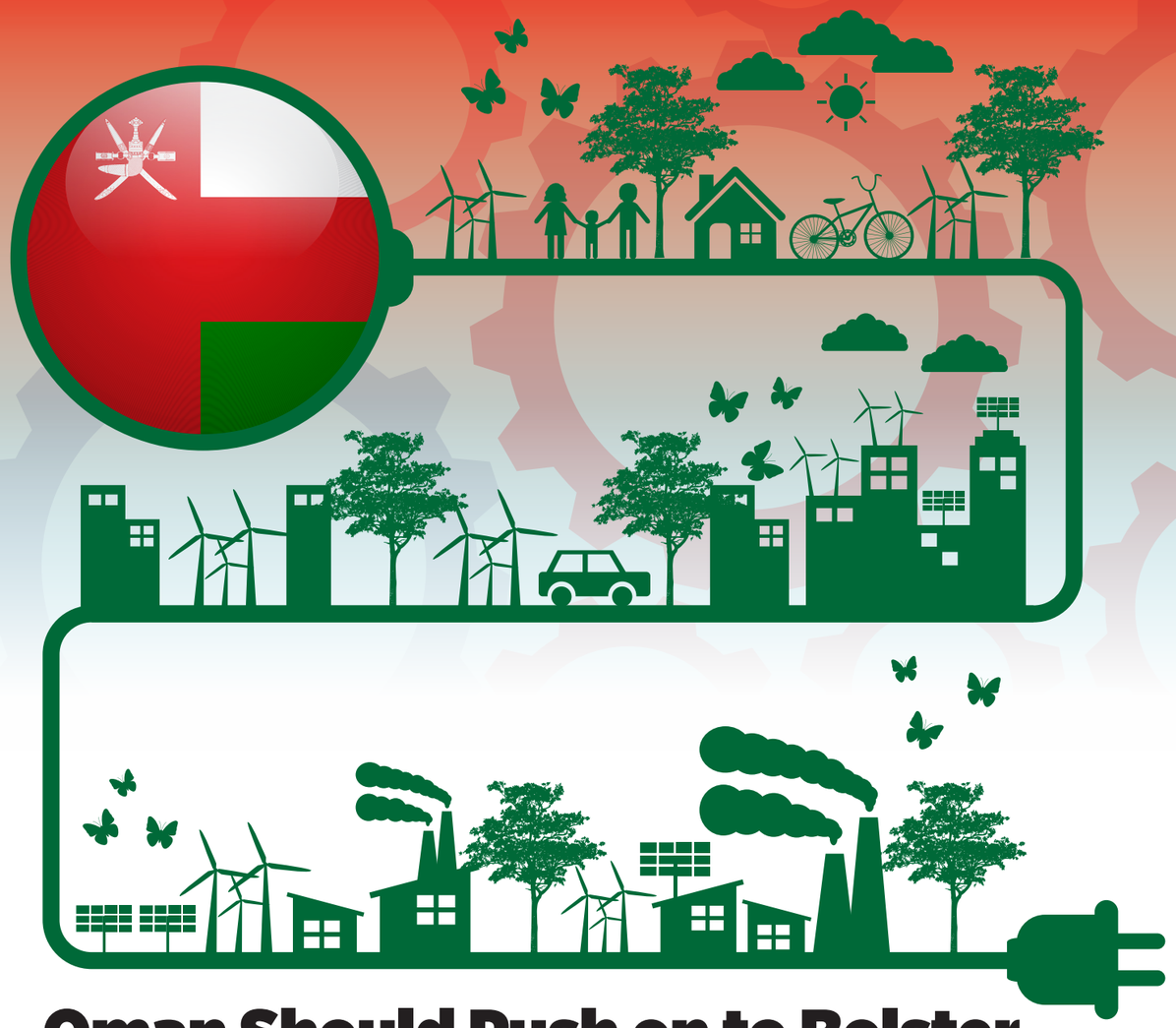

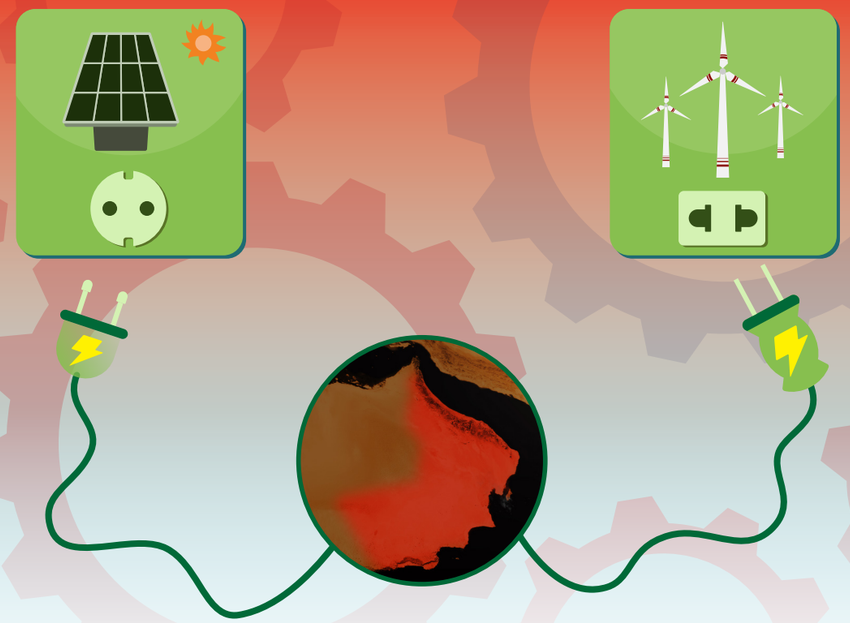

Oman Should Push on to Bolster Financial Architecture for Renewable Power & Electricity Spot Trading

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OMAN HAS MADE MUCH PROGRESS ON REGULATORY reform of the power sector and on putting in market structures, which leaves them readier than other GCC states for full privatization and segregation of distribution and generation.

The plan is to fully privatize generation, distribution and transition so that within 10 to 20 years it becomes a fully open spot market for trading power. There is potential that renewable projects could benefit from power trading but that would require government involvement together with the developer to garner the potential upside.

Oman was the first Gulf country to implement the Independent Power Producer (IPP) framework, and it's one of the few which has defied the odds and been able to execute these projects without sovereign guarantees because lenders trust the system.

We expect the rest of the GCC to follow suit and continue to expand the use of project finance to fund future power generation projects. Although these countries may be wealthier than Oman and rated higher by international credit rating agencies, they have had their own challenges in implementing IPP projects that need to be overcome to replicate fully Oman's success so far. on a wider scale.

Another investment obstacle for renewables is that as the cost of PV falls and gets more competitive, profit margins drop, so equity investors could lose interest in the lower returns. This becomes even more likely when alternatives like sovereign bond issues with high investment returns of 8%, are offered by the same countries trying to attract funds into their renewables sector.

It is important to align the deal structure with government regulatory requirements however it should not be dependent on public investment.

It is standard for there to be a direct agreement between the grid entities and the developer, but there is no responsibility on the Omani government for financing. Ever since Oman changed its sector law in 2004, everything has been externally funded by the private sector and that has relieved the government from otherwise having to invest about $10 billion.

The plan moving forward now for Oman is to fully privatize generation and distribution, and it will be necessary to get the financing structures right to achieve that. It can be difficult to accommodate different Export Credit Agencies (ECA) on the same deal --the Duqm refinery project that recently closed financing for example, was severely delayed because of trying to accommodate all its ECAs before bringing on the commercial banks.

The good thing about a competitive tender is that the market decides. There is a higher cost of finance, tax burden and cost of construction for renewables projects here and they do have to compete against hydrocarbon projects, which typically have a higher return. The utility industry by contrast is generally lower and renewables even more so.

But countries can create other incentives to sweeten the investment deal such as granting industrial zones a 'holiday period' on pay, not charging rent on land or removing taxes on imports of solar PV equipment as Jordan has done - these are all very simple things governments can do when tendering a project and that are now common practice.

In Oman for example, it is more financially attractive to have local partners because they don't have to pay withholding tax on their dividends. But, on that point, Oman needs to better align the disparity in withholding tax rates on renewable projects for different countries-- at the moment, it imposes none on the UK, 5% on China and 10% on the GCC.

And when it comes to extracting the best value from local industry, as an example, 50% of the cost of solar PV comes from the manufacture of panels, so it doesn't make sense for Oman to compete with a country like China, which produces over 90% of all solar panels worldwide. It would be more logical to focus on other parts that can be manufactured locally but which do not face fierce pricing competitiveness.

In Oman, there is a requirement that after you finish construction, within one year you have to IPO 40% of the project. So once the construction is completed and that risk is gone, if you can refinance the project, you can improve your profit margin and viability of the project.

The other scenario which sometimes encourages refinancing is if the economics of the country have improved during the project construction period. Developers can also opt to approach the existing pool of lenders and renegotiate. In Europe, 'green' bonds have attracted quite a lot of hype but not so far in this region. Here, we see more examples of institutions doing renewable projects, like the EBRD in Jordan and Lebanon and the IFC (World Bank) taking a 5% shareholding in ACWA Power because they like our renewables focus.