



مجلس الأعمال السعودي الأمريكي  
U.S.-Saudi Arabian Business Council



2017

**INDUSTRY SECTOR REPORT PROSPECTUS**

# Infrastructure Sector: Overview and Commercial Prospects in Saudi Arabian and U.S. Construction, Real Estate, and Transport

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Based on data from sources like Regional Economic Models Inc. (REMI) and the Middle East Economic Digest (MEED), we have incorporated novel analyses into a broader sector-level narrative on Saudi Arabian and U.S. infrastructure sectors. We are pleased to present a report highlighting trends, forecasts, government initiatives, major contract awards, and a spotlight of our member companies in the sector.

To obtain a complete copy of the report, please contact Danielle Wedde, Economic Business Analyst, at [dwedde@us-sabc.org](mailto:dwedde@us-sabc.org).

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# Executive Summary

Saudi Arabia's construction industry is the largest in the Middle East, shaped by a changing labor force and an expanding residential segment to meet growing demand for affordable housing. Historically, contracts with the Saudi Government have been a main driver of the construction sector, more so than free market drivers of the private sector, and so as government revenues have declined, new contracts have as well. While some contracts halted in 2016 due to lower oil prices in the region, a strong stream of projects are in the pipeline because of government stimulus. Payments to contractors and a larger 2017 budget allocation are factors positively contributing to sector recovery over the coming two years. The infrastructure sector proves paramount to Saudi Arabia's diversification as part of Vision 2030. Along with increased spending, the government aims to attract foreign private sector investment and to boost private sector partnerships (P3s) overall.

Megaprojects currently underway in Saudi Arabia create a foundation for new and ongoing projects for international design and consultancy services and a strong source of revenue inflows. Other opportunities will arise from private investment involvement with large foreign contractors.

Despite these emerging opportunities, there are some elements that may hold the sector back from expansion. In particular, heavy regulation may prevent the sector from realizing growth. There are not enough domestic workers to meet the labor force needs, so the sector depends heavily upon expatriate labor for work on large infrastructure projects. In this regard, government efforts to increase national employment and to limit immigrant workers may contribute to a shortage in terms of labor requirements. Additionally, production of building materials domestically may not be sufficient for the near future, so regional demand could in turn cause costs to rise for builders, diminishing margins.

As part of Vision 2030, the Saudi Government is expected to help diversify the economy through residential and non-residential building as the government prioritizes these projects. Residential growth continues to be driven by large demand for affordable housing. The Saudi Government is working to construct housing units for its citizens, and tax law changes aim to incentivize real estate developers to begin construction on empty plots. As the government establishes project management offices (PMOs), there may be a lag in beginning certain housing projects and other social projects such as healthcare. We expect the demand for residential and real estate to

continue along this trajectory, increasing by 38.3 percent by 2030 with a compound annual growth rate (CAGR) of 2.5 percent.

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In effort to boost investment in the nation's housing stock, Saudi Arabia's Capital Markets Authority approved rules for exchange-listed real estate funds in 2016. Real estate investment traded funds (REITs) were offered on the Tadawul to gather investment in various areas of real estate, and are subject to different rules than other forms of real estate ownership, making foreign investment in the sector more feasible.

As spending by the Saudi Government has slowed over the past year, the construction industry has been hit particularly hard, with impacts transcending the supply chains of these projects. However, given Saudi Arabia's longer-term goals of economic diversification, continued development of the nation's infrastructure will be a critical investment in the region's success. Since the Saudi Government has resumed payments to contractors and as work has continued on existing active projects, a large amount of work is set to be completed, creating jobs and leading to future prosperity. Our forecasts estimate that there were approximately 1.51 million private sector jobs in the Saudi construction sector in 2017.

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Documented increases in private sector activity and a growing number of public-private partnerships (P3s) is cause for optimism. In the face of slowed government spending over the past couple of years, Saudi Arabian construction companies have become more efficient, and advances in automation may only increase productivity in the sector. Growth in the market is expected in the medium to long term because of strain on existing infrastructure and increasing demand.

Following contraction of the market in 2016, the downturn appears to have ended momentarily for the infrastructure sector in the Kingdom. Large construction

and transportation contracts have already been awarded into 2017, demonstrating new market activity. We project that construction sector recovery will continue into 2018 with a modest 3 percent CAGR through 2030. In the near term, this growth is estimated to be approximately a 5 percent CAGR through 2020.

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Modest increases in oil prices, larger budget allocations for infrastructure, and resumed payments to contractors, evidence of private sector involvement, and expansion of Saudi Arabia's non-oil economy into 2017 are factors supporting growth of the Saudi infrastructure sector. By 2020, construction activities are expected to contribute \$42.2 billion to Saudi Arabia's economy, real estate and renting are expected to contribute \$44.9 billion, and transportation is expected to contribute \$32.5 billion to Saudi Arabia's economy. While awarded construction contracts largely declined in the first half of 2017 across the GCC, new contract awards saw a 12.3 percent year-on-year increase, totaling nearly \$16 billion for H1.

Even though transportation infrastructure saw slowed growth in contracts in 2016, transportation contracts have also picked up in 2017, especially for aviation. Some projects were significantly slowed, though not likely indefinitely cancelled, as these projects are critical for long-term growth prospects. Megaprojects in this sector will continue as planned, including work on expansion of King Abdulaziz International Airport, the Riyadh Metro, and the Makkah Metro. Substantial contracts have been awarded by the General Authority for Civil Aviation (GACA) and the Saudi Arabian Ministry of Transportation (MOT) throughout 2017 as the Saudi Government works to privatize airports and develop roads and transit systems under Vision 2030. For instance, GACA has awarded contracts for construction on Taif International Airport, Hail Domestic Airport, and upgrades for the King Khalid International Airport in Riyadh. We expect that the total demand for transportation will increase by 44.5 percent from 2017 to 2030 with a CAGR of 2.9 percent. Among the open transportation projects in Saudi Arabia as of 2017 Q2, rail comprised the largest share with 77 percent of contracts. Aviation projects accounted for 12 percent, roads and bridges accounted for 9 percent, and ports accounted for 2 percent.

Large contracts were awarded for the construction of energy and utilities infrastructure in 2016 and 2017

such as the award for industrial facilities at the Jizan IGCC Power Plant and the award for water transmission infrastructure from Shoaiba to Mina. Major projects that have been underway were continued such as the Shuqaiq Steam Power Plant in Jizan.

There was also a strong project pipeline for new power capacity in Saudi Arabia. As of Q2 2017, 24 percent of projects were in the pre-construction phase, and 76 percent of projects were under construction. The Saudi Electricity Company (SEC) and Saline Water Conversion Corporation (SWCC) have awarded billions of dollars for large contracts in 2017, such as the third phase for the Yanbu Power Plant. U.S. companies such as Jacobs Engineering, McDermott, and Honeywell continue to win major contracts in Saudi Arabian infrastructure, and there is an American presence throughout the sector.

In the U.S., opportunities underpin the challenges facing the country's infrastructure system because there is potential to further boost economic growth, increase efficiency, and generate interest of foreign and American innovators. As with Saudi Arabia, private financing options can help to close the gap in infrastructure needs while raising incentives to succeed.

Like Saudi Arabia, the private sector has a significant role in U.S. infrastructure projects, and this role may increase under the current U.S. administration's initiatives, diversified financing, new P3 initiatives, and replication of successful private company involvement already completed or underway.

Despite aging U.S. structures, and the challenges faced with a growing infrastructure gap, the U.S. market also has many strengths. The U.S. infrastructure market is the second largest globally, and supported by high quality credit and a robust municipal bond market. A great deal of freedom exists at the local level in terms of project priority, and there is a growing framework for P3s. Many states, including Virginia, have already successfully partnered with companies for the design of highway systems.

In both the United States and Saudi Arabia, investment in infrastructure impacts both individuals and businesses alike. Strategic investment in the efficient delivery of energy, efficient and safe transport of people and goods, increased connectivity, and rebuilding of deteriorating infrastructure are essential to increasing national competitiveness and productivity. Not only do these investments directly affect the infrastructure industries in question, but they also create a foundation for broader economic expansion, underscoring economic outputs across the economy.

## Selected Infrastructure Sector Trends

- A year-on-year increase in new Saudi Arabian contract awards in 2017, compared with other Gulf countries that saw contraction during the year.
- Increased awards to international consultancy and engineering firms on large Saudi Arabian infrastructure projects.
- Continued adjustment to Saudization by Saudi firms through training and development programs.
- The General Authority for Civil Aviation's continued privatization of Saudi Arabia's airports.
- High 2017 activity for new awards in Saudi Arabia's construction segment. A development pipeline dominated by transportation segment projects, especially land transport and aviation. Expansion of industrial seaport capacity to meet rising demand of throughput.
- Domestic and international capital market debt as a new source of funding for government-backed projects.
- Overall price declines for raw materials used in the Kingdom's construction market.
- More productive labor, especially in the transport segment.
- Increased capacity and efficiency of infrastructure in Saudi Arabia – supporting a burgeoning tourism industry, international investment across multiple sectors, and higher labor productivity.
- Industrial construction across areas like manufacturing and metal and minerals providing an increasing share of future opportunities as the Kingdom works to diversify its industrial base.
- Declines in prices for Saudi Arabian real estate, especially for commercial property, residential plots, and apartments.
- Large increases in residential real estate demand. Expanded initiatives from the Saudi Government to provide citizens with affordable housing options. Contribution of the residential segment constrained by low values of contracts compared with industrial building.
- Greater opportunities for foreign investment in Saudi Arabian real estate through the creation of Real Estate Investment Trusts (REITs), and greater financing options for construction projects.
- U.S. firms leading foreign firms for building and transport projects in Saudi Arabia, but South Korea leading for energy and utilities projects.
- A move towards private sector partnerships in U.S. infrastructure projects, especially at the state level.
- Increases in U.S. building in power, office, and educational facilities.
- Large demand and value-added from construction activities in California, Texas, Florida, Illinois, and Pennsylvania.



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