REUTERS/HAMAD I MOHAMMED

IN BAHRAIN, A SYMBOL AT THE HEART OF REVOLT

Bahrain's Gulf Finance House sold hugely marked-up property projects to investors. Then the market crashed

BY FREDERIK RICHTER AND MARTIN DE SA'PINTO
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UNTIL A FEW MONTHS ago, the twin towers of the Bahrain Financial Harbour development -- clad in green glass and shaped like over-sized toy sea-horses -- were symbols of the island state's role as a regional financial hub.

Today the towers have taken on a different significance: concrete expressions of the way business and politics so often merge in the Gulf and, as a result, targets in the unrest that has roiled Bahrain and the wider Middle East since the beginning of the year.

Built by Gulf Finance House, a listed investment company run by Bahraini businessman Esam Janahi, the towers have also come to embody the ruling al-Khalifa family's fight to preserve its power and protect the vast wealth of the country's economic elite.

Land in the Gulf Arab region is largely controlled by a small number of ruling families who use it as a kind of currency, doling out plots to favoured families and developers to forge political relationships and make money. For it to work, the system depends on businessmen like Janahi, merchants who ostensibly operate independently from the state but whose success rests, at least in part, on political connections.

Janahi, whose net worth local bankers estimate was several hundred million dollars before the global financial crisis, used his close ties to the al-Khalifas to build the centrepiece of the Bahrain Financial Harbour. He could then point to that as a model to help secure further land deals from rulers and governments across the Middle East and as far away as India, convincing investors to put up billions of dollars for property projects, most of which have never been built.

GFH was far from the only firm to turn sand into money. The basic game plan was played out dozens of times by various companies across the Gulf in the past decade or so. But Janahi and his firm were among the biggest.

Janahi did not respond to a request for an interview for this story, but a GFH spokeswoman answered questions by email. Reuters also interviewed almost a dozen bankers who work or have worked in the Gulf region, most of whom have direct knowledge of GFH transactions.

MAIN MAN: Gulf Finance House Chairman Esam Janahi announces a project in August 2008. **REUTERS/HAMAD I MOHAMMED**

Our investigation shows the company charged investors huge markups on land deals and took out enormous up-front fees. Such fees are legal in the Gulf but western bankers say they would be highly unusual in Europe or the United States, where the industry collects big payouts only when a project is successfully built and sold.

Documents obtained by Reuters show that GFH, which has teetered on the brink of collapse for several months, also sometimes shifted investor money from one project to plug holes in another.

The documents also suggest that GFH's property projects were hurt by blurred lines between the personal interests of Janahi and GFH itself. Investments and payments seemed to move back and forth between the two with very little scrutiny.

Investors in GFH have been left with huge losses -- $1.07 billion in 2009 and 2010 -- and plenty of questions about whether the company's myriad projects were ever going to be built in the first place.

In Bahrain, where the ruling family has been involved in several property developments over the past decade, it's become a symbol to ordinary people -- especially the poor Shiite majority -- angry about a system that shuts them out and widens already gaping inequalities.

When thousands of anti-government demonstrators failed to win tangible concessions from the government earlier this year, a small group singled out the BFH towers, blocking the main road outside the building (which also houses Reuters' Bahrain bureau) and waving one-dinar notes to highlight how cheaply they said the country's prime minister had acquired the building.

"We're expanding our protests and we came here because this building symbolises (the inequalities of) the whole economy," one protester told Reuters outside BFH in March, the pavement around him littered with stones and makeshift barricades after hours-long tear gas battles with security forces.

THE BOOM

ESAM JANAHI WAS RELATIVELY unknown before he founded GFH, way back in the pre-oil boom era of 1999. Armed with a degree in business administration from Hull University in the United Kingdom and an uncanny ability to navigate the Gulf's political and business elites, he quickly began pulling off deals, each one seemingly bigger than the last.

Blessed with boyish looks and what many who have met him describe as real charm, Janahi won financial backing from around the region, including from a clutch of private investors in Kuwait, the Royal Guards of Oman pension fund and the Saudi-based Islamic Development Bank.

The oil boom that began in late 2002 kicked off a six-year economic expansion that transformed the region. In Bahrain, which sits just off Saudi Arabia's east coast and is connected to its much bigger neighbour by a 25 km (16 mile) causeway, new skyscrapers shot up and several sq km of land were reclaimed and added to its northern shore.

The new land was designed to host projects built by private firms such as GFH. It also turned into a source of revenue for the ruling al-Khalifa family.

Like other Gulf rulers, the al-Khalifas control most of their country's land. Documents from Bahrain's business registry show that using a complicated series of companies, the royal family partnered with private-sector developers in several projects.

The Bahrain Financial Harbour was one such project. A copy of a property deed -- obtained by Bahrain's main Shi'ite opposition group Wefaq and handed to reporters in March -- shows that the Ministry of Finance transferred the land on which GFH built its towers to the Bahrain Financial Harbour Company in 2003. Bankers with knowledge of the deal say Prime Minister Sheikh Khalifa bin Salman al-Khalifa, who has governed Bahrain since independence four decades ago, granted the land in return for a 50 percent stake in the project. The other 50 percent was owned by GFH.

The prime minister's stake was held through an investment vehicle called Emar Bahrain, according to bankers with direct knowledge of the matter. There are no commercial registry entries for Emar Bahrain, but the business registry shows the chairman of Bahrain Financial Harbour Company is Sheikh Rashid Khalifa Hamad al-Khalifa, a high-ranking official in Bahrain's interior ministry, who is married to the prime minister's daughter.

A second document obtained by the opposition and passed to reporters shows how Prime Minister al-Khalifa may have personally benefited from the deal. In 2005, according to the sales contract, Emar Bahrain transferred a parcel of land to the prime minister for one Bahraini dinar, or less than $3. The prime minister's office has told the Bahrain News Agency all transactions were legal and that the company received land elsewhere in return as compensation.

Even before the Financial Harbour deal, Janahi had close connections to Bahrain's rulers. "He had a diplomatic passport," said someone who has done business with Janahi and has intimate knowledge of GFH. "He was a member of the shura council" -- Bahrain's upper house of parliament whose 40 members are appointed by the king. The development deal cemented those ties, and helped open more doors around the Middle East.

In response to questions, GFH said it had 10 successful years before the financial crisis hit investment firms around the globe. It says it was the first firm to partner with governments in the region on real estate and infrastructure projects.

"Indeed, Esam Janahi and other Executive Management members do hold valuable relationships with regional governments which were a direct result of spearheading GFH," the company said in an email. It went on to point out the "impressive track record that GFH showed in creating opportunities and unlocking value in emerging markets".

GRAFFITI: A protester writes on a photo of Bahraini Prime Minister Sheikh Khalifa Bin Salman Al Khalifa in February. Thousands of anti-government demonstraters took to the streets earlier this year.
REUTERS/CAREN FIROUZ

THE MODEL

DURING GFH'S BUSIEST years -- between 2006, when the Financial Harbour towers neared completion, and 2008, just before the Gulf's real estate crash -- the company used the towers as a signature project to negotiate more land deals with heads of state and governments elsewhere in the region.

"It's not something that was openly advertised, but they would brag about how they were getting the land for next-to- nothing, and about how they were making huge sums of money," said a Gulf-based banker who had a business relationship with GFH and spoke on condition of anonymity.

The model was simple. "You basically go and cut a deal with your buddies in Morocco, or Egypt, Tunisia, Syria," said a senior investment banker in Bahrain. Having paid very little for a parcel of land "they (GFH) would go over to investors and mark it up by something like 40 percent, in some cases even more, and sell it." Other bankers and two senior company insiders confirmed such a markup was typical at the company.

GFH was not alone in this practice. Bahrain-based investment bankers say it was common practice for Bahraini investment firms to add huge mark-ups to the value of a plot of land or company they had bought cheaply before selling it on to investors. Companies in Dubai, Abu Dhabi, Qatar and elsewhere did the same thing.

"The returns could reach up to 200 percent," said an investment banker who worked at a Bahraini investment firm affiliated with Esam Janahi, and who also asked to remain anonymous.

The mark-ups meant investors initially owned something worth less than what they had paid for it, an anomaly that most hardly noticed as long as property values kept rising.

It was also common practice for GFH to book massive up-front fees on the money they raised from investors. In some cases, real estate projects were split into several phases so that fees could be collected each time investor money was rolled over into the next phase, according to Bahraini bankers.

Such an arrangement is highly unusual outside the Gulf, according to people who work in the industry in Europe and the United States. Management fees charged by private equity houses and asset managers in other parts of the world are typically modest.

GFH does not dispute that it charged fees at the start of its projects. "GFH's business model did utilise upfront fees in addition to management and success fees, as did many institutions," it said in its statement to Reuters.

PROBLEMS

LOCAL BANKERS ESTIMATE GFH raised a total of $5 billion between 2002 and today: much of that money is still locked up in unfinished projects.

One such project, on about 1,750 acres of land outside Mumbai, India, was unveiled in late 2007. It is unclear what GFH paid for the land, but it seemed to have no problem selling the project -- a massive business and residential complex targeting international companies -- to private individuals around the Gulf.

An internal GFH document seen by Reuters and verified by four former insiders shows that by September 2009, GFH and Abu Dhabi Investment House (ADIH), a company run by Janahi's brother Rashad, had jointly raised $1.1 billion for the project. After up-front fees and commissions had been taken out, only about 25 percent of that money reached the Mumbai project, according to the document.

Additional documents seen by Reuters show other GFH projects had similar fees deducted. In July 2008, for example, GFH said that its second-quarter earnings had come mostly from fees on real estate projects, in particular a project in Libya.

An investor in that project, known as Energy City Libya, told Reuters two months ago that he had completely written off his investment as no visible progress had been made and he no longer expected the project to be completed. Progress has been slow in Mumbai as well.

GFH says it is committed to completing all of its projects and that it has signed an agreement with a new partner to complete the land acquisition in Mumbai and begin work.

MONEY SHIFTERS

THE MUMBAI PROJECT illustrates another aspect of the way GFH did business. The internal document shows that the $1.1 billion earmarked for India included money that was meant to come from a separate GFH project in Qatar.

GFH claims that it offered investors in the Qatar Energy City project the option of rolling their funds into the Mumbai project.

But a letter sent by GFH to one investor in January this year showed the company could not collect sufficient funds to complete the roll-over.

GFH also wrote that the decision by FIFA to give Qatar the 2022 football World Cup raised other possibilities. Perhaps investors would prefer to shift their funds into a new project structure in Qatar instead?

Shifting money between projects was pivotal to the way GFH operated. GFH "was a monoline business focused on originating new real estate projects, not completing old ones," said a former company insider who did not wish to be named.

"They didn't have enough money to complete the old projects once they had sucked out all their commissions -- they sold them on to related parties, generating even more commissions -- so they had to keep coming up with new ones," he said.

While it lasted, skyrocketing property prices hid the markups and the fees. But when the global financial crisis hit in late 2008, property prices in the region collapsed.

AN ACCOUNT WITH GOD

IN A COURTROOM IN Manama last September, Janahi waited as ordinary families trooped before a judge to settle their disputes. When his turn came, the tall, heavyset businessman stepped forward, arranged his meticulously starched white head-dress and took an oath on a golden-framed copy of the Holy Quran.

The ceremony came when the court could not decide if his version of a $250 million business deal gone sour was real.

After his many property projects had begun to run out of funds in early 2009, investors and business partners lined up to question the integrity of GFH's business model.

One man in particular pointed a finger: Qatari businessman Khaled al-Suweidi, who accused Janahi of using him to gain access to land needed for a proposed "energy city" in Qatar and then reneging on a promise to share an expected $250 million in profit.

Registry documents show that Janahi and Suweidi did jointly register a company in the Cayman Islands. But Suweidi lacked sufficient proof of a financial agreement -- hardly surprising in a region where multi-billion projects are often agreed with minimal

WHOSE MONEY IS IT ANYWAY?

BY FREDERIK RICHTER

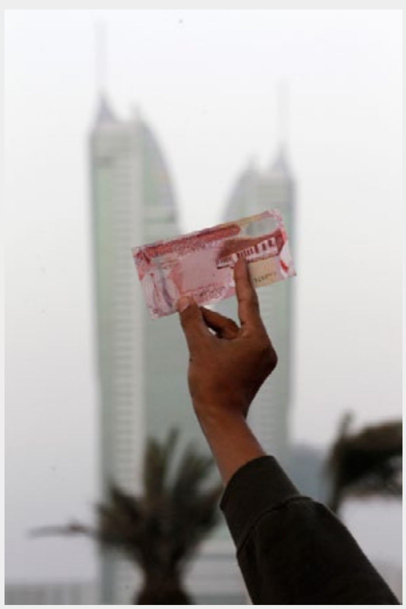
As with many Gulf-based firms it's difficult to find a strong dividing line between GFH's finances and the personal accounts of its senior managers.

GFH began life as a private equity company. Over the years it created dozens of financial services and real estate companies (and even a coffee shop chain) that funded each other and for which it brought in investors that it then charged fees.

One of the largest banks the company created was First Energy Bank (FEB), for which it raised $1 billion in capital in 2008, mostly from shareholders in Abu Dhabi and Libya. The company was established to invest in energy projects in the Middle East.

From the beginning, Esam Janahi held a 10 percent stake in FEB, which two inside sources have told Reuters he received as a commission, although that is not substantiated by documents that Reuters has seen. He sold his stake last October and used the proceeds to pay back $50 million GFH owed FEB, according to two bankers with direct knowledge of the transaction.

"Paying back the money from his own pocket was part of the stake sale agreement from the very beginning," one of the bankers said. "The central bank and people even higher up (in the government) wanted him to personally sort out the mess he's left behind."



CURRENCY WAR: A protester holds a Bahraini Dinar in Manama, March 5, 2011. Protesters say the buildings in the Bahrain Financial Harbour (background) were sold to Prime Minister Sheikh Khalifa Bin Salman Al-Khalifa for that amount. **REUTERS/HAMAD I MOHAMMED**

A former employee at a company involved in GFH's many proposed "energy cities" around the region said they were opaque. "Esam Janahi has set up many companies, an energy city here, an energy city there, and they all somehow hold stakes in each other. It's one big mess," said the source.

Corporate governance at GFH was weak to non-existent, according to Bahraini bankers and former GFH employees. They say Janahi was the dominant figure at GFH and information at the firm was guarded by his small entourage. A former GFH executive said he only rarely had access to Janahi and this group of people, which was so isolated that it amounted to a management team within the official management team.

"We learned about many deals and decisions just by looking at the screens," the source told Reuters.

Bankers say things were further complicated because GFH often made investments with firms controlled by Janahi's brothers. Khalid Abdulla-Janahi was the Chairman of Bahraini investment firm Ithmaar <ITHMR.BH>, before he was demoted by its main Saudi shareholder in early 2010, after heavy losses and a Reuters report that revealed financial stress at a Geneva-based subsidiary.

"There were so many affiliates (at GFH). Management sold their stakes without telling us -- we didn't know, 'Is this your money or my money?'" said the former GFH executive.

GFH says it has offered stakes in its projects to employees and board members to align their interests with those of the investors. "This is a normal practice across all investment banks," it said.

documentation.

By the time of Janahi's court appearance, Bahraini Prime Minister al-Khalifa had already made up his mind about his one-time business partner. In May 2010, he seized full ownership of Bahrain Financial Harbour and cut ties with Janahi. In return for a chunk of prime property that had been valued at $175 million during the boom years, GFH received $40 million in cash and a few plots of land.

Unable to pay its debts, the company's balance sheet fell below the regulator's capital adequacy ratios at the end of last September. The firm has since raised just over a fifth of the $500 million it has targeted in fresh capital to cover losses.

NO SCRUTINY

ONE OF THE REASONS the company is still creaking on, argue critics of Bahrain's government, is that Janahi's ties to the prime minister allowed him to escape the scrutiny of the country's regulator, the Central Bank of Bahrain (CBB).

"Janahi did business with the prime minister who was just beyond the (influence of) the CBB," said the former business associate with intimate knowledge of GFH.

The central bank did not force GFH to disclose the departure of its CEO Ted Pretty in February, a piece of news that would be seen as important and market-moving in other jurisdictions. And when last year GFH's auditors said the firm no longer complied with the regulator's minimum capital adequacy requirements, the CBB did nothing -- at least publicly.

The CBB rejects that criticism. It said in a statement to Reuters that Bahraini law "gives the CBB legal, operational and financial independence so that it may undertake protecting the interests of depositors and customers of financial institutions without interference from any third parties."

The central bank also said that booking up-front fees was legal under the international regulatory standards it applies as long as they are disclosed to investors, but that it had nevertheless discouraged the practice. Confidentiality provisions prevented it from commenting on GFH specifically, it added.

Western bankers still think the CBB is one of the best in the Gulf, though central banks in the region generally lack independence from ruling families.

Investors in GFH, though, are livid with the regulators.

"The central bank and the ministries we have spoken to, they're not taking any decision… they just said go to the courts," said Mohammed Boodai, a prominent Kuwaiti businessman who had several million dollars invested with GFH. "We want a real auditor coming from the outside to check the papers and documents they have got there."

MARTIAL LAW

GFH IS AS MUCH SYMPTOM as cause of the region's malaise. Protestors in Bahrain -- most of them members of the country's poor Shi'ite majority -- have called for the ouster of the ruling family and an end to the system which allows companies like GFH to prosper.

At the heart of the protestors' complaints: economic inequality and land ownership. The region's business and political elites cashed in during the economic boom, but few others benefited.

"I still live with my entire family in a small flat. This palace is bigger than my entire village," a protester told Reuters on the same March day when more than 10,000 protesters trooped by several km of royal estate covered with palm tree gardens.

Intended to be a fully fledged financial district, Bahrain's Financial Harbour is now little more than two partially occupied business blocks. Most of the few shops that opened in the shopping mall between the towers have closed in recent months.

Janahi still lives in Bahrain. One former insider says he doesn't travel much anymore.

When anti-government demonstrators blocked the road outside the buildings in March, the government declared martial law and the country's neighbours, including regional heavyweight Saudi Arabia, sent in troops to help put down the unrest.

The armoured personnel carriers and soldiers surrounded the Financial Harbour for the next two months.

(Frederik Richter reported from Manama, Martin da Sa'Pinto from Zurich; Additional reporting by Sarah White in London; editing by Simon Robinson and Sara Ledwith)

COVER PHOTO: An anti-government protester at a roadblock near the Bahrain Financial Harbour in Manama in March. **REUTERS/HAMAD I MOHAMMED**

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