

COMMITMENT TO THE LONG TERM UAE VISION REMAINS



Despite the clear impact of the global financial crisis on the UAE, the long term vision for the country continues to be the main focus of the UAE Government. Market fundamentals remain intact for the UAE to maintain its position as a business, cultural, tourism and logistics hub for the whole GCC region

GDP growth for 2010 has been slower than expected, at a rate of 2.4%, with problems caused by depressed oil prices and lack of financial liquidity. There remains a commitment to deliver the 'Abu Dhabi 2030 Vision', but the priority is to meet immediate demand, complete projects already under construction and progress those projects with long term benefits to the UAE.

The development of Abu Dhabi's social infrastructure agenda remains a key element of the medium term plan with continued investment in the health and education sectors. Sustainable energy development in the Emirates is a key focus as the drive continues towards reduced reliance on natural oil reserves.

The development of a modern and affordable transport system remains a vital part of Abu Dhabi's plans. However, the majority of transport projects are still in design stage and some public transport improvements have already been stopped or deferred due to the changes to predicted demand/population growth.

The residential and commercial markets have witnessed a continued downward trend throughout 2010, which is unlikely to improve in 2011 due to further supply entering the market in the next six to 12 months. There is likely to be further pressure on rental levels, but there remains a consistent unrealised demand for quality residential and commercial space.

UAE is well placed to continue its dominance as the region's leading logistics and tourism hub - other regional markets continue to act as competition to the Emirates' growth and the challenge remains to maximise the opportunity of the current climate and emerge stronger.

A Considered Approach

The effect of the crash, in late 2008, was an immediate change in contracting and procurement practices, from a 'build it fast' priority to 'value for money' priority. The contracting and consulting supply chain has now stabilised and compressed to meet the market demands, which is more focused on clients' time, cost and quality aspirations.

Owners of completed properties are increasingly focused on operational costs associated with assets and the need to differentiate to retain market value. The inherent central costs levied upon tenants/owners for services and energy are being considered throughout the asset lifecycle, tackling issues such as:

- The structure of charges associated with district cooling
- Property maintenance costs (external cleaning and security for instance) dramatically vary dependent on the basic design features and arrangements of the building
- The design life of key items of plant and equipment in multi-user buildings
- The management of warranties, and the importance of effective planned maintenance from the date of building completion, are getting better recognition as a factor of asset value in the medium to long term
- Differentiation of product by cost in use, location and functionality now feature highly in a tenant's consideration and those assets that meet these criteria will differentiate in the market.

Be ready when the finance is there

Whether an economy, a master developer or a rail authority, you need to be ready when the finance is available. It is essential to make projects attractive to investors by optimising asset performance and providing security of investment. The increased level of governance around lending from banks has increased dramatically in the last 18 months and with the expense of raising debt, it is essential to attract affordable finance to meet clients' business aspirations.

Key steps to achieving success include:

1. Identify the best time to buy

Whilst a window of opportunity exists to maximise the benefit of the downturn of construction costs, the usual caveats still apply to purely selecting on cheapest price; 'buy now pay later' will become a risk as the prospect of claims and insolvencies start to gather pace from the supply chain.

2. Recognise the view on out-turn viability

Developers, investors and banks need to recognise a view on out-turn costs and overall project viability, rather than current day costs and current day values to ensure commercial success of projects.

3. Identify points of market differentiation

Understanding your customers and their needs will allow the differentiation of your product within a competitive market. The identification of best time for delivery of product to the market will deliver benefits from rising demand against lagging increase in construction prices.

4. Organising your business for market recovery

Businesses will need to be flexible to be able to respond and meet the needs of the future market. Right sizing of the organisation to fit a revised portfolio of projects is essential, as is establishing clear roles and responsibilities to ensure ownership and accountability.

5. To be the best, work with the best

The fight for talent and expertise will become a challenge for businesses, and those companies with a more sustainable approach to people and resource management will ultimately succeed as the recovery takes shape.

6. Take a controlled approach to cash-flow expenditure

Restrictive cash lending leads to an increased need of security of investment. With a drive for more effective and knowledge based business decisions for built asset portfolios, the need for project due diligence, governance and strict management of cash flow is required. Prediction and linking time of delivery to cost is key to effective control and the development completion.

7. Identify appropriate procurement strategies

Developers and investors will need a realistic approach to buying strategies and allocation of risk. Everything should be reviewed from the procurement strategy, contracts and selection of the supply chain to drive out waste and improve efficiency. Clear identification of business needs are required and risk should be apportioned to the party that has the ability to carry it.

8. Flexible approach in purchasing strategies

Purchasing and contracting strategies need to be developed whilst maintaining flexibility in a recovering market and seeking solutions where positive business results are achieved. There is, and will be, a much more assertive approach to debt collection and contractual management as all parties protect their own commercial interests.

9. Effectively manage and mitigate risk through effective project controls

In an increasingly litigious market, evidence suggests that in an upturn, a much more commercially assertive approach will be taken by contractors and suppliers. Project controls are needed to manage time, cost and quality with the ability to report on real time basis and allow for effective business decisions throughout the project.

10. Proactive asset management and planned maintenance

A whole life cycle approach to development is required with a view on operating costs, not just construction costs. Having proactive maintenance techniques written into contract terms will ensure long term asset efficiency and greater value from asset ownership and operation.

A New Way of Working

The downturn in the construction market has seen employers return to more traditional approaches to the procurement of construction projects. When the market was booming, speed to site was the primary driver as was securing the right contractors and consultants.

This led to a move towards innovative procurement routes with a two stage process engaging the contractor earlier in the project becoming common. We also saw partnering and cost reimbursable contracts coming into use as contractors were able to influence the procurement and contract strategy.

We are now back into a buyers' market and employers are now reverting back to their traditional approach, with lump sum fixed priced contracts based on the FIDIC forms of contract once again becoming the norm.

Employers with money are using the downturn in the market to create contracting arrangements that are moving considerable risk to the contractors. Bid Bonds, on demand Performance Bonds, 10% retention and extended payment terms are all commonplace. As the contractors are hungry for work they are having to accept terms and conditions far more onerous than they would have before and are not able to fully price the risks they are being made to carry, for fear of becoming too expensive in what is an extremely competitive market.

Whilst many employers feel that they are getting great deals at the moment, there is real concern that many will benefit in the short term with low tender prices but will eventually pay later. The reality is that contractors, like any business, cannot afford to lose money so they will have to seek ways of making the projects deliver a return.

When we saw similar behaviours during the last recession we were left with a litany of claims and disputes as contractors either failed to perform to time or quality or aggressively pursued variations and claims.

Employers need to be on their guard in such a market and make sure they have the right contractor at the right price, and that they proactively manage their projects to ensure they end up with a successful project delivered to time and quality rather than in a protracted war of attrition where the only winners are the lawyers.

Construction price index

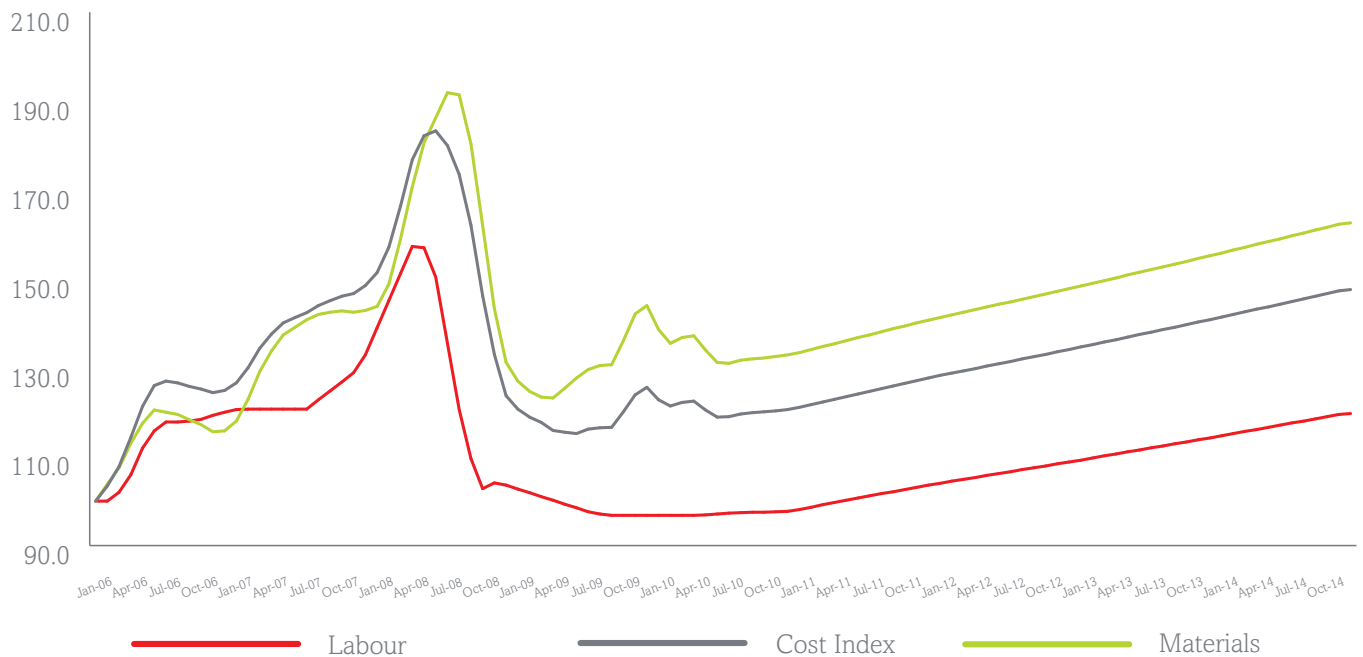
Construction inflation in the UAE is expected to show an increase of around 1% this year, according to the EC Harris Cost Index. Materials' prices are, on balance, expected to be flat with a slight rise in overheads and profits while construction labour rates are expected to show no movement over the year.

Commodity prices have shown huge volatility over the past year, reflecting an uncertain recovery in world markets. Steel prices in particular have showed huge monthly variations with a peak in prices in March 2010 followed by substantial falls over succeeding months. However prices are considerably higher than a year ago with rebar prices in September 2010 up by 18% and structural steel prices up by 13% when compared with a year ago. The volatility in steel prices was seen earlier this year when rebar and structural steel prices in March were, respectively, 31% and 30% higher than in February but prices since then have fallen considerably.

Aluminium and copper prices have both shown substantial increases over the past year with aluminium prices up by 32% and copper prices 26% higher than in September 2009 and up by 20% in the past 3 months alone. Increases in the price of copper will, of course, have a substantial impact on the installed cost of mechanical and electrical engineering installations and these increases are bound to filter through to higher sub-contractor prices for MEP installations. Cement prices, in contrast, have fallen over the past year and are now some 17% down on prices in September 2009.

Looking ahead the market is expected to remain flat for the remainder of this year and then show some pick-up over the next couple of years; as a result contractors will be under less pressure to cut costs in order to secure work. The EC Harris forecast is that tender prices will rise by approx 2.7% during 2011, picking up to 4.2% in 2012.

Construction Cost Index - UAE (Base January 2010 = 100)



Recommendations

What is clear is that there are many lessons learnt from the boom times. Innovative procurement routes designed around the need to accelerate progress of projects have largely been replaced by routes with perceived lower risk and a need for detailed due diligence and certainty prior to contractual commitment. These routes are typically based on full design being developed prior to going to the market, involving competitive tendering with the result being a fixed price lump sum.

A large proportion of the market sees this as the way to go, however, a consolidated approach is needed. What is clear is

that with tender prices at their lowest since 2006 there may not be a better time to go to market. Speed to market may be on the agenda again as clients look to take advantage of the market but the focus must remain on the out turn value achieved when products are placed in the market.

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