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REGULATING CONSTRUCTION: ADAPTING TO NEW STANDARDS

How regulatory trends are affecting the construction sector

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MEED
Middle East business intelligence

RAISING STANDARDS

Regulatory changes pose challenges for companies and regulators. But they also provide opportunities

The Gulf construction industry is facing an important transition as it seeks to iron out the chronic weaknesses exposed by the downturn in regional project spending that followed the 2014 collapse in oil prices.

At the same time, the traditionally-slow-to-change industry is seeking to utilise new technologies such as digital design software, 3D printing and drones in order to improve productivity and efficiency.

While much of the transformation taking place in GCC construction is coming from within the industry, there are also changes taking place outside the industry that require action. Increasing regulatory standards and new legislation require construction companies to reform in order to avoid penalties.

Over the past two years, the MEED/Mashreq Construction Partnership has looked at how the construction industry in the UAE is responding to these challenges by harnessing new technologies in its planning, design and construction process. It has also examined the opportunity to transform client/contractor relations and improve project delivery with a fairer balance of risk allocation in contracts and earlier contractor involvement in the design phase of a project.

In its latest report, the partnership looks at the role of government in shaping construction in the region through regulation and enforcement.

From financial rules and accountancy standards, through to environmental protection and health and safety on site, government regulation has a major impact on every aspect of the construction industry.

Take, for instance, the recently introduced Basel III regulations in the UAE, a game-changer from both a banking and contractual perspective. While the regulatory framework improves a bank's ability to deal with financial stress and credit crisis—such as the one faced in 2007-08—the regulations increase borrowing costs for the construction sector, with long-term implications for the entire industry.

The upcoming Dubai Expo 2020 has turned international gaze towards the region, forcing contractors to adopt best industry practices. Health and safety, technology and innovation are the frontrunners here, but lack of clarity on the part of the regulators makes it difficult to gauge the standard or level of implementation.

At the same time, increased regulations can also lead to higher cost for all players, an expense not everyone is willing to bear.

As the region seeks to raise standards to match the highest levels of international scrutiny, it also raises the bar for construction companies to improve standards and to innovate to find more efficient ways of working.

EXECUTIVE SUMMARY

As international standards are tightened, greater consistency is required in enforcement of regulations

- Regulations establish transparency and uniformity when it comes to stakeholder roles, duties and ethical responsibilities.

- The global economic crisis of 2007-08 has forced the international banking and financing sector to re-evaluate its stance on capital requirements and contracting finance.

- Banking regulations such as Basel III and International Financial Reporting Standard (IFRS) 9 were brought into force to focus on risk assessment of borrowers, which directly translates into increased cost of borrowing for contractors.

- IFRS 15 defines revenue recognition periods based on the percentage of construction work completed rather than units delivered to a customer. This has helped smooth overall revenue recognition and reduce earnings volatility for listed companies. But many small and medium-sized enterprises (SMEs) are yet to adopt these standards.

- Transitional changes have affected construction relationships in the year since value-added tax (VAT) was introduced in the UAE and Saudi Arabia on 1 January 2018. Existing construction projects had to factor in extra costs, affecting already tightened cash flow.

- Adoption of VAT regulations in member states such as Bahrain, where VAT has been implemented starting 1 January 2019, will impact cross-border transactions and investments.

- Weak enforcement of regulations is a deep-seated problem for the impact of laws relating to health, safety and environment. Timely inspections can help keep the stakeholders in check.

- In the UAE, there is additional inconsistency in standards and enforcement of regulations across different emirates. A federal regulatory body could help curb this issue.

- High-profile, world-level events such as Dubai Expo 2020 are boosting regulatory improvements and adoption of best industry practice.

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GAUGING SENTIMENT

Regulations keep an industry in check and ensure standards are followed. Do industry participants agree?

Regulatory changes introduced across the construction industry will have both a long and short-term impact. The view of leading figures across the construction sector in the UAE is that these trends could ultimately contribute to improving both sustainability and relationships between designers, contractors and stakeholders.

The introduction of new laws simplifying visa and contractual documentation, coupled with digital innovation in areas such as blockchain, will stimulate greater co-operation and transparency across the construction industry.

But at the same time, increased regulation can easily lead to greater costs that have to be absorbed by the industry. It is often difficult for smaller firms to accommodate these costs.

MEED conducted a construction industry survey to gauge opinion on some of the risks and challenges facing the regional construction industry. Participants offered their views on subjects such as financial risks, performance bonds, VAT, environment, health and safety, and labour welfare.

When asked about the biggest financial risk facing the UAE's construction companies, more than 60 per cent of respondents highlighted the issue of late payments leading to cash flow problems. Less than two per cent felt lack of finance was an issue, but eroding margins due to tough competition was cited by nearly 14 per cent as a pertinent financial risk.

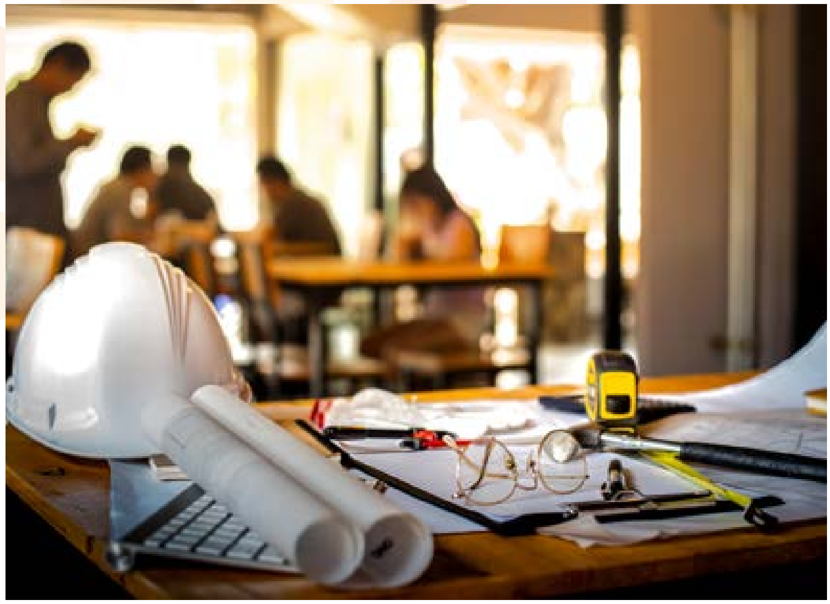
Design and regulation

An important project, both at a national and international level, is the Musuem of the Future, underway in Dubai. The torus-shaped building, designed to be a physical metaphor for Dubai's forward-looking vision, is intended to become a focus of the future of science, technology and innovation, as well as a hub for the launch of new technologies and creative ideas. Dubai Future Foundation announced the completion of the basic structure in November 2018, and the building is set to be completed by 2020.

Killa Design, established by architect Shaun Killa, is the principal company behind the design of the museum. With the responsibility of executing the architectural challenge, Killa explains his thoughts on new regulations within the design and build industry: "Within the design field, the new DCD [Dubai Civil Defence] fire regulations have made it more difficult to obtain approvals and

What is the biggest financial risk facing construction companies in the UAE?

Source: MEED Construction Industry Survey



building certificates. This is added risk and cost for the contractor."

He touches upon the issues he felt needed to be addressed to improve the work culture in the construction industry.

"There is wide abuse of contractor bonds, late or no payments to contractors or unresolved VOs [variation orders]. All this creates contractor uncertainty," says Killa. "Also, some A-grade contractors are possibly leaving the Middle East. There are also delays in projects and inflation in costs due to the uncertainty of receiving final payments or counter-claims.

"Based on this, it would be good if some practices can be learnt from international markets."

But he also sees some benefits for the coming years in the form of more emphasis on environmental protection.

"Future regulatory laws may include stronger sustainability initiatives, improvements in the transport sector with electric cars and driveless vehicles, perhaps ownership of [these] vehicles," says Killa. "This may help reduce traffic congestion and negate the need for car parking structures."

Innovation and looking beyond 2020

A positive indicator of growth in today's industry is the increased willingness of construction companies to adopt new techniques and innovate traditional practices. However, lack of definite regulations can significantly affect a contractor's knowledge and use of technology. Nearly half of the industry survey respondents felt that the lack of up-to-date regulations was hindering innovation in the regional construction industry. One respondent suggested that universities could aid through research and collaboration.

Swiss architect André Meyerhans worked independently under Acmeyerhans architecture + design on several Middle East projects, including the Al-Nadi Tower in Abu Dhabi, before starting to operate under FischerMeyerhans, which is involved in the initial stages of design for the Dubai Expo 2020 pavilions.

Meyerhans feels there is a risk that ongoing construction is firmly geared towards achieving goals for a set date for the expo, rather than what is necessary for sustainable growth of residential, commerce, education or any other sectors. But with regards to factors such as employment laws and VAT, he feels new regulations could be positive.

Is the lack of up-to-date regulations covering the use of new technology preventing the implementation of innovation in construction?

Source: MEED Construction Industry Survey

"Most of the construction-related activities seem to be more in relation to the obligation to develop empty plots and finish construction by 2020, rather than being demand driven," says Meyerhans. "As long as laws are simplifying transactions and making transactions more transparent, they definitively add positively to business.

"On the other hand, there are certain innovations that add an administrative burden and costs which cannot easily be [absorbed]—in particular by smaller companies."

Improving stability and confidence within the industry is something that should be prioritised in any new rulings, Meyerhans adds.

"What would be interesting is a governmental mechanism that would ultimately lead to a higher payment morality—this is most likely to be an initiative which would be worthwhile not only for the construction business, but also the real estate sector."

Meyerhans notes that the regional construction indus-

try is looking into binding contractual bond agreements and contractors' agreements into a blockchain, "thus enabling reduction of the cost of bonds and freeing liquidity. This seems to still be an idea for the future—even though it works in the US and Europe".

Blockchain is a decentralised data system where every party involved in a transaction holds a copy of what has occurred through the design and construction process, operations and entire lifecycle of the building. The information cannot be deleted by any of the parties.

Improved workflow is another potential blockchain benefit, as the platform allows numerous parties to work in collaboration simultaneously.

Another aspect where blockchain could improve effectiveness is building information modelling (BIM). At present, BIM utilises peer-to-peer networks for information sharing—blockchain could allow for instantaneous updates to every single person working on a BIM project.

But the industry needs to be flexible when it comes to accommodating new laws and trends and any benefits that might accrue, says Meyerhans.

"New laws always mean a change and the economy needs to adapt to it," he said. "Whether this will be better at the end or not depends on the laws. But the fact that it keeps the participants across the market agile is a benefit.

"On the other hand, it is important for investment to have consistency, so as to evaluate any risk. Too much change sometimes evokes a feeling of unpredictability and, thus, reduces investments."

U+A Architects is involved in major projects along Dubai Creek as well as globally. Managing director Pedram Rad says cutting back on some of the regulations around visas could help the industry become more agile and responsive to evolving requirements. He also says the introduction of VAT has been a major step.

"VAT was a hiccup in the market, but it is the most important of the new laws to be introduced. Any new law [carries] a risk. As an example, VAT is useful and is great for the country's economy, but in the short term [it] will have a negative impact.

"Also BIM requirements are, on one hand, complicating the deliverables, but will be of benefit in the long term. Another important factor is the shortage of skilled technical personnel as a result of the economic downturn, while political issues in the Middle East are always an issue."

Rad adds: "Long-term visa availability could help, as would waiving some of the banking regulations for visas and other municipal fees. When it comes to learning from other markets in other countries then we could look at the UK market, perhaps in both the sector of law and also that of other methods of construction."

CRUNCHING NUMBERS

The implications of emerging monetary regulations may mean increased pressures on contracting finance models for the construction sector

When asked what would make the biggest improvement to the financial risks facing construction contractors in the UAE, more than one quarter of respondents to the construction industry survey called for new regulations to make the cashing-in of performance bonds conditional on third-party certification or arbitration. Many called for greater commitment and increased industry partnerships.

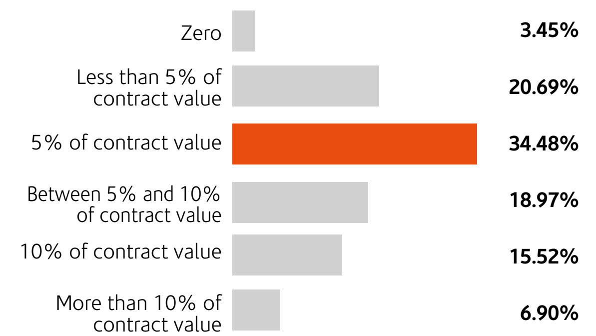
Assessing risk

Banks assess the creditworthiness of obligors in the contracting industry on the basis of a combination of financial information and qualitative factors including the governance structure and the industry outlook. The outcome of this assessment is reflected in the credit risk rating of the borrower.

Because of the bespoke nature of construction projects and the diverse and fragmented construction client base, providing finance to construction contractors is highly complex and requires expert, first-hand judgement from businesses.

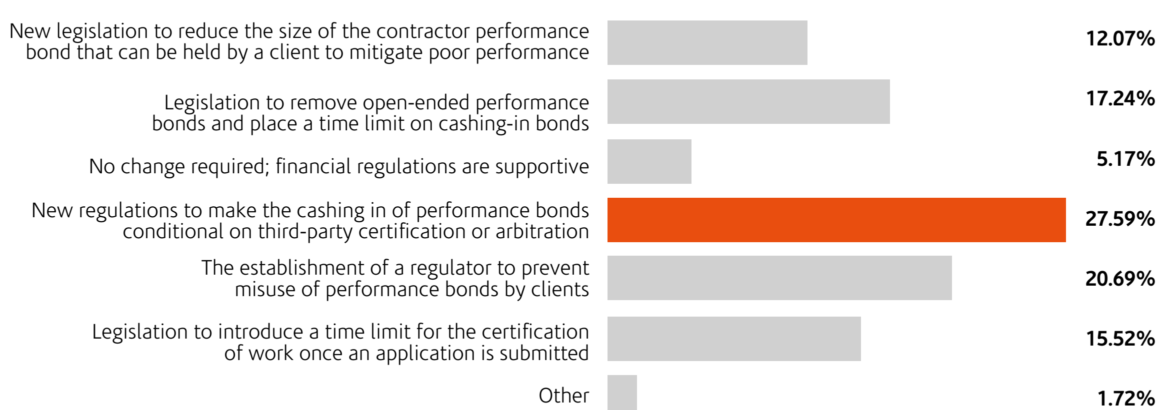
As part of the ongoing monitoring of clients' creditworthiness, Mashreq Bank has deployed a dedicated team of engineers who work to understand project progress and provide critical input to the banks' credit risk managers and risk rating models. The ultimate objective of having a risk rating model in place is to generate a score, which translates into a likelihood of default of that borrower. The higher the likelihood of default, the higher is the amount of capital retained by the bank to cover the risk of exposure. However, capital carries a cost which reflects shareholder's expected return on capital .

What level of contractor performance bond should be retained by a client organisation as protection of non-performance by the contractor?



Source: MEED Construction Industry Survey

Which change will lead to the biggest improvement in the risks facing construction contractors in the UAE?



Source: MEED Construction Industry Survey

Rigid international financial regulations since the global financial crisis in 2008 require banks to maintain higher levels of core capital, increasing the cost of capital allocated to financing activities. This translates into higher pricing for the relationship between a bank and contractor.

But the pricing can vary from bank to bank, depending on how each bank scores its borrower. Different banks can have varied approaches to the same customer, impacting the capital pricing charged to the borrower. Regulations ensure regional banks follow a standardised approach from a capital adequacy perspective, but the likelihood of default still remains subjective to a bank's risk modelling.

About one third of GCC institutions use off-the-shelf risk rating models typically designed around major western markets such as the US. These models can be significantly disconnected from the reality of the regional and local markets. With new regulations such as the International Financial Reporting Standard (IFRS) 9, scrutiny on many regional banks has increased and some of these banks might find that their model fails the validation test and will have to redevelop these off-the-shelf models.

Not all banks follow this approach. Mashreq Bank is one of the few banks in GCC that has tailored risk models since 2005. This has allowed Mashreq to collect credit risk data and perform multiple model validation cycles.

Exposure that a bank holds on its books refers to three elements in terms of pricing—cost of funds, cost of capital and expected loss.

Most credit exposures in the contracting industry are non-funded in nature—for instance guarantees and performance bonds—and attract capital charge. For an institution to minimise capital charge, it should work on the collaterals. There are many different kinds of collateral, but a central bank will usually recognise tangible collaterals such as cash, deposits, shares and bonds.

Basel III

Following the debilitating effects of the 2007-08 financial crisis on banks globally, the Basel Committee on Banking Supervision built on Basel I and Basel II guidelines as part of the continuous effort to enhance and tighten the banking regulatory framework. Basel III seeks to equip banks to deal with financial shocks and improvise their financial stability by strengthening regulation, risk management, transparency and capital requirements. It focuses on increasing bank liquidity and decreasing bank leverage in order to improve the quality of a bank's capital ratios and the standards for short-term (Liquidity Coverage Ratio) and long-term funding (Net Stable Funding Ratio).

Bank's capital is divided into Tier 1 and Tier 2 capital. Tier 1 capital is the core capital consisting of shareholder's equity and retained earnings. Tier 2 capital is supplementary capital and mainly consists of revaluation reserves, hybrid capital instruments and subordinated term debt, general loan-loss reserves and undisclosed reserves. The new accord, Basel III, creates additional challenges for the banking industry as banks are now required to maintain a higher quality of Tier 1 capital, consisting of more equity Tier 1 capital (CET1) and additional Tier 1 capital (AT1). Mashreq is well capitalised and hardly has any Tier 2 capital.

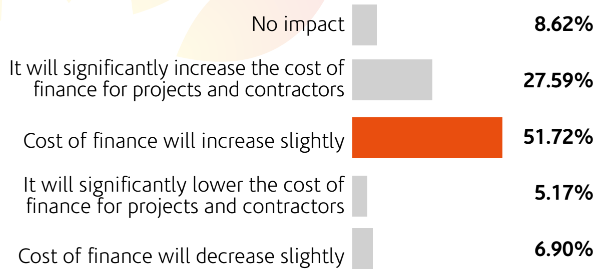
The new Basel III reforms also lay out the basis for liquidity requirements. The Liquidity Coverage Ratio (LCR) is the total amount of high-quality liquid assets compared with net cash outflows. The introduction of the LCR will necessitate banks to hold significantly more liquid, low-yielding assets, which will negatively impact the profitability of the bank. The Net Stable Funding Ratio (NSFR) would incentivise the banks to reduce their dependence on short-term funding and improve stability of the funding mix.

IFRS 9

Until 2017, banks only considered impairments that occurred as a result of a customer default. Effective 2018, IFRS 9 requires banks to switch from an 'incurred loss' model to an 'expected loss' model. Under the concept of IFRS 9, expected credit losses are used for calculating impairment allowance for the bank. Future expectations are taken into account and larger impairments can be provisioned earlier on. The change in the impairment allowance is reported in profit and loss.

Impairment is recognised under one of the three stages under IFRS 9. When an asset is acquired, the asset is recognised as Stage 1 and the impairment allowance is measured as the present value of credit losses from default events projected over the next 12 months. If the asset

On 1 January 2019, Basel III regulations were introduced in the UAE to improve capital adequacy in the banking sector. What impact do you think this will have on the UAE construction sector?



Source: MEED Construction Industry Survey

quality deteriorates ie, there is a significant increase in credit risk, it gets recognised as Stage 2. The impairment allowance is then measured as the present value of all credit losses projected for the instrument over its entire life.

Stage 3 is where the financial asset is credit impaired. If the creditworthiness of the customer improves, the allowance can once again be recognised to that of Stage 1 following a cooling period of at least a year. However, varying regulations in the region can translate into different pricing and lending periods for the same customer. Macroeconomic conditions and industry outlook also play a key role in estimating impairment allowance.

Open-ended guarantees present a special case for most banks in the Middle East. Should such an asset be classified as Stage 2, the impairment allowance would rise significantly in the absence of a fixed maturity date. The legal committee of the UAE Banks Federation (UBF) is now looking into and drafting the terms of such guarantees, but it requires input from government entities who are the primary users of open-ended guarantees.

Impact on lending

A combination of increased capital requirements and stringent liquidity requirements under Basel III will mean an increased cost of borrowing for a contractor. Since banks will have to retain capital to meet the standard requirements, lesser capital will be available for project finance.

The magnitude of impact on a bank depends on its capital structure, and further development of the regulation may carry greater uncertainty for the banks on their pricing.

Looking forward

Banks need to have consistency when it comes to using risk models in the region. In the absence of a common framework, there will be an arbitrage between banks. Collecting credit default data to predict situations such as likelihood of default can help minimise such differences.

The construction industry should work very closely with the banking regulators, to avoid a situation where the nation is the best at upholding regulations, but at the same time there is run-off of business from the country. There is an interesting trade-off between complying with the regulation, and at the same time maintaining certain economic stability and being profitable for investors. The business should be involved in refining the regulations.

Abdourabbih Abdouss

The UBF is a not-for-profit organisation representing 50-member banks operating in the country. It can influence or negotiate the way the regulation is applied, to make sure the banking system is stable. If the industry tries to voice its problems to the UBF, these may ensure that their concerns are used when applying regulations to a particular economy. A transparent relationship between the industry and UBF is a critical channel that should be pursued.

With input from Abdourabbih Abdouss, head of enterprise risk management architecture and analytics, risk management, Mashreq Bank

REVENUE RECOGNITION

IFRS 15 was created to improve transparency of financial statements, but lack of data gathering is an obstacle when defining recognition periods

In May 2014, the International Accounting Standards Board published the International Financial Reporting Standard (IFRS) 15, which significantly impacted real estate companies as they could now recognise revenue over the construction period if certain conditions were met. This meant greater transparency for real estate entities, but also certain challenges such as volatile contract margins and data requirements.

> **"By implementing the standards, SMEs may benefit from overall revenue recognition and reduce earnings volatility"**

It has been more than three years since major real estate players in the UAE adopted IFRS 15 accounting standards. IFRS 15 rules require developers to recognise revenue based on the percentage of completed units, as opposed to earlier regulations that mandated revenue to be calculated based on the number of completed units handed over to customers. This standard is particularly beneficial for off-plan sales, as it allows developers to recognise revenues and profits partially from the sale of off-plan properties during different stages of their completion.

The move was lauded by experts, with ratings agency Moody's saying the adoption of IFRS 15 will aid in accurately reflecting companies' financial performance, thereby supporting transparency in the sector. According to Moody's, this will also help better align earnings and cash flows, leading to financial results that better reflect the underlying activities of UAE property developers.

In a country where real estate and construction is a major contributor to the national economy, efforts to increase transparency may create more confidence in purchasing off-plan property, as well as attracting foreign direct investment in the property market in the country.

Three years on, listed and regulated entities in the UAE have applied IFRS 15 standards as they publish quarterly results. However, small and medium-sized enterprises (SMEs) may have some catching up to do—

it would seem they are yet to appreciate the impact of the new standards and the information needed to comply with the fresh approach to revenue recognition, as mandated by the IFRS 15 standard. By implementing the standards, SMEs may benefit from overall revenue recognition and reduce earnings volatility.

Revenue recognition

Given current market conditions, construction companies' revenues, profits and margins are under immense pressure. Revenues may change under the new standard if construction contracts do not qualify for revenue recognition over time. For instance, issues may arise when deciding if leasing, development activities and other such services are simultaneously received and consumed by real estate owners.

In my experience, some companies may find that applying the new revenue standard will result in a revenue accounting outcome similar to the current percentage-of-completion (POC) method. However, cost accounting may result in a volatile contract margin over the lifecycle of a typical contract—there is no automatic link between revenue and cost or the old matching concept. Therefore, construction contracts that use a balance sheet true-up to create a consistent margin over the life of the contract may change under the new standard.

The biggest challenge accompanying the transition to revenue recognition continues to be data requirements. For instance, the main costs for construction contracts are related to staff, materials and depreciation.

Sidharth Mehta

Sophisticated systems may be required to determine how to segregate costs between those relating to "future performance" and those that need to be "expensed off directly to the income statement". In addition, it is not uncommon for costs to be incurred for variation orders before they are approved. Whether these costs should be expensed off or not depends on how performance obligations are designed in a contract.

Overall, it is possible that we will see many changes with respect to accounting for revenue and costs in the construction sector. While the impact may or may not be significant, companies need to do a thorough analysis of their contracts. Only then are they in a position to assess what type of counsel they require. Companies can also turn to the professional services of accountancy firms that are capable of helping in the implementation process—from issue diagnosis to solution development to deployment.

Sidharth Mehta is a partner and head of building, construction and real estate at KPMG Lower Gulf

HAS VAT BEEN A TAXING EXPERIENCE?

As the UAE continues to create a knowledge-based economy, revenue diversification is a natural step

The introduction of value-added tax (VAT) is just one of the many fiscal strategies that will enable the UAE to achieve its medium to long-term objectives to become an economic powerhouse and word-class business hub.

A VAT system by its nature is a flexible tool for governments to regulate their annual budgets, contributing to higher revenue intake and a healthier ability to influence economic growth. This is evidenced in numerous OECD, IMF and domestic Central Bank financial and economic reports. These indicate significant increases in tax-to-GDP ratios as a result of the introduction of a new VAT regime and/or the fluctuation of rates within mature regimes.

The UAE and indeed the GCC's rationale for the introduction of VAT, together with the related revenues it hopes to generate, give some context to our consideration of whether it has impacted activity in the region, and in particular the construction industry.

VAT has the essential characteristic of an economically neutral tax—ie, it flows through businesses and tax supplies to final consumers. Once a new VAT system has been introduced and businesses have adjusted, VAT should not be a direct cost for businesses and careful management of associated compliance, cash flow and administration costs should limit the indirect impact. Associated inflation is also generally short lived.

Has the introduction of VAT impacted your operations in the region?

Source: MEED Construction Industry Survey

"For such an important, high-value sector, the application of a considerably low rate of 5 per cent was crucial in aiding the industry to adjust to this new demand on working capital"

For a VAT regime to be successful in its aim of neutrality for businesses, and therefore limit the impact on trade, there are a number of key contributing factors: the VAT rates and structure; VAT thresholds and phased introduction; administration of the system; and exemptions.

Transitional challenges

If we look at these in the context of the construction industry, they give us a clearer picture of some of the challenges that businesses may have faced during the first year of implementation in the UAE and Saudi Arabia, and the resulting impact on the industry across the region.

For such an important, high-value sector, the application of a considerably low rate of 5 per cent was crucial

in aiding the industry to adjust to this new demand on working capital. Also, the implementation of a simple VAT system was tactical in supporting comprehension and early adoption, especially in the UAE where businesses did not historically have experience with federal tax regimes.

However, the application of (differing) exemptions/zero-ratings for bare land and residential properties in the UAE and Saudi Arabia, can be a fairly complex concept for businesses in the real estate sector. As in all markets, when new regulations are introduced there can be confusion around scope and clarifications are always required. It is extremely difficult to prevent such misunderstandings. Consequently, some of these challenges are likely to be replicated in other GCC countries, particularly as other nations, such as Bahrain, will introduce their own rules for exemption/zero-rating to construction services and the real estate industry. Generally speaking, exemptions can challenge the healthy functioning of a VAT system.

With the thresholds for delayed/voluntary registration rarely applicable to players in this sector, transitional transactions were a key area of dispute for businesses, with the transitional rules in VAT law providing little relief from the commercial challenges faced.

Conclusively, increased costs were created for businesses in a number of areas (such as irrecoverable VAT associated with exempt supplies—bare land and residential, cash flow burden due to large refunds pending from the tax authorities on up-front costs of construction, and so forth), which placed short-term additional pressure on the sector.

Do you have:

Do you think the introduction of VAT in other GCC states will impact your operations?

Source: MEED Construction Industry Survey

However, these are expected costs of implementation for businesses, which would have been considered by the UAE in its decision to implement VAT in the region.

Settling in

Joanne Clarke

As with all VAT implementations across the globe, this impact is mitigated over time as businesses adjust to the new regime, communications with and clarifications from the tax authorities become more fluid, refunds are settled quicker and the region adjusts to the revised pricing. The pace of adjustment will be wholly dependent on the increased ease of administration, the application (and level) of penalties post audit and the frequency of changes to the VAT regime over time.

VAT regimes do not sleep and are known to continuously evolve and develop over time. It is an area that will require consistent investment from the government and the construction industry alike to ensure a smooth transition and full compliance.

Joanne Clarke is the VAT tax director at Pinsent Masons

IN SAFE HANDS

Technology can be a game-changer in terms of improving health and safety, but regulated standards have to be put in place before full potential is achieved

Health and safety on construction sites has long been a sensitive area for the industry. It is used by critics to challenge companies, while industry players often promote good performance as a major achievement.

Previous MEED/Mashreq Construction reports have highlighted that the regional construction industry could do better in standardising and enforcing safety regulations. Lack of training and stringent regulation and unwillingness to absorb the added costs by the contractor have all been cited as barriers to a safer industry.

Legislation

About 86 per cent of the industry survey participants believe regional governments could do more to enforce regulations when it comes to health and safety management in the region.

"[There needs to be] consistent application and enforcement across the full scope of contractors," said one survey respondent. "Not just focus on multinational companies and large local companies. Treat all contractors the same."

"[There should be] common regulations in the UAE," said another. "[There] should be no difference between Dubai and Abu Dhabi."

"While the government is making clear progress towards improving its health and safety standards in the construction industries with a lot of recent changes, the lack of unified and prescriptive legislation is causing the contractor to experience challenges when overseeing large and culturally diverse workforces on complex and usually fast-paced construction projects," says Mohammad Bidad, group health, safety and environment manager at Arabian Construction Company.

Bidad explains that there is a lack of a single, uniform body or authority responsible for health and safety monitoring, regulating and prosecuting across the UAE.

"The Ministry of Labour, Dubai Municipality, Abu Dhabi Municipality, Zones Corp and the Abu Dhabi Occupational Safety and Health Centre, among others, each produce their own legislation, guidance and documentation."

Speaking for the UAE construction industry, James McMillan, a senior associate at Al-Tamimi & Company, says the UAE's health and safety laws are a little fragmented at a federal level and "if the business is located within a free zone, different health and safety regulations and standards may apply".

At a national level, the UAE Federal Labour Law No 8 of 1980 stipulates worker health and safety guidelines. In Dubai, health and safety is upheld by the Dubai Municipality Code of Practice for Construction Projects, and similarly in Abu Dhabi there is a Code of Practice for Construction Projects, which includes levels of training and reporting procedures.

"Construction in a desert climate is, however, a very challenging health and safety environment," says McMillan. "To ensure compliance, greater enforcement will be necessary and potentially a specific federal level health and safety law."

International scrutiny

The announcement of high-profile, world events such as Expo 2020 in Dubai and the Fifa World Cup 2022 in Qatar have put the region under an international spotlight. With the world's eyes on the regional construction industry, the sector needs to maintain better health and safety standards.

"Post the announcement of the Expo 2020 event, the emirate is a wave of opportunity," remarks Bidad. "The government [set] aside AED17bn ($4.62bn) in the 2016 budget for infrastructure development up till 2020. The investment spreads over different asset classes broadly covering housing, roads, railways, schools, health facilities and public buildings.

Should governments enforce better regulations when it comes to health and safety management in the region?

Source: MEED Construction Industry Survey

"While offering huge opportunities, the contractors in the emirate have also been requested to develop and improve the level of health and safety in their operations."

For Tier 1 contractors, such as Alec, this increased scrutiny is not a problem.

"We welcome the scrutiny as it helps level the playing field in terms of competition," says managing director Barry Lewis. "Our company policies are aligned with international best practice. The challenge, however, still exists within subcontractors and the supply chain as they have not necessarily fully grasped the seriousness or implications of compliance."

Should the government standardise technology that improves the health and safety of workers on construction sites (ie, wearable sensors, protective exoskeleton suits, analytics to predict errors, and so forth)?

Source: MEED Construction Industry Survey

Technology

Increasingly, technologies such as wearable sensors, protective exoskeleton suits and robots are finding favour in the construction industry.

However, without set regulations and standards, the market will control how the industry uses the technology, since competition between service providers would be based on lowest-price solutions. This could result in conflicting and possibly hazardous products.

About 81 per cent of our survey respondents believe the government should standardise such technology. Many also suggest incentivisation for those who implement technology solutions.

There are also others who think both the technology and the market need to be much more mature before the government takes any steps.

"Technology imported into the UAE should ensure conformity with GCC Standardisation Organisation (GSO) standards," explains McMillan. "Any product being offered for sale in the UAE should also be registered with Emirates Authority for Standardisation & Metrology (ESMA)."

McMillan adds that ESMA and GSO will often adopt EU/US or International Electrotechnical Commission standards in relation to new technology in the market.

"International standards are often directly applicable in the region and if suppliers of such technology can provide testing certificates and certification of compliance from other jurisdictions, GSO and ESMA will often accept such evidence of compliance.

"Regulators are playing catch up, and will require time and any epidemiological evidence of the use of technology before considering whether further regulations are required. Certain regulators are already forward thinking—for example, in the UAE, Dubai Health Authority introduced Telemedicine Regulations in 2017, which in theory could allow workers remote access to a healthcare practitioner from a construction site."

IN THE BEST INTEREST

A productive workforce ultimately leads to an efficient supply chain

The drop in global oil prices in mid-2014 affected the regional construction industry in more ways than one. Fiscal spending cuts were an unavoidable result, which in turn squeezed contractor cash flow.

As is always the case, it appeared that those with least power suffered the most. News reports highlighted the plight of migrant, blue-collar workers, whose salaries were held back during the financial crunch. In many cases, illegal retention of passports by employers left these workers stranded in foreign lands. A torn seam was exposed in the cascading, downward rush of the economy.

MEED's construction industry survey polled opinion on labour welfare legislation, especially for migrant workers. The majority of respondents were of the view that while the law addresses some factors, much more could be done by the government. Some 22 per cent believed, however, that the existing laws are sufficient. As one participant wrote: "It's a practical and fair compromise; what is missing is not that important."

Labour law

The main law that regulates the employment relationship in the UAE is Law No 8 of 1980 Regulating Labour Relations (as amended, the "Labour Law"). The law focuses on aspects such as Emiratisation, recruitment, place of work, contracts, medical insurance, wages, accommodation, and so forth.

"When recruiting migrant workers, once an employee enters the UAE on an entry permit, the employer must make an application for a residence visa to the immigration authorities," says Ivor McGettigan, a partner at Al-Tamimi & Company. "Prior to this, the employee must pass a medical examination."

It is illegal for an employer to pass recruitment or visa fees onto its employees. The circumstances in which an employer may deduct money from an employee's salary are limited within the labour law.

Furthermore, before an employee enters the UAE for employment purposes, an employer (assuming it is not a free zone entity) must have the employee sign a standard form offer letter stating the basic terms of employment and file it with the Ministry of Labour.

The requirement to submit an offer letter was introduced in 2016 pursuant to a ministerial decree and only applies to foreign nationals. The offer letter contains the key terms of the employment agreement and the standard offer letter is in Arabic and English, with further templates available in different languages if needed. The offer letter will often be signed by the employee in their home country prior to entering the UAE.

The intention behind this decree was to ensure minimal differentiation between the initial offer made to the employee and the ultimate employment contract, while the language requirement ensures that the employee understands the document. This was considered a move to protect more vulnerable workers in the region, especially blue-collar construction workers.

"A number of decrees came into law in early 2016 with the primary aim of protecting blue-collar workers," says McGettigan. "One decree introduced the requirement that a notice period (of between one to three months) be included in limited-term contracts; the previous position was that limited-term contracts simply ended upon expiry."

The same 2016 ministerial decree also introduced the requirement that, in the event of termination of a limited-term contract, each party must indemnify the other to a level agreed by the parties (the agreed indemnity cannot exceed three months' total wages). Under the labour law, an employer who terminates an employee's limited-term contract before its expiry is liable to pay the employee three months' pay as "early termination compensation". It is unclear at present whether the agreed indemnity amount under the decree is intended to be in lieu of early termination compensation (as provided for

What do you think of the current labour welfare legislation in the UAE, particulary for migrant workers?

Source: MEED Construction Industry Survey

by the labour law) or in addition to this.

Where an employer terminates a limited-term contract prior to its expiry, there is no defence to a termination claim other than if it was for gross misconduct.

A wage protection system (WPS) was introduced in the UAE in 2009, which requires employers to pay their employees' salaries electronically via the WPS to enable the local authorities to monitor the salary payments.

The labour law does not specify a minimum wage, but there have been instances where countries have specified a minimum wage for their citizens who work in the UAE.

The labour law also defines regulations relating to medical insurance (mandatory for UAE employers to provide health insurance to their employees) and occupational injury; labour bans; workings hours and midday breaks; accommodation and gratuity.

"There are no trade unions in the UAE and employee representatives are not common," notes McGettigan. "The labour law expressly prohibits strike action, and strike or union action can potentially amount to criminal behaviour under the UAE Penal Code."

In practice, the penalty for employees who lead or take part in strikes generally amounts to temporary suspension from duty, adds McGettigan. For more serious or repeated offences, there is a risk of deportation to the employee's home country.

"Where a minimum of 100 employees are involved in a dispute with an employer, the recently instated Ministerial Resolution No (749) of 2018 recognises such collective agreements and stipulates the process that must be followed to resolve the dispute."

According to the resolution, employers and employees should settle their collective disputes firstly through direct negotiation, followed by mediation, conciliation and arbitration. This is relevant to the construction sector, as collective disputes have historically involved blue-collar construction workers.

Mental health

Kareem Farah, CEO of Engineering Contracting Company, says there has been increased focus on labour welfare in the UAE and elsewhere in the region in recent years. "The situation has improved greatly across the board for labourers, from how they are recruited and paid to how they are accommodated and transported, and what happens to them if their employer gets into financial difficulty." Farah adds that mental health is another important and often neglected area for worker welfare.

Emiratisation

The UAE's Emiratisation policy has set recruitment targets for the private sector, however McGettigan points out that for construction companies, "there is little or no observance of the quotas among the blue-collar workers". However, the Emiratisation policy does state that health and safety officers of construction companies must be nationals.

Expo 2020 Dubai

Expo officials revealed in October 2018 that nearly 40,000 workers—both manual and non-manual—are expected on the expo site, including employees of third-party stakeholders and participating countries, during the first half of 2019 when construction peaks.

The scale of Expo 2020 requires that best possible practices are followed in all areas, including worker welfare. A survey respondent says: "The UAE should work towards mandating the Expo 2020's worker welfare requirements. This may add costs in the short term, but will contribute to raising the UAE's human rights profile, which may contribute to the further attraction [of investment]."

The event is also acting as a testing ground for innovation. Expo Live is a partnership grant programme launched by Expo 2020, to support novel solutions. With Expo Live's backing, UAE-based Smart Labour has developed a mobile app that helps blue-collar workers to improve their reading and writing skills, while offering rewards such as mobile calling credit. As of July 2018, more than 40,000 workers are registered on the app.

Smart Labour has partnered with the UAE Ministry of Human Resources & Emiratisation to implement the app across the country and develop it further, even adding Dubai Smart Government's happiness voting meter. The goal of the app is to promote happiness and a feeling of wellbeing, which the government believes ultimately leads to a more productive workforce.

COULD DO BETTER

A sizeable proportion of the UAE construction industry says more could be done to enforce environmental regulations

Nearly 47 per cent of respondents to the MEED Construction Industry Survey said environmental protection is extremely important to their company. More than half believed the UAE is making substantial efforts when it comes to monitoring construction and its impact on the environment. There is room for improvement, however. More than 41 per cent of respondents said the government could do more to improve the situation.

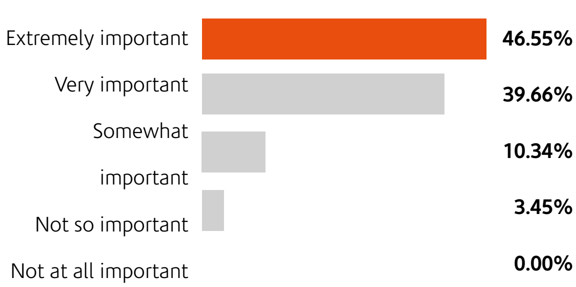
One respondent remarked: "Education, awareness, contractual agreement, time-to-time updates to the relevant construction groups and strict adherence inspection [should] be followed as [per] legal requirements pertaining to environmental issues by authorities. People should be involved in giving their general feedback and ways to resolve before the prequalification of the project."

Another said: "Some shareholders with power of decision are not always aware of the importance [of environmental regulation]."

Daker el-Rabaya, managing director for waste processing, treatment and disposal at Sharjah-based environmental company Bee'ah, believes there is "a level of legal ambiguity regarding laws governing the ethics and professional etiquette of proper construction and demolition waste removal".

"There are no specific laws concerning construction and environment at present, and this is a problem," he says. "Smaller companies are taking advantage of legal loopholes through unethical practices of dumping and discarding recyclable waste to both landfill and non-landfill sites. This has and will result in serious environmental concerns in the short and long term, as waste either deteriorates in an unsanctioned space or provides health hazards to the ecosystem and municipalities in proximity."

How important is environmental protection to your company?



Source: MEED Construction Industry Survey

The increasing profile of environmental compliance requirements in the region has highlighted that construction companies are not putting enough effort into their environmental responsibilities. While laws have been introduced, they are not consistent across the GCC.

"In certain jurisdictions, the regulations are among the best in the world and require construction companies or the owners of projects to prepare, for approval, construction environmental management plans (CEMPs) that are updated periodically," says Rob Hounsome, regional director of infrastructure and environment at Ramboll. "Additionally, these jurisdictions require companies to submit biannual reports on environmental performance and undertake audits reviews at construction sites to ensure compliance." These CEMPs help the companies consider the major impacts associated with construction activities ranging from controlling dust and emissions from vehicles and stationary equipment, reducing the potential for spillages and impacts to soil and water, increasing the efficiency of resource use such as energy, water, etc, and ensuring that all wastes are effectively managed.

Gregg Shuman, regional vice-president of engineering and consulting for the Middle East and Africa at SNC-Lavalin, says legislation is not the issue. "What is most important is enforcement of environmental protection."

Polluter pays

The UAE Federal law No 24 of 1999 for Protection and Development of the Environment deals with liabilities and compensation for environmental damage.

"The key concept is that the polluter pays," says James McMillan, a senior associate at Al-Tamimi & Company.

Article 71 of the 1999 Environmental Law provides that "any person who, intentionally or by way of negligence, causes damage to the environment or others as a result of violation of the provisions stated in this law or the orders or resolutions issued for its enforcement, shall be held responsible for all the costs of treatment or removal of such

damages and any compensation incurred as a result".

"Similar provisions exist within the comprehensive Saudi Arabian national environmental legislation in the form of the General Environmental Regulation, Council of Ministers Resolution No 193," says McMillan.

Impact assessment

In 2014, legislation in the GCC countries was introduced requiring the completion of an Environmental Impact Assessment (EIA) during the front-end engineering and design stage of a project.

EIA studies are licence requirements for projects likely to impact the environment (air, soil, water, groundwater, etc) as stipulated under the 1999 Environmental Law and its executive regulations.

Regulatory bodies within the UAE, such as Sharjah Municipality and Dubai Municipality, are the competent authorities, that set criteria for projects requiring EIAs, which must be carried out by approved third-party consultants such as the environmental consulting division of Bee'ah.

Typically, development projects will require EIA studies and some emirates may further require a CEMP following the production of an EIA to ensure all mitigation measures are implemented during the construction phase. In any case, each and every EIA study should investigate the impact of construction activities on the environmental components, and should propose the mitigation measures to reduce or eliminate those impacts.

"In the past, a significant number of companies in the Middle East looked upon these requirements only as a necessary cost of doing business, completing EIAs and ticking the right boxes, and then reports ended up collecting dust on shelves," says Shuman. "However, a number of key initiatives have been taken by governments across the region to reinforce EIA implementation and measurement, such as the Estidama system introduced by Abu Dhabi's Urban Planning Council in 2011 to rate the sustainability of a given development throughout its lifecycle from design through construction to operation. This has resulted in a change in companies' approach to sustainability."

Do you think the government sufficiently addresses environmental issues when it comes to construction?

Source: MEED Construction Industry Survey

Illegal dumping

"Actions should always have consequences," says El-Rabaya. "And if there are adequate legal ramifications in place, it will act as a deterrent for future incidents to repeat themselves. Clear laws of sanctioned spaces that are accessible to smaller companies would aid them in avoiding illegal dumping, as would laws supporting the proper sorting of construction waste."

McMillan says: "While the existing laws in the UAE and Saudi Arabia do set out a number of general environmental standards to improve public health and ensure sustainability, enforcement action may be required by regulators to ensure compliance with environmental laws in the region. Specific adoption of certain EU standards in relation to pollution prevention and waste management may also be a further step forward within the region to ensure continuous improvement and a consistent approach."

LESSONS LEARNED

Early industry engagement with planned legislation can shape the effectiveness of future regulations

Regulations and standards are an integral and necessary part of any industry. In the fragmented and generally bespoke construction sector, these laws become all the more necessary to cement uniformity, given the varying types of contractors, clients and projects. Regulations ensure common protocols are followed across industry practices.

At the same time, the varying nature of the industry makes it difficult to establish a one-size-fits-all approach. Even within the region, jurisdictional differences, even within one country, can produce varied and inconsistent regulations, for instance environmental laws across the UAE. Further, lack of clarity on the part of regulators is an issue highlighted by many industry players.

Industry regulatory bodies could offer a solution. Such bodies could report directly to or be a part of the government, collating the voices of the industry as per the 'department' it oversees. This would especially be useful when it comes to financial regulations, where changes such as Basel III, IFRS 9 and VAT affect the contractor cash flow and project finance. Unless the industry presents its views to the regulatory body in a succint manner, the legislation may fail to uphold the best interests of the industry. This will lead to frustrated contractors and a possible disregard for rules. Plus, severe cash constrictions could also lead to international companies departing from the country.

It is important to involve all players in the market, not just the large-scale ones. Lack of adoption by small and medium-sized enterprises impacts the entire economy, as noticed in the case of IFRS 15 revenue recognition rules.

While it is instructive to take cues from established markets in the West, these should be merely for understanding how a law could impact the industry, and should not be a benchmark for how operations are carried out in the region. The GCC market differs greatly, both in the way it does business and cultural attitudes towards contractual relationships. To ensure successful implementation of laws, the regulators need to understand the mindset of the local players.

Merely signing off laws is not the solution. Regular inspections, follow-up and feedback is essential. This not only keeps the industry in check, but also enables a timely overhaul of a regulation as per the economy.

ABOUT MEED

MEED has been integral to delivering business information, news, intelligence and analysis on the Middle East economies and activities for over 60 years. Attracting a key senior management audience through its content and activities, MEED is a media brand, publication and data business that covers a spectrum of services which inform, engage, connect and ultimately support our subscribers and partners in their business development and strategic growth.

Recently acquired by GlobalData Plc, MEED is now part of one of the largest data and insights solution providers in the world with the capacity to build global communities for our clients.

Our purpose is to support the region's companies make better and more timely decisions through our innovative data solutions and grow through our comprehensive and world-class marketing solutions.

To find out more email: info@meed.com

ABOUT MASHREQ

Established in 1967, Mashreq is the oldest bank in the UAE, with award-winning financial solutions and services. Throughout its 50 years' history, Mashreq has differentiated itself through innovative financial solutions, making it possible for its customers to achieve their aspirations.

Today, Mashreq has a significant presence in 11 countries outside the UAE, with 21 overseas branches and offices across Europe, the US, Asia and Africa.

Mashreq launched its new Vision and Mission recently, outlining its commitment towards its clients, colleagues and the community. In line with its vision to be the region's most progressive bank, Mashreq leverages its leadership position in the banking industry to enable innovative possibilities and solutions for its customers across corporate, retail, international, treasury and Islamic banking.

Mashreq is proud to be the first financial institution in the UAE to be awarded the Gallup Great Workplace Award for four consecutive years from 2014-17. Mashreq also continues to invest in recruiting, training and developing future generations of UAE national bankers.