Rebuilding the construction sector

Tebodin Ukraine’s Valery Levko: Construction recovery to centre on industry and infrastructure projects

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Two years ago the first indication most people in Kyiv had that a recession might be about to bite was when the cranes of the capital’s thousands of construction sites gradually ground to a halt. The once booming Ukrainian residential and private sector construction market was hit hard by the impact of the 2008 credit crunch, and so it comes as no surprise to hear market insiders predicting that the recovery within the construction sector will likely be mainly driven by projects in the less fast moving or consumer-dependent industrial sector, alongside state-financed infrastructure undertakings tied to Euro 2012.

Opportunities to modernize
Valery Levko, Kyiv Director of Dutch-end international consultancy and engineering company Tebodin, says that across Ukraine’s strategically crucial heavy industry sector he is seeing decision-makers take advantage of below capacity workloads at plants in order to overhaul Soviet era technologies and modernize wasteful practices, which means more and more work for construction companies and engineering consultants across the country. “For the foreseeable future the most attractive sector of the construction market is likely to be industrial construction,” Valery shares. “The industrial sector has been particularly hard hit by the effects of the global financial crisis but many players have used this lull in demand as an opportunity to modernize facilities. The metallurgy sector has been at the forefront of this trend with practical steps towards the reduction of natural gas consumption.”

Industrial initiative to improve energy efficiency
This push for greater energy efficiency in Ukraine’s heavy industry sector has been a long time coming and could have a significant long-term impact on both the economy and the country’s geopolitical position with regard to its dependence on subsidized Russian energy supplies. “At present the Ukrainian economy is one of the biggest per capita energy consumers in the world and practically every large industrial concern which currently relies on gas supplies for its energy
needs is looking for alternative options,” explains Valery Levko. “This could mean either alternative traditional energy sources or new technologies – anything which will reduce energy consumption and reliance on Russian gas. Thanks to the current political environment the big challenge now is to find something which is produced locally which can be used to substitute this dependence on increasing gas prices. The answer to this problem has resoundingly been coal. Until relatively recently 90% of Ukraine’s annual cement production relied on gas, but last year 50% was produced using coal. We expect that within 2 years the market share for coal will have risen to around 90%,” he shares. Mr. Levko thinks that the supposedly cheap gas rates secured as part of the Kharkiv Agreement between Ukraine and Russia are a ‘virtual discount’ which has not impacted on long-term thinking in the heavy industry sector. “Industrial leaders need to look not one year ahead but ten years ahead, and so this move away from Russian gas is a strategic step towards greater efficiency.”

Making use of modern waste for energy technologies
Alternative energy is also enjoying something of a vogue in post-crisis Ukrainian industrial circles, leading to enthusiasm for all things ecologically friendly. “Cement plants can utilize the domestic waste of any large city to produce energy,” Levko explains before conceding that many traditional political forces within the country do not all initially welcome such innovations. “This kind of project is not difficult from a technical point of view but they are often unpopular with local authorities and public opinion which views them as a negative environmental factor and potential additional ecological pollutant. The construction of household waste treatment and incineration plants could play a role in increasing energy efficiency but only if they are ecologically sound and if local authorities can be encouraged to adopt a new perspective on the issue and begin looking at industrial concerns as both suppliers of heat electricity (or chip energy) and potential partners in the disposal of household waste. This is worth serious consideration because many of Ukraine’s biggest cities are already struggling to cope with the level of garbage they are producing. Landfill sites are already full and new locations can be costly to develop. Instead of looking for more landfill sites, local governments can opt to utilize existing technologies already in operation in neighboring Poland and throughout the West. A number of projects along these lines have the highest priority in major cities like Kyiv, Donetsk and Kharkiv, but they remain politically sensitive due to perceptions that waste incineration plants are not environmentally friendly.”

Shopping malls offer best bet in retail and residential sector
Since the bubble burst on commercial real estate in the autumn of 2008 Ukraine has seen hundreds of construction projects frozen and the country’s big cities remain littered with the skeletal outlines of half-finished apartment blocks and business centres. Levko argues that while many of these will eventually find new owners and investors, most will need to be redesigned to suit the changing needs of the market. Furthermore, with consumer spending power still recovering from the impact of the 2008 crisis, it may take some time before there is enough disposable income in Ukrainian pockets to attract international construction groups back to the market. “At the moment the commercial sector of the Ukrainian construction market cannot offer quick returns and high profitability and so remains fairly unappealing. There is simply not enough consumer demand in Ukraine for residential property right now. Apartment buildings, office centres and retail outlets are unlikely to experience much growth in the coming few years, but any dynamic in the private sector construction industry is likely to focus on multi-functional office-hotel-mall-type centres. There is still a considerable deficit of this kind of real estate across Ukraine and they appeal to investors as they represent a European lifestyle option which is increasingly popular with Ukrainian audiences. Any increase in shopping centre construction will likely focus on regional capitals and provincial cities,” he predicts.

Euro 2012 airports just the beginning
Despite much doom-mongering in the Ukrainian media, Mr. Levko remains relatively upbeat about the prospects of the country’s Euro 2012 preparations. He acknowledges that the lack of an investor-friendly legal framework has hampered the country’s ability to finance major road and rail construction works but believes that Ukraine’s strategically important regional airport development plans remain on track. “The future of infrastructure projects in Ukraine will ultimately depend on the adoption of the appropriate PPP (public-private partnership) mechanisms along the lines of those established elsewhere in Europe,” he says. “However, the situation is not so gloomy - all the designated Euro 2012 airport projects are progressing at a good pace. Kharkiv airport is close to
completion while work in Kyiv, Donetsk and Lviv in also moving forward.". Tebodin has been behind the architectural plans for a number of Ukraine’s next generation of regional airports as General Designer of Boryspil and Lviv international airports, and Levko sees this airport development trend developing well beyond the framework of Euro 2012 preparations. “Generally speaking, the development of Ukraine’s airport infrastructure is a kind of chain reaction: as soon as you begin constructing modern airport facilities in two or three regional capitals, every big city will begin looking at its airport facilities. Once these initial four Euro 2012 airports are operational, attention will turn to other regional hubs such as Odessa and Dnipropetrovsk, with the Odessa authorities in particular active at present in trying to attract investors for a new international airport. Sevastopol airport is also a very attractive prospect, but it does continue to suffer from being both a military and civilian facility. In fact, it may eventually require government intervention to resolve the manner in which Sevastopol airport will function,” he opines.

Potential beneficiaries of EU free trade zone deal
The construction sector could also be one of the beneficiaries of a free trade agreement between Ukraine and the EU. Talks over a free trade deal have been ongoing for the past two years and the new Yanukovych government has made finalising an agreement one of the objectives of their foreign policy approach to ties with Brussels. Levko explains that a free trade zone including Ukraine and the EU would likely mean a significant reduction in the price of construction materials entering Ukraine from European markets. With much of the building sector dependent on EU sources for both materials and state-of-the-art machinery, the impact could be significant. “The construction industry depends to a large extent on EU imports for its raw materials and equipment, so a free trade zone would remove many of the tax barriers and force prices down. These savings would serve to make the market more competitive,” he reasons.

Stability still key to investor appeal
With the broader Ukrainian economy demonstrating evidence of a recovery and the country experiencing relative political stability for the first time in some years, Levko feels that the construction sector is now well beyond the worst of the recent recession and is on the way towards a strong recovery. According to international institutions and various fund analyst predictions, Ukraine could be in line for a return to pre-crisis GDP levels within 2 or 3 years, while continued stability will also signal an eventual return to international investor attention. “The construction sector has been waiting for political stability for some time, and in the first half year of the new administration we have seen some signs that these expectations are gradually being realized. We’ve seen a reduction in political tensions and this has had a positive impact on the construction sector as investors do not like instability, whether we’re talking about international investors or Ukrainian investors. If we want to see international players returning to the Ukrainian construction market in the kind of numbers witnessed in the boom years of the mid 2000s then we need political and economic stability coupled with a boost in the consumer capacity of the Ukrainian public,” he concludes.

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