FIS Formal Statement on Retentions

Retentions are an archaic way to manage quality and no longer fit for purpose. They undermine a positive culture in construction and engender a lack of trust.

At any one time, it is estimated that in England alone, between £3 billion and £6 billion of retention money is withheld. Around 10% of this is estimated to be related to the finishes and interiors sector.

FIS currently support Build UK's Roadmap to Zero Retentions. This is built on The Construction Supply Chain Payment Charter introduced by the Construction Leadership Council, to create a more collaborative payment culture, setting down the ambition to move to zero retentions by 2025.

In summer 2020 the Scottish Parliament consulted on retentions and FIS has supported the CICV Position in Scotland, that proposes all Tier 1 and Tier 2 contractors be given the opportunity to offer a Retention Bond on all public sector projects where retention is selected as the primary security in place of cash retention.

Background in support of Statement

Retentions are typically 3-5% of contract value. By way of example, the standard JCT contract allows for them to be released in two parts, when your work reaches practical completion (although a delay period is often built in) and the second half typically on project completion. This second payment can be years after defects liability has expired. A concern raised through FIS is that the Main Contractor is not under any obligation to advise on project completion date and release is seldom automatic.

Publicly there is general consensus across the sector that the retention culture is negative - this was underpinned with the failure of Carillion which is estimated to have taken £250m-£500m of retention monies out of the market. The concern is that the industry cannot claim that it delivers buildings that are defect free and hence the pressure will remain for retentions to prevail unless a viable alternative can be found. Key international studies suggest that the measured direct costs of avoidable errors are in the order of 5% of project value. This equates to approximately £5 billion per annum across the sector in the UK and is higher than average profit levels across the industry (around 1-2%).

Government have used the fact that there is not unanimity from the industry on a solution as a reason not to take more formal action. CLC have supported the BuildUK Roadmap.

In construction, two sectors have effectively eradicated retentions, scaffolding and lifts. Scaffolding is fundamentally different from work in the Finishes and Interiors Sector in so far as you get paid effectively in two lumps (ignoring deposit) i.e. when it is put up and when it is struck. Problems in the middle, if any, are cognisant of a final payment on striking the scaffold and once down you can't really have a legacy scaffolding issue. Lift contracts tend to be intrinsically linked to service contracts that extend way beyond the final construction works.

Roadmap to Zero Retentions

This **roadmap** sets out the framework, including key milestones for implementation by the supply chain, to deliver zero cash retentions within construction between now and 2023. This is two years ahead of the industry ambition and the milestones will be kept under review to ensure that the transition to zero cash retentions takes place as quickly as practicably possible.

As part of the move towards zero cash retentions, Build UK members have agreed a number of 'minimum standards' on retentions. By implementing these minimum standards within their contracts, the intention is to help reduce the challenges associated with the existing use of cash retentions. Build UK are clear that they should not be viewed as best practice and, in those sectors, where the minimum standard is already not to accept cash retentions, for example in the piling and lift sectors, this should be maintained.

Prior to supporting the BuildUK Position, FIS were a leading and vocal supporter of the Aldous Bill - the Bill proposed by Peter Aldous MP that cash retentions be held in trust accounts to protect the supply chain. Officially named the Construction (Retention Deposit Schemes) Bill, it was pushed back on a number of occasions. Parliament was dissolved for the General Election at the close of 2018 before the Bill could progress.

Alternatives / Interim measures

A concern raised has been that the Roadmap does not fully address concerns around defect management and without viable alternatives the Roadmap may just result in the can being kicked down the road again. A number of alternatives have been proposed as interim solutions, with the ultimate prize being a get it right first time approach with greater supply chain collaboration and trust supporting the withdrawal of retention. In the meantime, alternatives for consideration are:

Retention Deposit Scheme

The Latham report in 1994 originally recommended that the industry evolve to retentions in trust.

Recommendation 27: Trust Funds

> 10.18 I have already recommended that mandatory trust funds for payment should be established for construction work governed by formal conditions of contract (see Chapter 8). It is important that public sector clients have the same requirements, in order to maintain confidence amongst subcontractors. If the main contractor fails, it would be the duty of the trustee to ensure direct payment out of the trust fund to subcontractors. If the client fails, payments would be made out of the trust fund to the contractor. Similar arrangements should cover retention monies if that system continues (see Chapter 11). The statutory provisions should ensure that the trustees are legally empowered to make full payments direct to contractors or subcontractors for work done, or materials supplied and/or already incorporated within the work, without the Receiver of the failed participant being allowed to take such monies on behalf of other creditors[92]. Separate provisions will be required for Scottish Law, but I am told that it is possible to devise them to obtain the same results[93].

This is effectively the position of the Aldous Bill, which did have widespread support within the specialist sector (including from FIS). The response to the latest consultation in England suggests that there is still support for a Trust based approach. Project Bank Accounts can provide a similar retention facility. The push-back has been over the costs of administering Project Bank Accounts.

Retention Bonds

Retention bonds are an alternative way of avoiding problems associated with retention recovery. Amounts that would otherwise have been held as retention are instead paid, with a bond being provided to secure the amount. Similar to retention, the bond's value will usually reduce after the certification of practical completion.

When operating on a Bond, a subcontractor is usually allowed a fixed period of time to rectify any defects, stipulated by the retention bond. Should they fail to rectify the defect, the retention bond can be called on by the contractor and the surety must cover the remedial costs, before then pursuing the subcontractor. Whilst subcontractors must pay the surety's premiums, the benefit to them is that they do not have to chase retention monies post-completion, and no retention monies will be withheld. This cash flow security is often seen as worth the cost of the premium. Similarly, retention bonds are advantageous to contractors in improving the cash flow and financial stability of the subcontractor, making them less likely to default on the works.

Whilst many see this as an effective **interim measure**, resistance to this approach amongst specialists has largely centred on cost and an underlying principle that retentions should be removed.

Supporting information

Nov 2020: Cash retention under construction contracts: consultation analysis

Feb 2020: A Westminster Hall Debate hosted by Alan Brown MP on Cash Retentions in Construction

Feb 2020: UK Government response to the most recent Retention Consultation, February 2020 (published over two years after the consultation closed)

April 2019: Retentions in the Scottish Construction Industry Scottish Government, Pye Tait Consulting,

October 2017: Retentions in the Construction Industry BEIS Research Paper.

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