# Retention Payments in the Construction Industry:
# A Response from Build UK and CECA

## Executive Summary

- Build UK and the Civil Engineering Contractors Association (CECA), with the support of the Construction Products Association (CPA), recognise that cash retentions cause significant issues across the supply chain, as demonstrated by Carillion entering liquidation in January 2018, and the abuse of the practice (including late and non-payment) must be addressed.
- Build UK and CECA members remain fully committed to achieving zero cash retention within construction and we are calling on **Government to introduce legislation to ensure there is zero cash retention within the industry by no later 2025**.
- Existing alternatives to retentions can help to mitigate against the abuse of retentions, and a retention deposit scheme would provide security of retentions in the event of insolvency.
- However, the size of the prize is much greater - to abolish the use of cash retention altogether - and we believe that a joint approach of Government legislation, supported by the industry developing and implementing a phased roadmap, is the best way to achieve the cultural change needed.

## Build UK and CECA welcome the consultation and recognise that the practice of cash retentions causes significant issues across the supply chain

1. This is a joint response from Build UK and CECA, with the support of the CPA. Together, the three organisations represent the construction supply chain, from clients and the contracting supply chain to manufacturers and suppliers.
2. Retentions are a key issue for the construction industry and we welcome the Government's review of the long-standing problem with its consultation *'Retention payments in the construction industry'*. We consulted widely with our members at the end of 2017 and this issue takes on even greater significance following Carillion going into liquidation.
3. Cash retention – the withholding of a percentage of payment on construction work until it is certified as having been completed free of defects – is intended to provide security to the industry's clients that any defects will be rectified appropriately. However, retentions are problematic for all parties in the supply chain and the practice of 'passing on' retentions in order to secure cash flow, coupled with the loss of retentions due to insolvency, particularly in light of Carillion going into liquidation, has a significant impact upon cash flow and working capital throughout the supply chain.
4. The abuse of retention, specifically late and non-payment as a strategic lever at the end of a project, is particularly challenging in terms of cash flow and must be addressed. There is often a significant administrative and cost burden to secure the release of retention, particularly for smaller companies in the supply chain.
5. Where retention is not recovered, there can be a significant impact on a company's profit margin on a project, which is already likely to be under pressure. This reinforces the need to change the construction business model as current operating margins are not sustainable for the level of risk that companies are taking on.
6. It is now widely accepted that retentions fail to provide an appropriate or proportionate mechanism for ensuring quality and fair payment. To achieve cultural change and deliver benefits for the entre supply chain, we firmly believe that any solution must tackle the root causes of the abuse of retention.

## Build UK and CECA members remain fully committed to achieving zero cash retention within the industry

7. *Construction 2025* which was published by Government in 2013 committed to '*creating the conditions for construction supply chains to thrive by addressing access to finance and payment practices*'. The Construction Supply Chain Payment Charter, which was introduced by the Construction Leadership Council (CLC) in 2014 to create a more collaborative payment culture, sets out a commitment to '*not withhold cash retention or ensure that any arrangements for retention with our supply chain are no more onerous than those implemented by the client in the Tier 1 contract.*' The Payment Charter also states an ambition to move to zero retentions by 2025. The development of the new Construction Sector Deal offers an opportunity for Government and industry to reconfirm the commitment to, and outline the steps which will be taken to, remove retentions.
8. There is unanimous support from Build UK and CECA members for the abolition of cash retentions, and there are already some clients, projects and sectors (for example piling and lifts) which do not apply or accept cash retention. We believe that Government must introduce legislation to abolish retention and that this, supported by an industry-led roadmap, would drive the cultural changes required to transition from current practice to zero retentions.
9. There are a number of significant benefits for the industry, its clients and stakeholders, that would be realised by removing retention:
    a. An increase in working capital within the supply chain to support investment, productivity and growth;
    b. Without the threat of unfair payment, there would be an incentive to improve quality of completed works on construction projects as well as increased assurance that any defects that did occur would be rectified appropriately; and
    c. Increased collaboration and transparency in the construction industry by ensuring that any forms of security used against defects would be appropriate and proportionate.
10. A legislative abolition of the practice of retention offers a game-changing opportunity for the industry and we are **calling on Government to introduce legislation to ensure there is zero cash retention** within the industry by no later than 2025.
11. Legislation to abolish cash retention, supported by an industry-led roadmap (see point 17 below), offers the best chance of success as it would ensure that the previously mentioned underlying issues of retention are addressed. With this joint approach, we believe the timescale of 2025 should be brought forward (see point 20 below).

## Existing alternatives to retentions can help to mitigate against the abuse of retentions

12. Whilst committed to abolishing cash retention, Build UK and CECA members recognise that alternative solutions must be identified and made available to the industry in order to provide security in the event of defects.
13. There are currently a number of possible alternatives, which require further exploration, analysis and implementation in order to move towards zero retention, and we will be undertaking this work in 2018 and looking to work in partnership with Government.
14. The consultation considers a retention deposit scheme (similar to the Tenancy Deposit Scheme) in the first instance. It follows the Pye Tait research which was generally supportive of the principle of ring-fencing the monies which would otherwise be withheld through retention. This is because a retention deposit scheme is recognised as both mitigating the risk of insolvency,

which is critically important to the supply chain, as demonstrated by the liquidation of Carillion earlier this month, and supporting the fair and objective release of retention where there are no proven and substantiated defects.

15. However, we are concerned that a retention deposit scheme seeks to address a symptom of retention (protecting against insolvency), as opposed to the cause (difference in quality delivered by the supply chain and inconsistency in rectifying defects), which is why our preference is for Government to legislate for zero retention.
16. If Government chooses not to go down this route and has an appetite to pursue a retention deposit scheme, we are committed to working in partnership to design and develop a scheme and members are supportive, in principle of an industry-wide, open-to-all scheme, along the lines of the Tenancy Deposit Scheme.

## However, the size of the prize is much greater - to abolish the use of cash retention altogether

17. With Build UK and CECA members' reinforced support to deliver zero cash retention, there is a greater prize within the grasp of industry – to abolish the practice of retention entirely. However, we recognise that the ambition has been in place since 2014 with few steps taken to make progress towards it. To deliver zero cash retention, we believe that a joint approach of Government legislation, coupled with industry developing and implementing a phased roadmap, would be the only way of achieving the cultural change needed.
18. The Government's role would be to:
    a. Legislate to ensure there is zero cash retention in the industry by no later than 2025;
    b. Confirm and implement as soon as possible, a robust policy position to stop the use of cash retention in central Government departments and work to influence local Government, agencies such as Network Rail, and major capital infrastructure projects to adopt a similar position; and
    c. Work in partnership with industry to develop alternatives to cash retention.
19. Build UK has developed a roadmap in consultation with members, providing a phased approach to transitioning from current practice to zero retention at the earliest opportunity. The roadmap seeks to ensure:
    a. Wide scale adoption and implementation of the roadmap by the industry;
    b. Ensuring any forms of security used against defects are appropriate and proportionate; and
    c. Effective and regular monitoring of progress against the roadmap, and in particular its implementation by members.
20. The Build UK roadmap, which is included as an annex to this consultation response, sets out a series of milestones to deliver the abolition of retention by 2023. The first significant milestone is a series of 'minimum standards' adopted on new contracts by 2019. The aim of these minimum standards is to reduce the challenges associated with the existing use of cash retentions within the industry, ahead of their abolition.
21. During the development of the roadmap a number of challenges have been raised:
    a. Concern as to whether a critical mass would be genuinely willing to adopt the agreed standards and change their practices. The roadmap sets out Build UK's intention to obtain the endorsement of the CLC, to seek commitment of central and local Government, together with other relevant industry bodies, to implement the minimum standards on retentions, and to develop a process for monitoring and enforcing progress on implementing the roadmap;

b. Scepticism about the industry's ability to deliver the roadmap. However, it is noted that Build UK and CECA's project to deliver Pre-Qualification Reform by summer 2018 is an example of where significant progress is being made by industry on a long-standing issue (see box below); and
c. The need for exploration and analysis of alternative forms of security, including those from other jurisdictions. A key milestone to deliver zero retentions is for industry and Government to work together to develop proposals for other forms of security and protecting retention monies.

**Pre-Qualification Reform - Delivered by Industry for Industry**

Reform of the pre-qualification process in construction has been an objective of the industry for many years with limited progress made.

With the endorsement of the Construction Leadership Council (CLC), Build UK and CECA have taken a collaborative, industry-driven approach to identify the challenges, understand the key drivers of all the parties involved, and jointly overcome the barriers that have previously hindered progress. By working with members, central Government, and third-party assessors to identify and implement realistic milestones, we have ensured that all stakeholders are an integral part of delivering successful reform within an agreed timeframe. This inclusive approach has been key to our success in moving from talking about change to developing an effective industry-owned solution that is relevant for the whole contracting supply chain.

In summer 2018, Build UK and CECA will launch a pre-qualification system which delivers the industry's ambition of a single assessment standard, greater transparency and reduced bureaucracy.

22. There are a number of opportunities that arise from an industry-led approach:
    a. The adoption and implementation of an industry-agreed roadmap by the construction supply chain can achieve wide scale change across the industry;
    b. The industry itself delivering change on this key issue; and
    c. A phased approach, such as that set out in the roadmap, could deliver significant improvements to the existing use of retention in a shorter period of time.
23. With industry support to progress the roadmap, alongside Government legislation for zero cash retention, Build UK and CECA are committed to taking forward this work by engaging with the wider industry, gaining the support of the CLC and collaborating with the Government, and monitoring the implementation of the milestones within the roadmap.

## Industry Recommendations

- Implement industry-agreed roadmap to deliver zero cash retention by 2023, with an industry-wide, robust monitoring and enforcement mechanism
- Explore and design alternatives to cash retention
- Develop and present to Government the design and key features of a retention deposit scheme.

## Government Recommendations

- Legislate to ensure there is zero cash retention by no later than 2025.
- Confirm and implement, as soon as possible, a robust policy position to stop use of cash retention in central Government departments and work to influence local Government, agencies such as Network Rail, and major capital infrastructure projects to adopt a similar position
- Work in partnership with industry to develop alternatives to cash retention.

## Further Information

24. Build UK is the leading representative organisation for the UK construction industry. Offering influential and dynamic leadership, Build UK is transforming the delivery of construction projects for the benefit of the industry, its clients and the UK economy. Representing more than 40% of UK construction, Build UK creates the conditions for supply chains to thrive by delivering change on key industry issues.
25. The Civil Engineering Contractors Association (CECA) is the representative body for companies which work day-to-day to deliver, upgrade, and maintain the country's infrastructure. With more than 300 members split across eight regions, CECA represents firms who, together, carry out an estimated 70-80 per cent of all civil engineering activity in the UK, in the key sectors of transport, energy, communications, waste and water. CECA represents civil engineering contractors building and maintaining the UK's critical infrastructure networks in transport, energy, water, waste and communications.
26. The Construction Products Association represents the UK's manufacturers and distributors of construction products and materials. The sector directly provides jobs for 333,000 people across 23,000 companies and has an annual turnover of more than £56 billion. Nearly 80% of all products used in the UK are made in the UK. Manufacturers and suppliers invest significantly into R&D and ensuring their products are tested and meet performance standards required by regulations, and are therefore fit for purpose. Whilst the impact of cash retentions is typically more significant for contractors and builders than for manufacturers, this issue of creating a business culture and practices across the wider construction supply chain that assures quality in the built environment is very relevant to us.
27. Build UK and CECA would be pleased to discuss or expand any of the issues raised in this response. For further information, please contact:

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## Annex: Roadmap to Zero Retentions

### Vision

Fair and transparent payment practices are essential for a thriving construction industry and a strong and sustainable supply chain.

In recognition of this, Build UK and its members are looking to realise the ambition set out in the Construction Supply Chain Payment Charter for zero retentions by 2025, by developing and implementing this roadmap.

### Objectives

1. Wide scale adoption and implementation of the roadmap by Build UK members and the wider industry
2. Ensuring any forms of security used against defects are appropriate and proportionate
3. Effective and regular monitoring of progress against the roadmap, and in particular its implementation by Build UK members.

### Background

Cash retention – the withholding of a percentage of payment on construction work until it is completed free of defects – is intended to provide security to the industry's clients that any defects will be rectified appropriately. Retentions are problematic for all parties in the supply chain and the practice of 'passing on' retentions in order to secure cash flow, coupled with the loss of retentions due to insolvency, has a significant impact upon cash flow throughout the supply chain. As such, retentions generally do not provide an appropriate or proportionate mechanism for ensuring quality and fair payment.

The Construction Supply Chain Payment Charter, which was introduced by the Construction Leadership Council to create a more collaborative payment culture, sets out an ambition to move to zero retentions by 2025.

In accordance with the Objectives above, this Build UK roadmap sets out a 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 ambition in the Payment Charter and the milestones will be kept under review to ensure that the transition to zero cash retentions takes place as quickly as practicably possible.

### Challenges to Delivering the Roadmap

- Difference in quality delivered by the supply chain and inconsistency in returning to site to rectify defects
- Providing security when working with a supply chain where there is not an established relationship
- A perceived lack of viable alternatives to retentions that provide similar levels of security
- Ensuring that any use of cash retentions until 2023 and other forms of security are implemented 'back to back' through the supply chain to prevent any one party bearing the financial impact.

### Intended Outcomes and Benefits

- Adoption and implementation of the Build UK roadmap by the construction supply chain to achieve wide scale change across the industry
- Improved quality of completed works on construction projects, and increased assurance that any defects that do occur will be rectified appropriately, without the threat of unfair payment
- An increase in working capital within the supply chain to support investment and growth

- Increased collaboration and transparency in the construction industry, ensuring that any forms of security used against defects are appropriate and proportionate
- Government recognition that the industry is stepping up to deliver change on this key issue and support for implementation of the roadmap within public sector procurement.

## Key Milestones

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| **2018** | Build UK to consult with members to establish current practice on retentions, including identifying organisations and projects which do not withhold retentions |
| | Build UK members to agree and commit to implementing this roadmap, including minimum standards on retentions by 2019 |
| | Build UK to seek the endorsement of the Construction Leadership Council for this roadmap |
| | Build UK to seek commitment of central and local Government to implement the minimum standards on retentions by 2019 |
| | Build UK to work with members to develop proposals for other forms of security and protecting retention monies |
| | Build UK to agree process for monitoring members' progress on implementing the minimum retention standards |
| **2019** | Build UK members to implement the minimum retention standards - maximum retention rate of no more than 1.5% and minimum contract value of £50,000 |
| | Build UK to monitor members' progress on implementing the minimum retention standards |
| | Build UK to provide support for implementing other forms of security where appropriate |
| **2020** | Build UK to review this roadmap and in particular the key milestones and minimum retention standards |
| **2021** | Build UK members to implement enhanced minimum retention standards - maximum retention rate of no more than 1% and minimum contract value of £100,000 |
| | Build UK to review this roadmap and in particular the key milestones and minimum retention standards |
| **2023** | Zero cash retentions |

## Minimum Standards on Retentions 2019

To help move towards zero cash retentions by 2023, it is intended that Build UK members will adopt the following minimum standards on retentions on new contracts by 2019. The aim of these minimum standards is to reduce the challenges associated with the existing use of cash retentions within the industry and they should not be viewed as best practice. In those sectors where the minimum standard is already not to accept cash retention, for example in the piling and lifts sectors, this must be maintained.

- Any arrangements for retention are no more onerous than those implemented by the client in the Tier 1 contract *(this is the commitment within the Construction Supply Chain Payment Charter)*

- No retention is deducted on elements that are not incorporated into the permanent works, such as demolition and scaffolding
- No retention is deducted on contracts with an original contract value of less than £50,000, increasing to £100,000 from 2021
- Retention is deducted as a single sum from the payment immediately following practical completion, or where milestones are used from the penultimate milestone payment, rather than from each interim payment
- Retention will be withheld at no more than 1.5% of the contract value at the time of practical completion, reducing to 1% from 2021
- Any retention withheld will be released on an agreed calendar date calculated, on a fair and reasonable basis, by reference to either:
    - the actual date of Practical Completion of the sub-contract; or
    - the anticipated date for Practical Completion of the main contract at the time the sub-contract is entered into, plus the Rectification Period under the main contract.

  If there are defects in the works performed under the sub-contract, release is delayed until they have been rectified.