The Chartered Institute of Building

submission to the

Department for Business, Energy & Industrial Strategy

on the consultation on

Retention Payments in the Construction Industry

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Department for Business, Energy & Industrial Strategy (BEIS): Retention Payments in the Construction Industry

Introduction

The Chartered Institute of Building (CIOB) is at the heart of a management career in construction. We are the world's largest and most influential professional body for construction management and leadership. We have a Royal Charter to promote the science and practice of building and construction for the benefit of society, which we have been doing since 1834.

Our members work worldwide in the development, conservation and improvement of the built environment. We accredit university degrees, educational courses and training. Our professional and vocational qualifications are a mark of the highest levels of competence and professionalism, providing assurance to clients and authorities who procure built assets.

We welcome the opportunity to respond to this consultation and are happy to be involved in the debate as it develops.

General comments

1. The CIOB welcome the Department for Businesses, Energy and Industrial Strategy (BEIS) consultation on retention payments in the construction industry. We recognise that cash retentions cause significant issues across the supply chain, and the abuse of the practice, including late and non-payment, must be addressed.

2. In October 2017, the Government published the Pye Tait review, *Retentions in the Construction Industry*[1]. The review sought to assess the costs and benefits of retentions and alternative mechanisms. It found that the average retention was 4.8%.

3. The report also found that reasons for non- or late-payment of retentions included:

    - Disputes over defects;
    - Contractors becoming insolvent;
    - Non-payment in a higher tier of the supply chain;
    - Contractors not asking for their retention money, with some tier 3 companies pricing work to offset the retention costs, and others keen to maintain good relationships with their main contractor.

4. It found that these reasons can result in higher overheads, poor relationships, constraints in growth and in some cases insolvency.

[1] BEIS, Retentions in the Construction Industry, October 2017

5. We agree that whilst measures such as the Prompt Payment Code, Construction Supply Chain Payment Charter and Project Bank Accounts (PBA) have had a positive influence in improving payment practices, the number of construction contracts using these voluntary measures remain low. One of the primary reasons for this is could be a lack of support to adopt the above schemes which could be bureaucratic, particularly at SME contractor level.

6. We support the Build UK, Civil Engineering Contractors Association (CECA) and Construction Products Association (CPA) ambition to move towards zero cash retentions by the year 2025. There are clearly a number of significant benefits for the culture of the industry, its clients and stakeholders, which could be realised by removing retention, these are:

    - 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, productivity and growth;

    - Increased collaboration and transparency in the construction industry, ensuring that any forms of security used against defects are appropriate and proportionate.

7. In light of this, we believe a legislative solution to abolish the practice of retention offers a game-changing opportunity for the industry. The joint Build UK, CECA and CPA response calls on the Government to legislate for zero cash retention by no later than 2025. The response also sets out an industry-led roadmap to assist the construction supply chain move towards a zero cash retentions system.

8. Although we do have our concerns about how such a system will be instilled, we are supportive of the ambition. Carillion's collapse has put late payments to suppliers in sharp focus. With over £800m in payments owed to sub-contractors, there is a very real chance that significant proportion of this money will be lost which leaves numerous sub-contractors at risk of financial collapse. Lessons must be learnt from Carillion and it must be viewed as an opportunity to change the construction business model.

9. The consultation's Impact Assessment estimates that the total amount of retentions unpaid each year due to upstream insolvencies is £229 million, in 2015 prices. With retentions being approximately 5% of contract value, this means profit is being lost on about £8bn of turnover, assuming a 3% margin.

10. The impact of protecting retentions and putting them out of reach of the current retention holders would increase the borrowing

requirement of those using the money by an estimated £2.1bn. In order to borrow £2.1bn extra, the industry requires considerably more equity than it has at the moment, perhaps an additional £10bn when you factor in the risk. Having to put an additional £10bn into capital can drastically reduce the return on capital employed. So it is understandable to see the reluctance to give up retentions, because retentions are another form of cheap and profitable business finance.

11. Late or non-payment of retentions is common. Again as the consultation points out, many lower tier subcontractors eventually give up any expectation of receiving the retentions, be it through not wanting to alienate their customer, having to meet obligations on a non-connected contract, or through delay and procrastination tactics designed to wear them out.

12. The consequences can be devastating. The Federation of Master Builders (FMB), in a recent survey, reported that 5% of members have had to withhold paying wages due to late or non-payment. This is labour exploitation. It is no good those at the top of the supply chain saying smaller firms do not have enough working capital in their business when it is clear it is being appropriated by those up the supply chain, either through retentions or long payment terms.

13. Whilst we are supportive of abolishing cash retention, we recognise that alternative solutions must be identified and made available in order to provide security in the event of defects. We believe that these alternatives require further analysis and trialing across the construction industry as it moves towards zero retention. This will, however, require a strong partnership between industry and government in order to reach this challenging ambition.