Contractor's Guide to Retention

Everything you need to know & how to get it back.

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In the construction industry, retention is security held by a procuring contractor to guarantee the performance of a supplying contractor and in particular to safeguard against defects in the event that the supplying contractor fails to satisfactorily rectify them. The security is usually in the form of cash withheld (retained) but it can be substituted for a bank guarantee or insurance bond.

Retention applies to both head contractors (both a procuring contractor and a supplying contractor) and subcontractors (generally a supplying contractor only) and is usually up to 5% of the total contract value of the works. Construction works are focused on the construction, demolition, renovation, maintenance or repair of building and infrastructure.

Considering that the Australian construction industry generates over $360 billion in revenue*, producing around 9% of Australia's Gross Domestic Product, the amount of money held in retention each year is decidedly substantial.

Contractor retention is deducted from all of the interim payments made to the head contractor from its employer/client, which in turn is deducted from all the subcontractor's payments.

*https://nationalindustryinsights.aisc.net.au/industries/construction

Once the head contractor's works are complete, half of the retention money is released. This stage of works has different names in different contracts but "practical completion" is a common term, and should signify the first release of retention in construction contracts. It's important to note that payment of withheld retention monies are not conditional or dependent upon events or obligations under another contract.

Ordinarily there follows a period commonly known as the "defects liability period (DLP)." Unless specified in the contract, the DLP ends 12 months from the date of practical completion. During this period the head contractor and subcontractors have to make good any defects in the works.

Usually, unless remedial work is urgent, the works are inspected at the end of the defects liability period and a schedule of defects is produced. The head contractor and subcontractors remedy the defects and, when they have done so, the works are inspected again and, if made good, the balance of retention is paid. This signifies the second and final release of retention in construction contracts.

Regardless of whether you are a head contractor or a subcontractor, having a clear system in place can help to ensure you get your retention back.

To keep track of your construction retention, it's essential to make and receive appropriate, written notifications at the time of practical completion and again at the expiration of the defects liability period.

Here are some handy tips to help the process:

- Notify your procuring contractor of the date of practical completion of your part of the works as soon as possible after they have been completed. If you are a head contractor or subcontractor, insist upon the employer/client or head contractor issuing a certificate of practical completion, or at least an acknowledgement, so that you have an undisputed date from which to calculate the defects liability period.
- Record the date of practical completion and set a reminder in your tracking system to alert you when you have reached the end of the defects liability period.
- You should always request in writing to release retention. This is usually in the form of a "claim for practical completion" and, after defects remediation, a "claim for final completion." This request is also referred to as a retention release request (sometimes "initial" and "final" release requests).
- If retention is not released you should investigate why ASAP. You may be entitled to interest on amounts paid late!
- Bank guarantees are effectively equivalent to cash (worse, they're often supported by mortgaged assets) and often even harder to get back.
- It is essential to keep good records and copies of all correspondence both sent and received.

Payment Process Workflow

If retention is not released when requested, the system you have in place should flag this and the contract should be singled out for special attention.

For these situations, apply these steps:

- Check carefully what the contract says. If you have achieved the necessary stage(s) that triggers the release of retention and have followed due process, your employer is in breach of contract if they do not release it, and you may be entitled to suspend works.
- Remind them politely of this fact. Cut through the administrative layers and speak directly with a decision-maker, usually the Commercial Manager or Director.
- Show them your records of correspondence; how many times you have asked for the money and any responses received. Insist politely that the construction retention is released immediately. If necessary, offer to personally collect a cheque if that is most convenient.

Being able to refer to a contract which has clearly outlined the stages of works that signify the release of retention is hugely beneficial when it comes to progressing claims throughout a project. A retention clause in a contract includes the amount of money to be retained, and describes when and how this amount will be paid back, as agreed by both parties.

If the procuring contractor does not release retention when you have put pressure on them and produced all records of correspondence to support your claim, you should take the matter extremely seriously. It may be a sign that they are experiencing financial difficulties and urgent action may be required.

You may be able to take court action or apply for adjudication to recover money due to you if you have not received a payment schedule within a certain timeframe (for example 10 business days) after making a claim, and if you receive no payment by the due date. You may also consider suspending works if you have not been paid by the due date.

Resolving Retention Disputes, State by State

It's important to understand that each state in Australia, and New Zealand, has its own legislation in place when it comes to the protection, and proper handling and payment of retention money.

These Acts seek to protect contractors' and subcontractors' retention money being held in trust for major construction projects - including if a construction company becomes insolvent, or in the event that retention money is being held without a reasonable excuse.

New South Wales

Retention on projects valued over $20 million in New South Wales must be held in a trust account with an authorised deposit taking institution (ADI). All deposits and withdrawals are to be recorded in a ledger and provided to the subcontractor at least once every three months, or as agreed. Payment claims must be served within 12 months of last carrying out construction work or supplying related goods and services. Read more here.

Victoria

Claims for payment can be made for 'progress payments' for work done since a date determined by the contract, or under the SOP Act (Building and Construction Industry Security of Payment Act 2002). If the contract does not specify when the contractor is entitled to be paid, the SOP Act sets the date. Any 'paid when paid' or 'paid if paid' clauses in the contract have no effect. Payment claims must be served within three months of last carrying out construction work or supplying related goods and services. Read more here.

Queensland

Retention trust accounts should be in place to hold the cash retention for contracts, and subcontractors are considered secured creditors in the event of bankruptcy or insolvency. Retention money owing must be released 12 months after practical completion if the contract does not specify the defects liability period (DLP). Payment claims must be served within six months of last carrying out construction work or supplying related goods and services. Read more here and here.

Western Australia

A retention trust scheme introduced by a bill drafted in 2020 aims to protect contractors and subcontractors if an employer/contractor on a project creates a barrier to accessing retention money so that it is not available to be paid out. Retention money must be held in a dedicated trust account with an approved financial institution, such as a bank, and the account holder is required to maintain account records and provide them to the contractor/subcontractor with reasonable notice. Read more here.

Northern Territory

Payment claims, including for retention money, work similarly to how things progress in WA (discussed above). Contractors can apply for adjudication to resolve payment disputes that require third party intervention. Read more on page 27 here.

Australian Capital Territory

A claim for a progress payment can only be made on and from the reference dates specified in the contract. If no reference date is specified, then a payment claim can be made on and from the last day of each calendar month. Contracts cannot include a 'pay when paid' provision, which means that subcontractors owed money must be paid. If money held is not released, claimants can apply for adjudication to resolve the matter. Payment claims must be served within 12 months of last carrying out construction work or supplying related goods and services. Read more here.

South Australia

The 'Security of Payment Act' provides a clear dispute resolution process called adjudication. Its aim is to be an orderly process following definite time frames, and requires the claimant to take different actions based on whether a respondent serves, or fails to serve, a written response to a claim. Payment claims must be served within six months of last carrying out construction work or supplying related goods and services.
Read more here.

New Zealand

Retention money in commercial construction contracts must be held in trust in the form of cash or other liquid assets readily converted into cash, unless a financial instrument is purchased (such as insurance or a payment bond). The law provides default payment provisions and bans the use of 'pay when paid' clauses in contracts. It also outlines fast-track adjudication of disputes and ways to enforce payment. If payment obligations are not clear in a contract, default provisions apply, such as monthly progress payments. Read more here.

Tasmania

The state's 'Security of Payment Act' creates a dispute resolution process (adjudication) that allows a contractor or subcontractor to promptly obtain payment based on an assessment of the claim's merits by an adjudicator. Time frames are set to help move the process along as efficiently as possible. Payment claims must be served within 12 months of last carrying out construction work or supplying related goods and services.
Read more here.

In Short...
It's Your Money!

We recommend you have systems in place to track key dates. At the very least your system should record when you have requested retention release and any reasons for non-payment.

Get on the front foot and request in writing the release of retention and not wait for this to happen. This is usually in the form of a "claim for practical completion" and, after defects remediation, a "claim for final completion".

If retention is not released you should investigate why ASAP. You may be entitled to interest on amounts paid late!

Remember - it is essential to keep good records and copies of all correspondence both sent and received.

Want to Take the Hard Work out of Calculating Retention?

Payapps has created a simple video that shows how easy it is for contractors to manage construction retention - from a project's start to the final release of retention in contracts. ~~Click here to watch video.~~

Want to See How Well It Works?

Book a free, personalised 20 minute demo to see how Payapps can help you improve contractor collaboration up and down the supply chain. Payapps is cloud-based, can be accessed anywhere, and is simple to use!

Book a Demo!

About Payapps

Payapps is a cloud-based collaboration tool for the construction industry. It helps main contractors and subcontractors simplify and expedite project progress payment approvals, including variations and retentions.

A simpler and faster digital process ensures greater transparency, increased accuracy, improved compliance, reduced financial risk, fewer disputes and fairer outcomes.

Payapps significantly cuts progress payment processing time, helping to meet regulatory requirements. Compliance is improved and made easier with documentation verification integrated with the approval process.

Seamless integration with a wide range of project, construction and financial management software helps provide real-time data on all project payment requests and approvals.

For more information about using Payapps to submit, assess and approve progress claims, visit www.payapps.com.

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