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## BUILDSAFE RETENTION FUND

### NEW RULES FOR RETENTIONS

The Construction Contracts Amendment Act 2015 introduces significant and important new rules governing holding and payment of retentions into the Construction Contracts Act 2002 from 31 March 2017.

Retentions are defined as an amount withheld by a party to construction contract (party A) from an amount payable to another party to the contract (party B) as security for the performance of party B's obligations under the contract.

Presently, retention money is an asset of the party that is holding it, and if that party goes broke, the money is distributed to secured and preferential creditors (ie banks, staff, IRD etc) with any residual monies (seldom any) divided among unsecured creditors including the contractors and subcontractors who had actually earned that money.

From 31 March 2017, retention monies held by one party to a commercial construction (which by definition includes all subcontracts irrespective of whether they relate to residential building projects) above a certain value and entered into or renewed on or after that date, must be held on trust, either in cash or liquid assets that may readily be converted to cash, for the subcontractor or contractor from whom the retention was withheld.

In the event of an insolvency, these assets will be trust money to pay out the retentions or fix any defects relating to a specific retention in

respect of which the asset is held. These assets rank ahead of all other parties in a liquidation including secured creditors.

The retention regime is being introduced largely in response to the Mainzeal collapse in 2013 (which left a trail of unpaid subcontractor creditors) with the intention of protecting subcontractors from the potential insolvency of a head contractor holding retention monies under a commercial construction contract and using those funds as a source of working capital.

When Mainzeal collapsed, it had \$11.3M owing to it in retentions yet it was holding back \$18.3M in retentions from its subcontractors. Plainly those subcontractors would likely never get paid the monies they had earned.

The Mainzeal collapse highlighted the scale of abuse of the current retentions regime and the risk to subcontractors of losing retention monies when the head contractor/employer uses those monies as working capital and subsequently goes broke.

### WHO MUST HOLD RETENTION MONEY IN TRUST?

- Property developers who deduct retentions.
- Head Contractors who deduct retentions.
- Subcontractors who in turn use subcontractors and deduct retentions.
- Residential property owners where the property is an investment property or the owner is a company (that is not a trustee for the occupants) who deduct retentions relating to construction works on their land.



## THE PROBLEM

Sadly, there are some patently obvious difficulties and challenges with the new retentions regime, namely:

- where payments are debt funded, there might never actually be a cash balance;
- employers are entitled to hold retentions in the form of cash or other liquid assets (such as publicly traded shares or plant and vehicles) that are readily converted into cash, and to invest those retention monies as they see fit;
- up-chain retentions and accounts receivable are not likely to meet the requirements of the Act that retention money must be held on trust and may be held in liquid assets that are readily converted into cash;
- retentions are not required to be held in a separate trust account, The retention money may be co-mingled with other monies. The lack of an obligation to keep retention funds separate from general funds means there may be practical difficulties in establishing whether trust funds existed and identifying the actual 'trust funds' which will leave contractors having to rely on equitable tracing for an effective remedy. This can be complicated and expensive. In the end the contractor may find itself bearing the cost and risk of resolving these complexities and sharing in an asset with other contractors and/or sitting behind other secured creditors in terms of priorities;
- because the bulk of contractors' profit on many construction projects is tied up in retentions and margins are generally low, many construction contractors may not be financially capable of holding cash or liquid assets of a corresponding value to the retentions on trust;
- a party holding retentions must keep proper accounting records of all retention money held and those records must correctly record all dealings and transactions in relation to that money, they must comply with generally accepted accounting principles, and they must be readily and properly auditable;
- contractors and subcontractors that have retentions deducted are entitled to inspect the records of the retention holder at any reasonable time;

- in the absence of a designated trust account for each contractual relationship, compliance costs in relation to co-mingled trust monies will inevitably be high and there is a risk that commercially sensitive information will be obtained if the inspection process is not carefully managed;
- retention money must be released on the date it is payable under the contract and interest is payable on late payments; and
- if a company goes into liquidation, those who owned or managed the company will have personal liability for unpaid retentions.

## THE SOLUTION

To redress the shocking abuse of the retentions regime exposed by the Mainzeal collapse, BuildSafe® established a Retention Trust Fund escrow service whereby retentions are held by BuildSafe® in separate trust accounts for each contractor on any project.

The cost to use the service is minimal at a mere \$100 to establish a trust account for each contractor and \$25 per transaction into or out of that account. In the overall scheme of things, the cost of using the BuildSafe® Retention Trust Fund is nothing compared to the likely compliance costs where retention money is co-mingled and/or held in liquid assets, or the financial hardship that the loss of retentions would cause following insolvency of an employer or head contractor.

BuildSafe® has provided a highly credible, trustworthy and independent security of payment escrow service and free building contracts to the industry since 2009, reducing the financial risk of building projects for contractors and owners alike.

We say the proper solution to meeting the new retention rules is for each contractor's retention monies to be held in a separate independent trust account where they fall outside the insolvent account and clearly and indisputably remain the property of the contractor.

Please contact us at [info@buildsafe.co.nz](mailto:info@buildsafe.co.nz) to make arrangements for your retentions to be held safely and securely by BuildSafe® at minimal cost.

[www.buildsafe.co.nz](http://www.buildsafe.co.nz)