PROCUREMENT ADVICE NOTE [PAN]

CHIC Building efficiency

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1 GENERAL

1.1 Introduction

1.1.1 Retention is a contractual requirement in construction works contracts that enables CHIC Members (the employer) to retain a proportion of the monies due to a Contractor for the work undertaken to date. It is held as security against any defects in the Works that become apparent before the end of the contract Defects Liability Period.

1.1.2 Retention has traditionally been applied in both public and private sector construction works contracts. While it continues to be an important tool in managing housing sector contracts, it is important that it is applied in a consistent yet proportionate manner.

1.1.3 This guidance brings together best practice in relation to the application of Retention in housing sector construction works contracts. It highlights relevant legal requirements, together with their application to the use of Retention.

1.1.4 This guidance is written from the perspective that CHIC's preferred standard construction form of contract is the JCT suite of contracts. The principles within this guidance may, however, be applied to other forms of construction works contracts.

1.2 Background

1.2.1 Subcontractors are integral to the UK housing sector, providing specialised skills and flexibility to main contracts and community projects. Their involvement allows for complex projects and the adoption of modern methods of construction (MMC), supporting local economies by diversifying skills and supply chains.

1.2.2 The eradication of poor payment practices, particularly between main contractors and subcontractors, remains a key focus for the sector in its construction contracts. This is because these practices lead to increased disputes and costs across industry and can expose small and medium-sized (SMEs) firms to the risk of insolvency.

1.2.3 This is particularly relevant to the management of Retention, where the failure by the Contractor to release Retention monies to subcontractors on time, or at all, can pose real financial risks to these organisations.

2 THE PURPOSE OF RETENTION

2.1 The main benefit of Retention arises from the incentive it provides to encourage the Contractor to rectify minor defects. Specifically, those that do not justify the Member suing the Contractor due to the small costs involved.

2.2	There can be confusion regarding the purpose of holding Retention. Often the reason for holding Retention is cited as protection against the Contractor's insolvency or to remedy major defects which become manifest in elements after work has been completed.
2.3	However, in the case of a contractor's insolvency, 1.5%, 3% or even 5% Retention may not fully compensate the Member for the additional costs that are generally incurred procuring a new Contractor and having the Works completed. In private sector contracts, an insurance bond of 10% of the contract value is normally requested to cover such eventuality, but bonds are not recommended in housing sector contracts due to their cost across the sector.
2.4	It should be noted that Retention can only be retained by the Member in relation to a defect for which it can demonstrate that the Contractor is liable. The cost to remedy a significant defect would, in general, exceed the amount of Retention held. However, the costs involved would normally be sufficient to justify the Member commencing litigation against the Contractor, except, of course, where the Contractor accepts liability and rectifies the defect.
2.5	In the event that minor defects materialise after practical completion, and where the Contractor has refused to return and rectify them, the Retention provides a sum of money to have the defects attended to without impacting upon the Member's revenue or maintenance budgets.
3	**THE EFFECTS OF RETENTION**
3.1	*Financial impact*
3.1.1	Members should be aware that the application of Retention in a construction project can have a material financial impact on the Contractor and its supply chain. The impact is dependent on the: • ratio between the anticipated cost of rectifying defects and the amount of Retention held; • ratio between final profit and the amount of Retention held; • ratio between the length of the contract period and the Defects Liability Period; • number and value of subcontracts; and • potential for insolvency of a higher tier Contractor or Subcontractor in the supply chain.
3.1.2	In addition, Retention can represent a significant part of a contractor's profit from a construction project. This means that the realisation of a contractor's profit may be delayed for a year after its work is completed.
3.1.3	The imposition of excessive Retention, or failure to release the Retention fund at the appropriate time, can have a significant effect on the profitability and solvency of contractors and their supply chains.
3.1.4	Furthermore, improper withholding of Retention can lead to unnecessary disputes across the supply chain. These disputes can ultimately impact upon the delivery of the project, adversely affecting the timeliness, cost and quality of the finished product.

3.2	*Withholding Retention and/or reduction in Retention payable*
3.2.1	While it is important that Members are aware of the financial impact of Retention on the Contractor and its supply chain, there are instances in which it is appropriate to withhold or reduce the Retention payable. For example, the release of Retention monies may justifiably be reduced or permanently withheld where a Contractor or Subcontractor has failed to rectify defects in its Works. This also applies where the amount owed to the contractor has been reduced as a result of delays or other costs incurred as a result of actions by the Contractor or Subcontractor.
4	**LEGAL REQUIREMENTS WHEN MANAGING RETENTION**
4.1	**Reporting on Payment Practices and Performance (Amendment) Regulations 2025**
4.1.1	They require qualifying companies to report on various aspects of how they deal with retentions in their 'qualifying construction contracts' for financial years on or after 1 April 2025. ('Construction contracts' is defined in line with the **Housing Grants, Construction and Regeneration Act 1996**.
4.1.2	The changes mean qualifying companies must report on whether they use retention clauses in qualifying construction contracts. Where they do, they must also report on practice to ensure that any retention clause used with subcontractors is no more onerous than the retention clause used by the client in the same supply chain (and a description of that practice).
5	**GUIDANCE ON MANAGING RETENTION**
5.1	Good practice in the management of Retention
5.1.1	Having taken account of the intended use of Retention and the potential impacts resulting from their application, the following Principles represent good practice in their management. They should be applied by Members in the delivery of their construction projects.
5.2	**Principle 1 - Use Retention only when required**
5.2.1	Retention should not be used in contracts where the Contractor's performance, in relation to defects, can be incentivised by alternative means.
5.2.2	For example, Retention should not be applied in contracts awarded under Frameworks, Measured Term Contracts and Term Service Contracts where the Contractor is expected to be retained to undertake subsequent Works/contracts. This is because the opportunity for future work can be used to incentivise the Contractor to remedy defects in previous Works/contracts.
5.2.3	If it is not certain that the Contractor will be retained to undertake subsequent Works/contracts, such as within the last year of a framework agreement, then Retention may be applied.

5.3	**Principle 2 - Apply Retention at a proportionate level**
5.3.1	There should be consistency in the application of Retention across the sector. Therefore, Retention should be applied at a standard rate of 3% in housing sector construction contracts. This should reduce to 1.5% upon completion of the Works/ practical completion.
5.3.2	Release of the remaining 1.5% Retention is at the end of the contract Defects Liability Period, which should not exceed 12 months from the completion of the Works/practical completion.
5.3.3	As current policy requires that 'no worse' terms are passed on to the supply chain, it is important that the Retention applied to first tier subcontracts, by the Contractor, reflects that included in the main contract.
5.4	**Principle 3 - Release Retention promptly**
5.4.1	Retention should be released promptly when due. For example, a Subcontractor's Retention must be released at the end of the subcontract Defects Liability Period and not held until the end of the main contract Defects Liability Period. Similarly, subcontract Retention should be reduced by half on completion of the subcontract Works as opposed to completion of the main contract Works.
5.5	**Principle 4 - Application of a Retention-free amount**
5.5.1	The NEC4 form of contract makes provision for an amount of the contract sum to be excluded from Retention, known as a Retention-free amount. This is intended to assist the Contractor's cash flow in the early stages of the contract.
5.5.2	Members should consider applying an appropriate Retention-free sum when there are any high cost, early installed items for which Retention is not suitable. For example, this may include the provision of expensive equipment by specialist manufacturers where the risk of minor defects is low.
5.5.3	The Retention-free amount should be set out in the tender documentation. It is calculated and deducted at the start of the contract. Once the contractor has invoiced to the sum of the Retention-free amount, Retention is then applied for the remainder of the contract.
5.6	**Principle 5 - Monitor the use of Retention to detect abuses within the supply chain**
5.6.1	The National Public Procurement Policy Statement (NPPS) and Procurement Act 2023 require Contractors to report monthly on the application of fair payment practices in public construction contracts. Fair payment is monitored in these contracts by the Project Manager.
5.6.2	The Act introduces Prompt Payment provisions to help make public procurement accessible to smaller businesses, with a mandatory 30-day payment term. This requirement will affect the whole supply chain, so subcontractors also benefit. 5.6.3 Under the new regime, Contracting Authorities will have to use 30-day payment terms in new contracts. This must also be passed down their supply chain.

5.6.4	CHIC, through their fee recovery process can use payment data as an indicator of a supplier's past performance in relation to prompt payment in housing sector contracts and through the introduction of a Creditor Days Ratio as a measure, create a more sustainable sector in which SMEs can thrive.
6	**PROVISION FOR RETENTION IN CONSTRUCTION CONTRACTS**
6.1	*JCT Contracts*
6.1.1	CHIC's preferred form of construction works contract, the JCT 2016 (Standard Form), makes provision for the application of Retention.
6.1.2	CHIC recommends amendment to the standard form of contract on relevant contracts which nominates CHIC as the Retention Escrow provider (Project Wallet) which requires transfer of the retention money each month by the Member into the Project Wallet (PW).
6.1.3	The Retention Percentage stated in JCT 2016 should be 3%. The Defects Date should not normally exceed 52 weeks after completion but for short, straightforward contracts it may be 26 weeks or lower.
6.1.4	The first interim certificate issued after practical completion will result in the release of one-half of the Retention currently held in the PW. The remainder will be released at the end of the Defects Liability Period upon the issue of the Defects Certificate.
6.1.5	If the Contractor produces substandard work, the Member can take one of the following actions:
	• Insist that the Contractor corrects the defect to provide the quality specified in the Contract Specification; • Accept the defect and also a quotation from the Contractor for reduced prices, an earlier completion date, or both, in return for a change to the Contract Specification; or • Recover the cost of having it corrected by another contractor if the Contractor fails to correct the defect within the Defect Correction Period.
6.1.6	Where the latter is the case, Retention is used to recover costs. Where persistent poor performance exists, the procedures under managing poor performance under the agreed KPI regime may be invoked. This can result in the issue of a *Contract Performance Notice (under the Procurement Act 2023)* where the Contractor may be excluded from public procurement competitions. If the contract still has a significant period to run, or if performance is so poor that it cannot be allowed to continue, termination may be considered.
7	**PERSISTENT FAILURE TO REMEDY DEFECTS**
7.1	*Managing performance*
7.1.3	The protocol for managing poor contractor performance should be stated as part of the contract documentation with Members required to report on the 'Standard Contract' KPIs as outlined in the CHIC Framework Contract (refer PAN 01-25).

7.1.4	Members must ensure that they have effective contract management procedures in place and that they monitor payments to subcontractors and make use of the KPI reporting regime for managing poor contractor performance where there is persistent poor payment of first-tier subcontractors.

DEFINITIONS

Retention	Money held by the Member from money due to the Contractor for work undertaken as security against any defects in that work that become apparent before the end of the contract Defects Liability Period.
Defect	Is a part of the Works that is not in accordance with the Works Information or is a part of the Works designed by the Contractor that is not in accordance with the applicable law or the Contractor's design that the Project Manager has accepted. It also includes unfinished or omitted parts of the Works.
Defects Certificate	Is either a list of defects that the Supervisor has notified before the Defects Date which the Contractor has not corrected or, if there are no such defects, a statement that there are none. It Is issued either on the Defects Date or at the end of the last Defect Correction Period, whichever is the later. Its issue signifies the end of the contract.
Defect Correction Period	A specified length of time, identified in the contract, within which a notified defect must be corrected. There may be different periods for different categories of defect.
Defects Date	Is a date, identified in the contract, until which the contractor is liable to rectify any defects. It is a duration from Completion, rather than a specific day, typically 26 or 52 weeks from the completion date.
Retention-free Amount	Is a portion of the Price for Work Done to Date to which no retention is applied.
Defects Liability Period	A length of time, identified in the contract, after the completion of the whole of the Works within which the making good of defects is the responsibility of the contractor, usually 12 months.
Retention Percentage	A rate of retention, identified in the contract, which is applied to the excess of the Price for Work Done to Date above any retention-free amount.
Supervisor	Appointed by the Member to check that the Works are constructed in accordance with the contract. The Supervisor issues the Defects Certificate.