

RETAINAGE PRACTICE IN THE CONSTRUCTION INDUSTRY

Executive Summary

Commissioned by the Foundation of the American Subcontractors Association as the first study in its Contractors' Knowledge Quest research series, "retainage Practice in the Construction Industry" provides insight into contemporary attitudes toward the practice of retainage, as well as historical background illustrating the evolution of attitudes toward the practice. Author Dr. Dennis Bausman of Clemson University explains the historical trend toward reduction of retainage on construction projects, largely driven by high-profile industry efforts to reduce retainage on projects funded by federal government agencies. Dr. Bausman also reveals contemporary perceptions of construction owners (public and private), architects, construction managers, general contractors and subcontractors about the role and effects of retainage, and analyzes the significance of these perceptions for the construction industry.

"Retainage Practice in the construction Industry" provides quantitative data that answer some of the long-standing questions about retainage in the construction industry. Through careful review of the survey responses of over 1,000 owners, architects, construction managers, general contractors and subcontractors, Dr. Bausman definitively answers questions such as whether retainage influences project relationships (it does), whether owners and their agents really believe that retainage is needed as an incentive for quality work (they are neutral), and whether there usually is substantial "float" time between the general contractor's receipt of subcontractors retainage and payment to the subcontractor (there is).

Dr. Bausman's analysis is guided by the research program set forth in the research objectives of "Retainage Practice in the Construction Industry":

1. Identify the detriments of retainage for members of the construction team.
2. Identify the benefits of retainage for members of the construction team.
3. Identify alternatives that will minimize the detrimental impact of retainage.
4. Where such alternatives are already in use, evaluate their effectiveness.

One key finding is that alternatives to retainage are not in wide use, despite the industry's overall progress toward retainage reduction. The survey data also confirm that there are differences among construction team members about what the benefits and detriments of retainage are, and the desirability and effectiveness of different alternatives.

The differences are numerous. For example, Dr. Bausman writes:

Owners and their agents strongly believe that retainage is paid in full on each project. However, construction managers at-risk, general contractors, and subcontractors (at-risk builders) state that they receive 100% of their retainage on only 89.6%, 93.8%, and 89.6% of their projects respectively. There apparently is a disagreement on the definition of *paid in full*. In addition, there is a wide divide on the timeliness of payment. Owners, architects, and construction managers submit that retainage is paid promptly upon completion, whereas at-risk contractors and subcontractors claim it is not. Here it appears there is a disagreement on the definition of *prompt payment*.

There is yet wider disagreement on other issues:

1. Owners/agents believe that at-risk construction managers and builders are not less likely to pursue a project if funds are retained, while majorities of at-risk CMs, general contractors and subcontractors all say they are less likely to pursue such projects.
2. Federal government construction owners – the group with the most experience in totally eliminating retainage – believe that the elimination of retainage on projects has had a

- favorable impact on project relationships, while other owners – who rarely eliminate retainage – believe that retainage elimination does not facilitate project relationships.
3. Owners/agents believe that retainage abuse is not widespread, while all other parties, and especially subcontractors, believe that the economic leverage of retainage is used to favorably settle claims or changes for extra work.

The study concludes with recommendations on possible alternatives to retainage. Central to these recommendations are two findings: (1) That the view, pervasive among owners, that retainage adds no costs to construction projects is a position not “in harmony with economic theory,” and (2) that alternatives to the current practice of retainage might meet the main concern of owners who defend current practice, which is proper completion of projects. Assurance of subcontractors’ proper completion of projects does not require that subcontractors be universally saddled with financial risk until the whole project is complete. For example, Dr. Bausman determines that the whole construction team could support reduction of retainage levels; line-item release of retainage to early-finishing trades; escrow accounts for retained funds; and prompt payment of retained funds. The conclusion of the study also mentions alternatives to retainage suggested by survey respondents, such as that funds be retained for non-performance only.

The historical background, data and analysis of “Retainage Practice in the Construction Industry” are a profound contribution to the body of knowledge on the practice of retainage, and no doubt will make this study a must-read for everyone who wants to understand the topic. For the complete report go to www.fasaonline.com.