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| | The NHS Wales Shared Services Partnership response to the Finance Committee and Economy, Infrastructure and Skills Committee's joint inquiry into retention payments in the construction sector. |
| Contact: | <p>Neil Davies, Director, Specialist Estate Services Neil.Davies4@wales.nhs.uk Tel: 02920 904 117</p> <p>Andrew Waddington, Interim Head of NHS Building for Wales Andrew.Waddington@wales.nhs.uk Tel: 02920 904 123</p> |
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Introduction

1. The NHS Wales Shared Services Partnership (NWSSP) welcomes the opportunity to respond to the Finance Committee and Economy, Infrastructure and Skills Committee's joint inquiry into retention payments in the construction sector.
2. NWSSP is an independent organisation, owned and directed by NHS Wales. NWSSP supports NHS Wales through the provision of a comprehensive range of high quality, customer focused support functions and services. Our aim is to support NHS Wales by creating a dedicated shared services organisation with a distinct identity which: shares common operating standards in line with best practice; has sufficient scale to optimise economies of scale and purchasing power and improving quality; and has an excellent customer care ethos and focus on service quality.
3. This submission will address the Terms of Reference of this inquiry in turn.

Terms of Reference

- a) To what extent retentions are an issue for companies based and/or operating in Wales, including how issues might differ through the supply chain?**
4. From 2006, the NHS in Wales has procured all major capital construction projects with works cost in excess of £4m (ex. VAT) via construction frameworks managed by NHS Shared Services Partnership – Specialist Estates Services (NWSSP-SES).
 5. The first generation *Designed for Life; Building for Wales* (DfL1) framework terminated in 2012. Currently, the only remaining legacy project procured through DfL1 is the Grange University Hospital at Llanfrechfa.
 6. No retention is applied to the first 85% of the construction value within DfL1 contracts between NHS Clients and Supply Chain Partners. A retention deduction is only applied to

the last 15% of the construction value at the rate of 10%. The duration over which retention is held is, therefore, limited to the contract period remaining after 85% of the work by value is complete. The actual retention percentage deducted is, therefore, up to a maximum of **1.5%**, with half of the monies released at practical completion. The remaining balance is released following the completion of the 12 month Defects Liability Period and the issue of the Certificate of Making Good Defects.

7. The second generation frameworks: *Designed for Life; Building for Wales 2 – Regional Frameworks (DfL2)* and *Designed for Life; Building for Wales 3 – National Frameworks (DfL3)* started in 2011 and 2012 respectively and terminated in 2017. There are, currently, two legacy projects procured through these frameworks that remain in development following that date.
8. No retention is applied to the first 85% of the construction value within DfL2 and DfL3 contracts between NHS Clients and Supply Chain Partners. A retention deduction is only applied to the last 15% of the construction value at the rate of 5%. The duration over which retention is held is, therefore, limited to the contract period remaining after 85% of the work by value is complete. The actual retention percentage deducted is, therefore, up to a maximum of **0.75%**, with half of the monies released at practical completion.
9. The second generation DfL2 and DfL3 framework contracts incorporated, within their Core Principles, the requirement for the Supply Chain Partner to sign up to a Fair Payment Charter. This included for any Health Board / Trust arrangements for retentions to be replicated on the same contract terms throughout the supply chain.
10. The third generation NHS Building for Wales (NHSBfW) regional and national frameworks commenced in 2018. There are currently 14 projects in design development stage.
11. No retention is applied to the first 85% of the construction value within NHSBfW contracts between NHS Clients and Supply Chain Partners. A retention deduction is only applied to the last 15% of the construction value at the rate of 5%. The duration over which retention is held is, therefore, limited to the contract period remaining after 85% of the work by value is complete. The actual retention percentage deducted is, therefore, up to a maximum of 0.75%, with half of the monies released at practical completion.
12. The third generation NHSBfW framework contracts incorporate the Construction Leadership Council Fair Payment Charter. This includes for any Health Board / Trust arrangements for retentions to be replicated on the same contract terms throughout the supply chain.

13. NWSSP – Audit & Assurance undertake ‘open book’ audits of the frameworks at a project level. To date, no instances of more disadvantageous arrangements for retention payments throughout supply chains have been identified.
14. NHS Clients procure capital construction projects with works cost below £4m (ex. VAT) via their own directly managed local frameworks or via competitive tender procedures on a project-by-project basis in accordance with their standing financial instructions. NWSSP has sought clarification on the retention percentages applied by all Health Boards and Trusts on these contracts. Generally, these are reported as between **3 - 5%**, dependent upon the cost or complexity of the works with half of the monies released at practical completion.
15. A number of NHS Clients have also incorporated the Construction Leadership Council Fair Payment Charter within these local frameworks and direct tenders.
16. NWSSP-SES has worked closely with the construction industry in establishing the framework arrangements including providing the opportunity to comment on detailed contractual proposals. No comments have been received in respect of our approach retention since inception of the first generation frameworks.

b) Whether there are any benefits to the use of retentions;

17. The conventional thinking behind retentions is that they provide a "fund" for the employer to use to rectify defects or to recover liquidated damages or other claims, in case the contractor fails to carry out defects rectification or goes into insolvency. The potential to promptly recover retention monies also provides an added incentive for the contractor to quickly attend to any outstanding defects following expiry of the Defects Liability Period.

c) Alternatives to the use of retentions and what role the Welsh Government could play in developing and delivering those alternatives.

18. One option could be to rely on financial due diligence and on incentives such as potential repeat work, etc. This could work in a long-term framework with large well-established contractors, because the relationship makes it more in the contractor's interest to resolve problems than to walk away.
19. A second option could be to obtain a parent company guarantee from the contractor's ultimate parent company under which it agrees to pay any liabilities of the contractor (financial guarantee), or carry out the works/defects rectification if the contractor fails (performance guarantee), or both. This has the benefit of impacting less on the sub-contractors, as it is a promise to pay, rather than an actual withholding of monies.

20. A third option could be a retention bond. This works in a similar way to a performance bond; i.e. the contractor pays a premium to a third party ("bondsman") which in turn enters into a binding promise to pay the retentions to the employer if the contractor fails to complete the works or make good defects, or becomes insolvent.
21. Insurance will cover some types of loss which retentions are used to compensate. However, this is unlikely to be an option save for the largest and most complex of projects (e.g. PPI, MIM).
22. A final option is to make greater use of collateral warranties. Although, collateral warranties will not help where the problem arises from the contractor's breach or financial failure. Indeed, getting sub-contractors to complete their works under a collateral warranty, when the contractor has gone insolvent, often involves the employer having to pay the sub-contractors sums which are due to them from the contractor.
23. It should be noted that none of the above options are without risk, and for both Client and Contractor the traditional approach to retention perhaps still offers the best approach, as long as the retention percentages and methodologies are reasonably assessed and fairly applied.
24. The Welsh Government is ideally placed to help facilitate and direct a conversation on retentions and its alternatives, as it is both a significant funder and developer. The Welsh Government also has excellent links to the industry through a number of stakeholder bodies such as Construction Excellence for Wales.
25. NWSSP would welcome the opportunity to discuss any of the points in this paper if requested.