

# Impact Summary: Proposed Amendments to the Construction Contracts Act 2002 (retention money regime)

## Section 1: General information

### Purpose

The Ministry of Business, Innovation and Employment (MBIE) is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing Cabinet’s final decisions to proceed with a policy change to the retention money regime.

### Key Limitations or Constraints on Analysis

#### Quality of data and assumptions

The quantitative cost-benefit analysis (CBA) set out in this Regulatory Impact Summary has a number of underlying assumptions. The key details of these assumptions are outlined below (see annex 2 for further detail on the assumptions):

- MBIE utilises findings from HoustonKemp’s CBA of the New South Wales (NSW) building and construction industry as a basis for analysis (*Financial impacts of statutory trusts in the building and construction industry*, April 2019). MBIE considers this analysis is conclusive and also reflective of the New Zealand market<sup>1</sup> and the changes MBIE is recommending.
- MBIE sought targeted consultation from major stakeholders in the construction sector on a set of possible changes to the retention money regime in the CCA. Where MBIE asked respondents to list specific cost and benefits of 1) clarifying the trust requirement, 2) limiting the co-mingling provision and 3) of adjudicators issuing penalties for breaches of statutory requirements. These findings were then considered alongside MBIE’s CBA to address all elements raised.

#### Constraints

The options identified in this Regulatory Impact Summary have been limited to addressing the specific issues identified in the implementation review of the retention money regime under the *Construction Contracts Act 2002*. A wider review of the *Construction Contracts Act* is out of scope.

<sup>1</sup> Applies to assumptions and proportionality of book keeping, trust, audit fees and bank account utilisation. With insolvency, working capital and behaviours of businesses by size are assumed to be typical in New Zealand as in NSW.

**Responsible Manager (signature and date):**

Matthew McDermott  
Manager, Building Policy  
Building, Resources and Markets  
Ministry of Business, Innovation and Employment

Date: 12 March 2020

*To be completed by quality assurers:*

**Quality Assurance Reviewing Agency:**

MBIE

**Quality Assurance Assessment:**

MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Impact Summary prepared by MBIE. The Panel considers that the information and analysis summarised in the Impact Summary meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

**Reviewer Comments and Recommendations:**

## Section 2: Problem definition and objectives

### 2.1 What is the policy problem or opportunity?

#### Background

Retention money involves part of a payment under a construction contract that is held back by a payer (for example a contractor) as security to ensure that a payee (for example a subcontractor) fixes any defects with their work. The amount held for retention money is stipulated in the terms of a contract. Industry practice is that retention money held are between 2 and 10 per cent of the contract price. Retention money is paid after a 12 month period when work is confirmed as being defect-free.

Although retention money forms part of the security to ensure that a subcontractor fixes any defects with their work, there have been instances where contractors have used retention money as working capital. The use of retention money as working capital can add additional risk:

- if a contractor becomes insolvent before paying retention money, there can be impacts on the contracting chain
- subcontractors have limited ability to manage financial risks undertaken by contractors (for example the success or failure of projects undertaken by the contractor).

Retention money exists as part of a contracting chain, and more than one firm in a contracting chain can hold retention money. The *Construction Contracts Act* regulates the payment provisions in construction contracts, including providing for adjudication, and the use of retention money withheld under commercial construction contracts.

#### Amendments to the Construction Contracts Act 2002

The retention money regime in the *Construction Contracts Act* came into force on 31 March 2017 to change behaviour in the construction sector and to help ensure that principals and contractors did not use retention money as working capital which would transfer their business risks to subcontractors. The practice of holding retention money is voluntary within the construction sector, and is not required under legislation. However, for those firms holding retention money, provisions in the *Construction Contracts Act* apply.

Retention money held under construction contracts are required to be held on trust in the form of cash or other liquid assets (readily converted into cash), unless a complying financial instrument is purchased to protect payment. Under the 2017 changes, subcontractors are also able to inspect the records of head contractors to check that retention money are being properly held.

#### Feedback from the construction sector on the retention money regime

Government and the construction industry have agreed to improve the construction sector through the Construction Sector Accord and its Transformation Plan. The Construction Sector Accord was signed and launched in April 2019, which includes high-level goals and the outcomes. Members of the construction sector have raised a number of concerns regarding the nature of the trust requirement created by the retention money regime through the Construction Sector Accord and other engagement channels.

## Considering the effectiveness of the retention money regime

Recently, there have been several high profile examples of large construction companies going into receivership, resulting in non-payment of retention money to subcontractors. These include Ebert Construction, which went into receivership in 2018, and the collapse of Stanley Group and Tallwood Holdings, resulting in both companies going into liquidation. The High Court decision in *Bennet v Ebert Construction Limited (In rec & liq)*, noted that the *Construction Contracts Act* had policy gaps and the trust requirement was imprecise.

In 2019, MBIE commissioned an implementation review considering the effectiveness of the retention money regime under the *Construction Contracts Act*, this was conducted by KPMG. The review included surveys, interviews and a desktop review with a total of 71 firms responding across New Zealand. The review indicated overall compliance across the sector and reasonable levels of knowledge of the retention money regime.

The findings from the review raised a number of concerns, including:

- retention money being co-mingled with working capital or not being held on trust in a separate bank account
- information to subcontractors on the status of money held as retention money provided on a variable basis and quality
- lack of mechanisms to deter the use of retention money as working capital or retention money not being set aside.

The findings were consistent with other reports in the construction sector (including the BDO Construction Survey Report 2018 and 2019), and informed MBIE's analysis. These findings are likely to be caused by a mix of lack of understanding and non-compliance. In December 2019, MBIE agreed with and noted the findings from the implementation review, and informed stakeholders. A full copy of the review of the retention money regime was made available on the Building Performance website.

## Assessing the problems with the retentions regime

Following the implementation review, MBIE assessed the problems with the retentions regime. This noted the wider context of lifting the overall performance of the construction sector, as outlined in the Construction Sector Accord. Consideration was given to existing case law, experiences in overseas jurisdictions, existing studies in the construction sector, and findings from the implementation review. The following problems were identified with the retentions regime:

- the policy that the *Construction Contracts Act* gives effect to has contradictions, limiting its effectiveness to protect retentions
- greater incentives are required to comply with the regime
- there is limited information on how to comply, and the rights and obligations given to parties under the *Construction Contracts Act*.

## 2.2 Who is affected and how?

Clarifying and strengthening the existing retention money regime will affect the following groups of people:

- principals/clients (persons commissioning construction work)
- building and construction contractors (payers)
- building and construction subcontractors (payees).

There are a number of groups that support the overall financial management and performance of the retention money regime. There are likely secondary effects of changes to the retention money regime on the following groups:

- accounting firms – changes to the retention money regime is likely to affect accounting practices for construction contracts
- legal firms (including adjudicators of construction contract disputes)
- banks – retention money would be held on trust in a separate bank account
- insolvency practitioners – an appointed receiver or liquidator administer the retention money account in the event of insolvency
- in the event of insolvency other service providers/creditors/building product suppliers may be indirectly affected because there are now less funds available for the liquidator.

## 2.3 What are the objectives sought in relation to the identified problem?

This RIS assesses options to address the problem described in 2.1.

The overall objective is to enhance the efficiency of the construction sector by ensuring that risk is managed fairly across contractors, sub-contractors and clients, balanced with compliance costs.

# Section 3: Options identification

## 3.1 What options have been considered?

### Criteria

The following criteria were used to assess the options considered.

<b>Assessment criteria</b>
<b>Clarity and greater certainty of outcomes</b>  Will the option be easily understood and interpreted by stakeholders directly affected?  Will the option result in more consistent outcomes?
<b>Effectiveness and value</b>  How effective will the option be in addressing the problem identified (in section 2)?  Is the option commensurate with the size and scope of the problem (in section 2)?

MBIE considered two options for changes to the retention money regime:

- option 1 – enhanced guidance
- option 2 – strengthening and clarifying the existing retention money regime.

### Counterfactual

Under the *Construction Contracts Act 2002*, retention money must be held on trust in the form of cash or other liquid assets readily convertible into cash, or in an alternative arrangement involving a complying financial instrument to protect the payment of retention money. Retention money do not need to be paid into a separate bank account, and may be co-mingled with other moneys.

A subcontractor has the ability to request accounting and other records for inspection with regard to retention money held. However, under the current regime retention money can be held with working capital. This results in retention money being difficult to identify, and may be considered part of a contractor’s assets in the event of liquidation.

With regard to dispute resolution, determinations on the detail of respective contracts can be made through an adjudication process outlined in the *Construction Contracts Act*. There is no mechanism in which non-payment of retention money or not holding retention money on trust or complying financial instrument can be penalised under the *Construction Contracts Act*.

### OPTION 1: Enhanced guidance

As the existing retention money regime came into force in 2017, awareness levels may still be increasing around requirements for holding retention money in the construction sector. One of the findings from the implementation review commissioned by MBIE was that compliance of the retention money regime could be increased through additional information and guidance.

An information and education campaign could be created, this would include further guidance on how the construction sector may be able to comply with the retention money regime. The campaign would focus on the following areas:

- accounting records – providing additional guidance to subcontractors around their right to ask to inspect records and what to ask for may help to normalise requests for information on retention money held
- information on how contractors can comply with the retention money regime – supplying additional guidance to contractors about how to comply with the requirements could have a positive effect on behaviours around retention money and compliance.

Additional guidance would also support voluntary practices of holding retention money on trust in a separate bank account. However, the issue of co-mingling of monies would continue, as there is no specific provision to prevent co-mingling of retention money with working capital. Additionally, there are limited mechanisms in which subcontractors can receive recourse if retention money are unpaid without reasonable grounds, and no deterrent for non-compliance with the regime.

### **OPTION 2: Strengthening and clarifying requirements through amendments to the retention money regime**

A package of amendments to the retention money regime would strengthen and clarify the use of retention money. This package would include:

- strengthen and clarify the existing “on trust” requirement for retention money
- improve the transparency of retention money
- introduce a new offence and penalty in the CCA to deter non-compliance.

In addition to amendments, an education and information campaign, along with updated guidance, would accompany the package. This campaign would be similar to the one described in option 1 with additional aspects, such as new penalties and offences.

#### *Clarifying the trust requirement and co-mingling of retention money held*

Following the collapse of Ebert Construction, a case was determined by the High Court on money to be paid to liquidators. The High Court rejected the argument that the *Construction Contracts Act* had created a ‘deemed trust’ and held that positive steps were required to create the trust. The Court considered that some of the subcontractors were not entitled to have their retention money paid to them because there was no intention to withdraw them for payment (and therefore, the required aspects of a trust did not exist).

The *Construction Contracts Act* would be amended to make the intention clearer by stating that retention money must be held on trust in a separate bank account from other moneys. Similar legislation in NSW establishes specific requirements for separate bank accounts to hold retention money on trust. The retention money regime would be amended to align with these requirements.

#### *Enhancing transparency of retention money held*

Under the retention money regime, subcontractors with retention money withheld may inspect the accounting record of contractors. An existing requirement under the *Construction Contracts Act* for payment schedules requires that, in a case where the difference of payment is because the contractor is withholding payment on any basis, the contractor’s reason or reasons for withholding payment must be given.

There are a number of requirements for the form in which a payment schedule is given. The payment schedule is triggered when a payment claim is given by a subcontractor to a contractor. A payment claim acts as a formal demand for payment, and can include demands for various types of payment including, progress and final payments. Under section 21 of the *Construction Contracts Act*, a valid payment schedule must:

- be in writing
- identify the payment claim to which it relates
- state a scheduled amount.

If the scheduled amount is different from the claimed amount the payment schedule must also indicate:

- the manner in which the contractor has calculated the scheduled amount
- the reasons for any difference between the scheduled amount and the claimed amount
- where the difference is because the contractor is withholding payment on any basis, the contractor's reasons for withholding payment.

This payment schedule would be amended to include a statement of retention money held, including the amount and manner in which the money is being held. This would increase the transparency for subcontractors. It would also provide a clear record when retention money are not being held on trust in a separate account or complying financial instrument.

#### *Introducing a specific legislative deterrent for non-compliance*

A new offence and penalty would be introduced. A deterrent, in the form of an offence and penalty, would increase compliance with the retention money regime, and deter against the use of retention money as working capital. This deterrent would be supported by additional guidance, outlining ways in which subcontractors and contractors can comply with the regime.

The offence would apply to both companies and their directors. The offence would have a corresponding penalty. To provide incentives for compliance, CCA would include a strict liability offence for a payer to fail to hold retention money on trust in a separate bank account or complying financial instrument. This would have a corresponding penalty for failing to comply - a maximum fine of \$200,000.

When considering maximum penalties for a potential new offence, the value of the deterrence effect was assessed - that is, how effective it would be in changing behaviours. The maximum penalty was compared with other relevant legislation such as penalty regimes in the *Fair Trading Act 1986* and *Building Act 2004*.

In the analysis of a potential new penalty, the following factors were considered:

- the harm the offence may do to an individual, group, or the wider public
- the possible harm to the integrity of the building and construction regulatory system
- the fairness of the fine and its appropriateness in creating compliance
- how other penalty regimes have responded to similar offences.



MBIE also considered offences otherwise covered by other legislation. Serious offences currently covered under other legislation would continue to apply (for example offences under the *Crimes Act 1961*, *Fair Trading Act 1986* and the *Companies Act 1993*).

**3.2 Which of these options is the proposed approach?**

MBIE’s preferred approach is option 2.

Assessment criteria	Counterfactual	Option 1	Option 2
<b>Clarity and greater certainty of outcomes</b>			
Will the option be easily understood and interpreted by stakeholders directly affected?	0	+	++
Will the option result in more consistent outcomes?	-	+	++
<b>Effectiveness and value</b>			
How effective will the option be in addressing the problem identified (in section 2)?	-	+	++
Is the option commensurate with the size and scope of the problem (in section 2)?	0	+	++

**Key:**

- ++ much better than doing nothing/the status quo
- + better than doing nothing/the status quo
- 0 about the same as doing nothing/the status quo
- worse than doing nothing/the status quo
- much worse than doing nothing/the status quo

The options were assessed against the counterfactual. The criteria used to assess the options are provided in 3.1.

## **Option 1 - enhanced guidance**

### *Clarity and greater certainty of outcomes*

Enhanced guidance is unlikely to prevent the use of retention money for other purposes, but may increase awareness in the construction sector of the risks associated with the use of retention money for other purposes (e.g. as working capital). This would create more consistent outcomes for retention money held. Supplying additional guidance to contractors on how to comply with the requirements could also have a positive effect on behaviours around retention money and compliance. However, firms would still be able to co-mingle working capital with retention money. As a result, there would be some improvement, but this would be constrained by the current regulatory settings.

### *Effectiveness and value*

This option addresses part of the problem outlined in section 2, in particular the problem associated with limited information on how to comply. However, other problems outlined in section 2 would not be addressed. For example, the financial risk related to a project is unlikely to be affected substantially by enhanced guidance on the retention money regime.

The costs associated to all parties involved is considered minimal, as a result this option would be commensurate with the problem outlined. For the construction sector, there is likely to be more information on how the retention money regime works, and information asymmetry between contractors and subcontractors would be reduced.

## **Option 2 - strengthening and clarifying the existing retention money regime**

### *Clarity and greater certainty of outcomes*

By amending the trust requirement and removing the ability of firms to use retention money as working capital, the policy rationale of retention money used as a financial protection against defects is enhanced. Legislative changes to the retention money regime will likely have positive flow-on effects across the construction sector in cashflow management, this would result in improved outcomes.

Implementing the proposed package of changes under option 2 would enhance the efficiency and effectiveness of the construction sector by ensuring that risk is managed fairly across contractors, subcontractors and client. This is because money set aside for subcontractors is not utilised as working capital. Financial risks undertaken by contractors (for example the success or failure of projects) are therefore not passed on to the subcontractor.

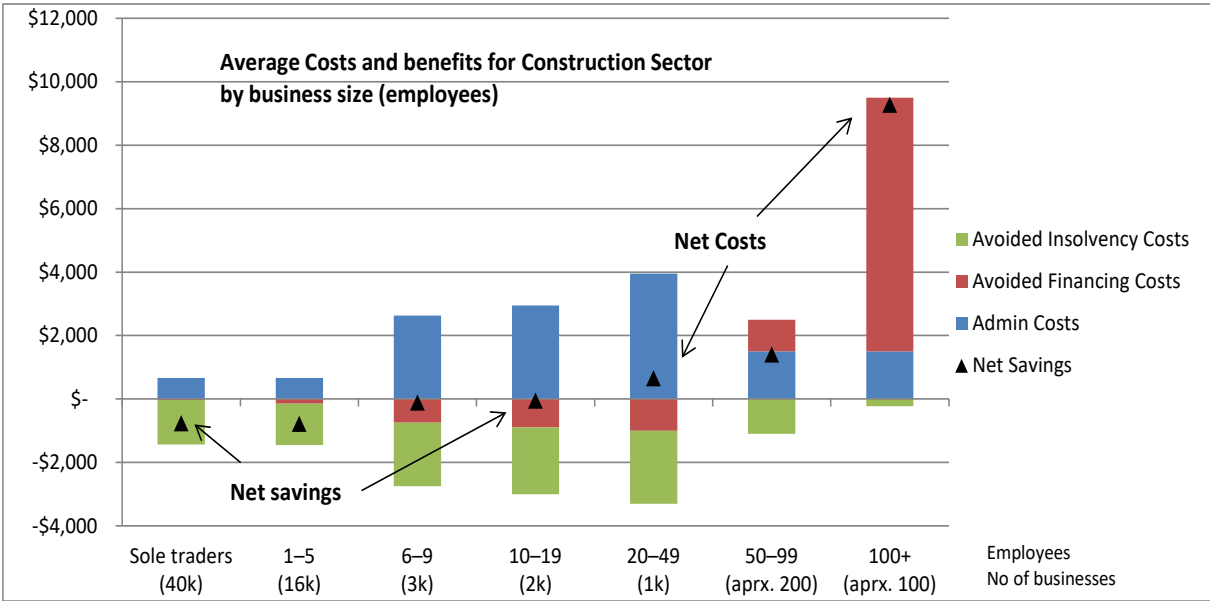
### *Effectiveness and value*

This option would address the problem identified in section 2. There would be some additional cost of compliance for medium to large firms. However, this is offset by avoided insolvency and avoided financing. Construction contracts are self-enforcing, so participants already have costs associated with enforcement. It is unknown whether this would increase or decrease under option 2.

Overall, MBIE considers that there is an improvement for the construction sector as a whole. Building and construction businesses with fewer than 20 employees are expected to be better off (on average), while those with 20 or more employees (just 2 per cent of the building and construction firms) are expected to be worse off on average (however this negative net savings represents a smaller proportion of their turnover). Based on MBIE's analysis, small firms would be better off under option 2, compared to large firms.

The following graph illustrates to the benefits and costs by firm size.

**Figure 1: Average costs and benefits for the construction sector by business size (employees)**



**Transitional arrangement**

Transitional arrangements were considered for option 2. For option 1, no transitional arrangement was considered. For option 2, MBIE asked whether a 12 month period would be appropriate for a transitional arrangement as part of targeted consultation. As part of targeted consultation MBIE analysed whether a 0-6 month, 6-12 month or longer than 12 month transition period was appropriate.

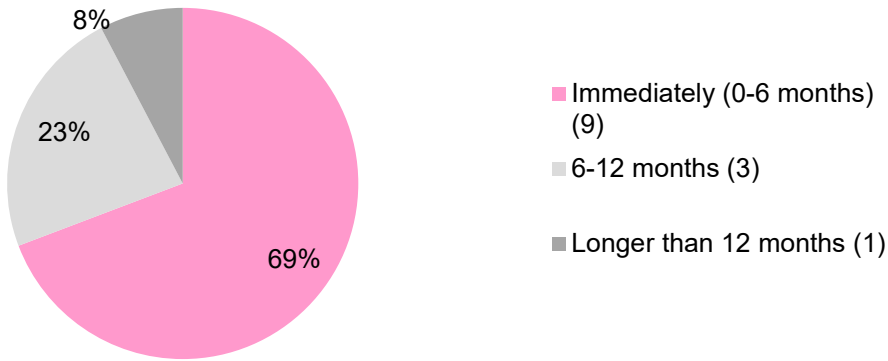
The three periods considered would affect the ability of the construction sector to manage the impact on cashflow, and the additional administrative costs associated with setting up a separate account on trust. The KPMG implementation review noted that the majority of firms were holding retention money in a separate account, so the impact of length of the transition period on these firms would be minimal. The length of the transitional arrangement would affect firms co-mingling retention money.

Alongside feedback received through targeted consultation, MBIE considered the cashflow impact on the sector when analysing an appropriate transitional arrangement. According to the KPMG report, for stable businesses, the cashflow impact will largely work its way through once retention accounts are fully funded. As a number of businesses are already fully funding retention accounts, the cashflow impact may not have a long term impact on businesses in the construction sector.

Thirteen respondents commented on the appropriateness of a 12 month period. Some respondents agreed that 12 months was appropriate. However, other respondents said that a shorter period was preferable. As respondents included a number of industry bodies and membership organisations (including both subcontractors and contractors), MBIE did not analyse the feedback by contractor or subcontractor groups. Figure 2 shows the period respondents thought most appropriate.

Figure 2: Appropriate transition period following amendment of CCA as identified in targeted consultation

**Appropriate transition period from enactment**



Based on this feedback, MBIE considers a shorter 6 month transition period appropriate to ensure that information and guidance is provided to the construction sector about changes, and that standard contracts are amended to incorporate proposed changes.

## Section 4: Impact Analysis (Proposed approach)

### 4.1 Summary table of costs and benefits

The following is MBIE's analysis based on a feedback from stakeholders during targeted consultation, a study of a similar regime in New South Wales, and existing MBIE information regarding the construction sector in New Zealand. See annex 1 and 2 for further detail and explanations on costs and benefits by business size.

Affected parties	Comment	Impact
Additional costs of proposed approach, compared to taking no action		
Building and construction contractors and subcontractors	Costs include administrative costs relating to: <ul style="list-style-type: none"> <li>• bank fees</li> <li>• incremental book-keeping</li> <li>• establishing a separate bank account for holding retention money on trust</li> <li>• audit fees.</li> </ul>	\$4.0 million per annum \$7.6 million per annum \$39.0 million (one off) \$4.6 million per annum
<b>Total monetised costs</b>		\$55.1 million initially, then \$16.1 million annually  Medium
<b>Non-monetised costs</b>		Low

### Expected benefits of proposed approach, compared to taking no action

Building and construction contractors and subcontractors	Benefits include avoided insolvency costs and avoided financing costs.	\$88.9 million per annum for avoided financing costs  \$7.6 million per annum for avoided insolvency costs
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<p><b>Total monetised benefits</b></p>	<p>.</p>	<p>Calculated at \$96.6 m per annum</p> <p><b>\$50 - \$100 million per annum</b></p> <p><i>Adjusted for sensitivity analysis (50%)</i></p> <p>Medium/Low</p>
<p><b>Non-monetised benefits</b></p>	<p>Benefits for the proposed package of changes include:</p> <ul style="list-style-type: none"> <li>• greater confidence and certainty for firms utilising retention money, as the requirements for holding retention money have been clarified</li> <li>• potential for better cashflow management as money held for retention money are not used as working capital and a more resilient construction sector</li> <li>• greater transparency for payments.</li> </ul>	<p>Medium</p>

## 4.2 What other impacts is this approach likely to have?

There is a risk that strengthening the retention money regime might lead to an impact on overall cashflow for construction companies. From targeted consultation and KPMG implementation review, the majority of stakeholders indicated that they were holding retention money in separate accounts from working capital.

According to the KPMG implementation review, the cashflow impact will largely have worked its way through once retention accounts are fully funded. Furthermore, the cashflow impact is not likely to have a long term impact, given retention funds are anticipated to be fully funded during 2020.

## Section 5: Stakeholder views

### 5.1 What do stakeholders think about the problem and the proposed solution?

MBIE consulted the sector following the delivery of an implementation review from KPMG. The sector generally supported the majority of the proposed changes. The sector highlighted matters of operational detail that MBIE has either incorporated into the final policy design, or will consider has part of operational policy design.

Based on the issues raised and additional policy work, targeted consultation was undertaken with a range of stakeholder groups across the construction and related sectors over a four week period from 28 January to 21 February 2020, on whether further changes were required to strengthen and clarify the existing retention money regime. The targeted consultation document was sent to 33 key industry stakeholder groups. These groups represented a cross-section of the construction sector (including membership organisations, which disseminated the targeted consultation to their members). Due to the limited nature of changes, MBIE did not seek to undertake full public consultation.

MBIE sought feedback on five main areas:

- clarifying the existing trust requirement for retention money
- removing the ability for businesses to co-mingle retention money with working capital
- creating a requirement for a confirmation receipt for retention money
- providing adjudicators the ability to enforce breaches of statutory requirements for retention money
- creating penalties for non-compliance with the retention money regime, and considering whether to extend those penalties to directors of construction companies.

In total, MBIE received 22 responses to the targeted consultation, one stakeholder provided a general comment separate to the targeted consultation process and MBIE has noted this feedback (a 67 per cent response rate). The following table shows the types of respondents who provided feedback. Overall, MBIE's proposals were well-received with the exception of the proposal to allow adjudicators to issue penalties for breaches of the retention money regime. Respondents included industry bodies and membership organisations. The proposed mechanism for issuing penalties has since been amended to reflect stakeholder views.

#### Respondents by proportion of total

Stakeholders	Number
Construction industry stakeholders	14
Dispute resolution and legal stakeholders	5
Banking and accountancy stakeholders	3



## Section 6: Implementation and operation

### 6.1 How will the new arrangements be given effect?

#### How the proposals will be given effect

The changes proposed to the retention money regime would be introduced through a Bill to amend the *Construction Contracts Act* to give effect of decisions in 2020. Additional guidance and information will also be provided the sector to improve understanding of the retention money regime and support regulatory changes.

#### When the proposals will be given effect

It is intended that a Bill be introduced by July 2020. Changes would come into force following a 6 month transition period after the Bill receives Royal Assent.

#### Implementation risks and mitigation

Key risks in implementing the package of changes to the retention money regime include risks associated with the sector's understanding of requirements. To mitigate the risk, MBIE will be updating its guidance to the construction sector. An education campaign will also be prepared to further bring attention to the requirements in holding retention money under the *Construction Contracts Act*.

#### Enforcement

Government relies on self-enforcement of construction contracts, including the retention money regime. A component of the proposed changes is to remove some information asymmetry regarding retention money held through additional information in the payment schedule. This will facilitate firms in self-enforcing the retention money regime.

## Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

The policy proposals considered in this RIS would provide an updated legislative regime governing retention money in construction contracts. The proposals are based on advice and information provided by the building and construction sector, insurance industry, and banks, as well as evidence from international comparators.

MBIE intends to monitor the regime as part of its on-going engagement with the construction sector. This will be achieved through on-going liaison with the construction sector, and monitoring disputes (adjudications and court decisions) and insolvencies.

### 7.2 When and how will the new arrangements be reviewed?

The Construction Sector Accord is a platform for the construction sector and government to work together. Several government agencies, including MBIE, work with the construction sector in the programme and have specific responsibilities in the Accord and Transformation Plan.

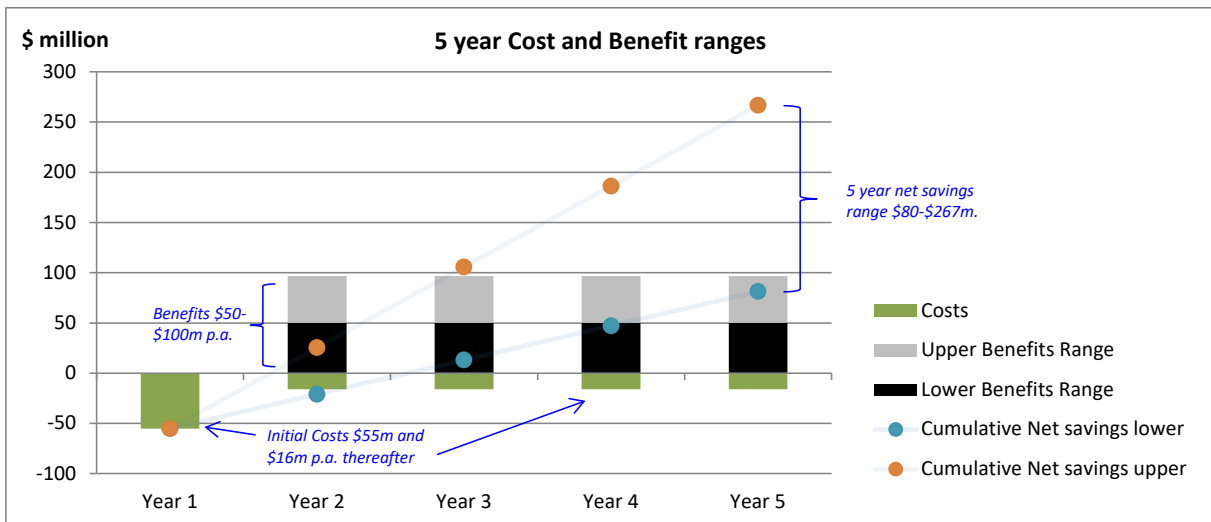
A focus area under the Construction Sector Accord is the retention money regime in the *Construction Contracts Act*. The Construction Sector Accord provides an opportunity for stakeholders to outline any on-going issues with the retention money regime. MBIE also intends to review the retention money regime after five years of the recommended changes coming into force.

# Annexes

## Annex 1: Costs and benefit summary by business size

Business Size		Estimated Admin costs		Estimated Avoided				Savings		
employees	no of businesses	per business	Total	Financing Costs		Insolvency Costs		per business	Total	
0	39,285	\$ 660	25,928,100	30	1,178,550	1400	54,999,000	\$ 770	\$30,249,450	benefit
1-5	16,170	\$ 660	10,672,200	150	2,425,500	1300	21,021,000	\$ 790	\$12,774,300	benefit
6-9	2,970	\$ 2,632	7,817,040	750	2,227,500	2000	5,940,000	\$ 118	\$ 350,460	benefit
10-19	2,085	\$ 2,950	6,150,750	900	1,876,500	2100	4,378,500	\$ 50	\$ 104,250	benefit
20-49	1,014	\$ 3,950	4,005,300	1000	1,014,000	2300	2,332,200	\$ 650	-\$ 659,100	disbenefit
50-99	228	\$ 1,500	342,000	-1000 -	228,000	1100	250,800	-\$ 1,400	-\$ 319,200	disbenefit
100+	111	\$ 1,500	166,500	-8000 -	888,000	225	24,975	-\$ 9,275	-\$ 1,029,525	disbenefit
	61,863									
				Benefits	7,606,050	and	88,946,475			
		<b>total costs</b>	<b>55,081,890</b>			<b>total benefits</b>	<b>96,552,525</b>		<b>Total Saving</b>	<b>\$41,470,635</b>

organisations with <20 employees are expected to be approx \$718 p.a better off (on average), while those with 100+ are expected to be approx \$9k worse off (a small proportion of their turnover)



## Annex 2: High level assumptions

### General

- Findings from Houston Kemp (*Financial impacts of statutory trusts in the building and construction industry*, April 2019) in New South Wales are conclusive and also reflective of the New Zealand market, in that they are applicable to assumptions and proportionality of book keeping, trust, audit fees and bank account utilisation on New Zealand businesses. With insolvency, behaviours of businesses by size are assumed to be typical in New Zealand as in New South Wales.
- All costs and benefits findings from targeted consultation on 1) clarifying the trust requirement, 2) limiting the co-mingling provision and 3) of adjudicators issuing penalties for breaches of statutory requirements have been considered and where applicable incorporated into the CBA.
- MBIE assumes that there is a correlation between number of employees and business turnover, for example, an organisation with 100+ employees has higher turnover than a business with less than five employees. MBIE extracted data on the number of building and construction businesses by employee, but not by turnover.

### Costs

Where applicable – note not all businesses will incur the following costs. Assumptions have been made by various cohorts:

- bank account fees being \$12 per month (assumptions made on the percentage of businesses)
- book-keeping hourly rates being \$50 (assumptions made on the percentage of businesses)
- the establishment of a separate bank account to hold retention money on trust being \$1200 (one off, assumptions made on the percentage of businesses)
- audit costs – annually for large organisations, and not applicable as performed internally by smaller organisations. However, it is assumed that larger businesses will have audit processes already in place, so this would be an extension of existing business processes.

### Avoided financing costs

- Working capital – MBIE assumes that payments in the construction industry are paid 30 days past due date, on average. With the statutory trust proposal in place, MBIE assumes that this will improve to 15 days past due date.
- Avoided project delay financing – MBIE estimates the cost of financing for project delays by first estimating the rate of insolvencies arising from cashflow or receivable problems, and the number of construction businesses. MBIE applies this rate to industry turnover to estimate the value of work affected by insolvency. MBIE calculates the financing cost of delay to principals by multiplying that amount with a financing rate over 30 days, being the assumed duration of an expected delay. To calculate the savings for principals from avoiding delays, MBIE also assume that the whole cost of delay can be avoided.

### **Avoided insolvency costs**

- Insolvency fees – MBIE estimates avoided insolvency fees by calculating an annual rate of insolvencies in construction businesses from inadequate cashflows and receivables:
  - MBIE assumes that the statutory trust scheme will reduce insolvencies from inadequate cashflows and receivables by 50 per cent (a highly sensitive assumption – sensitivity analysis has been conducted at just 25 per cent)
  - an average insolvency fee of \$5,000.
- Avoided bad debts – MBIE calculates avoided bad debts for subcontractors as the product of:
  - the amount of work (as measured by turnover) derived from relationships with contractors
  - the average rate at which business turnover is affected by insolvencies.

### Annex 3: Summary of feedback and changes to the proposals

Overall, MBIE’s proposals were well-received with exception of the proposal to allow adjudicators to issue penalties for breaches of the retention money regime. Table 1 summarises MBIE’s recommendations following feedback received during targeted consultation.

#### MBIE’s recommendations based on feedback from targeted consultation

Area	Changes to the retention money regime outlined in the targeted consultation paper	Comments from respondents	MBIE’s recommendations
<b>Strengthening and clarifying the trust requirement for retention money withheld</b>	MBIE proposed to clarify the trust provision within the <i>Construction Contracts Act</i> to ensure retention money are safeguarded and held on trust in a separate bank account specifically for retention money or another complying financial instrument.	<p>Respondents were broadly supportive of the proposal to clarify the trust provision, particularly as doing so would ensure better compliance with the regime, protect retention money as the <i>Construction Contracts Act</i> intended, and prevent liquidators from using retention money to pay creditors.</p> <p>Overall, respondents preferred that retention money be held in a separate bank account rather than a formal trust entity created through a solicitor, to avoid costs associated with legal fees.</p>	MBIE recommends clarifying the trust requirements in the <i>Construction Contracts Act</i> to ensure that retention money are held on trust in a separate bank account or other complying financial instrument.
	MBIE proposed to clarify the co-mingling provision to only allow for retention money to be held together in an account, and remove the ability of contractors to co-mingle retention money with working capital.	<p>Respondents commented that it would be beneficial to be able to co-mingle retention money as setting up a separate bank account for each project or contract would be cost-prohibitive.</p> <p>Respondents also commented that the benefits of this proposal include removing the opportunity for businesses to use retention money as unsecured working</p>	MBIE recommends that the existing co-mingling provision in the <i>Construction Contracts Act</i> be amended so that the provision allowing contractors to set up a separate account for retention money also allows them to hold retention money for different subcontractors together.

		capital, ensuring that adequate funds are available in the event of insolvency, and providing greater transparency and certainty for all parties.	
<b>Improving the transparency of retention money held</b>	MBIE proposed that if retention money are being held, a confirmation receipt of retention money held should be provided proactively by the contractor to the subcontractor.	Most respondents agreed with this proposal though many suggested including the receipt as part of the payment schedule requirements in the <i>Construction Contracts Act</i> .	MBIE recommends that the consultation proposal be amended to include the confirmation of retention money held as part of the existing payment schedule requirements in the <i>Construction Contracts Act</i> .
<b>Improving compliance with the retention money regime in the construction sector</b>	MBIE proposed to enhance the powers given to adjudicators with relation to retention money. This would allow adjudicators to issue penalties for breaches of statutory requirements for retention money.	<p>Most respondents said they did not support the proposal to give adjudicators the power to issue penalties for non-compliance. Respondents commented that the courts are best placed to enforce the <i>Construction Contracts Act</i>. Respondents also expressed concern about the quality of adjudicators.</p> <p>Some respondents commented that empowering adjudicators to issue penalties for non-compliance would increase the costs and time required for adjudication.</p> <p>Other respondents commented that the proposal would comparatively reduce costs to the plaintiff and shorten the dispute resolution process.</p>	<p>MBIE recommends that the consultation proposal be amended to utilise the existing court system instead of the adjudication process as a means to enforce the new offences and penalties for non-compliance with the <i>Construction Contracts Act</i>.</p> <p>MBIE notes that respondents have outlined concerns regarding the cost and the quality of adjudication. This could be a consideration in a future, wider review of the <i>Construction Contracts Act</i>, as it is beyond the scope of this review of the retention money regime.</p>
	MBIE proposed to introduce penalties for failures to comply with the obligations to hold retention money as outlined in the <i>Construction Contracts</i>	The majority of respondents agreed with the introduction of a penalty for non-compliance. Respondents noted that this would support	MBIE recommends that new offences and penalties are introduced for failures of complying with obligations of holding retention money as outlined in the

	<p><i>Act</i>. In the first instance these penalties would apply to construction companies. Adjudicators or a Court would be able to make orders regarding breaches.</p>	<p>greater compliance with the requirements of the <i>Construction Contracts Act</i> and improve commercial practices.</p> <p>Many respondents also agreed that a breach of the obligation to hold retention money on trust should result in personal liability of directors.</p>	<p><i>Construction Contracts Act</i>.</p>
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#### Annex 4: List of respondents in targeted consultation

Twenty-two unique responses were received as a result of targeted consultation, one stakeholder separate from the targeted consultation process provided feedback on the retentions regime (MBIE has noted this feedback). The responses included email feedback regarding the proposals (some respondents noted they were not providing a formal submission, but had feedback, they have been included as respondents). Feedback was received from the following groups and organisations:

<b>Construction industry stakeholders</b>	<b>Dispute resolution and legal stakeholders</b>
Aspec Construction Limited	Bankside Chambers
Fire Risk Sprinklers Limited	Building Disputes Tribunal
Steel Construction New Zealand	Calderglenn Associates Limited
Specialist Trade Contractors Federation	Hesketh Henry
New Zealand Institute of Quantity Surveyors	Arbitrators' and Mediators' Institute of New Zealand
Civil Contractors New Zealand	<b>Bank and accountancy stakeholders</b>
Security Specialists	Chartered Accountants Australia New Zealand
Registered Master Builders Association	New Zealand Bankers Association
New Zealand Construction Industry Council	Pricewaterhouse Coopers
Fletcher Building Limited	
Concrete New Zealand Incorporated	
New Zealand Certified Builders Association	
South Pacific Fire Protection Group Limited	
Downer Group	