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UTILITY CONTRACTORS OF ALASKA, INC.

Alaska Chapter of the National Utility Contractors Association

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MEMO TO: All Concerned Parties

FROM: UCA Governmental Affairs Committee

DATE: March 10, 1981

RE: Proposed Legislation: Construction Contract Retainage -
Payment of Interest Thereon

THE PROBLEM

In construction contracting it is standard practice for the owner agencies to make partial payments to the contractor during the construction period on a regular basis - typically every thirty days. These "progress payments" or "pay estimates" as they are often called are made to pay the contractor for portions of the work completed to date so that the contractor can, in turn, pay his suppliers, subcontractors, and workmen.

However, it is also the standard practice for the owner agencies to "retain" a portion of the money owed to a contractor under any particular pay estimate as "retainage." Theoretically this retainage represents the contractor's profit on the job and as such is held back by the owner until the job is complete. (It should be noted that the retainage is often more than the profit.) The retainage is seen as protection for the owner against the possibility that the contractor may not complete the job or may not pay all his bills. In other words, the retainage is held as a kind of cash bond to guarantee the contractor's performance under the contract.

Even after the contract is complete, it is customary for the owner to hold a portion of the retainage for a period of time as additional insurance against a possible lien or the third party claim.

For example, suppose XYZ contractor has a contract with the Municipality of Anchorage in the amount of \$1,000,000 to install a new water transmission main. Lets also assume that XYZ receives notice to proceed and begins work on May 1. On May 31, XYZ is 20% complete; on June 30, 40% complete; on July 31, 60% complete; on August 31, 100% complete. Now under this scenario, on June 1, XYZ would submit to the engineer a "pay request" for payment of work completed to date; i.e., 20% or \$200,000. Assuming the engineer approves the pay request as being accurate, the Municipality would then pay XYZ \$200,000 less 10% retainage or \$180,000. On July 1 XYZ again submits a pay request this time for 40% or \$400,000 and the Municipality then pays XYZ \$400,000 less \$180,000 already paid, less 10% or \$40,000 retainage, or another \$180,000. This process continues until the project is complete with the Municipality

Memo re. Interest on Retainage

March 10, 1981

Page 2

always holding as retainage a portion of the amount due the contractor at any given time. Thus, when the project is complete, XYZ is still owed a considerable chunk of cash which the Municipality has held back as retainage. This retainage is not actually paid until some specified time after the project is complete (in the case of the Municipality of Anchorage, the percentage of retainage is reduced to 2% when the project is complete and the final 2% retainage is paid 90 days after project completion).

The actual percentage of retainage held and the length of time that retainage is held varies with contracting agencies and sometimes with contract size, but the basic principle of withholding a portion of the money earned by the contractor is the same with almost all construction contracts. To summarize, retainage is money earned by the contractor but not paid to the contractor for some period of time after it is earned.

The problem is that the practice of holding retainage adversely affects the contractor's cash flow. In these days of high interest rates, working capital is a precious commodity to any contractor. While the owner's right to hold retainage is not disputed, it should be recognized that the practice adversely affects the contractor's cost of doing business by forcing him to borrow working capital or, at the very least, forego interest which could be earned with cash on hand. Therefore, the contractor must bid higher prices for his services.

The contractor's problems with retainage are sometimes further compounded by owner agencies which, for one reason or another, fail to pay the contractor retainage due on time. When this happens (and it happens not infrequently) the contractor has no recourse except the courts. Typically, of course, the high cost of litigation makes recourse to the courts an unacceptable solution to the contractor's problem.

PROPOSED SOLUTION

Legislation should be passed making it public policy in the State of Alaska that when retainage is held by the owner, the contractor shall have the right to direct that the retained money be invested in a savings institution of his choice and that the interest earned thereon shall accrue to the contractor. As an alternative, interest on retainage should be paid to the contractor directly by the owner.

Sincerely,

UTILITY CONTRACTORS OF ALASKA, INC.

Don May,
President