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MEMORANDUM

TO: Riley-Purgatory-Bluff Creek Watershed District Board of Managers
FROM: Michael Welch, Smith Partners
RE: **Retainage**
DATE: March 5, 2021; updated October 27, 2022

At the March 3, 2021, regular meeting, the managers directed legal counsel and the engineer to review the retainage provisions of Riley-Purgatory-Bluff Creek Watershed District’s standard construction contracts to confirm conformance with statutory requirements and to determine whether RPBCWD was effectively securing its position as to contractors’ performance on projects through withholding retainage.¹ Legal counsel and the engineer followed up with a prior version of this memo in March 2021. This updated version memo briefly explains how RPBCWD’s standard contracting provision for retainage protects RPBCWD’s interests and aligns with state law.

Minnesota Statutes section 15.72, subdivision 2(a) explicitly limits the percentage of a contract for public improvements to 5 percent of the value of the contract: “A public contracting agency² may reserve as retainage from any progress payment on a public contract for a public improvement an amount *not to exceed* five percent of the payment.”³ (Emphasis added.)

In practice, retainage means that if a contractor submits a \$20,000 invoice for labor and materials on an RPBCWD project, the RPBCWD engineer will bring forward a recommendation to pay \$19,000, with \$1,000 held back as retainage. If the next invoice is also for \$20,000, RPBCWD may withhold another \$1,000, such that RPBCWD will be holding \$2,000 in funds the contractor has earned.

RPBCWD may continue to deduct and withhold retainage until the project in question is “substantially complete” – that is, constructed and functioning for the intended purposes. At

¹ Retainage is a portion of the cost of work completed under a contract that the project proponent does *not* pay the contractor. Retainage is a widely used and statutorily defined tool for ensuring performance of contractors.

² A public agency subject to the statute is defined as “... any agency of the state of Minnesota or any of its political subdivisions authorized by law to enter into public contracts.” Minn. Stat. § 15.71, subd. 3. RPBCWD is a political subdivision authorized to enter into contracts. Minn. Stat. § 103D.335, subd. 13.

³ Minnesota Statutes section 337.10, subd. 4(b), also limits retainage to 5 percent.

that point, RPBCWD has 60 days to pay out all retainage, unless it articulates specific reasons for continuing to retain such funds.⁴

RPBCWD's standard contracting practice has been to set retainage at the legally authorized maximum of 5 percent, but allow the engineer to recommend, based on a finding that the work is progressing satisfactorily, discontinuing deduction of retainage from invoices submitted after work representing 50 percent of the value of the contract is completed. (RPBCWD would continue to hold retainage already held back from invoices until substantial completion.) Such practice was – and is – also consistent with state law: “A public contracting agency may reduce the amount of the retainage and may eliminate retainage on any monthly contract payment if, in the agency's opinion, the work is progressing satisfactorily.” Minnesota Statutes section 15.72, subdivision 2(a).

In response to questions from the managers, legal counsel, the administrator and the engineer reviewed RPBCWD retainage practice and determined that 1. the discretionary discontinuance of retainage at 50 percent completion was not a significant incentive for contractors to provide lower, better bids or performance; and 2. administration of contracts would be easier if RPBCWD's practice was simply to retain 5 percent of all invoices until substantial completion. Staff does not intend to include the discretionary reduction provision in future construction contracts.

As a coda, it is important to note that retainage is one tool RPBCWD has to motivate contractor performance. RPBCWD also:

- only pays for work completed – even after substantial completion. That is, if a contractor is required to maintain vegetation on a project site for three years *after* substantial completion of construction of the project, the contractor is not paid for such plant-establishment efforts until each year's work is completed.
- holds performance and payment bonds for the full amount of the contract on all bid projects.

Counsel will be on hand for the November 2, 2022, workshop of the managers to answer any questions on this memo and the topic of retainage generally.

⁴ The bases for continuing to withhold retainage after substantial completion are articulated in Minnesota Statutes section 15.72, subdivision 2(e).