

The Treasury

Official information regarding the Crown's support for Air New Zealand as a result of the COVID-19 pandemic

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Impact of COVID-19 on the aviation industry, and Cabinet update

Background

- The aviation industry, alongside many other industries, has been significantly impacted by COVID-19.
- On the 14th of March 2020, the Government announced comprehensive travel restrictions, which have recently been extended further, to protect the health and wellbeing of New Zealanders.
- Air NZ was provided a trading halt on the 16 March 2020 and announced significant reductions to its network in response to the shocks to the aviation sector.
- After having exhausted discussions with other lenders, Air NZ reached out to the Crown, as its majority shareholder, to discuss potential financial assistance. Air NZ also publicly announced that it was in discussions with the Government about possible financial assistance.
- Consistent with the announcement from Air NZ, on the 16th of March 2020 I brought an oral item to Cabinet to discuss this potential financial assistance, and confirmed that the Government had entered into negotiations with Air NZ to agree a Term Sheet under which liquidity support would be offered. I tasked the Minister of Transport and the Associate Minister of Finance (Hon Parker) to undertake negotiations.
- Consistent with this, on Friday 20 March 2020 I announced that the Government agreed a debt facility with Air NZ for a maximum of \$900 million in order to provide the company with much needed liquidity during these unprecedented conditions.
- I made this decision using my statutory powers under section 65L of the Public Finance Act.

Arm's length negotiations were held with Air NZ, with the Government's objectives in mind

- I did not take the decision to enter into negotiations with Air NZ lightly.
- COVID-19 is an unprecedented event, and Air NZ:
 - Since Crown ownership in 2002, it has been a profitable and highly performing entity.
 - It has been well run by an experienced board and senior management.
 - Has a very strong reputation in the aviation sector.
 - Has a large, highly skilled, workforce, with a strong positive culture.
- There are benefits in preserving as much of the strengths and capabilities of Air NZ as possible, for when air travel returns to normal.

- The broader impacts of not providing immediate support for Air NZ, both on confidence and the economy, would be significant. It would also be much more difficult to address the Government's air transport priorities (repatriation, air cargo, maintaining minimum flight networks, just transition for staff) if the government doesn't provide immediate support.
- Negotiations were held with the Government's objectives in mind; that ultimately the Government wanted to support Air NZ in a commercial, fiscally sustainable, targeted and proportionate manner, whilst taking account of:
 - Ensuring there are flights to repatriate New Zealanders and to return foreign citizens home.
 - Ensuring air freight capacity, particularly for pharmaceuticals and other critical time sensitive cargo continues to be available.
 - Supporting the Pacific.
 - Cushioning the impact of the economic shock on workers.
 - Supporting confidence in the near-term.
- In addition, I was clear that the Government wanted to:
 - Ensure domestic destinations across NZ remain serviced as well as key international routes.
 - Ensure adequate supervision of any debt facility to manage the Crown's financial exposure.

I am confident that the agreement reached, in the form of a Term Sheet, is the best way of achieving the Government's objectives, and this has been confirmed by the Crown's team of specialist advisors

- During negotiations the Crown was advised by a specialist team of experts: Korda Mentha, Goldman Sachs and Chapman Tripp. Goldman Sachs has separately provided a letter endorsing the Term Sheet as the most appropriate and effective response to the company's current commercial situation.
- Furthermore, officials have advised that the agreement is the best way of achieving the Government's objectives as the Term Sheet is not solely to protect Air NZ, but rather to protect the core part of Air NZ's services that support the wider economy and the wellbeing of New Zealanders.
- Through this agreement we successfully have:
 - Maintain, as a minimum, services to North America, Hong Kong, Singapore, Sydney, Melbourne, Brisbane, and a number of Pacific Islands, at the frequencies of at least one return flight a week.
 - Maintain, as a minimum, to be reviewed after one month from the date of this terms sheet:
 - at least one return flight per day to every currently serviced domestic location other than Auckland, Wellington, Christchurch and Dunedin; and

- at least two return flights per day to each of Auckland, Wellington, Christchurch and Dunedin for passengers and cargo.
- With regard to broader social objectives, such as employment goals, I am in separate conversations with other Ministers (Health and Transport) to ensure we can still achieve them.

The agreement requires the Crown to provide a commercial loan facility for a maximum of \$900m, structured in a way to manage the Crown's financial risk and with appropriate monitoring and supervision

- This loan is to be contained in two separate tranches of \$600m and \$300m, over a maximum duration of 24 months (separable into two 12 month periods).
- The effective interest rate on the first tranche is initially expected to be between 7% and 8% per annum and the effective interest rate on the second tranche is expected to be around 9%. The effective interest rate on both tranches will increase by 1% if the loan remains after 12 months. This reflects that the Crown will be exposed to greater financial risk.

However, both officials and the Crown's expert advisory team have been clear with me, and negotiating Ministers, on the risks associated with the Term Sheet

- The negotiated attached Term Sheet has been undertaken in a compressed timeframe and within a dynamic economic environment as market conditions continue to worsen. This timeframe was due to the trading halt Air NZ had in place with NZX, and that in order for Air NZ to re-open on the market on Friday, a deal needed to be done before NZX announcements at 8.30am on Friday 20 March 2020.
- The Term Sheet has been developed based on all parties' best understanding of the impacts over the next year of COVID-19 and the Government's response to it on: economic activity; the demand for Air NZ's services; and any restrictions on Air NZ's ability to operate services.
- In the event that circumstances significantly changed such that the impact on the aviation industry was more enduring and severe further action would be required - and the Term Sheet allows and pre-positions the Crown for this action, including conversation to equity. Officials and their advisers are undertaking further work in preparation for this scenario.

Overall I am pleased that we have taken our responsibilities as majority owner seriously in order to support our national airline. Air NZ has a unique and critical role in our economy and society, and the timely intervention undertaken by the Government will allow the company to continue to undertake this role.

Recommendations

The Minister of Finance recommends that the Committee:

1. **Note** that on 16 March 2020, Cabinet noted that:
 - 1.1. the Minister of Finance intended to make a decision under s65L of the Public Finance Act as to whether, and on what terms, the Crown should support a loan to Air NZ;
 - 1.2. the Crown's position on the loan and its terms were to be negotiated by the Minister of Transport and Associate Minister of Finance (Hon David Parker) (collectively "Negotiation Ministers") [CAB-20-MIN-0108 refers];
2. **Note** that the Negotiation Ministers, supported by expert advice from Korda Mentha, Chapman Tripp, and Goldman Sachs, agreed in-principle to a draft term sheet and subsequently referred it to the Minister of Finance for consideration and decision;
3. **Note** that the Minister of Finance, as the Minister responsible for the administration of the Public Finance Act 1989, has the power (under section 65L of that Act) to lend money to Air NZ if he determines it to be necessary or expedient in the public interest to do so;
4. **Note** that the Minister of Finance, under section 65L of the Public Finance Act, agreed and signed the negotiated term sheet to support Air NZ as it manages the significant impact of the Covid-19 outbreak;
5. **Note** the agreed term sheet requires the Crown to provide a standby loan facility for a total possible amount of \$900m and a maximum duration of 24 months, where:
 - 5.1. the loan is comprised of two tranches, a first tranche of \$600m and a second tranche of \$300m, and
 - 5.2. the effective interest rate on the first tranche is initially expected to be between 7% and 8% per annum and the effective interest rate on the second tranche is expected to be around 9%. The effective interest rate on both tranches will increase by 1% if the loan remains after 12 months
6. **Note** that while Air NZ's intention is to maintain its services to the full extent that can be justified based on customer demand, the agreement imposes minimum service standards on Air NZ that requires it to:
 - 6.1. maintain, as a minimum, services to North America, Hong Kong, Singapore, Sydney, Melbourne, Brisbane, and a number of Pacific Islands, at the frequencies of at least one return flight a week;
 - 6.2. maintain, as a minimum, to be reviewed after one month from the date of this terms sheet:

- 6.3. at least one return flight per day to every currently serviced domestic location other than Auckland, Wellington, Christchurch and Dunedin; and
- 6.4. at least two return flights per day to each of Auckland, Wellington, Christchurch and Dunedin for passengers and cargo.
7. **Note** that the term sheet includes a number of mechanisms to allow the Crown to manage its financial exposure, such as:
 - 7.1. a requirement that no dividends can be paid by the company for the duration of the term of the loan;
 - 7.2. the ability for the Crown to convert its loan to equity at any point after financial close;
 - 7.3. the ability for the Crown, from six months after financial close, to require the company to undertake a capital raising with the proceeds applied to repayment of the loan;
 - 7.4. holding security for the loan against Air NZ's unencumbered aircraft; and
 - 7.5. requiring Air NZ to meet various financial covenants.
8. **Note** that various supervision and monitoring requirements have also been imposed, including:
 - 8.1. the appointment of an Investigative Consultant that will engage with Air NZ senior management and be provided assurance regarding all material changes in company performance that may give rise to financial implications for the company;
 - 8.2. a Crown observer (likely to be the Investigative Consultant) on the Audit and Risk Committee with access to all documents from Air NZ management to the Board of Directors; and
 - 8.3. the company must provide for approval by the Crown of an operating finance plan, including cash flow forecasts and key assumptions that cover Air NZ's activities for the duration of the loan.
9. **Note** that the term sheet has been negotiated as a commercial, arms-length, arrangement and fulfils the government's objectives to provide support in a commercial, fiscally sustainable, targeted and proportionate manner;
10. **Agree** to establish the following new multi-year appropriation, to run from 23 March 2020 to 30 June 2021:

Vote	Appropriation Minister	Title	Type	Scope
Finance	Minister of Finance	COVID-19: Loans to Air New Zealand	Non-Departmental Capital Expenditure	This appropriation is limited to loans to Air New Zealand as part of the Government's response to COVID-19.

11. **Approve** the following changes to appropriations to give effect to the policy decisions above, with a corresponding impact on net core Crown debt;

	\$m - increase/(decrease)
Vote Finance Minister of Transport	2019/20 to 2021/22
Non-Departmental Capital Expenditure: COVID-19: Loans to Air New Zealand	900

12. **Note** that the indicative spending profile for the new multi-year appropriation described above is as follows:

Indicative annual spending profile	\$m - increase/(decrease)				
	2019/20	2020/21	2021/22	2022/23	2023/24
	600	300	-	-	-

13. **Agree** that the proposed change to appropriations above be included in the 2019/20 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;
14. **Note** that there will be an initial impact on net core Crown debt, however, this will reverse over the term of the loans as it is repaid;
15. **Note** that as the loans will be established on a commercial basis and be repaid within ten years, there is no impact on Budget allowances;

Authorised for lodgement

Hon Grant Robertson

Minister of Finance