MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Tourism Recovery Fund: further decisions on the use of loans and their terms and conditions

Date:	2 October 2020	**Priority:**	**Urgent**
Security classification:	In Confidence	**Tracking number:**	MBIE 2021-1005

Action sought		
	Action sought	**Deadline**
Tourism Recovery Ministers Group: Hon Kelvin Davis **Minister of Tourism** Hon Grant Robertson **Minister of Finance** Hon Nanaia Mahuta **Minister for Māori Development** Hon Eugenie Sage **Minister of Conservation** Fletcher Tabuteau **Under Secretary Regional Economic Development**	**Agree** that STAPP and ITO loans be used to pay commercial debt, subject to some conditions. **Agree** to further terms and conditions of STAPP and ITO loans.	5 October 2020

Contact for telephone discussion (if required)				
Name	**Position**	**Telephone**		**1st contact**
Danielle McKenzie	Manager, Tourism Policy	04 896 5113	s 9(2)(a)	
s 9(2)(a)	Principal Policy Advisor	s 9(2)(a)	s 9(2)(a)	✓
s 9(2)(a)	Policy Advisor	s 9(2)(a)	-	

The following departments/agencies have been consulted
The Treasury, Provincial Development Unit

Minister's office to complete:

☐ Approved ☐ Declined

☐ Noted ☐ Needs change

☐ Seen ☐ Overtaken by Events

☐ See Minister's Notes ☐ Withdrawn

Comments

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Purpose

To seek agreement on the use of the Strategic Tourism Assets Protection Programme (STAPP) loan and further terms and conditions of the loan.

Recommended action

The Ministry of Business, Innovation and Employment recommends that you:

a **Agree** that STAPP and ITO loans may be used to pay commercial debt (Principal and Interest), subject to firms demonstrating that they have exhausted alternative options to repay the debt and demonstrating how the debt payment would fit into their plan to remain solvent.

Agree / Disagree

b **Agree** that the default interest rate is 3% plus our use of money interest rate in line with the Small Business Cashflow Loan Scheme.

Agree / Disagree

c **Agree** that interest on STAPP and ITO loans will start accruing two years from the date of first drawdown.

Agree / Disagree

d **Agree** that defaults by a subsidiary company will not be treated as a default by its holding company and *vice versa.*

Agree / Disagree

Danielle McKenzie
Acting Manager, Tourism
Labour, Science and Enterprise, MBIE

02 / 10 / 20

Hon Kelvin Davis
Minister of Tourism

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Hon Eugenie Sage
Minister of Conservation

..... / ...... / ......

Hon Grant Robertson
Minister of Finance

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Fletcher Tabuteau
Under Secretary Regional Economic Development

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Hon Nanaia Mahuta
Minister for Māori Development

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Background

1. The purpose of the STAPP and the support for Inbound Tour Operators (ITOs) is to cushion the impact of COVID-19 on the tourism sector, and to position the sector for recovery.

2. The STAPP is intended to assist with the protection of strategic assets in the tourism landscape that form the core of New Zealand's essential tourism offerings. It aims to support these strategic assets through the disruption caused by COVID-19 and to ensure that these strategic assets are maintained until international tourists can return to New Zealand.

3. The reasons for supporting ITOs that are operating at or near zero revenue and will continue to do so until international visitors return, include that:

   a. ITOs are a key link between overseas wholesalers and travel sellers;

   b. ITOs have strong relationships in our major markets; and

   c. in order to be prepared for when New Zealand's borders reopen, ITOs need to maintain some ability to prospect, build and maintain a pipeline of high value visitation to New Zealand.

4. 106 tourism firms and 26 ITOs will be supported through STAPP and ITO loans (STAPP loans). Tourism Recovery Ministers have previously agreed on high-level terms and conditions of the concessionary loans scheme *[briefing 2021-0526 refers]*.

5. MBIE Tourism is working with the Provincial Development Unit and the Treasury to finalise a loan agreement template for STAPP loans. During our design and drafting of the loan agreement, a few matters have arisen and they need ministerial consideration.

Issues requiring Ministerial consideration

Using STAPP loans to pay off commercial debt

6. We understand a number of tourism operators would like to use their STAPP loan to pay off debt.

7. Firms generally operate with commercial debt as a standard part of their operating model. Repayment of this debt is planned for based on the financial position of the borrower, and repayment terms are negotiated with the lender.

8. In the case of tourism firms, many have debt with lenders with repayment schedules based on pre-COVID-19 volumes of trade. This means that their current repayment obligations to lenders may be overly burdensome and may threaten their solvency position.

9. The broader objectives of STAPP loans are to ensure that firms are able to meet their minimum viable operating costs to ensure that they remain viable. Allowing firms to pay off commercial debt aligns with these objectives.

10. Generally, debts held with the commercial sector will have a higher interest rate than STAPP loans. Allowing firms to use their STAPP loan to repay commercial debt may save costs to firms, and support their survival. However, there are some risks involved with this approach, which require consideration.

11. Broadly, we see three broad ways which firms may seek to use their STAPP loans to pay off commercial debt, and comment on these in detail below:

    - Paying interest on debt

- Making regular scheduled amortisation or principal payments that were in place prior to COVID-19
- Making unscheduled or voluntary principal repayment (often due to default).

Paying interest on debt

12. We anticipate that this will be the most common way that firms will use their STAPP loan to pay off commercial debt. This is the most reasonable (and defensible) basis that a firm would use their STAPP loan to repay commercial debt.

13. By allowing firms to pay off interest with their STAPP loan, firms would be enabled to use their cash flow to meet other costs (such as wages, fixed costs and operating costs). In turn, this improves their financial position and keeps them solvent.

Regular scheduled amortisation or principal payments that were in place prior to COVID-19

14. Amortisation is the gradual process of writing off the principal of a debt.

15. Firms may have a scheduled amortisation payment that was previously negotiated with lenders which they are obliged to meet. If they are unable to meet these payments, they risk becoming insolvent.

16. We anticipate that fewer firms will have amortisation payments to make, and would expect that firms first negotiate with lenders before using STAPP loans to meet these payments. In the current environment, we would also expect banks to work with borrowers to provide flexibility.

17. Before allowing borrowers to use STAPP loans for this purpose, we would expect to see evidence that they have attempted to work with their bank, and to understand how the use of funds in this way will support their ongoing solvency.

Unscheduled or voluntary repayment of principal

18. We anticipate that this would be the least common reason a firm wants to use their STAPP loan to pay off commercial debt.

19. Generally, an unscheduled or voluntary repayment of principal occurs in two situations:
    - the firm has defaulted on their debt and the lender has called for repayment of the principal; or
    - a firm is doing particularly well and wants to lower the amount of debt that they are carrying, usually with the anticipation of taking on further debt for capital investment.

20. Firms who intend to use STAPP loans to make an unscheduled or voluntary payment of their principal would be carefully examined to ensure that their reasons for doing so are legitimate.

21. If we allow firms to do this, then there is a risk that firms will use STAPP loans to pay off their principal and simply cease trading, potentially leaving other creditors (such as employees) unpaid.

22. Unless this type of payment could be objectively justified we would not support the use of STAPP loans in this case.

Considerations

23. Permitting the use of STAPP loans to repay commercial debt without any conditions may have some unintended consequences such as firms just surviving without any future prospect of success, and they will not be incentivised to adjust economically.

24. To achieve the policy intent of STAPP and align with the Minister of Finance and Associate Minister of Finance's decision that lending to the Loan recipients is in the public interest, we

propose that firms may use the Loan to repay their commercial debt only if they meet the following criteria:

a. They have exhausted all alternative options to repay the debt, including refinancing from lenders and/or sought interest-only payment periods.

b. They will demonstrate how debt payment using the Loan would fit into their plan of remaining solvent.

25. These requirements would reduce the risk of default, and encourage firms to remain solvent for the duration of the STAPP Loan period.

26. We have noted a number of issues in the Risks section of this briefing which Ministers may wish to consider.

27. There could also be some other type of commercial debt that might emerge during the loan negotiation process with Loan recipients. We will seek further ministerial decision, if required.

The default interest rate will align with the Small Business Cashflow Scheme

28. TRM have not made a decision on what the default interest rate for STAPP loans should be.

29. TRM have indicated that they want STAPP loans to closely resemble other government loan schemes.

30. As we have modelled STAPP loan terms and conditions on the Small Business Cashflow Scheme, we propose that the default rate is the same as this scheme (3% plus the use of money interest rate).

Interest will start accruing two years from the date of first drawdown

31. We propose that interest on the borrowed amount will begin accruing two years from the date of the first drawdown; not from the date of the signing the loan agreement.

32. This will provide firms the flexibility to draw down the loan only when necessary and will not unreasonably penalise firms who choose not to draw down the loan immediately after signing the loan agreement.

Treatment of Loan recipients and its holding company in case of a default

33. STAPP loan contracts between the Crown and firms vary. Some contracts are with holding companies, while others are with their subsidiaries. This is based on how they applied initially for STAPP funding.

34. Given this, in the event of a default, we propose to treat firms based on how they applied for STAPP funding.

35. For example, if an application was made by a subsidiary company and then defaults on their STAPP loan, this default would be treated as a default of the subsidiary company.

Risks

36. There is urgency to this decision. Some tourism firms are seeking details on the loan agreement and access to the loan facility with urgency. We are unable to provide the draft agreement until Tourism Recovery Ministers make decisions on these final loan matters.

37. Allowing firms to repay commercial debt may result in:

a. Some firms using the Loan to repay their principal repayments with existing lenders and just walk away as there is no incentive to continue operating. This is mitigated through the conditions placed on paying commercial debt: firms must demonstrate that principal repayments fit within the strict context of remaining solvent. We anticipate that this would only be allowed in very few (if any) situations and the bar to meet this criteria will be set intentionally high.

b. Insolvency for some firms. For example, a borrower could use their whole STAPP loan amount to pay down an existing loan in the short term, leaving them with no ability to pay any ongoing expenses, particularly if borders remain closed. This risk is mitigated by only allowing firms to draw down on their loan periodically, and placing the criteria detailed above on any commercial debt payment.

c. A perception risk that STAPP loans are seen as providing repayments to overseas banks/lenders over other creditors, such as employees. This risk is mitigated by limiting how firms can repay commercial debt using the above criteria.

38. There is a risk that STAPP and ITO loan recipients may default on their loan repayments, particularly if international borders remain closed for longer than five years.

Next steps

39. Subject to the Ministers decisions, the PDU will offer loan agreements to approved ITOs and STAPP applicants. We expect that PDU will offer the loan agreements to ITOs and a first tranche of STAPP applicants within two weeks' time from the date of decision on the matters in this briefing.