

Kāpiti Coast District Council financial support to Air Chathams – Summary Statement

The below summary statement provides additional detail on Council's loan to Air Chathams in 2020 further to an investigation by the Office of the Ombudsman New Zealand into a Local Government Official Information and Meetings Act 1987 (LGOIMA) request recommending that additional detail be released on Council's website given the public interest in the matter.

Why did Council provide financial support to Air Chathams?

In June 2018, following the withdrawal of Air New Zealand's Auckland-Kāpiti service at very short notice, Kāpiti Coast District Council (Council) supported Air Chathams with the introduction of its new Auckland Kāpiti service.

Prior to the COVID pandemic, Air Chathams was a profitable business. Each of the three mainland routes were profitable (Whakatāne and Whanganui) or broke-even (although Council made a contribution during the establishment phase for landing fees and marketing). As a consequence, the existence of the three routes contributed to the cost-base of Air Chathams, enabling the company to operate more efficiently both from a resourcing and a financial perspective. The newest route offered by Air Chathams was the Auckland-Kāpiti service

The COVID pandemic had significant impact on New Zealand's domestic airline industry including Air Chathams. Central government put together a funding package for Air New Zealand but there was limited support for regional airlines.

In early 2020, due to the impact of the COVID pandemic, Air Chathams approached Council in relation to further financial support to ensure the continued viability of the Kāpiti-Auckland route. Air Chathams also made similar approaches to Whakatāne District Council and Whanganui District Council. There was a real risk that in the absence of financial support from the Councils Air Chathams would be forced to withdraw services for each of the three routes.

Council was interested to understand options that may be available to Council to support the continued viability of the air service in Kāpiti.

On 28 May 2020 in a public excluded meeting (see report at Attachment 1), Council approved support to Air Chathams by providing it with a five-year interest-free loan of up to \$1 million, subject to officers being satisfied by the financial due diligence work commissioned by the Council (Grant Samuel report). This meeting was conducted online by Zoom due to Covid-19 restrictions in place at the time.

This support included:

- a first tranche of \$500k being paid upon that condition being satisfied
- approval for the second tranche to be sought from Council
- any second tranche will be subject to a government underwrite being in place.

This funding was conditional on the execution of a loan agreement between Council and Air Chathams. Council extended the first tranche of funding of \$500k to Air Chathams on the terms of a loan agreement prepared by Council's external legal advisors to the satisfaction of the Chief Executive.

The Council report in May 2020 focused on the role Council played in 2018 establishing the Kāpiti-Auckland route, the widespread community support for and appreciation of a regular Kāpiti-Auckland air service and the importance of the route to the economic development of the district (the net benefit to Kāpiti was estimated at \$3.4M a year). The Council paper clearly set out the risks that Air Chathams may not be able to repay the loan after the 5-year non-repayment period due to the financial performance of Air Chathams with start-up operating costs, a fragile economy following the Covid-19 pandemic (and low consumer confidence), and with revenue dependent on passenger numbers, aircraft types and airway costs. At paragraph 36 of this Council report, it stated that Council must consider the risks that the money might not be able to be repaid and that the loan might need to be written off.

What is the Grant Samuel report?

Council jointly commissioned Grant Samuel to undertake the financial due diligence report into the financial support to Air Chathams, on behalf of both Kāpiti Coast District Council as well as Whanganui District Council and Whakatāne District Council.

The Grant Samuel group of companies provides corporate advisory services in relation to mergers and acquisitions, capital raisings, corporate restructuring and financial matters generally. Grant Samuel is independent of the Councils and had no involvement with, nor interest in, the outcome of any proposed financial support.

The purpose of the report issued in June 2020 was to evaluate the proposed financial support to Air Chathams. The proposed loans were three separate loans on similar terms (one from each council) The loans were proposed to be unsecured and interest-free with a term of five years, each loan to be tied to a particular route with associated performance obligations (minimum service schedule and number of flights) and reporting obligations (including financial performance and provision of management accounts).

Grant Samuel evaluated the proposed loans to Air Chathams on the basis of a number of factors including:

- the operations and financial performance of Air Chathams prior to the COVID pandemic to assist in forming a view on the viability of the business;
- the financial position of Air Chathams prior to the COVID pandemic to assist in forming a view on the gearing of the business and its financial obligations and cash flows;
- the impact of the COVID pandemic on the business;
- the business plans and operating assumptions of the business post-COVID to test for reasonableness;
- the viability of the routes between Auckland and Kāpiti Coast, Auckland and Whakatane and Auckland and Whanganui with and without the proposed loans;
- the financial and operating forecast of the business, and where appropriate incorporating these in a financial model to consider a forward-looking operating scenario;
- the proposed loan terms to ensure these are practical for both the Councils and Air Chathams;
- the current trading conditions for Air Chathams;
- the timing and circumstances surrounding the proposed loans;
- the attractions of Air Chathams' business; and
- the risks of Air Chatham's business.

The Grant Samuel report concluded that in the absence of the proposed loans, Air Chathams was likely to downsize and drop the regional services. The report found that with the proposed loans, Air Chathams would likely be able to continue services across the three key routes. The report, in considering the financial position of Air Chathams and future forecasts and

assumptions, noted that if for whatever reason the Air Chathams business was placed in receivership, the probability of the Councils recovering its loan advances in the circumstances would be slim. The report also concluded that there was no certainty that Air Chathams would be able to repay the proposed loans at maturity due to the difficulties of predicting the future financial performance of the company in the circumstances.

As per Council's 28 May 2020 report, the Chief Executive at the time was delegated authority to execute the loan agreement subject to "officers being satisfied by the financial due diligence work that has been commissioned". When the Grant Samuel report was received, it was shared with Whakatāne District Council and Whangai District Council and there was a high-level discussion of the report. This conversation was not focused on the issue of public perception given the strong community support for the continued viability of the air service in Kāpiti and the other districts. Having considered the Grant Samuel report, the Chief Executive executed the proposed loan agreement with Air Chathams for the first tranche of funding. This was an endorsement of the Grant Samuel report finding that in the absence of the proposed loan, Air Chathams was likely to downsize and drop the regional services.

Request for second tranche of funding

In early 2022, Air Chathams approached Kāpiti Coast District Council to explore the possibility of accessing the second tranche of the loan agreement, being a further \$500k referred to as "facility B".

Council commissioned Grant Samuel to undertake a further report as due diligence to inform the decision. Air Chathams requested that Council not proceed with seeking the further tranche of funding due to the likelihood that central government would not underwrite the loan and that this could impact central government funding.

Impairment of the loan to Air Chathams

Council is required to review all assets and impair them where the net realisable value is below their carrying amounts.

In 2022, Council's auditors carried out tests to satisfy themselves that Council does not overstate its assets in relation to the Air Chathams loan. The auditors reviewed the Air Chathams' financial accounts including the continued challenges faced by the industry at the time. The auditors noted there were challenges in Air Chathams ability to repay the loan at the time.

Council's auditors queried management as to why Council did not impair the loan or moreover, what testing had we done to satisfy Council that the loan was fully recoverable given Air Chathams financial performance and the current state of the airline industry.

In light of the auditors' feedback, Council management (authorised by the Chief Executive) made the decision to impair the loan to nil. This was not only to be prudent regarding the sustainability of Council assets, but also to adhere to the auditor's guidance and accounting standards, which was for Council assets net realisable value to not be below their carrying amounts. The loan to Air Chathams did not meet these requirements.

At the time when this was raised by Council's auditors, discussions were had between Council staff on whether it should be impaired. Ultimately the Chief Executive authorised the loan be impaired, aligned with our auditor's guidance and financial due diligence undertaken. This was subsequently approved by Council's Risk and Assurance Committee when they approved the [Annual Report](#) financial statements for the 2021/22 year (refer page 113 of the report).

While Council has impaired the loan, no decision has been made to write-off Council's loan and it remains payable on the terms of the loan agreement. Council may therefore revisit the decision around impairment of the loan if Air Chathams financial position subsequently improves.

Additional information in the financial support from Council to Air Chathams including relevant Council reports and the original Memorandum of Understanding between Air Chathams and Council is set out in Attachment 1. Redactions are made to protect commercially sensitive information relating to Air Chathams under section 7(2)(b)(ii) of LGOIMA.

Attachments

Attachment 1 – Additional information on the financial support from Council to Air Chathams including Council reports dated 18 June 2018 and 28 May 2024 (released from public excluded).