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## **THE ROLE OF LEASING IN THE SUSTAINABLE DEVELOPMENT OF GEORGIAN AIR TRANSPORT**

### **Annotation**

The economic-legal relations related to leasing are ancient and have been developing for centuries, with the support of state programs to stimulate leasing relations. All economic-legal relations related to leasing belong to the new or recent period of history. Historical documents testify that lease has been known to man since time immemorial.

The idea of leasing is old, but the term “leasing” was formed in this form late. Information about the essence of leasing transactions comes from the era of Aristotle (384-383-322 BC to AD). It is to him that the very often quoted phrase belongs, “Wealth is in use, not ownership”.

The first actual leasing transaction is documented in 1066, when William the Conqueror leased ships to Norman shipowners to conquer the British Isles. One of the first statutory acts regulating leasing-like relations in Great Britain, the “Welsh Canon” was adopted in 1284. With the development of industry in Great Britain at the beginning of the 19th century, the number of products that were leased also increased. Companies emerged whose sole purpose was the leasing of locomotives and railcars. When drafting the contracts, they included the right to purchase (option), which would be presented to the lessee at the end of the leasing period. The reason for such an addition to the contract was that the users of the equipment treated the wagons with much more attention when they imagined themselves as their owners in the future, and such contracts received the name of “lease-sale”.

During World War II, the United States government provided a sharp advance to the leasing business. The scale of the vehicle leasing business has grown rapidly. The first case of automobile leasing was recorded in 1918. The legal father of the automobile leasing business is considered to be Frank’s sales agent from Chicago, who was the first to introduce automobiles for lease.

Leasing was used in the former USSR during World War II, when American equipment was ordered in 1941-1945. US aid to allies, including the value of products, amounted to \$49.1 billion. A real revolution in lease relations in the USA took place in the 50s of the 20th century. Technological devices, machines, mechanisms, ships, airplanes were massively leased.

The USA has become the birthplace of new business. In the 60s, the volume of leasing operations in this country exceeded one billion dollars, and at the end of the 80s it was 110 billion dollars. i.e., in a quarter of a century, it grew hundreds of times. The leasing business soon crossed the borders of the United States, and such an important concept for the leasing business as “international leasing” began to

take shape.

A few years later, the mentioned company began to open its branches in other countries (first in Canada in 1959). The first leasing company in France was established in 1957. The first leasing company in Italy appeared in 1963. The first leasing company in Germany was founded in 1962 with a registered capital of one million marks.

At the beginning of the 60s, the leasing business also found development on the Asian continent. The main part of the leasing market is currently concentrated in the triangle, "USA-Western Europe-Japan". Japan is characterized by the expansion of the leasing operation, which includes combinations of purchase and sale, leasing and loans. Such services are called complex leasing. In Western Europe, mainly specialized leasing companies appear as leasing providers, in most cases 70-80% of them are controlled by banks or considered as their subsidiaries.

The modern understanding of leasing derives from the classical principles of Roman law regarding the separation of the concepts of owner and user of property. The origin of leasing as a special type of business is based on the two most important components of the concept of ownership - use of the thing, i.e. On the possibility of separating the legal right of a person to the object of ownership and its use in accordance with its purpose in order to receive income.

1982 was the most important year for aviation equipment leasing: the McDonnell Douglas company, through leasing and based on a new financial policy, was able to conquer the market for DS-9-80 type aircraft in competition with "Boeing-72". The concept proposed by Douglas was called "fly before you buy".

The leasing company literally credits the lessee. Therefore, leasing is often called "credit-lease" in contrast to the "purchase" agreement, according to which the ownership of the goods is transferred from the seller to the buyer. In leasing, ownership of the leased object is retained by the lessor, and the lessee acquires it only for temporary use. From an economic point of view, leasing is similar to a loan that is given for the purchase of equipment. During leasing, the lessee becomes the owner of the leased property only after the expiration of the contract and payment of the full value of the leased property. However, such similarity is characteristic only for financial leasing. Another type of leasing, for example operational leasing, is a higher level of entrepreneurial activity compared to banking and commercial activities, as it implies and requires knowledge of financial business, as well as equipment and real estate market conditions, as well as taking into account the changing needs of clients and lease peculiarities.

Recently, leasing is more often defined (Convention on International Financial Leasing, May. 1988, Ottawa) as a specific form of financing investments in the purchase of durable consumer goods, real estate and other elements of fixed capital through financial (leasing) companies, which acquires property for a third party Ownership rights and will lease it for a medium or long-term period. In this case, leasing, as an alternative to full financing (lending), takes its place as a flexible and cost-reducing tool.

Leasing fee should include the cost of depreciation of the leased object. The Model Law on Leasing, or the law of November 13, 2008, is a further development of the Ottawa Convention and aims to help developing countries to eliminate the normative gaps in leasing disputes and to harmonize norms with developed countries.

Depending on the duration of the transaction, the scope of the leasing duties and the quality of the objects' compensation, two main types of leasing are distinguished: financial and operational. Leasing with partial payment is usually called operational. Its essence lies in the fact that the costs of the lessor related to the purchase and maintenance of the leased property are not fully compensated during the lease term, since the term of the leasing agreement is shorter than the normative term of the property. The lessor is forced to transfer it for temporary use several times, thereby increasing the risk of recovering



the residual value of the leased object when there is no demand for it. Another peculiarity of operational leasing is that the obligation of service, repair, and insurance rests with the leasing company. Leasing with full payment of leased property is called financial leasing. The period during which the property is transferred for temporary use is close to the period of exploitation and depreciation of the entire value of the property or a large part of it. Financial Leasing - This is an agreement that provides for the payment of leasing payments during the period of its validity, which cover the total amount of depreciation of the equipment or a large part of it, additional costs and the income of the lessor.

In the process of discussing ownership relations, leasing as a long-term lease and its economic role, which can also be called property credit, deserve attention. In general, leasing refers to the transfer of goods for consumption for a specified period and for a certain fee. In practice, there is both domestic leasing, when the leasing operation is carried out within the country, and international leasing, when the partners related to the agreement are in different countries. Through leasing, an entrepreneur can raise working capital. In addition, leasing allows the entrepreneur to avoid paying a large sum of money for the equipment at once. Modern business without leasing is unthinkable. It is estimated that one third of the equipment sold in the world is sold through a leasing operation. It promotes the development of small and medium-sized enterprises worldwide and is a useful financial tool for retooling the enterprise. Today, Georgian enterprises suffer from a lack of modern equipment. Leasing will allow them to step into the rhythm of the XXI century. If only yesterday enterprises considered expensive capital, collateral and loan repayment period as the main obstacle to their business development, today it is possible to solve these problems through leasing. Commercial banks, in relation to the leasing company, do not act as lenders, but directly as lessors, thereby directly participating in the leasing business. The development of leasing business gives banks the opportunity to expand their range of operations, diversify banking products, improve the quality of customer service and establish new partnership relationships.

The lease term (lease period) is determined by taking into account depreciation, or using the accelerated depreciation method of the leased equipment. The use of accelerated depreciation is economically advantageous for the lessor and the lessee. The first gets back the invested funds in a shorter period of time, and the second gets the opportunity to reduce the amount of profit tax and also the period of transfer of ownership of the property, if this condition is stipulated in the contract. Throughout the lease term, the lessee charges depreciation on the leased property.

In the document governing international air transport (Doc #9626), leased aircraft are referred to as aircraft that are used under the terms of a lease contract, and the contract is usually made taking into account a specific situation. The Chicago Convention on International Civil Aviation of 1944 (Article 83bis) deals with the leasing, chartering and exchange of aircraft during international flights. In developed countries, 34% of the investments required for the renewal of fixed assets are financed by leasing, in developing countries this figure is 3-15%, and in Georgia it is equal to 2%.

Leasing differs from a loan in several factors. However, the more universal distinguishing features are as follows: Leasing services can be used at any stage of the asset's life cycle. The search process, model and supplier selection, negotiations with various parties, financing of asset purchase and transportation/installation to the destination, insurance, follow-up monitoring and involvement in its renewal/sale process – all this is part of the leasing company's expertise. In addition, when using leasing, the customer does not need additional real estate for security. The financed asset itself, whether machinery, aircraft or other fixed asset, constitutes the security of the leasing agreement. Consequently, leasing is more affordable for small and medium-sized businesses. For example, unlike other banking products, during the analysis of the leasing project, the financial effect of the asset to be purchased and/or the liquidity of the asset must be taken into account, which increases the probability of making a positive decision on the project. This

naturally leads to the following situation: leasing is available for startups even at the initial stage of their development. The effectiveness of the multifaceted impact of leasing on the economy is determined by the fact that it simultaneously activates private capital investments in the field of production, improves the financial situation of direct producers and increases the competitiveness of domestic businesses. These advantages, which are manifested in the use of the leasing mechanism, also apply to the field of air transport, where leasing is not only a way to renew the most active part of the main funds, but it is also one of the ways to revive the domestic aviation market.

A concrete assessment of the advantages of leasing can be carried out taking into account the individualities of each project. Therefore, a complex evaluation of the effectiveness of leasing operations is required: development of a specific scheme of leasing operations, analysis of the state of the normative base, selection of the leasing provider, supplier, specialized leasing company, financial evaluation of the project (determination of profit, calculation of profitability, redemption periods), analysis of possible risks and their reduction.

Leasing is the right to use an asset, which is transferred by the leasing company to the lessee with a customized payment schedule. In European countries, fixed assets are mostly financed by leasing. Under the leasing agreement, the lessor is obliged to transfer the specified property to the lessee for a specified period with or without the right to purchase this property. The leasing contract is concluded in writing. It should include: the total price, the amount of the leasing fee and its payment terms, the final payment amount. The method of its calculation in case of early termination of the contract. Leasing agreement may provide for different forms of payment of leasing fee by the lessee, in particular, by advance payment, insurance deposit, etc. Leasing property insurance may be provided for in the contract.

The most demanded leasing products in Georgia are auto leasing and leasing of fixed assets. In the leasing of fixed assets, most often, financing of construction equipment is requested. The construction sector is one of the most developing areas in Georgia, the correct assessment of the liquidity of the leasing asset is an additional benefit for the lessee. Given that the subject of leasing is owned by the leasing company until the end of the leasing agreement, it is important to match the value of the asset with its actual condition. After the end of the contract, the asset becomes the property of the lessee. The main value is responsible financing, therefore the solvency of each customer needs to be properly analyzed so that every signed contract is based on mutual responsibility.

The first leasing company in Georgia was established in the early 2000s. During these 15-20 years, especially after overcoming the 2008 war and global economic crisis and the introduction of leasing legislative changes in 2010, the industry has achieved considerable success and continues to grow steadily. During the years 2010-2018, the leasing portfolio (based on data from three companies) has grown significantly – on average, 30% annual growth. The natural corollary to the growth of the industry has not been delayed: the entry of several leasing companies into the market has been announced. The increase in the number of companies strengthens the competitive environment, which in turn contributes to the increase in the range of products and the improvement of conditions. The development of the leasing market ultimately brings great benefits to the leasing companies themselves and their employees, as well as to the country's economy and the small and medium business sector, which is facilitated by the process of investment in fixed assets. Therefore, in many cases, the state actively promotes the leasing industry.

According to the statistics of the European Central Bank, in the countries where the leasing sector functions successfully, the unemployment level is lower than in the countries where it is in the stage of development. Awareness is one of the main challenges for the leasing market in Georgia.

The recovery, development and growth of Georgia's economy requires significant investments, which is almost impossible due to limited financial opportunities. One of the solutions to this situation is the



development of leasing relations. Georgia, like the whole world, faced a new challenge. The situation caused by the Russia-Ukraine war naturally leads to a decrease in the demand for leasing products. Logistical processes are also significantly complicated.

Leasing operations are distinguished by the high cost of leasing objects (especially for air transport) and as a result, high risks, as well as the difficulty of financing the expensive leasing process for small airlines. Leasing has a positive effect on the expansion of the aviation market, in particular, on the creation of additional jobs and the increase of competitiveness. Experience shows that the successful development of the leasing mechanism and the expansion of its scale is possible only in the presence of competitive and customer-fighting airlines.

The current economic situation in Georgia favors the introduction and development of leasing. It is known that Georgian Airlines "Airzena" became the first Georgian airline that used American Boeings on the Georgian air market, which enabled the airline to compete with foreign airlines established on the Georgian air market. On January 12, 1999, they brought a medium-sized Boeing 737-500 to Tbilisi Airport on the basis of a leasing agreement for a period of 5 years. In a very short time, they also signed an agreement with the German leasing company "HAPAG LLOYD" to receive two more Boeing 737-300-112 seats under the leasing agreement. Later, in 2005, they also imported Boeing 737-400 aircraft of the same class under a leasing agreement. These agreements provided for operational leasing, that is, after the expiration of the leasing period, the aircraft were to be returned to the owners. Implementation of leasing operations was followed by a mixed reaction by the said airline, but the past period has fully confirmed that the decision was made correctly. In our opinion, it would also be advantageous for Georgian airlines to import aircraft of foreign production under a financial leasing agreement for an optimal term - 7-8 years. Domestic airlines now have the option to import aircraft subject to a subsequent buyout.

According to the information of the Civil Aviation Agency of the Ministry of Economy and Sustainable Development, in 2020, the low-cost airline Wizz Air served the most passengers with regular flights to the airports of Georgia, and carried 172,012 passengers in the reporting period. It was 8%, 12% in 2018, and 16% in 2019. According to the number of passengers transported by regular flights in 2020, the Turkish airline company Turkish Airlines is in second place, with 12% of the market. In 2020, compared to 2019, the share of Turkish Airlines increased by 1%, since in 2018-2019 the airline owned 11% of the market. It should be noted that according to the passenger flow transferred to the Georgian air market (in percentage terms), "Turkish Airlines" equaled the figure of 2017, because "Turkish Airlines" was the owner of 12% of the Georgian air market in 2017. The third place in the ranking is Georgian Airways, its traffic in 2020, with 43,106 passengers, is 6% of the market. According to statistics, in 2019 Georgian Airways owned 10% of the market, in 2018 it was 11%, and in 2017 it was 10%. According to the figures of 2020, in the fourth place by the flow of transported passengers, there are several companies with a 5% market share - Ukrainian Skyup airlines (+2%), Turkish Pegasus Airlines (+1%) and Belarusian Belavia (+2%). Flydubai, Air Arabia and Lufthansa own a 4-4% share of the Georgian aviation market. 3-3% are owned by: Ukraine International Airlines (FlyUIA), Azerbaijan Airlines (AZAL), Qatar Airways and Ryanair. According to the passenger flow carried by regular flights in 2020, the following airlines have a 2-2% share in the Georgian aviation market: Isirair Airlines, Qeshm Airlines, LOT Polish Airlines and Aircompany Armenia. According to the figures of 2020, according to the flow of passengers transported by regular flights, 93% of the market comes to foreign airlines, and 7% to national air carriers. In May 2023, Tbilisi International Airport served 270,001 passengers, which is 77% of the number of passengers in the same month of 2019, and compared to the data of May 2022, it is an increase of 14%. The operating company of Tbilisi and Batumi airports also announced that Batumi International Airport served 46,057 passengers in May 2023, which is 95% of the same month of last year, and 97% of the data for the same period of 2019.



## Passengers transferred from Georgian airports with regular and non-regular flights

2014	2015	2016	2017	2018	2019	2020	2021	2022
2008171	2261006	2940455	4073959	5033323	5209505	833846	2496448	4441316

As it is clear from these data, the situation of the Georgian aviation market is still unfavorable, as the share of Georgian airlines in passenger services is quite low, one of the ways to solve it is to improve the leasing relations, its legal basis, this process has already started, but it is proceeding at a slow pace.

According to the Georgian legislation, leasing is defined by the Civil Code of Georgia (Article 576-80). Part 1 of Article 576 establishes that leasing is a mutual relationship consisting of the rights and duties of the leasing provider, the lessee and the lessee. is defined by law as a necessary condition for the formation of a leasing contract. Articles 576-580 of the Civil Code of Georgia also establish the rights and obligations of the parties to the leasing agreement.

For the purposes of Article 576 of the Civil Code of Georgia, the procedure for calculating the annual effective interest rate, commission, financial cost, penalty and/or any form of financial sanction was determined on the basis of Order No. 18/04 of the President of the National Bank of Georgia of 2019, according to which the calculation of the rate requires the lessee. The present value of the lease payments equals the lease financing amount. It is expressed as an annual percentage and is calculated taking into account the financial costs incurred by the lessee on leasing and is calculated by the following formula:

where,

- a) K-leasing financing issue serial number
- b) K' - serial number of the leasing fee
- c) Leasing financing amount issued in AK-K order
- d) A' - K' - corresponding leasing fee
- e)  $\Sigma$ -sum sign;

- f) m- the total amount of leasing financing
- z) m' - the total number of leasing payments

h) tk - the time interval expressed as a fraction of a year between the first disbursement of leasing financing and subsequent disbursements from the second to m

i) tk' - the time interval expressed in years or as a fraction of a year between the initial date of leasing financing and payments of leasing fees from the first to m'

j) annual effective interest rate of i-leasing.

For the purposes of the Tax Code of Georgia (Art. 8, Art. 38-39), leasing is defined in accordance with the Civil Code of Georgia (Art. 576-580), but with the condition that the subject of leasing must be an asset subject to depreciation. And the leasing company is an enterprise whose income from property leasing during the calendar year is not less than 70 percent of its income.

According to the Tax Code of Georgia, a resident is obliged to pay property tax on leased assets, an individual is also obliged to pay property tax on assets leased by him, if he is engaged in economic activity, or if he receives a leased asset from a non-resident. Nevertheless, compared to banks, leasing companies are in a bad position, because banks do not have to pay property taxes on loans. In addition, when a taxpayer's property is seized for tax debt, it applies to all of the taxpayer's assets, except for leased property, Since the leasing company is not a financial organization, the requirements of the tax authorities have priority over the requirements of the leasing companies when imposing a seizure, which we believe



is unfair. We believe that it is better for the state to provide guarantees in the amount of 60% of the project cost during aircraft leasing. But it is important to note that the problem is not solved in this way, since such conditions are unrealistic in most cases. The process is complicated by high bank interest rates on loans for leasing operations. Leasing becomes attractive for the aviation sector if the lessor takes credit for the purchase of aircraft equipment from the manufacturers with a repayment period of about 7-8 years and an annual interest rate of no more than 8-9 percent.

The aviation leasing market in Georgia is in the process of formation. For its development, it is important to increase the awareness of leasing as a financial product. In addition, it is necessary to perfect the legal framework, which is an ongoing process and requires some time. We believe that after passing these stages, the role of leasing operations in the aviation market will increase significantly, which will have a positive impact on the sustainable development of the country's economy.

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