LEVERAGED LEASING FINANCING FACILITY

PRE-FEASIBILITY STUDY

FINAL

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USAID ECONOMIC PROSPERITY INITIATIVE (EPI)

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ABSTRACT

The purpose of this report is to present and analyze potential options and structures for an Investment Facility that will be dedicated to financing leasing companies in Georgia and that can attract international financiers to participate. The Facility will serve as a mechanism to provide access to capital for leasing firms in Georgia to facilitate their expansion, with a focus on the use of leveraged leasing, an innovative financing structure that can be attractive to international financiers and that achieves tax efficiencies for leasing companies. In addition to presenting the potential options and structures for the Facility, the report also presents the pros and cons of the various options and the next steps and fact finding that would need to be taken to further advance the initiative.

DISCLAIMER: This report is presented for informational purposes and includes analysis and suggestions based on initial research. The information in the report is presented for the purposes of deciding whether or not to further develop the concepts presented. A full feasibility study and/or due diligence should be conducted by the recipient of the report and any other readers of the report before pursuing or entering into the structures and transactions discussed here or structures and transactions of the like.

ABBREVIATIONS

And selected definitions

DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
EPI	USAID Economic Prosperity Initiative
GDP	Gross Domestic Product
GEL	Georgian Lari (currency)
IFC	International Finance Corporation, the investment arm of the World Bank Group
JSC	Joint Stock Company (a legal entity under Georgian law)
LESSEE	The entity that uses an asset and leases the asset from an owner.
LESSOR	The entity that owns an asset and leases the asset to the Lessee.
LEVERAGED LEASING	A leasing structure whereby a leasing company puts up some of the money required to purchase the leased asset and borrows the rest from a lender.
LLC	Limited Liability Company (a legal entity under Georgian law)
NBG	National Bank of Georgia (Georgia's central bank)
NON-RECOURSE LOAN	A loan for which the borrower is not itself liable. In the event of default, the lender has access to the collateral of the loan and nothing else.

RECOURSE	Access or resort to an entity for help or protection; the right to collect from a maker or endorser of a negotiable instrument
SPV	Special Purpose Vehicle (a legal entity under Georgian Law), also in some legal jurisdictions referred to as a Special Purpose Entity (SPE)
TRUST	A legal structure (recognized under Georgian law) that operates as an autonomous estate or pool of assets, whereby an individual (the Trustor) gives fiduciary control of property to a person or institution (the Trustee) for the benefit of beneficiaries.
USAID	United States Agency for International Development
VAT	Value Added Taxes (currently 18% in Georgia)

CONTENTS

I. EXECUTIVE SUMMARY

BACKGROUND

- Leasing can play an important role in facilitating capital investment, as it offers an alternative form of financing that addresses some of the common constraints to expansion. Companies can obtain equipment needed for expansion without straining their balance sheet and with fewer upfront costs. At the same time, it is a form of asset-based lending as opposed to balance sheet lending, serving as an alternative, tax efficient risk structure to build up the availability of capital in a country.

- Though there are 15 registered leasing companies in Georgia, there are reportedly only three that are operating, and only two with significant market share. The total leasing asset value in Georgia is approximately $30 million (contracted from $40 million in 2010), in comparison with a total asset value of the banking sector in Georgia of approximately $7.6 billion.

- The prevalence of lease financing in relation to the amount of investment, the size of the banking sector, and GDP is relatively low in Georgia in comparison to Western countries and other developing countries, suggesting significant room for leasing industry growth in Georgia. Additionally, initial case assessments of the development of leasing on their emerging markets demonstrate that rapid growth in the leasing sector is possible. This analysis is presented in detail in **Appendix A (Background)**.

- Leasing laws in Georgia (policies and tax treatment), with a role by EPI and as reported in EPI's "Developing Leasing in Georgia" reports, has recently been improved to make leasing businesses more viable and attractive in Georgia.

- Several factors indicate that there are opportunities for attracting financing to the leasing sector and thereby expand the use of leasing. These include the relatively undeveloped and small size of the leasing sector in Georgia together with the recent regulatory improvements and several other emerging market case examples. An expanded leasing market will increase availability and benefits of this alternative form of financing to Georgian enterprises.

WHAT IS LEVERAGED LEASING?

- <u>Overview</u>: Rather than funding the entire lease transaction for a client, the leasing company only has to contribute a portion (for example, 10-30%) of the total cost of the equipment, whereby a lender finances the remainder. The lease receivables and the equipment behind the leases secure the loan. The loan is a non-recourse loan, which means the leasing company itself is not responsible to pay the loan even in case of default. The loan is tied to and paid from the specific lease or set of leases and lease cash flows that secure the loan only. Since the leasing company finances a portion of the lease itself, the loan achieves collateralization greater than 100%.

- Tax Benefit: Leveraged leasing is usually structured so that the leasing company benefits from what becomes an efficient tax structure. Though the leasing company is directly financing only a portion of the lease, the leasing company can still depreciate the full value of the leased equipment, and can deduct the interest payments to the lender from its net income tax base. This tax efficiency makes leasing companies more financially competitive, thus in theory making them able to offer more attractive rates to its lessees. *(Note: this tax benefit normally only occurs for operating leases, not financing leases, since it is the lessee who books the depreciation in financing leases. The majority, or 90%, of leases in Georgia are financing leases; however, for taxation purposes under Georgian law, financing leases are treated as operating leases. Thus, leasing companies in Georgia will have significant potential to benefit from the tax efficiency of leveraged leasing.)*

- For more detail on the nature of leveraged leasing, please refer to **Appendix B (Explanation of Leveraged Leasing)**, which is useful for the discussion of the structure of the leveraged leasing facility.

PROPOSED LEVERAGED LEASING FACILITY

- Overview: A Facility (fund, special purpose vehicle or trust) into which a set of international investors can invest and that are interested in a means for investing into the leasing sector in Georgia. The Facility would then engage in leveraged leasing transactions with leasing companies in Georgia.

- Financing pools of leases vs. individual leases: Each loan from the Facility would likely finance a pooled set of leases for a given leasing company, but also from time to time the facility would issue a leveraged lease loan to a leasing company for one single, larger lease. For more detailed discussion on this topic, please refer to **Appendix C (Single vs. Multiple and Existing vs. New Leases).**

- Financing existing leases vs. new leases: The simplest approach at the outset of the Facility will be to finance a portion of the existing portfolios of leasing companies. This way the Facility can analyze the overall portfolio of the leasing company and select a portion for the leveraged leasing loan. It also allows the Facility to begin making loans immediately rather than waiting for leasing companies to make new leases or sets of new leases. However, the Facility would eventually also finance new leases. If the leasing companies cannot self-finance the origination of a new lease or a set of new leases, then the leasing company will have to obtain bridge financing in order to originate the lease (that is, buy the equipment and sign the lease contract, as this is needed to serve as collateral for the leveraged lease loan) or work with the Facility to achieve a simultaneous signing of the lease (or set of leases and the loan) based on a pre-approval or to sign and disburse the loan based on pre-approval of leases to be signed and equipment to be purchased. For more detailed discussion on this topic, please refer to **Appendix C (Single vs. Multiple and Existing vs. New Leases).**

- Size and Life of the Facility: It is estimated that the Facility could be capitalized with total capital commitments in the range of **$60-100 million**, with a life of 6-10 years (whereby loans could be made over a period of 3-5 years, with an additional 3-5 years for scheduled reflows back into the Facility). Though the existing size of the leasing sector in Georgia is currently only $30 million, we project the Facility's size range because (1) of the case examples from other countries included in **Appendix A**

(Background) that suggest rapid growth potential in Georgia's leasing sector and (2) there is an opportunity for several single large-scale transactions for large infrastructure projects taking place or soon to take place in Georgia which could be financed through the Facility (provided that the leasing companies can attract the needed equity capital to co-finance the transactions and obtain any bridge financing that would be needed for such transactions). At the outset of establishment of the Facility (e.g., in the first year), approximately $10-15 million in transactions could potentially be implemented as loans for portions of the existing portfolios of the existing leasing companies (e.g., 33-50% of the total amount of leasing assets currently in Georgia). It would not be possible to bring all of Georgia's currently existing lease portfolios into the Facility because (1) the investors in the Facility will likely be selective about the type and quality of leases to be financed through the facility; (2) most leasing companies would already have traditional recourse loans with minimum collateral or cash flow requirements that limit the amount of the portfolio that can be relinquished to a leveraged leasing scheme; and (3) the owners of leasing companies would likely not be interested in leveraging their entire portfolios. Lastly, while it would be more realistic to fund raise with a limited life Facility (e.g., limited commitments from investors for a limited period of time), the Facility could keep an option on the table (pending approval from investors) for extensions or conversion into an ongoing entity.

- The Role of Equity Investors in the Facility and the Potential Tax Benefit to Equity Investors: While the presence of an equity investor provides a cushion that lowers the level of risk borne by debt investors, it would not be mandatory that an equity investor participate in the Facility (unless the Facility is an LLC or JSC, which would require at least a nominal equity investment, as opposed to an SPV or Trust). However, of note, though not at all critical to the concept, there is another potential benefit to equity investors that can be considered. The equity investors in the Facility could potentially share (that is, split pro rata) the depreciation with the leasing companies, as companion "equity position holders" in the leveraged leases. However, this will require analysis by a Georgian tax expert whether this could be achieved in this structure. It may require that the Trust structure (Option 2 for structuring of the leveraged leasing loans presented below) may prove necessary, and that the Trust issue notes and participatory certificates or that the equity investor somehow participate directly in the Trust as a beneficiary (rather than through the Facility).

- Future Potential of the Facility to Issue Publicly Tradable Securities: While this is commonly done in the West and other highly developed markets with large leasing sectors (attractive because the tradable securities provide investors with investment liquidity), it is believed that this is not an option that should be considered at this stage. First, there is a lack of history of using tradable securities for Georgian companies both domestically and internationally. Second, such structures typically involve an asset value of $200 million or more, whereby the assets within such a pool are quite identical (i.e., all car leases, or all equipment leases of a certain type and size range, etc.), and such a scale of homogenous leases is not in Georgia's foreseeable future.

- Legal and Corporate Governance Structuring of the Facility: As mentioned above, the Facility could be established as an LLC, JSC, SPV, or Trust, domiciled within or outside of Georgia, and this will depend on the needs/goals of the investors and will require further research and vetting. The Facility would also require a Facility Administrator to manage the Facility, and a number of aspects of corporate governance would need to be worked out in the following areas, which are further detailed in **Appendix C (Corporate Governance of the Facility):**

- Duties and responsibilities of the Facility Administrator;
- Terms for a cash reserve in the Facility (for ensuring availability of cash to repay debt investors and pay Facility fees/expenses);
- Exact/strict standards for lease portfolios that can be brought under the Facility;
- Standards for leasing companies that can receive loans from the Facility;
- Procedures for any pre-approvals or simultaneous signings;
- Terms for capital commitments and drawdowns from investors;
- Reporting and auditing requirements;
- Establishment of Board of Directors and/or Loan Approval Committee;
- Requirements for Board/Committee meetings, approval responsibilities;
- Establishment of allowable costs.

- <u>Legal Structuring of the Leveraged Leasing Loans from the Facility</u>: There are two basic options for structuring the leveraged leasing loans from the Facility to the leasing companies. In both cases, the amount of the collateral (the aggregate outstanding balance of the lease contracts) should be greater than the amount of the loan. **Option 1 (Escrow Approach)** involves a simple pledging of the assets and use of an escrow account opened by the Leasing Company to which the leasing payments are made and from which the loan is paid. **Option 2 (Trust Approach)** involves the establishment of a Trust to which the lease receivables and rights to the equipment are assigned, whereby the assets of the Trust serve as the collateral on the loan and whereby the Facility becomes one beneficiary of the Trust (in that the Trust makes the loan payments on behalf of the Leasing Company), and the Leasing company becomes the other beneficiary of the Trust (with rights to the cash remaining after payment of the loan). These two options are further detailed in **Appendix E (Structuring Options for Leveraged Leases)**, along with the pros and cons of each for further consideration.

- <u>Option to Create a More Flexible "Facility"</u>: There is the possibility to establish a Facility that would be, if agreed by the investors, far more flexible in its potential activities than simply leveraging leasing deals. For example, the Facility could potentially engage in the following:

  - Leveraged leasing loans to leasing companies;
  - Regular loans to leasing companies (for example, to finance early stage or start-up leasing companies);
  - Equity investments into leasing companies (for leasing companies lacking equity capital to expand through leveraged leasing or regular borrowing);
  - Directly finance equipment leases that are too large for any one leasing company to take on (as most leasing companies have a maximum lease size in their bylaws).

  This may make sense in order to maximize the ability to scale up, given the limited number of leasing companies operating in Georgia and the limited size of existing lease portfolios that could be acceptable for participation in the Facility, and to achieve financing for the leasing sector more tailored to the realities/needs of the sector. In fact, for the regular leveraged leasing facility, an important part of the next steps will be to assess the true demand/usability of the leveraged leasing facility. It may be that some leasing companies are too small or too much in their early stages and lack the financial resources to finance even the minority equity position of leveraged leasing deals. Of note, however, with this open ended flexibility, the Facility would need a strategically operating “Facility Manager” that will seek out and structure various types of transactions, rather than a “Facility Administrator” that plays more of a review/approval role. Additionally, investors would have to be willing to participate in a facility with a less pre-defined set of transactions and returns. It is unlikely that the traditional commercial banks that are targeted by the pure leveraged leasing facility would be willing and interested to participate in such a flexible Facility.

- Supplemental Technical Assistance Facility: The Facility’s success and impact could be enhanced significantly by supplementing it with a technical assistance facility that can fund consultants/trainers. This latter fund will help leasing companies improve their leasing practices, internal management systems, and reporting standards. This could be financed by EPI or another development funding source, and could be managed or overseen by the Facility Administrator (which will have developed an intimate, practical understanding of the leasing companies in Georgia and their technical assistance needs and have a working relationship with the leasing companies).

- Option to Launch the Project with a Pilot Investment: Prior to planning, structuring and organizing the full Facility described above (which will obviously require significant time for fundraising, structuring, establishment of standards and corporate governance among others) a practical way of proceeding will be to focus on facilitating a single transaction for a set of leases for a single Georgian leasing company. EPI can help to facilitate a leveraged leasing loan from a single lender or from a small set of investors. This will focus activities on the more realistic and practical goals of assessing a single portfolio, seeking investors for a single and specific transaction, and focusing on developing a legal structure that will work for the investors identified. After establishment, EPI will have a stronger knowledge and understanding in place for decision making and planning for the broader Facility.

- Start-up Expenses Associated with the Facility: There will be numerous start-up/organizational expenses prior to the actual establishment of the Facility, and there is a potential role to be played by EPI and or an anchor investor in this area. These items, such as the feasibility study items and organizational/start-up activities, are outlined in **Appendix F (Recommended Next Steps)**. These costs, or at least a portion, can be reimbursed by the Facility after establishment as an Organizational Fee paid to the organizer.

- Ongoing Expenses Associated with the Facility: These are discussed in greater depth and where relevant in **Appendix D (Corporate Governance of the Facility)** and **Appendix E (Structuring Options for Leveraged Leases)**.

NEXT STEPS

The next steps, outlined in detail in **Appendix F (Recommended Next Steps)**, include the following:

- Feasibility Study (estimated 2-4 months)
- Launch of Fundraising/Start-Up (estimated 4-8 months)
- Launching of Operations

II. APPENDICES

A. BACKGROUND

B. EXPLANATION OF LEVERAGED LEASING

C. SINGLE VS. MULTIPLES & EXISTING VS. NEW LEASES

D. CORPORATE GOVERNANCE OF THE FACILITY

E. STRUCTURING OPTIONS FOR LEVERAGED LEASES

F. RECOMMENDED NEXT STEPS

A. BACKGROUND

PRECEDENTS FOR JUSTIFICATION OF THE SIZE OF FACILITY

The Facility is presented with a total size of $60-100 million to be invested over 3-5 years, which (assuming no fees or set aside for reserves) is a range of $12-33 million to be invested per year.

Given that the current leasing sector in Georgia currently has a total asset value of only $30 million, and considering that the sector contracted from a total size of $40 million in 2010, it is important to consider whether the sector can absorb leasing volumes of $12-33 per year. Part of the initial absorption could be re-financing of the existing portfolio, however the proceeds would still mainly be used for new leases.

The chart below presents the experience of Uzbekistan and Tanzania, starting at a time when their macroeconomic situations (size of GDP and annual total investment into the country, as well as the size of the banking sector) were very similar to that of Georgia today. The chart shows that the total size of the leasing sector grew by $36 million per year over 6 years in Uzbekistan and $27 million per year over 3 years in Tanzania. This demonstrates that it is realistic to believe that Georgia could absorb the additional $12-33 million into the leasing sector each year, though the relevance of the fact that Georgia has a much smaller population (and thus whether a smaller market for consumer leasing would prohibit such growth in Georgia) needs to be explored.

Country	Georgia	Uzbekistan	Tanzania
Population*	4.4 million (2010)	28 million (2010)	41 million (2010)
Nominal GDP *	$11.7 billion (2010)	$11 billion (2001) $22 billion (2007) $39 billion (2010)	$13.7 billion (2005) $19 billion (2008) $23 billion (2010)
Total Investment*	$2.4 billion (2010)	$2.5 billion (2001) $6.7 billion (2007) $12 billion (2010)	$3.3 billion (2005) $5.6 billion (2008) $6.5 billion (2010)
Total asset value of the banking	$7.6 billion (Dec 2011) [1]	$7 billion (sometime in 2001-	NA

[1] National Bank of Georgia statistic

sector		2007, not specified)	
Leasing Sector Information	Total asset value of leasing sector in 2011: $30 (down from $40 million in 2010) Leasing laws changed at end of 2011 to make leasing more viable in Georgia. Ongoing EPI technical assistance programs for leasing companies.	The leasing market grew by $220 million 2001-2007 (average of $36 million per year), and at which time the total asset value of the banking sector was $7 billion.[2] This was achieved with a focused program by IFC and the SECO, including regulatory improvements, technical assistance for leasing companies to improve standards, and direct lending to leasing companies (as part of next steps, discuss experience with IFC).[3]	The leasing market grew from $20 million (1% penetration in financing investment) to $100 million (3% penetration) from 2005-2008 (average of $27 million per year).

**Source: IMF statistical database (some are estimates).*

The table on the following page presents, for a range of countries (both developing and developed countries), annual leasing volumes as a percent of GDP and as a percent of total fixed investment in property, plants, and equipment (PPE).

Based on 2010 GDP of US$11.7 billion[4] for Georgia, an annual leasing volume of $12-33 million per year would be 0.1-0.26% of GDP. Based on a total investment in Georgia's gross fixed capital formation in 2010 (comparable to fixed investment in PPE) of US$2.2 billion[5], an annual leasing volume of $12-33 million would be 0.5-1.4% gross fixed capital formations. These figures are well below the average figures for the countries presented, and more conservatively, well below the figures presented for the smaller markets If the average figures for Ukraine, Turkey and Kazakhstan are applied (even more conservative than for all smaller countries), Georgia would be able to have a total annual leasing volume of $50 million (based on GDP comparison) or $64 million (based on fixed investment in PPE comparison).

However, it should be noted that the volumes of the comparable countries are significantly larger than in Georgia and thus are not ideal comparisons. Also of note/concern from the table is that most countries experienced a contraction in the annual leasing volume in 2009 as compared to 2008. This was likely due to the global financial crisis rather than a long-term trend in the leasing sector, but as part of the recommended Feasibility Study, growth rates in the global sector for 2010 and 2011 should be obtained and considered.

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[2] "Leasing in Development: Guidelines for Emerging Markets", International Finance Corporation, September 2009 (herein referred to as "IFC Leasing in Development"), page 10.

[3] IFC Leasing in Development, page 4.

[4] International Monetary Fund, June 2011 Georgia report.

[5] National Bank of Georgia.

Excerpts from White Clarke Global Leasing Report

Country	Annual Volume of Leasing (US$ billion)	% Growth in Annual Volume	Annual Leasing Volume as a % of GDP		Annual Leasing Volume as a % of Total Fixed Investment in PPE (% Market Penetration)
	2009	2008 to 2009	2009	2007	2009
1. Ukraine	na	na	0.3	2.0	na
2. Latvia	0.36	-74.8	1.4	6.3	8.1
3. Estonia	0.57	-66.4	3.0	8.7	14.8
4. Kazakhstan	0.72	9.1	0.7	na	2.1
5. Bulgaria	0.94	-71.2	2.0	5.5	7.9
6. Iran	1.40	5.0	0.4	na	4.0
7. Romania	1.58	-71.2	1.0	4.6	4.9
8. Turkey	1.93	-59.0	0.3	1.2	3.7
9. Hungary	2.32	-64.8	1.8	5.4	11.6
10. Poland	7.04	-45.9	1.6	3.2	0.6
11. Russia	8.87	-60.4	0.7	2.6	4.1
12. United Kingdom	14.69	-31.2	0.7	0.9	17.8
13. France	31.84	-19.8	1.2	1.7	10.0
14. Germany	55.30	-26.0	1.7	2.4	3.1
15. China	41.01	86.7	0.8	0.2	13.9
16. US	173.90	-14.8	1.2	1.4	17.1
Average	22.83	-33.6	1.2	3.3	8.2
Average 1-10 (smaller markets)	1.87	-48.8	1.2	4.6	6.4
Average 10-16 (larger markets)	54.27	-10.9	1.1	1.5	11.0
Average for Ukraine, Turkey, Kazakstan	1.33	-25.0	0.4	1.6	2.9

Table source: White Clark Global Leasing Report, 2011

CASE PRECEDENTS FOR LEASE LENDING FACILITIES IN OTHER EMERGING MARKETS:

AN important part of the next steps will be to research case precedents of lease lending facilities established in other emerging markets. While there are a number of private sector examples in developed, Western markets involving publicly tradable securities (for example, Caterpillar Financial Asset Trust Issuing Entity in 2008, Adriano Lease Securities S.r.l in December 2011, which have been used as part of research for this pre-feasibility study), it would be extremely valuable to have case precedents from emerging markets and without publicly tradable securities.

One lead for accessing and assessing case precedents is EPI Leasing Consultant Rafael Castillo-Triana, who was involved in structuring a leveraged leasing transaction in Mexico, working with Deutsche Bank and the Latin America Export Bank in 1998.

Another lead is to engage in meetings and discussions with IFC, which has been engaged in extensive leasing sector development project and has experience with organizing syndicated lending with partner financial institutions. While initial desk research did not result in any case precedents involving IFC, direct discussions with IFC may prove otherwise.

B. EXPLANATION OF LEVERAGED LEASING

- Overview: Rather than funding the entire lease transaction for a client, the leasing company only has to contribute a portion (for example, 10-30%) of the total cost of the equipment, whereby a lender finances the remainder. The loan is secured by the lease receivables from lessees (supported by the lease itself) and the equipment behind the leases.

- Without Recourse to the Leasing Company: The loan to the leasing company is a non-recourse loan. By non-recourse it is meant that the lender has no recourse to the leasing company for recovery of the loan; the lender's recovery of the loan is limited to the collateral only. That is, the leasing company is not responsible to pay the loan even in default. The lender, therefore, looks only to the quality of the collateral, not to the financial position or financial performance of the borrower itself, to assess the ability to generate cash flows to pay the loan (although as the leasing company will be the servicer of the loan, the lender will assess the leasing company for the quality of its internal practices for monitoring leases, collecting payments, etc.).

- Amount of Collateral: The lack of recourse to the borrower makes the loan higher risk for the lender than a traditional loan with recourse (due to a more limited set of claims for security), and thus the lender usually requires the collateral in an amount greater than the loan. For this reason, the lender usually finances only part of the lease (as mentioned above) and takes a senior security position (usually both in order of payments and in terms of the security). Thus the lender has some additional protection in that its claim does precede the leasing company's claim in the case of default of the leases.

- Lending for Existing Leases Only: Because the lease and the equipment asset behind the lease serve as the security on the loan, the leasing company should originate the lease on its own (that is, purchase the equipment to be leased and sign the lease agreement with the lessees) prior to entering the leveraged leasing transaction. If the leasing company is not able to temporarily finance the equipment purchase on its own, then it should obtain temporary/bridge financing for the purchase, or it may be possible to coordinate simultaneous signings and/or to negotiate a leveraged leasing loan based on pre-approval of the equipment to be purchased and the lease to be signed, with the contingency that the actual purchase and lease meet the pre-approved terms.

- Use of Funds: If the leasing company is able to originate the lease with its own resources, then once it receives the leveraged leasing loan proceeds, it is free to use those proceeds as it wishes (e.g., purchasing equipment for new leases, paying off existing loans, etc.). If the leasing company had to obtain bridge financing to temporarily finance the lease, then the leveraged leasing proceeds would likely need to be used to repay that loan. If the leveraged lease loan is carried out simultaneously with the equipment purchase, then the use of funds goes directly to the equipment purchase.

- Lending for a Pool of Leases: In most cases, a leveraged leasing loan will be made for a pool of leases selected from a leasing company's overall portfolio rather than for one individual lease. This allows the lender to achieve risk diversification and an economy of scale by analyzing a portfolio of leases at once and structuring a single, larger loan for the portfolio rather than analyzing each individual lease and structuring multiple, smaller loans.

- Tax Benefit: Leveraged leasing is usually carried out because the leasing company benefits from what becomes an efficient tax structure. Though the leasing company is directly financing only a portion of the lease, the leasing company can still depreciate the full value of the leased equipment, and can deduct the interest payments to the lender from its net income tax base. This tax efficiency makes leasing companies more financially competitive, thus in theory making them able to offer more attractive rates to its lessees.

- Tax Benefits in the Georgian Context: Ninety percent of leases in Georgia are "financing leases" as opposed to "operating leases". With financing leases, the lessee normally books the fixed asset and the depreciation of its asset on its balance sheet. With operating leases, the leasing company books the fixed asset and the depreciation of the asset on its balance sheet, and the lessees books the lease payments as rent on its income statement. This mean that the leasing company in Georgia would not be utilizing the tax benefit, one of the most important aspects of leveraged leasing, would not be utilized in Georgia. However, in Georgia, financing leases are treated as operating leases for the purposes of taxation. Thus, leasing companies can achieve significant tax efficiencies from leveraged leasing structures.

C. SINGLE VS. MULTIPLE & EXISTING VS. NEW LEASES

Financing Pools of Leases vs. individual Leases:

Each loan from the Facility would likely finance pooled set leases for a given leasing company. This is because many of the lease transactions in Georgia are for small leases (e.g., under $1 million), which do not justify the time and energy of the leasing company or the Facility to structure separate loans for each individual lease. If a loan is issued for a pool of leases, then the Facility can select and analyze the pool of leases at one time (e.g., analyze type, size, timing of payments, risk and other factors). However, in the case of some large leases (for example, equipment for major infrastructure projects) a leveraged leasing loan could be made from the facility for an individual lease.

Financing a Portion of Currently Existing Portfolios:

The simplest approach at the outset of the Facility will be to finance a portion of the existing portfolios of leasing companies. This way the Facility can analyze the overall portfolio of the leasing company and select a portion for the leveraged leasing scheme. It also allows the Facility to begin making loans immediately rather than waiting for leasing companies to make new leases or sets of new leases, and avoids the need for leasing companies to self-finance new leases, find bridge financing for new leases, or structure more complicated simultaneous signings (simultaneous signing of a lease or set of leases and the leveraged loan). **One issue with this, however, is that the leasing companies and the Facility will have to check the terms of any existing loans of the leasing companies** which may have minimum requirements for the amount of equipment collateral (as well as type/quality) in place and minimum requirements or needs for cash flow from the leases that must stay independent/available to back the existing loans. This can be resolved by fact that the use of proceeds from the leveraged leasing loan can be used to pay off all or a portion of existing loans and/or to finance equipment purchases for new lease deals.

Financing New Leases:

Though it makes sense for the Facility to begin by financing portions of leasing companies' currently existing portfolios, eventually the Facility can certainly finance new leases. If the leasing companies can self-finance the origination of a new lease or a set of new leases, then the structuring of the leveraged leasing loan will be straightforward. Otherwise, the leasing company will have to obtain bridge financing in order to originate the lease (that is, buy the equipment and sign the lease contract) or work with the Facility to achieve a simultaneous signing based on a pre-approval.

D. CORPORATE GOVERNANCE OF THE FACILITY

Facility Administrator:

An Administrator would be needed to manage the Facility, and duties and responsibilities would include the following:

- Seeking/negotiating new leveraged leasing deals
- Due diligence on leasing companies (review of internal processes)
- Due diligence on the portfolios (individual leases or set of leases) to be financed under the facility.
- Drawing down capital contributions from investors
- Disbursing loans to leasing companies
- Payment/cash management, including receiving payments from escrow accounts, replenishing the reserve (see below), and disbursing proceeds to Facility investors.
- Preparing paperwork/reports for Facility investors
- Organizing/facilitating any third party audits required (likely annually)
- Any tax filing/reporting.

Need for a Cash Reserve in the Facility:

A cash reserve need to be established within the Facility (1) to ensure the availability of cash for paying the Facility Administrator Fee and other direct Facility costs (taxes, legal fees, etc.), and (2) potentially to provide additional risk mitigation to the senior lenders of the facility. In such a case, the amount that would be on lent to the Leasing Company would be slightly less than the capitalization of the Facility (loan to the Leasing Company would equal the capitalization of the facility minus the reserve amount). The reserve amount could be expected to be somewhere in the range of 1-3% of the capitalization of the Facility.

Development of Exact/Strict Standards for Lease Portfolios that can Integrated into the Facility:

In the case of the single Leasing Company deal, it is understood that the Lender or group of lenders/investor would not enter into the leveraged leasing deal until they each did a comprehensive analysis of the portion of the Leasing Company portfolio to be leveraged, as well as a certain amount of due diligence on the Leasing Company itself (as the servicer of the portfolio). For the scaled-up Facility, a very clear and particular set of standards for the lease portfolio would have to be established, for example:

Standards for Leasing Companies that can Receive Loans from the Facility:

Although the loans will be tied to the performance of the lease portfolio rather than the financial position or performance or leasing company, the leasing company will still be serving as the servicer of the loans and thus some review of the quality of the leasing company will be necessary. Standards could include, for example, a minimum period of operational experience, a minimal financial performance, or a minimal quality of lease management/reporting in place. Of note, major (top 1-10) international auditing firms audit all three of the operating leasing companies in Georgia. Also of note, Georgian leasing companies are reportedly following Basel 1 (A-H ratings based on number of days late and availability of lessee financial statements) and are in the process or expected start implementing Basel 2 (self-assessment/categorization of risk).

Standards for the Quality of Leases to be Financed through the Facility:

Detailed and strict standards for the quality of leases and lease portfolios that can be brought into the leasing facility will have to be established. For example: Types of leases, outstanding maturity of the leases, payment history performance, quality of lessees, standards for the selected portfolio of the leasing company versus the leasing company's overall portfolio (that is, picking the highest quality leases among the portfolio or some other tier).

Procedures for any Pre-approvals or Simultaneous Signings:

In the case that the leasing company cannot self-finance a new leasing deal or obtain 3rd party financing for a new leasing deal, clear procedures and standards for implementing simultaneous signings or pre-approvals will have to be established to ensure that the certainty and quality of the assets securing the loan are not as risk.

Corporate Governance Structure for the Facility:

In addition, an overall corporate governance structure for the Facility would need to be in place. Although the Facility Administrator could handle analysis and selection of leasing companies and lease portfolios (that is, conducting due diligence to ensure that they meet the above noted standards), a corporate governance structure would be needed to establish the requirements and rights of the facility investors:

- Terms for the Total Capital Commitments and Drawdowns from Investors: Investors would not be expected to make a 1-time initial payment into the Facility but could make disbursements in line with the lending of the Facility. Rather, terms would have to be established for the overall capital commitment, the time period over which drawdowns from investors can be made, the time period over which loans from the Facility can be made, and whether or not investors have the option to participate or not participate in individual loans/drawdowns or whether they are all obliged as long as the loans proposed meet a certain set of standards.

- Terms for extending the Facility beyond the initial term and capital commitment.

- Terms for introducing any new investors into the Facility.

- Reporting requirements from the Facility Administrator to the Investors

- Establishment of a Board of Directors (with representatives of the investors) and/or a Lending Committee to:

  - Review and issue final approval on loans proposed by the Facility Administrator.
  - Hold periodic (quarterly or annually) to review/discuss performance of the Facility.
  - Handle certain decision-making aspects and approvals (clear definition of the roles and responsibility of the Facility Administrator vs. the role and responsibility of the Board and/or Lending Committee must be established).

Adjustments to Corporate Governance Structure if a More Flexible Facility is Adopted:

Rather than a Facility Administrator, there would be a Facility Manager, which would be an experienced debt fund manager or private equity fund manager, with leasing expertise, that would handle strategic management and decision-making (with investor/board oversight of course) rather than an administrator that simply follows a set of pre-determined procedures and simply benchmarks portfolios against a set of standards. The Facility Manager would likely operate with an equity stake in the Facility or some sort of bonus structure or carried interest to incentivize dedicated management in the interest of the facility investor. With this flexible structure, the corporate governance documents would need to set parameters (restrictions and/or guidelines) for the types of investments the Facility can and cannot do, the returns targeted, and the decision-making process for approving transactions (who approves, what information needs to be presented/provided, etc.).

E. STRUCTURING OPTIONS FOR LEVERAGED LEASES

Two options for structuring the leveraged leasing loans issued by the Facility are presented here, along with the fees involved, the pros and cons of each, and issues for further exploration.

For purposes of demonstration, we present a Leasing Company that begins with lease contract portfolio with a current outstanding balance of $10 million. We then present a $3 million loan to the Leasing Company, secured by a portion of the company's lease portfolio with a total outstanding balance equal to $4 million (achieving 133% collateralization).

Option 1 (Pledge with Escrow): $3 million non-recourse loan from the Facility to the Leasing Company, whereby the lease receivables of a $4 million portfolio are pledged as collateral on the loan. Specifically, the lease receivables, supported by the lease contracts, and the equipment tied to the leases (owned by the leasing company) are pledged, and to provide additional security in line with the risks of the structure, the Leasing Company sets up an escrow account in its own name, to which the lessees are told to direct their lease payments are directed and whereby the escrow manager pays the loan payments to the Facility from this escrow account. Once the loan is paid, the residual cash remaining in the escrow account is returned to the Leasing Company' s regular account.

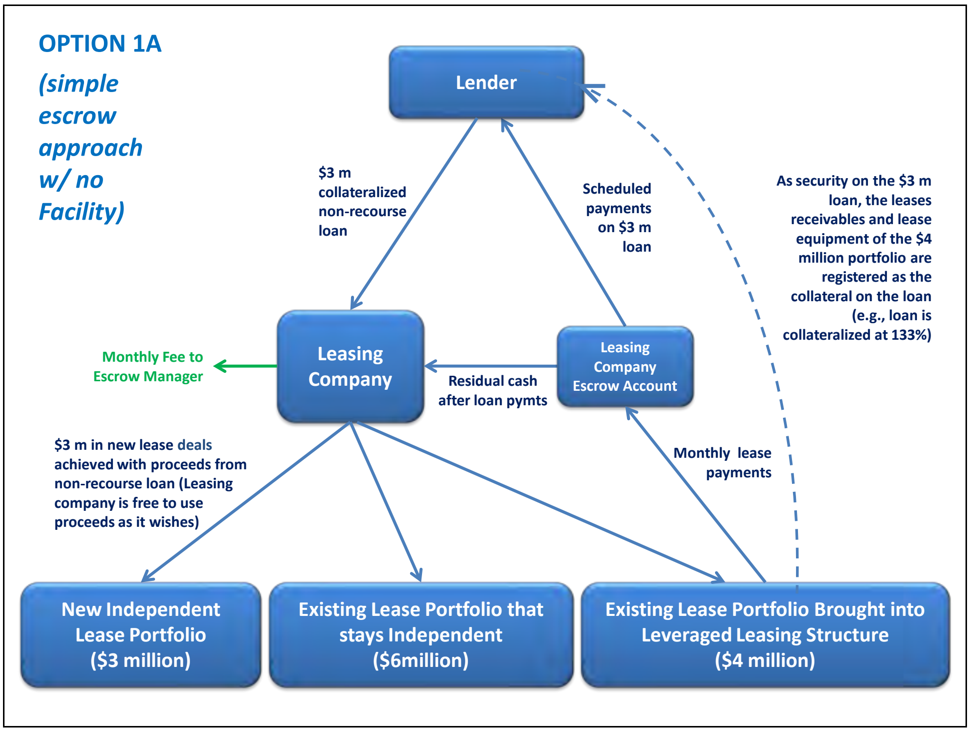
Option 2 (Assignment of Lease Receivables and Pledge of Equipment to a Trust): The Leasing Company establishes a Trust, and the Leasing Company (a) assigns (which is the legal equivalent of sale for non-tangible assets) the lease receivables of $4 million of its portfolio to the Trust, and (b) pledges or assigns to the Trust the full rights/proceeds of the equipment that is tied to the leases (and the equipment insurance right as beneficiary) in the case of default on a lease. In return, the Leasing Company is established as the beneficiary of the Trust. Then, the Facility makes a $3 million non-recourse loan to the Leasing Company, whereby the assets of the Trust are pledged as collateral on the loan and whereby the loan is repaid to the Facility directly from the Trust. The Facility is then added as a Beneficiary to the Trust with a senior position over the Leasing Company, and the Trust manager will pay the loan from the Trust, and then pay the residual cash remaining to the Leasing Company.

Each option is presented with three schematics each:

(a) A single loan directly from a single lender to a single leasing company, since a single leveraged lease transaction by one lender may be pursued as a Pilot prior to launching the full Facility.
(b) A single loan from a Facility (into which multiple investors invest) to a single leasing company, as this also may be pursued as a Pilot prior to considering and planning for multiple transactions.
(c) Multiple loans from a Facility (into which multiple investors invest) to multiple leasing companies, as this is the ultimate vision for the Facility.

Within each of the two options, (a), (b), and (c) maintain the same lending structure – the difference is simply a progressive scaling up (that is, switching from a single lender to a facility with multiple investors, and then scaling up from a single loan to one leasing company to multiple loans to multiple leasing companies).

OPTION 1A (SIMPLE ESCROW APPROACH W/ NO FACILITY)



Basic Structure:

- $3 million non-recourse loan from the Lender to a Leasing Company.
- To secure the loan, a full senior right to the lease receivables (supported by the lease contracts themselves) and the equipment of the leases (as well as the right to proceeds of the insurance for the equipment) of a portion of the Leasing Company's portfolio (with an outstanding balance of $4 million) are pledged/registered as the collateral on the loan.
- Additional protection on the cash flows that back up the loan is achieved by setting up a special escrow account for the payments of the assigned leases, and the loan is then pain from this escrow account. This achieves a secure structure in line with the security structure of the loan, which would not be achieved if the lease payments were mixed with Leasing Company's general accounts.
- The escrow account is established in the Leasing Company's name (but with rights of the Lender to be honored), and all lessees of the $4 million portfolio are notified that lease payments should now be made to that account.
- The loan is then serviced from this escrow account. Note that the loan will have an actual re-payment schedule with an actual interest rate. It is NOT the case that the loan payments are simply a portion of the lease payment cash flows. The lease payment cash flows are just part of the collateral/security arrangement of the loan, whereby the loan has its own independent schedule (but of course is planned ahead of time to be sustainably paid from the lease payments).
- Funds remaining in the account (residual cash) are then available to be transferred from the escrow account to the Leasing Company's general account.

Achievement of an "Equity" Position for the Leasing Company and its Importance for Tax Benefits: By fact that Leasing Company has access only to the residual cash remaining after payment of the loan, and since the leases are serving as collateral only rather than full "assignment" or sale to the Lender, you can see with this structure, what is achieved is that Leasing Company is still in essence holding the "equity position" on the portfolio. This effective "equity position" is an important part of what justifies the beneficial taxation (at least under US law). Because the Leasing Company holds the "risks and rewards" of ownership, it maintains its right to claim the full depreciation of the leasing equipment. Thus even though Leasing Company is effectively financing only 25% of the leases, it can deduct the interest on the loan and fully depreciate the leasing equipment – thus achieving an attractive tax structure. Of course, this interpretation needs to be verified with the Georgian government.

Order of Payments and the Need for a Cash Reserve: One important aspect of the terms to be decided is the order and timing of payments from the escrow account to the Lender and to Leasing Company. One simplistic approach would be that no cash could be transferred to Leasing Company's general account from the escrow account until the loan to the Lender is paid in full. However, there are a number of other options as well. For example, payments could be made pro rata to the Lender and to Leasing Company as long as no leases are late or in default. Once a lease is late on payment or goes into default, a freeze could be placed on the payments to Leasing Company (either in full or in proportion to the number of leases that are late or in default). Another option is that Leasing Company is paid pro rata along with principal payments only, and then receives the residual cash in the account once the loan is paid in full. Lastly, Leasing Company could place a "cash reserve" into the escrow account (at time of establishing the escrow account), which would serve as a cash cushion for servicing the loan in the absence of cash from lease payments (potentially in an amount equal to 1-3% of the loan amount). The ability for Leasing Company to receive payments from the escrow account could be continent on having a full reserve account (i.e., the reserve account must be replenished by lease payments before Leasing Company can receive any payments).

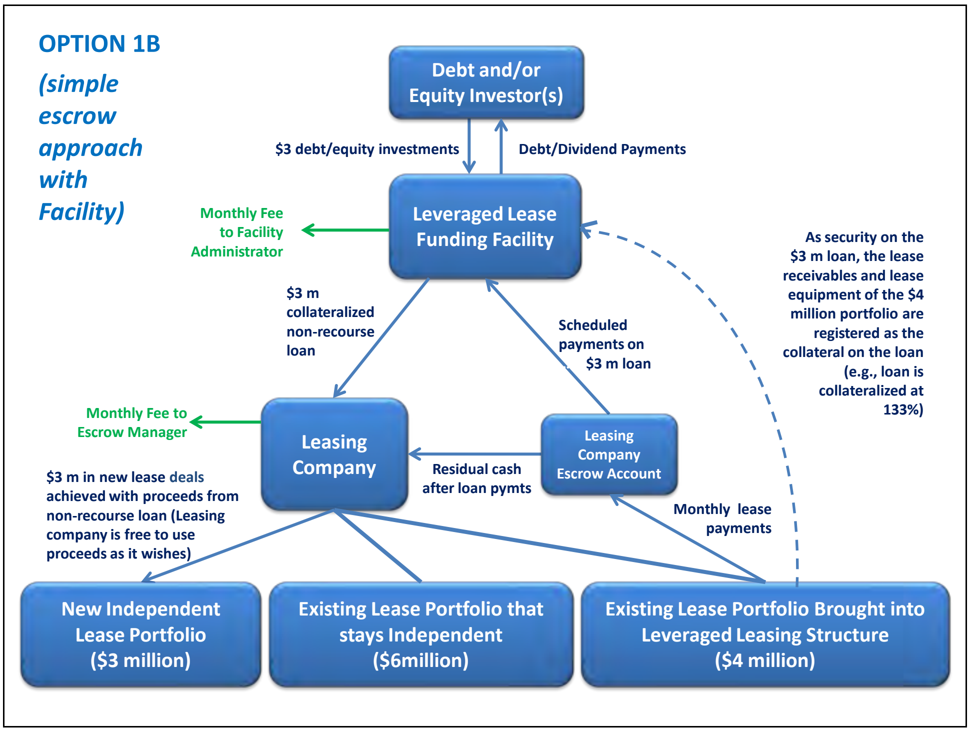
The Leasing Company as the Loan Servicer but with a No Loan Servicing Fee: Leasing Company would continue as the servicer of the leases. Because the ownership of the leases has not been fully/formally transferred to the lender or to an outside entity, there is no reason to charge the lender a loan-servicing fee (whereas, in the Trust approach, the leases are fully assigned to the Trust and therefore the Trust pays Leasing Company a lease servicing fee). In addition to servicing the loans, the Leasing Company would be expected to issue monthly or quarterly reports to the Lender and the Escrow Account Manager regarding performance of the lease portfolio.

Role of the Escrow Account Manager and Escrow Management Fee: The escrow account manager will have to build and maintain a complete understanding of the terms of the loan; that is, how much is to be paid to the lender and when the Leasing Company can and cannot be paid. It will also have to monitor for late payments and defaults by lessees as payments to the Leasing Company may be contingent upon this (as mentioned above). It will also have to maintain and replenish the reserve account (if a reserve account is incorporated into the structure). Lastly, terms would also likely be established that if any equipment is sold as a result of default, the proceeds from such sale must be paid into the escrow account rather than into the Leasing Company's general account. As such, the escrow manager will have an active monitoring role in terms of monitoring the lease payments and status of the leases (achieved via monitoring of payments into the escrow account vis a vis lease payment schedules per the terms of each lease, and via the routine reports received from Leasing Company). Leasing Company would pay the fee to the Escrow account manager.

<u>Risk to the Lender of a Potential Leasing Company's Bankruptcy or Tax Liens on the Leasing Company</u>: One weakness with this model in comparison to the Trust approach (Option 2) is that this approach does not achieve as strong of a "bankruptcy remote" structure. The Lender would do its due diligence to ensure that it has a senior claim on the leases (and lease receivables and equipment collateral). But there is risk that a lender could dispute this with overall claims on Leasing Company. The legal ownership of the leases still lies with the Leasing Company and there is risk that other lenders or holders of liens on Leasing Company could argue for a claim on these lease receivables. This risk also exists for any potential tax claims by the Georgian government on Leasing Company. Under current Georgian law, tax claims precede lender claims on companies in Georgia. However, this tax law may change in the near future.

<u>VAT Treatment</u>: Currently in Georgia, when a leasing company purchases equipment, it pays VAT to the vendor (seller of the equipment). When lessees make lease payments to the leasing company, the lessee pays VAT to the leasing company. Thus leasing companies in Georgia are VAT collectors, collecting VAT, deducting the amount paid to vendors and paying the different to the government. (The reason lessees pay VAT with their lease payments are because in Georgia financial leases, which constitute 90% of the leases in Georgia, are treated as operating leases for tax purposes, and the lease payments are considered "rent" payments). The escrow terms will include a provision that the VAT portion of the leasing payments should immediately be transferred to the Leasing Company's regular account (as opposed to maintained for application to loan payments) so that the leasing company can properly declare and submit its net VAT due to the government on a timely, monthly basis.

<u>OPTION 1B (SAME AS ABOVE BUT WITH "FACILITY")</u>



This option is completely identical to the Option 1A, except that the Lender would not lend directly to the Leasing Company. Instead, the lender would lend to a "Facility" (either an LLC, SPV, or Trust), which would then lend to the Leasing Company. The reason the Facility would be set up would be so that multiple lenders (and even equity investors) could participate in the deal.

Need for a Facility Administrator with a Facility Administration Fee: This structure would require that there be a Facility Administrator, likely a bank, to receive payments from the escrow account and allocate them to the set of investors in line with the terms established by the investors (that is, either pro rata, or according to priority depending on their status as senior or junior lenders or preferred or common equity investors).

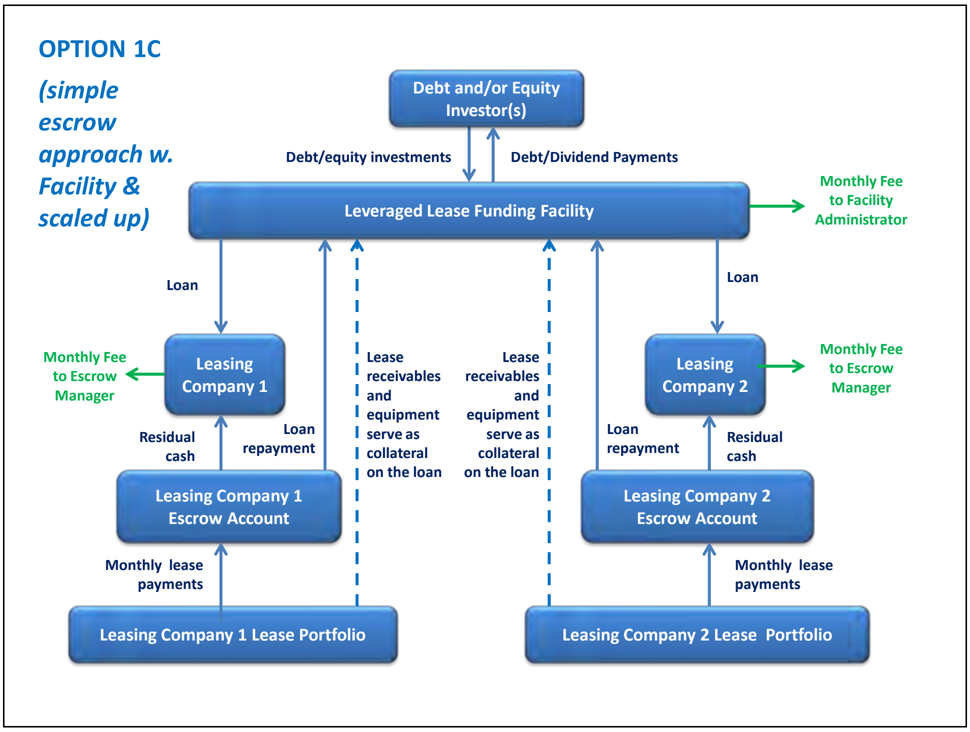
Need for a Cash Reserve in the Facility: A cash reserve needs to be established within the Facility (1) to ensure the availability of cash for paying the Facility Administrator Fee and other direct Facility costs (taxes, legal fees, etc.), and (2) potentially to provide additional risk mitigation to the senior lenders of the facility. In such a case, the amount that would be lent to the Leasing Company would be slightly less than the capitalization of the Facility (loan to Leasing Company would equal the capitalization of the facility minus the reserve amount, as well as less any Facility closing fees/expenses). The reserve amount could be expected to be somewhere in the range of 1-3% of the capitalization of the Facility.

The Role of Equity Investors into the Facility: As is standard for any equity investor / debt investor relationship, the equity investor brings an equity cushion to the table to lower the level of risk borne by the debt investors, and the debt investors allow the equity investors to achieve leverage to increase the potential equity returns. However it would not be mandatory that an equity investor participate in the Facility (unless the Facility is an LLC as opposed to an SPV or Trust, which would require at least a nominal equity investment).

Potential Tax Benefit to Equity Investors: With the leveraged leasing facility, there is also another potential benefit to the equity investors. The Leasing Company is able to book the equipment assets and equipment depreciation on its books because of its effective "equity" position in the leveraged leases. The equity investors into the Facility could potentially share (that is, split pro rata) the depreciation with Leasing Company as companion equity position holders in the leveraged leases. However, this will require analysis by a Georgian tax expert whether this could be achieved in this structure. It may not be possible since the equity investors are participating in the lease portfolio through the loan from the Facility only, rather than a direct equity position in the leveraged portfolio. In order for the Facility's equity investors to be able to claim a portion of the depreciation, the Trust structure (Option 2) may prove necessary, or some modified form of that structure.

OPTION 1C (SCALED UP TO INCLUDE MULTIPLE FACILITIES)

The Leveraged Leasing Funding Facility could be scaled up to lend to multiple leasing companies in Georgia. For each leasing company, the Facility can follow the exact same structure as that used for the single transaction presented in Options 1A and 1B. This is shown in the following schematic (identical to Option 1b but with multiple loan recipients):



The following outlines a number of important aspects of structuring a scaled-up facility:

Role of the Facility Administrator: The role of the Facility Administrator would become more extensive than that presented in Option 1b for a single, pre-determined transaction. New leveraged leasing deals would have to be identified, vetted, and executed by the Facility Administrator, and the corporate governance of the Facility would establish the procedures, rules and approval responsibilities for this. This is discussed in detail in **Appendix D (Corporate Governance of the Facility)**.

Development of Exact/Strict Standards for Lease Portfolios that can be Integrated into the Facility: In the case of the single loan transaction presented under Options 1a and 1b, it is understood that the Lender or group of lenders/investor would not enter into the leveraged leasing deal until they each did a comprehensive analysis of the portion of the Leasing Company portfolio to be leveraged, as well as a certain amount of due diligence on Leasing Company itself (as the servicer of the portfolio). For the scaled-up Facility, a very clear and particular set of standards for the lease portfolio would have to be established. This is also discussed in detail in **Appendix D**.

Other Corporate Governance Aspects of the Facility: A number of other aspects would have to be defined in the corporate governance documents of the Facility. Although the Facility Administrator could handle analysis and selection of leasing companies and lease portfolios (that is, conducting due diligence to ensure that they meet the above noted standards), a corporate governance structure would be needed to establish the requirements and rights of the facility investors, in areas such as (also discussed in greater detail in **Appendix D**):

- Terms for the Total Capital Commitments and Drawdowns from Investors: Terms for extending the facility beyond the initial term and capital commitment.
- Terms for introducing any new investors into the facility.
- Reporting requirements from the Facility Administrator to the Investors

- Establishment of a Board of Directors (with representatives of the investors) and/or a Lending Committee to review and approve loans and handle other decision-making aspects of the Facility.

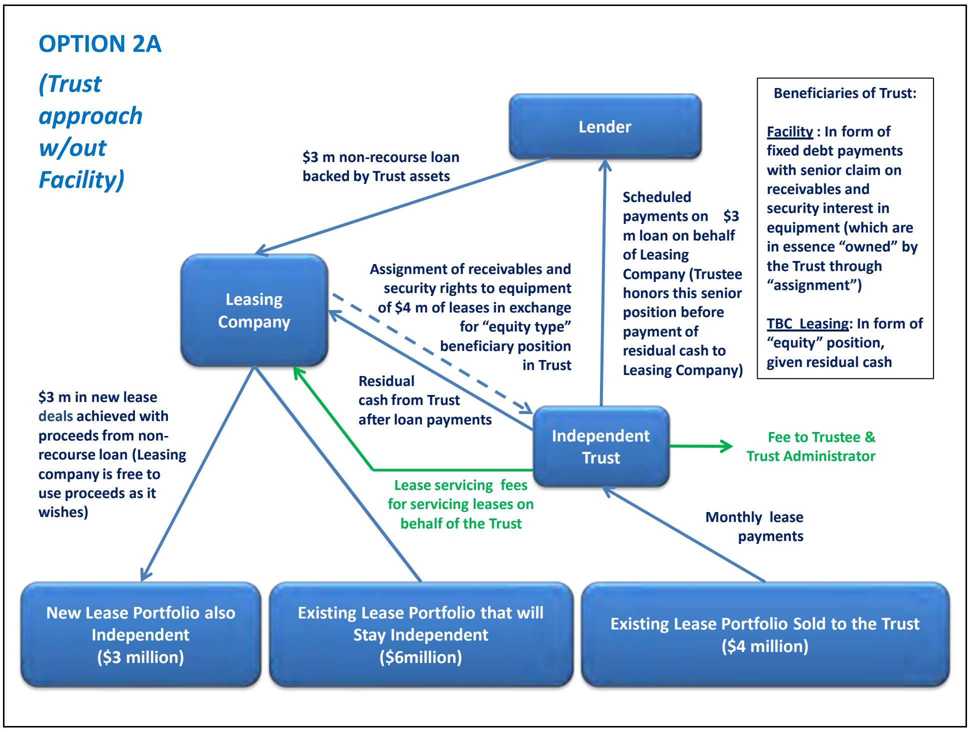
Startup Expenses Associated with the Facility: These are discussed in **Appendix F (Recommended Next Steps)**.

Ongoing Operating Expenses Associated with the Facility:

- Facility Administration Fee (Monthly, from Facility to Fund Administrator): Described above. The amount of the fee would depend on the extent and complexity of the role of the Facility administrator (e.g., most complex if carried out as a Fund Manager-type role).
- Escrow Management Fee (Monthly, from Leasing Company to Escrow Manager): Described above. The amount of the fee would depend on the complexity of the loan terms and the priority of payments made.
- Other Facility Costs: These would depend on the corporate governance structure of the facility, but could include, for example, legal fees, Board member travel expenses, other Board meeting expenses, annual audit fees, and taxes. In the case of any defaults, the legal costs of seizing collateral and other such actions would likely be charged as direct costs to the Facility rather than being paid out of the Facility Administration Fee.
- Other Escrow costs: These could include legal fees, but such fees could potentially be wrapped into the fee to the escrow manager if such fees are reasonably predictable.

OPTION 2A (TRUST APPROACH WITH NO FACILITY)

As mentioned above, one problem with Option 1 is that there is potential legal risk that it does not achieve a fully “bankruptcy remote” structure for the Lender. Thus, an alternative option is to establish an independent trust to which the leases can be assigned (which is the legal term for an effect “sale” of intangible assets”) which achieves greater bankruptcy remoteness (though this needs full vetting by lawyers and tax advisors).



Basic Structure:

- The Leasing Company begins with an aggregate lease contract balance of $10 million.
- A Trust is established, to which the Leasing Company transfers lease receivables, along with the lease contracts, with an aggregate contract balance of $4 million to the Trust. The transfer is done by the legal form of "assignment" (which is the legal form of "sale" of all the rights, title and interest in intangible assets), whereby the leases and lease receivables are assigned to the Trust, and a security interest in the equipment owned by the leasing company that is leased to the lessees (that is, a right to ownership/proceeds of the equipment in case of a default of a lease). Thus upon transfer the property of the Trust will be as follows:
  - The receivables and the collections on the receivables (supported by the lease contracts);
  - Security interests in the equipment behind the receivables (right to full ownership in case of a lease default);
  - Rights to the proceeds under the insurance policies that cover the equipment;
  - The proceeds of sale of any repossessed or returned equipment;
  - Other related rights such as remedies for breaches of representations and warranties made by the Leasing Company that originated the receivables.
- In return for the transfer, the Leasing Company is established as the beneficiary of the Trust.
- All lessees of the $4 million portfolio are notified that lease payments should now be made to the Trust and that the Leasing Company will continue to be the servicer of the leases.

- The lender then issues a $3 million non-recourse loan to Leasing Company, to be backed by the assets of the Trust and re-paid by the Trust on behalf of the Leasing Company. The Lender is added to the Trust as a beneficiary, to be paid according to the loan schedule and with a senior claim on the assets of the Trust.
- Funds remaining in the account (residual cash) after payment of the loan are then available to Leasing Company as the holder of the subordinated "equity-type" position in the Trust.

Records and Files: Although the lease receivables are assigned ("sold") to the Trust, the original lease documents would be maintained by Leasing Company on behalf of the Trust. The Leasing Company would create special "lease receivables" files in the name of the Trust, with the original leases attached and documentation on the Trust's security interest in the equipment tied to the leases. In its computer records, it would also be noted that the leases/lease receivables have been assigned to the Trust and that the Trust has a security interest in the equipment.

Achievement of an "Equity" Position for Leasing Company and its Importance for the Tax Benefits: By fact that Leasing Company has the subordinated beneficiary position in the Trust, with access only to the residual cash remaining after payment of the loan, you can see with this structure, what is achieved is that Leasing Company is still in essence holding the "equity position" on the portfolio where it holds the "risks and rewards" of ownership. As mentioned earlier in the memo, this effective "equity position" (in addition to still being the legal owner of the equipment) is an important part of what justifies the beneficial taxation (right to fully depreciate the asset) under US law, but this interpretation needs to be verified with the Georgian government.

Order of Payments: As explained under Option 1A, one aspect of the terms to be decided is the order and timing of payments from the Trust account to the Lender and to the Leasing Company (for example, if Leasing Company can draw cash from the Trust only once the loan is paid in full, or if some cash can be drawn according to a certain schedule and provided certain terms are met such as replenishment of the reserves and/or a certain level of portfolio performance).

Cash Reserve in the Trust: Also a reserve of cash (Reserve Account) will need to be maintained in the Trust, in order to ensure the Trust's ability to pay the Trust Administration Fee, other Trust costs, and to provide some risk mitigation for the Lender. Leasing Company would make the initial establishment of the Trust reserve, with a small percentage of the proceeds from the loan (likely in the range of 1-3%).

Leasing Company as a Loan Servicer and with a Loan Servicing Fee: Leasing Company would continue as the servicer of the leases. As the effective owner of the leases, the Trust would be expected to pay a loan-servicing fee to Leasing Company for servicing of the loans. In addition to servicing the loans, Leasing Company would be expected to issue monthly or quarterly reports to the Lender and/or the Trust regarding performance of the lease portfolio. Loan Servicing activities mainly include:

- Purchasing of equipment (before leveraged leasing deal)
- Lease Structuring (before leveraged leasing deal)
- Purchasing equipment (before leveraged leasing deal)
- Issuing lease (before leveraged leasing deal)
- Billing & collecting

- Cash application
- Asset management
- Handling of VAT payments
- Purchasing of any insurance for the equipment
- Repossessions and sale of repossessed equipment.

Role of the Trust Manager and the Trust Administration Fee (and Trustee Fees/Expenses): The Trust Administrator (like for the Escrow account manager) will have to build and maintain a complete understanding of the terms of the loan; that is, how much is to be paid to the Lender and when the Leasing Company can and cannot be paid. It will also have to monitor for late payments and defaults by lessees as payments to the Leasing Company may be contingent upon this (as mentioned above). It will also have to maintain and replenish the reserve account (if a reserve account is incorporated into the structure). Lastly, terms would also likely be established for triggering the Leasing Company to facilitate sale of any equipment assets on behalf of the Trust in the case of a default. As such, the Trust Administrator will have an active monitoring role in terms of monitoring the lease payments and status of the leases (achieved via monitoring of payments into the Trust account vis a vis lease payment schedules per the terms of each lease, and via the routine reports received from the Leasing Company) – really more of monitoring of Leasing Company's responsibility to handle and report on all of this. The fee to the Trust Administrator would be paid out of the Trust itself. Also, as the Trustee (see note on legal description of trusts below) has the legal responsibility of the Trust, the Trust will also be expected to pay a fee and/or reimburse the costs of the Trustee (particularly during any defaults the Trustee may have to play a more active role according to its duties).

Lower Risk to the Lender of a Potential Leasing Company's Bankruptcy or Tax Liens on Leasing Company: One strength of this Trust model is that it achieves a stronger "remote bankruptcy" structure. Because the lease receivables are the legal property of the Trust, an entity completely separate from Leasing Company, there is little to no risk that the government (in terms of tax liens on Leasing Company) or other lenders to Leasing Company could make claims on the and cash flows of the Trust. However, since the leasing company still holds the title/ownership of the equipment behind the leases, there is still potential risk regarding the equipment (as noted under Option 1a, the legislation on priority of tax claims may be changed in the near future). One alternative structure that could be considered to address the risk of the equipment is actual transfer of ownership of the equipment to the Trust; however, this will need vetting by tax advisors and lawyers regarding structure and interpretation by the government of Georgia regarding the Leasing Company's right to depreciate the asset, which is intended as one of the main benefits of leveraged leasing but could be compromised by transfer of the asset to the Trust.

Brief Summary of a Trust's Legal Structure in Georgia: Per Article 724, under a contract of property trust, the Trust or (Leasing Company in our case) transfers property to the Trustee, who holds and manages it in accordance with the interests of the Trustor. Per Article 725, on the rights and duties of the Trustee, (1) the Trustee shall be bound to manage the property held in trust in his own name, but at the expense and risk of the Trustor, and (2) the Trustee enjoys the owner's entitlement in relations with third persons. If the Trustee, contrary to the interests of the Trustor, is not acting in the same good faith as in managing his own affairs, he shall be obligated to compensate the damage thereby arisen.

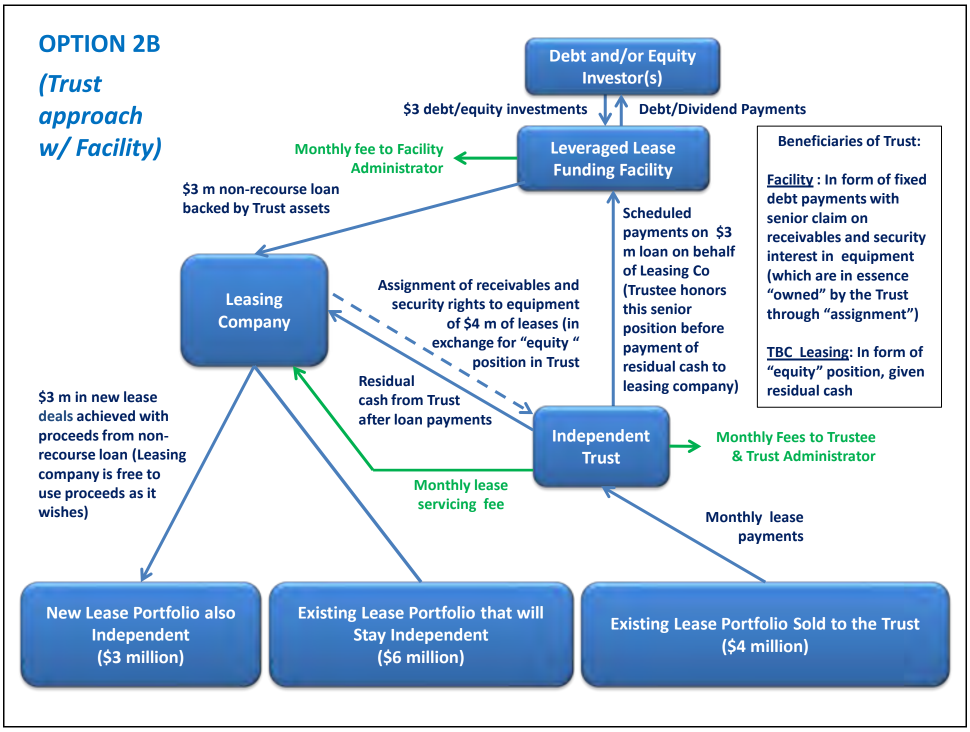
Pros/Cons of a Trust vs. SPV vs. LLC/JSC: One of the benefits of a Trust versus an SPV or LLC/JSC is the tax benefit. However, this should be further explored. One of the negatives about a Trust is that though Trusts have been a legal form in Georgia since 1997, there is limited experience/use of trusts (aside from issuing of securities) and the tax code does not clearly address/define tax treatment of trusts. This should be further explored. One issue with SPVs to be explored is the issue of ownership and that typically (in the European setting) the beneficiary should not be the owner.

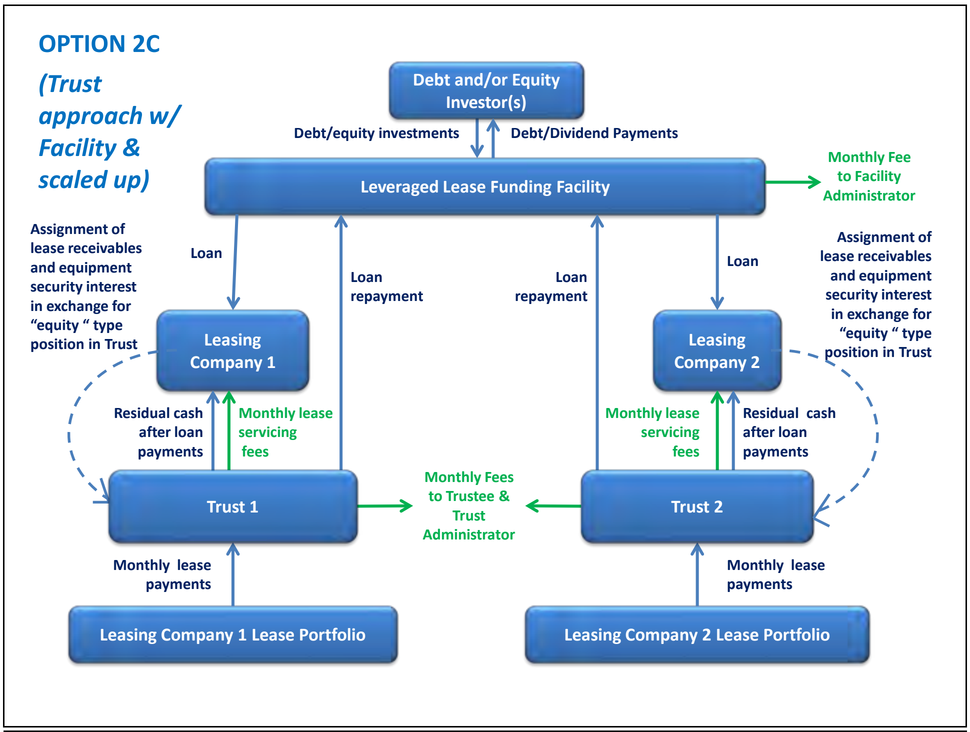
Assessment and Resolution of VAT Treatment: One issue with the Trust option is the issue of treatment of VAT. Currently, when a leasing company purchases equipment, it pays VAT to the vendor (the seller of the equipment). When lessees make lease payments to the leasing company, the lessee pays VAT to the leasing company. Thus leasing companies in Georgia are VAT collectors, collecting VAT, deducting the amount paid to vendors and paying the different to the government. (The reason lessees pay VAT with their lease payments are because in Georgia financial leases, which constitute 90% of the leases in Georgia, are treated as operating leases for tax purposes, and the lease payments are considered “rent” payments). If the lease payments are paid to the Trust, it is not clear how the Leasing company will be able to obtain and declare this as VAT collected and this needs to be assessed. The leasing company ideally wants to collect this VAT, so that it has VAT collection from which it can offset its VAT paid to vendors.

Alternative of Directing the Loan to the Trust Rather than to the Leasing Company: During the research phase the question was posed whether the loan from the Lender could be to the Trust rather than to the Leasing Company. This could be done, and this could be done in the scenario (a) that the Trust has a security interest in the equipment or in the scenario (b) that actual title to the equipment is initially transferred to the Trust. In this case, the leasing company’s relationship to the Trust and the Loan would be only as Lease Servicer, and in scenario (a) the owner of the equipment). However, in both scenarios, it would be unlikely that the Leasing Company could deduct the interest on the loan. In scenario b, it is also unlikely that the Leasing Company would be able to claim the deprecation on the equipment. Lastly, a mechanism for transferring the $3 million loan proceeds from the Trust to the Leasing Company would need to be vetted.

OPTION 2B (TRUST APPROACH WITH FACILITY) AND OPTION 2C (TRUST APPROACH WITH FACILTY & SCALED UP)

As in the case of OPTION 1, this Option 2 with the Trust approach can also be scaled up to include a Facility (to accommodate multiple investors) and to include lending to multiple leasing companies. The explanation for incorporating these aspects does not differ from the points noted under Options 1B and 1C; thus, only the schematics are shown below:





<u>Ongoing Operating Expenses Associated with the Facility</u>:

- Facility Administration Fee (Monthly, from Facility to Fund Administrator): Described above. The amount of the fee would depend on the extent and complexity of the role of the Facility administrator (e.g., most complex if carried out as a Fund Manager-type role).
- Trust Management Fee (Monthly, from Trust to Trust Manager): Described above. The amount of the fee would depend on the complexity of the loan terms and how priority of payments are made to the Facility vs. to the Leasing Company, use of the reserve, number of leases and lease payments coming into the account, reports required, etc.
- Trustee Fees: The official Trustee of the Trust, with legal fiduciary responsibility to ensure that the Trustor (beneficiaries) rights are honored, will have either fixed or occasional fees, for example, for time/effort involved with any defaults/repossessions and related legal fees.
- Other Facility costs: These would depend on the corporate governance structure of the facility, but could include, for example, legal fees, Board member travel expenses, other Board meeting expenses, annual audit fees, and taxes. In the case of any defaults, the legal costs of seizing collateral and other such actions would likely be charged as direct costs to the Facility rather than being paid out of the Facility Administration Fee.
- Other Trust Costs: These could include, for example, legal fees, and audits – both routine and/or related to defaults.

F. RECOMMENDED NEXT STEPS

FEASIBILITY STUDY (ESTIMATED 2-4 MONTHS)

- Further vetting of the proposed structures from a tax, legal and IFRS perspective
- Discussions and official interpretation/confirmation of the structure from the National Bank of Georgia (NBG), in particular regarding treatment of non-recourse loans considering there is no special definition of this in Georgian tax law.
- Initial assessment of investor interest (discussions/meeting with private international banks, DFIs (such as IFC, EBR, ADB, KFW), and other potential investors
- Consideration of MIGA, OPIC or other political risk insurance
- Discussion of requirements, standards and return expectations with potential investors
- Further assessment of interest of Georgian leasing companies in use of the facility
- Case precedents of lease funding facilities in other emerging markets
- Further analysis on policy environment (monitoring of results/implementation of recent policy changes, timing for obtaining court orders for seizing equipment, etc.
- Research/analysis on the quality of and the practices at the leasing companies and the quality and characteristics of their portfolios.
- Rating/auditing standards at leasing company level that are in place and new standards/procedures that can be utilized
- Discussions with NBG regarding potential/plans for national regulation of leasing companies
- Assessment of interest rates in leases and potential interest rates on loans
- Assessment of prevalence of GEL vs. USD denominated leases whether investor seek denomination of loans in GEL or USD, and if a currency swap may need to be incorporated into the structure.
- Assessment/estimate of start-up/organizational expenses and plan for how and by whom (EPI and/or anchor investor) such expenses will be covered and whether they can be reimbursed by the Facility upon establishment.

LAUNCH OF FUNDRAISING/START-UP (ESTIMATED 4-8 MONTHS)

- Development/Finalization of Prospectus
- Fundraising
- Procurement of a Facility Administrator (or Manager)
- Procurement of escrow or trust managers
- Due Diligence
- Drafting and signing of Facility Documents (Investment Agreements, Facility Administrator Agreement among others)
- Establishment of entities and initial capitalization drawdowns

LAUNCHING OF OPERATIONS

- Launch and carry out activities according to the Facility Documents.

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