



Original Contribution

ON PARTICULAR ASPECTS OF AGRICULTURAL LEASE FUNDING

R. Dimitrova*

Department “Economics”, New Bulgarian University, Sofia, Bulgaria

ABSTRACT

The present article presents some of the aspects inherent to lease as an alternative method for funding farmers when it comes to finance lease. As a matter of fact, this type of lease is profitable in agriculture when it comes to delivering and using high-tech fixed assets.

Key words: lease, farmers, finance lease.

INTRODUCTION

In the financial sector, the “lease” term is used quite often in the last twenty years. Additionally, a finance lease is perceived as one of the cutting edge and most convenient manners for funding enterprises, i.e. it is a source of funds for them. Some authors perceive the lease as one of the non-traditional funding patterns for investment projects (1). It is well-known that the term “lease” originates from the English verb “to lease” and means “renting something”. In the present article, it is about the other type of lease, the operating lease that has some of the rent features. Yes, via lease we hire mainly fixed assets. Nevertheless, a lease is also a manner of funding enterprises that do not have enough “fresh” cash resources with which to acquire machines, facilities, vehicles, equipment, buildings, and other assets necessary for doing their business. Farmers also need machines and facilities that they could hire or receive funding from a leasing company.

ESSENCE AND FEATURES OF FINANCE AND OPERATING LEASE

In specialized economic literature, as well as in practice they believe that lease is based on credit or rental relations since the lessor provides

financial service to the lessee or rents the particular asset for him or her. Thus lease is perceived as a rental agreement under which the lessor undertakes to provide the right of using a particular asset, usually in the mid- and long-term for a particular period of time and remuneration specified in advance (lease instalments) (2). In other authors’ opinion lease is means with which some economic subjects raise sources that are external to them in the pattern of fixed tangible and/or intangible assets, owned by other economic subjects in order to fund investment projects or satisfy consumer needs (1- 3) . These two opinions exhaust the lease essence in its two aspects – in the capacity of rent and of funding mode. The most important feature of lease transactions is that the right of use and right of possession are distinguished (4). When it comes to entering a lease agreement, the right of possession still belongs to the lessor, and the right of use is in lessee’s benefit. In the case that both parties agreed after the lease period expires the ownership could be transferred, i.e. the lessee has the right to purchase the asset with which he or she acquires the right of possession. This is described in another clause of the lease agreement.

Lease’s history in our country that is especially active since the beginning of the current century shows that the following enterprises are interested in it (5):

***Correspondence to:** Assoc. Prof. Dr. Reneta Dimitrova Ph.D., Department “Economics”, New Bulgarian University, Sofia, Bulgaria, r.dimitrova@nbu.bg

- That are short in financial resource – usually small- and medium-sized enterprises that are trying via lease to make up for their limited capacities to raise cash resource with other means. Namely via lease funding they get the chance to re-schedule the costs for capital construction in the pattern of lease instalments that distributes the cash flows in a more favourable to them manner during the period in which they achieve inflows at sufficient amounts;
- That in doing their business are dependent on the latest achievements in the hi-tech sector. Via lease they are striving for ensuring regular replacement of the obsolete equipment with a cutting edge one;
- That would like to get tax benefits from the lease operations;
- That are producers and are striving via lease to increase the turnover of their sales;
- That are start-ups and quite naturally are of lower creditworthiness and higher risk.

In financial theory and practice, there are various criteria for defining the types of lease transactions. The most common lease classification is in view of its economic essence – finance and operating lease. Finance lease would be the subject matter of the present article.

When defining a particular lease agreement as finance or operating (also used as “operational lease”), the most important thing is to analyse transaction’s essence. In its essence, lease agreement is an agreement according to which lessor provides the lessee with the right to be using the fixed tangible asset for lump sum payment or sequence of payments during the contractual term (6). Since the lessor and the lessee could treat a particular lease agreement differently, in some countries as a rule the agreement should define the type of lease. There is no such requirement in Bulgaria and in order to classify the lease operation, we use IAS “Leases”. According to this standard, the lease agreement is an agreement according to which the lessor provides the lessee with the right to be using an asset for lump sum payment or sequence of payments during the contractual term (7). Once again, according to this standard, the finance lease is defined as an agreement whereas in essence all the risks and benefits resulting from

owning a particular asset are transferred and in the end of the agreement the ownership right could be transferred or not. Thus, we conclude that finance lease’s main feature is that the lessee in the end of the lease period has the right to acquire the asset used by it, i.e. the ownership is transferred at the time of paying the agreed instalments. Paragraph 10 of IAS 17 mentions several important features that if present define a lease as finance:

- The lease agreement transfers the asset ownership to the lessor as of the end of this contractual term;
- The lessee gets the option of buying the asset at a price that is expected to be significantly lower than its fair value, as of the date on which the option is exercisable;
- The term of the lease agreement covers most of asset’s useful life whereas the ownership right could be transferred or not;
- In the beginning of the lease agreement, the present value of the minimum lease payments is equal entirely or almost entirely to the fair value of the leased asset;
- The leased assets are of specific nature since only the lessee operates them, without making significant modifications in or onto them.

The standard finance lease for new assets has a duration of up to 60 months, i.e. 5 years. Additional negotiations concerning the terms and conditions of the lease transaction should be held for longer term.

When it comes to most companies, the subject matter of finance lease are mobile items being tourist vehicles, heavy-duty vehicles, trailers and semi-trailers, specific equipment, machines, facilities, technological equipment, spare parts, computer equipment, real estates and others, in conformity with particular requirements related to (5):

- Lease of second-hand items is allowed only in the case the consumer properties were preserved and on the grounds of these we could define the fair market value that could be the evaluation of licensed valuator, insured value, invoice value and others;
- The asset should have useful life of not less than 5 years and after the expiration of the lease agreement, the asset should be fit for use, for at least one year;

- The asset should be liquid, i.e. a well-developed secondary market should be available in the country that makes its repeated realization possible, if necessary;
- The asset ought not be unique and should not be acquired in order to satisfy lessee's special needs, i.e. it is standard equipment;
- The asset should be essential for the business development of the lessee;
- The asset should be equipped with series number that makes it easily identifiable;
- The asset should have reasonable guarantee term and after-warranty service provided by its supplier;
- In terms of real estates, the real estate should be turn-key completed, with received permit for use or completion stage "Rough construction".

From lessor's point of view, finance lease is a credit transaction and from lessee's point of view it is funding the investment operations. Unlike the lessor, the lessee bears all the costs and risks inherent to the leased object's operation and maintenance, as well as the payment of taxes, fees, insurances and other debts.

Operating lease precedes the finance lease and featured with two important characteristics: there is no termination ground; except for the cases whereas it is included in the agreement and the fact the ownership undergoes no changes. In financial practice, we define operating lease as rental for longer term, i.e. the lessee uses the fixed tangible asset while paying regular money instalment in the pattern of rent to this end. Practice shows that the effective term of the agreement is from several hours to not more than three years, and on rare occasions exceeds this limit. Operating lease is used mainly for specialized equipment and the leased objects are mainly machines, facilities and vehicles with wide lease market. Unlike the finance lease, in the case of operating lease the one who bears all the burdens and risks related to ownership is the lessor.

After the expiration of the contractual effective term, the lessee returns the rented asset and upon parties' mutual consent it could be renewed. There is an option for termination of the agreement ahead of terms, yet after satisfying particular clauses, terms and conditions.

We could draw the conclusion that the differences between these two lease types are mostly about the purposes they serve. Finance lease is a manner of investment funding, while the operating one provides the opportunity for assimilating the cutting edge scientific achievements thanks to renting them. Operating lease is effective in the case of companies with big fleet, whereas in terms of sectors such as agriculture it is still not applicable.

An essential part of a particular lease transaction is the parties to it, namely: lessor, lessee, supplier (producer); insurer, commercial bank.

Among them, the only party that does not take part in the lease transaction, as a rule, is the bank. Most often lessors are companies to which finance lease if not the only one is the main business. Lessees have only one goal: they are short of money and via lease-funding, they make up for their limited capacities to raise equity in other way or procure the tangible assets they need.

Suppliers (producers) are the third party and their activity is limited to selling lease property in the terms and with the quality that is in conformity with the requirements defined in the contract for purchase and sale entered with the lessor. In numerous cases, producer and lessor are one and the same company – the manufacturers of equipment, of vehicles for example.

As a rule, insurance companies take part in each and every lease transaction with: property insurance in lessor's interest onto mobile items /excluding vehicles/ and real estates, the insurance of properties includes the "Earthquake" risk; "Casco" insurance and "Third party liability" insurance for vehicles in lessor's interest; "Financial risk" insurance for non-payment of a lease instalments under agreements for leasing mobile items.

An important player in the lease transaction are banks. They are not a subject as a rule, but should they become one, this happens in the following manners:

- Directly – if a bank itself is a lessor. Actually, the Credit Institutions Act includes finance lease in the activities that the commercial banks could do;

- Indirectly – if the bank issues the credit line to a lease company.

LEASE AS MEANS FOR FUNDING FARMERS

The availability of funding at a sufficient amount is a prerequisite for the successful start-up and development of each and every business endeavour, irrespective of the sector it could be referred to. The practice has proven that the hindered access to cash limits investment not only in tangible assets but also the ones for training and improving the qualification of employees and workers, for advertisement, software products, and others.

Agriculture is one of the sectors of the Bulgarian economy that is being paid attention and this attention is about lease companies including in their programs the following important goal – to cooperate with farmers for the implementation of new, cutting edge equipment that would facilitate the work process. In all cases, this would bring about better results and higher quality of the produce. While supporting the business of farmers, lessors would cooperate for improving the effectiveness of the operations being performed. Furthermore, a finance lease would make it possible for farmers to take advantage of the latest technological achievements to the fullest thus improving the results of their business, i.e. lease is beneficial when delivering the fixed assets that are latest from the technological and technical point of view.

Funding farms brings risk to leasing companies. It is not by chance that the European Commission works towards promoting lease funding via numerous new policies and programmes. One could observe the way these are accepted and used by the leasing companies in our country based on the lease products offered by the leading leasing companies.

It is worth paying attention to the policy for funding agriculture implemented by the large leasing companies. With a finance lease, they fund the purchase of farm equipment. We would like to draw your attention to the fact that the leasing companies offer two main types of finance lease – with open and with closed end. In the case of finance lease with open end, the lessee is provided with the opportunity to decide whether to acquire the asset or give up on the

opportunity. In the case of finance lease with closed end, after delivering the lease object, the lessor issues an invoice to the lessee for the whole principal. What is typical about it is that VAT is payable as lump sum and in advance at the time of delivering the asset.

Lease funding performed by DSK Leasing JSC is interesting (8), since it is offered according to the following terms and conditions:

- Farmers and legal entities are being funded;
- New, as well as second-hand agricultural machines are being funded, whereas the second ones should not be older than 12 years in the end of the lease period;
- Cash is released in EUR currency. Its minimum amount is 1000 EUR excluding VAT. An important detail is that lessee could pay VAT in instalments throughout the effective term of the lease agreement together with the particular lease instalment;
- The deductible per cent depends on whether it is about a new or second-hand agricultural equipment – in the case of new one it is at least 15 %, and second-hand – at least 20 %;
- The term in the case of this product does not depend on whether it is a new or second-hand agricultural equipment and is 48 months;
- The lease instalments are monthly annuities;
- The insurances are “Casco” and “Third party liability”.

The next leasing company worth paying attention to when it comes to lease funding issued to farmers is UBB Interlease (9). Its terms and conditions are the following:

- Farmers and legal entities are being funded;
- New, as well as second-hand agricultural assets are being funded;
- Cash is released in EUR currency – at least 10 000 EUR excluding VAT, yet the extinguishment could be done in BGN;
- In the case of new agricultural machines, no deductible may be required;
- The term for funding new assets is 72 months, and for the second-hand ones – upon experts’ discretion;
- Lease instalments are monthly.

Raiffeisen Leasing (10) is a company with history of many years. The company funds the purchase of agricultural equipment according to the following terms and conditions:

- Legal entities are being funded;
- New, as well as second-hand agricultural equipment is being funded;
- The effective term of the lease agreement depends on whether it is about new or used equipment – when it comes to a new one, it is up to 72 months, and second-hand – up to 48 months;
- The deductible per cent depends on whether it is about a new or second-hand agricultural equipment – in the case of new one it is at least 15 %, and second-hand – at least 20 %;
- Since it is a finance lease of closed end, the VAT is paid in instalments during the period, together with each and every lease instalment that is a month annuity;
- At the end of the period, the age of the leased asset could be not higher than 8 years.

UniCredit Leasing (11) also funds the acquisition of agricultural machines, attached inventory and specialized agricultural equipment. Their terms and conditions are the following:

- Legal entities are being funded;
- Four products are on offer – finance lease with open end, finance lease with a closed end, finance lease with open and with closed end and VAT capitalization, as well as funding under European programmes.
- The terms and conditions of these lease funding sources should be specified with the experts of UniCredit Leasing.

Until now it was about purchasing agricultural equipment via finance lease that is already established in our country. Nevertheless, more limited is the acquisition of agricultural lands via finance lease. Lease transactions for agricultural lands are entered by a relatively low number of leasing companies. One of these companies is “Elana Agrocredit” JSC (12). Their terms and conditions are the following:

- The requested money sum is funded to 100 %;
- The deductible is up to 20 % of the purchase value as an initial instalment;
- The collateral is the purchased agricultural land whereas it becomes ownership after the payment of the last extinguishment instalment;
- Annual fee at the amount of 5 BGN per decare.

The positive aspect of this leasing company’s work is that it provides turnover credits to the farmers who are lessees. The collateral is the agricultural land acquired by the particular farmer via lease transaction.

All leasing companies require that the lease applicants provide the following documents:

- Request for lease funding of agricultural equipment;
- Accounting statements – balance sheet, statement of revenues and expenses, the tax return for the last financial year;
- Document that certifies the farmer is entered in the registers of the Ministry of Agriculture and Food;
- Copy of the offer provided by the supplier of agricultural equipment, being the subject matter of the lease transaction;
- Certificate on the presence or absence of debts issued by the revenue body under article 87, paragraph 6 of the Tax-Insurance Procedure Code;
- Copies of the identity cards of company lease applicant’s representative and if there are joint and several debtors.

An important aspect of lease funding is its digitalization. In recent years, we observe a process of digital technologies penetrating the lease business. This is taking place faster in leasing companies that were incorporated by commercial banks. As a matter of fact, in recent years they have been working quite actively for banking business digitalization and have achieved high results. Why do we need digitalization of lease funding? The first reason is that this way companies save their clients’ time since they do not have to visit the leasing company’s office. The second reason is that clients are provided with easy and rapid access to the particular lease product at all times. The first step in this direction is the digital calculators with which every person or entity that would like to receive lease funding could calculate the annuity extinguishment instalments. For example, an important step is for the lease-agreement to be signed digitally. This would cut the time down from start until the end of a lease transaction. The efforts made by the lease companies should be targeted namely in this direction – ever more expansive digitalization of their business.

CONCLUSIONS

The development of farms requires financial resources at significant amounts that the farmers could receive from the commercial banks in the pattern of investment loans. Nevertheless, the procurement of equipment could be performed with a finance lease. Investment bank loans, as well as a finance lease, are important and necessary financial instruments to ensure farmers' effective operations.

Finance lease has numerous advantages and some of these are:

- Funding via finance lease does not require additional collaterals;
- The costs in the pattern of fees and commissions are lump sums;
- VAT is not part of the lease transaction and no interest should be accumulated on it;
- The object of lease funding is reflected in the asset column of the balance sheet that correspondingly has positive effect on lessee's financial indicators;
- Interest and asset depreciation should be recognized as a cost and correspondingly cut down the taxable profit of lessee.

On the basis of the above, we could draw the conclusion that finance lease as a funding manner

complements investment bank crediting, thus significantly extending the opportunities for farmers to develop their business successfully and be competitive.

REFERENCES

1. Petrov, G. et al., Corporate finance, Trakiya, BG, 2012.
2. Nikolova, I., International commerce funding, New Bulgarian University, BG, 2015.
3. Aleksandrova, M., Kalchev, E., Enterprise finance, New Bulgarian University, BG, 2013.
4. Nikolova, N., Principles of corporate finance, Ciela, BG, 2010.
5. Dimitrova, R. et al. Introduction in finance, New Bulgarian University, BG, 2019.
6. Mitev, P., Corporate finance. Excel, University of National and World Economy, BG, 2016.
7. International Accounting Standard (IAS) 17 Leases. <https://audit.bg.com/dokumenti/MSS17>.
8. <https://dskleasing.bg>
9. <https://interlease.bg>
10. <https://www.rlbг.bg>
11. <https://www.unicreditleasing/aktivi/selskostonpanska-tehnika/>
12. <https://agrocredit.elana.net>