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PERFECTING YOUR SECURITY INTEREST IN A DRONE

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As technology evolves, industries are finding new, creative ways to leverage technology to increase efficiency. Unmanned aerial vehicles, otherwise referred to as "drones," are a perfect example of a technological advancement that has enhanced many industries. One industry in particular that has benefited from the use of drones is the agricultural industry. Farmers are currently utilizing drones for various tasks including crop spraying, crop and livestock monitoring, and field mapping. The precision farming and increased efficiency that drones offer has caused demand in the agricultural industry to increase rapidly. One leading commercial drone manufacturer estimates that in 2023, over 300,000 drones operated globally to treat millions of acres of farmland across the world.

Now, precision farming and increased efficiency comes at a cost. Most "sprayer drones" cost around $15,000.00 with some costing upwards of $30,000.00, exclusive of accessories and batteries. With many farming operations utilizing multiple drones at once, the cost of adoption likely exceeds $100,000.00. Farmers most certainly will look toward financial institutions for financing. Therefore, as agricultural and commercial drone usage becomes increasingly popular, lenders

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should know how to protect their rights and interests when using the drone as collateral.

Procedurally, perfecting a security interest in a drone is the same as perfecting a security interest in any aircraft. The secured party must file a security agreement with the Federal Aviation Administration (the "FAA") Aircraft Registration Branch. To properly file a security agreement, send the appropriate documentation to the Aircraft Registration Branch via U.S. Postal Service at P.O. Box 25504, Oklahoma City, OK 73125-0504. Once the security agreement is filed with the FAA, from that date, the security agreement is valid against all other persons and creditors who do not have a recorded interest. Similar to a UCC-1 filing, a security agreement filed with the FAA Aircraft Registration Branch provides public notice of the secured interest to all subsequent creditors.

Unlike a UCC-1 filing, a security agreement filed with the FAA Aircraft Registration Branch requires a more detailed description and notarized signatures. A security agreement eligible for filing with the FAA Aircraft Registration Branch must also be in a form acceptable to the FAA, a sample Aircraft Security Agreement form, AC Form 8050-98, can be found on the FAA's website for reference (https://www.faa.gov/documentLibrary/media/Form/AC_Form_8050-98_09-2024_final.pdf). Promissory notes, financing statements, and disclosure statements are not eligible documents for filing. In general, the security agreement must include the following information: (1) a description of the drone, including the make, model, manufacturer's serial number, and the FAA registration number; (2) an acknowledgement that the owner of the drone is granting a security interest in the drone to the secured party; (3) signatures by both parties; and (4) an acknowledgement before a notary public. Finally, the security agreement must be accompanied by the appropriate recording fee.

Once an eligible security agreement is filed, the FAA will return a Conveyance Recordation Notice, AC Form 8050-41, to the secured party. The recordation notice describes the drone, lists the parties and the date of the security agreement, and lists the FAA recording number and date of filing. It also operates as a lien release. Once the secured party agrees to release its lien on the drone, the secured party may sign the AC Form 8050-41 and return it to the FAA Aircraft Registration Branch. If a secured party misplaces the AC Form 8050-41, the FAA also accepts a signed letter from the secured party containing the same information along with a statement of release. Additionally, should the parties wish to amend the filed security agreement, any amendments or supplemental documents may be recorded with the Aircraft Registration Branch if the documentation describes the original conveyance by listing the date of the security agreement, the parties, and the FAA recording number and date of initial filing. All subsequent filings must be signed by the parties and accompanied by the appropriate recording fee.

While perfecting a security interest in a drone is similar to any aircraft, perfecting a security interest in drone accessories is more akin to perfecting equipment under the UCC. In addition to the aircraft itself, secured parties must file security agreements that identify aircraft engines, propellers, and other spare aviation

parts with the Aircraft Registration Branch to perfect their interests. However, drone batteries, charging stations, and other accessories do not fall within the definitions of aircraft engines or other spare aviation parts. Therefore, to perfect a security interest in drone batteries and accessories, the secured party must file a UCC-1 financing statement with the appropriate Secretary of State identifying the collateral as equipment.

Secured parties should be aware that federal law prohibits the operation of unregistered commercial drones. Nearly all types of drones are required to be registered with the FAA. Additionally, if the commercial drone is not registered, the secured party cannot perfect their security interest. Best practices dictate the secured party to encourage registration. There is, however, a limited exception to registration. Drones strictly used for recreational purposes that weigh less than 0.55 pounds do not need to be registered with the FAA. However, all other drones must be registered. Upon registration, the owners receive a Certificate of Registration and an FAA registration number. Depending on the size of the drone, the FAA registration number may either begin with an "N" or an "FA." Regardless, the security agreement must contain the FAA registration number to be eligible for filing with the Aircraft Registration Branch.

As of April 1, 2025, more than one million drones have been registered with the FAA. Industries across the U.S. are implementing drones to increase their efficiency and improve production. The agricultural industry, for example, has already witnessed a substantial rise in drone utilization; this trend will only continue as technology advances and regulatory developments progress. As of early 2025, the FAA regulations limit drone usage to one (1) drone per pilot, and in some instances, a visual observer is also required. Thus, as the regulations stand, two (2) persons are required to operate one (1) drone. The FAA regulations have limited drone efficiency. However, in 2024, multiple agricultural drone manufacturers have petitioned the FAA for an exemption. With an exemption, pilots may operate a swarm of three (3) drones at one time. Effectively tripling their efficiency.

Although drone usage is highly regulated by the FAA, the FAA does not require drone operators to maintain a drone insurance policy. Instead, the FAA limits certain aspects of drone usage and requires extensive pilot training. To become a drone pilot, the FAA requires each person to earn a Remote Pilot Certificate through required trainings and a knowledge-based test. However, even with all the regulations and required trainings, accidents and unpredictable conditions happen. Now, many agricultural businesses have a general or commercial liability insurance policy, but drones are typically excluded from such insurance policies because drones are deemed to be "aircrafts." Financial institutions should consider drone liability insurance and hull coverage as a lending requirement to further secure their rights and interests.

Eventually, drone usage in commercial industries, including the agricultural industry, will become commonplace. Financial institutions seeking to finance this technological adoption must be aware of their rights and interests. For help perfecting your security interest in a drone, contact an experienced legal professional.

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ECONOMIC UNCERTAINTY – ACTIONS TO PRESERVE AND PROTECT COLLATERAL

The recent U.S. economic turbulence has caused, and will probably continue to cause, challenges in lending. Borrowers, when pushed, will sometimes take actions that are not customary in the lending relationship. Below are some pre-collection and verification tips to mitigate a lender's "loss of collateral."

It is important to recognize that when a borrower goes into default it may be too late for a lender to protect its collateral. To minimize any collateral dissipation, lenders should explore and exercise various pre-collection activities prior to a default. The steps can include:

- **Inspection.** While it seems a simple step, many times lenders do not verify the existence of the collateral. Do on-sight inspections to verify all the collateral is still present.

- **Compare Inspection Reports with Borrower's Records.** Lenders should compare and review inspection results with borrower's tax depreciation schedules and balance sheets/financial statements. Do the actual inspection results correlate with the borrower's written records?

- **New Entities.** It is common for borrowers as part of estate planning or business planning to transfer various assets into a trust, an LLC, and the like. Lenders should ask the borrower if it has established any new legal entities. This information is paramount to ensure that the lender has (and maintains) a security interest in the collateral with the "real" owner.

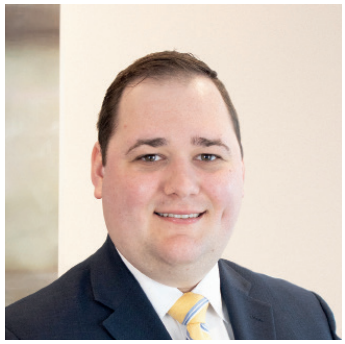
- **Performing UCC, Judgment Lien and Tax Lien searches.** Again, this seems simplistic but it's important to check and verify the accuracy of a borrower's financial statement. The searches may provide the lender with additional information as to whether or not the borrower has

obtained any new secured creditors, and or if the borrower has fallen into arrears with other creditors that have obtained a judgment. against the borrower.

- **Review Loan Documents.**
    - When a potential problem loan is identified, the lender should do a thorough review of the loan documents, to include:
        - Verifying the UCC-1 financing statement properly identifies and states the business legal name, and if an individual, that the UCC-1 meets the driver's license test (e.g. the name and spelling on UCC-1 financing statement should be identical to the information on the borrower's driver's license).
        - Verifying the loan documents are properly signed by the borrower(s) and guarantor(s) and that all the necessary parties have signed the loan documents.
    - In reviewing the loan documents the lender should also identify any unencumbered assets. Quite often, vehicles are listed as collateral on a balance sheet, but the lender has not "perfected" it's lien in the vehicle by having its name listed as the lien holder on the title.
- **O&E Reports.** Obtain updated owners and incumbers reports on real estate loans. This will allow the lender to identify any junior creditors, tax liens, transfers of real estate (e.g., to a trust), and the like.

In summary, being proactive by investigating and taking pre-collection actions allows the lender to possibly mitigate any potential loss of collateral. If collateral is missing, the lender is in a position to take immediate action. If the inspection and pre-collection efforts do not turn up any unusual findings, the lender can feel more comfortable going into a workout situation if the borrower becomes delinquent.

DEFINITION OF "CONVENTIONAL LOAN" EXPANDED IN MINNESOTA



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Minnesota Statutes section 47.20 identifies specific requirements relating to conventional loans, requirements of language that must be in a mortgage securing a conventional loan, and what must be in a notice of default, among other requirements. For example, under Minnesota law, lenders are required to provide conventional loan borrowers a thirty-day notice of default on all conventional loans in the state of Minnesota. During the 2024 legislative session, the Minnesota legislature amended the definition of "conventional loan" contained within Minn. Stat. § 47.20, significantly broadening the coverage of the definition. Lenders should review their processes and procedures, along with their mortgage and notice of default forms, to confirm compliance with the new law.

Before the 2024 amendment to Minn. Stat. § 47.20, a "conventional loan" was a loan or advance of credit to a noncorporate borrower in an original principal amount of less than or equal to $100,000.00, secured by a mortgage on residential real property.[1] The $100,000 threshold meant that most residential mortgages were not considered "conventional loans" under Minnesota statute. Now, effective August 1, 2024, the loan amount for a "conventional loan" is less than or equal to "the conforming loan limit established by the Federal Housing Finance Agency ("**FHFA**") under the Housing and Recovery Act of 2018."[2] The 2025 conforming loan limit value for one-unit properties is $806,500.[3] This significant expansion of the definition of "conventional loan" means that financial institutions in Minnesota will need to ensure that loans made after August 1, 2024, to noncorporate borrowers secured by a mortgage on residential real property in amounts less than or equal the applicable FHFA conforming loan limit comply with the requirements for conventional loans established in Minn. Stat. § 47.20.

Among other things, Minn. Stat. § 47.20 establishes maximum interest rates, imposes limitations on a lender's ability to receive future appreciation of a mortgaged property, sets refund requirements for precomputed loans, provides requirements for loan assumptions, permits the collection of late fees, restricts provisions permitting discount points, and requires certain provisions in and for conventional loans. The requirements are summarized as follows:

- **Maximum Interest Rate.** Conventional loan interest rates must be less than the Fannie Mae posted yields on 30-year mortgage commitments for delivery within 60 days on standard conventional fixed-rate mortgages as of the last business day of the second preceding month plus 4%.[4] Because Fannie Mae stopped posting Required Net Yields ("**RNY**") in June of 2024, the Minnesota Department of Commerce has published guidance that the Average Prime Offer Rate ("**APOR**") as defined in 12 C.F.R. § 1026.35(a)(2) may be substituted for the RNY.[5] Thus, for example, a conventional loan made on April 25, 2025, would have a maximum interest rate of 10.85%, because the APOR as of the last business day of the second preceding month (February)

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[1] Minn. Stat. § 47.20, subd. 2(3) (2023).
[2] Minn. Stat. § 47.20, subd. 2(3) (2025).
[3] *FHFA Announces Confroming Loan Limit Values for 2025*, FEDERAL HOUSING FINANCE AGENCY, Nov. 26, 2024, https://www.fhfa.gov/news/news-release/fhfa-announces-conforming-loan-limit-values-for-2025.
[4] Minn. Stat. § 47.20, subd. 4a(a).
[5] Crow, Michael, *Interpretive Opinion Regarding Maximum Interest Rates under Minn. Stat. §47.20, subd. 4a(a)*, MINNESOTA DEPARTMENT OF COMMERCE, July 2024, https://mn.gov/commerce-stat/money/home-loan-rates-interpretive-opinion.pdf.

was 6.85%.[6] If the conventional loan is for a duration of ten years or less and for the purpose of purchasing subdivided land or a timeshare interest, the maximum interest rate is three points higher, or 15.75%, whichever is lesser.[7] So, for the same loan discussed above, the maximum interest rate would be 9.85%. An interest rate can be higher, so long as it was locked pursuant to an interest rate commitment or loan commitment and was not higher than the maximum rate of lawful interest at the time the commitment was issued.[8]

- **Future Appreciation of Mortgaged Property.** If a conventional loan provides that the mortgagee or lender shall receive any share of future appreciation of the mortgaged property, the lender's proportionate share must be less than the lesser of the acquisition cost or fair market value of the property divided by the original principal amount of the loan, and cannot exceed an annual rate of return higher than the maximum interest rate described above.[9] A lender can only receive appreciation upon a sale or transfer of the property, or any interest in the property, or upon the maturity of the loan.[10] A lender must disclose the terms and conditions upon which the lender or mortgagee can receive any future appreciation of the mortgaged property. [11]
- **Precomputed Loan Refunds.** If a conventional loan expresses the debt owed as a sum comprised of the principal amount and the amount of interest due for the entire term of the loan, assuming all payments will be made when due, the loan must provide for a refund of any finance charges that would not have been payable if the interest was computed from time to time, in the event that the loan is paid one month or more before the final installment due date.[12] For example, if a conventional loan of $200,000 for 15 years at 6% expressed the debt as being $303,788.46, and at the end of the 13th year, the borrower paid off the remaining $40,505.14, the loan would need to provide a refund of $2,425.47, representing unaccrued interest for the last two years.
- **Loan Assumptions.** If a conventional loan is made to enable a borrower to purchase a one to four family dwelling for the borrower's primary residence, the lender must permit a transferee of the property to assume the borrower's loan if (1) the transferee meets the normal standards of credit worthiness used by the lender, (2) the transferee executes a written assumption, (3) the transferee agrees to pay interest at a new interest rate not exceeding the lender's current market rate or the most recent Freddie Mac auction yield, if greater than the existing rate.[13]
- **Discount Points.** Discount points are allowed on a conventional loan only if the loan yield does not exceed the maximum interest rate discussed above.[14]
- **Required Provisions.** A conventional loan must:
  - Be evidenced by a promissory note and mortgage printed in not less than 8-point font, or legible handwriting.[15]
  - Provide that the borrower shall be furnished with a conformed copy of the note and mortgage upon execution or within a reasonable time after recording the mortgage.[16]
  - Provide that a lender who intends to foreclose must give the borrower a written notice of default, sent by certified mail to the address of the mortgaged property or such other address as the borrower may designate in writing, unless the default consists of a sale of the property without the lender's consent, and that the notice (1) describe the nature of the default, (2) identify the action required to cure the default, (3) provide a cure date not less than 30 days from the date the notice is mailed, (4) that failure to cure the default may result in acceleration of the amounts secured by the mortgage and sale of the mortgaged property, (5) that the borrower has a right to reinstate the mortgage after acceleration, and (6) that the borrower can bring a court action to assert nonexistence of a default or any other defense to acceleration and sale.[17]

The expanded definition of "conventional loan" likely is not retroactive,[18] meaning a loan made prior to August 1, 2024, in the original principal amount of more than $100,000 continues to not be a "conventional mortgage", so there is no need to modify preexisting mortgages which do not comply with the requirements discussed above. But, for any loan which fits the newly expanded definition of conventional loan, a notice of default should comply with the requirements set forth in Minn. Stat. § 47.20, subd. 8(3). Moving forward, it is likely that most of your institution's residential loans will be "conventional loans". Financial institutions in Minnesota should review their mortgage forms, processes, and procedures to ensure compliance with section 47.20.

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[6] *Rate Spread Calculator*, CONSUMER FINANCIAL PROTECTION BUREAU, https://ffiec.cfpb.gov/documentation/tools/rate-spread.

[7] Minn. Stat. § 47.20, subd. 4a(c).

[8] Minn. Stat. § 47.20, subd. 4a(d). A commitment is issued when delivered or mailed to the borrower. *Id*. If a forward commitment fee is required, the commitment is issued when delivered or mailed to the person paying the fee. *Id*.

[9] Minn. Stat. § 47.20, subd. 4b(1).

[10] Minn. Stat. § 47.20, subd. 4b(2).

[11] Minn. Stat. § 47.20, subd. 4b(3).

[12] Minn. Stat. § 47.20, subd. 5.

[13] Minn. Stat. § 47.20, subd. 6a.

[14] Minn. Stat. § 47.20, subd. 7.

[15] Minn. Stat. § 47.20, subd. 8(1).

[16] Minn. Stat. § 47.20, subd. 8(2).

[17] Minn. Stat. § 47.20, subd. 8(3).

[18] Statutes are presumed not to be retroactive unless the legislature clearly and manifestly intended the statute to have retroactive effect. Minn. Stat. § 645.21; *Gorman v. Northland Family Physicians, Ltd.* 645 N.W.2d 413, 416 (Minn. 2002). Nothing in 2024 Minn. Laws, ch. 114, art. 2, § 9, which made the amendment discussed in this article indicates a legislative intent that the statute have retroactive effect.

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