

Protecting Aircraft Collateral Protects Lenders

BY MICHAEL G. CORTINA

SECURED LOANS REQUIRE COLLATERAL, and lenders usually protect the collateral with certain provisions—like requiring insurance in a certain amount. This works well for collateral on common loans like real estate or automobiles. But, what about uncommon types of loans? Is insurance enough?

Take, for example, a loan for an aircraft. Maintaining insurance is a must, but there are other ways to insure that the collateral is protected. Airplanes can be quite expensive. Modern single-engine propeller planes can be valued anywhere from \$80,000.00 to over \$2M, and lenders

that finance them need to be sure that the collateral maintains its value as much as possible in order to avoid an event of default due to the value dropping below the bank's loan-to-value covenant. Besides insurance, what can lenders do to keep value as high as possible on aircraft? Two words—engine programs.

On most aircraft, the engines are the most used and most expensive component. This is especially true for jet aircraft, but the same can be said for propeller and turbo props as well. Aviation is a highly-regulated industry, and the Federal Aviation Administration requires rigorous maintenance on all aircraft regardless of the type. Engines on propeller planes, for example, usually must be completely overhauled or replaced when the engines

reach between 1,800 and 2,000 hours of use. Aircraft with higher-horsepower engines, like, for example, crop dusters, cost between \$200,000.00 and \$600,000.00 to overhaul, and unless the owner has steadfastly saved for this expensive and mandatory maintenance event, the owner may not have the funds to overhaul the engine, making the bank's collateral essentially worthless.

Engine programs are a way for the bank to insure that the owner is able to have the airplane's engine overhauled without having to pay for such an expensive maintenance event at one time. Engine programs for aircraft are similar to warranty programs for automobiles—if a covered maintenance event occurs, it is paid for by the program. There are

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companies that contract with owners to stabilize aircraft maintenance costs so that any maintenance event is completed on-time and by the best people. Such companies take regular payments—monthly or annually—and whenever a maintenance event occurs on an aircraft, the company not only pays for it, but also provides the right people to accomplish the task. Such programs not only insure that expensive events such as engine overhauls are accomplished, but they also

insure that owners do not “skimp” on other maintenance because it is all part of the cost of the program.

Engine programs make it so that aircraft are always maintained, which makes them retain their value. Because they retain their value, the lenders always have collateral that holds its worth for the duration of the loan.

Counsel for lenders should strongly encourage that their clients require aircraft borrowers have their aircraft be enrolled in

a bank-approved engine program as part of the loan agreement. Such a requirement protects the bank by protecting the collateral. The borrower also benefits because enrollment in such a program not only maintains the airworthiness of the borrower’s aircraft, but also the value of their property. ■

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