

## Secured Lending in Turkey: Establishing Mortgage over Real Estate

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### Introduction

1 In Turkish commercial practice, using real estate as a collateral to take out a loan has always been an appealing option to borrowers looking to obtain financing for their businesses or real estate acquisitions, since real estate is traditionally considered as the most reliable security from the perspective of domestic and international banks and other lending institutions. This is to a large extent owing to historical macroeconomic and structural problems such as the high inflationary environment seen in the past few decades, as well as a lack of corporate culture of using alternative financing methods.

Under Turkish law, a mortgage can be created over real property as a security for any kind of debt, be it actual, future or contingent, or whether the amount of debt is definite or indefinite, or if the debt is a monetary debt or a non-monetary obligation such as performance or non-performance of an action. The real property over which the mortgage will be encumbered may be land plots, independent sections (*e.g.* buildings, apartment units), or independent and permanent rights *in rem* (*e.g.* usufruct, ground lease). Moreover, a mortgage can be created over the shares of co-owners of a real property.

The real estate does not necessarily belong to the debtor, as third parties may secure the obligations of a debtor by granting

collateral. In other words, the real estate owner can pledge his property in favour of the lender for the debt of others. However, in case the mortgage is granted by an affiliate company to secure the debt of its parent company, the restrictions provided by the Turkish Commercial Code (“TCC”) regarding upstream guarantees and financial assistance restrictions will be applicable.

The provisions with regards to the mortgage including its scope, types, creation, perfection and priority are mainly regulated under Turkish Civil Law No. 4721 (“TCL”). TCL also contains a notable restriction in respect of creating mortgage on conjugal homes. As per the relevant provision of the TCL, the spouse who owns the conjugal home cannot create a mortgage over such property without express consent of the other spouse.

### Scope of Mortgage

A mortgage over real estate secures the following debt components:

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- i. Principal amount,
- ii. Default interest,
- iii. Legal charges paid for enforcement proceedings,
- iv. Contractual interest that becomes due in the three-year period prior to the date of filing for foreclosure, or
- v. Contractual interest that becomes due in the three-year period prior to the date of declaration of bankruptcy, and
- vi. Interest accrued starting from the date of declaration of bankruptcy or the date of filing for foreclosure, to the date of foreclosure.

In addition, expenses incurred by the lender, including such as insurance premiums, are also secured by the mortgage, to the extent that such expenses are necessary for the protection of the mortgaged real property.

A mortgage established over a real property constitutes an encumbrance over its fixtures and fittings as well. Fittings can be separately registered in the records of the Real Estate Registry, constituting a legal presumption that the registered items qualify as accessories of the mortgaged property and are therefore within

the scope of the mortgage. The burden to prove otherwise lies with the mortgagor or any third party having a claim on those items. Furthermore, in case an additional construction is made on the already-mortgaged property, the subsequently constructed buildings will automatically become subject to the mortgage.

### Mortgage Types

Depending on whether the amount of debt is definite or indefinite, the TCL envisages two types of mortgage: (i) principal mortgage, and (ii) limit mortgage.

A principal mortgage secures the certain amount of loan to be extended to the borrower, and it certifies an absolute and unconditional debt acknowledgement by the borrower. In such case, although the mortgage records show only the principal amount, the lender is entitled to collect the interests and expenses in addition to the principal amount within the scope of mortgage.

A limit mortgage, on the other hand, is usually created to secure unspecified, uncertain and potential debts. The limit indicates the maximum amount that could be collected by the lender out of the proceeds upon foreclosure of the mortgaged property. Therefore, even if the total amount of the proceeds is more than the limit set by the mortgage, the lender can collect the proceeds up to the specified limit, even when the aggregate of the loaned amount, interests and expenses exceed the limit.

### Creation and Perfection

Turkish law requires two formalities in order to have a validly existing and enforceable mortgage. The first step is to execute an official mortgage agreement before the land title registry having jurisdiction over the concerning real estate. At this stage, the contractual terms agreed by the parties that form the mortgage agreement are typed into the standard form constituting the official deed of mortgage. The deed of mortgage is then signed by the parties or their representatives before the land title registrar, whose signature and seal are also affixed to the deed. Upon issuance of the mortgage deed, a copy of the deed is given to the creditor.

In the second step, the mortgage is annotated by the registrar under the liens section of the real property's land title records, as a result of which the mortgage is deemed perfected and become enforceable and legally binding against any third party, including future owners of the property and other creditors.

### Priority among Mortgages

To maximise the economic utility of the property, the property owner has the right to create multiple mortgages on the same property. In such case, the proceeds from the foreclosure of the mortgaged property will be paid out to the creditors in their order of priority. The order of priority is determined in accordance with the principles of so-called "fixed degree" system adopted in the TCL.

According to the fixed degree system, the property owner may divide the value of the property into fractional portions, each of which is represented by a degree. In this framework, the number of degrees and the maximum amount to be secured in a particular degree are determined by the property owner and are required to be registered in the land title registry. The most important feature of the fixed degree system is that if a loan secured by a mortgage that has been assigned to a particular degree is paid off and the degree becomes vacant, subsequent mortgages assigned to lower degrees do not automatically move up to the next higher degree. Thanks to this system, the owner of the property is entitled to create a new mortgage in place of the one that has been de-registered.

Also, the property owner may create multiple mortgages within the same degree, provided that the aggregate amount to be secured by the mortgages does not exceed the monetary threshold specified for the particular degree to which the mortgages will be assigned. Parties may determine in what rank a mortgage will be placed among mortgages within the same degree. Otherwise, all mortgages within a degree will be deemed to have the same rank. In this case, there will be no order of priority between such mortgages, and the proceeds of the foreclosed property will be distributed *pro rata* to creditors of the same rank, should the proceeds of sale not be sufficient to satisfy in full the amounts secured by same-ranked mortgages.

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The property owner may grant a creditor the right to move up to a vacant degree through agreement of the parties. This right can be granted at the time when the mortgage is created and perfected by way of a provision to be added to the mortgage agreement, or through a separate agreement to be concluded on a later date. In the latter case, the agreement will be subject to the same creation and perfection requirements applicable to the mortgage.

### Currency

As a rule, the mortgage amount must be denominated in *Turkish Lira* at the time of registration, regardless of whether the concerning debt is owed in a foreign currency or not. However, TCL provides an important exception in favour of banks and other credit institutions, be they headquartered in Turkey or abroad. According to the exception, an FX denominated mortgage may be created with a view to securing FX credits extended by a domestic or foreign credit institution, provided that the credit and the mortgage are denominated in the same foreign currency. In this regard, an FX denominated mortgage may be created to secure any kind of FX credit, including cash and non-cash loans, such as letter of guarantee, letter of credit, import-export credits, etc.

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On the other hand, the law does not allow the creation of multiple mortgages having different foreign currency denominations within a particular degree. In other words, once an FX denominated mortgage has been assigned to a certain degree, subsequent mortgages to be assigned to the same degree must have the same foreign currency denomination with the previously registered mortgage.

### Release of Mortgage

Debts secured by mortgage are immune from statute of limitations, meaning such a debt can be claimed and enforced as long as the mortgage remains registered. Once the debt is paid off or otherwise extinguished, the release of mortgage is perfected through erasure of mortgage records in the land title register. The de-registration should be requested by the creditor, otherwise the

property owner has the right to file a lawsuit against the creditor for forced de-registration.

### Fees payable to Government Agencies

There are certain fees, including fixed and proportional fees, required to be paid for registering a mortgage. As of 2018, the fees and rates are as follows:

- Stamp duty - %0,948 of the total amount of debt as specified in the loan agreement
- Land title fee - %0,455 of the mortgage amount as stated in the official deed of mortgage
- Service fee – TRY 103,50
- Certified copy of the mortgage deed – TRY 34,50

Apart from above, certain other fees are applicable to modifications to be made on the mortgage records. In practice, fees and charges are usually incurred by the debtor.

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