



# **HOUSING FINANCE IN TURKEY**

**CAPITAL MARKETS BOARD**

**DEPARTMENT OF INSTITUTIONAL INVESTORS**

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## INTRODUCTION

Housing has been one of the major problems in Turkey as in other developing countries. Irregular urbanization depending on mass emigration and economic issues make the solution of the problem more difficult.

In Turkey, the rate of house ownership is about 70% including unauthorized housing. The main problem that exists in Turkey concerning housing is the fact that there is still a massive number of shanty housing structures especially in big cities. According to the Housing Administration Secretariat, 55% of housing stock in Turkey comprise of unauthorized housing and 40% of housing stock needs renewal.

Currently, only 3% of housing finance is derived from the existing housing finance system. The banks generally provide home loans as a part of their consumer credit products and home loans represent a small share of the total consumer credits of the banking sector. Despite the fact that the ratio of mortgage credit to GDP is approximately 10% in similar emerging market countries, this ratio is insignificant in Turkey, which means a potential for a massive growth in the near future.

At present, banks offer fixed rate mortgages without a prepayment fee. Variable rates and prepayment fees are forbidden according to the provisions of Consumer Protection Law. Banks offer home loans with maturities up to 20 years. But the average maturity of the banks' mortgages is 3-4 years. These loans are funded from deposit accounts, whose average maturity is about 2 months. Deposits are currently the only source of funding for banks and there is no alternative source for funding. This creates a maturity mismatch problem for the banks, however, since home loans still constitute a minor part of the balance sheet of the banks, this risk is manageable at the moment. On the other hand, under current conditions, it is not feasible to expect a massive growth in the primary mortgage market.

In addition, since the LTV ratio is up to 75% with an average of 40% and payment to income ratio is up to 50%, and taking into consideration the fact that those loans are all short term, only the most wealthiest 20% of the population can afford to become a borrower in this market.

Considering the necessary preconditions that are required for a successful housing finance system, while the situation in Turkey is satisfactory in some areas, there is also a need to improve some other areas.

Turkey has quite an effective title registry system although it is paper based. There is not a central title registry which can handle the transactions all over the country, and it is needed to apply directly to the title office for each transaction. Nevertheless, it is possible to complete the transactions in less than a week with minimum costs. The title agency also has an ongoing project to build a centralized title registry and information system.

The appraisal profession in Turkey is also one of the areas that should be improved. At the moment, there is no public or self-regulatory body responsible for the regulation and the supervision of the appraisal profession in general. Because of the need to appraise properties



of real estate investment trusts, publicly owned corporations and capital market institutions, Capital Markets Board has regulations regarding the business standards. The individual appraisers and appraisal companies who will serve at this market are also licensed by Capital Markets Board.

In terms of insurance products; hazard and earthquake insurance products are readily available at the market and there are attempts from private institutions to provide title insurance. Still, no mortgage insurance product is available in Turkey.

Foreclosure of the mortgages is regulated in Law of Foreclosure and Bankruptcy and the same rules apply to both commercial and residential mortgages. Foreclosure is done by the foreclosure offices. As the objections of the debtors result in the involvement of the courts, it may take up to 3 years to conclude a foreclosure due to the courts workload.

In Turkey, there is a general consumer protection law regulating consumer lending as well as other subjects. The responsible authority for administration of this law is a directorate at the Ministry of Industry and Commerce. Mortgage lending is regarded as a type of consumer lending and is subject to the same rules with it. Consumer Protection Law was a reaction after 2001 crisis and is quite prohibitive. As provisioned in the law, variable rates and prepayment penalties are forbidden for any type of consumer credits, including home loans.

### **THE DRAFT LAW FOR HOUSING FINANCE**

The Draft Law prepared by Capital Markets Board of Turkey aims to improve the infrastructure in order to promote primary mortgage market and establish a secondary mortgage market to provide alternative funding mechanisms to the primary lenders. By the draft law, Law of Foreclosure and Bankruptcy, Capital Markets Law, Consumer Protection Law, Banking Law, Law on Public Finance and Debt Management and various tax laws are amended.

The purpose of the amendments are:

1. Definition of housing finance and primary lenders,
2. Decreasing the time needed to foreclose mortgages,
3. Regulation of appraisal profession (both individual appraisers and appraisal companies),
4. Regulation of consumer protection issues,
5. Regulation of mortgage capital market instruments,
6. Regulation of secondary market institutions,
7. Authorization of Undersecretariat of Treasury to provide reimbursement guarantees to eligible mortgage capital market instruments,
8. Providing tax incentives to support development of both primary and secondary mortgage market.



These issues are briefly explained below.

### **1. Definition of “Housing Finance” and Primary Lenders**

For making references in other laws, an article defining housing finance has been added to Capital Markets Law. Accordingly, housing finance is defined as the loans secured by mortgages on authorized residential houses and leasing transactions on such houses. The property has to be an authorized building with all necessary certifications and the borrower must pledge his own property. The requirement for an authorized building aims to prevent unauthorized construction and unrecorded (and untaxed) economy.

This definition is referred in Law of Foreclosure and Bankruptcy, Consumer Protection Law, the tax laws and Capital Markets Law itself. Consequently, the changes in these laws will be applied to loans and leases stated in the definition. For example, the receivables arising from those type of loans and leases will be subject to securitization and be accepted as collateral of mortgage capital market instruments, lenders will benefit from the new procedure of foreclosure only if the loan is under the scope of this definition, and the interest paid only for those type of loans and leases will be tax deductible.

It is important to notice that the definition also includes home equity loans and it is not necessary to buy a house. Loans secured by residential property, although it may be used for other purposes, will also be under the scope of the definition. The definition also covers loans for modernization of the houses as long as they are secured by a mortgage. Besides, it is necessary that the house that is subject to mortgage must belong to the borrower.

It is also important to note that, although it is one of the funding sources for housing, the definition does not cover installment sales. At the moment, there are construction companies making installment sales, and more importantly, the Mass Housing Administration applies mainly installment sale method. By the way, in order to benefit from the advantages and incentives provided to the “housing finance” transactions, those companies will have to transform their business methods and will have to work with financial institutions.

On the other hand, as in stated in the last draft law, the primary lenders are banks, participation banks (Islamic banks) that lend or lease directly to the customer for the purposes of housing finance, as well as the leasing companies and consumer finance companies (non-bank institutions) which are found eligible to operate in housing finance by the regulatory authorities.

Currently, the banks are already providing home loans, and participation banks have similar products. However, the leasing companies mostly operate in investment finance, and do not have consumer products, while the finance companies provide car loans and other type of consumer loans but home loans. Up to now, the leasing companies and the consumer finance companies have not been in the housing finance business. The amendments made in the last draft law paves the way for these companies to operate in the housing finance business, nevertheless, in order to prevent the regulatory arbitrage between the banks and non bank institutions, the regulatory authority of non-bank institutions (which is Undersecretariat of Treasury at the moment and assumed to be Banking Regulation and Supervision Agency according to Banking Law accepted by the Parliament) to adapt the secondary legislations to the new business area of these institutions, before letting them operate in housing finance.



## **2. Decreasing the Time Needed to Foreclose Mortgages**

One of the main problems inhibiting the development of housing finance in Turkey is the long foreclosure process which can last for 2-3 years. Foreclosure Law in Turkey has various clauses to protect the rights of the debtor and to ensure that the property is liquidated at a fair price. However, the opportunities provided to debtor are subject to misuse, and the debtors can make objections and challenges in order to slow down the process.

With the amendments in Foreclosure Law, it is mainly aimed to shorten the foreclosure process and prevent the misuse of certain rights by the debtors, in case there is a default in the repayment of the borrower financed via housing finance system. It is proposed to increase the amount of deposit needed to suspend foreclosure and to increase the penalty to prevent misuse of the right to demand the cancellation of the tender.

On the other side, to facilitate the foreclosure of the receivables arising from housing finance that are secured by pledge of a mortgage, the creditor can use distraint as well as the liquidation of the mortgage. With the recommendation of the Ministry of Justice that it is not suitable to follow the both ways at the same time for the same borrower according to the Turkish foreclosure system. The last draft law allows the creditor to choose one of the either ways first, and then go with the other way if the receivables are not collected at all. Consequently, the creditors will be able to distraint and sell other properties of the borrower in first instance.

On the other hand, in Turkey's foreclosure procedures, the foreclosure officers may appoint any expert to appraise the property before the tender. In the draft law, it is suggested that only licensed appraisers be appointed, but, since the number of licensed appraisers is very limited yet, a three year transition period is required for this clause to become effective. However, during this transition time period, the foreclosure officers can anyway appoint licensed appraisers if available. This clause will incite appraisers to take the examinations, be licensed, and help the development of the appraisal profession.

## **3. Regulation of Appraisal Profession**

Capital Markets Board currently have a regulation on real estate appraisal business, and licenses both the individual appraisers and the appraisal companies. The aim of this regulation was to make sure that the properties held by publicly owned companies and real estate investment trusts are valued properly. Apart from the regulation of the Capital Markets Board, there is neither any other regulation nor any other authority to regulate the subject.

As a result, the regulations of Capital Markets Board will also be a reference for the mortgage business and the appraisers licensed according to those regulations will serve in this sector. However, because the scope of the current regulations is inadequate, and in order to meet the requirements of the sector, the international valuation standards are translated into Turkish to be a sub regulation of the Board.

Considering the current limited business area, the number of licensed appraisers is also very limited. Today, there are only about 100 appraisers that have a license. In order to increase this number to satisfy the needs of mortgage business, "Housing Appraisal



Profession” with fewer requirements is introduced. “Housing Appraisers” will be able to value only houses, rather than other more complicated real estates.

Another issue related to appraisal profession covered in the law is the establishment of the Occupational Association of Real Estate Appraisal Specialists of Turkey as a self regulatory body. This association will finally assume the current responsibilities of the Capital Markets Board in terms of regulation and supervision of the appraisal business.

#### **4. Regulation of Consumer Protection Issues**

The amendments made to Consumer Protection Law aim to facilitate the heavy restrictions of the existing regulations and introduce some further consumer protection methodologies.

As mentioned above, Consumer Protection Law prohibits variable rates and prepayment penalties for any type of consumer credits. In the draft law, home loans are regulated separately from other types of consumer credits and the restrictions on variable rates and prepayment penalties are abolished for home loans.

According to the law, the primary lenders will be able to give loans at variable rates based on generally accepted indices. It is also required that the lender must define a cap at the contractual stage and provide the consumer with the maximum amount of the monthly installments he/she will have to pay in case the index rises. So that, the consumer will be able to foresee the worst scenario and measure the risks he/she is undertaking.

The draft law also permits the use of prepayment fees in fixed rate mortgages. The prepayment fee restriction continues for variable rate mortgages, but, lenders will be able to charge prepayment fee up to 2% of the outstanding balance for fixed rate mortgages. Although the 2% prepayment fee is far from being a yield maintenance, it will be a tool for the lenders to measure and manage their risks.

Another important amendment in Consumer Protection Law is the inclusion of the leasing transactions. Although leasing transactions are not used for housing finance at the moment, they are included in the definition of “Housing Finance” and consequently Consumer Protection Law is also amended in a way to cover leasing transactions.

Moreover, the article 4 of Consumer Protection Law regulates the defective goods issue. By adding the article 10/B to Consumer Protection Law, mortgage finance transactions are defined in the article, whereas housing loans not in the scope of housing finance are put in article 10. In order to protect the consumers, the responsibility of housing finance institutions that grant a loan on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, is limited up to the credit amount granted regarding defective good and delivery, and the scope of that responsibility is differentiated for the housing loans within the scope of housing finance and not in the scope. By amending the article 7 of Consumer Protection Law, the responsibility of the housing finance institutions in campaign sales are also made clear.



The reason why the responsibility is limited to the granted credit amount is to foster the supply side of the houses, while the amount of the authorized houses to be used as collateral by the housing finance system is quite low.

Finally, the amendments made to Consumer Protection Law also include new rules on pre-contractual information that must be provided to the customers by lenders.

## **5. Regulation of Mortgage Capital Market Instruments**

The draft law introduces two types of new capital market instruments; covered bonds and mortgage backed securities to be issued by housing finance funds.

Covered bonds are on-balance sheet funding instruments which are widely used in the Continental Europe, and until the mortgage covered bonds are redeemed, the assets in the cover pool cannot be used for any other purposes and can not be attached by other creditors of the issuer. In the covered bonds' selling success throughout the world markets, it is important that there are detailed regulations in the related laws and these regulations comply with each other. Besides the covered bonds, asset covered bonds, secured by other types of assets which are not qualified for mortgage covered bonds, are also defined in the draft law.

The last draft law encompasses the covered bonds more in detail; identifies the matching principles between the cover pool and the bonds issued, and recognizes the penalties for the cover monitor, in case he/she fails to perform his/her responsibilities, who is, in the previous draft laws, authorized by the Board for monitoring and inspecting the cover pool.

The draft law also brings out housing finance funds, formed in SPV structure, for securitization of home loans which is suitable both for pass through and structured issues. Unlike the mutual funds' participation shares, the mortgage backed securities to be issued by the housing finance funds may be issued in terms and with coupons, as well as be traded at the markets, providing more liquidity and marketability, and that will end up with a less cost of funding. The asset finance funds, issuing asset backed securities, are also regulated in the draft law to securitize the receivables arising from the ones other than the housing finance in SPV form.

Capital Markets Board is given the authority by the draft law to make the sub regulations regarding to these instruments more in detail.

## **6. Regulation of Secondary Market Institutions**

“Mortgage Finance Corporations” are defined in Capital Markets Law as secondary market institutions. Two types of business lines are defined in the draft law for MFCs. They can function either as a conduit for the securitization of the receivables arising from housing finance, or provide liquidity facility, as well as they can perform both functions at the same time.

MFCs are defined as capital market institutions and they will be subject to regulation and supervision of Capital Markets Board. Any eligible investor will be able to establish a MFC and enter into secondary mortgage market in Turkey.



As a conduit, MFCs will be able to buy home loans from primary lenders, hold them in portfolio, sell them, issue covered bonds secured by the home loans in their portfolio, and also securitize these loans via housing finance funds.

As a liquidity facility, MFCs will be able to provide loans to primary lenders (housing finance institutions) secured by the home loans of the primary lenders. In other words, lenders will be able to borrow from MFCs and pledge their assets to MFCs. By the draft law, assets pledged to MFCs will be bankruptcy remote, and similar to covered bond investors' bankruptcy privilege, the assets pledged to MFCs will be secure from attachment by third parties in case of the bankruptcy of the primary lenders.

The market demands and feasibility studies will determine, which of these facilities should be performed by those institutions.

## **7. Authorization of Undersecretariat of Treasury to Provide Guarantees**

Regarding the positive social and economic impacts of a well functioning housing finance system, it is assumed that covered bonds, mortgage backed securities and capital market instruments of mortgage finance corporations to be issued in Turkey or abroad be under treasury reimbursement guarantee up to 400 million YTL (About 300 million USD). Unlike the previous draft law empowering Council of Ministers, Undersecretariat of Treasury is authorized with the current draft law to determine the eligible securities for Treasury reimbursement guarantee, the conditions for the issuers and underlying assets related to these instruments, the guarantee fee, guarantee's duration and other issues by a bylaw.

## **8. Providing Some Tax Incentives to Support Development of Both Primary and Secondary Mortgage Market**

The amendments in tax laws aim to decrease the overall operational costs during the transfer of funds from capital markets to homebuyers. Accordingly, the transactions are exempted from stamp duties and any other type of transaction tax.

Secondly, the amendments in the tax laws provide tax deductibility for the households. The households will be able to deduct interest paid to home loans or home leases from their personal income tax base.

The tax incentives will promote the system, which in return will decrease informal housing, increase housing standards and contribute to economic growth. Also, the homebuyers that would prefer informal and unqualified housing will be motivated to buy formal and qualified houses in order to benefit from tax deductibility.



## THE DRAFT LAW AMENDING THE LAWS RELATED TO HOUSING FINANCE SYSTEM

### GENERAL RATIONALE

Housing finance system has a key role in both affordable housing for the families and in the development of the construction, finance and other related sectors in the economy. Solving the problem of housing finance in a modern financial system has positive social effects arising from the increase in the homeownership and also promotes economic development and planned urbanization.

In Turkey, there are many problems related with housing sector such as informal and unqualified housing, unplanned urbanization, unofficial economy and high rents. More than half of the housing stock in Turkey consists of informal houses without a license. As a result of the ongoing in-country migration, informal housing and unplanned urbanization have become a big problem in the large cities. Besides the fact that most of the housing is informal, it is assumed that about 40% of the housing stock needs renewal. Considering the earthquake risk, strengthening of the poor buildings is a very essential need to be handled.

On the other hand, when we look at the finance opportunities of the homebuyers, we see that only 3% of the housing finance is made through finance institutions while the rest of the homebuyers either self-finance their homes or borrow in an unsystematic way from their friends or relatives. In Turkey, the ratio of the banks' housing credits to gross national product is almost zero. This ratio is; between 4% and 12% in Latin America Countries, between 1%-22 % in Middle East Countries, between 2% and 59 % in East and South East Asian Countries, 53% in USA and 43% in the average of EU Countries.

In Turkey, banks' housing credits have terms up to 20 years and the interest rates are far from being affordable. Homebuyers borrowing from a bank have to pay a high real interest rate. The reasons of why the volume of housing credits is that less than the other countries are short terms and high interest rates, which result in very high monthly payments. In Turkey, only upper level income families can afford banks' housing credits. On the other hand, there are investors both in Turkey and abroad who are willing to provide funds to home buyers in more favorable terms than the current housing finance opportunities. In all over the world, every year about 5 trillion USD of funds are transferred to homebuyers over the capital markets. While countries with similar economic development are able to utilize the international funds, the lack of a modern housing finance system that would match investors and homebuyers prevents Turkish homebuyers to benefit from those funds.

Housing finance system that will be set up in Turkey will act as a bridge between the savers and home buyers, and provide home buyers more widespread and favorable borrowing opportunities. Besides this main function, the housing finance system will help solving the problems related to housing sector and contribute to economic growth by stimulating development of financial markets and construction sector.



Together with the launching of the housing finance system, the increase in the demand for housing and the resulting boom in construction sector and the related sectors will play an important role in economic development and lessening of unemployment. While both the construction and other related sectors boom, the system will prevent unofficial transactions in those sectors. Because the financial institutions will be a part of the transaction, the construction companies may also have to record the transactions more properly.

The system will also help solving the informal and unqualified housing problem. Secondary institutions (mortgage finance corporations) that will fund the primary lenders (housing finance institutions) will also establish standards for qualified houses and this will force the developers to produce houses that comply with these standards.

The capital market instruments issued by mortgage finance corporations, housing finance institutions and housing finance funds will be alternate investment opportunities for the investors and help to the widening and deepening of the financial markets. Under current situation, there is no corporate bond issue in Turkey and the term of the government securities are about a year at most. The lack of long term debt instruments limits the markets and it becomes impossible to forecast longer terms and to price them. The maturities of the capital market instruments that will be issued in this system will be parallel to the housing loans and are expected to reach even 20 or 30 years in line with the economic developments as in foreign country examples. When these mortgage capital market instruments begin trading at the markets, market participants will be able to forecast longer terms. This will also invigorate forward and futures markets, and provide the pension funds with the long term investment alternatives they seek.

Establishing an efficient housing finance system requires a coordinated work in different areas. Housing finance system can be stated, mainly, as a mechanism which would transfer the funds to the home buyers, however the efficiency of the housing finance system depends on macroeconomic stability, in the first run, and easily accessible and secure title registration system, easiness in establishing and transferring liens, well functioning appraisal profession, effective foreclosure procedure, proper capital market institutions and instruments available for securitization of mortgages, minimum operational costs from lending to securitization process, and tax incentives provided by the government at least at the start-up period. Even all these preconditions are met; there may be a need for public intervention in order to trigger the system.

As stated above, economic stability is the main precondition for the success of a housing finance system. Nevertheless, macroeconomic stability does not necessarily mean that inflation rate, unemployment or real interest rate levels must be at the same level as in the developed countries. Although these variables have to be in some level, the critical point lies in keeping these variables stable. Indeed, in developing countries with higher inflation and real interest rates, there are examples of establishing and sustaining successful housing finance systems. In this regard, the recent developments in Turkish economy provide the necessary stability required for the success of the housing finance system. Besides, the housing finance system itself will contribute to economic development and stability.

In order to provide the infrastructure needed for establishing an institutional housing finance system, Law of Foreclosure and Bankruptcy Numbered 2004, Capital Markets Law Numbered 2499, Consumer Protection Law Numbered 4077, Public Finance and Debt



Management Law Numbered 4749 and various tax laws are being amended. With these amendments, the infrastructural needs for the system are being satisfied and the secondary institutions named “Mortgage Finance Corporations” that will play a key role in the system are being regulated.

The intention behind the amendments in Law of Foreclosure and Bankruptcy is to quicken the foreclosure period when the borrower defaults. The work load of foreclosure offices and the courts of Turkey and the abuse of some of the rights provided to borrowers inhibit the foreclosure process. While it is possible to complete foreclosure in about 2-3 months in some developed countries, this process can last for up to 2-3 years in Turkey. Since the foreclosure process is slow, lenders tend to be more cautious and hinder the development of the market. Moreover, a quick and effective foreclosure process is also important for the investors who will invest in mortgage capital market instruments. If this process lasts for long, it is not possible to expect that the investors will show interest to the mortgage backed capital market instruments and assume those instruments as collateralized, and also not possible to expect that the system will work.

The lessening of the foreclosure process by the amendments in Law of Foreclosure and Bankruptcy will, as well, make it more difficult for the borrowers who are in default. However, since the current default rates of mortgages are very low, it is assumed that this trend will continue. Consequently, the amendments in Law of Foreclosure and Bankruptcy, while disturbing only a small portion of the borrowers, will contribute much to the system and the rest of the home buyers. Moreover, before going to the foreclosure process, it will be possible for the indebted to renew the terms of the contracts or go into agreement with the creditors. Even after the amendments in Foreclosure Law, the lenders will still look for ways to agree with the indebted and renew the contract rather than go to foreclosure offices and courts. The amendments made in Law of Foreclosure and Bankruptcy is limited to the prosecution of residential mortgages. “Housing finance” and “housing finance institutions” are briefly defined in Capital Markets Law, and by those definitions, the system only covers the banks, the participation banks, as well as the leasing companies and the finance companies which are found eligible by relevant regulatory agency.

With the amendments in Capital Markets Law, secondary market institutions named “mortgage finance corporations” are being regulated briefly and Capital Markets Board is given the authority to make regulations that are more in detail. Mortgage finance corporations and housing finance institutions can issue mortgage capital market instruments. These capital market instruments will provide on or off-balance sheet finance opportunities for the lenders and the mortgage finance corporations.

For this purpose, all the capital market instruments collateralized by the receivables arising from housing finance are called mortgage capital market instruments, which are mortgage covered bonds, mortgage backed securities, capital market instruments other than stocks that are issued by mortgage finance corporations and other capital market instruments collateralized by the receivables arising from housing finance.”

Asset covered bonds and mortgage covered bonds, which are widely used in the Continental Europe, are regulated as the securitization instruments for the housing finance. In recent years, those instruments are being used not only in countries that have a developed housing finance system, but also in developing countries that are eager to establish one. In



covered bond' selling success, it is important that there are detailed regulations in the related laws and these regulations comply with each other. The most important aspect of that instrument is that, unlike the fund structure, the securitized assets stay in the balance sheet of the issuer and the issuer gives a guarantee for the credit risk.

Furthermore, asset finance funds and housing finance funds are regulated to match with the "special purpose vehicles" in the world. While housing finance funds are regulated to be used to securitize the receivables arising from housing finance, asset finance funds are defined as a general securitization tool to be used to securitize the receivables arising from the ones other than the housing finance.

For a well functioning housing finance system and establishing effective, liquid private securities market, Treasury is empowered to provide a guarantee up to 400 million YTL (About 300 million USD) for reimbursements of covered bonds, mortgage backed securities and capital market instruments of mortgage finance corporations to be issued in Turkey or abroad.

The amendments in tax laws aim to decrease the overall operational costs and support the housing finance system. Any tax burden during the transfer of funds from capital markets to home buyers adds to the cost of fund for the home buyers. Apart from preventing the additional transaction taxes, the amendments provide tax deductibility for the interest payments of mortgages. The tax incentives will promote the system, which in return will decrease informal housing, increase housing standards and contribute to economic growth. The home buyers that would prefer informal and unqualified housing will be motivated to buy formal and qualified houses.

It is assumed that the tax incentives directed to the transaction taxes will not produce serious losses in tax revenues. The transactions that are supported with incentives are mainly related to housing finance provided by mortgage finance corporations and the securitization process. Since there is already no such an institution and no such a securitization, not any tax revenue has already been given up. On the other hand, the tax deductibility is going to make some tax losses, however, considering the potential increase in the recorded transactions of the taxpayers, which are already off-record, and the positive impact of this in tax revenues will, in the long run, offset the losses incurred by deductibility.

**Article 1 -** The following paragraph is added to the Article 45 of Law of Foreclosure No. 2004 dated June 9, 1932 as paragraph two just after paragraph one.

"In the foreclosure of the receivables arising from housing finance defined in paragraph 1 of Article 38/A of Capital Markets Law No. 2499, dated July 28, 1981 that are secured by pledge of a mortgage, the creditor can use distraint as well as liquidation of the mortgage."

## **RATIONALE**

In order to create an effective housing finance system which helps to the development of the construction, finance and other related sectors and which helps to meet the housing needs of the individuals, an exception is made to the general rule of Law of Foreclosure in



order to shorten the period of foreclosure of housing finance receivables. The general rule requires that the creditors must first liquidate the mortgage. In case the revenue from the sale of the real estate is not enough to meet the debt, the creditors are given the right to distraint and sell other properties of the borrower.

For housing finance receivables that conform to the definition made, the creditors will be able to distraint and sell other properties of the borrower in first instance. If the revenue from the sale is not enough to meet the debt, the creditor will also be able to liquidate the mortgage.

**Article 2 -** The following paragraph is added to the Article 128 of Law No. 2004 as paragraph three just after paragraph two.

“In the foreclosure of the receivables arising from housing finance defined in paragraph 1 of Article 38/A of Capital Markets Law No. 2499, the foreclosure officer asks to the individual appraisers or the appraisal companies authorized in accordance with the subparagraph (r) of the Article 22 of the same Law to appraise the real estate to be sold.”

## RATIONALE

In order to have an effective housing finance system, the receivables collection period should be provided in a quick and effective way. To determine the rights of the creditors properly and immediately, the qualifications and the working standards of the housing appraisers should be regulated appropriately.

Capital Markets Law regulates the appraisal profession, the qualification of the appraisers, the working standards, the reporting standards, and the valuation principles for the individual appraisers and the appraisal companies, and the penalties in case of noncompliance to those regulations. Besides, the appraisal companies are listed and the appraisers are given examinations to get licensed by Capital Markets Board, whereas their registers are filed. The valuation of the houses by the listed companies or licensed appraisers in the foreclosure process will enhance the quality of the service, as well as minimize the number of the objections to those valuations and increase the trust to the housing finance system by shortening the foreclosure process.

The amendments provide that both listed appraisal companies and independent and self employed licensed appraisers are authorized to make the valuations.

**Article 3 -** The following paragraph has been added to the Article 128/a of Law No. 2004 as paragraph two just after paragraph one.

“In the foreclosure of the receivables arising from housing finance defined in first paragraph of Article 38/A of Capital Markets Law No. 2499, the expert examination required in the first paragraph will be done by the appraisal companies and individual appraisers authorized in accordance with the subparagraph (r) of Article 22 of the same Law, dated July 28, 1981.”



## RATIONALE

According to the Article 128 of Law of Foreclosure, when another expert examination is required due to a complaint made to the foreclosure court, the court must choose an institution or an appraiser who is licensed in accordance with the subparagraph (r) of Article 22 of Capital Markets Law.

The amendments provide that both listed appraisal companies and independent and self employed licensed appraisers are authorized to make the valuations.

The requirement for the examination to be made by the individual appraisers or appraisal companies authorized by Capital Markets Board, will enhance the quality of the service, as well as increase the trust to the housing finance system.

**Article 4 -** The following paragraph has been added to the Article 134 of Law No. 2004 as paragraph three just after paragraph two.

“The rate stated in second paragraph shall be 20% in the foreclosure of the receivables arising from housing finance defined in first paragraph of Article 38/A of Capital Markets Law No. 2499.”

## RATIONALE

The requests for annulment of the legal tender cause extension of the foreclosure process of mortgages due to long lasting court process. Therefore, prevention of the misuse of the right of requesting annulment of a legal tender is aimed by increasing the fine rate applied.

**Article 5 -** The following paragraph has been added to the Article 149/a of Law No. 2004 as paragraph three just after paragraph two.

“The rate stated in second paragraph shall be 40% in the foreclosure of the receivables arising from housing finance defined in first paragraph of Article 38/A of Capital Markets Law No. 2499. If the request for appeal is objected, the indemnity stated in second paragraph will be paid to the creditor; and if the value that is appraised and finalized after the sales request of the creditor does not meet the whole amount of receivables, the rest of the receivables will be covered via collateral; if there is still an excessive amount of collateral, that amount is returned to the person who deposited the collateral.”

## RATIONALE

To expedite the foreclosure of mortgages, the deposit ratio needed to stop the sale by the borrower who appeals the decree of the investigation authority that has refused the request for canceling of the execution has been increased from 15% to 40% of the receivables foreclosed. Hence, it is aimed that the usage of such requests with bad intention could be prevented.

If the request for appeal is objected and the appraised and finalized value is below the amount of receivables, the rest of the amount will be covered by the collateral and if there is



still an excessive amount of collateral left, that amount will be returned to the person who deposited the collateral.

**Article 6 -** The following temporary article has been added to Law of Foreclosure No. 2004.

“Temporary Article 1 - After three years from the date the third paragraph of Article 128 and second paragraph of Article 128/a of this Law become effective, in the foreclosure of the receivables arising from housing finance defined in second paragraph of Article 39/A of Capital Markets Law No. 2499, the appraisal and expert examination may be made by other appraisers and experts rather than the appraisal companies and individual appraisers authorized in accordance with the subparagraph (r) of Article 22 of the same Law, dated July 28, 1981.”

### RATIONALE

With the second and third article of this law, it is required that the appraisals needed in the foreclosure process made by the appraisal companies and individual appraisers authorized in accordance with Capital Markets Law. With this article, a three years transition period is foreseen for this requirement, so that the number of the licensed appraisers and authorized appraisal companies increase and the standards of the profession develop. In the transition period, other experts will be able to serve as well as the appraisal companies and individual appraisers authorized in accordance with Capital Markets Law.

**Article 7 -** The following subparagraph (k) has been added to the article 3 of Capital Markets Law No.2499 dated July 30,1981.

“k) Mortgage Capital Market Instrument: Mortgage Capital Market Instruments are, mortgage covered bonds, mortgage backed securities, capital market instruments other than stocks that are issued by mortgage finance corporations and other capital market instruments collateralized by the receivables arising from housing finance.”

### RATIONALE

In order to make references in other articles of the law, housing finance related securities are given a common name.

**Article 8 -** Article 13/A of Law No:2499 has been amended as follows.

“Mortgage Covered Bonds

Article 13/A – Mortgage covered bonds are debt securities which are general obligations of the issuer and secured by assets in the cover pools. Mortgage covered bonds can be issued by banks and mortgage finance corporations defined in Article 39/A of this law.

Issuers are required to register the collateral assets, apart from their other assets, in a cover pool. The procedures for registration of assets shall be determined by the Board. The



Board may oblige registration of the assets in the cover pool also in a third party registration agency.

The cover pool may consist of housing finance receivables, receivables secured by mortgages on other authorized real estate properties, substitute assets and contracts protecting against the risks associated with these.

For housing finance receivables, no portion of a receivable in excess of 75% of the value of the house securing the receivable and for receivables secured by mortgages on other authorized real estate properties, no portion of the receivable in excess of 50% of the value of the real estate securing the receivable can be included in calculation of cover value. In this respect, the Board may oblige that the appraisal has to be done by appraisers or appraisal companies authorized with this law according to principles defined by the Board. For housing finance receivables or receivables secured by mortgages on other authorized real estate properties to be included in the cover pool, all the payments due up to date of inclusion must have been made by the debtor.

Substitute assets may consist of cash, domestic public debt instruments, securities issued under treasury guarantee, securities issued by governments or central banks of OECD member states and other similar securities found appropriate by the Board.

Each of receivables secured by mortgages on other authorized real estate properties and substitute assets may not be higher than 15% of the cover pool.

Issuers may enter into contracts in order to protect assets in the cover pool from interest rate, currency, credit and similar risks. The contracts made for the purpose of protecting the assets in the cover pool from risks are also part of the cover pool.

At all times until redemption of the mortgage covered bonds,

- a) The nominal value of the assets in the cover pool must equal or exceed the nominal value of the mortgage covered bonds.
- b) The yield from the assets in the cover pool must equal or exceed the yield of the mortgage covered bonds.
- c) The revenues from the assets in the cover pool must meet the payments to the mortgage covered bond owners.
- d) The net present value of the assets in the cover pool must exceed the net present value of the mortgage covered bonds by 2%.

The principles regarding the execution of this article shall be determined by the Board.

Additional assets can be included in the cover pools in case of issuance of additional mortgage covered bonds or in order to comply with the principles written in paragraph 8. With the consent of the cover monitor, the issuers may take out or replace an asset in the cover pool for good cause.

Issuers must appoint a cover monitor approved by the Board. The qualifications of the cover monitor shall be defined by the Board. The Board may request replacement of the cover monitor or may replace the cover monitor ex officio.

The cover monitor must inspect,



- a) The existence and quality of the assets in the cover pool.
- b) The establishment of the cover pool and registration of the assets in the pool.
- c) Registration of the assets in the cover pool in a third party registration agency if the Board obliges such registration.
- d) Conformity with regard to principles laid down in paragraph 8. with respect to this article and report to the issuer and the Board.

The cover monitor is entitled to demand any kind of information from the issuer, registration agency and the title offices, to inspect relevant records and to get information from the employees. The issuer, registration agency and the title offices are required to provide the information and documents requested by the cover monitor. If the cover monitor is blocked to reach the information and documents he requested, he is obliged to inform the Board immediately.

Until the mortgage covered bonds are redeemed, the assets in the cover pool cannot be used for any other purposes other than securing the mortgage covered bonds, cannot be pledged, cannot be used as collateral, cannot be distrained including the collection of the public receivables, can not be subject to precautionary measure decisions of courts and cannot be included into the bankruptcy process.

The contracts made for the purpose of protecting the assets in the cover pool from risks must have a clause that prohibits the counterparty from terminating the contract in the event of bankruptcy of the issuer.

In case an issuer fails to meet its obligations, the total value of the obligations of the issuer exceeds total value of its assets, the management of the issuer is taken over by public authorities, the operation license of the issuer is cancelled, or the issuer goes bankrupt, the income of the assets in the cover pool is used primarily to make payments to the mortgage covered bond holders and counterparties of the contracts made for the purpose of protecting the assets in the cover pool from risks. In this case the Board is authorized to decide for,

- a) Liquidation of the assets in the cover pool, early redemption of the mortgage covered bonds, and appointment of a manager to manage relevant transactions; or gradual liquidation of the assets in the cover pool, and appointment of Investor Protection Fund to manage liquidation.
- b) Transfer of all assets in the cover pool and liabilities related to the mortgage covered bonds to another qualified issuer.
- c) Appointment of a manager, who will manage the assets in the cover pool and make payments to the mortgage covered bond holders with the income of the assets in the cover pool.

In case the issuer defaults and the assets in the cover pool are not enough to pay the receivables of the mortgage covered bond holders, mortgage covered bond holders have the same rights with the other creditors over the other assets of the issuer.

The limits set in Article 13 are not applicable for mortgage covered bonds. Issue limits, issuing requirements, the contracts made for the purpose of protecting the assets in the



cover pool from risks and the procedure for registration of these securities with the Board, shall be determined by the Board. Apart from the issues that are mentioned in this article to be determined by the Board, the Board is authorized to make regulations in any issue related to the mortgage covered bonds if deemed necessary.

### **RATIONALE**

The amendment of the Article 13/A of Capital Markets Law defines the mortgage cover bonds. Cover bonds are general obligations of the issuers secured by assets owned by the issuer which have to be qualified according to the article. In case an issuer fails to make principle or interest payments of covered bonds, the income of the cover assets will be used to make payments to the bondholders and the cover assets will not be attached by other creditors of the issuer including collection of public receivables.

In order to separate cover assets from other assets of the issuer, these assets will be registered in cover pools. Principles regarding establishment of cover pools and registration of assets in the cover pools will be regulated by the Board. In order to perfect the distinction between cover assets and others, the Board has the authority to oblige registration of the assets in a third party registration agency as well as the issuer.

There are three groups of cover assets. First group encompasses housing finance receivables defined in the Article 38/A of Capital Markets Law amended by Article 12 of this law. Accordingly housing finance receivables are the receivables from the loans that are secured by mortgages on authorized residential houses and rent payments from leasing of such houses.

The second group consists of receivables secured by mortgages on other authorized real estate properties. For housing finance receivables, no portion of a receivable in excess of 75% of the value of the house securing the receivable and for receivables secured by mortgages on other authorized real estate properties, no portion of the receivable in excess of 50% of the value of the real estate securing the receivable can be included in calculation of cover value. Besides the Board may oblige that the appraisal has to be done by appraisers or appraisal institutions authorized under this law according to principles defined by the Board.

The third group consists of substitute assets which are cash, domestic public debt instruments, securities issued under treasury guarantee, securities issued by governments or central banks of OECD member states and other similar securities found appropriate by the Board.

Each of receivables secured by mortgages on other authorized real estate properties and substitute assets may not be higher than 15% of the cover pool. Accordingly, at least 70% of the cover pool will consist of housing finance receivables.

As stated in the article, the issuers can make contracts in order to protect assets in the cover pools against risks and such contracts are also a part of the cover pool.

In case an issuer fails to meet its obligations related to mortgage covered bonds, the assets in the cover pool will be used to make payments to the bondholders. So, it is important that any time there are enough assets in the cover pool to meet the obligations related to the



mortgage covered bonds. The balance requirements are defined in the law with 2% over-collateralization. The inspection of the balance requirements and the quality of the assets in the cover pools will be made by cover monitors appointed by the issuers and approved by the Board. In addition, the cover monitors are provided necessary authorities to perform their functions.

The article prohibits the use of assets in the cover pools for purposes other than securing the mortgage covered bonds and it also prohibits the attachment of these assets by third parties including collection of the public receivables. On the other hand, in case an issuer fails to meet its obligations, the total value of the obligations of the issuer exceeds total value of its assets, the management of the issuer is taken over by public authorities, the operation license of the issuer is cancelled, or the issuer goes bankrupt; the income of the assets in the cover pool will be used primarily to make payments to the mortgage covered bond holders and counterparties of the contracts made for the purpose of protecting the assets in the cover pool from risks.

While the article lays down general issues regarding mortgage covered bonds, the Board is given the authority to make necessary regulations.

**Article 9 -** The Article 13/B below has been added to be placed just after Article 13/A of Law No. 2499.

#### “Asset Covered Bonds

Article 13/B – Asset covered bonds are debt securities which are general obligations of the issuer and secured by assets in the cover pools. Eligible issuers, issue limits, issue requirements, types of assets that can be used as cover assets, limitations regarding types of cover assets, registration and valuation of cover assets and reporting standards regarding asset covered bonds shall be determined by the Board.

The Board may oblige the issuers to appoint and cover monitor. The cover monitor has to inspect the existence and quality of the cover assets, establishment of the cover pools, and registration of the assets in the cover pools, and has to report to the issuer and the Board.

The cover monitor is entitled to demand any kind of information from the issuer, registration agency and the title offices, to inspect relevant records and to get information from the employees. The issuer, registration agency and the title offices are required to provide the information and documents requested by the cover monitor. If the cover monitor is blocked to reach the information and documents he requested, he is obliged to inform the Board immediately.

Until the asset covered bonds are redeemed, the assets in the cover pool cannot be used for any other purposes other than securing the asset covered bonds, cannot be pledged, cannot be used as collateral, cannot be distrained including the collection of the public receivables, can not be subject to precautionary measure decisions of courts and cannot be included into the bankruptcy process.

The Board may oblige registration of the assets in the cover pool also in a third party registration agency.



## RATIONALE

The eligible cover assets are limited for the mortgage covered bonds defined in Article 13/A of Capital Markets Law by the amendment made by Article 8 of this law. To enable financial institutions to issue bonds secured by other types of assets which are not qualified for mortgage covered bonds, asset covered bonds are regulated under this article. Since asset covered bonds are less standard, the article sets minimum rules for them and gives the Board the authority to regulate asset covered bonds in details.

**Article 10 -** The subparagraph (r) of first paragraph of Article 22 of Capital Markets Law No. 2499 has been amended as follows.

“r) To set the qualifications for the appraisal companies to appraise the real estates that would operate in capital markets and to publish the list of the appraisal companies which have met these qualifications,

To determine the specifications for the appraisal companies and the appraisers which will appraise the real estate during the lending process of the housing finance institutions and the process of foreclosure of the receivables arising from housing finance defined in first paragraph of Article 38/A of the Law, and to publish the list of the appraisal companies and the appraisers which have met these qualifications.”

## RATIONALE

It is necessary to establish the housing finance system on a healthy ground to prevent home buyers, housing finance institutions (primary lenders) and investors from facing losses. Therefore, during the lending process to the consumers by housing finance institutions and during the foreclosure of the receivables arising from housing finance as defined in paragraph 1 of Article 38/A of Capital Markets Law, the authority to determine the specifications for the appraisal companies and the appraisers and to publish the list of those has been given to the Capital Markets Board.

**Article 11 -** The following third paragraph has been added to subparagraph (b) of Article 28 of the Law No. 2499 to be placed just after paragraph two, and the other paragraphs are concatenated.

“Following the sale of mortgage capital market instruments, the registration fee corresponding to maximum 0,1% of the sale amount shall be deposited to the Board’s bank account. The principles and methods regarding the rate, calculation and payment of registration fee shall be determined by the Board.

## RATIONALE

Although issuers are obliged to pay to the Board’s bank account a fee corresponding to three per thousand (This ratio may be reduced by Council of Ministers if deemed appropriate and, the registration fee is applied currently as 0,2%.) of the issuance value of the capital market instruments registered with the Board according to Capital Markets Law, with this law, considering the social impact of housing ownership, the maximum rate is stated as 0,1%



of the sale amount, instead of 0,3%, of the issuance value of the capital market instruments. Within this maximum rate, it is considered that the principles and methods regarding the rate, calculation and payment of registration fee shall be determined by the Board.

**Article 12 -** The Article 38/A given below has been added to be placed just after Article 38 of the Law No. 2499.

“Housing Finance”

Article 38/A - “Housing finance” comprises of the loans that are secured by mortgages on authorized residential houses and leasing transactions on such houses. For the loans, the house that is subject to mortgage must belong to the borrower.

“Housing finance institutions” are banks and participation banks (Islamic banks) that lend or lease directly to the customer for the purposes of housing finance, and leasing companies and consumer finance companies which are found eligible to operate in housing finance by the regulatory authorities.

The Board is authorized to require the valuation of houses should have been performed by the authorized real estate appraisal companies and appraisers, in the lending or leasing stage for the loans and leasing receivables, which are the basis and the collateral of the mortgage capital market instruments to be issued.

## RATIONALE

With this article, housing finance is defined as reference to Law of Foreclosure and Bankruptcy, Consumer Protection Law and various tax laws. Housing finance is defined as the loans secured by mortgages on only authorized residential houses and leasing transactions on such houses. In the Article, housing finance institutions that lend or lease directly to the customer for the purposes of housing finance are specified as banks, participation banks, and leasing companies and consumer finance companies which are found eligible to operate in housing finance by the regulatory authorities.

Furthermore, by taking into consideration the vital importance of real estate appraisal business functioning properly and the need for competent real estate appraisers and appraisal companies with a high quality standard, it is provisioned that it can be required by the Board that the valuation of houses be performed by the authorized appraisers and real estate appraisal companies in the lending or leasing stage of the loans and leasing receivables.

**Article 13 -** The Article 38/B given below has been added to be placed just after Article 38/A of the Law No. 2499.

“Housing finance fund

Article 38/B - Housing finance fund is a property established by means of the funds collected in return for mortgage backed securities issued on behalf of the mortgage backed securities` holders, in accordance with the principle of fiduciary ownership.

The founders, the fund establishment limit, the assets to be taken into the fund portfolio including contracts done for the purpose of hedging these assets against the decrease



in value or increasing the credit valuation, the portfolio restrictions, and the conditions to issue and register the mortgage backed securities with the Board are determined by the Board. The founders may provide guaranty for the mortgage backed securities issued.

Such a fund does not have any legal identity; however, its assets are separate from those of its founder. Until mortgage backed securities issued by the fund are redeemed, the assets of the fund can not be used for purposes other than the ones stated in this Law, may not be pledged or cannot be used as collateral, cannot be distrained and can not even be subject to precautionary measure decisions of courts, cannot be included into the bankruptcy process, even for the purpose of the collection of the government receivables.

The fund manager shall represent, manage or supervise the management of the fund in such a manner as to protect the rights of the holders of the mortgage backed securities. The founder is responsible from the protection and the custody of the fund assets. The conditions to be the fund manager and the principles and methods related to the management of the fund assets are determined by the Board.

The provisions of the Code of Obligations regarding procuration shall apply to the relationship between the founder, the fund manager and the mortgage backed securities' holders, so long as this Law and related regulations do not provide otherwise.

The Board is granted to require that the bookkeeping and the custody of the fund assets be held by another registration entity.

In case of having the credits backed by collateral or the receivables arising from the financial leases for a real estate in the fund portfolio, the Board may require that the collateral or the ownership (in case of financial leases) be registered to the title register under the name of the founder or fund manager, on behalf of the fund. It shall be declared that the registration is made on behalf of the fund.

The statute (trust indenture) of the fund is a contract between investors, the founder, and the fund manager, if there is, which consists of the conditions involving the management of the fund portfolio in accordance with the provisions of proxy agreement and custody of the fund portfolio in accordance with the principle of fiduciary ownership.

Founders are obliged to apply to the Board with the status of the fund and necessary documents to be determined by the Board, in order to establish the fund and to register the mortgage backed securities to be issued.

Different classes of mortgage backed securities for different classes of fund portfolio may be issued. The principles regarding the classes of mortgage backed securities and the rights arising from a certain class of mortgage backed securities must be specified in the statute of the fund.

The Board determines the principles and methods regarding the valuation standards for the fund assets, the principles of the operation and the management of the fund, the merger, the close up and the liquidation of the fund, the scope of the portfolio management and the custody contracts, the conversion of the fund, and the registration and announcement of the fund.



In case of a failure of the issuer or the fund to repay, the Board may require that the fund be managed by the Investor Protection Fund, or another representative, designated by the Board. In that case, the founder keeps the liability, to repay, in full and in time, the portion of the mortgage backed securities issued which can not be paid by the fund portfolio.

The board is granted to take the necessary actions in case of a bankruptcy or liquidation of the founder or the fund manager.

### **RATIONALE**

With this article, housing finance funds to be used to securitize the receivables arising from housing finance are defined. Thus, the housing finance funds will provide securitization of the receivables arising from housing finance through mortgage backed securities. Easily buying and selling of these securities which give participation rights at the fund portfolio may provide liquidity and diminish the cost of funds provided for mortgage finance at the end. The housing finance fund is a sub-type of asset finance funds, added to Capital Markets Law with this Law, as Article 38/A.

This structure, which is named “trust” structure in foreign markets, is currently used in our mutual funds and for this respect, housing finance funds are designed like mutual funds. However, in opposite to the mutual funds that issue participation certificates, the housing finance funds issue mortgage backed securities. But, as different from mutual funds and similar to bonds and other fixed rate instruments, mortgage funds will be subject to the issuance of mortgage backed securities in term and with coupons and be traded at the market. Structured finance applications are allowed by the stipulation of different classes of participation certificates issued for certain parts of receivables of mortgage funds. By establishing different sub-pools in the same receivables pool, different types of mortgage backed securities may be issued. The founders may also provide guaranty for the mortgage backed securities issued.

The other aim of establishing housing finance funds is to separate related assets from the founder’s property and, by this way, to protect the assets in case of bankruptcy of the founder. In such a case, because related assets are not displayed in the founder’s balance sheet, third parties may not claim on these assets, and these assets can only be used for the claims of mortgage backed securities’ holders. The Board may require that the assets be registered under custody of a separate registration entity, so that the problems that will arise from taking out the assets off the balance sheet will be mitigated. The assets of the fund can not be used for purposes other than the ones stated in this Law, may not be pledged or cannot be used as collateral, cannot be distrained and can not even be subject to precautionary measure decisions of courts, cannot be included into the bankruptcy process, even for the purpose of the collection of the government receivables.

The Board is granted to require that the bookkeeping and the custody of the fund assets be held by another registration entity, so that the potential problems that would be faced to take the assets out of the founders’ balance sheet would be minimized.

On the other side, it is provisioned that; the fund manager should be responsible to represent and manage the fund in such a manner as to protect the rights of the holders of the



mortgage backed securities, be responsible from the protection and the custody of the fund assets, and the conditions to be the fund manager and the principles and methods related to the management of the fund assets shall be determined by the Board.

In case of having the credits backed by collateral or the receivables arising from the financial leasing contracts for a real estate, the registration of the collateral or the ownership to the title register is necessary for the mortgage backed securities' holders. In case of a transfer of those receivables from the founder to the fund portfolio, the collateral of those receivables should also be transferred to the fund. Otherwise, the system would be exposed to abuses. For that reason, the Board may require that the collateral or ownership be registered to the title register under the name of the founder or fund manager, on behalf of the fund. It should be declared that the registration is made on behalf of the fund.

The board may determine the principles and methods in relation to the establishment and operation of the fund, and is granted to take necessary actions in case of a bankruptcy and liquidation.

**Article 14 -** The Article 38/C given below has been added to be placed just after Article 38/B of the Law No. 2499.

#### Asset finance fund

Article 38/C - Asset finance fund is a property established by means of the funds collected in return for the asset backed securities issued on behalf of the asset backed securities' holders, in accordance with the principle of fiduciary ownership. The assets to be held by the fund portfolio are determined by the Board.

The provisions of the article 38/B other than the first one are also applied to the asset finance funds.

### RATIONALE

With this article, asset finance funds are defined as a general securitization tool to be used to securitize the receivables arising from the ones other than the housing finance. The assets to be held in the asset finance fund portfolio can be the ones other than the housing finance definition and defined by the Board. With this article, the assets will be taken out of the founders' balance sheet. It is considered that the asset finance funds will provide a new and wide opportunity to the capital markets in the securitization field.

**Article 15 -** Article 39 of Capital Markets Law No. 2499 has been amended as follows:

“Other capital market institutions are institutions whose establishment and principles of operation are determined by the Board, including institutions which are engaged in clearing and settlement functions, rating of the capital market instruments, institutions which are engaged in the supervision of issuers and capital market institutions, companies which carry out capital market activities such as investment consulting and portfolio management, asset management companies, mortgage finance corporations, venture capital mutual funds, venture capital investment companies, futures transactions intermediary institutions, real estate appraisal companies to operate in capital markets and portfolio custody companies.”



## RATIONALE

The expression of “institution of mortgage covered bonds” stated in article 39 of the Law No. 2499 is replaced with the expression of “mortgage finance corporations” in order to let those capital market institutions perform their activities in a wider scope by not limiting their operations to the issuance of mortgage covered bonds, moreover real estate appraisal companies are also counted as a capital market institution.

**Article 16 -** Article 39/A given below has been added to be placed just after Article 39 of Capital Market Law No. 2499.

### “Mortgage Finance Corporations

Article 39/A – Mortgage finance corporations are joint stock corporations that are classified as capital market institutions and established with the purpose of taking over and transferring receivables arising from housing finance, managing portfolios composed of taken-over receivables arising from housing finance and as a financial resource by means of taking over receivables.

The areas of operation of the mortgage finance corporations are as follows:

- a) The take-over, transfer and management of receivables arising from housing finance,
- b) Providing financial resource by means of taking over receivables arising from housing finance,
- c) Issuing any type of capital market securities,
- d) Running risk management activities for their operations,
- e) Other areas of operation approved by the Board.

Mortgage finance corporations must apply to the Board for establishment and operating license.

With regard to providing finance by means of taking over receivables arising from housing finance, those receivables can not be used for any other financial purpose, may not be pledged or provided as guarantee and may not be seized by third persons. The Board may authorize a separate registry institution to keep records of the receivables.

The principles related to establishment, licensing for the operation areas defined in paragraph two, and obligations of mortgage finance corporations shall be determined by the Board.

## RATIONALE

With this article the objectives and areas of operation of the mortgage finance corporations, which will play a central role in the housing finance system, are regulated. It has been provisioned that the principles of operation and terminations of these institutions be regulated in detail by Capital Markets Board.

**Article 17 -** Article 40/D below is added to Capital Markets Law No: 2499.

“The Occupational Association of Real Estate Appraisal Specialists of Turkey



Article 40/D- Those who possess a real estate appraisal specialist license, are obliged to apply for a membership to Occupational Association of Real Estate Appraisal Specialists of Turkey which is a legal entity attributed as a public institution. For this purpose, the concerned license holder is obliged to make the requisite application within three months after it has been announced by a legal notice that he/she is granted the right to hold a license. The licenses of those who do not conform to this obligation are cancelled by The Board.

Occupational Association of Real Estate Appraisal Specialists of Turkey is assigned and authorized; to make researches in order to foster the development of real estate markets and real estate appraisal practices, to train and license, to establish the standards of the profession for the sake of solidarity of its members and for their due diligence required to act in the occupation, to take any preemptive steps as to avoid any unjust competition, to make, carry out and inspect regulations on the issues granted to itself by the legislations or on the issues set by the Board, to cooperate with the relevant institutions on behalf of the member institutions on related issues in order to execute disciplinary penalties as stated in the statute of the Association, and to observe any professional progresses, administrative and legal regulations to enlighten the members.

The association prepares and publishes regional and national statistics regarding real estate valuations. The information concerning real estate valuations within the context of housing finance must be transmitted to the Association according to the procedures that shall be determined by the Association.

The Association is obliged to conform to the Law, Board's by-laws, communiqués and conclusions and any related regulations in all its rulings and regulations that will come into effect.

Members are obliged to obey the statute of the Association and the decisions taken by the Association.

The Association is subject to the provisions of Article 40/C of the Law.”

## **RATIONALE**

Real estate appraisal specialists have the opportunity to make appraisals in person in the housing finance system. Considering the potential of this occupation to develop in scope, it has been aimed to establish an occupational association in order to foster the development of real estate appraisal practices, setting out the standards for appraisals and to carry out all or part of licensing activities.

**Article 18 -** The following paragraph to be placed just after the first paragraph has been added to Article 46/A of the Law No. 2499.

“In case of a decision about the gradual liquidation of the mortgage finance corporations is given according to paragraph (h) of Article 46, the Board may decide that the gradual liquidation of mortgage finance corporations shall be carried out by the Fund, or may decide that, when an issuer fails to meet its obligations, the total value of the obligations of the issuer exceeds total value of its assets, the management of the issuer is taken over by public authorities, the operation license of the issuer is cancelled, or the issuer goes bankrupt,



the gradual liquidation or management of the cover pools of mortgage covered bonds or asset covered bonds, or, when the founder or asset finance fund or housing finance fund is in difficulty of paying back, the management or gradual liquidation of assets of the fund assets shall be carried out by the Fund. The Board determines the kind of Fund's income which will be used for the expenditures during the liquidation or management in the scope of this paragraph.

## RATIONALE

In cases of the existence of situations mentioned in the article, in order to make it possible that the management or gradual liquidation of assets of mortgage cover bond, asset cover bond, asset finance fund and housing finance fund, and gradual liquidation of mortgage finance corporations shall be carried out by Investors' Protection Fund, a new paragraph is added to Article 46/A of Capital Market Law.

**Article 19 -** The following Article 46/C has been added to Law No. 2499.

### “Gradual Liquidation of Mortgage Finance Corporations

Article 46/C – A decision may be made by the Board for the gradual liquidation of mortgage finance corporations, the authorities of which have been removed in accordance with subparagraph (h) of the first paragraph of Article 46 of this Law. The liquidation operations of these institutions shall be carried out by the Investors' Protection Fund.

The objective of gradual liquidation is to liquidate the assets of mortgage finance corporations by setting aside the amount obtained by transforming the assets to in kind or cash according to their attributes. In the decision and operations of gradual liquidation, the provisions related to liquidation in the Turkish Commercial Code, the Execution and Bankruptcy Law and the other legislation shall not be applied. The principles and method of application for gradual liquidation of mortgage finance corporations shall be set forth in a regulation promulgated by the Board.

After a decision is made for gradual liquidation, the duties and authorities of the legal organs of the mortgage finance corporation shall be carried out by the Fund until the liquidation is concluded. However, the provisions of subparagraph (h) of the first paragraph of Article 46 is reserved.

Payments by the mortgage finance corporation for which a gradual liquidation decision is made shall be stopped and as of the date of this decision all its assets except the assets of housing finance funds, the assets of asset finance funds and the collateral pools of asset covered bonds and mortgage covered bonds may be used only by the Fund. The Fund shall determine the assets and liabilities of the mortgage finance corporation. The cash debts in the scope of the obligations that should be liquidated shall be calculated over the total principal capital and accrued interests at the date of the decision of gradual liquidation. The rights and obligations arising from securities with maturity dates after the date of the decision for the gradual liquidation of the mortgage finance corporation shall be determined as of their maturity dates. Legal default interest shall be applied at the rate envisioned in the third paragraph of Article 2 of Law No. 3095 Related to Legal Interest and Default Interest as of the maturity date of term debts and as of the date of the gradual liquidation decision for the



other debts. In accordance with the legislation, guarantees given by the mortgage finance corporation are also taken into consideration in the assets account.

The Fund shall determine the real holders of rights and the amounts of their receivables which are in the scope of liquidation of the mortgage finance corporation based on the records kept by the Board, the records of the mortgage finance corporation, the records of other official and private institutions related to these organizations and other reliable information and documents. In case there is the existence of the conditions described in Articles 278, 279 and 280 of Execution and Bankruptcy Law, an annulment lawsuit may be opened by the Fund.

For the mortgage finance corporations which are not subject to gradual liquidation but for which a decision of bankruptcy has been made, payment shall be made from the Fund, with the approval of the Fund management, to the creditors for securities arising from the securities transactions on the list by considering the amounts owed which appear on this list.

The assets of the mortgage finance corporation shall be used for the payment of the receivables of the holders of the rights in the scope of the objective of the liquidation. However, if the liquidation balance is not sufficient to meet all of these receivables, then payments shall be made by pro rata distribution. After all of these receivables are met, then from the remaining portion, first of all the public receivables and from the remaining amount, the receivables arising from the liquidation expenses made by the Fund shall be paid. The balance is distributed to the other creditors. If the assets of the mortgage finance corporation are not sufficient to meet the receivables of the holders of rights in the scope of the objective of liquidation, the payments made from the Fund and the liquidation expenses, then the Fund, with the concurrence of the Board, may request the bankruptcy of the mortgage finance corporation.”

## RATIONALE

With Article 46/C that has been added to Capital Markets Law, gradual liquidation of mortgage finance corporations is regulated. In gradual liquidation, which is a special method, the provisions related to liquidation in Turkish Commercial Code and Execution and Bankruptcy Law shall not be applied. The reason why such a special liquidation method is needed is that, the liquidation method set forth in general provisions is not in compliance with with the structure of capital markets and that it results in the lessening of trust in the market. It has been compulsory that a special liquidation method is determined because mortgage finance corporations are defined as capital market institutions and the liquidation of these institutions in a short period of time is important for the demand from investors towards capital market instruments issued by these institutions.

According to paragraph (h) of Article 46 of the Law, the authority to make the decision for gradual liquidation of mortgage finance corporations belongs to the Capital Markets Board. However, gradual liquidation of mortgage finance corporations shall be carried out by the Investors' Protection Fund.

**Article 20 -** The fifth subparagraph of paragraph (A) and paragraph (C) of the first paragraph of Article 47 of the Law No.2499 have been amended as follows.



“5- The related real persons and authorized persons of legal entities who sell or use as a or in whatever manner for the benefit of themselves or someone else, cash or other assets of any kind which are consigned or delivered physically or by registration to capital market institutions, cover monitors in the context of Articles 13/A and 13/B of this Law and to find managers in the context of Articles 38/B and 38/C of this Law, in the course of capital market activities or as a trustee or to manage them or who use them as a guarantee or for whatever use, or who conceal or deny or transform and alter records including those kept in a computer environment for such purpose or hide such acts,”

“C) Those who act in violation of the second paragraph of Article 6 of this Law or Articles 7, 9, 10, 10/A, 11 or 12; the fifth paragraph of Article 13; the second, third, fourth, fifth, sixth, eighth, ninth, tenth, eleventh, twelfth and thirteenth paragraphs of Article 13/A, the second, third and fourth paragraphs of Article 13/B; the third paragraph of Article 14; the first, second, third, fourth and fifth paragraphs of Article 15; Article 16 or 16/A; subparagraph (a) of Article 25; subparagraph (b) of Article 28; Article 34; Articles 38, 38/A, the third, fourth and twelfth paragraphs of Article 38/B, the third, fourth and twelfth paragraphs of Article 38/B in the context of Article 38/C, Article 39/A, Articles 40/B, 40/D, Article 45, the second and fifth paragraphs of Article 46; Article 46/A, Article 46/B or Article 46/C,

shall be punished with a heavy pecuniary fine of from 25 billion TL up to 75 billion TL.”

### RATIONALE

With this article,

- It is aimed to prevent the misuse of the assets in the cover pool of mortgage covered bonds and asset covered bonds, and assets in the portfolios of housing finance funds and asset finance funds, and for this purpose, the misuse of those assets is considered as a crime of “abuse of confidence” in the context of the Article 47/A-5 of Capital Markets Law.

-The scope of the Article 47/C of Capital Markets Law is enlarged to regulate the penal liability of acting in violation to the articles added to Capital Markets Law with this law.

**Article 21** - The paragraph given below has been added to be placed just after the fourth paragraph of Article 47/A of the Law No. 2499.

“For the members who do not conform to the responsibilities in the fifth paragraph of Article 40/D of this Law, a pecuniary punishment of from 1 billion TL up to 5 billion TL shall be imposed by the Board of Directors of Occupational Association of Real Estate Appraisal Specialists of Turkey. The Association notifies the relevant party of the punishments given.”

### RATIONALE

With the fourth paragraph of the Article 47/A of Capital Markets Law, entitled as “Administrative Pecuniary Punishments”, it is determined that the Board of Directors of the Association of the Capital Market Intermediary Institutions of Turkey shall impose a pecuniary punishment of from 1 billion TL up to 5 billion TL, for the members who do not



conform to the responsibilities in the fifth paragraph of Article 40/C of the Law. With the paragraph added to the Article 47/A of Capital Markets Law by this Law, just like the provision of fourth paragraph, it is determined that the Board of Directors of Occupational Association of Real Estate Appraisal Specialists of Turkey shall impose a pecuniary punishment of from 1 billion TL up to 5 billion TL, for the members who do not conform to the responsibilities stated in the Law.

**Article 22 -** Temporary Article 10 has been added to the Law No:2499.

“Temporary Article 10 – The Statutes of Occupational Association of Real Estate Appraisal Specialists of Turkey shall be put into force within three years from the date that this Law goes into effect. Those who have license of real estate appraisal, are obliged to the Board for membership in Occupational Association of Real Estate Appraisal Specialists of Turkey within this period.

These membership applications shall be concluded by the Board. The Board shall call the Association members to their first general assembly meeting within one month after the Statutes go into force. The costs related to the first meeting will be assumed by the Board until the organs of the Association is formed.”

### **RATIONALE**

With Article 40/D added to Capital Markets Law, it is aimed to establish the Occupational Association of Real Estate Appraisal Specialists of Turkey, while, with this article, it is aimed to determine the principles of establishing the statute of the Association. Taking into consideration that there is going to be a transition period following the entry into force of this Law, a third year period has been foreseen for the preparation of the statute.

**Article 23 -** The subparagraph (r) given below has been added to the Article 3 of Law on Protection of Consumers no. 4077 dated 23.2.1995

“r) Housing Finance Institution: Institutions that provide housing finance as defined in the second paragraph of Article 38/A of Capital Markets Law No. 2499 dated 28.07.1981”

### **RATIONALE**

“Housing Finance Institution” is added under the definitions in Consumer Protection Law, for the purpose of protecting the consumers who benefits from housing finance. By adding this definition, it is determined that, the phrase “Housing Finance Institution” in Consumer Protection Law No.4077 (as also stated in Capital Markets Law No.2499 Article 38/A second paragraph), encloses banks, participation banks, and leasing companies and consumer finance companies which are found eligible to operate in housing finance by the regulatory authorities, that lend or lease directly to the customers for the purposes of housing finance. In other words, institutions defined in the second paragraph of Article 38/A of Capital Markets Law No.2499, will also conform to the provisions of Consumer Protection Law No.4077.

**Article 24 -** The third paragraph of the Article 4 of the Law No.4077 has been amended as follows.



“The manufacturer-producer, seller, dealer, agent, importer, creditor who grants credit in accordance with subsection five of Article 10 shall be jointly liable for the defective good and for the consumer's right of selection provided for in this Article. The housing finance institution that grants credit in accordance with the sixth paragraph of Article 10, shall be severally liable up to the credit amount, for the defective good and for the consumer's right of selection provided for in this Article, with the manufacturer-producer, seller, dealer, agent, importer. In the case of mortgage finance transactions in accordance with the eight paragraph of Article 10/B, the housing finance institution who grants credit on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, shall be jointly liable to the consumer, up to the credit amount for one year from the delivery, with the manufacturer-producer, seller, dealer, agent, importer, for the defective good and for the consumer's right of selection provided for in this Article. In the event that more than one person is responsible for the damages caused by the defective good, such persons shall be held jointly responsible. Non-cognizance of the defect existing in the good sold shall not eliminate this responsibility. ”

### RATIONALE

The Article 4 of Consumer Protection Law by this Law regulates the defective goods issue. By adding the Article 10/B to Consumer Protection Law, mortgage finance transactions are defined in the Article, and in the case where mortgage finance transactions are concerned, the housing finance institutions that grant a loan on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, shall be jointly responsible to the consumer, up to the credit amount for one year from the delivery, with the manufacturer-producer, seller, dealer, agent, importer, for the defective good.

In terms of the housing loans not in the scope of housing finance, the housing finance institutions that grant a loan on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, shall be jointly responsible to the consumer, up to the credit amount, with the manufacturer-producer, seller, dealer, agent, importer, for the defective good and for the consumer's right of selection provided for in this Article.

So that, concerning the housing loans, either in the scope of housing finance or not, granted by housing finance institutions on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, housing finance institutions shall be held jointly responsible to the customer up to the credit amount, with the seller and other accountable persons, in case the house is defective, in order to protect the consumer.

**Article 25** - The third paragraph of the Article 7 of the Law No.4077 has been amended as follows.

In the event that the delivery of the good or performance of the service announced or undertaken has not been effected at all or as it should have been, the seller, supplier, dealer, agent, manufacturer-producer, importer and creditor who grants credit in accordance with subsection five of Article 10 shall be jointly responsible. In the event that the delivery of the house announced or undertaken has not been effected at all, as it should have been or in time, the housing finance institution who grants credit, under the terms of housing finance in



accordance with Article 10/B, shall be jointly responsible up to the credit amount, with the seller, supplier, dealer, agent, manufacturer-producer, importer.

### **RATIONALE**

The Article 7 of Law No.4077 regulates the campaign sales. With the provision added to the Article, concerning the housing loans either in the scope of housing finance or not, the housing finance institution who grants credit on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, shall jointly responsible, with the seller, supplier, dealer, agent, manufacturer-producer, importer, in the event that the delivery of the house announced or undertaken has not been effected at all, as it should have been or in time.

**Article 26 -** The paragraph given below has been added to be placed just after the fifth paragraph of Article 10 of the Law No 4077.

In the case of housing loans not in the scope of the housing finance, defined in the Article 38/A of Capital Markets Law, the creditor, that grants credit on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, shall be jointly liable to the consumer, up to the credit amount, with the seller, if the house sold has not been delivered at all or in time.

### **RATIONALE**

With the paragraph added to the article 10 of Law No. 4077, which regulates the consumer credits; in the case of housing loans not in the scope of the housing finance, the creditor, that grants credit on condition that a sales contract is concluded with a specified seller, or for the purchase of a specified house, shall be held jointly liable to the consumer, up to the credit amount, with the seller, if the house sold has not been delivered at all or in time. So that, whereas the principles concerning the housing loans within the scope of the housing finance and for authorized houses are regulated with Article 10/B, it is aimed to limit the scope of the responsibility of the housing finance institutions for the housing loans used for unauthorized houses or the houses in construction, with the granted credit amount, if the house sold has not been delivered at all or in time, in order to foster the supply side of the houses.

**Article 27 -** The Article 10/B given below has been added to Law No.4077.

#### **“Mortgage Finance Transactions**

Article 10/B - Housing finance institutions are obliged to provide general information about loans or leasing transactions and “Pre-contractual Information Sheet” including the conditions of the loan or leasing agreements offered to the consumer before making the contract. Consumer has the right not to accept the offer.

The scope of the general information and the standards of “Pre-contractual Information Sheet” to be provided by housing finance institutions shall be determined by Ministry of Industry and Trade. Contracts signed before one day passed after the Pre-contractual Information Sheet provided to the consumer, will be invalid.



Housing finance contracts have to be written and a copy of the contract has to be submitted to the consumer. The conditions of the contract cannot be amended against the favor of the consumer during the term of the contract.

In case the borrower misses a payment, housing finance institution is obliged to notice the borrower with return mail within five working days.

If the housing finance institution reserves the right to claim the payment of the remaining credit amount at once, in case one or more payments are not made, this right can only be used on the conditions that the housing finance institution fulfils all its liabilities and that the consumer defaults on at least two consecutive payments. For the mortgage finance institution to use this right, it has to give at least a month notice that the payment is due.

In case the financial leasing agreement is cancelled by the housing finance institution in order to receive the remaining credit amount after the one month notice, the housing finance institution is under the obligation of selling the house. Before the sale, the housing finance institution assigns the appraisers or the appraisal companies, authorized by subparagraph (r) of paragraph 1 of article 22 of Capital Markets Law No 2499, to determine the value of the house and sells the house according to the determined value. The consumer must be informed about the value of the house before ten business days of the sale of the house. The housing finance institution shall sell the house acting in a prudent way, regarding the value of the house. The consumer is responsible for the loss of the housing finance institution exceeding the amount that is obtained through the sale of the house. In case the amount obtained through the sale of the house is above the remaining debt, then the amount exceeding the debt will be paid to the consumer. Article 7 and article 25 of Financial Leasing Law No 3226 dated 10/06/1985 is not applied to the financial leasing agreements regarding the housing finance.

Following the sale of the house and payment of the remaining debt above the sale value, the consumer has to vacate the house. If the house is not vacated, the owner has the right to exercise foreclosure according to article 26. and article 27 of Law of Foreclosure.

If the housing finance is backed by a personal guarantee, then the housing finance institution can not demand payment from the guarantor before calling upon the borrower.

It is prohibited that the housing finance institution links the payments to commercial paper or accepts commercial paper as guarantee of the payments. If, in spite of this prohibition, the housing finance institution accepts a commercial paper from the consumer, then the consumer has the right to demand this paper back from the housing finance institution. Besides that, the housing finance institution is obliged to compensate for the losses of the consumer resulting from the transfer of the commercial paper to the others. Commercial paper can be accepted as guarantee if the mortgage is not linked to housing finance.

The repayment amounts for loan agreement, the lease payments for leasing agreements that are above principal will be accepted as interest payment.

The interest rates of the credits issued for housing finance or financial leasing agreements can be fixed or variable with the condition that it is stated in the contract. In case the interest rates are decided to be fixed, the interest rates which are stated in the contract



cannot be changed without the consent of both parties. In case the interest rates are decided to be variable, the interest rates determined by the contract can be changed according to an index stated in the contract which must be a generally accepted and widely used index in national or international level, however a maximum amount of interest rates which can not be exceeded must be stated in the contract. In case the interest rates are decided to be variable, then it is necessary that the consumer be informed about the possible effects of this method. Central Bank of Republic of Turkey shall regulate the indexes to be used, whereas Ministry of Industry and Trade regulates the principles and guidelines to inform the consumers.

The consumer may prepay the total sum indebted, as well as one or more installments not yet in due and payable. In either case, the housing finance institution is obligated to make necessary deductions in interest and fees corresponding to the sum prepaid. The Council of Ministers shall determine the principles and guidelines for determination of the extent to which the deduction in interest and fees shall be made corresponding to the sum prepaid.

In case the interest rate is determined to be fixed, on condition that it is stated in the contract, for one or more payments made before due, the creditor may demand a prepayment fee from the consumer. The prepayment fee cannot exceed 2% of the prepaid sum, calculated by making the necessary deductions of interest and fees. A prepayment fee cannot be demanded from the consumer, in case the interest rate or lease payments are determined to be variable.

The contracts for mortgage credits must contain at least the following issues:

- a) For mortgage credit contracts, the amount of the credit.
- b) For mortgage credits the information about the house to be mortgaged, for leasing agreements the information about the house to be leased,
- c) The annual interest rate (for the variable interest rates the initial and the maximum interest rates)
- d) The total debt amount with interest and other components (for the variable interest rates the total amount of debt to be calculated separately for both the initial interest rate and the maximum interest rate)
- e) For the contracts with variable interest rates, the calculation method of the changes in the index and the interest rate.
- f) For the first year, monthly; for the other years, annual payment plan in which the payment dates, the principle, the interest and other costs are shown separately (for the variable interest rate contracts, two payment plans with the initial interest rate and the maximum interest rate)
- g) Number of pay backs/lease payments, the days of the month on which the payments shall be made, the date that the payments shall be made, if the preset days happen to be official holiday, first and last payment dates,
- h) The guarantees to be demanded.
- i) The interest rates for late payments of credit contracts, not to exceed the contractual rate plus 30% of the contractual rate (the current rate for variable interest rates), the interest rates for late payments of the lease agreements,
- j) The legal consequences of the default of the consumer,



- k) The conditions as to the installments to be paid before due and if a prepayment fee is determined, the principles regarding the calculation of this fee,
- l) If the credit is in terms of a foreign currency, the conditions as to which exchange rate to be used for the calculation of installments and the total credit amount,
- m) The cases when to value the house and the eligible appraisers,
- n) Insurance information of the house, if there is.

The monthly invoices sent to the consumer must include the information in (d) and the amount of the indebtedness.

### **RATIONALE**

With this article, loans provided by mortgage finance are differentiated and regulated separately from the consumer loans which are also regulated in this law. In addition to that, financial leases aimed at housing finance are also included in the law, in order to protect the consumers not only in credit agreements, but also in financial leasing agreements.

In housing finance system, financial leasing transactions are foreseen as alternative financing tools as well as the credits granted to the consumers. For that reason, by adding provisions regarding the financial leasing agreements, the consumers financed by financial leasing agreements should also be protected like the consumers financed by housing credits.

With the “Pre-contractual Information Sheet”, the consumer has the option to gather information about the contract before accepting the contract.

An important amendment put into force with this article is making variable rate mortgage credits possible. The aim of this regulation is to abolish the variable rate prohibition in housing credits. Allowing variable rate credits will facilitate the risk management of the lenders and this will help increasing of the terms and decreasing of the installments. The draft does not inhibit the consumers to borrow in fixed rates, however allows those to borrow in variable interest rates. Besides, Central Bank of Republic of Turkey is designated to determine the indexes related to the payments.

On the other hand, while at present, the financial leasing agreements can enclose variable lease payments, with this amendment, the principles to be followed in these agreements are regulated in parallel to the variable rate credit agreements. In order to apply the provisions of this amendment, the leasing companies will have to determine an interest similar to the interest rate in credits.

While it is made possible to determine variable interest rates, it is made compulsory to determine an upper limit for these rates or payments. This will put an upper limit to the risks of the consumers, regardless of the developments in the underlying index.



On the other hand, informing the consumers about the possible effects of the method used in the variable rate credit agreements and variable rate financial leasing agreements is made compulsory. The total debt amount, and the amounts of installments in credit agreements and the lease payments in financial lease agreements, that the consumers will encounter when the interest rates reach the upper limit stated in the contracts, have to be calculated and shown in the contracts. Besides, the indexes to be used to determine the variable interest rate shall be set by Central Bank of Republic of Turkey, whereas other methods to inform the consumers shall be regulated by Ministry of Industry and Trade.

Another important amendment put into force with this law is to allow the housing finance institutions to charge prepayment fee to the consumers in case of the fixed rate credit agreements and financial leasing agreements. In case of prepayment, housing finance institutions will calculate the total sum to be prepaid by taking into account the necessary deductions of interest and fees, as well as charge a prepayment fee up to 2% of the remaining debt. With fixed rate or payment agreements, the consumers can make a profit by ending their current agreements and ending up with new agreements according to the developments in the market. This profit of the consumer is a loss for the financing institution in return, so a prepayment fee will be a tool to balance the loss and the profit of the parties. A prepayment fee will not be applied to the variable rate credit agreements or financial leasing agreements.

**Article 28 -** The subparagraph given below has been added to the subparagraph 4 of the first paragraph of amended Article 8 of Corporate Tax Law No.5422 dated June 3, 1949:

“f) The earnings of the housing finance and asset finance funds (These earnings are not subject to taxing at source (Withholding tax) in respect of the Article 94 of Income Tax Law)”

### **RATIONALE**

Housing finance and asset finance funds will be a tool essentially used for the purpose of securitization. Because of being a mechanism transferring the incoming revenues to investors instead of keeping them within, the transparency of these funds in terms of Tax Law, in other words, the direct transfer of revenues and financial obligations arising from these revenues to investors without any additional cost is foreseen. Therefore, the earnings of these funds shall be subject to neither income tax nor corporate tax.

**Article 29 -** The subparagraph given below has been added to the first paragraph of Article 63 of Income Tax Law No.193 dated December 31,1960:

“6. Interest payments of the portion of debts up to one hundred YTL arising from housing finance, which is defined in the first paragraph of Article 38/A of Capital Markets Law No.2499, of individuals owning no house registered to title register office and individuals owning only one house that is registered to title register office,”

### **RATIONALE**

The interest payments of sources that are used for the purpose of housing finance are added to items that can be deducted in the calculation of real net values of wages with the amendment in this article.



By this way, the individuals have the opportunity to deduct the interest relating to up to one hundred YTL of the credits used for owning their first or second house.

Especially, for the sake of including the individuals who own a house in another city or in slum area to the system, the opportunity to deduct from tax base is provided for the second house as well as the first house.

By taking the social and economical benefits of the housing finance system to be established into account, for the purpose of providing the expected benefits and for the success of the system, the encouragement of individuals and therefore the encouragement of the whole system is foreseen by enabling the deduction of interests of sources used for housing finance purpose.

A registered housing finance system is important for the appropriate functioning of the economy and the prevention of unfair competition arising from informal economy. By this way, in addition to the encouragement of housing finance system, the real estate sector will be under registration.

**Article 30 -** The first and fifth subparagraph of the second paragraph of Article 75 of Law No.193 is amended as follows:

“1. The dividends of stocks of all kinds (including dividends of founder’s share and other bonus share and all kinds of payments paid to shareholders under the name of interest paid for preparation period or other names and profit shares paid for participation certificates of mutual funds established in accordance with Capital Markets Law and interests paid for securities of housing finance and asset finance funds.)

5. The interests of bonds (including mortgage capital market instruments and asset covered bonds issued by mortgage finance corporations and housing finance institutions) and treasury bills of all kinds and income gained from securities issued by Mass Housing Administration, Public Partnership Agency and Privatization Agency (Value increases resulted from the redemption of securities which are issued in foreign currency or which are indexed to foreign exchange, gold or another value are not regarded as income)

## RATIONALE

With this article the income gained from the mortgage backed securities issued by housing finance funds, asset backed securities issued by asset finance funds, and mortgage capital market instruments and asset covered bonds issued by mortgage finance corporations and housing finance institutions are qualified as a “securities income”.

**Article 31 -** The subparagraph given below has been added to the first paragraph of amended Article 89 of Law No.193:

“10.With the condition that wages of earners are not deducted additionally during the calculation of net amount of wages; interest payments of the portion of debts up to one hundred YTL arising from housing finance, which is defined in the first paragraph of Article



38/A of Capital Markets Law No.2499, of individuals owning no house registered to title register office and individuals owning only one house that is registered to title register office.

### **RATIONALE**

With this Article, by deducting the interest payments of housing finance debts from individuals' tax base, individuals and consequently the system will be encouraged. By this way, for the income to be declared in income tax declaration, the individuals have the opportunity to deduct the interest relating to up to one hundred YTL of the credits used for owning their first or second house from the income to be declared and an amendment which is parallel to the amendment made for the real wages in the Article 10 of this Law is introduced.

On the other hand, the provision above is added for the purpose of preventing wage earners to double deduct the interest payments of housing finance funds.

**Article 32 -** The subparagraph 16 given below has been added to the first paragraph of amended Article 94 of Law No.193:

“16. Interest and profit share income generated from the mortgage capital market instruments issued by mortgage finance corporations and housing finance institutions”

### **RATIONALE**

With this Article, it is foreseen that withholding tax rate that will be applied to the income gained from mortgage capital market instruments issued by mortgage finance corporations and housing finance institutions will be determined according to the Article 94 of Income Tax Law. For the time being withholding tax rate is % 25 according to the Article 94 of Income Tax Law. However, since according the same article, for each income and payment separately, Council of Ministers is authorized to redetermine the rate by decreasing it down to 0 or by increasing it up to one times, it is assumed that, by Council of Ministers' decision, the withholding tax rate must be determined as % 0 and the withholding tax must be collected from the ones that gain income.

**Article 33 -** The subparagraph (5) of paragraph (1), paragraph (2), paragraph (5) and paragraph (8) of the provisional Article 67 of Law No.193: have been amended as follows.

“6- The provisions of this article is not applicable; for the income derived from the restitution of participation certificates to the mutual funds established according to Capital Markets Law (except exchange traded funds) and from buying and selling of the stocks of closed-end investment companies; for the income derived from buying and selling of securities issued by Turkish Treasury abroad, mortgage capital market instruments issued by mortgage finance institutions, housing finance institutions and housing finance funds abroad, earnings derived from their redemption and their regular returns and for the incomes derived from the divestment of stocks which belongs to full fledged taxpayer and are kept for longer than two years and from the collection of dividends on behalf of stock owners.

2) Securities income written in subparagraph of five of paragraph two of Article 75 of this Law (except earnings derived from securities issued by Turkish Treasury abroad and



mortgage capital market instruments issued by mortgage finance institutions, housing finance institutions and housing finance funds abroad) shall be subject to 15 percent of withholding tax to be collected by the payors (except the payments made to banks and intermediary institutions or made to other real and legal person by the intermediary of banks and intermediary institutions). The payments of the incomes of the securities by the banks and intermediary institutions, which are delivered to them without verifying the purchase value, shall still be subject to withholding tax. If the security is purchased by the mediation of a bank or an intermediary institution, the difference between the redemption value and the purchase value shall be taken into account for the calculation of withholding tax. These incomes shall not be subject to withholding tax in the context of Article 94 or Article 24 of Corporate Tax Law.

“5) The withholding tax accrued according to the subparagraph (1), (2), (3) and (4) shall not be affected by whether the revenue holder who is a real person/a legal entity or is a limited or full fledged liability, or is a taxpayer/ tax-exempt, and income gained is tax exempt. Meanwhile, the income of exchange traded funds, pension funds, housing finance funds and asset finance funds established according to Capital Markets Law, shall not be withheld according to the subparagraph (1) and (4).

8) Income of mutual funds (except exchange traded funds, housing finance funds and asset finance funds) and closed-end investment companies established according to Capital Markets Law, which are exempted from corporate tax shall be subject to 15 percent of withholding tax, whether the income is distributed or not. This income is not additionally withheld according to the Article 94. Yearly declaration is not given for the income gained from reimbursement of participation certificates of mutual funds and closed-end investment companies and trading shares. If a declaration is given because of other income, these incomes are not included in the declaration. Income included in the commercial enterprise is outside the scope of this article.”

## RATIONALE

In the context of the first subparagraph of provisional Article 67 which is added to the Income Tax Law No.193 with Law No.5281 the difference between purchase price and sale price of the capital market instruments issued by the housing finance funds and asset finance funds, after 1/1/2006, the difference between purchase price and termination value in case of termination and term interests shall be subject to 15 percent withholding tax rate, and with the amendment of subparagraphs 5 and 8 of referred article;

a) The exemption of income gained from purchase and sale of the securities and other capital market instruments included in the housing finance fund portfolios and asset finance fund portfolios and their term interests from withholding tax,

b) The exemption of portfolio management income (not included in corporate income tax) gained by housing finance funds and asset finance funds from withholding tax,

are considered, and additional costs are aimed to be prevented from these funds which have the structure of directly transferring revenues to the investors.



Additionally, parallel to the securities issued abroad by Turkish Treasury abroad, income derived from buying and selling of mortgage capital market instruments issued by mortgage finance institutions, housing finance institutions and housing finance funds, earnings derived from their redemption and their regular returns are exempted from withholding tax of 15 percent.

**Article 34 -** The subparagraph (u) of Article 29 of Expenditure Taxes Law No. 6802 dated July 13, 1956 has been amended as follows and the subparagraph (y) given below has been added to the Article 29 of the Law.

“u) The premiums gained by banks, insurance companies, pension companies and mortgage finance corporations as a result of selling their stocks above their nominal values during their establishment and capital increases.

“y) The money gained from all transactions (including those based on foreign currency) in the context of housing finance carried out by mortgage finance corporations, housing finance institutions and housing finance funds.

### RATIONALE

With the amendment in the subparagraph (u), it is foreseen that issue premiums gained by mortgage finance corporations are exempted from Banking and Insurance Transactions Tax. With the amendment, it is aimed to decrease the costs, which may exist during the establishment and capital increase of mortgage finance corporations, to the minimum levels.

With the subparagraph (y) added to the Article, it is foreseen that the money gained from all transactions in the context of housing finance carried out by mortgage finance corporations, housing finance institutions and housing finance funds be exempted from Banking and Insurance Transactions Tax. It is aimed to decrease the operational costs of mortgage finance corporations and housing finance institutions, and in parallel to this, to decrease the cost of funds to the home buyers as much as possible.

**Article 35 -** The subparagraphs (o) and (p) given below have been added to the Article 59 to be placed after subparagraph (n) of Duties Law No. 492 dated July 2, 1964:

“o) All mortgage transactions made in the context of housing finance by housing finance institutions and mortgage finance corporations,

p) The transfer of the house, which is subject to financial leasing agreement, to the lessee”

### RATIONALE

While receivables arising from housing finance are transferred from housing finance institutions to mortgage finance corporations, the liens established in the title registry will also need to be transferred. It is aimed that transfer of liens does not bring any tax burden. Similarly, the aim is to decrease the operational costs and consequently the cost of funds to the home buyers as much as possible.



**Article 36** - The subparagraph (f) has been added to the paragraph named “1-Ad Valorem Fees” to be placed after subparagraph (e) of tariff no.1 tied to Law No. 492.

“f) 0.54% of the amount when the subject of the lawsuits is related to a certain amount and when the demand for cancellation of the auctions related to foreclosure of the receivables arising from housing finance defined in first paragraph of Article 38/A of Capital Markets Law No. 2499 is refused.

The Council of Ministers, is authorized to decrease the rate written on this subparagraph, down to 0.10% or increase the rate up to the rate written on the Law for certain types of trials or in general.”

### **RATIONALE**

The demand for cancellation of the auctions related to foreclosure of the receivables arising from housing finance are made subject to ad volarem tax duty of 0,54% instead of a lump sump tax duty. The aim is to prevent misuse of the right to demand cancellation of the auction and shorten the foreclosure process.

**Article 37** - The subparagraph 23 given below has been added to the chapter (V) “Papers relevant to institutions” of Table no.2 tied to Stamp Duty Law No. 488 dated July 1, 1964:

23. Papers issued during establishment and other transactions of mortgage finance corporations and housing finance funds, for which the stamp duty is to be paid by these corporations and funds.

### **RATIONALE**

It is aimed that mortgage finance corporations are exempted from any stamp duty in order to decrease transaction costs.

**Article 38** - The subparagraph (r) below has been added to the fourth paragraph of Article 17 of Value Added Tax Law No:3065 dated November 2, 1984.

“r) In the context of the financial lease agreements, related to the housing finace defined in Article 38/A of Capital Markets Law No:2499, delivery or lease of the house by the financial leasing company.

### **RATIONALE**

In the context of Value Added Tax, the delivery or lease of the goods, subject to financial leasing, by or to financial leasing companies are subject to value added tax of 1 percent. By their nature, financial leasing transactions consist of the three stages; buying it, leasing it and delivering it to the consumer at the end of leasing period. For this reason value added tax is collected during all these stages. To prevent these excessive collections. The delivery and lease of the house to the lessee are exempted from the value added tax.



**Article 39** - The subparagraph (9) of tariff no.1 tied to Law No. 3065 has been amended as follows:

“ 9. According to Financial Leasing Law No:3226, delivery or lease of goods subject only to financial leasing (including the vehicles written in the eight paragraph of this list) by or to financial leasing companies (except financial lease transactions in the context of housing finance defined in Article 38/A of Capital Markets Law No:2499) (However, for the delivery or lease transactions of goods written in the list numbered (IV) tied to Special Consumption Tax Law and vehicles written in 87.03, 8703.10.11.00.00, 8703.10.18.00.00, 87.11, 89.03, 8901.10.10.00.11, 8901.10.90.00.11 positions of the list numbered (II) tied to the same law, tax rate foreseen in the paragraph (a) of Article 1 of this Resolution; for the delivery or lease transactions of land route vehicles other than those mentioned above, tax rate foreseen in the paragraph (c) of the same article is applied.)

### RATIONALE

In the subparagraph (9) of tariff no.1 tied to Law No. 3065, it is foreseen that, delivery or lease of goods subject only to financial lease transactions by or to financial leasing companies shall be subject to value added tax of 1 percent. According to this provision, if the good is a house, value added tax rate is applied as 1 percent regardless of the size of the house. On the other and, in the subparagraph (11) of the same tariff, it is stated that, delivery of the houses larger than 150 meter square is subject to 18 percent value added tax, while those smaller than 150 meter square is subject only to 1 percent. To prevent the application of different value added tax rates during the transactions done in the context of housing finance by all housing finance institutions, a provision in parenthesis is added to the subparagraph (9) of tariff no.1.

**Article 40** - Article 2 of Law On Regulating Public Finance and Debt Management of 03/28/2002 has been amended as indicated below:

“Article 2- This Law covers the institutions and establishments included in the general, annexed and autonomous budget, institutions subject to provisions of private law with more than 50% of their capital belonging to the state, funds, state banks, investment and development banks, metropolitan municipalities, municipalities and establishments affiliated to municipalities, and other local government agencies, the establishments whose payment obligations have been guaranteed by the Undersecretariat of Treasury under the projects foreseen to be realized under such financing models as build-operate-transfer, build-operate and transfer of operational right and similar financing models, mortgage finance corporations, housing finance institutions and non-governmental organizations to be limited with grants.”

### RATIONALE

Considering the social aim of the housing finance system, mortgage finance corporations and housing finance institutions are added to the list of entities eligible for Treasury reimbursement guarantee.

**Article 41** - Definition in Article 3 of Law no 4749 has been amended as indicated below:



“Treasury Reimbursement Guarantee: Guarantees provided for reimbursement of foreign debts of state economic enterprises, establishments subject to provisions of private law with more than 50% their capital belonging to the state, funds, state banks, investment and development banks, metropolitan municipalities, municipalities and establishments affiliated to municipalities, other local government agencies, and the guarantees provided for reimbursement of debt stemming from the mortgage capital market instruments issued by the mortgage finance corporations and housing finance institutions.”

### **RATIONALE**

The type of Treasury reimbursement guarantee provided for the mortgage capital market instruments issued by mortgage finance corporations and housing finance institutions will be “reimbursement guarantee”.

**Article 42 -** The following paragraph has been added to the Article 3 of Law no 4749.

“Up to 400 million YTL, the reimbursements of the covered bonds, defined in the article 13/A of Capital Markets Law no 2499 and issued in Turkey or abroad, mortgage backed securities, mentioned in the article 38/B and issued in Turkey or abroad, and capital market instruments issued in Turkey or abroad by mortgage finance corporations defined in the article 39/A are under treasury guarantee with respect to this law. Capital market instruments eligible for treasury reimbursement guarantee, the conditions for the issuers and underlying assets related to these instruments, the guarantee fee, guarantee’s duration and other issues shall be determined by a bylaw. The guarantee amount mentioned in the paragraph will be increased every year by the revaluation rate announced by the Ministry of Finance.

### **RATIONALE**

Considering the social impacts of the housing finance system, a legal background is provided so that reimbursements of the covered bonds mortgage backed securities and capital market instruments of mortgage finance corporations to be issued in Turkey or abroad are foreseen to be under treasury reimbursement guarantee up to 400 million YTL. Capital market instruments eligible for treasury reimbursement guarantee, the conditions for the issuers and underlying assets related to these instruments, the guarantee fee, guarantee’s duration and other issues shall be determined by a bylaw of Undersecretariat of Treasury.

**Article 43 -** This act will become effective upon promulgation.

### **RATIONALE**

The date the law will be the effective is determined.

**Article 44 -** This act will be enforced by the Council of Ministers.

### **RATIONALE**

The authority that will enforce the law is determined.