



Commercial Leases in Turkey

Over the last decade, commercial real property investments have significantly developed in Turkey. 299 shopping centers are operational in Turkey,¹ with a total gross leasable area of 8.2 million m² and 82 new shopping centers are expected to be opened. Istanbul's office market has grown by 128% through 2003 to 2013 and reached 3.4 million m² and there is still a gap between supply and demand. These developments in the real estate sector make Turkey a tempting alternative for both local and foreign investors/developers.

The developing economy and rapid increase in commercial leases (e.g. office, store, hotel and private hospital etc. leases) has led to an increase in real estate prices. The significant increase in real estate prices and construction costs inevitably compels investors to borrow loans from financial institutions, to acquire and develop real properties.

Financial institutions require certain securities while granting high amounts of loans, in order to ensure repayment of the loan. A common way to secure repayment is to establish a mortgage on the property. Under Article 851 of the Turkish Civil Code ("TCC"), it is also possible to establish a lien in foreign currency, in favor of financial institutions.

Commercial real property investors tend to lease newly constructed units to third parties, instead of selling such units. For this reason, the rental fee to be received from the prospective tenants of shops and office leases becomes a key factor to increase the bankability of investors' contemplated projects. As a common practice, investors assign their rental fee receivables directly to the financial institution, in order to secure repayment of the loan. Accordingly, the tenants pay their rental fees directly to the relevant financial institution. Given that most of the loans borrowed from financial institutions are in foreign currencies (commonly in USD and Euro in Turkey), it becomes critically important that rental fees are also determined in the same foreign currency, to eliminate currency conversion related risks. In addition, rental fees determined in foreign currency should be subject to a certain increase, in order to align the rental fees with the inflation rate as well as the continuously increasing market prices of real property.

In this respect, (i) determination and increase of the rental fee in a foreign currency and (ii) ensuring the payment of the rental fee for the whole rental term are key factors for investors to increase the bankability of their investments. Given that lease agreements are governed under the Turkish Code of Obligations ("TCO"), the determination and increase of rental fees in foreign currency as well as penalty provisions in lease agreements will be subject to the TCO.

¹ <http://www.invest.gov.tr/en-US/sectors/Pages/RealEstate.aspx>

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Under Article 344 of the TCO, the rental fee may be agreed in a foreign currency. However, the rental fee determined in foreign currency cannot be subjected to an increase before five years.

Similarly, under Article 346 of the TCO, the landlord (i.e. investor) cannot impose any obligations to the tenant other than the rental fee and common expenses. In this regard, penalty or acceleration clause provisions under lease agreements in the event of non-payment of the rental fee are not valid.

Due to the fact that these provisions have heavily impaired commercial leases and the bankability of investments of developers, they were criticized during the preparation period of the TCO. After heavy lobbying efforts in the lead of shopping center investor/developers, it was determined that the entry into force of these provisions (along with other important provisions) was postponed until 1 July 2020 for commercial lease agreements (where the parties are merchants or public legal entities). By doing so, for the first time, the lawmaker implicitly acknowledged that there is a difference between a residential lease and a commercial lease.

Accordingly, since the enactment of Law No. 6570 on Real Property Leases back in 18 May 1955, the parties to a commercial lease agreement are enjoying the principle of freedom of contract, at least on rental fee related provisions. For now, it seems that the freedom will last until July 2020. However, we are quite hopeful that, now that the first step is taken, the lawmaker will consider enacting a specific law for commercial leases, whereby merchants may be able to fully enjoy the freedom of contract and bear the responsibility of what they agree on.

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