

### INTEREST RATES IN PREPAID RESIDENCE SALES

Prepaid residence sales are regulated under the Law on the Protection of Consumers ("CPL") and the Regulation on Prepaid Residence Sales ("**Regulation**"). In a prepaid residence sale agreement, consumer undertakes to pay the purchase price in cash or installments, and seller undertakes to transfer and deliver the residence to the consumer after the full or partial payment of purchase price. This article discusses the interest rates applicable to prepaid residence sale agreements.

#### 1. **Principal and Default Interest under the Turkish Code of Obligations ("TCO") and the Turkish Commercial Code ("TCC")**

Principal interest is the interest accrued on the principal amount before the debtor defaults on the payment as cost of borrowing. The amount of difference between the spot purchase price and the sum of the installment amounts is the principal interest. On the other hand, default interest is accrued from the due date until the date of payment if the debtor defaults on the payment.

#### ***Free Determination of the Interest Rates in Commercial Transactions***

As per the TCC, parties can freely determine principal and default interest rates in commercial transactions without being subject to the limitations under the TCO. Given the definition of "consumer transaction" and other related articles under the CPL, relations between merchants and consumers cannot be considered as a "commercial transaction" for consumers. Thus, limitations on interest rates under the TCO apply to consumer transactions. Although some scholars have different opinions, the Cassation Court does not consider consumer transactions as commercial transactions in its precedents.

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## ***Limitations on Interest Rates under the TCO***

As per the TCO, if annual principal interest rate is not determined by the parties' agreement, legal interest rate (which is 9% as of the date of the publication of this article) will be the principal interest rate applicable to such transaction. The TCO regulates that the highest principal interest rate determined by the parties in non-commercial transactions cannot exceed 50% more than the legal interest rate, meaning that it cannot exceed 13.5%.

If annual default interest rate is not determined under the parties' agreement, again, legal interest rate will be the default interest rate applicable to such transaction. Highest annual default interest rate in non-commercial transactions cannot exceed 100% more than the legal interest rate, i.e., it cannot exceed 18%.

Such limitations on principal and default interest rates will also apply in cases where one of the parties is a merchant and the other is a consumer. Without prejudice to special regulations, maximum annual principal interest rate that can be determined is 13.5%, and maximum annual default interest rate that can be determined is 18% in consumer transactions.

## **2. Principal and Default Interest Rates in Prepaid Residence Sales**

### ***Installment Sales***

The Regulation lists (i) amount of interest, (ii) annual principal interest rate, and (iii) annual default interest rate that cannot exceed 30% more than the principal interest rate determined under the agreement, as the mandatory elements of prepaid installment sale agreements regarding residences. The Regulation establishes an upper limit on the default interest rate applicable to prepaid installment sale agreements regarding residences.

The Regulation does not set a principle regarding the highest principal interest rate that can be applied in prepaid residence sale agreements. Therefore, general limitations on principal interest rates in TCO also applies to prepaid residence sale agreements. Thus, highest principal interest rate that can be determined by the parties in prepaid installment sale agreements regarding residences is 13.5%.

Under the Regulation, highest annual default interest rate that can be agreed upon by the parties in prepaid residence sale agreements cannot exceed 30% more than the annual principal interest rate determined by the parties. Considering that the highest annual principal interest rate can be 13.5%, the highest annual default interest rate can be 17.55% (13.5% + 30% of 13.5%).

### ***Spot Sales***

Regarding spot sales, since the entire purchase price is paid by the consumer at once and not in installments, there is no need for the principal interest (which is the cost of borrowing). For this reason, the Regulation does not require inclusion of principal interest rate and amount in prepaid installment sale agreements regarding residences. Additionally, there is no upper limit on annual default interest rate, unlike prepaid installment sale agreements regarding residences. As per the TCO, maximum annual default interest rate is 18% in spot sales.

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## 3. Failure to Determine the Principal Interest Rate in Installment Sale Agreements

In practice, sellers tend not to include the principal interest rate in prepaid installment residence sale agreements or determine the principal interest rate as 0%.

As per the Regulation, the principal interest rate, the principal interest amount and the default interest rate (not exceeding 30% more than the agreed principal interest rate), must be included in the prepaid installment residence sale agreements. Accordingly, the law assumes that there is surely a principal interest in sales made in installments. In line with this assumption, in one of its decision dated 2018, the Council of State approved the administrative fine imposed on the seller of residences who had failed to specify the annual principal interest rate in a number of its prepaid installment sale agreements and specified the annual principal interest rate as 0% in remaining of its agreements.

When the principal interest rate is not specified in installment residence sale agreements, the amount of the principal interest cannot be differentiated from the actual amount of the installments. The need to differentiate the actual amount of the installments and the amount of principal interest is vital in terms of the amount of discount to be applied for the consumer's early payment of the installments (as the consumer will not be obliged to pay all the principal interest due to its early payment) and the amount of discount to be applied for the installments, which are made payable due to the consumer's default on payments (as the consumer will not be obliged to pay the total amount of principal interest since all of the installments are made due by the seller before their actual due dates).

## 4. Conclusion

It would be very difficult to prove that there is no principal interest applied in installment residence sale agreement if the principal interest rate and principal interest amount are not specified. Even if the seller proves that no principal interest is applied for the installment residence sale agreements, there is still a risk of sanctions to be imposed due to the failure to specify the interest rates, which are considered as mandatory elements of installment residence sales. For the reasons mentioned above, it will be useful for sellers to determine the amount, principal interest rate and default interest rate not exceeding 30% more than the principal interest rate, and include these in the installment sale agreement to prevent risk of sanctions to be imposed.

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