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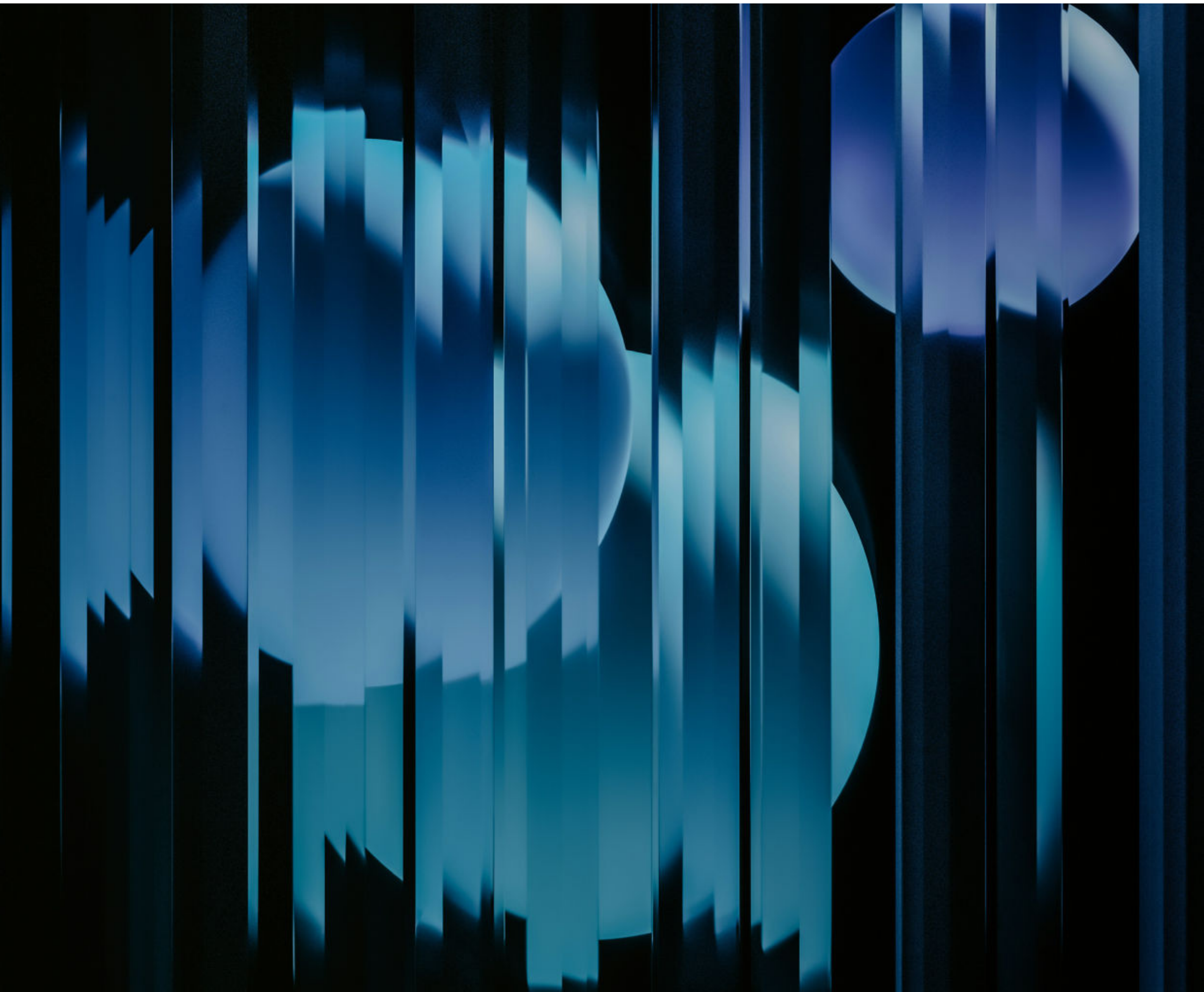
Building Completion Insurance: A Safeguard Mechanism in Off-Plan Housing Sales and Urban Regeneration Projects

July 2026



Introduction

In an off-plan housing sale, the consumer pays the purchase price of the residential property before construction has been completed, thereby assuming the risk of the seller's insolvency, delay in performance, or failure to complete the building. Building completion insurance is a form of suretyship insurance that provides protection to right holders in the event of the seller's or contractor's bankruptcy, the renunciation of the inheritance following the death of a natural person seller or contractor, or the failure to complete and deliver the property within twelve (12) months following the agreed delivery date. Upon the occurrence of the insured event, the insurer may satisfy its obligations either by paying cash indemnity or by procuring the completion of the project.

Legal Framework and General Principles

The legal framework governing building completion insurance varies according to the nature of the project. In off-plan housing sales, the applicable framework is set out under Law No. 6502 on the Protection of Consumers and its implementing regulation, whereas urban regeneration projects are governed by Law No. 6306 on the Transformation of Areas Under Disaster Risk and its Implementing Regulation. The operation and scope of the security mechanism are further regulated by the General Conditions for Building Completion Insurance and the Information Guide issued by the Insurance and Private Pension Regulation and Supervision Agency (SEDDK).

In off-plan housing projects comprising thirty (30) or more residential units, the seller is required, prior to commencing sales, to secure consumer payments by means of a bank letter of guarantee, a progress-payment (hakediş) system, a tied loan arrangement, or building completion insurance. Likewise, in urban regeneration projects, the contractor is required to provide building completion insurance or an equivalent form of security before obtaining the construction permit. Accordingly, building completion insurance is not the sole mandatory security mechanism; rather, it constitutes a distinctive alternative that offers the additional benefit of the insurer's technical and financial due diligence together with the ability to procure the completion of the project where the insured risk materializes.

Scope and Operation of the Coverage

Although building completion insurance is concluded between the contractor or seller and the insurer, it is intended to protect landowners and consumers. Such protection is provided through individual guarantee certificates issued in the name of each right holder.

Guarantee Certificate and Commencement of Coverage

The guarantee certificate is the document evidencing the insurer's obligation toward a given right holder and the maximum guaranteed amount. In urban regeneration projects, a separate certificate is issued and delivered to each landowner following the issuance of the building permit and the establishment of floor easement; in off-plan sales, a separate certificate is issued to each consumer upon completion of the sale (the amount being based on construction cost for landowners and on the sale price for consumers, with the term set as the project duration plus twelve (12) months). The insurer's liability commences upon the date the certificate is issued and delivered (following expiry of the withdrawal period in off-plan sales) and continues, with respect to certificates already issued, even if the policy terminates; conversely, where the underlying construction or sale agreement terminates, the protection afforded by the certificates likewise ceases as a general rule.

Circumstances Triggering the Insurance

Pursuant to the General Conditions for Building Completion Insurance, the insurance coverage is triggered where the contractor or seller:

» becomes bankrupt;

» being a natural person, dies, and the heirs renounce the inheritance; or

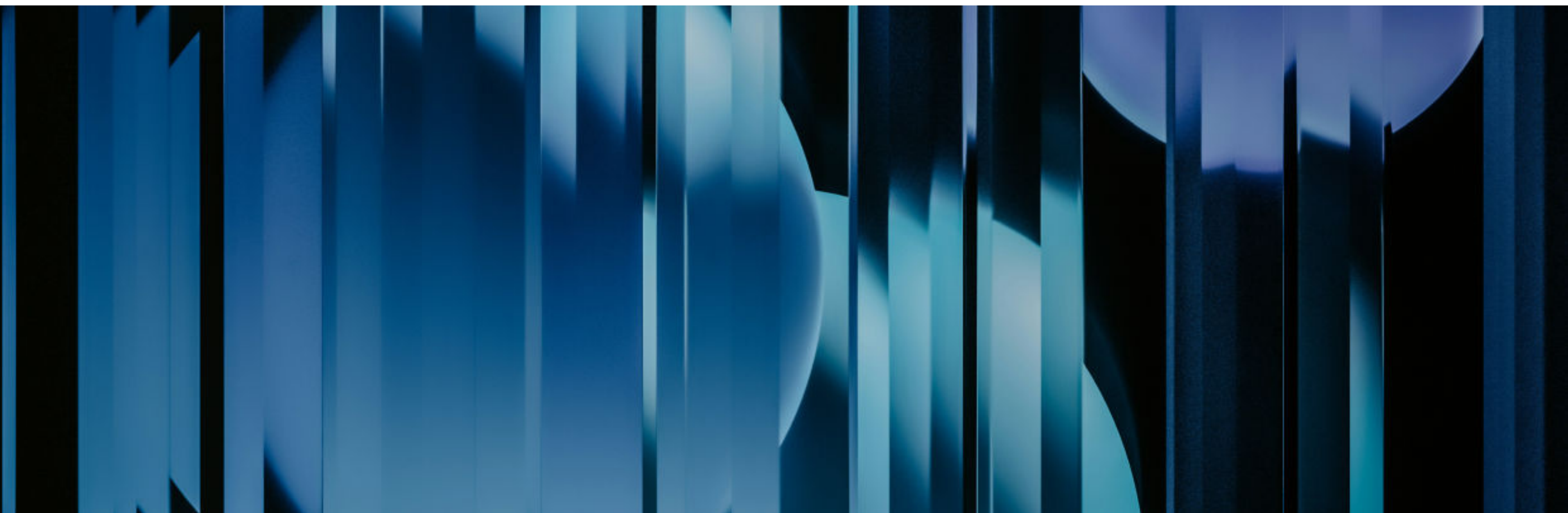
» fails to complete and deliver the property within the maximum period stipulated in the agreement or applicable regulations, or within twelve (12) months following the committed delivery date, including as a result of actions contrary to applicable regulations or to the project.

Mere delay is not, in itself, sufficient to trigger the insurer's liability; the delay must reach the period and conditions stipulated in the agreement. Upon occurrence of the risk, the right holder may apply to the insurer under the guarantee certificate issued in their name, and the insurer may request the necessary information and supporting documents and conduct a site inspection.

Cash and In-Kind Indemnification Methods

The insurer selects either the cash or in-kind indemnification method depending on the risk and informs the parties accordingly. Under cash indemnification, consumer payments are reimbursed together with statutory interest, while the landowner's guaranteed amount is adjusted according to the New Housing Price Index and paid within the maximum guarantee limit.

Under in-kind indemnification, the insurer has the project completed and delivers the properties to the right holders through rights transferred to it, such as floor easement, land share, or independent sections, or through a deed of promise to sell executed in its favor (in any event within a maximum of twenty-four (24) months); in this process, a limited rent payment may also be made to right holders, subject to the conditions applicable to in-kind indemnification.



Building Completion Insurance in Off-Plan Housing Sales

Although the insurance contract is concluded between the seller and the insurer, the protection afforded under the policy is for the benefit of the consumer. In this respect, the seller is under an obligation to provide the required information, while the consumer is responsible for verifying that the relevant residential unit is covered by the insurance and that a guarantee certificate has been duly issued in their name.

To benefit from the protection provided by the insurance, payments should be made exclusively through banking channels to the account designated in the relevant agreement, and all payment receipts should be retained. Payments made outside the banking system or without documentary evidence may significantly impair the consumer's ability to assert a claim under the insurance at a later stage.

Building completion insurance does not discharge the seller from its contractual obligation to complete and deliver the property. Rather, it serves solely as an additional layer of protection against the risk that the seller may fail to fulfil that obligation.

Building Completion Insurance in Urban Regeneration and Different Project Models

The practical structure of building completion insurance varies depending on the ownership of the land, the contractor's interest in the project, and the applicable financing model. These factors play a decisive role in the insurer's risk assessment and in determining the nature and extent of the countersecurity required by the insurer.

Urban Regeneration Projects

In urban regeneration projects, the contractor is required to provide building completion insurance or an alternative form of security prior to obtaining the construction permit. The protection afforded by such insurance is intended for the benefit of the landowners, whereas the role of the competent administrative authority is limited to verifying compliance with this statutory requirement. Compared with a bank letter of guarantee, building completion insurance may also offer a financing advantage by preserving the contractor's available credit facilities for construction-related expenditures.

Build-to-Share (Kat Karşılığı) Construction Model

Under the build-to-share construction model, the contractor's consideration consists of land shares or independent units to be transferred progressively as construction advances. Accordingly, upon reviewing the relevant agreement, the insurer may require that transfers be made conditional upon the achievement of specified construction milestones, be subject to the insurer's prior consent, or otherwise be restricted. Such safeguards may be implemented through supplemental protocols executed by the parties.

Build-and-Sell (Yap-Sat) Model

Under the build-and-sell model, where the project land is owned by the contractor, the insurer may require a mortgage over the project land or the independent units, or, where such security is insufficient, countersecurity over the contractor's other assets. The nature and amount of the required security are determined on a case-by-case basis, taking into account the project's financial condition and stage of physical completion.

Principal Benefits and Practical Challenges for the Parties

From the Perspective of Landowners and Consumers

The insurer's pre-underwriting assessment and its ongoing monitoring of the project throughout the policy period provide right holders with an additional degree of confidence even before the underlying agreement is concluded. By facilitating the early identification of potential risks, this process also serves a preventive function. Nevertheless, the protection afforded under the insurance is not unlimited; it is confined to the amount, duration, and conditions specified in the insurance policy and the guarantee certificate, and right holders are likewise required to comply with their notification obligations within the prescribed time limits.

From the Contractor's Perspective

For contractors, the principal advantage of building completion insurance is that it enables the statutory security requirement to be satisfied without consuming available bank credit facilities, while also enhancing the contractor's commercial credibility. On the other hand, obligations relating to insurance premiums, reporting requirements, insurer approvals, and transfer restrictions necessitate a higher degree of financial and operational discipline.

The Insurer's Risk Analysis and Monitoring of the Project

Prior to issuing the insurance policy, the insurer assesses the contractor's financial and technical capability, as well as the project's budget, financing structure, and feasibility of completion. The Insurance and Private Pension Regulation and Supervision Agency (SEDDK) characterizes this process as a secondary review of an administrative, technical, and financial nature.

This assessment continues throughout the policy period. By monitoring the progress of construction, the project's financial condition, and any emerging risks, the insurer may, where necessary, require additional security or impose restrictions on the transfer of rights. This review does not replace the statutory building inspection process; rather, it serves as a complementary mechanism aimed at the management and mitigation of financial risk.

Issues Relating to Taxes and Fees

Although building completion insurance policies are exempt from stamp duty, it remains uncertain whether mortgages and other forms of collateral obtained by the insurer as counter-security benefit from the same exemption. This uncertainty creates a cost disadvantage for building completion insurance when compared with bank letters of guarantee.

These additional costs may, particularly in projects requiring substantial security, encourage contractors to prefer bank letters of guarantee over building completion insurance. Despite the industry's calls for an express statutory exemption, the issue has yet to be clarified under the applicable legislation.

Checklist for Right Holders

To ensure that they are able to benefit from the protection afforded by building completion insurance, right holders should verify the following:

» whether the project is covered by building completion insurance;

» whether an individual guarantee certificate has been issued in the name of each consumer or landowner;

» whether the guaranteed amount, coverage period, and beneficiary details stated in the guarantee certificate are accurate;

» that all payments are made exclusively through banking channels to the account designated in the relevant agreement;

» that the guarantee certificate, payment receipts, and all annexes to the relevant agreement are properly retained; and

» that the delivery schedule and any amendments to the project are monitored and documented in writing.

It should also be borne in mind that building completion insurance does not cover construction defects, diminution in value, or contractual disputes of any kind.

Conclusion and Assessment

Building completion insurance constitutes a comprehensive security mechanism against the risk of project non-completion. Its value lies not only in the indemnification it provides upon the occurrence of the insured event, but also in the insurer's continuous financial and technical assessment and monitoring of the contractor throughout the project lifecycle. Although the structure of the required security varies depending on the project model, whether a build-to-share or build-and-sell development, the underlying objective remains the same: safeguarding economic value while promoting the successful completion and sustainability of the project. The product provides landowners and consumers with an additional layer of protection, while offering contractors a valuable financing alternative. The broader adoption of building completion insurance will largely depend on legislative clarification of the existing uncertainties surrounding the applicable tax and fee regime.

GenTemizer is a Turkish law firm based in Istanbul, Türkiye. We advise various businesses in relation to their investments, M&A, competition law/antitrust, project financing and construction projects as well as on operational and dispute resolution matters in the context of the Turkish regulatory framework. We have also advised investors in relation to government sponsored privatisation projects.

We are listed in *Legal 500, IFLR1000* and *Chambers and Partners* as one of the leading law firms in Türkiye. Each of our partners have also been recognised as one of the leading lawyers in Türkiye. We understand and can meet the demanding requirements and innovative, responsive thinking required for an investment transaction in Türkiye.

For more information, you can contact us.

Ömer Erdoğan
Partner
oerdogan@gentemizer.com

Cerensu Çetin Yenigün
Counsel
ccyenigun@gentemizer.com

Gökçe Aksoy
Associate
gaksoy@gentemizer.com

Kıvanç Turan
Associate
kturan@gentemizer.com

Ekin Pekşen
Legal Trainee
epeksen@gentemizer.com

www.gentemizer.com