



Seminar Proceedings Series
No.28

ISLAMIC BANKING MODES

FOR BUILDING FINANCING

ISLAMIC RESEARCH AND TRAINING INSTITUTE
ISLAMIC DEVELOPMENT BANK
JEDDAH, SAUDI ARABIA

ISLAMIC RESEARCH AND TRAINING INSTITUTE (IRTI)

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The Islamic Research and Training institute was established by the Board of Executive Directors of the Islamic Development Bank (IDB) in 1401H (1981). The Executive Directors thus implemented Resolution No.BG/14-99 which the Board of Governors of IDB adopted at its Third Annual Meeting held on 10 Rabi Thani 1399H (14 March 1979). The Institute became operational in 1403H (1983).

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ISLAMIC RESEARCH AND TRAINING INSTITUTE
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JEDDAH, SAUDI ARABIA

ISLAMIC BANKING MODES FOR HOUSE BUILDING FINANCING

Proceedings of a Workshop organized in Khartoum (Sudan) during 18-21 Rabi' Thani 1412H (27-29 October 1991 G) by The Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB) - Jeddah and The Sudanese Estates Bank - Sudan.

Edited by

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بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

In the Name of Allah, The Beneficent, The Merciful

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FOREWORD

In pursuance of its responsibility to foster economic development and social progress of its member countries in particular and Muslim communities at large through methods and means that conform to Islamic *Shari'ah*, the Islamic Development Bank (IDB), established in 1401H (1981) the Islamic Research and Training Institute (IRTI). The main purpose of IRTI is to undertake basic and applied research, provide training and disseminate information in the areas of Islamic Economics, Banking and Finance.


One of the tasks that have received much consideration of IRTI is the evolution of modes and instruments that can be used for mobilization and disbursement of financial resources for development, in compliance with , the teachings of Islamic *Shari'ah*. In order to fulfill this objective, IRTI pursues in-house as well as external research work and organizes workshops and seminars to which contributions are sought from all over the Muslim world.

The proceedings hereby presented to the honourable reader are the outcome of a workshop on "Islamic Banking Modes for House Building Financing" organized in Khartoum (Sudan) during Rabi Mani 1412H (October 1991) in collaboration between IRTI and the Sudanese Estates Bank.

The proceedings comprise three working papers and eight case studies. , The working papers presented to the workshop attempt to explore and discuss several issues relating to *Fiqh* as well as economic aspects of house building financing and spell out the modes and instruments sanctioned for this purpose by the provisions of Islamic

Shari 'ah. Within the conceptual framework outlined by these papers some genuine experiments originating from various Islamic countries and Muslim communities were also discussed for the sake of facilitating exchange of views and deriving lessons for future course of action.

It is hoped that the publication of these proceedings will induce further fruitful thinking and provide a useful contribution to the sincere efforts exerted for serving the Ummah.

A handwritten signature in black ink, appearing to read 'M. Fahim Khan' with a stylized flourish at the end.

Dr. M. Fahim Khan
Officer-in-charge, IRTI

GLOSSARY OF ARABIC TERMS

<i>Bay 'ajil</i>	A sale contract on the basis of deferred payment of the price and present delivery of the good sold.
<i>Bay 'al Hazal</i>	A false sale which neither the seller nor the buyer really intend to conclude.
<i>Bay'al W a f a'</i>	A sale contract which stipulates that at a specific future time the seller will repay the price and get back the good sold.
<i>Bay 'al Tawliyah</i>	A sale in which the seller accept to offer the good sold to the buyer at its purchase price.
<i>Bay 'al Taljiah</i>	A sale contract which the two parties find themselves forced to make accordingly they pretend to be effecting it while actually they are not.
<i>Bay'al Thanaya</i>	A sale contract involving a pledge from the seller to repay the price and get back the good sold at such and such date or whenever he finds himself able to do so.
<i>Bay'al Salam</i>	A sale contract in which the price is to be paid at present while the good sold is to be delivered after a specific period of time. The good sold is well defined though not available when the contract is signed.
<i>Dhira'</i>	Arm length, a measurement device.
<i>Fiqh</i>	Islamic jurisprudence.
<i>Fuqaha</i>	Plural of faqih, Muslim jurist or scholar who is knowledgeable in <i>fiqh</i> .
<i>Fatwa</i>	Advice of a faqih on <i>a fiqhi</i> issue.
<i>Gharar</i>	Uncertainty.

<i>Iqtina'</i>	Possession.
<i>Ijma'</i>	Consensus.
<i>Istihsan</i>	Preference.
<i>Istisna'</i>	A contractual arrangement whereby one party (purchaser) orders a specially defined product to be produced for him by the other party (seller) in the future against a specific price. Raw materials to be supplied by the producer.
<i>Hadith</i>	Saying of the Prophet Muhammad (Pbuh).
<i>Hanafi fuqaha'</i>	Those who share the views of the <i>Fiqh</i> Scholar Abu Hanifa'.
<i>Hambali fuqaha'</i>	Followers of the <i>Fiqh</i> Scholar Ahmad Ibn Hanbal.
<i>Halal</i>	Not prohibited in <i>shari'ah</i> , permissible.
<i>Mudarabah:</i>	An Islamic contract in which one side provides capital and the other side provides work (labor). The profits are to be shared in the proportions agreed upon before implementation of the contract. Provider of the capital bears all net loss according to this contract unless there has been violation of the contract terms or neglect from the part of the working partner.
<i>Musharakah</i>	Partnership, more than one party subscribe to the capital of a business undertaking and share Profits/Losses according to their respective shares.
<i>Murabahah Lil Amir bil Shira'</i>	A contract which involves sale with a profit mark-up on the cost. The seller purchases the goods ordered by the client from a third party and then sells these goods to the client, at a price higher than the purchase price, payment to be made in future, generally in installments.

<i>Mustasni</i>	The purchaser referred to in the <i>Istisna</i> contract above.
<i>Muqawalah</i>	A <i>Muqawalah</i> contract is the same as the <i>Istisna'</i> contract.
Maliki <i>fuqaha'</i>	Those who share the views of the renowned <i>Fiqh</i> Scholar Malik.
<i>Musawamah</i>	Bargaining.
<i>Najash</i>	False bidding up of price by a third party for the sake of exploiting the buyer.
<i>Qiyas</i>	A method of deriving <i>Shari 'ah</i> rules based on the analogy of one event to another for which a clear cut ruling is available.
<i>Riba</i>	Usury, in the Islamic <i>Shari'ah</i> usury is lending money against interest regardless of whether the rate of interest to be paid is high or low.
<i>Shari 'ah</i>	The laws derived from the Qur'an and the Sunnah.
<i>Sani</i>	The producer/maker referred to in the <i>Istisna'</i> contract above.
<i>Shirkah</i> or <i>Sharikah</i>	Partnership.
Shafi' <i>fuqaha'</i>	Those who share the views of the renowned <i>Fiqh</i> Scholar al Shafi'.
<i>Sheikh</i>	A title for addressing honorable persons like <i>fiqh</i> scholars, tribal leaders etc.
<i>Sunnah</i>	Teachings of the Prophet Muhammad (Pbuh).
<i>Sadaqah</i>	Voluntary charity.
<i>Sahabah</i>	Companions of the Prophet Muhammad (Pbuh).

Takaful

Literally it means mutual support among the members of a society or group of people. As a concept the word takaful is used as a substitute for the term insurance which in a sense involves an element of social security and support.

Ulama'

Shari'ah scholars.

INTRODUCTION

MAHMOUD AHMAD MAHDI

The significance of housing finance in a modern society is a fact that could hardly encounter dispute. The importance of shelter as a basic human need, the rapid growth of urban centers and the continuously increasing cost of housing are often cited among factors that bring this issue into focus.

Despite its indubitable significance, house-financing has neither received so much consideration as a theoretical issue of Islamic banking nor could it manage to get its due share as an Islamic banking activity.

In most of the developing countries, public investment in this sector compared to other sectors of the economy has been quite negligible. Besides lack of financial resources which directly hampers expansion in this sector, some policy considerations also seem to have been aggravating the housing problem.

Under conditions of multi-digit inflation which characterize most of these countries and the consequent inclination of so many people to invest in land and buildings, government policy may inevitably be dragged towards depressing shelter investment. Sudan throughout the last two decades stood as a fitting example.

Induced by their desire to emphasize the need for channeling resources towards sectors like agriculture, industry, transportation... etc., so many Sudanese economists and policy designers would argue that it would be more efficient under such circumstances to diverge the limited amount of available finance away from land and house building investment.

According to them, what they describe as the "cement jungle" of Khartoum is a prevalent manifestation of mal-investment decisions that need to be rectified.

This notion has consequently led the successive governments of the country to underestimate the indispensable amount of finance that need to be allocated to this sector and hence assign a low priority rank to provision of shelter, in their development plans. Until recently commercial banks in Sudan were officially prevented from financing any activity of this nature.

What these policies seem to have completely ignored, is the significance of defining the specific nature of housing to be provided. When we speak about luxurious housing the demand for which usually originates from the well-to-do classes of the society it seems that we are defining a commodity that is somewhat different from low-cost housing demanded by the poor. One could, therefore, argue that drawing a clear line of demarcation between the two commodities in question is a prerequisite for devising appropriate policy prescriptions.

It was not, however, until 1991 that this fact was fully recognized in Sudan and the commercial banks were urged upon to facilitate finance to popular, low-cost housing.

Apart from policy considerations the housing sector seems to have been one of the less attractive sectors of the economy for money lenders. As will be seen later on, some authors believe that the reason behind reluctance of bankers to extend funds to the housing sector is the long term nature of investment in this sector coupled with its relatively low rate of return (Ausaf Ahmad). Conventional as well as Islamic banks are alike in this respect, especially at times of inflation as then it would not pay lending institutions to undergo the venture of tying up their capital to an activity of such a low rate of capital turnover. Residential housing has, therefore, remained more like a public than a private good.

Consequently, concerned institutions, policy makers and experts in the field of banking and finance need to design appropriate ways and means whereby financing and investment in this sector could be enhanced.

It was this type of thinking that induced the Sudanese Estates Bank to propose to the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB) a joint workshop on "Islamic Banking Methods for Housing Financing". The workshop was accordingly organized in Khartoum (Sudan) during 18-21 Rabi' Thani 1412H corresponding to 27-29 October 1991G. The main objectives of the workshop, which comprised three technical papers and seven case studies, were to explore the ways and means that are permissible in Islamic *Shari'ah* for providing finance to the housing sector and to evaluate the experiences of some financial institutions that are already involved in this field.

This volume contains the papers, case studies and written comments presented at the seminar. The text is divided into three parts. In the first part, the three technical papers and commentators' reports on two of them are presented. Part two includes case studies presented by Islamic financing *institutions*, while part three is devoted for case studies of participating institutions not operating according to Islamic principles. In the few coming pages, a brief outline of each paper or case study will be shown.

The first of the three technical papers is Abdin A. Salama's paper entitled "Housing Finance in Islamic Countries". In this paper Dr Salama starts with criticizing interest-based methods of *financing* practiced by the conventional banking system. According to Salama, conventional banks , operating in Islamic countries must be losing a considerable part of their potential savings since there are so many Muslims who would never invest their money in such banks as long as they deal in *riba*. Moreover, Salama observes that interest-based financing does not provide a good cushion at times of hyper-inflation. Erosion of the real value of repaid loans seriously affects the ability of banks to cope with the massively growing demand for housing loans. This is particularly true in underdeveloped countries where lack of developed financial markets bars the way towards diversification of bank portfolio.

Having embarked on the deficiencies of the interest-based financing system, Salama then explains how the interest-free system advocated by Islam is more efficient. He discusses some Islamic methods of financing including: *murabahah*, *bay'ajil*, *istisna*, and decreasing *musharakah* and explains how each of them can be practiced in the housing sector.* He indicates that *murabahah* and *bay'ajil* for instance can be used for short-term financing and thus provide financial institutions with good turnover of capital and secure large profits that compensate operations of less rate of return.

Finally, Dr Salama deals with problems faced when house-financing is practiced according to the Islamic model. He refers in this connection to the problem of hyper-inflation and its effects on the cost of housing and discusses the difficulty involved in determination of the rate of return on *murabahah* and the trade-off between fixing a high rate to cater for inflation or a moderate rate that can be tolerated by demanders of low-cost housing. Dr Salama also speaks about non-repayment risk which tends to be higher in the absence of interest and also about the lack of institutional facilities. He singles out, as an example, of institutional shortcomings, lack of developed money markets and the consequent difficulty of matching long-term assets with short-term liabilities.

One of the problems discussed by Dr. Salama in this context relates in particular to application of instalment sale techniques. This problem occurs when the bank purchases a house and then sells it to the client in installments. As, according to *Shari'ah*, the bank has to possess the house before selling it to the client, the bank will have to register the house in its name first and again the house will be registered in the name of the client after he pays all installments. Since a registration fee has to be paid each time this will affect the price of the house. The higher the registration fee is, in the country where the house is sold, the greater the difference is going to be between the cost of a house sold through this technique and a similar house sold through a technique that does not necessitate double registration.

* For the meaning of all Arabic terminologies please see Glossary.

Dr. Salama seems to support the solution resorted to by the al Baraka Bank - London which purchases the house directly in the name of the client.

However, the commentator on Dr. Salam's paper does not regard this as much of a solution. It would be more appropriate according to him if the bank and the client would share the extra cost of registration.

It is clear that sharing the extra cost would still involve an additional payment that could possibly set the price of the house sold under this technique less competitive compared to the price of an identical house sold without double registration. Therefore, a *fiqhi* viewpoint is quite essential to precisely define possession in this context.

Acquiring a house is no doubt a long process which starts from the stage of offer and acceptance between the buyer and the seller, payment of the price and authentication of the contract by an authorized advocate, and finally approaching the concerned authorities for registration. Our respectful *fuqaha* could then tell at what of these stage this prerequisite of whether a step less than final registration of the property in question would solve the problem or not.

As a conclusion, Dr Salama recommends development of housing certificates and support from central monetary authorities to government-owned housing institutions.

The second technical paper is that of Dr Ahmad Ali Abdullah on "Forms of Real Estates Investment". In a brief manner, Dr Abdallah's paper sets out to show the landmarks of the various shari'ah-accepted terms of contracts which can be used in the housing sector. In this connection, the paper discusses *istisna*, *murabahah*, *murabahah lil amir bil shira'*, decreasing *musharakah*, *ijarah*, and *qard* methods of financing. It explains how each of these methods can be put to application and what issues and problems may possibly encounter its application.

While discussing the method of decreasing *musharakah* adopted by the al Barakah Bank - London, Dr. Abdullah made some debatable remarks pertaining to valuation of the bank's shares when they are

successively transferred to the client. A transaction under this method takes place when the bank and the client agree to purchase a house jointly each subscribing a given percentage of the total cost. The house will then be let to the client for a rent determined according to the prevailing market rate. The rent payable to the bank by the client after a given time period is proportionate to the bank's share in ownership. While the client continues to buy more and more shares from the bank, the rent payable by the former to the latter declines at the same proportion of share acquisition. When the process of share transfer comes to an end the entire house becomes the property of the client.

What Dr. Abdullah objects to is keeping the share value fixed while subjecting the rent to periodical adjustment according to market rates. According to him shares should also be subjected to revaluation in the same manner since keeping a fixed share value would ensure that the bank will get back what it has paid besides an excess gain in the form of rent revenue. This, according to Dr. Abdullah entails a suspicion of *riba*, since the bank will never run the risk of having a declining share value.

Dr. Abu Ghuddah who commented on the paper argues that there is no suspicion of *riba* in this transaction. The mere fact that the bank will get back its full subscription to the capital plus an excess gain does not hold true only in the case of this method. The same happens in the case of *murabahah* where the sale is conducted on mark-up basis.

Briefly speaking the issue raised by Dr. Abdullah in this regard seems to be thought provoking.

The third paper presented by Justice Muhammad Taqi al Othmani on "Methods of House-financing According to *Shari'ah*" embarks also on the same issues tackled by Dr. Abdullah's paper. *Sheikh* Othmani has put more emphasis on the *fiqh* aspects of the techniques discussed in his paper. He starts with emphasizing the role of an Islamic state in providing the basic human needs including shelter. Yet due to lack of adequate resources, *Sheikh* Othmani indicates that most of the Islamic states may not be able to secure this need for the needy members of their societies without encountering serious constraints. For this reason, ' methods of house-financing tolerable by the poor need to be pursued.

Sheikh Othmani's paper is solely devoted for the discussion of two techniques, viz. sale on deferred payment basis and decreasing *musharakah*. Under the first method the paper shows the case of a financier selling a house he owns to a client and receiving the value in deferred installments mutually agreed upon. According to *Sheikh* Othmani, this technique could take one of two forms, the first when the contract does not indicate separately the original cost of the house and the profit margin. The total value for which the house is sold is divided into installments. This case could be denoted as instalment sale per se. If, however, the contract refers to the original cost and the profit margin separately, this is *murabahah*. The author then goes on to explain that instalment sale could be for the whole or only part of the property. A client who does not afford to purchase a house alone may be in a position to pay part of the cost. The financier could in this case pay the remaining part of the cost and share the ownership of the house with the client. The financier can then sell his share to the client for a profit on deferred payment basis.

The second technique discussed by *Sheikh* Othmani is decreasing *musharakah*. This method of financing involves three contractual relationships between the two parties viz joint ownership, lease and sale contracts.

It may deserve mentioning here that the difference between this method and the partial instalment sale described above is that in this method (decreasing *musharakah*) the financier leases his share in the house to the finance receiver for a rent that keeps declining according to the gradual process of share transfer while in the earlier (partial instalment sale) method, no lease contract is effected between the two parties.

The most notable aspect of *Sheikh* Othmani's paper is the elaborate discussion it presents regarding the pledge that the client gives to the financier as a collateral of buying the financier's share in the house. The issue of whether such a pledge is binding, from the *shall 'ah* standpoint or not is no doubt quite essential for the efficacy of this contract. *Sheikh* Othmani in his paper indicates the viewpoints of the

different *fiqh* schools on this issue and explains how the three contracts referred to above can be concluded without violating *shari'ah* rules.

In part two of this book, five case studies submitted to the workshop by Islamic banks and financing institutions involved in the field of house-financing are presented. These include the experiences of the Jordan Islamic Bank, the al Barakah Bank, London, the al Barakah Turkish Finance House, the All India Council of Muslim's Economic Upliftment and the Islamic Cooperative Housing Corporation, Canada.

Each of these case studies describes the magnitude of the housing problem in the area where the institution presenting the case study operates, what methods of house-financing are adopted by the institution and what pros and cons that could be distinguished in the context of its experience.

One of the case studies that have generated much interest of the forum is the case study of the al Barakah Turkish Finance House and its \ housing certificates. Dr. Adnan Buyukeniz's paper entitled "Housing Certificates as an Interest-free Financing Instrument: The Turkish Case " provides a full account of the nature and application of these certificates. His brief presentation provoked a great deal of interest pertaining to the conceptual as well as the practical aspects of this important house-financing device.

The two case studies presented in part three of this volume though not coming from institutions based on the rulings of Islamic *shari'ah*, could hardly be regarded as less important than the other papers. Prof. S. S. Yahya's case study entitled "Shelter Options for Islamic Africa" presents a detailed account of the magnitude and socio-economic dimensions of the housing problem in the poor Islamic states of Sub-Saharan Africa. The author also highlights some of the economics of low-cost housing and its technical aspects. Then he sets out to discuss different policy options that poor Muslim states of Sub-Saharan Africa could pursue in their endeavor to tackle the housing problem. Given the huge amount of funds required for solving this problem, a strategy that aims at creating an enabling environment to induce private investment in this sector may prove to be more rational than a policy that tempts these

states to get themselves involved in direct financing. Finally, Prof. Yahya defines six guiding principles extracted from *shari'ah* in order to serve as guidelines for a successful housing policy.

It should also be mentioned that Dr. Yahya's paper has so many peculiarities over a mere case study. It contains a great deal of useful remarks and statistics pertaining to the technical, economic and social aspects of the housing problem in general. Had not the paper been mainly addressing the case of Sub-Saharan Africa, it would have been more appropriate to include it in part one of this text in order to pave the way to the discussion on various conceptual issues.

The second case study of part three shows the experience of the Housing Bank of Jordan and shows the attempts it has made in order to resolve the housing problem.

In conclusion, the significance of this seminar originates from the fact that it came at such time when so many demographic, social and economic factors seem to be pushing the housing problem to the forefront of development priorities. In view of the fact that inadequacy of financial resources is one of the major factors that tend to aggravate this problem, it is only natural that a seminar on house-financing gains such importance. Therefore, the participants to the seminar were keen enough to emphasize the painstaking efforts that need to be exerted by Muslim scholars, research' institutions, practitioners and policy makers engaged in the fields of Islamic banking and finance in order to develop appropriate methods of house-financing that are based on the teachings of Islamic *Shari'ah*. Thank God that such efforts are not to start from scratch. A good few of these financing techniques are, either already in practice or being strongly recommended for use. What still needs to be done is subjecting these techniques to a process of careful scrutiny and refining so as to make them tolerable and appealing to both the financier and the receiver of finance without trespassing on the domain of *shari'ah*-restricted dealings'. Based on the theoretical papers and the case studies presented to the workshop, the participants have recommended certain financing techniques that can be practiced in the housing sector. These include: *istisna'*, decreasing *musharakah*, housing funds, instalment sale,

interest-free loans etc., as the reader will find in more details in the annexes of this volume.

Part One

HOUSE BUILDING FINANCING IN
ISLAMIC PERSPECTIVES :
THEORETICAL ISSUES

HOUSING FINANCE IN ISLAMIC COUNTRIES

ABDIN A. SALAMA'

INTRODUCTION

This paper, highlights several issues pertaining to housing finance in Islamic countries. It also tries to tailor operationally methods of finance that are consistent with Islamic *shari'ah* and that could be adopted by financial institutions in Islamic countries. In this connection the paper makes use of the experience of its writer in the developing of the Sudanese Estates Bank.

INTEREST FINANCE

The goal of a financial institution in an Islamic state should take into consideration the goal of achieving the basic needs of the society in that state of which housing is one of a paramount importance. Following the techniques of Islam that prohibit dealing in interest will be an important principle that determines the operations of such institutions while lending and borrowing.

Interest financing is prevalent in all Muslim countries except in few of them like' Iran, Pakistan and Sudan which are endeavoring to establish their own financial systems based on Islamic *shari'ah*. However, much work is left to be done in tailoring means and methods of housing finance that are consistent with Islamic *shari'ah*.

In some countries housing finance is provided by banks and specialized financial institutions through interest-based . financing techniques.

These methods of financing usually force so many Muslims to refrain from borrowing from financial institutions. Alternatively, they may have to count on their own savings, borrow from relatives, or

*Former Managing Director, Sudanese Estates Bank, Sudan.

emigrate to where they spend years to accumulate enough savings in order to provide a shelter for their families. Given the rising costs of housing on the one hand and the limitations of most of the above mentioned sources of funds on the other, such people may have to wait for years in order to have enough money for building their own houses.

Interest-based financing may also fail to, provide a good cushion against inflation, especially in case of hyper-inflationary conditions that prevail in many Muslim countries. Under such conditions interest rate becomes negative especially when there are administrative controls that prevent interest rate to go up to the extent that it may compensate the rate of inflation.

Finance provided under such circumstances when repaid will be greatly eroded in real terms and far below the level required for meeting new demands. Diversification of the portfolio of a financial institution may provide a cushion against such adverse effects, but lending is the main function of a financial institution that operates on the basis of interest. Hence, a financial institution may not find it so easy to diversify its operations especially in a developing country where capital and money markets are not well developed.

SOME ISLAMIC METHODS OF FINANCING

On the other hand Islamic methods of financing, even when applied under conditions of undeveloped financial markets, could provide a flexible portfolio for a financial institution dealing in housing finance. During conditions of inflation Islamic methods of financing based on profit-sharing may act as a cushion as profits distributed, assuming a well managed portfolio, may reflect inflation rate better than interest rate and thus enhance mobilization of savings. Therefore, from a portfolio point of view, Islamic methods of financing may provide a good cushion against inflationary conditions.

On the asset side banks and financial institutions operating in the housing sector may use *murabahab* methods to provide short-term finance in the form of providing building materials; or it may use *bay'ajil* in the form of buying and selling a house to a customer; or financing repairs

and maintenance by *murabahah* in the form of providing building materials. Such short-term operations could provide financial institutions with good turn over of capital and secure large profits that compensate operations of direct finance extended to individuals to build houses which in many cases is provided at low rates of return. But such profitable operations are not without problems. Operations such as buying and selling a house to a customer on the basis of *bay'ajil* may entail some problems and issues that remain to be resolved. For instance the *shari'ah* pre-requisite that the title of the house should be transferred to the bank and only then it can be transferred to the customer. When this condition is fulfilled, there will be an extra tax burden as there will be a double capital gains tax to be paid by the customer. This is simply because the tax paid by the bank will be shifted to the customer as an extra tax burden over and above what he has paid. Faisal Islamic Bank of Sudan has adopted a strict approach according to the ruling of its *shari'ah* advisory board in that the title should be transferred to the bank and then to the customer and all consequent expenses should be shifted to the customer. The al Barakah Bank London uses another approach whereby it purchases the house and register it directly in the name of the client. Such arrangement may solve the problem of double taxation if a consensus between *shari'ah* supervisory boards on it is reached.

(1) *Musharakah*

Applications of *musharakah* in house financing could take many forms. The customer may, for example, provide the land and part of the finance or one of them and the bank provides the other. The house will be jointly owned according to the percentage of finance provided by each partner including the value of the land. When the unit is completed it can either be used by the customer or let. In all cases a rent will be determined, and the customer can either pay the share of the rent due to the bank and use the premises or the premises can be let out and the rent shared between the bank and the customer as explained earlier.

(2) *Iqtina'*

Musharakah could also take the form of *Iqtina'* where a customer who shares the ownership of the house with the bank pays a regular rent and a regular instalment to his bank simultaneously. As he continues to do so, he will increase his share in the "*shirkah*" and reduce that of the bank. Accordingly the rent will decrease as the customer continuously pays installments. When the last instalment of the finance extended by the bank is paid, the rent will be zero.

(3) *Muqawalah (Istisna')*

Muqawalah or *Istisna'* could be practiced by institutions dealing in housing finance. Here either the customer would choose a contractor acceptable to the bank or the bank chooses such a contractor. In both cases it is the responsibility of the bank to see to it that the house is built according to the specifications. The specifications has to be in such a way that meets the customer's choice and ability to repay. The bank will sign two contracts - one with the building contractor and - the other with the customer.' In some cases the bank may need to establish its own contracting unit properly staffed and equipped to undertake the responsibility of such contracts or to have properly recruited contractors.

(4) *Bay'ajil*

A much easier method that could be adopted by Islamic financing institutions dealing in housing finance could be by direct selling of housing units on the basis of *bay'ajil*. This method was adopted by Faisal Islamic Bank of Egypt in establishing and selling a number of housing units.

Such applications based on Islamic methods of financing distinguish those institutions from institutions that operate on the basis of interest-based lending and borrowing.

PROBLEMS OF HOUSING FINANCE

Hyper-Inflationary Conditions

1) As stated earlier, hyper-inflationary conditions hamper the operation of housing finance institutions in many ways through increasing the cost of housing units. Hyper-inflationary conditions may lead to phenomenal increases in the cost of house building that could not be matched with increases in the incomes of the households, especially in the presence of wage controls which keep wages growing at a rate lower than hyper-inflation. A small percentage of households who remain better off during inflationary conditions may continue to opt for luxurious housing and thus bid up the cost of building due to increased demand for imported materials as well as demand for funds. Given the limited ability of households to meet such costs, a lot of defaults may be encountered.

2) Hyper inflationary conditions may also have some impacts on the rate of return to be charged in *murabahah* and *bay'ajil* operations. In case housing finance needs are of a long-term nature and when the rate of return of *murabahah* is fixed in such a way that it would cater for inflation rate, such a *murabahah* rate must be very severe on low income earners. This is due to the fact that the rate of return determined in case of *murabahah* will fall on the total balance of *murabahah*. When such incidence is compared to interest-based financing, the latter's impact may be lower as the increasing interest rate is charged on the remaining balance.

On the other hand if the *murabahah* rate is determined at a rate below the rate of inflation, the ability of the financial institution to mitigate the adverse effects of inflation will be negative in real terms and it will not be able to face new commitments.

Musharakah method may stand better when compared with *murabahah*, *bay'ajil* or interest-based financing in that it provides a cushion against inflation from the view point of the financial institution, as *musharakah* secures a percentage of the value of the asset to the financial institution. While the value of the building appreciates with inflation, the share of the financial institution will also be appreciating

and the financial institution, therefore, becomes secured against inflation. If the building is sold, the share of the financial institution will increase due to capital appreciation. In case *musharakah* continues, it will reap the lock-in-effects as well as the increases in rent.

Inflationary conditions also influence housing finance in the sense that they increase the cost of building materials especially when most of these building materials are imported from abroad. Inflationary conditions abroad are reflected in the cost of building materials and hence in the cost of housing units. The operations of financial institutions engaged in housing finance will thus be adversely affected. More finance will be required for a less number of housing units while savings will be reduced and the ability to repay of earlier borrowers will be greatly jeopardized.

On the other hand as the asset buildings of the individuals appreciate due to inflation, their repayment commitments in real terms will depreciate. This may make it easier for a small section of borrowers to repay earlier.

Non-Repayment Risk

3) Non-repayment or delay in repayment stands as a risk that faces a housing finance institution under all methods of financing. Interest rate acts as a deterrent to non-repayment. If the principal of the loan is not repaid, interest will accumulate as the remaining balance stands fixed. In case of some Islamic methods of financing on the other hand, non-repayment entails no cost on the borrower. This is true in the case of *murabahah* and *bay'ajil*. However, under decreasing *musharakah* the rent may have a deterrent impact on a customer who evades repayment as it will remain fixed as long as no repayment of the principal takes place. It could also be added that under methods of *murabahah* and *bay'ajil* the bank needs to adopt extra precautionary measures, such as, mortgage. However, it is necessary that a special court be established to take prompt measures against defaulters as the success of these methods depend on how quick financial institutions could get their funds repaid. The al Baraka Group applies a penalty against defaulters which is assessed on the monthly rate of return achieved by al Baraka. The

penalty is imposed only when the delay is due to delinquency. This practice is not yet widely adopted by Islamic banks.

Lack of Institutional Facilities

4) A major problem that faces housing finance is that needs in this sector are of a long-term nature while resources available to housing finance institutions are in most cases of a short-term nature. Matching long-term assets with short-term liabilities remains as a difficult issue that need to be resolved.

In the absence of capital and money markets, the problem of matching long-term assets with short-term liabilities tends to be more serious in many Islamic countries. Financial needs in this sector are immense while resources available through financial intermediation are not enough to meet them. Many financial institutions have developed some long-term certificates like contractual saving schemes which tie lending in the future to an initial amount of deposits. The success of such schemes depends on whether the return on beneficiaries' deposits will match the rate of inflation or not. Very high inflation rates may discourage such savings. To make such certificates more appealing, efforts should be made to make them liquid on demand, or they could be given some privileges in case of inflation. Designing contractual saving schemes may be a successful way to mobilize savings to the housing sector. In this connection, five requirements need to be met:

- (a) Such savings should be liquid.
- (b) Such deposits could be used as a lien against borrowing in case of need.
- (c) Such deposits may be used for meeting holders short-term needs, such as, provision of building materials, maintenance loans, and other loans.
- (d) A number of deposit holders could be provided systematically and within short term periods with loans before the date of their entitlement to the loan is due.
- (e) Such savings may be made as a compulsory scheme to employees at the public and private sectors.

Also such savings may share in the profits of the bank annually or to make it more appealing every month or quarter.

Housing finance certificates as experienced in Turkey may be a successful method in financing this sector'. Issuing such certificates where the cost of building can not be easily determined should give only preference in attaining a unit in the housing schemes, without firm commitment to the cost of the unit. Housing finance institutions operating according to Islamic methods could develop special deposit schemes that may be used either in short-term investments or to be tied up to a specific housing scheme i. e. long-term uses.

- It is preferable that liquidation of financial certificates which would be used in long-term operations not be made easy i. e. contracts may be signed in such a way that the depositor or certificate holder will lose much in case of withdrawal and also the financial institution should distribute annually rates of return to such deposits or certificates that may be competitive with market rates.

The financial resources needed to achieve decent housing units to a large sector of the population are so big and can not be catered for through housing finance institutions only. Deposits usually seek quick returns and in many cases housing projects need long-term funds and have low rates of return.

Such type of projects should be provided to the poor at low costs and some form of government subsidy is needed. Therefore, financial institutions solely relying on intermediation may not be suitable to achieve them.

Direct government finance in the- form of large additions to the capital of public institutions operating in this sector or in the form of easy loans or *Qard Hassan* extended to such institutions will help in provision of such needs. In return these institutions could extend finance on the basis of *Qard Hassan* or charge a very low *murabahah* rate whereas they

(1) More details about these certificates are given in the case study on Turkey.

could erect such houses and sell them to buyers with a higher profit margin with easy conditions. Such measures will enable financial institutions to lend long and at a lower cost of finance.

Such financial assistance has proved successful in many Islamic countries in their endeavors to solve the housing problem. The experience differs; between rich, semi-rich and poor Islamic countries. In rich countries there is a tendency to use large government subsidies through institutions operating in the housing sector which are fully government-financed institutions. In poor countries there is an increased reliance on financial institutions and extra efforts are spent on enhancing their efforts in funds mobilization. The reason is that in rich countries, government surpluses are large while in poor countries government deficits always deter governments from extending large subsidies to housing schemes. In the case of Sudan since the establishment of the Sudanese Estates Bank in 1967 until the end of the 1970s, direct government finance to this sector took the form of additions to the capital of the Bank. Such additions enabled the Bank to build a number of housing units for many middle-income people and provide a large number of housing loans, But later on when government deficits prevailed, government subsidies to the bank stopped.

Saudi Arabia, a good example of a rich Muslim state, established the Saudi Estate Development Fund and through continuous government support provided easy loans to a large sector of the population. In addition to this, the Saudi government has built many housing schemes in major cities of the Kingdom.

Egypt has undertaken several measures to enhance the role of housing finance institutions. Egypt Estates Bank and the Housing Bank for Development and Construction are operating as full-fledged banks. The government provides these banks with easy loans at very low interest rates.

COMMENT ON THE PAPER ENTITLED:
"HOUSING FINANCE IN ISLAMIC COUNTRIES"

AUSAF AHMAD'

Housing constitutes an integral and important part of basic human needs in addition to food and clothing. However, it has several features which make it more prominent than the other two needs. Firstly, the expenditure on housing is much larger in absolute amounts than on food and clothing. Secondly, housing is a fixed asset. Therefore, expenditure on housing acquires the character of investment because of its long-term nature. Thirdly, and probably most importantly, housing is and has been a vehicle of economic development as it generates demand for various basic industries, such as, steel, cement, other building materials and fixtures etc.

The housing problem in Islamic countries, like in most of developing countries, is acute and represents a serious challenge to policy makers. Evidently, the nature and magnitude of the problem differs in urban and rural areas. Space may not be a serious problem in rural areas, yet the quality of rural housing leaves much to be desired. In urban areas, on the other hand, there are large pockets of slums which have emerged as, a result of continuous and large scale rural-urban migration. The general standard of housing even in urban areas is poor to say the least. The demand for and supply of housing in many Islamic countries are not equal. This has resulted in acute shortage of housing which continues to be aggravated by the pressures of ever increasing population (of course, the labor-short and oil rich economies are exceptions).

• The Islamic Research & Training Institute (IRTI).

House building is mainly a private activity, yet for a large number of people it is not possible to construct a house of their own due to a number of factors such as lack of funds, exorbitant land values and increasingly high cost of materials and construction, particularly in the urban areas. Therefore, housing finance by financial institutions, both public and private, assumes pivotal importance. The usual commercial banks have generally been reluctant to finance housing, particularly for residential purposes. To these banks, short-term quick return financing is most often preferable to long-term housing investment. Many developing countries, including Islamic countries, have gone on to establish specialized financial institutions for providing housing finance such as the House Building Finance Corporation of Pakistan.

These commercial banks and financial institutions provide housing finance on the basis of interest rate. There is evidence suggesting that modern commercial banking did not make much headway in the Muslim countries as it did in the Western countries or even in some non-Muslim Asian countries because Muslims have reservations about the interest-based banking system on religious grounds'. The emergence of Islamic banks in several Islamic and in some non-Muslim countries during the last 15 years and adoption of Islamic banking system by Iran, Pakistan and Sudan has raised the issue of how interest-free finance could be provided to various sectors such as short-term trade, industry and agriculture. Somehow, in all this, the question of housing finance has remained neglected. It is this issue which has been taken up by Dr. Salama in his paper entitled "Housing Finance in Islamic Countries".

Many economists with Islamic background have contributed to the critique of interest rate and related theories from an Islamic point of view. Dr Salama criticizes the' interest-based housing finance on the ground that it does not provide any hedge against hyper inflationary conditions. Citing the case of Sudan, it has been pointed out by Dr Salama in his presentation that the funds lent in 1970, under hyper

(1) T. Wholers-Scharf, Arab and Islamic Banks: New Business Partners for Developing Countries (Paris: OECD, 1983), Pp 79-80 and Ausaf Ahmad, Development and Problems of Islamic Banks (Jeddah: IRTI, 1984) Pp 1-4.

inflation, when repaid in late 1980, were not sufficient to finance, even 1/200 of the cost of the same number of housing units. This point should be well taken, as hyper inflation influences the cost of building materials more than proportionately and leads to erosion of the resource base of commercial banks.

In the rest of his paper, Dr Salama discusses some Islamic methods of financing primarily based on *murabahah* and *musharakah*, as well as some problems associated with the application of these techniques. Hence, this comment is confined to raise some additional points on relevant issues while making occasional reference to views of Dr Salama on these issues.

1. *Murabahah* is the most popular Islamic financing technique which is being applied in, a variety of sectors by different Islamic banking and financing institutions. As far as financing of building materials, such as, cement, bricks, fixtures etc. is concerned, *murabahah* can be applied successfully without much problems. However, some Islamic banks also finance the sale and purchase of already built houses on the basis of *Murabahah*. This entails a serious problem. According to Islamic rules, a *murabahah* contract will not be valid unless the asset being sold comes in the ownership of the bank. It is well known that Muslims are forbidden to sell some thing which is not in their possession. This requires double registration of the house. First in the name of the bank at the time of the sale deal between the first seller of the house and the bank, and the second time, in the name of the final purchaser when the sale deal between, the bank (second seller) and the final purchaser is signed. Given the high prices of houses under inflationary conditions and also the high rates, of registration fee which is usually a fixed percentage of the declared value of the house, the cost of double registration may come to a significant amount.

Dr. Salama suggests that the practice of the al Baraka Bank, London, whereby the bank buys the house and registers it directly in the name of the client may solve the problem of double taxation. This reviewer is of the opinion that this may not be much of a solution. There does not seem to be any escape from double registration if we wish the

murabahah sale to be a valid one. Nevertheless, one could move in two directions to solve this problem:

- (a) In those countries where the Islamic banking system is being enforced on an economy wide basis, a plea can be made to concerned authorities to charge a lower registration fee if the deal is finalized through an Islamic bank. It may also ensure greater flow of bank finances to the housing sector.
- (b) In those countries, where option (a) is not feasible for any reason, a consensus may be evolved for distribution of registration fee between the buyer and the Islamic bank. In many countries, it is customary that registration fee is paid by the buyer. Islamic banks may adopt some practice so that the cost of first registration should be paid by the Islamic bank and that of the second registration be paid by the buyer. Under no circumstance, the Islamic bank should attempt to shift the cost of the first registration to the buyer as it may turn out to be exploitative.

2. It is suggested that *musharakah* could also be used as a method of financing housing in Islamic countries. Under this method, total finance required for building a house will jointly be provided by two partners (in this case the bank and the client) and the proceeds shall be shared between the two. This technique may be used quite successfully in case of commercial buildings as well as housing units which are meant for rental purposes. However, its applicability and usefulness for 'owned residential buildings' need to be closely examined. Is it permissible to attach an imputed value to a residential house? How the imputed value shall be arrived at? On what basis the 'rent' of the house will be determined if the house has been built through the use of *musharakah* funds? Shall the bank be a permanent partner in the house? These are some of the questions which need to be answered before *musharakah* could be used as an important source of housing finance in the Islamic countries.

3. In the opinion of this reviewer, the method of decreasing participation or *Iqtina* is more amenable in dealing with the issue of

housing finance. The bank may open a separate *musharakah* account for each housing project financed under this scheme. The client may be given an overdraft facility up to a maximum of the bank's equity in the project. After completion, the client will pay to the bank part of the equity as well as a rent for using the share of the bank in the house. Hence the bank's equity will be successively declining until the ownership of the house is fully transferred to the client when the bank's equity in the project is reduced to zero. In applying this method, we shall do well by heeding to the warning given by the Council of Islamic Ideology that "It would not be advisable to use it widely or indiscriminately in view of the danger attached to it of opening a back door for dealing on the basis of interest"².

4. Keeping in view the uneven distribution of income, large number of poor, pressure's of rising population, prohibitive costs of land and construction and general shortage of housing particularly in the urban areas, the Islamic banks, housing banks and specialized housing finance institutions, should consider evolving the programs of low cost housing. In some developing countries like India, special programs have been undertaken to provide housing to economically weaker sections of the population. It should be possible for the Islamic countries to draw upon such experiences in developing countries.

The Islamic banks and specialized housing finance institutions could build low cost houses/flats and apartments and offer them to the general public on the basis of *murabahah*. The banks will have to declare the cost of acquiring such houses and their margin of profit in advance. Total price which will be inclusive of these elements may be deferred to be paid in installments according to a pre-agreed upon schedule. It should also be possible to pay the whole amount, or a part of it on the spot while the rest is deferred.

(2) Council of Islamic Ideology: "Report on Elimination of Interest from the Economy". Reprinted in Ziauddin Ahmad et. al (eds) Money and Banking in Islam, 1983, Islamic Institute of Policy Studies, p 118.

FORMS OF INVESTMENT IN REAL ESTATES IN ISLAMIC PERSPECTIVES

AHMED ALI ABDALLAH'

Shelter development constitutes one of the major concerns that have confronted and will continue to confront man as an individual as well as the community at large and has ranged among the basic concerns of reformers and governments.

This problem has gained further significance with the rise of large groupings in the forms of great towns that have never ceased to emerge and proliferate every now and then as a result of well known causes. The Islamic banking system has come to realize this fundamental issue as an integral part of its; general concern about achieving economic and social well being of Muslims.

The experience of financing housing through Islamic modes is a practice that has come into full being only after the advent of the Islamic banking system. The birth of this system is now looked upon by Muslims as an instance of! divine mercy sent to those who have held fast and immunized themselves against *riba* and those who have committed the sin of dealing in it as, well.

Providing finance to the housing sector has continued to be one of the early concerns of a number of Islamic countries. In the Gulf area, for instance, where the establishment of Islamic banks synchronized with the galloping building expansion and increasing revenues of these countries as a result of the 1970's oil boom, a considerable part of investment has gone to the housing sector. We shall refer to this later on.

Egypt also, challenged with its high population density and rapid expansion of its old towns is now facing an acute housing problem.

• Secretary General, Supreme Council of Banking and Financing Institutions, Sudan.

Islamic institutions there have to address this problem and react to it according to its real magnitude and prompt urgency. In fact they have already begun to pay due attention to this vital sector and thus companies specialized in real estate investment have been established.

In Sudan the stated policy forbids the banking system, except for the Sudanese Estates Bank, to deal in real estates investment. The Sudanese estates bank is one of the banks that belong to the public sector and it is specialized in real estate investment. Its contribution in this area is appreciable, but it is still limited.

Islamic Banks in these countries as well as elsewhere have now entered the era of real estate investment in accordance with Islamic *shari'ah* which we shall discuss later on. These banks have for the first time given consideration to the needs of both Muslims and non-Muslims in this vital field on a basis compatible with their conventions and living conditions.

ISLAMIC METHODS OF HOUSE BUILDING FINANCING

House-financing covers a vast and diverse range of activities which spread from the slightest kind of maintenance works to the biggest architectural constructions. Therefore, the majority of the Islamic modes of financing could prove to be feasible in this sector in one way or other. In this paper we shall be dealing with the following methods:

1. *Istisna'*

A. Definition

It involves an order given by a purchaser to a manufacturer so that the latter produces a well-defined article for the former against a price agreed upon. The raw materials are to be provided by the manufacturer or *sani*. *Istisna'* could also be defined as "sale of a well-defined article to be delivered in the future and not sale of a service".⁴

(4) Al Baberti, al Enayah Ma' Fat'h al Qadir, al Matba'ah al Amiriyah al Kubra, Egypt, 1316H, part 5, p. 356.

B. Permissibility in *Shair'ah*

The Hanafi fuqaha' have dealt with the *Istisna'* contract independently and in comprehensive details pertaining to its meaning, permissibility, conditions and controls, etc.

According to them although this contract does not conform with *Qiyas* yet, it is permissible in *Sunnah*, *Ijma'* and *Istihsan* due to the urgent need for it.⁵

The Maliki fuqaha', though did not treat *Istisna'* as a separate contract yet they gave it much consideration and so did the Shafi' and the Hanbali fuqaha' who dealt with it within the context of *salam* in industry. It may worth mentioning, however, that the Maliki fuqaha' consider *Istisna'* either as an absolute sale contract or *salam* in some particular cases.⁶

Briefly speaking, the predominant view particularly among the Hanafi fuqaha' is' that although *Istisna'* is basically prohibited on the ground that it involves "sale of what is still non-existent", yet it is sanctioned by *shari'ah* as an exceptional case due to the need for it. Therefore, it is a permissible practice that does not conform to '*Qiyas*' .

C. The Legal Force of the *istisna'* Contract

The *fuqaha'* have disagreed as to whether an *istisna'* contract is legally binding. Some would classify it as permissible "*Ja'iz*" rather than a binding contract. al Kasani for instance defines it as "a contract which is not binding for both parties when the article is not yet produced and so is the case when the article is made, but not yet viewed by the *Mustasni*. The *sani* may even sell the article to somebody else at this stage because the agreement was not effected on this particular article but on a one similar to it to be supplied by the *sani*. If, however, the *sani* delivers the article as per specifications agreed upon he will then loose his option to

(5) Ibn Abdin: *Rad al Muhtar Ala al Dur al Mukhtar*, (al Halabi), Part 5, P. 223.

(6) Al Bahwati, *Kashaf al Qina'*, Saudi Government, Part 3, P. 377. al Sarakhsi, al Mabsout, *Dar al Marifa* (Beirut), Part 51, P.48.

withdraw from the contract while the *mustasni* still maintains this option"

So many contemporary scholars believe that the *istisna'* contract is binding to its two parties once it is concluded. This view has also been adopted by *Majalat al Ahkam* which states in its Article No. (392) that "Once an *istisna'* contract is signed none of its two parties is entitled to withdrawal". However, if the *sani* delivers a commodity that does not satisfy what has been agreed upon the *mustasni* has the right not to accept it.

Wahbah al Zuheili⁸ considers this stand point of al *Majallah* as a sound one. According to him such a standpoint will help the two parties of the contract to avoid dispute and it also keeps harm off the *sani*. This is particularly true in view of our present day needs as such dealings are sometimes made on highly expensive things such as ships and aeroplanes.

Moreover, *Shaikh* Siddiq al Dharir also shares the view that declaring the *istisna'* contract to be of a binding nature will make it involve no *gharar* and appears to be more acceptable view than otherwise.'

In conclusion, one can find out very strong arguments favoring the binding nature of the *istisna'* contract. These arguments heavily draw on practical requirements which aim at securing the benefits of both parties of the contract without demolishing any of the *shari'ah* rules. This reflects the realism, flexibility and width of scope of the Islamic *shari'ah* that caters for controlling transactions in such a way that serves all legitimate interests.

(7) Al Dasouqi, Hashiyat al Dasouqi ala al Sharh al Kabir, Dar al Fikr, Part 3, P.195.

(8) Wahbah al Zuheili, al Fiqh al Islami wa Adillatuhu, Dar al Fikr, Beirut, P.634.

(9) Siddiq al Dharir, al Riba Wa Atharuhu Fi al Uqud, al Dar al Sudaniyah Lil Kutub-Khartoum and Dar al Jeel, Beirut, 2nd ed. 1990, pp. 458-461.

2. *Murabahah*

I don't think that I need to deal lengthily with the *murabahah* sale or '*murabahah lil a'mir bil shira*' as both are well known to this forum. *Murabahah* is a legal term for selling a thing for a profit, when the seller explicitly declares that he has purchased this thing for so much and is willing to sell it for so much.

In brief *Murabahah* could be applied by Islamic banks in house-financing particularly when the bank acquires building materials and sells them to its clients on mark up basis. In this connection it could be useful for the bank to possess building materials in order to, first, meet its requirements for implementing its *istisna'* contracts and second to sell materials to its clients through *murabahah*. It should exert every effort to make the deal such that the cost of the purchased materials becomes less than or equal to their cost when the client purchases them directly from the market.

In this case, one will never tire of hammering on the fact that these institutions, in order to provide low-cost finance, may need to establish relationships with wholesale merchants of materials and purchase from them at whole-sale prices, so that when the Bank's margin of *murabahah* profit is added to these whole-sale prices, they will not exceed market prices.

3. *Murabahah Lil Amr Bil Aria'*

However hard the Bank may work, it may not be able to provide building materials that will satisfy the needs of all its clients. Furthermore, some clients may order materials according to certain specifications which the Bank cannot satisfy.

In such cases, and other similar cases, the Bank cannot help purchasing these specified materials and selling them to the clients in accordance with the contract of sale known as "*murabahah lil amr bil shira*".

Hence, *murabahah* and "*murabahah lil amr bil shira*" contracts are two of the most important techniques of real estates financing especially for clients who wish to acquire building materials to be manufactured by specific producers, or in cases where financing covers only part of the operation, etc... Also one of the applications of these two methods of *murabahah* could be the purchase of ready-made houses from or through the concerned institution.

4. Decreasing *Musharakah*

Musharakah is a contract between two or more people who jointly subscribe capital and share the resultant profit/loss. *Musharakah* is therefore a form of partnership. Then one party, for appreciable reasons, desires to dispose of its share, gradually or at once by selling it to its partner. This usually occurs in the case of joint ownership of a lodging or tools of a profession.

Decreasing *musharakah* is one of the techniques that were discussed and approved since the first Islamic Banking conference held in Dubai on 23-25 of *Jumad Thani* 1399H. Its form is such that the financier agrees with the finance receiver (e.g. the land owner) on contributing to construction of a building on the land, leasing the building and sharing its revenues.

For decreasing *musharakah* to be valid, the share of each of the two parties in the jointly owned property and the way the revenue generated is going to be shared should be clearly defined. The two parties should agree on the possibility that:

- a) The Bank sells its portion lump sum or in installments.
- b) Priority of purchase be given to the Bank's partner.
- c) The sale, on the part of the Bank, and the purchase, on the part of the partner, of the shares continue so that, the Bank's shares steadily decrease whereas those of the client increase until all the shares are owned by the latter.

- d) During this process titles and obligations are determined according to the share of each party in the jointly owned property.

The *Ulama* are in agreement regarding permissibility of decreasing *musharakah* and the fact that it caters for the interests of large sectors of professionals and craftsmen who are in need of those who can help them to own the tools of their professions and crafts. In decreasing *musharakah* the nominal value of shares is to be fixed, so that the interested client who wishes to purchase a certain number of shares will pay only their initial value, as paid by the Bank, irrespective of the rise or fall in the market value of these shares. This guarantees that the Bank will recover the sum it has paid in this *musharakah* and, moreover, get its share in the return on the invested principal.

There is some suspicion of *riba* in the return on the invested principal. *Sheikh* al Darir for instance, is one of the *Ulama'* who have questioned the permissibility of this return. According to him the value of the share should be determined according to the market price of the article in question. We shall have more to add in this request later on.

5. Decreasing *Musharakah* and *Ijarah*

Decreasing *musharakah*, as such, is general, it deals with all aspects of partnership. There is also decreasing *musharakah* with *Ijara'*, which is concluded between the financier and the person who wants to own a residential house. In this connection we can refer to what has been indicated by the al Barakah Bank, London in a pamphlet on this subject and which can be summed up as follows:

Objective: The program aims at promoting investment in real estates without committing *riba*. Such a project is based on the principle of decreasing *musharakah and Ijara'* "Islamic Trust Funding".

Contractual Relationship

The contractual relationship between the bank and the client takes place as follows:

- 1, The contractual relationship rests on the basis of participation between the client and the al Baraka Bank in purchasing a real estate according to agreed-upon proportions.
2. The share of the al Baraka Bank is not to exceed 70 % in the case of residential and 85% in the case of non-residential buildings.
3. The price of the real estate is divided into shares, the value of each share being one sterling pound. This value remains fixed throughout the period of the contract. If the price of the purchased house is 100,000, the total value of the al Baraka's shares will be 70,000 and that of the client, 30,000.
4. It is incumbent on the client to purchase the al Baraka's shares within an agreed-upon period which should not exceed seven years for non-residential buildings and twenty years for residential. The al Baraka's shares decrease gradually until the whole real estate becomes the property of the client.
5. The partners fix a rent for the real estate which will be reconsidered with the view of raising or lowering it, subject to changes in the real estate market.
6. The real estate is registered in the name of the client and mortgaged to the benefit of the al Baraka Bank as a guarantee for repayment.
7. The two parties agree to sell the real estate in case the client fails to purchase the al Baraka's share in it..

This technique adopted by the al Baraka Bank is the very technique of decreasing *musharakah*, and it is confined to the procurement of real estate for lodging purposes. Hence it is pertinent to the subject of this paper. If anything can be taken against this technique, it is the statement in paragraph (3) namely, "the value of the share should remain fixed throughout the period of the contract". This, as we have mentioned before, leads to a suspicion of *riba*, since according to this statement the Bank will ensure the recovery of the principal as well as

its share in the rent in proportion to its shares. It would have been more appropriate to leave the value of the share to be determined according to the estate market while taking into account the relationship between the two parties, as this is what the concept of absolute participation presupposes. It is surprising that paragraph (5) clearly states that only the rent should be reconsidered in accordance with the rise and fall in the market price of the real estate. One could argue that the principal (the shares) should also be treated on equal footing as far as changes in market prices of real estates are concerned. One can even consider the principal to be more worthy of such adjustment (according to changes in market prices) than the rent.

Except for, this, the technique used by the al Baraka Bank is appropriate for application in extending finance to those who need partial financing in order to build a shelter or a business enterprise, in accordance with the aforementioned conditions.

6. Qard (Loan)

A qard can be defined as "A specific contract stating the payment by a lender of an identified sum of money to a borrower who has to repay him the same amount later on". The proof for permissibility of *Qard* in *shari'ah* can be found in the holy verse:

"Ye who believe when ye deal with each other in transactions involving future obligations in a fixed period of time Reduce them to writing. "¹⁰

Also our Prophet (peace be upon him) has told: ' When God took me for a journey by night (from the Sacred Mosque to the Farthest Mosque). I found written on the Gateway to the Garden the reward of *Sadaqah* is ten-fold, while that of *Qard* is 18 times its actual worth. I asked *Jibril* why *Qard* is better than *Sadaqah*? He answered because the petitioner may ask for what he owns, but the borrower is prompted by his need to borrow.¹¹

(10) Al Baqarah: 282.,

(11) See Ibn Majah, Sunan Ibn Majah, Fual Abdul Baqi, Part 2, p. 812.

"Whoever relieves a Muslim from the strain of a calamity in this life of here" says our Prophet (Pbuh), "God will relieve him from one of the calamities, of Doomsday".¹²

Hence, *Qard* is one of the important transactions that reflect faith of believers in terms of action, mutual support, fraternity and love, and contributes to social security, as well. This is why *shari'ah* has encouraged people to practice it and promised them great reward in return.

Qard is to be offered for the sake of *Allah* and counting only on his reward. This is why the *fuqaha'* have stated that the lender should not demand from the borrower any interest over and above the principal, for any loan *involving* some interest is considered as *riba*. Some *fuqaha'* have gone to the extent of not only forbidding the lender from stipulating interest beforehand but also emphasizing that he should not accept a present or a favor (in return for the loan) unless such a conduct has long been operative between the borrower and the lender. This is so in order to avoid the suspicion of committing *riba*.

If, however, the interest has not been stipulated, there is no prohibition. Abu Rafi states that our Prophet (Pbuh) borrowed a virgin she camel from a person. When the *Sadaqah* camels were delivered to him, he ordered Abu Rafi to give back the lender one of the virgin camels of the *Sadaqah*. Abu Rafi told the Prophet that there were no virgin she-camel. There was only a virile male camel. Our Prophet (Pbuh) ordered him to give it to the lender, commenting that "the best of you (Muslims) is the one who is best at repaying debts".¹³

Therefore, if the gift synchronizes with the settlement of the debt or is after repayment, but it is not one of the conditions stipulated for repayment, it is not prohibited. On the contrary, it constitutes one of the aspects of excellent repayment advocated by Islam.

(12) See Muslim, Sahih Muslim, Part 4, P. 1996.

(13) See Malik, al Muata', Part 2, P.680 and also Muslim, Sahih Muslim, part 3,P.1224.

It follows from what we have mentioned before that *shari'ah* pays due care to loans and highly appreciates the great role they can play in our socio-economic life. *Shari'ah* considers loans as a means amongst other means of social security and co-operation among the individuals of the society. Moreover, lending is one of the good deeds that will be generously rewarded for by the Almighty, God. Therefore, lending is not a mere device of financing or investment. And loans should not yield material interest to the lender.

Regarding administrative fees to be paid by the borrower, Banks in Sudan, particularly specialized banks like the Estates Bank, charge administrative fees, instead of interest. This provokes queries about the rules that govern these administrative fees, from the *shari'ah* point of view.

If these administrative fees are meant to make the borrower incur the cost of lending only, it is permissible from the *shari'ah* point of view, since the lender receives exactly what he has spent. Whenever there is cost as a result of administering the loan, the lender has the right to make the borrower bear this cost.

However, if these fees exceed the actual cost of administering the loan, i.e., if they result in a revenue over and above the actual cost, this is *riba* in the strict sense and hence, it is prohibited. Unfortunately, most if not all of our transactions are conducted along the latter supposition. I am afraid this is operative up till now.

Regarding 'uses of the *Qard*, although estate banks usually extend finance as a means of making profit and hence building a resource base that will enable them to expand their activities to a large group of beneficiaries, yet consideration may need to be made to some exceptional cases. Some poor families for instance or families severely affected by catastrophes may fail to meet the obligations of finance provided through profit oriented means of financing. For such families *Qard* financing would become of a paramount importance.

**COMNENT ON THE PAPER ENTITLED:
"FORMS OF INVESTMENT IN REAL ESTATES"
ABDUL SATTAR ABU GHUDDAH***

In his paper Dr. Abdallah examined four methods of housing finance viz:

1. *Istisna'*
2. *murabahah*
3. Decreasing *musharakah* in general terms and through *ijarah*.

In his presentation, Dr. Abdallah made a fleeting reference to a compound form of *istisna'* and *murabahah*. This is implicitly indicated in Dr. Abdallah's statement that "there are two types of *muqawalah* contracts. In the first type the manufacturing materials are provided by *the mustasni* and that is *ijarah*, while in the second the *sani* provides the materials and manufactures a well-defined article, and this is *istisna'*".

Istisna' is therefore considered to involve *murabahah* when the party wishing to acquire the house purchases the required construction materials on *murabahah* basis from the bank. The profit margin of the seller could thus be calculated on the basis of a certain rate added to the cost price, which is one of the important characteristics of *murabahah*. An agreement of *istisna'* could then be reached to build the house with these materials.

This form is distinguished from the form of pure *murabahah* which is applicable to sale of construction materials only or to a house completely built. Again it is distinguishable from mere *istisna'* because mere *istisna' is* based on bargaining. It involves no *murabahah*, since the cost of the property sold is indeterminable, whereas it should necessary be so as a basis of *murabahah*.

• *Shari'ah* Advisor, the Al Baraka Group, Jeddah.

The speaker has not mentioned all the methods of financing applicable to housing. He has neglected the most important and easiest to implement one which is sale on deferred payment basis (installment sale). It is among the forms approved - for real estate financing as per Resolution No. 52/1/6 of the six session of the Islamic *Fiqh* Academy, Jeddah . In paras (b) and (c) of the Resolution, the following is stipulated:

- (a) Countries capable of providing housing finance shall undertake construction of houses which could be sold to the people on deferred payment basis or by installments, in accordance with *shari'ah* regulations stipulated in Resolution No. 52/2/6 of the same session.
- (b) Investors, both individual and corporate, may undertake . construction of houses to be sold on deferred payment basis".

Resolution No. 53/2/6 referred to above regulated sale by installment according to *shari'ah* as follows:

1. It is permissible to fix a price for deferred payment arrangements higher than spot sale price. It is also permissible to mention both prices at the time of effecting the contract, yet the deal should not be concluded before the two parties agree on a specific price and the way it is going to be paid. If the sale is concluded without clear cut agreement on whether payment of price is to be made on spot or deferment basis the contract is null and void according to *shari'ah*.
2. It is not permissible in *shari'ah* to mention in the installment sale contract, a gain to be taken against accepting deferred payment as disassociated from the sale value of the goods sold. This holds true whether such a gain is determined by the two parties or according to the prevailing rate of interest.
3. In case, a purchaser (debtor) fails to pay due installments on time he should not be forced to make extra payment as compensation whether according to prior agreement or not, because forcing him to do so causes the transaction to become *riba*.

4. It is unlawful for a solvent debtor to evade payment of due installments. Nevertheless, compensation for delayed payment should not be stipulated as a precondition in the contract.

5. A creditor who sells in installments may lawfully place a condition whereby the installments would be considered due before their time in case the debtor fails to make timely payments of a number of earlier installments and provided that the purchaser agrees to this at the time of effecting the contract.

6. The seller 'may not retain ownership of sold property but he may however place a pre-condition indicating mortgage of the property for his benefit against delay of repayment by the debtor.

In his paper, the author also cited methods of housing finance applied by the al Baraka Bank London and the Sudanese Estates Bank as examples of application of decreasing *musharakah* and *Qard* in housing finance. Following are some observations regarding the author's remarks in this connection:

1. METHODS APPLIED BY AL BARAKAH BANK - LONDON

In criticizing the practice of maintaining a fixed nominal value of the shares in decreasing *musharakah* (P.33) adopted by the al Baraka London, the author says: "If anything can be taken against this technique it is the statement in paragraph (3), namely, "the value of the share should remain fixed throughout the period of the contract - this, as we have mentioned before, leads to a suspicion of *riba*". The author then suggests that this method could be based on determination of the value of the share *as well as the rent according to the prevailing market rates.*

As a matter of fact, the practice of maintaining a fixed value of the shares does not, on its own, justify disposing of the whole method. This fixation takes place in the form of a sale process whereby the buyer makes an offer within a certain time frame and according to a certain price, cost price (i.e. *tawliyah* sale) while the seller retains the right to accept the offer whenever he so wishes. Or it may take place in the reverse form where the seller makes the offer and it is up to the buyer to

accept it or not. Maintaining a fixed value of the principal while making profits happens also in *Murabahah* as the owner of the principal gets both the cost he incurs plus profit. The same also happens in *bay'al wafa* despite what has been said about it.

So far as the methods discussed by the author are concerned, there could exist some major shortcomings to which the author has made no reference. These include:

- a) Burdening the client with all the expenses of registration of the property (on the basis of the fact that ownership will be transferred to him). Whereas in *shari'ah* such expenses must be shared by the two owners as they relate to the property itself.
- b) Burdening the client with the cost of insurance of the building.
- c) When the client fails to buy the bank's share, and the house is sold to a third party, the bank will first recover its own funds advanced for purchasing the house before allowing the client to take his share. If the bank's funds are not fully recovered the client may be forced to pay the bank the deficit. So far as the al Baraka Bank - London is concerned, this method has been aptly amended in accordance with *shari'ah* provisions after severe criticism often from the legal point of view. The criticism usually points out to the view that this method is superficial rather than involving *riba*.

2. METHODS OF HOUSE-FINANCING ADOPTED BY THE SUDANESE ESTATES BANK

The author examined two points:

1. The administrative fees which are sometimes so exaggerated that they implicitly involve *riba*. This issue has already been discussed by the Islamic *Fiqh* Academy in response to frequent queries from the Islamic Development Bank. According to the *Fiqh* Academy, bank administrative

fees should exclusively be confined to actual loan servicing expenses. Fees exceeding actual loan servicing expenses are dealt with in the resolution of the *Fiqh* Academy as follows:

"The method adopted by real estates, housing and other similar banks, of charging interest on loans, be it small or large, is not permissible according to *shari'ah* because it is *riba*". The resolution goes on confirming this view by adding that "whether such interest is explicit or charged under the pretext of loan servicing"

2. Loan Uses- In his paper the author explained that while the financing offered by real estate banks originally takes the form of investment, there exist certain exceptions to loan uses. These include cases of poor families and clients incapable of paying the profits as well as emergency cases.

Such cases are explicitly dealt with in the resolution of the Islamic *Fiqh* Academy governing real estate financing. That resolution included an explanatory introduction indicating that housing is one of the basic human needs and that it should be made obtainable through lawful means with *halal* funds. The first method proposed as an alternative was:

"The state should make available for deserving parties advance loans specifically for house construction to be recovered in appropriate installments that are free from interest".

The speaker, in page (34) elaborates on settlement of a loan and rightfully uses the word "present" to describe the permissible gain resulting from settlement of loan by paying more than the principal without prior agreement. Despite his clear elaborations on the view points of classical as well contemporary *fuqaha'* on the subject there appears a phrase in page (35) which needs correction where the author states that "if, however, the interest has not been stipulated, there is no prohibition. The word "present" or "benefit" here is more suitable than the word "interest".

In the first para of page (35) the author states that borrowing is a method of social security. However, it may be more accurate to say that it is a sort of *takaful* rather than social security because loans in Islam are voluntary donations, while social security has become one of the functions which a state has to provide through welfare schemes that benefit civil servants and other groups in the society at the time of retirement. Offering loan in Islam is not a regular activity so that it can be used as a social security device and means of promoting social welfare.

Dr. Abdullah, when quoting *Sheikh* al Dharir made some comments on the fact that *Sheikh* al Dharir seems to consider the idea of Abu Yusuf that *istisna'* is a legally binding contract for its two parties as an unquestionable doctrine. Dr. Abdullah's elaboration goes on as follows:

"Following the other viewpoints mean that both *sani* and *mustasni* cannot know when the choice is fixed and whether the contract is going to be operative or not. This is *gharar* which can be evaded by making the contract binding". Using the word *gharar* in this context to mean prohibition is completely unacceptable because there is in fact *gharar* which is not prohibited. This is when for instance *gharar* is only negligible or it relates to the original content of a non-binding contract.

Ibn al Humam distinguished between the two types of *gharar* when he indicated that the first type which is prohibited relates to the "property sold" while the second which is permissible (subject to choice) relates to whether "ownership is ascertained or not" .¹⁴

The author quotes a few but reliable *fiqh* references most of which deal with the forms of *istisna'*. Sayings of the prophet (Pbuh) and books of *Sunnah* are also resorted to by the author.

(14) Ibn al Humam, Fat'h al Qadir, Part 5, p.110.

METHODS OF HOUSE BUILDING FINANCING ACCORDING TO *SHARI'AH*

MOHAMMAD TAQI AL OTHMANI*

In the Name of God, Most Gracious, Most Merciful

Praise be to Almighty God, and peace and blessings be on our lord Muhammad, the trustworthy Prophet, and on his sanctified companions, and on all those who follow them faithfully up to the day of Judgement.

Shelter is one of the essential needs which man cannot do without, for Almighty God has said:

"And God hath given you in your houses an abode" ¹⁵

Aisha was quoted as saying that the Prophet Muhammad, God's peace and blessings be upon him, said: "There are three forms of happiness = a good wife, a spacious home and a fast beast of burden" .¹⁶

The procurement of an appropriate, spacious home in the world of today has become the forefront of man's problems especially in crowded cities because of the complexities of life, overpopulation and the high cost of living. Those who can afford to buy or build their own homes are in the minority compared to those who cannot.

This has given rise to institutions which extend finance to people who want to build or buy houses, most of these institutions operate according to a systems based on *riba*. They extend loans to their clients, and ask in return for a certain rate of interest agreed upon in the contract.

• Member, *Shari'ah* 'Appellate Bench, Supreme Court of Pakistan.

(15) Al Nahl:80

(16) Reported by Ahmad, al Bazzar and al Tabrani in al Awsat.

As such a contract is based on *riba*, which is one of the cardinal interdictions forbidden by God the Almighty in His Glorious Book, it is a serious matter for any Muslim to be party to a contract based on this wrong basis.

It is thus incumbent upon the Muslim *Ulama* to propose to the people methods of real estate financing which do not contradict with the rulings of *shari'ah*, and can replace interest-based financing.

We therefore wish to give a brief account of methods compatible with *shari'ah* which can be used for real estate financing. We shall give proof of their permissibility, and how can they be put to practice.

A Muslim state should abide by its duty of securing the basic needs for its people without asking them for profits. Since shelter is a basic human need, man is entitled to it within his financial ability.

Hence, a person who cannot afford to acquire his own house should be provided with a home by the state. This would be secured either from the *Zakah* fund if he deserves *Zakah*, or the state should sell him the house at cost price without any profit, or give him an interest free loan.

These three methods form the basis for real estate dealings which are in line with the spirit of Islam and the nature of Muslim society. They are based on sympathy, being helpful, and sensitive to other people's sorrows and well-being, and lending a helping hand to the weak to secure for them a happy and reasonable standard of living.

However, application of these methods is conditional upon the state having bountiful resources. For each of these methods a large sum of money is required, especially with regard to present day high population pressures and sharp price increases. Doubtless, any country's resources can and should be augmented by cutting down unproductive and luxurious spending. However, most countries cannot afford to provide homes for their population even if they cut down on these expenses.

It is therefore necessary to select methods whereby the state makes donations to provide homes without being called upon to bear exorbitant cost, meanwhile being safeguarded against *riba* and other practices forbidden by *shadi'ab*. Below are some of these potential methods:

1. SALE ON DEFERRED PAYMENT BASIS

In this case, the financier owns a home which he would then sell to the client¹⁷ at a profit on deferred payment basis, and accept to receive the price in installments specified in the sale contract.

This deferred sale contract can be concluded without specifying the profit margin, in which case, the whole value of the house will be paid in installments without specifying in the contract how much of this value represents the cost and how much represents the profit margin. The sale can also be concluded by means of *Murabahab*, in which case the contract would state clearly the margin of profit of the financier, over and above the actual cost. If the house is already built, then the financier would purchase it and sell it to the client according to the method just mentioned. If, however, the house has not been built yet and the client wishes to build it, then the financier would authorize the client to build it. It would be the property of the financier, but the client would supervise construction of the house, as his representative. Once construction is completed, the financier would sell the house to the client in deferred payment basis. This is so if the client is completely unable to use his own resources to buy or build the house.

If, however, the client can provide part of the cost of the house and he wants the financier to provide the remaining part, which is the prevalent situation in most cases nowadays, then he can own part of the house. In this case the house would be owned jointly by the financier and the client; each would pay half the cost of the house for example, and it would become their joint property.

(17) In this text the term financier is used to denote the party offering real estate financing, while the term client is used to denote the party wishing to benefit from the finance.

Then the financier would sell his half to the client on deferred payment basis for a price exceeding that for which he had bought it.

If the intention is to build a house on a vacant plot of land, then the same procedure can be followed as regards the purchase of the land. The financier and the client can jointly purchase and own the plot of land and then the former sells his share of the land to the latter according to deferred payment arrangements. If the land is the property of the client or has become his through this arrangement, and the client requires financing to build the house on his land then the financier and the client can build the house jointly. Each of them could, for instance, pay half the cost of building the house. The house would become their joint property. Once construction is completed, the financier can sell his share of the building to his partner on deferred payment basis for a profit.

This is a perfectly sound procedure, although there might be some controversy about selling the house to a third party. Ibn Abidin says in this respect in Rad al Muhtar: "If one of the two partners in the building sells his share to a third party, it is not permissible while it is permissible for-him to sell it to his partner".¹⁸

As a warranty for honoring the deferred payments, the financier is entitled to ask the client for collateral such as holding the documents of the house. The financier cannot offer his financing services, however, unless he is perfectly sure that the client will buy his prospective share of the house or building, because if the client refuses to do so, after agreement with the financier, then the entire system will collapse. Therefore, for this system to succeed, the client has to give the financier a pledge beforehand that the farmer will later on purchase the share of the latter.

This pledge on the part of the client is a mere promise, and most *fuqaha'* do not consider it to be legally binding.

(18) Ibn Abidin, Rad al Muhtar, part 3, p. 365, Kitab al Shirkah.

There are a number of *fuqaha'*, however, who regard such a pledge to be religiously and also legally binding. This is the belief of Malik, God's mercy be upon him. Malik considers the pledge to be binding especially] if the one who has been given the pledge incurs some costs according to the promise. *Sheikh Muhammad Eleish al Maliki* says in this respect:

"Honoring, a pledge is a definite requirement. There is a controversy however on whether it is legally binding. Ibn Rushd has summarized this in his books; *Jami' al Buyou'*, *al A'riah* and *al Edah* which has been quoted by several scholars. Some *fuqaha* said that it is absolutely binding on legal grounds while other said that it is not. According to a third group, it could lose its legal force if there is a cause or if the person to which the pledge was made did not embark on any harm because of it such as when you say to somebody: I want to get married so give me *so* much as a loan. The pledge according to them becomes binding the person given the pledge embarks on certain commitment or cost and this is the commonly accepted view.¹⁹

According to al Qarrafi:

Sahnoun said: "a pledge becomes binding when (for instance) somebody says to another: Destroy your house, go for the haj, buy a house, or get married and I shall give you a loan. In all these instances the person given the pledge may embark on a certain action accordingly. However, a pledge not involving a reaction is *not* binding, and when it is honored it is to the credit of the person honoring it²⁰

Ibn al Shat says in *Hashiyat al Furuqe*:

(19) Sheikh Muhammad Eleish, *Fat'hal Alic al Malik*, part 1, p.356, *Masa'il al Iltizam*.

(20) Al Qarrafi, *al Furuqe*, part 4, p.25.

"I believe that a pledge is absolutely binding once it is uttered, and anything contradicting to this should be justified".²¹ Also some of the recent *Hanafi fuqaha'* believe that a pledge is legally binding in a number of matters as in the case of *wafa'* sale. Justice Khan said with regard to the *wafa'* sale." If the two parties concluded the sale without stipulating a condition to this effect and then such a condition is mentioned as a promise, the sale contract thus concluded is permissible while the promise is also binding as it ensures making a just deal".²²

Ibn Abidin also said in this respect:

"As in Jami'al Fusulayn, if the two parties mention sale without conditions and then mention the condition in the form of verbal agreement, the sale is permissible and the pledge should be honored as honoring pledges might be necessary for the benefit of the people!

According to these juristic texts, such a pledge can be considered legally binding. If a client make the pledge, in the agreement signed by both parties, that he will purchase the share of the financier in the real estate, then he is bound from legal point of view to honor his pledge.

The sale, however, should not be made before the financier owns his share, because a sale cannot be concluded on the basis of future ownership of the commodity by the seller. After ownership takes place, the sale contract could be signed on the basis of offer and acceptance.

2. DECREASING MUSHARAKAH

The second method of real estate financing is based on *musharakah*. This method can be summed up as follows:

(21) Ibn al Shat, al Hashiyah, part 4, pp.24-25.

(22) Fatwa Khaniya, Part 2, P. 138, chapter on conditions of sale.

(23) Ibn Abidin, Rad al Muhtar, part 4, p.135.

1. The financier and the client buy the house on the basis of joint ownership, in proportion to the sum paid by each. When each pays half the price, the house is shared equally between them; when one of the partners pays a third and the other the two-thirds, then it is owned by them, each according to what he has paid.
2. The financier then leases his portion to the client for a monthly or annual rent, mutually agreed upon.
3. The portion of the financier is divided into a definite number of shares, such as ten shares.
4. At the end of a regular period of time, agreed upon between the two parties (every six months for example), the client buys one of the shares. So if the portion of the financier is worth 200,000 rupees, for example, the value of each of the ten shares will be 20,000 rupees, and therefore, at the end of every six months, the client buys a share for this amount.
5. With the purchase of each share from the financier, his ownership in the house decreases proportionately and that of the client increases.
6. After the purchase of each share, the rent payable to the financier decreases proportionately. If the entire payable rent is 1,000 rupees for example, then the rent will decrease by 100 rupees for each share. So after the sale of the first share it will become 900 rupees, then after the sale of the second share it will become 800 rupees, and so on.
7. Once the client has bought all the shares of the financier, the house will become his property and both the partnership and the rent contracts end up.

This method of real estate financing entails three contracts:

- | | |
|---------------------|--|
| The first contract | To establish joint ownership. |
| The second contract | To lease the share of the financier to the client. |

The third contract : To sell the successive shares of the financier to the client.

We shall discuss each contract separately and then see how the entire method complies with *shari'ah*.

As for purchase of a house jointly, there is nothing that contradicts with *shari'ah*. It has been defined by the *fuqaha'* as follows:

"Property sharing is when more than one person own an asset or a debt through purchase, inheritance or any other means".²⁴

Therefore joint ownership of the house is permissible in *shari'ah* since it has taken place through a purchase which the two partners made from their own sources.

As for leasing of the share of the financier to the client it is also valid. Ibn Qudamah says in this respect: "Leasing of joint property is not permissible except to the partner. Both partners can lease (to a third party) together. This is the view point of Abu Hanifah and Zafrah. That is because only one partner may not be able to deliver the object offered for lease. Therefore, he alone should not offer it for lease. Abu Hafs al Akbari considers such leasing as permissible as pointed out to him by Ahmad. This is also compatible with the view point of Malik, al Shafi'i, Abu Yousuf and Muhammad. According to them, if the property offered for sale is known the sale becomes valid and so is the case for leasing. Moreover as a partner is allowed to sell and lease to his partner, he can do the same with a third party".²⁵

In *al Dur al Mukhtar* al Hasfaki indicates that "Leasing of jointly owned property is not permissible except to the partner" .²⁶

(24) Tanwir al Absar Ma'Rad al Muhtar, Part 3, pp.264-65

(25) Ibn Qudamah, al Mughni, part 6, p.137

(26) Al Hadaki, al Dur al Mukhtar Ma'Rad al Muhtar, Part 6, pp.47-48

It can therefore, be concluded that leasing one's share in a jointly owned property to one's partner is permissible according to the general consensus of the *fuqaha'*.

As regards the sale of a share in a house jointly owned, it is permissible as well. If the seller owns a share in both the land and the house, there is no difference in views about permissibility of the sale. However, if the seller owns a share in the building only, the general consensus of *the fuqaha'* supports the validity of selling to his partner although there is controversy about his selling to a third party. We have already mentioned Ibn Abidin's viewpoint in *Rad al Muhtar* in this respect which runs as follows:

" It is not permissible for any of the two partners to sell his share to a third party, while it is permissible for him to do so with his partner".
Since in the case of decreasing *musharakah* the sale is not effected, except with the partners, it is, therefore, permissible.

It is thus clear that each of these three contracts viz *musharakah*, Leasing and Sale contracts is sound on its own rights if each one of these contracts is concluded without being conditional on the other.

However, if, these contracts are concluded jointly with a prior agreement between the two parties, then their validity might be doubtful, because this act resembles concluding a deal within a deal and each contract will be an added condition to its subsequent one.

Such a conditional deal is not acceptable even according to those who permit some conditions on sale like the *Hanbali fuqaha'*. Ibn Qudamah considers this type of sale as invalid. According to him it could take one of three forms. One of which is when one party imposes, as a condition, a further contract to be concluded such as a loan, a sale, or a lease contract. This nullifies the sale and may nullify the condition also because the Prophet, peace be upon him, said "It is not permissible to link a sale with a loan or to impose two conditions (contracts) on a

(27) Ibn Abidin, Rad al Muhtar, Part 3, p.365.

sale".²⁸ al Tirmithi said that this is a correct *Hadith* and the Prophet (Pbuh) has forbidden concluding two sales in one deal and this practice amounts to the same Ahmad said: The same holds true for all that falls under the same meaning as when one party says to the other ... provided that you give me your daughter to marry, or that I give you my daughter to marry, that is not acceptable. Ibn Mas'ud said: "Two sales in one deal is usury". The same view was held by. Abu Hanifa, al Shafi'i and other '*ulama*'. Malik considers such a deal as permissible while the condition is invalid.²⁹

This precaution is necessary if one agreement is strictly conditional upon the other. However, if there is just an understanding between the two parties that they will make the lease at such and such time and each contract is finalized at its specified date, free of any condition, it seems that the contract is valid. This would also apply to a contract involving more than one deal. The *fuqaha*' approved it in a number of cases especially those relating to sale made for honoring a pledge (*bay'al Wafa'*) as we have previously seen in *al fatawa al Khariah* that "If the sale is made unconditionally, then a condition is introduced together with a serious pledge the sale is valid and the pledge should be honored because honoring a pledge could be necessary due to the need of people for it".

The same viewpoint was also shared by the Maliki *fuqaha*' regarding a sale coupled with a pledge which they call *bay'al Thanaya*. They consider this type of sale as originally invalid. al Hattab says: "*bay' al thanaya* is not permitted as when somebody say: I shall sell you this property for this price which I shall repay back to you at such and such date or whenever I can. In order to get back the property sold. This type of sale is invalid".³⁰ However, if the sale is made without this condition, then the buyer promises the seller that he shall sell back the good to him if he pays back the price, the pledge is sound and binding to the seller according to al Hattab who says in his book entitled "*Win al*

(28) Reported by al Tirmithi

(29) Shams al Din Ibn Qudamah, al Sharh al Kabir, Part 4, p.53 and also Muafaq al Din Ibn Qudamah in al Mughni, Part 4, p.290.

(30) Al Hattab, *Tahrir al Kalam fi Masa al Itizam*, p. 233.

Hukkam" that the buyer may tell the seller voluntarily after effecting the contract-that the latter can repay him the price at such and such date and get back the good sold. This pledge is binding to the buyer when the seller pays back the price within the stated period, at the end of it or slightly later. The buyer may not sell or offer the good sold to a third party within the stated period, if he does so the seller may revert the deal and get back the good sold".

This applies if the sale is effected unconditionally and the pledge is made after the sale. Some *fuqaha'* are of the opinion that the same ruling would apply if the pledge is made before the sale and then the sale is effected unconditionally. In this the judge Ibn Samarach (*a Hanafi fuqeeh*) says: "If an imperfect condition is made by the two parties prior to the contract then the contract followed, the contract is valid, but if the two matters happen simultaneously the contract becomes invalid".³²

On the issue of sale through a pledge he says: "Likewise, if they make a pledge prior to the sale, and then they conclude a contract free of the pledge, the contract is valid and no consideration should be given to the previous pledge".³³

Ibn Abidin has also reported this in his book *Rad al Muhtar* in which he says: "As stated in *Jami al Fusulain*, if an imperfect condition is made prior to the contract and then the contract is concluded it is valid. Imperfection of the transaction happens if the two parties agree to make such a condition the basis of the contract. This is however permitted in *bay' al hazal* as will be shown later on".³⁴

This was commented on by the venerable scholar Muhammad Khalid al Atasi who said "I believe that this assertion contradicts with what is stated in *Jami al Fusulain* as far as I know. Comparing such a sale to *bay' al hazal* shows a wide difference. *Bay' al hazal*, as indicated in *al Manar*, takes place when the good to be sold is neither explicitly

(31) Ibid.

(32) Ibn Samarah, *Jami al Fusulain*, Part 2, p. 237.

(33) Ibid.

(34) Ibn Abidin, *Rad al Muhtar*, Part 4, p. 135.

nor implicitly referred to. Also similar to this is bay' al talji'ah which refers to a situation when the two parties enter into an agreement which neither of them really wants to fulfil, therefore, it is not a true sale. If then the two parties agree to base a contract on such an agreement it is clear that they do not want to establish a sale contract at all. How could that compare to the matter at hand? However, adherence to the strict text of the source is preferable.'

Accordingly, recent *fuqaha'* of the *Hanafi* school were of the view that a pledge that is independent of the sale contract, and which is not imposed as a condition on the deal -does not make the contract unacceptable whether such a pledge is made prior or after the contract. ³⁶

There might be a certain ambiguity regarding a pledge made prior to the contract. Apparently, it seems that such a pledge is meant to be regarded by the two parties when they come to conclude the contract even if they do not utter this explicitly. Consequently, there seems to be no difference between this contract which is preceded by a pledge between the two parties and a contract in which the prior pledge is imposed as a condition.

It could, therefore, be argued that judgement should be based on the end result of the transaction and therefore a prior pledge should be considered a precondition, which is not acceptable.

My answer as regards this ambiguity is that the distinction between these two cases is not only in what each of them appears to be, but there is a fine distinction in the essence of each case as well..

For if a contract is conditional upon another, a case which is termed as a deal within a deal, it is not a definitive contract, but dependent on the other. That is, it will not be complete without concluding the other. This would be a suspended contract, or one

(35) Al Atasi, Sharh al Majallah, Part 2, p.61.

(36) See al Faleh Muhammad al L a k n a w i , Etr al Hidayah.

concluding the other. This would be a suspended contract, or one deferred to a future date. If the seller tells the buyer: I shall sell you this house provided that you lease to me your house for this much of money, this means that the sale is conditional upon the subsequent lease, and once the contract is dependent on a future act, it is no longer definitive. Suspension of a contract is not permissible. In the above case the sale is automatically canceled if the lease condition is not fulfilled.

The case is different if the two parties mention this as a pledge from the outset, and then conclude the sale free of any condition. The sale in this case is concluded independently. If the buyer refuses to lease after that, this will not affect the definitive sale and it will remain valid. At most the buyer will be compelled to honor his pledge which he has uttered and is therefore binding. Because he has induced the seller to buy by reason of his pledge, then he is bound to honor his pledge according to the *Maliki fuqaha'*. This has no effect on the definitive sale which happened unconditionally; it remains inviolable even if the buyer does not honour his pledge.

Thus a sale which is conditional upon another contract remains hesitant between completion and rescission, and this hesitancy breeds its imperfection..

On the other hand, a definitive sale preceded by a pledge is inviolable as to the definiteness of the sale, but it is nevertheless completed, on the understanding that the pledge preceding the sale should be binding to the buyer, according to those who claim that a pledge is binding.

In conclusion, the flawless method of decreasing *musharakah* which adheres to *shar'iah*, is that the three contracts should be concluded in their due time and independently. However, it is possible to have an agreement whereby both parties pledge to enter into these contracts, agreeing to buy such a house with their joint funds. Then the financier would lease out to the client for a specific rent; then the client buys the share of the financier in a number of installments until he owns the entire house.

Such an agreement is only a pledge between the two parties to make up such contracts, but they shall not be made except when they are due and with the mutual consent of both parties. THus, the contract would be definitive and free of all conditions.

PART TWO

CASE STUDIES PRESENTED BY
ISLAMIC BANDS AND FINANCING
INSTITUTIONS

THE EXPERIENCE OF THE JORDAN ISLAMIC BANK IN FINANCING HOUSING PROJECTS

HUSNI ABDUL AZIZ YAHYA*

INTRODUCTION

Social systems with all their different doctrines and philosophies, had paid great attention to the question of housing, thus adding an economic dimension to its social and architectural dimensions. Consequently, provision of suitable housing has become the worry of most of the economic planners, and one of the major aspects in most of the development plans in many countries. The economic aspect of this issue is not confined only to allocation of part of the available resources to construction, nor to calculations of costs of and preference between the various kinds of materials used in construction. There is also another aspect of this issue, namely that the construction sector is considered one of the most important sectors generating work and employment opportunities, as its contribution to the national product is of no less importance.

THE DEVELOPMENT OF THE HOUSING SECTOR IN JORDAN

The housing sector is directly affected by the customary demographic changes which occur as a result of the natural growth of the population, and changes in standards of living. It is more seriously affected by the uncustomary and contingent demographic changes such as immigrations and migrations whether such changes are arbitrary e.g. caused by act of war, or voluntarily e.g. caused by the motive of seeking new and better work opportunities. The one society could be the source or recipient of one type or more of these movements. Since its independence, Jordan has been exposed to almost all these kinds of migratory movements. These include the involuntarily and arbitrary

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immigration from Palestine in the two years of 1948 and 1967 during which Jordan represented the recipient country. As for the era of the seventies and beginning of eighties, which has witnessed the "oil boom", Jordan represented the source country of intensive labor migration, and the Arab states of the Gulf represented the recipient countries. Soon enough Jordan, in its turn, has become the recipient of a similar labor immigration the main source of which was Egypt in addition to some other Arab and Asian countries.

Similar to so many developing countries, Jordan has also witnessed an active and continuous internal migration, in the direction of the main cities in search for work.

The housing sector in Jordan was able to cater for these major demographic changes through cooperation of both the public and the private sectors in this field. In the mid sixties, the government established a specialized corporation, namely the "Housing Corporation" to assume the responsibility of constructing housing unit to be sold to the 'employees of the public sector subject to conditions and terms suitable to their incomes. Then, soon enough this opportunity was made available to all the citizens to benefit from such projects. The corporation was able to supervise numerous, good housing projects despite the fact that it applies systems subject to red tape and that its services need to be further developed and improved.

At the beginning of the seventies, and within the context of the three-year development plan, the government has seen it necessary to encourage and enhance the establishment of a specialized bank for *financing* housing projects. Consequently, the Housing Bank was established in 1973 with the strong support and encouragement of the government. However, this Bank did not confine its activities to financing house-building projects only as it may be understood from its name, but it began to assume all the customary banking transactions, exactly as any other ordinary bank while maintaining its main activity in the field of financing housing projects.

Generally speaking, the general institutional and organizational framework which comprises the different organizations and institutions

working in the field of housing, includes two kinds of corporations with regard to the nature of services rendered by them, namely:

- Corporations Executing Housing Projects.
- Corporations Financing Housing Projects.

Both the public and the private sectors contribute to the ownership of these two types of corporations.

A) House Building Corporations

These include public and private corporations which undertake the construction of collective or individual residential premises with the aim of selling them whether for profit or not and they include:

- Governmental housing corporations such as the Housing Corporation and the Urban Development Department.
- Real estate companies which are mostly owned by the private sector and which exercise their activity with the main object of earning profit through construction and sale of real estate.
- Cooperative societies.

B) Housing Finance Corporations

These are institutions which provide finance to collective or individual housing projects whether for earning profit or not and they include:

- Specialized housing corporations "the Housing Bank".
- Commercial banks and financial institutions.
- Cooperative societies and saving funds.

Naturally, the methods, systems and means used by these house building finance institutions in the course of exercising their activities are not necessarily the same, as some of them aim at achieving social objectives, others are profit oriented. Again some of these institutions undertake their activities on *riba*, basis where as others operate according to the teachings and directives of Islamic *shari'ah*.

It is noteworthy that some of these financing corporations undertake directly the execution of housing projects as it is the case with the Jordan Islamic Bank which executed a distinguished housing project, viz. Rawdhah Suburb Housing Project on which we shall have more to say later on. However, it is to be noted in this respect too that the Housing Bank has not been involved so far in banking activity other than its activity as housing bank.

In general, the housing sector has been able so far, and within its above mentioned composition and setup, to maintain a balance between supply and demand in this sector, and even achieve a surplus in supply sometimes, especially in the sector of luxurious housing allocated to high-income groups. In 1984 the share of residential buildings in Gross Capital Product (at current prices) was 163 million dinars. In 1987 it declined to 85 million dinars.

ESTABLISHMENT OF JORDAN ISLAMIC BANK AND ITS ACTIVITIES : INCORPORATION OF THE BANK

The Jordan Islamic Bank for Finance and Investment was founded under a special act issued in 1978, and was registered as a public joint stock company in 1978 with an initial capital of four million dinars which was increased to six million dinars in 1986 and 7.2 million dinars in 1990. It assumed its duties since 1979.

The Bank was founded in fulfillment of the needs of a broad sector of depositors and investors who were longing to have banking and investment dealings on the basis of the Islamic *shari'ah*, a need which other conventional banks and financial institutions failed to satisfy. The statute, and articles of association of the Bank have defined its objectives and ends, as well as the basis on which it exercises its activities in a manner that would assure absolute avoidance of *riba* in its dealings. These laws made it incumbent upon the Bank to appoint a *shari'ah* advisor for it to study and review the regulations of the Bank in order to make sure that they are free from any aspect of *riba* which the Bank was committed to avoid.

THE OBJECTIVES OF THE BANK

The law of the Bank have clearly defined its objectives and ends. There include addressing economic and social needs in the field of banking services, and undertaking transactions of financing and investment according to the teachings and rulings of Islamic *shari'ah* which prohibit *riba*. In particular, the following ends are explicitly mentioned:

- (1) Rendering *riba-free* banking services with due attention to services which aim at reviving the various forms of social security and solidarity and serving common interest.
- (2) Developing suitable means for mobilizing funds and directing them towards participation in investment through *riba-free* banking methods.
- (3) Providing the necessary finance for meeting the needs of the various groups, particularly those groups which can in no way benefit from the *riba*-based banking facilities.

BANKING OPERATIONS

The Bank undertakes all aspects of customary or newly introduced banking activities within the scope of its prescribed commitment to the rulings and teachings of the tolerant Islamic *shari'ah*. These activities include the following:

- (1) Accepting deposits, clearing cheques, collecting trading bills, managing remittances, creating documentary credit, issuing warranties, securities, letters of guarantees and credit cards besides all 'other banking services.
- (2) Dealing in sale and purchase of foreign currencies according to the prevailing rate of exchange.
- (3) Administering properties and other assets on the basis of paid agency.

- (4) Undertaking the role of selected guardian to administer legacy and execute wills.
- (5) Conducting studies for its clients, and providing all kinds of information and consultancy services.

DEPOSITS

The Jordan Islamic Bank accepts deposits (in local and foreign currencies) in three kinds of accounts, namely:

1. Credit Accounts (current and call accounts): These are the accounts in which the holders deposit their funds with a trust charge without sharing in the profits or bearing any risks while authorizing the Bank to utilize the deposits. The Bank takes the gains and bears the losses and makes no conditions on depositing and withdrawal of such funds.
2. Joint Investment Accounts: These are the accounts in which the Bank accepts deposits from those wishing to participate with it in the financing and investment operations which it undertakes on the basis of joint *Mudarabah* in return for part of the profits which accrue in the relevant fiscal year. These are savings accounts, call deposits, and time deposits.
3. Special Investment Accounts: The Bank accepts deposits in the special investment accounts from those desirous of investing their funds in certain project or for a specific purpose through certain arrangements to be agreed upon between the depositor and the Bank. The Bank keeps separate accounts of all the revenues and expenses of these projects apart from all the other revenues and expenses of the joint investment which the Bank undertakes. The Bank share in the profits of these projects in return for its effort in administration. In case of loss, it is borne by the capital owner unless there is a certain misconduct or negligence on the part of the Bank (Mudarabah Financing).

FINANCING AND INVESTMENT OPERATIONS

The Bank's law stipulates that it may undertake all *riba-free* financing and investment operations through the means which fulfil its objectives including:

- (a) Provision of necessary financing - wholly or partially - in all operations that are subject to self-liquidation, including forms of financing by *Mudarabah*, *Murabahah lil a'mir bil shira'*, *Musharakah* and all other similar forms.
- (b) Utilization of the funds whose owners desire to invest them jointly with other resources to be provided by the Bank in accordance with the system of joint *Mudarabah* besides, investments made under any other special agreement.
- (c) Incorporation of companies in different fields, acquisition of mobile and immobile property as well as investing and leasing in fields such as agriculture, industry and housing.

ACHIEVEMENTS OF THE BANK

The Bank has succeeded in accomplishing so many objectives in various fields, including:

- Provision of large scale services to encompass the different regions of the Kingdom throughout its branch network which so far comprises 21 branches and three offices.
- Meeting most of the banking needs of those who are not desirous ! of participating in *riba*-based transactions. The number of dealers with the Bank has so far reached about 200 thousand citizens.
- The Bank succeeded in occupying the third position among banks operating in Jordan with regard to size of assets, deposits and investments.
- The Bank contributed to the training of pioneer cadres of Islamic banks and financial institutions in many Arab and

Islamic countries like Mauritania, Qatar, Turkey, Bahrain as well as others like China and the U.S.A.

Major Items of the Budget

Table No. 4.4 shows the evolution of the major items of the budget of the Jordan Islamic Bank during the period 1985-1990:

TABLE No. 14

**MAJOR ITEMS OF THE BUDGET OF THE
JORDAN ISLAMIC BANK**

Customer's Deposits

(Million Dinars)

Years	Total Assets	Credit A/c.	Joint Invest- -ment	Total Credit A/c + Joint Investment	Special Invest- -ment A/c.	Finance & Investmen t	Paid Capital & Reserves
1985	126.8	23.7	79.1	102.8	10.7	71.0	4.9
1986	161.7	26.6	101.0	127.6	16.0	96.6	9.8
1987	197.4	31.2	127.8	159.0	16.9	109.0	9.9
1988	222.6	35.1	143.7	177.8	17.2	124.2	10.3
1989	242.3	43.7	143.6	187.2	19.7	144.0	10.7
1990	244.8	38.7	161.7	190.4	14.2	148.9	11.9

Source: The Jordan Islamic Bank - Amman.

ISLAMIC FINANCING INSTRUMENTS USED BY THE JORDAN ISLAMIC BANK

The Jordan Islamic Bank assumed its operations in the field of housing and real estates side by side with a group of financial and real estate institutions in a competitive real estates market that has two segments:

- Competition among all the operating institutions exercising the same activity.
- Competition within one group of institutions whose activities are based on similar rules, means and fundamentals that distinguish them from ;other groups, such as Islamic institutions on the one hand and non-Islamic institutions on the other.

The Jordan! Islamic Bank undertakes according to its statute, the construction, sale and purchase of difficult types of, through techniques derived from *shari'ah*.

These techniques include:

FIRST: *MURABAHAH LIL AMR BIL SHIM*: According to this technique the Bank 'endeavors to fulfil the request of the client by purchasing what the client requests subject to commitment on the part of the client to purchase what he ordered and as per the method of determination of profit and repayment mutually agreed upon on commencement of the operation. It is evident that- this method of *financing* is more relevant to sectors of commodity production rather than services, and can be applied without limitations or restrictions on the commodity, with the only exception of *shari'ah* or legally prohibited commodities. Application of this technique could take one of the following forms:

The First Form is when the commodity, dealt in is building materials such as cement, steel, water supply devices, electrical equipment, doors, windows and the like. The Islamic bank sets down flexible terms and conditions for the purpose of granting this kind of financing in response to the needs of its customers. Such terms and conditions include in the following:

- (a) The plot of land on which the house is to be constructed should be owned by the beneficiary himself. This condition is applied; also to a house which needs to be expanded or completed.
- (b) The maximum period of repayment is eight years.

- (c) Instalment (monthly or annually) should not be more than 40% of the beneficiary's income (for the period). It should be noted that this condition has taken into consideration the other living needs of the beneficiary which he should meet. The client therefore would not burden himself with building a house with enormous financial commitments that he may find himself incapable of confronting.
- (d) The beneficiary should obtain the necessary license from the concerned authorities.
- (e) Appropriate guarantees, should be provided by guarantor/s who is/are financially capable of acting in this capacity provided that the instalment is within the limits of 25 % of the guarantors income. The property should be mortgaged in favor of the Bank in an initial lien if the value of the finance exceeds four thousand dinars.
- (f) The Bank sometimes grants a period of grace of not more than 6 months from the beginning of utilization.

As regards the *Murabahah* profit which the Bank receives on this kind of financing, it differs according to the period and method of repayment (monthly, annual, ... etc) and the period of grace, if any, and as per the rate of return desired by the Bank.

Table No. (5.4) below shows the number of those who benefitted beneficiaries from projects implemented by the Jordan Islamic Bank, and the size of finance granted to them during the years 1987-1990 for financing building materials.

TABLE No. 2.4

FINANCING BUILDING MATERIALS,
NUMBER OF BENEFICIARIES AND AMOUNTS
OF FINANCE IN MILLION DINARS
DURING THE PERIOD 1987-1990

(Million Dinars)

Year	No. of Beneficiaries	Size of Finance Granted during the year (Million Dinars)
1987	2400	7.5
1988	4000	7.0
1989	4500	14.0
1990	4400	12.2

Source: The Jordan Islamic Bank - Amman

One of the most outstanding housing projects which the Bank financed within this framework was the project of the Cooperative Society for Housing of Aqaba City Employees which comprised around one hundred and fifty housing units on a total area of about 23 thousand square meters, with a total financing of approximately one million dinar.

The Second; Method of *Murabahah lil amir bil shira' is* when the Commodity dealt in is a finished house (whether an apartment in a building, or an independent residence villa). However, this method encountered the problem of double registration of the units sold with land registration authorities that is the Bank should, on purchase of the house, register it in its name first then in the name of the client when the purchase deal is finalized.

As the registration department collects fees on transfer of ownership and registration of the sold property in the name of the new owner at a rate of 10% of the sale price (6% to be borne by the

purchaser and 4 % by the seller), the cost increases in this way by about 16% of the total price.

SECOND: DECREASING *MUSHARAKAH*: It means that the Bank enters in the capacity of a financing partner - wholly or partially - in an income - generating project, on the basis of an agreement with the other partner whereby the Bank obtains a proportional share of the net income with the right to maintain any part agreed upon, as an allocation or reserve for repayment of the principal offered by the Bank.

According to this concept decreasing *musharakah* is an investment and financing technique at the same time, and is applicable to several activities. However, its practical application has been limited at most times to the sector of construction by virtue of its clear nature and easiness of administering its projects, and exercising administrative and financial control on them. In the light of the above mentioned concept, decreasing *musharakah* is applicable only to income generating projects so that the bank may recover from its income the principal it offers. The relationship between the bank and the client is a partnership which does not entitle the bank to have recourse to the other sources of income of the client for `recovery of the principal offered by the former in case of failure of the project to achieve the expected income wholly or partially.

The method of decreasing *musharakah* is applied at present to commercial building projects and to financing housing projects allotted to the bank's employees in accordance with particular terms and conditions for each project as shown below:

DECREASING *MUSHARAKAM* PROJECTS 1.

Commercial Buildings

The Bank undertakes this kind of projects by providing wholly or partially the necessary finance for constructing the building, while the client provides the plot of land on which the building is to be constructed, and perhaps part of the financing as well. As both the Bank and the client are convinced of the feasibility of the project according to the studies conducted on it, they proceed in its execution, and then its

leasing, selling or exploiting in any form that leads to achievement of the required return. The Bank assumes (with authorization from the client) the responsibility of 'managing the project and the revenue generated therefrom is divided between the Bank and the client as follows:

- (a) 25 % of the revenue to be allocated as the Bank's share.
- (b) The remainder (75 %) or any portion thereof agreed upon will be allocated for repayment of the principal provided by the bank until full repayment of such principal after which the whole project and its return is passed on to the hands of the client.
- (c) The Bank does - not require any guarantees to this type of financing except initial mortgage the building in its favor.

The number of projects financed by the Jordan Islamic Bank through this method reached about 70 projects in 1989 in the different regions of the Kingdom of Jordan, on a total area of about 63 thousand square meters. The projects comprise more than 591 commercial stores in addition to offices. The total finance of these projects amounted to approximately seven million dinars. Foremost among these projects is a complex of craftsmen and tradesmen in Erbid Municipality which contains about sixty stores at a total cost of more than 360 thousand dinars.

2. Staff Housing Projects

Finance in this case is granted to the employees of the Jordan Islamic Bank with the purpose of building or purchasing houses for them according to the following conditions:

- i) The employee should be working at the Bank for at least four years.
- ii) The maximum finance equals 75 monthly basic salaries of the employee.

- iii) The Bank leases the house to the employee with an annual rent equals 6 % of the total finance to be paid in equal monthly installments till full repayment.
- iv) The rent income is divided into two parts at a ratio of 85% for repayment of the principal and 15% as revenue for the bank.
- v) The employee mortgages the house in initial lien in favor of the Bank as a guarantee for repayment.

The number of employees who benefitted from the staff housing project until mid 1990 was about 80 employees and the total finance provided amounted to above 1.5 million dinars.

THIRD: SPECIAL INVESTMENT PROJECTS: These are projects which the Bank undertakes and supervises their execution and administration at the request of the investors/depositors in the special investment account opened therewith. The Bank may, as well, participate in financing these projects as it is the case with the housing project of Al Rawdhah Suburb which was executed on the basis of this type of financing.

1. The Housing Project of Al Rawdhah Suburb: The Bank undertook the execution and administration of this housing project on *musharakah* basis with a number of investors with the object of availing the citizens with the opportunity of owning suitable residence on the one hand, and helping the investors achieve reasonable profit on the other. This project is considered a distinguished one with regard to its site, integrated services and technical specifications, as well as the prices of its units and the terms of selling them.

The project was constructed on a plot of land with a surface area of about 40 donums in one of the best suburbs of Amman, the capital. The project contains seven residential buildings comprising 213 apartments at areas ranging between 123-253 m², and thirty independent housing units (villas) at areas ranging between 170-200 m², and a modern shopping centre composed of 67 shops at areas ranging between

56-78.5m². The project also includes a model school, library, conference and festivals hall and a mosque (which was given together with one flat as donation to the Ministry of Awqaf and Islamic Affairs). There are, as well, a parking lot and a central heating station in the suburb in addition to other services and utilities. The total cost of the project amounted to about 14 million dinars.

METHODS OF SALE AND MARKETING POLICY

At the outset of its marketing campaign, the Bank adopted the following three methods of sale:

Cash sale: As the purchaser pays the price in full in cash on purchase, the Bank promptly transfers the ownership of the unit to the purchaser.

Installment sale: The Purchaser who desires to own one of the residential units of the project in this method, should make a cash advance payment of not less than 15 % of the price, while the remainder is to be paid in installments over a period of not more than 15 years.

Lease ending with ownership: This method is based on leasing the residential unit to the client for a monthly rent for thirty years at the end of which the Bank assigns the ownership of this unit to the lessee without return on condition that he pays the rent of the first year in advance. (The lease amount for the first year was 10% of the cost of the unit).

Table No.(6.4) shows the advance payment and monthly installments of the two methods of sale in installments and lease ending in ownership for a sample of the residential units. However the method of cash sale was not applied.

Applying the installment sale and lease ending in ownership methods the Bank was able to market all the residential units at of the project in a short period of time. A total number of 216 units were sold through lease ending in ownership, while the remaining units were dealt with through installment sale.

It is note worthy that the government has given, on its part, a facility to the collective housing projects financed by banks as it exempted the residential units of these projects from the registration fees if the total area of the unit is less than 1500. If the area is 1500 or more, proportional fees with respect to the additional area are to be paid.

As for the shopping centers in the suburb, they were leased in the ordinary manner subject to suitable conditions.

FOURTH: DIRECT INVESTMENT: The Bank does not adopt the method of direct investment in the sector of real estates in the case of residential buildings only, but also in the case of commercial buildings. The Bank invests a portion of the funds allocated for investment, in buildings in different parts of the Kingdom and utilize some of these buildings as commercial stores and offices as well as other numerous purposes. The total value of these investments amounted to about 5 million dinars.

Table No. 3.4

SALE AND LEASE OF HOUSING UNITS

Type of the Unit	Area (M ²)			Total	Sale Arrangements								
	Closed	Open			Instalment Sale			Minimum Rent for year(1)	Lease/Ownership				
					Minimum Advance Payment	Monthly Installments			15 Yrs.	Monthly Rent for subsequent years			
						5 Years	10 Years			15 Years	20 Yrs.	25 Yrs.	30 Yrs.
Large Villa	200	106		306	7050	849	445	310	5550	343	264	217	187
Small Villa	170	123		293	6000	724	379	264	4700	292	225	185	160
Large Flat	222	16		238	5400	648	239	236	4200	262	201	166	143
Medium flat	170	23		203	4300	515	270	188	3350	208	160	132	114
Below Medium at	139	-		139	3000	362	190	135	2350	146	113	93	80
Small Flat	122	-		122	2800	234	175	122	2200	135	104	86	74

SOURCES OF FINANCING HOUSING AND HOUSING-RELATED OPERATIONS

The funds utilized by the Jordan Islamic Bank in House Building Finance include the following:

1. Deposits in joint investment accounts.
2. Deposits in special investment accounts.

These two sources provide funding for the operations pertaining to construction of residential buildings as follows:

1. Operations of *Murabahah lil amir bil shira'* for financing building materials, and purchasing finished houses. There are also projects of decreasing *musharakah* and direct investment, financed from the deposits of the joint investment accounts.
2. Special investment projects: As is the case for the Rawdha project mentioned earlier. Such projects are financed from the special investment account and the Bank may contribute to them from its ordinary investment account.

CONSTRAINTS AND OBSTACLES OF FINANCING HOUSING PROJECTS

Islamic financing institutions encounter a set of legal and financial obstacles which jeopardize their expansion in financing housing projects. These obstacles could be summed up as follows:

A. Legal Obstacles

These are obstacles related to legislations and contracts such as:

- Ambiguity of the concept of Islamic contracts to the layman as well as to the concerned institutions and the absence of the spirit and philosophy of these contracts in the prevailing laws as is the case for the contract of lease ending in ownership referred to earlier.
- Inflexible interpretation of laws as regards the case with duplication of the registration fees on buildings referred to above.
- Inability of the Bank to benefit from the Central Bank as the lender of last resort to safeguard the amounts directed to housing finance.
- Unavailability of sufficient tax incentives, and multiplicity of taxes on houses and real estates such as the income tax, roofed spaces tax.

Had the tax law exempted the revenues the Bank generates from housing finance from the income tax wholly or partially, the Bank would have expanded its operations in this field while at the same time this exemption would have been positively reflected on the beneficiaries as well.

B. Financial Obstacles

These are the obstacles relating to supply of and demand for funds such as:

- The ability of the bank to control and monitor its cash flows by making trade off between the terms of maturity of the funds invested in financing housing projects which are usually of a long term nature and the terms of deposits with the bank, which are mostly of short and medium term nature.
- The ability of the bank to reconcile the demand of depositors and shareholders to achieve rewarding returns on their deposits on the one hand, and the demand of the clients to obtain low cost finance on the other.

Annex (1)

CONTRACT FORM No. (1)

CONTRACT OF INSTALLMENT SALE OF IMMOVABLE PROPERTY

A) First Party (Seller) - the Jordan Islamic Bank for Financing and Investment, Amman (Jordan).

B) Second Party (Purchaser)

Name	No. of Identity Card	Address
------	----------------------	---------

Third Party (Guarantor)

Name	No. of Identity Card	Address
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Whereas the First Party owns the plot of land No. (.....) in the No. (.....)in the city of.....

And whereas the First Party constructed a real estate project on the above mentioned plot of land for selling it on the basis of the Law of Ownership of Multistory Buildings and Flats No. 25 for the year 1968;

And whereas the Second Party reviewed the design, plans and technical specifications of the building as well as any modifications related to it and approved them all, and has thus exploited his right to any objection to the design, plans, sketches or technical specifications regardless of the reasons of his objection;

And whereas the Second Party desires and accepts to purchase the residential unit No. (--) of the above mentioned project on the basis specified above, and has submitted the application No. (-----) dated () for this purpose;

And whereas the First Party has accepted that he wishes and accepts to sell to the Second Party the above mentioned residential unit;

And whereas the Second Party has no right to change or modify the sold property specified in this contract or its agreed upon conditions except with a written approval from the First Party, and as then the first contract shall be considered annulled and a new contract needs to be effected,

And whereas the Third Party has accepted to provide to the Second Party an absolute joint guarantee that continues in effect till full repayment.

It has been mutually agreed by the above mentioned parties on the following terms and conditions:

1. The foregoing preamble, the relevant applications and other documents as well as the related designs, plans, specifications and modifications, shall be considered an integral supplementary part of this contract.

2. The Second Party agreed with the First Party on buying the residential unit in an amount of (-----) dinars (only ----- ---- dinars) as joint property as per the definition stipulated for in the Law of Ownership of Multistory Buildings and Flats, and the First Party agreed to sell to the Second Party this flat in the said price.

3. The Second Party undertakes to pay an advance payment in the amount of (---) dinars.

4. The balance of the agreed upon price of the sold property in the amount of (-----) dinars in addition to the expenses which the First Party has actually borne in connection with implementation of this contract, is considered a debt owed to the First Party by the Second Party and/or the Third Party as being a guarantor. The First Party enters the debt in the account of the Second Party as of the date of this contract. The Second Party shall be committed, on registration of the sold property to mortgage the estate described in article two above to the first party, in guarantee of

repayment of the debt and any charges or extra payments the first party has paid or shall pay on behalf of the second or third party.

5. The second party and/or third party shall be committed to pay to the first party the value of the debt specified in article four above in the following order:

- (a) Number of installments ().
- (b) The amount of installment is () dinars (only_____dinars).
- (c) The date of maturity of the first installment is the beginning of the month of _____ in the year _____ , and each of the remaining installments shall fall due at the beginning of every following month. The second party and/or third party shall be committed to sign any documents or bills of exchange in the value of each one or more of the installments to the order of the first party. However, in case of default to pay any installment or part thereof on its date of maturity, all the subsequent installments shall fall due and become payable.

6. The second party and/or third party shall have an absolute commitment to authorize the source from which he obtains his income or any other place of work he may move to in the future, to transfer the value of the above mentioned installments in repayment of the debt, to the first party. The second party and/or third party shall be committed, as well, to secure the approval of this source on this procedure, and not to cancel any such authorization except with the written approval of the first party. The first party may, on the basis of this authorization, request from the employer of the second party and/or third party to withhold the value of the installment from the income of the second party and/or third party and transfer it to the first party in repayment of the said debt.

7. 'The second party shall not be entitled to dispose of the sold property in any manner that may result in any harmful effects upon the first party

such as sale, lien, endowment, donation or any other usufructuary right as long as he did not pay its price in full and without obtaining a written approval of the first party. _ The first party shall not be held liable toward others for any commitments or rights arising there from.

8. The first party undertakes to transfer the ownership of the' sold property in the name of the second party after completing the dealings of partition in kind and any other necessary dealings as per the rules in force.

9. The failure of the second party to accept the cession of the said property as mentioned in this contract on the date fixed by the first party shall be considered as violation to and deviation from the contract. In this case, the first party may cancel the contract at its sole discretion and restore the sold property clear and free of any. objects, while holding the second party liable for any damage, failure or any other rights, however, serious they are without the need for a pre-notice procedure and the first party shall be taken for his word without an oath.

10. The second party shall be committed to place the sold property as guarantee for the debt under this contract on undertaking the cession by mortgaging it in favor of the first party, and to pay all the fees and dues resulting from the mortgage operation with the concerned department.

11. The first and, second parties agree to register the sold property and hand it over to the second party within a period not later than the date of signing this contract with a period of delay not exceeding two months. The first party should exert every effort to install water and electricity devices as agreed upon. However, the period of registration and handing over and that of delay do not include these services as being subject to circumstances of governmental dealings.

12. In case the immovable property mortgaged as guarantee to the debt is affected by natural forces or unforeseen events, the second party and/or

third party is obliged to notify the first party within thirty days from the date of occurrence of such an event.

13. The second party shall be committed, if the first party so requests in writing, to participate in the mutual insurance and self-insurance funds which the first party has established for this purpose, or to make insurance at any insurance company operating according to the rules of Islamic *shari'ah* and approved by the first party for this purpose.

14. In case of payment of any indemnities arising from and/or related to the death of the second party or damages in the insured properties or from acquisition of part of the properties placed in lien to the debt and/or for any other reason, the first party shall be entitled to receive all the compensations in order to settle the balance of the debt or any other commitments required from the second party to the first party. Any remaining amount shall be entitled to the second party or his legitimate heirs.

15. In case of violation of any of the conditions of this contract by the second party or his failure to repay any of the installments on its due date in whole or in part, he shall be considered to have breached the entire contract, and all the remaining installments shall fall due in one payment, and the first party shall have the right to implement the lien contract and sell the mortgaged property in fulfillment of the debt.

16. The second party shall be considered in his capacity as purchaser, partner with the other owners, in the ownership of the land of the building and the parts thereof prepared for common use, or any other part which is registered under this description, or the nature of the building necessitates its being common, and this particularly includes the following:

- (a) The foundations and main walls.
- (b) The common separating walls and the walls prepared for the chimneys and for bearing ceilings.

- (c) The ventilation ducts of the water closets.
- (d) The ceilings' pivots, vaults, entrances, staircases and its enclosures, corridors, hallways, elevators and the porters' rooms.
- (e) The heating and cooling systems, and all kinds of pipes, water mains, spouts, sewage; pipes, common installations, fittings and extensions of electricity and water and their accessories except these inside the sold property.

17. The second party shall have the right to use the part he owns in the building independently in the building, as he may also use the above described common parts for the purposes for which they are made in compliance with the public order and common interest, and in a manner that may not prevent the other partners from using their rights. He may not, as well, undertake any modifications in the part he owns independently or in the above described common parts without the approval of the first party and the other owners. Each owner should contribute to the costs of preservation, maintenance and renovation of the common parts, and his share in these costs is pro-rata the part he owns in the building. However, the owner may not give up his share in the common parts in order to evade participation in the above mentioned costs!

18. The second party shall be committed to maintain the external painting of the sold property without the least change in the color, shape or general appearance of the sold property, the building or the housing project as a whole.

19. The second party and/or third party undertakes to abide by all the conditions and obligations included in this contract and its annexes. This undertaking shall be applied to his inheritors who should not disregard any of the conditions which were binding to their legator. These commitments are indivisible among his inheritors, and they are all jointly committed to abide by these undertakings, conditions and obligations, and no one of them

may make any excuse for the possibility of fragmenting these commitments.

20. The first party shall be entitled to transfer, wholly or partially, all his rights under this contract and its annexes to any other party at any time without the need to obtain the approval of the second party and/or third party, and without the need for the first party to serve pre-notice or warning to the second party. However, this does not prevent the first party from notifying the second party with any of the above mentioned changes.

21. The parties agreed to pursue the method of handwriting between them as a proof of any dealings concerning the implementation of the items of this contract, and to abandon the procedure of legal notices and warnings and replace it with just sending a prepaid registered letter from one of them to the other on the above mentioned address or any other address with which the other party is notified.

22. The second party and/or third party acknowledge that the first party is trustworthy and taken for his word without an oath concerning the implementation of this contract, and that his books and accounts are considered final evidence for proving any amounts arising from and/or relating to this contract and its applications whatever it is and that all the entries and accounts of the first party are considered final and correct and that the second party has no right to object to them in any way. The second party shall also waive in advance any legal right that authorizes him to request reviewing and auditing of the accounts and entries of the first party by any court. The statements photocopied from these books and accounts and verified by the persons authorized to sign on behalf of the first party shall be accredited by the second party.

23. The second and/or third party acknowledge that if in case of maturity of any of the commitments they owe to the first party, they default to fulfil it despite their solvency and ability to do so, the first party may claim the loss it sustains as a result of and/or in relation to the event of their failure to

pay even during the period of delay. However, in case no agreement is reached concerning assessment of thus incurred loss, the claim shall be referred to the arbitration stipulated for in this contract. It is understood that a solvent debtor is a person who owns movable, or immovable property that neither Islamic *shari'ah* nor the laws and systems in force prevent disposing of it whether such property is mortgaged or not and if such property is sufficient to repay who or partially the obligations and commitments. The first party shall be entitled to claim the amount of loss it sustains without the need to serve a legal notification, warning, notice or any other procedure.

24. The third party acknowledges that he does not hold any right towards the first party to claim reduction of the value of the debt for any reason whatsoever.

25. The third party, guarantees the second party under this contract in continuous joint surety till maturity, and then absolute surety without any reservation, for full repayment of the debt and any charges related to it as per the terms and conditions of this contract.

26. If dispute arises in application of this contract and/or in relation to it, the first party may refer the dispute to a board of three arbitrators to be selected as follows:

- An arbitrator, to be selected by the first party.
- An arbitrator, to be selected by the second party.
- An arbitrator to be selected by the Chamber of Commerce and/or industry of Amman.

In case The Amman Chamber of Commerce and/or Industry apologizes for not being able to select the third arbitrator, the two other arbitrators selected by the two parties shall elect one with their mutual agreement. If they fail to do so, or if the second party abstains from selecting his arbitrator, then the competent court shall appoint an arbitrator and/or

arbitrators in accordance with the provisions of the Law of Arbitration in force in Jordan. Settlement of the disputes takes place on the basis of Islamic *shari'ah*, and 'arbitrators' award is binding to the two parties and is incontestable in any of the legally permitted methods of contest (whether passed unanimously or by majority). In case of unavailability of majority, the dispute subject of arbitration shall be referred to the regular courts of Amman which shall be the only court authorized to settle any claims and/or issues arising from and/or relating to this contract.

27. The second party shall be committed with the following:

- (a) Providing the first party with any documents it requires in relation to the dealing and its implementation whether at present or in the future. Failure to fulfil this request shall make the second party liable for delay, and consequently, the first party may refuse to register the sold property unless all the required documents for completing the file are made at its disposal.
- (b) Signing before the concerned legal authority the system of administration of the building, and the contract of the owner's society in accordance with--the legal provisions and conditions stipulated in the Law of Ownership of Multistory Buildings and Flats No. 25 for the year 1968 and the other related laws and regulations.
- (c) To be a member of the owner's society with a view of solving any common problems, and developing the spirit of cooperation among the inhabitants of the area:

28. The second and third parties authorize the first party to enter any installments or charges or amounts which fall due under this contract in the accounts of the second and/or third party opened with the first party, and that the mere signing on this contract is sufficient to make such authorization effective.

29. This contract shall be considered in force on all the undersigned parties and each party forfeits his rights in claiming the falseness of this contract and/or the circumstances which surrounded its formulation or raising any plea against its contents.

30. (a) The second party acknowledges that he has reviewed and took cognizance of the Articles of Association, Articles of Incorporation, and the Statute of the first party and shall be committed to them on the basis of shari'ah-permitted dealings.

(b) The provisions of the Jordanian Civil Law and the other regulations in force shall be applicable to this contract except in what has been mutually agreed upon between the parties.

(c) This contract is signed in the city of Amman in two original copies by the parties on the date shown below with their free will and without any shari'ah-related or legal prohibitions and both of its two copies shall be equally binding.

31. The following additional conditions shall also apply to this contract:

(a) The second party shall have a parking place for one car in the parking lots allotted for the housing units as per the type of the residential unit he owns and in accordance with the arrangements in force under the contracts of lease ending with ownership or the contracts of installment sale precedent to this contract.

(b) The purchaser shall bear all the legal fees and duties due on transfer of ownership whether those of the purchaser or seller.

Amman: On / / H.
 / / G.

First Party Second Party Third Party

Witness: Name: /Passport/I.D. Card No.....Issued
from.....on Address
.....
.....

Witness: Name: /Passport/I.D. Card No.....Issued
from:.....on Address
.....
.....

Annex (2)

CONTRACT FORM No. (2)

CONTRACT OF LEASE ENDING IN OWNERSHIP'

This contract was signed in Amman on / /19 , between:

FIRST PARTY: (LESSOR):

The Jordan Islamic Bank for Financing
& Investment

SECOND PARTY: (LESSEE):

THIRD PARTY: (GUARANTOR):

Whereas the First Party owns -----, provisional number () floor
provisional number () constructed on the plot of land No. (...) district of
----- No. (....) in -----

And, whereas the Second Party wishes to lease -----described above,
the Parties mutually' agreed on the following:

1. The foregoing preamble is considered an integral part of this contract.
2. The second party agreed upon leasing --- described above in accordance with the following:
 - (a) In the amount of () ----- dinars for the first year which begins on ----- to be paid in advance.
 - (b) In the amount of () ----- dinars annually starting from the beginning of the second year which starts on ----- and for a period of 29 years. "The rent shall be paid in equal monthly installments at a rate of () --- dinars to be paid at the beginning of every month.

(c) Annual services allowance at a rate of () -----dinars to be paid in advance at the beginning of every year. The services allowance shall increase steadily with the increase of the cost of common public services, which represent illumination, cleaning and all other common services. The First Party shall determine this increase solely without the least objection on the part of the Lessee and in this the First Party is trustworthy and taken for its word without an oath.

3. In case the Second Party defaults to pay any installment (in any year) on its date of maturity, all the subsequent installments for this year shall become payable promptly.

4. The First Party is committed to undertake, after the Second Party fulfills all the conditions of this contract, to register the above mentioned leased unit in the name of the Second Party at the end of the lease period.

5.(a) The Second Party is committed to bear all the expenses and charges relating to common utilities in the building such as, common water, sewage and electricity networks and the like.

(b) The Second Party shall bear a share in. the cost of the heating station which includes the costs of operation, maintenance, fuel, electricity, water and the cost of depreciation of this station as a result of operation and/or lapse of time and/or any other reason which necessitates replacing it with. another heating station. The First Party shall determine this share in the light of the thermal units which the heating meter on the leased unit indicates, and/or in accordance with the arrangement the First Party shall. make including fixing a minimum charge to be paid to the First Party in case of non-occupancy of the leased unit, by the lessee.

(c) The Second Party shall be committed, as well, to transfer the electricity and water meters of the leased unit in his name and at his own expense and to bear all the related expenses.

6. The second party has no right to object to any of the dispositions of the first party regarding the other flats in the building subject to the contract.
7. All the common public utilities in the said building belong to all the persons who have the right of using the building. These utilities include, for example, the staircases, the common spaces, the common facades, water, sanitary and electricity extensions from which all the persons holding units in the building benefit; and the second party has no right to object to their use or maintenance.
8. The first party may undertake any constructions, alterations, renovations or repairs of any kind or nature it deems suitable in the building without the objection of the second party and/or his successors to this in any way, provided this does not affect the second party's right of using the leased unit.
9. The second party is committed to pay the Roofed Spaces Tax and any other taxes and levies on the leased unit, as well as all the fees of registration including the stamp duties whether borne by the first or the second party.
10. The second party shall be committed to:
 - (a) Pay all the amounts required from him on their dates of maturity, or any other necessary amounts required from him without delay together with all due fees, taxes, levies and expenses and to take all the necessary measures for effectuating such payments.
 - (b) Refrain from doing any acts which may cause damage or noise or disturbance to his neighbors in the leased unit.
 - (c) Refrain from undertaking any alterations in the leased units and its utilities, such as deleting or adding any parts except after obtaining a written approval from the first party, and provided such alteration would not affect in any way the rights of the other partners.

- (d) Make up for any wear or tear, or damage which occurs in the leased unit, and undertake all the maintenance and repair works of any failures or damages.
 - (e) Refrain from sub-letting the leased unit or part thereof to any other person, or to allow any such person to occupy it without prior written approval of the first party.
 - (f) Safeguard the leased unit and its annexes, and take all the necessary measures and precautions for this. He should not, as well, put in the property any materials or equipment that may cause any damage to it, or threaten its safety or affect the rights of the other partners.
11. The second party shall be committed to maintain the external painting of the leased unit without the least change in the color, shape or general appearance of the building and the housing project as a whole.
 12. The second and/or third party undertakes to implement and abide by all the conditions and obligations included in this contract and its annexes. This commitment shall be applicable to his inheritors who shall have no right to discharge of any of the commitments which were binding to their legator. These commitments are indivisible among his inheritors, who are all jointly committed to implement and abide by, and no one of them shall make any excuse for the possibility of fragmenting these commitments.
 13. The first party shall be entitled to transfer wholly or partially all its rights under this contract and its annexes to any other party at any time, without the need to obtain the approval of the second party and/or third party, and without the need for the first party to serve pre-notice or warning to the second party. However, this does not prevent the first party from notifying the second party with any of the above mentioned changes.
 14. The parties mutually agreed to pursue the method of hand-writing between them as a proof of any dealings concerning implementation of the

items of this contract, and to abandon the procedure of legal notices and warnings and replace it with just sending a registered letter from one of them to the other on the above mentioned address or any other address with which the other party is notified.

15. The second party shall, if the first party so requests in writing, participate in the mutual insurance and self-insurance funds which the first party establishes for this purpose, or make insurance at any insurance company operating according to the rules and teachings of Islamic *shari'ah* and approved by the first party for this purpose.

16. In case of payment of any indemnities arising from and/or relating to the death of the second party or resulting from the occurrence of damage in the insured properties, or from acquisition or taking possession of part of the properties placed in lien to the debt and/or for any other reason, the first party shall be entitled to receive and cash all the compensations in repayment of the balance of the debt or any other commitments required from the second party to the first party. Any remaining amount from such compensations shall be entitled to the second party or his legitimate heirs.

17. The first party shall have the right to consider all the amounts due on the second party to it under this contract payable after serving written notice on the second and/or third party therewith, and shall also have the right to consider this contract terminated with all the rights arising therefrom automatically without the need to serve a legal court notice, or to resort to courts in the following cases:

- (a) Breach of the second and/or third party of the provisions of this contract and/or-any item of it.
- (b) Default of the second and/or third party to pay any of the due installments or any other amounts required by the first party under this contract within two weeks.

- (c) Default of the second and/or third party to pay the taxes and levies due on the building.
- (d) If any of the facts which the second and/or third party acknowledged -to be accurate and correct or any of the certificates or document they presented to the first party is found to be false.
- (e) If any governmental authority refuses to issue, delays, withdraws, amends or suspends the issuance of any license, registration, partition in kind, authorization or approval necessary for the purposes of this contract. In case of occurrence of any disagreement in this respect, the two parties may refer the matter to the arbitration board stipulated for in this contract.
- (f) Bankruptcy of the second and/or third party, or confiscation of the properties of either of them by court verdict, or his failure to either repay his debts, or enter into settlement arrangements with his creditors.
- (g) If any penalty or procedure to execute a court judgement or lien for repayment of debt is sanctioned upon the second and/or third party, or a liquidator or a custodian is appointed on all or part of the properties of the second and/or third party as a result of claim for liquidation.
- (h) If the surety and/or guarantee for purposes of this Agreement becomes invalid and ineffective at any time or not binding in whole or part for any reason.

18. In case the first party considers this contract canceled automatically without the need to serve a legal notice or the like, or to resort to courts, then the first party may claim the actual loss it sustained from the second party together with all the incurred and expected expenses. The second party shall give the first party an absolute authorization to estimate all this, and his

estimation shall be considered final and binding to the second and/or third party and their successors without the need for a legal notice. In the event of disagreement on estimation of the said loss, the two parties may refer such disagreement to the arbitration board stipulated for herein.

19. The second and/or third party acknowledge that the first party is trustworthy and taken for his word without an oath concerning implementation of this contract, and that his books and accounts are considered a sufficient evidence for proving any amounts arising from and/or relating to this contract and its applications. The second and/or third party shall also admit that they consider all the entries and accounts of the first party final, correct and true, and that they have no right to object to them in any way. They shall also waive in advance any legal right that allows them to request reviewing and auditing the accounts and entries of the first party by any court. The photocopied statements from these books and accounts after being verified by the persons authorized to sign on behalf of the first party shall be approved and accredited by the second party.

20. The second and/or the third party acknowledge that in case of his/their failure to fulfil any of their commitments to the first party after its maturity and despite their solvency and ability to do so, the first party may claim the loss it sustains as a result of and/or in relation to the event of their failure to pay even during the period of delay. However, in case no agreement is reached concerning assessment of the loss, the claim shall be referred to the arbitration board stipulated for in this contract. It is understood and agreed upon that a solvent person is the one who owns movable or immovable property that neither *shari'ah* nor the laws in force prevent disposing of, whether such property is mortgaged or not as long as it is sufficient to repay the obligations and commitments stipulated for herein, wholly or partially. The first party shall be entitled to claim the amount of loss it sustains without the need to serve a legal notification, warning, notice or to follow any other similar procedure.

21. The third party guarantees the second party under this contract by providing a continuous joint surety till maturity, and then an absolute surety and guarantee, without any reservation, for full repayment of the debt and its related charges as per the terms and conditions agreed upon.

22. If dispute arises from application of this contract and/or in relation to it, the first party may refer the dispute to a board of three arbitrators to be selected as follows:

- An arbitrator to be selected by the first party.
- An arbitrator to be selected by the second party.
- An arbitrator to be selected by the Chamber of Commerce and/or Industry of Amman.

In case Amman Chamber of Commerce and/or Industry apologizes for not being able to select the third arbitrator, the two other arbitrators selected by the two parties, shall select the third arbitrator. If they fail to do so, or if the second party abstains from selecting his arbitrator, the concerned court shall appoint an arbitrator and/or arbitrators in accordance with the provisions of the Law of Arbitration in force in Jordan. Settlement of disputes shall take place on the basis of Islamic *shari'ah* and the arbitrator's decisions whether passed unanimously or by majority are binding to the two parties and incontestable through any method of legal contest.

In the absence of majority decision, the dispute subject of arbitration shall be referred to the regular courts of Amman which have the jurisdiction to settle any claims and/or cases resulting from arbitration and/or arising from and/or relating to this contract.

23. The second party shall be committed to abide by all the provisions of the Law of Ownership of Multistorey Buildings and Flats and to sign at the concerned department any regulations relating to administration of the common parts of the building or any other part registered under this

description or the nature of the building necessitates its being common. This particularly includes the following:

- a) The foundations and main walls.
 - b) The common separating walls, and the walls prepared for the chimneys and for bearing ceilings.
 - c) The ventilation ducts of the water closets.

 - d) The ceilings pivots, vaults, entrances, staircases and their enclosures,. corridors, hallways, elevators and the porter's rooms.

 - e) The heating and cooling systems and all kinds of pipes, water mains, spouts sewage, pipes, common installations, fittings and extensions of electricity and water and their accessories except those inside the leased unit.
24. The second party shall be committed with the following:

- (a) Providing the first party with any documents it requires in relation to the agreement and implementation of its items whether at present or in future. Failure to fulfil this request shall make the second party liable for delay, and consequently the first party may refuse to register the sold property in the name of the second party unless all the documents required for completing the file are available at 'the disposal of the first party.

- (b) Signing before the concerned department on the regulations of administration of the building, and the contract of the owner's society in accordance with the legal provisions and conditions stipulated for in the Law of Ownership of Multistory Buildings and Flats No. 25 of 1968 and the other related laws and regulations.

- (c) To be member of the owner's society with a view to solving any common problems, and developing the spirit of cooperation among the inhabitants of the area.

25. - The second and third parties authorize the first party to debit their accounts with any installments or charges or amounts which fall due under this contract, and the mere signing of this contract by the second and the third parties is sufficient to make the first party authorized to make such entries.

26. This contract shall be considered effective and binding to the undersigned parties, and each party forfeits his right to claim the falseness of the declarations and/or the conditions which surrounded the formulation of the contract and/or raise any subjective or objective plea against the contents.

27. (a) The second party acknowledges that he reviewed and took cognizance of the Articles of Association, Articles of Incorporation, and the Statute of the first party, and shall be committed to them regarding the legitimate and *shari'ah-permitted* dealings.

(b) The provisions of the Jordanian Civil Law and the other regulations in force shall be applicable to this contract with the exception of what is mutually agreed upon between the parties.

(c) This contract is prepared in the city of Amman in two original copies by the parties on the date written below with their ' free will and without the existence of any legal defects or prohibitions, and each copy shall be equally binding as the other.

28. The following additional conditions shall apply to this contract:

(a) The second party shall have a parking place for one car in the parking lots allotted for the housing units as per the type of the

THE EXPERIENCE OF THE AL BARAKA INTERNATIONAL BANK LONDON IN FINANCING REAL ESTATE

KHALIL SHALTUT*

INTRODUCTION

This paper is intended to explain the different methods applied by the al Baraka International Bank, London, in providing short and medium term financing - either for commercial or for housing purposes. Financing is usually given through *murabahah*, *musharakah* or *istisna'* techniques which rarely differ a great deal from methods followed by other Islamic Banks. Besides discussing these methods, the paper presents a brief outline of a special kind of financing offered to British citizens, especially young married couples, to own houses. The paper will also indicate the progress achieved by the housing sector in Britain during the past twenty years, and the privileges presented by the British Government in order to activate this sector. There is also the role played by individuals on which some elaborations could be made.

It is well known that loans provided by traditional housing societies and banks constitute *riba*-based lending and borrowing which prevented the overwhelming majority of the Muslim community from owning houses. They were forced to reside in rented houses and in most cases the monthly rent they pay exceed^s the monthly instalment of a loan. In addition to that, a large number of Muslim investors living in Britain refrain from investing in these institutions in spite of the high expected return, so as not to get involved in *riba*-based dealings. Before explaining in detail the alternatives

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offered by the al Baraka Bank, it could be better to briefly clarify, analyze and provide statistics, regarding the British housing sector.

FIRST : THE HOUSING SECTOR IN BRITAIN

1. Housing Reserve

The number of housing units in Britain in 1987, reached 22,250,000 units compared to a population of 55 million. The annual absolute growth of the housing sector from 1950 to 1980 was estimated at 250,000 units. However, there was a noticeable drop in this rate of growth during the seventies as a result of the great increase in the price of land, and interest rates, during that period. As a result, constructors were forced to buy, rebuild and improve old housing units which were already over 150 years old. With the advent of the eighties and as a result of the increasing demand for new housing units, the British Government was forced to allow the expansion and widening of the green belt in order to increase the land area on which houses could be built. This led to a positive effect and returned the growth rate of housing units to its normal annual average of nearly 200,000 units.

2. Ownership

The following data indicate the percentage of housing units owned by their occupants in the total number of housing units, and also a comparison of ownership percentages with those of Western European countries.

As shown below, the ownership percentage was 10% in 1914 (10 out of every 100 families owned their houses). The rate rose to 25% in 1950 with an average growth rate of 15% in 36 years. The average growth rate for a similar time span (36 years),. i.e., between 1950-1986 was 36%, as the rate of ownership was 25 % in 1950 and rose to 64 % in 1986 showing a rapid rise in the number of house owners and the desire of individuals to own their houses.

Britain	Western Europe	
1914-10%	Belgium	61% (1981)
1950-25%	France	51% (1982)
1965-46%	Italy	59% (1981)
1975-53%	Spain	77% (1980)
1985-62%	Switzerland	30% (1980)
1986-64%	West Germany	37% (1978)
1989-69%		

3. Real Estates Prices

Real estates prices in Britain have for long been characterized by modest increases. The average annual increase kept pace with the average annual increase in wages and salaries. The average price of a housing unit was three times the average annual income of a single family. With the noticeable rise in prices in the eighties, this average rate rose to four times the annual income. Prices witnessed an unusual increase in the period 1985-1988, from 17% to 25,% annually. This has led to an imbalance between prices and incomes and many persons could no longer afford to buy their own houses. This period also witnessed a remarkable increase in inflation and a growing deficit in the balance of trade. To curb down the rate of inflation and the trade deficit by trying to depress consumer spending and control imports of commodities, the Government raised interest rates on sterling deposits. The cost of borrowing rose and as a result the cost of housing loans also increased.

The effect of all this was that many people refrained from applying for housing loans; foreigners also kept their investments away from the real estate market. This has negatively affected the prices of real estate during the past three years. The market witnessed a noticeable drop in prices. Analysts consider that prices have reached a realistic level and expect that they will show a stable rate of growth in the coming two years parallel to the annual rate of growth of incomes.

The following table shows the average price of a housing unit from the seventies onward which has been sliced out to indicate the average price per economic housing unit throughout Britain.

TABLE No. 4.5

**AVERAGE PRICE OF HOUSING UNITS
IN BRITAIN (1971-87)**

Year	Average Price in Sterling
1971	5,659
1976	12,759
1981	24,503
1986	36,869
1987	42,546

4. Role of the Government and Financial Institutions

The British Government has played an important and positive role in activating and expanding the housing sector by providing many incentives and tax exemptions to those interested in this sector. This had a positive effect on increasing the volume of work of construction companies and commercial activities in this sector, besides providing employment opportunities for many.

Measures of Encouragement took the following forms:

- (a) Decreasing interest rates on housing loans provided by housing societies and banks by 25 %. This was applied to the first Stg. 30,000 of the loan to decrease the cost for the middle income group.

- (b) Providing financial non-refundable grants with a maximum of Stg. 15,000 for every housing unit through the municipalities for buyers of old houses constructed before 1919 to rebuild, improve and modify them.
- (c) Providing discounts of up to 60% of the market value of housing units and real estates owned by the Government, to give their occupants the chance to own them and thus become property owners rather than tenants.
- (d) Providing discounts and tax exemptions to construction companies to build specially equipped housing units for the elderly, (those above 60 years of age) and the handicapped.
- (e) Decreasing the registration fees paid at sale time to about 1 % of the sale price of the unit. These fees are imposed on sales prices in excess' of Stg. 30,000.

In the light of these incentives, housing societies and banks competed in presenting loans to small savers and encouraging them to deposit their savings with them in order to finance housing construction. Housing societies won the lion's share of these total savings. In 1986 they were able to attract 64 % of the total savings deposited by individuals to whom they also gave priority in getting housing loans.

It should be noted here that these are short term savings of durations varying between 6 months to a year, contrary to housing loans which extend to 25 years. As a result, there was quite a difference between the time period of investment deposits and loans. Thus these housing societies were obliged to pay higher interest rates to depositor than those paid by banks, for these investment deposits, in order to maintain the liquidity needed for responding to financing requests. Banks entered as competitors to these societies. Methods and means of housing loans varied accordingly. However, the details of these methods and means are not the purpose of this paper.

I have tried to shed some light on the housing sector and means of financing it available to individuals in Britain. I have also shown the important role of banks and housing societies in meeting these financing needs. To respond to the wishes of Muslims we had to carry out research and studies in order to find a suitable financing method for those wanting to buy houses, that would be in line with the principles of the Islamic *shari'ah*, and which at the same time, would not contradict with the British laws or affect the advantages and benefits offered by the Government to small owners.

This paper presents besides the methods applied by the al Baraka Bank, London in financing housing operations, the details of these methods, the obstacles faced by the Bank and how it got over them. One of the Methods discussed here is Decreasing *musharakah*, while the Bank retains his user's rights in lieu of its share in the real estate. This Method is denoted by the Bank as "Islamic Trust Funding Agreement".

SECOND : METHODS OF FINANCING

The nature and type of financing offered differ as regards duration and extent of participation by the Bank in the financing, in accordance with the purpose of financing. Purposes can be summed up as follows:

- Buying land for constructing buildings and selling them immediately as housing or commercial buildings.
- Buying land to build houses for rent either as housing units or for other purposes.
- Buying housing or commercial units to refurbish and sell them over a short term period.
- Buying houses or offices for investment or housing purposes for long periods extending to 20 years.

The Bank invests with its client through one of . the following methods:

1. Murabahah

Murabahah is suitable for short or medium term business operations with a time-span not exceeding two years and is more suitable for responding to the needs of small contractors who want to buy the land, build and immediately sell the premises. It is also suitable for those who buy old houses to modify and resell them, or break them up into small apartments each sold as an independent small units. This type of investment witnessed a boom over the past five years due to the great demand for such units and the high profit accruing to investors from dealing in them.

Under this Method, the Bank buys the property directly from the owner and resells it to its client. To avoid paying the registration taxes twice, which would increase the price and reduce profits, the Bank authorizes its client to buy directly from the owner-seller. The client pays to the bank the first down payment which amounts to 30% of the price, at the time of buying the unit. The rest of the price - including the profit of the Bank - is paid by the client according to the agreement reached with the Bank, either upon completion of the modifications and sale of the units or in monthly or quarterly payments.

Usually, the Bank reaches a prior agreement with the client about the dates of repayment of what the client owes to the Bank according to the *murabahah* operation. In guarantee of its rights, the Bank maintains a monopoly of ownership in lieu of its loan to the client which it gives up only when full repayment is made. Another condition imposed by the Bank under this system is an insurance policy borne by the client against the dangers of fire, destruction, or occurrence of any damage to the property.

This type of financing can also be expanded to comprise building materials needed for construction or modification of units. But *murabahah* in this latter case requires that the funding provided by the Bank does not exceed 50% of the price of these building materials. The Bank buys these materials directly from their suppliers and resells them to its clients at a

profit. The total price is paid by the client either in installments or upon completion of the restoration and sale of the property.

The Bank also makes sure that the funds it provides are for the purpose of buying the building materials and not for payment for labor.

General Conditions

1. The individual or company requesting the finance should be someone operating in this field and of good repute.
2. The client must open an account with the Bank, and it is always preferable that he be an old client of the bank so that the Bank may be acquainted with the volume of his work.
3. The client presents his application with a copy of his curriculum vitae, financial position, and in case of companies their budgets for the previous three years, as well as a feasibility study of the project, cost schedules and all documents pertaining to the project for instance as the preliminary license granted by the municipality.
4. After studying the project and if the Bank is convinced of the possibility of its success, a real estate expert visits the site and presents his opinion about the project, and the expected sale price of the units after completion of the project. This report is presented to the appropriate authorities to study it and make sure of its compliance with the conditions and specifications presented by the client and agreed upon.
5. The Bank, either through a specialist employed by it, or through an assessor or surveyor, visits the site at regular intervals to make sure that the project is carried on as desired.

2. *Musharakah*

The details and rules of *musharakah* as a financing technique are well known therefore I shall briefly explain how it is applied by the al Baraka International Bank, *London*.

The Bank participates with the client at percentages agreed upon beforehand. The Bank's participation may reach 95 % of the purchase or valuation price, whichever is lower. The Bank agrees with the client on the division of profits after deducting all expenses including the salary of the client for management.

Such operations are usually concluded with clients with whom the Bank had *murabahah* dealings in several operations. Thus the Bank is in a position to judge the ability of the client, to do the work. This does not prevent the Bank from participation with well known construction companies in the real estate market. The Bank appoints its own construction engineer to follow up the stages, of implementation and to regularly supervise the project. The engineer presents periodic progress reports indicating the obstacles encountered, by the project so that measures can be taken to overcome them.

Applications for *musharakah* financing are studied carefully including the economic feasibility study and cost schedules, lists of the materials and equipment necessary for the project, schedules of financial flows and estimated profits and losses. *Musharakah* may last for short periods of two years or medium-range periods of five years. The time-span depends on the nature and type of the project financed. As for institutions who mainly aim at renting the unit they build, an agreement is reached with them on the division of income from rent or deducting it periodically from the *musharakah* account.

British laws are quite flexible with regard to this type of financing. It is quite easy to establish a limited company for *musharakah* in a particular

project with an agreed upon capital. The regulations of the company specify the role of each partner in the financing, management, duties and rights, as well as the division of profits and bearing of the losses, the period of the company and the bases upon which the partners can buy each other's shares. The rules also define what needs to be done in case of bankruptcy, sale, liquidation and the appointment, in case of dispute, of an arbitral tribunal that could comprise a jurist. The members of the arbitral tribunal are agreed upon in advance and its decisions are considered final if all parties concerned agree.

3. Decreasing *Musharakah*

I have referred in the foreword of this paper to the method of house building financing in Britain in which the loan can extend over a period of 20 years. Such loans are offered by building societies and banks. As I have already shown, Muslims living in Britain refrain from owning their houses through this method for the fear that they may thus be committing the sin of *riba*. After a great deal of research and study, a method has been devised, taking into consideration the teachings of the Islamic *shari'ah* in such dealings, as well as local laws and legislations and the necessity of assuring that buyers enjoy the same advantages made available to them by the prevailing methods. The Bank presented, in this context, the Islamic Trust Funding Agreement, based on decreasing *musharakah* with the client, while the Bank retains the right to rent its part to the client.

The relationship between the client and the al Baraka Bank is based on their joint ownership of the property. The property is registered in trust for both parties each according to his share, usually 70% for the Bank and 30% for the client. Let us assume that the price of the property is Stg 100,000; the Bank's share would be Stg 70,000 and that of the client Stg 30,000. The price of the property is divided into shares and the price of these shares would remain unchanged throughout the contract period. Each share is priced at Stg 1, thus the al Baraka Bank would own 70,000 shares and the client 30,000. The al Baraka Bank's shares are divided over the time

period that was agreed upon and which could reach 20 years. The client must buy a certain number of shares, and make payment: monthly or quarterly. The client may buy any number of shares once he has the means to do so, while the Bank must sell its shares upon request. Thus the Bank's ownership in the property decreases gradually until it ends, up with the end of the period agreed upon or earlier and the client, becomes the sole owner of the property. Since the client is the user and beneficiary from the property throughout the contract period, he pays for this privilege user's fees, estimated in accordance with the percentage of the Bank's ownership in the property. Thus user's fees decrease with the client's increasing ownership of the property until it vanishes with the end of the contract period. Total user's rights are assessed by adopting the ratio of financing in the real estate market as an indicator to reach the estimated value. The Bank's share is then calculated in accordance with its share in ownership represented by the number of shares it holds. Since the Bank's ownership decreases annually, the user's fees are reviewed annually on the date when more shares are bought.

Total user's fees, and the Bank shares in it are calculated as follows:

$$(R) = \frac{K \times S}{100}$$

$$(H) = \frac{1 \times Q \times (R)}{N}$$

- (R) : Fees for annual use of the property
- (K) : Total number of shares
- (S) : Ratio of financing in real estate markets
- (H) : Bank's share in user's fees
- (Q) : Shares owned by the Bank
- (N) : Number of annual installments (12)

Example

If there is an agreement to buy a unit for Stg 100,000 and the Bank finances Stg 70,000 for 10 years on the basis of average ratio of financing in the real estate market amounting to 10% with payments in monthly installments, the calculation is as follows :

$$\begin{array}{lcl} \text{Installments} = 12 & \text{Bank shares} & = 70,000 \\ \text{shares Total number of} & & \\ \text{shares} & = 100,000 & \text{Level of financing} = 10\% \\ \text{User's fee (R)} = \frac{100,000 \times 10}{100} & & = \text{Stg.10,000} \end{array}$$

Bank's share in user's fees for the first month (H) =

$$\frac{1}{12} \times \frac{70,000}{100,000} \times 10,000 = \text{Stg.583,33}$$

In addition to the monthly rent, the client buys a certain number of the shares of the Bank. This number is determined in such a way which makes things easy for the client who is not forced to buy an equal number of shares from the Bank every month.

The Bank allows the client to buy a smaller number in the first few years, increasing gradually while the rent decreases. In that way monthly payment remains practically at one level throughout the contract period.

The following schedule illustrates this clearly :

Schedule and dates of purchasing the Bank's shares

Date of buying	User's fees	Shares bought	Total monthly payment
1.01.1991	583,33	341,73	Stg 925,06
1.02.1991	580,49	344,57	Stg 925,06
1.03.1991	577,61	347,45	Stg 925,06
1.04.1991	574,72	350,34	Stg 925,06
1.05.1991	571,80	353,26	Stg 925,06
1.06.1991	568,86	356,20	Stg 925,06
1.07.1991	565,89	359,17	Stg 925,06
1.08.1991	562,89	362,17	Stg 925,06
1.09.1991	559,88	365,18	Stg 925,06
1.10.1991	556,83	368,23	Stg 925,06
1.11.1991	553,76	371,30	Stg 925,06
1.12.1991	550,67	374,39	Stg 925,06
TOTAL	6,806,73	4,293,99	Stg 11,100.72

ure adopted and general conditions :

the client has to complete a special form and present the specifications of the property he intends to buy as well as the documents pertaining to his dual income. The Bank checks all the information regarding income, ownership and other relevant affairs.

Once the previous step is undertaken and a decision is made by the Bank to offer the finance requested, the Bank sends its approval to the client in writing. The offer is valid for one month.

- The client accepts by signing the offer and returning it back to the Bank, whereupon the Bank names an assessor who makes a comprehensive survey and sends his report to the client. An accredited lawyer will also be informed to start legal procedures. At that time the client must deposit his *musharakah* share in an account opened with the Bank.
- The property is registered in the name of the client at the concerned department while also indicating the "Bank's rights" of ownership. The property is mortgaged to the benefit of the Bank as guarantee of repayment.
- The Bank studies all requests without a maximum limit.
- The Bank's ownership share at the time of signing the contract should not exceed 70% of the purchase or assessment value, whichever is lower in the case of non-residential units or 80% in the case of residential. The Bank has the right to increase or decrease this percentage.
- The deed of ownership is kept by the lawyer of the Bank. The property is held by the client in trust for both parties. The two parties shall sell the property at the appointed date, in case of the client's failure to pay the share of the Bank in user's fees.
- The client shall present all the papers and documents proving his ability to buy the al Baraka's shares during the period of the contract. The Bank retain the right to refuse any request in which the monthly payments of the partner exceed 40% of his monthly income. In the case of businessmen, a statement of annual income is presented. This statement must be certified by an accredited accountant and must cover the three years preceding the request and should be attached to a record of personal property, if any. This would facilitate payments and take into account that the client will not be adversely affected by payment of his obligations.

- The price of bought shares is deducted monthly or quarterly, as well as the Bank's share in the user's fees, from the account of the client with the Bank by a standing order given by the client. This means that the client must open an account with the al Baraka Bank and keep sufficient funds in it to meet his initial and current obligations. The client is also encouraged to have his salary deposited directly in this account.
- The client is responsible for all fees, including assessment and survey fees paid in advance.
- The partner should insure the property at full value against fire and destruction in accordance with the decision of the insurance agent or assessors/surveyor. The insurance policy should provide coverage for both shares of the Bank and the client.

THIRD : LEGAL AND SHARI'AH-RELATED OBSTACLES FACED BY THE BANK

The Bank faced many problems from the legal and *shari'ah* view points, especially since it was established recently. Compared to other banks it was a very short period for the Bank to build sufficient experience in dealing with these problems. This is in addition to the fact that the Bank operates in a country which does not recognize Islamic *shari'ah*. The nature of these problems varied according to the mode of financing, whether it is *murabahah*, *musharakah* or decreasing *musharakah*. We shall try to throw some light on the most important of these obstacles.

1. Non compliance with payments on time

Almost all Islamic banks face this problem. Our distinguished *ulama'* spared no effort to find a solution in order to deter clients from taking advantage of the inability of Islamic banks to impose delay fines on those who delay payment. After a good deal of research and study, the Bank decided to adopt the recommendations of the al Baraka Group seminar at

Istanbul. The recommendations of this seminar allowed the imposition of fine on clients who delay payment despite their financial ability. In this case, the fines should equal the losses incurred by the Bank as a result of delay of payment by the client. As an indicator for assessment of the thus incurred losses, the Bank took the average monthly profit of the Bank during the period of the delay. We must point out in this context, that these cases are examined with the utmost seriousness in order to be sure that the client is in fact able to pay and that he deliberately refrained from doing so.

However, if the reasons for non-payment are inevitable, such as fluctuations in the prices in the real estate market in the case of selling by *murabahah*, the Bank might consider changing the operation from *murabahah* to long term *musharakah*, renting out the property, and using the rent revenue to pay back the shares of the Bank. The Bank also resorted to another method to avoid payment evasion by increasing the financing period beyond the estimated time for the completion of the project. If we assume that the project shall be concluded within 12 months period, the Bank may extend the period of *murabahah* to 18 months. By the twelfth month, if the project has not been completed and sold, this account is held under close supervision so that the Bank may take the necessary decisions at the time of, or before, the date set for closing of the *murabahah* operation account.

2. Registration fees

The tax regulations in Britain impose a registration fee of 1 % to be paid by the buyer. To avoid double payment of this fee, especially in *murabahah* operations which require that the Bank buys and registers the property in its name first and then sells it to the client, who registers it in his name in turn, while maintaining, as guarantee, the ownership deed by the Bank, the advisory committee allowed effecting a mandate directly to the Bank to act on behalf of the client. The bank buys and registers the property in the name of the client but mortgages it in its own favor.

3. Cost of assessment, insurance and legal fees

Some agreements stipulate that the client shall pay the cost of assessment, insurance and legal fees. The shari'ah Committee supported some reservations regarding this matter and decided that the Bank and the client both must bear these expenses. This situation is now being remedied accordingly.

4. Acceptance of dealings with insurance companies

To protect the resources of the depositors, the British law obliges banks to insure property against damage, fire and destruction. Since there are no Islamic insurance companies, the *ulama'* allowed insurance of the property under the condition of "force majeure".

5. The Percentage ! of Real Estate Financing as an Indicator of Defining User's fee

This issue was the subject to a great deal of study, discussion and research in order to reach an indicator that is stable, clear and known to all parties, to define the Bank's share in user's fee. First the Bank thought of the rental value as a real indicator of user's fee, but it faced many problems. Rents differ from one municipality to another, even within the same municipality they differ from one area or even one street to another. Add to that the difference in the real estate units and its effect on the rental value. A villa in a certain area may be more expensively rented than the same villa in another place. Again how do we consider the rental value? On the basis of an unfurnished or a furnished unit? In estimating the rental value should we consider the best way of profiting from the property such as renting it as separate rooms rather than one house, or renting it to a company rather than a family?

The rent also depends on the type of furniture and equipment in the property.

All these difficulties, in addition to the administrative cost of revaluating the annual rent in every district, and the possibility that the Value Added Tax (VAT) amounting to 15% might be imposed on rents need an in depth study. In the light of all these factors, and in order to find a suitable method of defining user's fees, the Bank decided to ask knowledgeable *ulama'* about using the same financing indicators which are used to define the profits of *murabahah* operations, commodities and agricultural products dealings, for defining the Bank's user's fees in lieu of its share in the ownership of the property.

FOURTH : SOURCES OF FINANCE

Generally speaking the Bank depends, in real estate investment and financing, on three sources namely capital, short-term investment accounts and saving accounts. The choice of any particular source depends on the type, nature and duration of the financing operation. In short term *murabahah* operations not exceeding 18 months, the Bank resorts to fixed term investment accounts where the duration of the *murabahah* is equal to that of the deposit. As regards long term real estate financing under decreasing *musharakah* and due to the fact that depositors are reluctant to leave their deposits for long periods extending to 20 years without being able to withdraw sums for their living expenses, the Bank tends to depend on capital and savings accounts. The Bank also takes into account that the total funds invested in long term operations should fall within a certain percentage of capital and savings accounts in order to maintain constant liquidity. It should also be noted that the Bank sets a ceiling for sums invested in real estate financing operations in order not to exceed a certain percentage of sums allocated for multipurpose investments, as well as a percentage of capital in order to achieve a diverse investment portfolio.

As regards *musharakah* operations, the Bank depends on either investment accounts or capital as a source of financing. Other suggestions are currently being studied such as asking investors to directly participate in *musharakah* operations by buying shares in the companies especially set up

for that purpose after payment of a fee to the Bank. Another idea is to issue real estate investment certificates, the sales revenue of which would be used to finance real estate. A monthly price is set and announced, depending on the real value of the property bought or financed by the investment portfolio created for that purpose, with profit coupons payable annually. It is however not possible to provide a detailed account regarding these certificates in the context of this lecture.

FIFTH : NATURE OF HOUSING FINANCE

As we mentioned the Bank sets a ceiling from the start for the sums to be invested in real estate operations. Within these limits, there are certain sums for *murabahah*, *musharakah* and decreasing *musharakah* operations. These ceilings are reviewed periodically in the light of changes in the real estate market and the financial position of the Bank.

On this basis, we find that sums allocated to finance house and apartment buying by individuals and families cannot meet the demand.

To allow the largest number of depositors to own their houses, the Bank encouraged the financing of middle income housing, ranging in price from Stg 60,000 to Stg 80,000. In some cases, the Bank studies requests by clients who are well known to it and whose financial position is well demonstrated. In the range of its banking services, the Bank might help such clients to finance demands for luxury housing.

At any rate, the decision on the amount of finance to be given depends on the capacity of the client to pay back, without facing any financial hardship. As we have mentioned before this requires ensuring that the monthly payments made by the client do not exceed 40% of his net monthly income.

Real estate in Britain ranges from apartments, to houses and villas. Usually, apartments are bought according to the lease hold system, from 50 to 99 years. The owner of the apartment has no right to the land; the land on which the apartment is built remains the property of the original land owner. Houses and villas are bought outright, with no restrictions regarding the land ownership. Banks are not very eager to finance apartments where the leasehold is for less than 40 years. The market value of the apartment decreases when the leasehold is for a short period.

SIXTH : TOTAL INVESTMENTS

During the past five years, the Bank witnessed noticeable progress in the funds offered to finance real estate, either for personal use or for investment. Financing operations rose from Stg 3 million in 1984 to nearly Stg 32 million by the end of 1990 to serve nearly 450 clients and their families. With the expected increase in paid capital from Stg 30 million in 1990 to Stg 30 million and US\$ 30 million in 1991, and the registered growth in deposits from Stg 87 million at the end of 1989 to Stg 136 million at the end of 1990, the Bank expects to raise the ceiling it places on real estate investments in future as the Bank has reached the maximum limit under present ceilings.

We must point out here that real estate financing is a wide open field for investment. It requires further research and study and exchange of knowledge and expertise among Islamic Banks to develop the most efficient means of investment. It is a field with prospects of high profit and relatively little risk when compared to other types of investment in the industrial, agricultural and commercial sectors.

I pray to *Allah* that prosperity and progress may spread over our Islamic nation so that the living standards of the individuals may be improved. We could then expand the method of real estate financing on the basis of decreasing *musharakah* for individual and family housing needs in

all the Islamic countries. This could be similar to the system operating in Britain, so that with the help of *Allah*, we can provide peace of mind and financial stability as well as security for the Muslim citizen<whom we all serve.

God's peace and blessings be upon you.

ISLAMIC BANKING METHODS FOR HOUSE BUILDING FINANCING : A CASE STUDY OF INDIA

RAHMATULLAH ABDUL AHAD*

INTRODUCTION

House Building financing is one of the most important fields where social as well as commercial banks can play a significant role. For, the provision of housing has significance on both economic and welfare grounds. It is an area of investment where apparently risk to capital is relatively less. A World Bank paper rightly observed that housing has substantial social benefits including the welfare effects of shelter, sanitation facilities and access to health and education services. Improved health and education and better access to income earning opportunities can lead to higher productivity and earnings for low income families. It is thus for sound economic reasons that after food, housing is typically the largest item of household expenditure for poor families."³⁷

HOUSING PROBLEM IN INDIA

India has 680 million population with approximately 136 million households in 1981.³⁸ Of the total households, 17 percent i.e. 23.12 million households in the rural and urban areas are reported to be houseless. The housing shortage has crossed over 29 million dwelling units in 1990.³⁹

• Secretary General, All-India Council of Muslims Economic Upliftment.

(37) Housing the Urban Poor - The World Bank Research News, Vol. 6, No. 3, Writer 1985/86.

(38) Average family size in India is approximately 5 persons per family.

(37) Cherumilan & Heggade, Housing in India, Himalaya Publishing House 1987, p34.

In addition to quantitative shortage, poor condition and overcrowdedness of existing houses is yet another serious aspect of the problem in the country. For example, more than 10 per cent of the existing households are unserviceable. Similarly 20 per cent of the total urban population lives in slums devoid of basic facilities. This figure crosses 30 per cent in the case of cities with a population of over one million.⁴⁰

The majority are small housing units. It was found that 47.82 per cent were one room unit, 28.17 per cent were two rooms, 12 per cent were three room and the remaining 12.01 per cent were four and more room units.⁴¹

The suburbs and slums of the larger cities of India particularly Bombay, Calcutta, Delhi and Madras which have, on average, 30 per cent of their population as slum dwellers are overwhelmingly populated by Muslims with very poor socio-economic and educational background.

SCOPE OF HOUSING FINANCE

Despite the existence of a chronic housing problem, the housing sector has remained under-invested. According to a report,⁴² India spends about 2 per cent of its GNP on housing which is much less than required. As we have stated earlier poor housing facility directly hampers the efficiency of the work force and the economic growth of the country. Thus investment in housing is not only socially desirable, but is also economically indispensable. And it is here that the study and analysis of the role of Islamic Banks becomes significant. This is so not only because they are newcomers in the financial scene and can effectively become agents of socio economic change in the society, but also because in view of this shortage,

(40) Ibid. p 35.

(41) Ibid. p 36.

(42) N. M. Munji, India's Shelter Sector, Bombay, 28 August 1993.

financing schemes of Islamic banks in this field can gain ground without much competition.

ISLAMIC BANKS IN INDIA

Islamic Banks are financial institutions primarily dealing with deposits, withdrawals, credits and investment. They may be defined as those banking institutions which adhere to Islamic ideology in the conduct of their banking activity.⁴³ Thus Islamic Banks do undertake many social and commercial banking business but differ from conventional banks in the abolition of interest giving priority to public rather than merely individual motives, and adopting profit and loss sharing basis of investment etc. The major source of their funds is shares, demand and term deposits and they often borrow from individuals and other similar institutions."

The trend of establishing interest free financial institutions in India started in the 1950's but it was able to gain momentum only in the 1970's and the 1980's. According to an estimate, there are around 500 small and large financial institutions operating in different nook and corner of the country. As per survey conducted by the author himself on problems and prospects of interest free financial institutions, these institutions have been operating in India since more than five years ago.

Interest free financial institutions in India function as Islamic Banks in some respects although they do not offer the full range of banking operations like the conventional banks. This is because the law of the land does not permit the setting up of an interest-free bank. The existing institutions claiming to be interest free banks in India are performing social banking functions (*Qard Hassan*) while a few others are performing commercial banking functions. But by their basic nature and performance, all of them are non-banking financial institutions operating to satisfy the need

(43) Ausaf Ahmad, *Development and Problems of Islamic Banks*, IDB (IRTI), Jeddah, 1987.

(44) M. U. Chapra, *Towards A Just Monetary System*, Islamic Foundation, Leicester, U.K.

of Muslims for non-interest based financial dealings. On the feedback of approximately 20 per cent institutions regarding their mode of operation, it has been found that except few, all are performing the functions of a charitable society and, therefore, their basic and major function is advancement of qard hassan.

Charitable societies and trusts account approximately for 70 per cent of interest free financial institutions in India. Cooperative Credit Societies which account for approximately 15 per cent perform some of the functions of the conventional cooperative banks and, therefore, can be called as banks in a limited sense. But their limitation lies not only in their areas of operation and avenues of investment, but in other respects also. The Registration Authority confines the area of a Cooperative Credit Society to a particular town or district. Legally, it may be given an area of operation up to a whole state, but normally it is not thus given. These limitations greatly hamper the performance and growth of these institutions which can become the basis for the establishment and operation of interest free Banks in India. An equal number of interest free financial institutions are operating as business companies. Although as business companies they can undertake the business of their choice i.e. business permitted by Islam, they have limitations with regard to raising capital. They are permitted to raise capital either as shares or to a limited extent as deposits.

HOUSING FINANCE IN INDIA

Housing schemes are found both in the private and the public sectors. Private investment in housing is of three types. Firstly, investment in owner occupied housing which increases with the ability to pay for it. Secondly, housing investment for rental purposes where profit is the only motive. And finally, housing investment undertaken by private organizations for housing their workers. On the contrary Public Sector Housing Investment is done for achievement of socio-economic objectives. Housing schemes to provide shelter to Medium Income Group (MIG) and Low Income Group (LIG) have been undertaken by different state governments with the assistance of the

Central Government. According to this plan the Government constructs buildings and allots them to applicants through a lottery system. Once the allotment is made, the applicant is required to pay approximately 20 per cent of the total cost at the time of possession. He is required to pay the remaining 80 per cent in approximately 20 years' time. The rate of interest charged is around 18 per cent. This scheme is popular due to repayment facility.

With special reference to the Muslim community and Islamic organizations, it may be observed that no long-term planning has been envisaged to overcome this problem. There is no single example of social housing except, of course, few schemes to rehabilitate riot affected people at some places. Small well-to-do regional groups among the Muslims, such as Bohras, Ismailis, Memons, etc. do have some measure of social housing members of their groups. An example of concerted effort in this direction may be cooperative housing societies with financial assistance from national banks and the Housing Development Finance Corporation⁴⁵. As for Islamic organizations it is worth noting that no organization has done any remarkable work in this direction. The absence of any concerted effort on their part may be due to lack of perception and dearth of data on the gravity of the housing problem of Muslim India besides lethargy, lack of capital, and lack of finance, and lack of professional and technical skill etc.

HOUSING FINANCE BY ISLAMIC INSTITUTIONS

However, there are few organizations which have done little and intend and plan to do a lot in future. The prominent among them are:

1. Bait-un Nas'r Urban Cooperative Credit Society Ltd., Bombay.
2. Al Ameen Islamic Financing and Investment Corporation, Bangalore.
3. All-India Council of Muslims' Economic Upliftment, Bombay.

(45) A semi-government organization to promote and finance housing schemes.

Bait-un Nas'r Urban Cooperative Credit Society Ltd., Bombay

It is a cooperative credit society registered under Maharashtra Cooperative Act and operates on an interest free basis. It performs the traditional banking functions of accepting deposits, permitting withdrawals and advancing interest free loans.

The society pursues the goal of creating saving habits and providing interest free loans to interested members for productive and non-unproductive social purposes. It has advanced loans for purchase of flats. The details of such loans are worked out as under:

TABLE No. 5.6

**LOANS ADVANCED BY THE BAIT-UN NAS'R FOR
PURCHASE OF FLATS DURING THE PERIOD (1980-1990)**

Year	Total Loans as % of Total Working Capital	Total Housing Loans as % of Total Working Capital	Total Housing Loans as % of total loans
1980	84.00	-	-
1981	93.53	-	-
1982	94.20	-	-
1983	55.74	-	-
1984	82.95	-	-
1985	88.00	10.70	11.44
1986	60.84	25.33	14.64
1987	44.06	00.82	1.85
1988	40.98	9.57	23.34
1989	61.67	2.37	3.84
1990	50.57	1.36	2.68

It may be observed that the society in the first five years of its operation did not advance any loans for housing.⁴⁶ Since 1985 it started giving loans for housing purposes, but the percentage of housing loans to total working capital and total loans advanced has been considerably low except in 1985, 1986 and 1988. Furthermore the priority of housing loans seems to have declined further and further as the share of housing loans in the total working capital as well as in the total loans advanced has been diminishing through time.

The maximum amount of a housing loan a loan recorded is Rs. 25,000 (US\$ 976.56). These loans have normally been given for a maximum period of 40 months. The loan advanced had no link with any particular matching deposit for the purpose. However, such borrowers were required to buy shares of certain minimum amount which amounts, proximately, to 10 per cent of the value of the loans amounting to Rs. 000 (US\$ 390.62) and above and approximately 5% for small loans i. e. low Rs. 10,000 (US\$ 390.62). All these housing loans were advanced as *qard hassan* and against no return on capital. These loans were advanced to low and medium income groups to purchase houses constructed by private sector builders.

All loans advanced are required to be repaid in equal monthly installments as per the contract signed by and between the parties, for instance, a borrower availing a loan facility of Rs. 25,600 (US\$ 1,000) for ten months is required to pay an instalment of Rs. 2,560 per month.

(46) Absence of housing loans in the loan scheme of the society may be attributed to the lack of funds, less priority and operational difficulties.

TABLE No. 6.6

**AVERAGE SERVICE CHARGE COLLECTED
BY THE BAIT-UNNAS'R ON
INTEREST-FREE HOUSING LOANS**

<i>Year</i>	<i>Service Charge Rs.</i>	<i>Approximate Value in US\$</i>	<i>As Percentage of Principal Loan</i>
1980	25,400.00	992.18	2.47
1981	44,000.00	1,718.75	5.44
1982	58,300.00	2,227.34	4.75
1983	76,800.00	3,000.00	7.15
1984	1,35,700.00	5,300.00	5.84
1985	2,26,800.00	8,859.37	6.29
1986	2,74,500.00	10,722.66	9.43
1987	3,448,700.00	16,321.10	11.63
1988	3,50,800.00	13,703.12	9.81
1989	5,68,500.00	22,207.03	6.77
1990	7,93,400.00	30,992.18	8.57
<i>Average</i>			7.10%

According to the above table, the average service charge collected during all these years was about 7.10 per cent of the loan amount.

Loans advanced were qard hassan on which no return was expected.

Service Charges

Being registered under the Maharashtra Cooperative Societies Act, the Bait-un Nasr Society had to limit its transactions up to the primary banking functions. It can not enter into different kinds of Islamically permissible business ventures like *musharakah*, *murabahah*, and *ijarah* as practiced by Islamic banks worldwide. Hence to meet its operational cost, the institution had to resort to service charge system. Service charge refers to a levy collected from the borrowers with the object of meeting cost of operations only. In practice there are various methods of collecting service charges from the borrowers. Bait-un Nasr has a practice of levying a service charge based on actual calculation of the cost of operations. For the purpose of calculation, it classifies the costs of operation into cost of mobilization, cost of loan servicing and general overhead cost.

Cost of mobilization is the cost incurred in collecting deposits and maintaining records of them. The cost of mobilization varies directly as an annual percentage of the amount mobilized. This is so because to mobilize a larger amount requires proportionately more effort and, therefore, more cost.

Cost of loan servicing consists of all expenses incurred in giving loans, arranging for safe keeping of securities and following up of the borrowers for repayment till the entire loan is realized. The cost of loan servicing is treated as independent of the amount, for it is argued that it takes the same time and effort to process a loan of Rs. 500 or Rs. 1,000 or Rs. 5,000. Hence the cost will be the same. However, it will vary to some extent with the time. This is because a loan that is repaid in 10 months will require to be carried on with the bank's books of accounts for a period of 10 months whereas a loan which is repaid in six months will need to be carried on for only six months.

The determination of the service charge is made on the basis of the actual calculation of the costs under different heads on quarterly basis.

Based on the nature and amount of work, the total actual expenses are calculated under the above mentioned heads, viz. mobilization cost, loan servicing cost and general overhead cost.

As general overhead cost is no head by itself, it is, therefore, distributed among the mobilization and loan servicing cost in the ratio of each in the total expenses. For example, if the total mobilization cost calculated is Rs. 1,30,000 the total loan servicing cost is calculated as Rs. 35,000 and general overhead cost as Rs. 95,000 then the aggregate mobilization and loan servicing costs are worked out as below:

Mobilization Cost	Rs. 1,30,000
Added to ratio of overhead cost to total expenses, i.e. (130,000 x 95,000) / 165,000	+ Rs. 75,000
Rs. 2,05,000	
And,. aggregate loan servicing cost:	
Loan servicing cost	Rs. 35,000
Added to ratio of overhead cost to total expenses i.e. (35,000 x 95,000) / 165,000	Rs. 20,000
Rs. 55,000	

Suppose the total mobilization cost was incurred on the average outstanding loans of Rs.61,90,000 per month or 12 x 61,90,000 = 7,42,80,000.00 say Rs. 7,43,00,000 per year. The total mobilization cost per month will be worked out as -

$$\frac{2.05.000 \times 12 \times 100}{7,43,00,000} = 3.3\%$$

The loan servicing cost is Rs. 55,000 for the whole year or approximately Rs. 4,600 per month. This is spread over all the loans carried over the whole year. Assume the average number of loans outstanding throughout the year was Rs. 3,500. Then this cost is uniformly spread over all the loans irrespective of the amount. Hence the cost of loan servicing per loan per month is -

$$4,600 \div 3,500 \text{ i.e. Rs. } 1.30 \text{ per month.}$$

Thus the service charge collected equals to 3.3 per cent of the loan amount outstanding, added to Rs. 1.30 per loan per month. For example, if a loan of Rs. 1,000 is paid after six months in lump sum, then cost will be -

$$(1,000 \times 3.3) \div 1,200 = 16.5$$

$$\text{Added with } 1.3 \times 6 = 16.5 + 7.8 = \text{Rs. } 24.3$$

If a loan of Rs. 1,000 is taken for 4 months to be paid in equal monthly installments, then the service charge will be -

1,000		
750		
500		
250		

2,500	(2,500 x 3.3) ÷ 1,200	= 6.87
	+ 1.3 x 4	= 5.20

		12.07

Current Housing Scheme

In view of the housing problem and priority of the work, the society has launched out two schemes of 96 flats for actual users from the low

income group. According to these schemes, a member desirous of having a low cost house of one or two rooms + kitchen is required to open an account and continue to make deposit in it regularly. After a year his deposit profile is judged and a flat in the Housing Scheme is allotted.

Under these schemes a housing loan to the tune of approximately 48 per cent of the total cost of the flat Rs. 72,800 (US\$ 2,843.75) is given repayable in 60 equal monthly installments. The society levies a service charge at the rate of 11 per cent on the outstanding loan yearly.

Al-Ameen Islamic Financial and Investment Corporation India Limited (AIFIC)

It was incorporated in 1985 as a leasing company under the Companies Act of 1956. The main purpose of its incorporation was to encourage and mobilize savings, advance interest free loans and use funds in productive avenues permitted by Islam. The company has housing financing as one of the important programs in the ensuing years. The details of the housing scheme of AIFIC is as hereunder.

AIFIC plans to provide housing finance for a period of 7 years on interest free basis. Its housing finance is linked with a housing deposit scheme. A person desirous of getting this facility is required to open a saving account with AIFIC and continue to deposit a certain sum for a period of 3 years. At the end of the saving period, AIFIC will advance a loan of certain amount to be paid in equal monthly installments within a stipulated period. During this period the company will charge rent from the house owner in proportion of its financial contribution. For example, if the flat costs Rs. 3,00,000.00, (US\$ 11,718.75) the contribution of AIFIC will be Rs. 2,00,000.00 (US\$ 7,815.50). And if the normal rent fetched by the house is Rs. 3,000 per month (US\$ 117.18), then AIFIC will collect Rs. 2,000 per month (US\$ 78.12) as rent. The method of calculation of rent will be:

$$(AIFIC\ Loan \times Rent) \div Cost\ of\ the\ House.$$

The amount of rent will continue to decline in successive years as the borrower pays instalment of the loan monthly/yearly at the rate of approximately 14 per cent of the capital borrowed (i.e. within seven years).

In addition, al Ameen Group has also established a company named al Ameen Housing Development Company Ltd (AHDC). This company is incorporated exclusively to undertake building construction and land development.

India Council of Muslims Economic Upliftment Ltd. (AICMEU):

It is a registered social service organization operating since 1982 with purpose of assisting economically weaker Muslims. In pursuance of its objects AICMEU has promoted many subsidiary organizations of which the owing two have special relevance to the housing problem and housing finance:

1. Bait Al Zakah

Baitul Zakah is a step towards creation of an organized system of in India. It is a charitable organization providing economic aid to economically weaker people of the community. To face the acute housing problem in a city like Bombay, it grants housing aid for repair and purchase house to Muslims. During the first year of its operation, i. e. 1988-89, provided housing aid to the tune of Rs. 2,21,889 to 68 persons. This amounts to 78.79 per cent of total Zakah collected during the year. It may Observed that this has been in the form of economic aid and not loan or investment. Although a case can be advocated for productive use of money either in the form of loan or investment, yet provision for such grants could defended for several reasons. For instance there is a large number of r families facing house repair problems. Likewise there are families which have acquired small pieces of land admeasuring just 150 sq. ft. but do have sufficient money to build roofs.

2. AICMEU's Baitul Mal Cooperative Credit Society Ltd.

It is a registered cooperative credit institution functioning since 1984. It operates on an interest free basis and performs the traditional functions of a bank viz. deposits, withdrawals and advancements of interest free loans. It has a similar nature and mode of operation as that of Bait-un Nasr Cooperative Credit Society discussed earlier, the major function of the set-up is confined to social banking. Of late, the society has been granted permission to undertake and participate in business ventures on behalf of its members. This entitles the society to enter into commercial banking along with social banking. The managers of the institution feel that this permission and its optimum use will prove to be a landmark in the growth of the Islamic banking system in India.

The housing problem has been a priority problem before the managers of the society. That is why a considerable percentage of total loan advanced had been given for the purchase of house. The following table gives the details of housing loans and their relation to total capital and total loan advanced on yearly basis:

TABLE No. 7.6

**HOUSING LOANS ADVANCED BY BAITUL
MAL COOPERATIVE SOCIETY RELATED TO
TOTAL CAPITAL & TOTAL LOANS (1985 - 1990)**

Year	Total Housing Loan in Rs.	Approximate Value in US\$	% of Total Loan	% of Housing Loans to Total Working Capital
1985	17,500.00	683.59	5.34	5.76
1986	73,900.00	866.72	15.80	14.80
1987	84,800.00	3,312.50	18.87	16.81
1988	41,900.00	1,636.72	20.00	4.17
1989	1,75,300.00	6,847.65	17.83	18.71
1990	10,32,680.00	40,339.06	39.47	61.79
1991	3,70,000.00	14,453.12	32.33	21.80

Source: Sanctioned Loans Applications.

As evident from the above table, this institution has a liberal policy of granting housing financ.⁴⁷ The maximum amount of loan given for housing purposes is recorded as Rs. 40,000 (US\$ 1,562.5). The total number of beneficiaries during this period were 126. It may be noted that housing loans advanced have no link with deposits of any kind.

The maximum period of repayment varied from person to person with a ceiling time limit of 20 months only. The fund used for this purpose has been savings of the people entailing no return. Hence the whole finance was *qard hassan* only. It may further be observed that loanees are primarily

(47) The housing finance has no deposit link except, of course, a subscription of 10 shares worth total Rs. 100 only.

lower middle class people and have taken this finance to purchase low cost, one or two rooms + kitchen flats.

Borrowers are asked to repay the entire loan in equal monthly installments as per schedule agreed by and between the borrower and the society. For example, in case of a loan of Rs. 10,000 for a period of 10 months, the borrower is required to repay Rs. 1,000 every month as per agreed schedule. In case of default, the borrower is served a notice to explain the reason of default. If his explanation is accepted, delay in repayment is condoned and extra period granted. In case of non-acceptance of the explanation, the borrower is served with a legal notice to adhere to the terms of agreement⁴⁸ and pay the due amount within a specified period. Otherwise, the pledged security (normally gold ornaments) is sold.

Service Charges

AICMEU's Baitul Mal is also registered under Maharashtra Cooperative Act. Therefore, at the moment it has no way but to resort to the method of levying service charges on borrowers to meet the operational cost of the institution. But unlike Bait-un Nasr, Baitul Mal has a simple procedure of collecting service charges. As per the current practice, the society collects 3 per cent of the amount borrowed as service charge. This charge is collected from the loanees irrespective of the period of the loan. Baitul Mal justifies its system of collecting service charges on many grounds. In view of the society, collecting any fixed lump sum amount from the loanees ultimately becomes a certain percentage. Therefore, to overrule a definite correlation between the capital and additional amount becomes impossible. Moreover, a uniform charge from the loanees contains an element of injustice (zulm). This is so because a person availing a loan facility of Rs. 1,000 and a person availing a loan facility of Rs. 10,000 share equally and not proportionately in the operational cost of the society.

(48) The Proforma of the Contract form is given in Appendix.

Further more, service charge levy related to time period shows more resemblance with *riba* than charging in proportion to the facility availed irrespective of the time period. This is so because additional fixed return *riba is* primarily charged because of the use of money over a period of time.

As stated above the method of calculating service charge is very simple. For instance, suppose a person borrows an amount of Rs. 1,000 from the society for a period of 10 months. Another person borrows the same amount for a period of 15 months. And a third person borrows Rs. 1,000 for a period of 25 months. The service charge levied is:

$$(\text{Rs. } 1,000 \div 100) \times 3 = \text{Rs. } 30$$

While determining the rate of service charge, the society estimates the cost of operation of the succeeding year on the basis of actual expenditure incurred in the preceding year. Suppose an expenditure of Rs. 85,000 was incurred during the previous year. Now a probable increase in the expenditure due to salary increments, depreciation and price rise affecting printing and postage etc. is estimated. Suppose this all work out to be Rs. 15,000. Then total estimated cost of operation of the society for the former year works out to be Rs. 100,000 only. Now society fixes a reasonable target of the advancement of loan for succeeding year. Say, it fixes a target of Rs. 4000,000, then the rate of service charge to be levied on loans during the second year is worked out as -

$$= (1,00,000 \times 100) \div 4,000,000 = 2.5$$

The society will collect 2.5 per cent as service charge on loan amounts advanced during the year 1991-92 unmindful of the period of loan. The rate of service charges in future too will be determined accordingly. It may be observed that the rate in future may fluctuate in up or downward direction.

Some Issues Related to Housing Investment in India

It is evident that the role and performance of Islamic banks in financing housing is dismal. The probable reasons for this are lack of adequate finance, lack of priority, low investment return on deposits linked to housing schemes etc. In view of the high cost of housing, large sums are required for longer periods. This is so because the majority of those who demand houses belong to the low income group. Hence their ability to pay is very small. Similarly institutions like AICMEU's Bait-un Nasr are unable to mobilize the huge funds required. Compared to average growth rate of commercial banks which works out to be 15 to 20 per cent the vertical growth of both the institutions (AICMEU's and Bait Un Nas'r) is recorded at a compound rate of approximately 40 per cent p.a. But it may be noted that a major part of their total working capital cannot be advanced as long term loans as they come from demand deposits category.

It seems that institutions like AIFIC could not do much in the field of housing finance mainly for three reasons. Firstly, because such institutions are not allowed to enter the field of housing directly. Secondly, the housing loan is linked with deposit scheme. People having less patience hardly go for joining a scheme where they have to deposit a sum for 3 years. The depositors think that they would not be getting any return on the money saved. Moreover, inflationary rise of general prices will reduce the real value of the money saved. Thirdly, AIFIC also seems to give less priority to housing finance as return on investment in housing is lower in comparison to other fields.

It is also observed that the concept of interest free banking in India has not yet reached the common man. A section of the population is still doubtful and unconvinced about the operational methods of the interest-free banks and their success. Under this situation mobilization of huge funds for large scale operations remains a distant proposition.

Reviewing housing finance in India in general reveals many impediments which obstruct the vertical as well as horizontal progress of these institutions. Legal obstacles hindering housing investment is one such example. Rent control legislation exists in almost all states which freezes rents at about the 1950 levels for buildings existing prior to that date. For later buildings rents get effectively more frozen to protect the tenants and make it almost impossible to enforce lease terms on the duration of rentals. As a result some house owners would rather keep their properties vacant in preference to renting them out. Speculators prefer to keep houses or flats vacant in expectation of higher prices and for the fear that a tenant would not leave when necessary.⁴⁹

Other important obstacles are the existing building bye-laws and density norms formulated by Urban Development Authorities. The Floor Space Index (FSI) criteria makes cost of dwellings out of large proportions of the low income group people. Still another problem is related to the ownership of units in group housing due to absence of legislation allowing ownership. Similar to legal, fiscal policies are also deterrent to housing investment. There are no tax relief scheme for investment in the housing sector. This further hampers the growth of housing investment.

Unrealistic high cost housing prescriptions by the policy makers is often said to retard housing investment initiatives. The undue emphasis on use of architectural designs, contractors, engineers etc. raises the cost of production. Moreover, it becomes less acceptable in the Indian society as people have a practice of avoiding formal designs.

The large percentage of defaulters on hire purchase house schemes also hinders investment in housing.

⁽⁴⁹⁾ Ramesh Mohan, Problems and Prospects for Shelter in India: Some Policy Issues; Nagarlok, Vol. XIV, No. 2.

Measures for Financing Housing : Some Suggestions

In view of the different impediments of housing finance in India, there is a need to adopt new approach for financing housing in the country. Such an approach needs change of the emphasis from mere prescription of qualitative housing beyond the capacity of general people to the provision of facilities and conditions that enable the community to obtain more and better houses relating to their needs and abilities. The following policy framework of Islamic institutions may help to go a long way in providing shelter to the houseless community.

Islamic Institutions which have social and economic objectives can adopt a three-tier scheme, viz. Free Housing Schemes, Rental Housing Schemes and Ownership Housing Schemes. These schemes should use funds from charities, donations or zakah. Social housing complexes should be handed over to such agencies or institutions which collect reasonably low charges to maintain and plough back these funds for furthering the cause of social housing. A substantial amount of investment is required in the form of consultation fees whereas low cost housing with longer period of payment can help this group get shelter. It is suggested that low return on capital be compensated with higher returns on proportionate investment in commercial complexes. The proposition to finance and develop ownership flats and bungalows for middle income group can be a profitable socio-economic venture for these institutions. This also has social benefits because the section of the population lacking saving reserves cannot purchase houses on an outright or 2-3 years' installment basis. It would also be economic because this section holds relatively better ability to pay and would not mind paying reasonable lease rent during the co-ownership period.

It is suggested that an apex housing re-finance institution for loan as well as consultancy be established to boost the housing schemes of existing Islamic banks in India. It would not be inappropriate to suggest that the Islamic Development Bank (TDB) patronizes housing financing in particular and interest free movement in general in India for a meaningful growth. It

is high time that the IDB undertakes in-depth study and practical steps in collaboration with existing institutions in this direction.

Now This Indenture' Witnesses as follows

1. The Creditor shall lend and advance to the Borrower and the Borrower shall borrow from it Rs. _____ by way of term loan.

2. The repayment of the aforesaid loan charges and expenses shall be secured by the Borrower to the Creditor in the following manner:

- (a) Promissory note.
- (b) Equitable mortgage of all the rights and interests of the Borrower in the Flat/shop bearing No. _____ on the _____ of the building known as _____ situated at _____ on land bearing Survey No. _____ Hissa No. _____, City Survey No. _____ and/or the equitable mortgage of the flat, hereinafter referred to as the said Flat/Shop.;
- (c) Other documents as may be required by the Creditor, the documents contemplated under the sanction advice from the Creditor to the Borrower contained in the letter of the Creditor dated----- bearing Ref. No. _____ addressed to the Borrower.

3. The Borrower I shall repay to the Creditor the said Term Loan with service charges at the rate aforesaid on demand with permission of the Creditor to repay in equal monthly installments.

4. If the creditor agrees to accept the loan by installments as aforesaid, and in such event if the Borrower commits default in payment of any of the said installments then it shall be at the option of the Creditor to make the entire balance or the amount of the loan then outstanding due and payable at once and the Creditor shall be entitled to enforce the securities created in its favor for recovery of the amount of the outstanding loan together with

expenses incurred by the Creditor including damages and other losses suffered by the Creditor.

5. The Borrower shall also procure joint and several guarantee of

(1) _____

(2) _____

6. The Borrower hereby agrees and undertakes that, so long as the said amount of the loan or any part thereof remains outstanding to the Creditor, the Borrower will not dispose of the said Flat/Shop without the written consent of the Creditor and the Borrower will also not let, sub-let or give on leave and license basis or otherwise hand over or part with possession of the said Flat and create any third party interest in it in any manner whatsoever.

7. The Borrower agrees and undertakes to give any additional security that the Creditor may require from time to time.

8. The Borrower represents and warrants that:

(i) The information furnished by the Borrower to the Bank from time to time is factually true and correct and is deemed to constitute a part of the representations on the basis of which the Creditor has sanctioned the loan amount.

9. The Borrower represents and declares:

i) That there are no mortgages, charges, lien or other encumbrances of any nature whatsoever on the said Flat/Shop or any part of the undertaking, property or assets of the Borrower.

ii) That the Borrower is not a party to any litigation of a material character and that the Borrower is not aware of any fact likely to

give rise! to such litigation or to material claims against the Borrower;.

- iii) That the Borrower states that there is no material defect in title in respect of Flat/Shop to be charged and/or equitably mortgaged and/or hypothecated to the Creditor and there is not any scheme of a public nature affecting the same.
- iv) That no suit is pending in any Court nor there is any notice of any acquisition, requisition claim or proceedings in respect of the Flat/Shop to be charged and/or mortgaged and/or hypothecated to the Creditor.

10. The Borrower and the Creditor hereby confirm that these presents incorporate the terms and conditions on which the Creditor has agreed to lend and advance to ;the Borrower the aforesaid term loan and the Borrower has agreed to borrow the said loan. It is further agreed that this Agreement shall remain in full force and effect and to be operative immediately upon the loan agreed to be advanced by the Creditor, is advanced to the Borrower and shall remain in full force and effect and in operation till the entire loan together with service charges thereon and the costs, charges and expenses to which the Creditor is entitled are fully paid by the Borrower to the Creditor.

11. The Borrower has informed the Creditor that the said Agreement for purchase of the said flat is duly executed on stamp paper of Rs. 10 each and the same is lodged 'for registration with the Sub-Registrar of Assurances. The Borrower will produce and hand over to the Creditor the original registration receipt for having lodged the said Agreement for sale for registration and at ',the same time of the disbursement of the loan, the Borrower will hand !over to Creditor a letter addressed to the Sub-Registrar of Assurances directing the Sub-Registrar to deliver the Agreement for Sale duly registered to the Creditor and not to him after due registration.

12. The Borrower hereby agrees to make a declaration in the matter of the said loan in the form prepared by the Creditor with such additions and alterations therein as the Creditor may think fit and the undertaking of the Borrower contained in the said Declaration as regards the intimation and other things to be done in the event of any acquisition proceedings being started or commenced by the Income Tax Authorities under the provisions of Section 269 A B of the said Act and such declaration shall be deemed to be incorporated in this Agreement and shall form part of these presents.

13. The Borrower will also execute in favor of the Creditor an irrecoverable Power of Attorney for the sale of the said Flat/Shop in the event of default being committed by the Borrower in payment of the amount of the loan cost, charges and expenses.

14. The Borrower hereby agrees and undertakes to obtain from M/s _____ the Builders from whom the Borrower has agreed to purchase the said flat/shop a letter of consent in the form prescribed by the Creditor.

15. In the event of the society or other incorporated body being registered and the Borrower being a member of such society or other incorporated body and the flat/shop is situated in a building belonging to the society or other incorporated body then the Borrower will follow strictly the procedure prescribed by the Creditor for creating a security in its favor.

16. The Borrower agrees and undertakes to furnish such Information and particulars as may be required by the Creditor.

17. The Borrower shall pay all expenses, including legal charges as between attorneys and client, stamp duty and registration charges of and incidental to or in connection with or relating to the disbursement of the loan amount and investigation of title to the properties of the Borrower and also in respect of any other documents as may be required to be executed in.

future in connection with this Agreement or in respect of enforcement and realization of the security.

18. The Borrower hereby agrees to fully indemnify and keep indemnified the Creditor from and against all actions, proceedings, liabilities, claims, losses, costs, charges and expenses whatsoever in respect of or in relation to or arising out of all obligations and liabilities of the Borrower under this Agreement.

19. The Creditor shall be entitled to recall the loan granted to the Borrower or any part thereof by notice in writing to the Borrower in any of the following events, viz.

- (a) If default is made in the due and effective payments of any sum payable by the Borrower hereunder.
- (b) Upon failure of the Borrower to carry out or upon breach by the Borrower of any of the terms, conditions or covenants of this Agreement or of any undertaking agreement of obligations with the Creditor or on any security documents, deed or instrument executed, by the Borrower in favor of the Creditor.
- (c) If the Borrower shall take or permit to be taken or suffer any action or proceedings whereby the flat/shop shall or may be assigned attached or in any manner transferred or delivered to any receiver, assigned liquidator or other person whether appointed by the Borrower or by any court of law, tribunal government body or other person authorized by law.
- (d) If distress or execution is levied or issued upon or against any part of the property of the Borrower and is not discharged within fourteen days.
- (e) If any event or circumstances have occurred or may arise which are prejudicial to or impair or depreciate or jeopardize the security given to the Creditor.

20. It is further agreed by and between the Creditor and the Borrower that the Creditor will have the right to inspect the Flat/Shop, if necessary without notice to the borrower.

21. It is hereby agreed by and between the Borrower and the Creditor that in the event of the Creditor enforcing the security intended to be created as herein mentioned and the Creditor selling or causing to be sold the security being the flat, the Borrower will in such event vacate the said flat and hand over vacant and peaceful thereof to the Creditor upon being called upon to do so or in the alternative the Borrower shall hand over vacant possession of the flat to the purchaser thereof.

22. In the event of the Borrower committing default in observance and performance of the terms and conditions of these presents, or in the event of the Borrower committing default in payment of the amount of the Loan and interest in the manner agreed upon then and in any of such events the Bank shall be entitled to enforce the securities created in favor of the Creditor by all methods according to law and without prejudice to the aforesaid remedies the Creditor shall be entitled to sell off or cause to be sold off the said flat/shop.

IN WITNESS WHEREOF the parties hereto have executed these presents the day and year first hereinabove written, as hereinafter mentioned.

SIGNED AND DELIVERED by the
within named "BORROWER"

in the presence of

SIGNED AND DELIVERED by the within
named AICMEU'S BAITUL MAL
COOPERATIVE CREDIT SOCIETY LTD.
by its Manager/Officer

AICMEU'S BAITUL MAL COOPERATIVE
SOCIETY LTD
179 Vazir Building, I. R. Road, Bombay 400 003

DEED OF GUARANTEE

(Registered under the Maharashtra State
Cooperative Societies Act 1961)

Registered office: R. No. 7, 1st floor
179 Vazir Building
Ibrahim Rahmatullah Road
Bombay - 400 003

From:

1.
Address:

2.
Address:

Date:

and/or GUARANTORS, do hereby irrevocably guarantee JOINTLY AND SEVERALLY to the Creditor the repayment of the said advance/loans and of all costs, charges and expenses chargeable by the Creditor to the Principal debtor in respect of ,the said advance/loan.

2. It is also agreed that any admission or acknowledgement in written form by the principal debtor in relation to the said advance/loan and/or in relation to the subject matter of this guarantee and/or any judgement or award obtained by you against the principal debtor shall be binding on us, and we accept the corrections of any statement of account served on the principal debtor which is certified by an office bearer of the Creditor and the same shall be binding and conclusive as against us and we further agree that in making an acknowledgement or making a payment, the principal debtor shall be treated as our duly authorized agent for purposes of Limitation Act 1963.

3. (a) We agree that the amount here guaranteed, inclusive of all costs, charges and expenses shall be due and payable by us to the Creditor on your serving us with notice requiring payment of the amount and such notice shall be deemed to have been duly served on us either by actual delivery thereof or by registered post (with A.D) at our respective addresses mentioned herein above, or at other address in India to which we may be written intimation given to the Creditor.

3.(b) Any notice despatched by the Creditor by registered post (with A.D) to us at the address to which it is required to be despatched by this clause shall be deemed to have been duly served on us at the time when the notice would be in the ordinary course of post, notwithstanding that the notice may not in fact have been delivered to us or that the address to which it is despatched, may have ceased to be our address.

4. The death of any one of the sureties shall not operate as a revocation thereof with regard to the survivor or survivors, as the case may be, and

notwithstanding the demise of any one of both the sureties the legal heirs and representative and/or the Estate of the respective deceased sureties shall continue to be liable to the Creditor in respect of all money due and payable to the Creditor under the guarantee.

5. This guarantee shall not be revoked by us and shall remain in force, till all the amounts due and payable to the Creditor by the principal debtor are paid in full, inclusive of all costs, charges and expenses. We further specifically agree that we shall continue to be liable hereinafter for all the amounts due and payable to the Creditor by the principal debtor even though the principal debts has not renewed the documents and even though the amount due from the principal debtor gets time barred and although the creditor cannot recover the same from the principal debtor by filing a suit or by adopting any other legal proceedings against the principal debtor. We confirm that the above agreement to pay to the Creditor shall be treated as an express promise to pay the guaranteed debt within the meaning of Section 25 (3) of the Indian Contract Act, 1872.

6. We agree that the entries in the book of accounts maintained in the ordinary course of the activities of the Creditor with regard to the advance/loan made or given to the principal debtor and with regard to costs, charges and expenses debited to the principal debtor shall be conclusive evidence against us of the transaction and matters therein appearing and of the liability of the principal debtor for the sums shown to be due by such entries.

7. We hereby consent to your making any variance that you may think fit in the terms of your contract with the principal debtor by determining, enlarging or varying any credit to the principal debtor, and/or by making any composition with the principal debtor, and/or by promising to give time to the principal debtor and/or not using the principal debtor and/or by parting with any security which you may hold for the guaranteed debt. We also agree that we shall not be discharged from our liability by the creditor releasing the principal debtor and/or by any act or commission of the

creditor, the legal consequences of which may be to discharge the principal debtor and/or by any act of the creditor which would but for this present provision be inconsistent with our right as sureties and/or by the commission of the creditor to do any act which but for this present provision be the duty of the creditor to us would have required the creditor to do. Though as between the principal debtor and ourselves, we are sureties only, we agree that as between the ~ Creditor and ourselves we are principal debtor and accordingly we shall not be entitled to any of the rights conferred on sureties by virtue of Sections 131, 133, 134, 135, 137, 138, 139 and 141 of the India Contract Act, 1872. ! In confirmation of having waived our rights under the aforesaid sections as sureties, we declare that we have pursued the Explanatory Statement annexed hereto and understood the legal implications thereof.

8. We agree that if the principal debtor shall be found not to be liable to the Creditor as the principal debtor by reason of the principal debtor's incapacity to borrow or to effect contract or for any other reason whatsoever, we shall nevertheless be liable as principal debtors to pay to the Creditor all the sums that would have been recoverable by the Creditor from us as sureties.

9. We declare that this guarantee is in addition to and not by way of limitation of or substitution for any other guarantee or guarantees that we may have previously given or may hereafter give to the creditor (whether alone or jointly with any other parties) and that this guarantee shall not revoke or limit any such other guarantee or guarantees.

10. We declare that we have fully understood the legal implications and consequences of our having executed this guarantee. We also declare that the above guarantee has not been obtained by the Creditor from us, by means of any misinterpretation concerning the material or other part of the transaction, within the meaning of Section 142 of the Indian Contract Act, 1872.

11. We further declare that the above guarantee has not been obtained by the Creditor from us, by means of keeping silence as to any material or any other circumstances within the meaning of Section 143 of the Indian Contract Act, 1872.

12. We confirm that we have executed this guarantee voluntarily and in a sound state of mind, we further confirm that this guarantee form has been duly filled in our presence and that we have initiated across the respective blank spaces in the guarantee form.

For AICMEU'S BAITUL MAL
COOPERATIVE CREDIT Explained and interpreted to the
SOCIETY LIMITED within-named sureties before execution

(1) Name of Surety No. 1
.....

(2) Name of Surety No. 2
.....

(1) (Signature of Surety No. 1)
.....

(2) (Signature of Surety No. 2)
.....

Advocate.

(B)

By Hand Delivery

To

Sir,

Sub: Equitable Mortgage/Mortgage by Deposit of Title Deeds

1. _____)
_____) Mortgagors
2. _____)
_____)

AND

1. AICMEU'S BAITUL MAL COOPERATIVE Mortgagee
CREDIT SOCIETY LIMITED

AND

In the matter of Loan/Advance of : Mortgage Debt

Rs. _____

AND

My/Our Flat No. _____ situated on]
_____ Floor of _____ Building]
in "AICMEU'S Baitul mal Cooperative] Mortgage Security Credit
Society Ltd. _____]

I, _____
residing at _____
and I, _____
the deponents above named do hereby state on solemn affirmation as under:

I/We do hereby declare that I/We have this day deposited the original Agreement for sale and other documents of title in respect of the property described hereinabove, with you BY WAY OF AN EQUITABLE MORTGAGE with intent to create -a charge therein -for securing the repayment to you, on demand the sum of Rs. _____ (Rupees _____) loan and advance by you to us by way of loan for purchase of the said property.

2. I/We hereby undertake as and when required by you, to execute and register Mortgage in such form and containing such covenants and provisions as you deem fit and proper.

3. I/We hereby declare that I/We have voluntarily executed this Memorandum of Equitable Mortgage in a sound and disposing state of mind only after having fully understood its contents and the legal implications thereof.

4. I/We hereby declare that the statements made hereinabove by me/us are true to my/our own knowledge.

BOMBAY Dated This _____ Day of _____ 199 _____

Yours truly,

(1) _____

(2) _____

Encl:

- 1.
- 2.
- 3.
- 4.

Identified by me.
Advocate

Before me.

A CASE STUDY OF INTEREST-FREE HOUSE FINANCING

PERVEZ NASIM*

INTRODUCTION

Housing is one of the basic needs of human beings, and everyone desires to secure shelter for his family. Unfortunately, for the last 25 years, Muslims in this part of the world have been facing this challenge, either to buy a house and indulge in interest or, forget about buying a housing unit altogether. Some of us were led to believe that since we have no alternative, it is alright to pay interest in this part of the world. Yet others, although well settled economically; still hold the view that no matter why, indulging in "*riba*" is forbidden by God the Almighty.

While this debate is still on, some concerned Muslims took the challenge upon themselves to find out if there is an alternative. Due to their genuine concern and dedicated efforts, an alternative system has been developed. Various housing projects of very small to medium sizes have been started in different parts of Canada and U.S. This particular project has been developed to accommodate a large number of Muslims, and therefore, it has been incorporated into a "Housing Corporation". Our membership stretches all over Canada and in some parts of U.S. and overseas. However, at present, we are restricted to buying houses in Canada only.

Moreover, in this project, we took care of another important decision relating to interest with which we are faced. Almost all of us have some

• President, The Islamic Co-operative Housing Corporation, Toronto, Ontario, Canada

savings, in various amounts ranging from a short period of few months to a few years, for different pre-determined purposes and/or unknown contingencies. We do not like to put these savings in the bank and collect interest. At the same time, it hurts to see that neither we are benefiting nor any other Muslim brother/sister is being helped with this money. Rather, *riba* based banks are taking advantage of the situation and our savings are losing their value due to inflation.

By putting all these small savings in investment through some systematic channel such as the Islamic Co-operative Housing project, all of us can benefit. Therefore, this project provides us with an opportunity to invest our savings for any period of time and earn *Halal* income in the form of dividends..

The gist of three important legislations have been combined to form the basic foundation of this project. First and foremost the *shari'ah* concept of *musharakah*. Secondly, the organizational structure based on the local laws to ensure the practicability and perpetuality of the institution. Third, but not least important, adaptation of the mechanism which does not over burden the tax paying members pursuant to the Taxation Laws of the country. Achieving the conformity and compatibility of these three, often conflicting, legislations have been the biggest challenge but however was done.

STATEMENT OF THE OBJECTIVE

- (a) First and foremost the main objective of the Islamic Co-operative Housing Corporation Ltd. is to provide an opportunity to its members who are committed not to indulge themselves in *riba* for buying a house for their family, with security and as much flexibility as possible, within the taxation and legal framework of Canada.
- (b) The secondary objective is to provide an opportunity to committed Muslims all over the world for mobilizing and pooling their savings to invest them in the provision of houses to fellow Muslims, while

maintaining the security of the investment. Moreover, such investments will not be attached to a particular house so as to keep an individual's funds as flexible as possible, and the investors will have the right to redeem their investment with a reasonable notice, and share in the capital gain or loss and the rental income of the "co-operative" in the form of dividends.

GENERAL HIGHLIGHTS

1. One can become a member of the Housing Co-operative by paying \$75.00 Membership fee plus \$600.00 for minimum six (6) shares;
2. Members have to buy at least 6 shares of \$100.00 each in each calendar year in order to keep their membership active;
3. Shares can be sold or transferred to any member of the Housing Co-operative;
4. The Housing Co-operative helps its members in getting out of *riba* by paying off their existing mortgage(s). In order to qualify, the members are required to buy and hold shares equal to 10% of their outstanding mortgage(s) balance, in the Co-operative for at least six months.
5. Member's investment in the Housing Co-operative shares is very secure since legal titles of all housing units remain with the Housing Co-operative until all of the required shares are accumulated by the home buyers/members.

BENEFITS TO HOME BUYERS

1. Instead of keeping their savings in the bank they buy Housing Co-operative's shares while they wait their turn to buy their houses.

2. Purchasing the Co-operative shares works as an investment which will earn a dividend until they buy their houses.
3. The members are free to choose the location of their housing units.

BENEFITS TO THE INVESTORS

1. Investors/members are entitled to a dividend on their shares, based on their quarterly balance of shares i.e. March 31, June 30, September 30 and December 31 each year.
2. Instead of keeping their savings in the bank, they can buy Housing Co-operative's shares and earn *Halal* income in the form of Dividend.
3. Investment could also be started by the members on behalf of their children so that they will be in a position to buy their houses easily after they get married.
4. The members can save and invest some money for their children's College/ university education and marriages.

SUMMEARY OF THE SCHEME FROM *SHARI'AH* STANDPOINT

The nature of the transactions involved in the Housing Scheme of the Islamic Co-operative Housing Corporation Ltd. from the *shari'ah* point of view is as follows :

- A. Any person who purchases the common shares of the Corporation becomes a member of the Corporation in the sense that he participates in the profit and loss of the corporation. The profit, if any, is distributed among all the members in proportion to their investment in the corporation by purchasing the common shares.

- B. Any member of the Corporation in his individual capacity can purchase a house in partnership with the Corporation whereby the house is shared by the member and the Corporation, each in proportion of his respective investment in that house. But the title deeds of the house shall remain with the corporation as a security.
- C. The share of the Corporation in the house is, then, leased to the member on an agreed rent
- D. The member has a right to purchase the share of the Corporation in the house (mentioned in the articles as preferred shares) by a gradual process. Each time he buys a "Preferred Share" he buys a certain part of the share of the Corporation in the house, whereby the monthly rent payable by him is reduced to that extent.
- E. The last share of the house to be purchased by the member is a preferred share of class "G" the price of which shall be determined by- the Board to reflect 10% of the difference between the cost and the fair market value. At this stage the full title of the house along with the title deeds shall be transferred to the member.

PROGRESS AND OTHER DETAILS

(1) Housing Units

In the first year of its operation, the "Co-operative" was able to purchase only TWO, (2) housing units for its members. But now we are buying on the average, over TEN (10) houses every year as demonstrated below:

TABLE No. 8.7

HOUSES PURCHASED BY THE ISLAMIC
COOPERATIVE HOUSING CORPORATION
FOR ITS MEMBERS (1982-1990)

Year	Housing Units Purchased	Cumulative
1982	2	2
1983	4	6
1984	4	10
1985	20	30
1986	28	58
1987	16	74
1988	21	95
1989	13	108
1990	9	117

During the first three years the nature of Housing Units purchased (financed) was low to medium cost. But in later years this trend changed. Now it has shifted to medium and to more semi-luxurious houses.

With the exception of a few units which are Condominium Townhouses (jointly owned by housing complex residents) great majority of the housing units are detached (single dwelling) houses.

(2) **Membership**

Similarly, our Membership grew very slowly in the early years and progressed as follows:

TABLE No. 9.7

GROWTH OF MEMBERSHIP OF THE ISLAMIC
COOPERATIVE HOUSING CORPORATION
(1981-1990)

Year	New Membership	Cumulative
1981	26	26
1982	40	66
1983	44	110
1984	63	173
1985	141	314
1986	100	414
1987	71	485
1988	78	563
1989	78	641
1990	99	740

(3) Sources and Duration of Financing

Our Co-Operative's main source of finance is from our Members; prospective home buyers and others (members/investors) who buy shares with their savings. The majority of our Members are Canadian residents and about 10% membership is drawn from the United States and overseas. A significant amount of investment has also been made by various Islamic Centers/Mosques and other Charitable Organizations such as THE ISLAMIC SOCIETY OF NORTH AMERICA (ISNA). Monthly rental income is reinvested and our Members/Shareholders are issued additional shares on an annual basis for their respective dividends. Although these Stock Dividend Shares are redeemable like Common Shares, very few members redeem them.

The Duration of financing is flexible within the limits of 10 years and is dependent upon the amount financed by the "Co-Op". Many of our house buyers have completed the ownership of their housing units within an average of three to five years.

(4) Retirement Saving Plan and Business Investments Project

Another project has been launched to attract Tax Deductible Retirement Saving funds which are presently deposited in *riba* based institutions. A sister organization, THE AL-AMIN ASSOCIATION, collects these funds from Muslims and channels them through a trust company to ANSARCO INC., a Muslim investment company. The Ansarco Inc. then invests these funds in community based projects and other Muslim owned businesses ventures

Two other Muslim communities in the state of Missouri, U.S.A. and Montreal, Quebec, Canada, approached the Housing Co-op. and requested a presentation of a housing scheme so that they can use as a model. Subsequently, they established a housing scheme similar to the Housing Co-op model and named the project as ISLAMIC CO-OPERATIVE HOUSING

CORPORATION OF MISSOURI. In Montreal "QURTUBA HOUSING CO-OP PROJECT" has been formed and they are progressing very well.

FINANCIAL PROGRESS

(1) Share Capital

In October 1989 the General Body passed a resolution to increase our Authorized Capital. We have then received the Government's approval to increase our Authorized Capital from \$10 million to \$30 million.

As of December 31, 1990, we had "Issued Share Capital" in the amount of \$11.7 Million, with a steady increase of over 11 % per year. This increase does not include an amount of more than \$1.5 Million worth of shares which were redeemed by various members who needed their money for one reason or the other.

(2) Revenue and Expenses

The total income and expenses for the last eight years are shown in table (10.6) below:

TABLE No. 10.6

TOTAL INCOME & EXPENSES OF
THE ISLAMIC COOPERATIVE HOUSING
CORPORATION (1982-1990) [CANADIAN DOLLARS]

Year	Total Income	Expenses
1982	-	-
1983	8,000	800
1984	23,000	3,500
1985	90,000	15,000
1986	182,000	24,000
1987	265,000	38,000
1988	435,000	54,000
1989	452,000	79,000
1990	489,000	94,000

(3) Patronage Dividend

The "Co-operative" declared Patronage Dividend for the last 8 years as follows :

TABLE No. 11.6

PATRONAGE DIVIDEND DECLARED BY
THE ISLAMIC COOPERATIVE HOUSING
CORPORATION (1982-1989)

Year	Dividend Per Share	Percentage
1982	\$ 6.00	6.0
1983	\$ 7.20	7.2
1984	\$ 9.00	9.0
1985	\$ 9.60	9.6
1986	\$ 10.00	10.0
1987	\$ 10.00	10.0
1988	\$ 9.60	9.6
1989	\$ 9.40	9.4

ADMINISTRATION

(1) Management

The Islamic Co-operative Housing Corporation Ltd. is managed by a Board of Directors comprising seven members. The Board members are elected by general membership in the annual meeting for a period of two years. The Board consists of President, Vice-president, Secretary, Treasurer and three Directors who are assigned to various tasks. Two of the Board members are elected by the general members from four nominees submitted by our affiliate, The Islamic Society of North America.

All Board members are working voluntarily for this project. The office of the Housing Co-op is managed by an Office Manager, Office Assistant and Bookkeeper/Accountant. The Financial Statements are audited by a Chartered Accountant on an annual basis.

According to the By-Laws of the Housing Co-op. the Board is authorized to spend up to 20% of the Gross Income as operating expenses. The remaining 80% of the income is distributed as dividend to the members/shareholders in the ratio of their quarterly shareholdings as of end of March, June, September and December of each year.

(2) Investment Security

The Title Deeds of all housing units purchased for the Members are held in the name of the "Housing Co-Op". Whenever the members complete the acquisition of the required shares, they surrender those shares to the "Housing Co-Op". Then the Title Deed of the Housing Units is transferred to them. This way the investment of our Members/Shareholders is secured and almost guaranteed.

(3) Share Subscriptions and Redemptions

Funds for investment in the "Housing Co-op" shares are received through subscriptions from the members regularly. After depositing these funds in the bank, the share certificates are prepared and approved by the Board and, after necessary signatures, mailed to the members.

Whenever a member needs to redeem his shares, he simply signs the share certificates and submit them to the office for redemption. After preparing necessary paper work these shares are canceled. Then a cheque is sent to the member. Normally it may take a day or two for redemptions under \$10,000. However, the "Housing Co-op" requires a reasonable notice for greater amounts so that it can make adjustments for its housing commitments.

Although, by law, the "Housing Co-op" is not required to redeem any of its shares, keeping the flexibility objective in mind this is done as a free service to its members.

Appendix (A)

REGULATIONS

1. Housing Unit Allocation, Transfer and Disposition
2. Occupancy, Rent, and Maintenance
3. Major Improvements and Expansions

1. Housing Unit Allocation, Transfer and Disposition

a) Housing units will be purchased by the "Co-op" for eligible members. Titles to all housing units will be held in the name of the "Co-op" until members accumulate the required number of shares.

- i) List "A" : There will be a list maintained for eligible members who do not already own a housing unit. This will be called List "A".
- ii) List "B" : There will be another list maintained for eligible members who partially own a housing unit under mortgage. This will be called List "B".

b) When necessary funds are available, notice will be sent to members in List "A" and List "B", and applications will be invited from eligible members who are interested in acquiring a house through the "Co-op" at that time.

c) The application called "OCCUPANCY STATEMENT" will provide detailed and up-to-date information pertaining to the present residential status, i.e., type of housing unit, monthly rent/mortgage payments, balance of first and second mortgages with due dates, names of mortgage companies/landlord/management company, type of desired housing unit, choice of location, approximate price, range and number of shares the

member has acquired and planning to accumulate as of closing date, if a housing unit is bought for that member, etc.

- d) (i) Qualified Members List A: All complete and eligible Occupancy statements will be reviewed by the Board of Directors and based on the length of membership, accumulation of shares minimum of which will be equivalent to 20% of the first \$100,000 and 50% of the difference between \$100,000 and the cost of the house up to \$160,000. (Co-op's maximum contribution will be \$110,000 for any house) and other necessary considerations, three qualified members will be selected in order of preference and they will be given the permission to locate, negotiate and put an offer on the desired housing unit. This process will continue until the number of housing units approved previously are committed.
- (ii) Qualified Members Under Mortgage List B : All complete and eligible Occupancy Statements will be reviewed and members will be selected by the Board of Directors based on the length of membership, accumulation of shares minimum of which will be equivalent to 10% of the existing mortgage(s) balance, mortgage due date, and other necessary considerations.
- e) Transfer : If a member, after occupying the housing unit, wants to vacate it, he/she will have to inform the Board of Directors about his/her intention in writing at least 90 (ninety) days before such move. The Board of Directors will send the notice of purchase offer to eligible members in List "A", and will follow the same procedure as outlined in (D) (i) as applicable.

Based upon the criterion described in (D) (i), three members will be selected in order of preference, and they will be offered to negotiate the occupancy of the housing unit with the present owner/occupant.

f) If no member interested in that housing unit is found, or if no member can take over that housing unit within the stipulated time, then the owner/member will be given the permission to arrange the sale of that housing unit to outsiders.

g) i) As a result of a transfer/sale of a housing unit, any gain or loss realized, after deducting the cost of authorized major improvements and expansions, and certain legal expenses, will be divided as follows :

1) 90% to the member and 10% to the "Co-op", if at that time, member had accumulated shares equivalent to more than 50% of the cost of the housing unit;

2) 80% to the member and 20% to the "Co-op", if member had accumulated 50% shares of the cost of the house or less.

ii) To complete the ownership of the occupied housing unit, the member will have to accumulate shares equivalent to the cost of the housing unit plus one (1) Class "G" Preferred Share.

iii) The cost of the above Class "G" Preferred Share will be determined by the Board as 10% of the difference between present and fair market value of the said housing unit minus the actual cost, the cost of authorized major improvements and expansions, and certain legal expenses.

h) If a member wants to transfer/sell his/her housing unit within one year from the date of acquisition by the "Co-op", he/she will be required to pay a penalty of \$5,000.00.

i) Starting from the calendar year, beginning after 12 months from the date of acquisition of the housing unit, the member will have to buy

\$5,000.00 worth of shares or 10% of the cost of the housing unit, whichever is less, every year.

j) After occupancy, the member will not be, normally, allowed to sell or transfer any of his/her shares.

2. Occupancy, Occupancy Charges (Rent) and Maintenance

a) Occupancy Agreement : The occupancy agreement will be drawn for every housing unit occupied by a member.

b) Monthly gross occupancy charges (rent) will be based on rental market value and the current occupancy charges of comparable housing unit(s) previously purchased by the Co-op, and this will be reviewed every year.

c) Members will pay only proportionate (in proportion to "Co-operative" share in the house) occupancy charges (rent), plus \$10.00 administration fee which will be due and payable in advance on 1st day of each month. [These occupancy charges (rent) does not go towards the purchase of additional shares.]

d) Proportionate monthly occupancy charges (rent) will be adjusted for the following month in which additional shares of \$1,000 or more are purchased.

e) All maintenance expenses including Hydro, Heating, Gas, Common area/ Condominium fees, Realty Taxes, Water, Third Party Liability Insurance, Legal fee, garbage/snow removal, landscaping, repairs, material, labor, special levies, including real estate commissions etc. will be the entire responsibility of the member/occupier.

However, an allowance for Realty Tax, Third Party Liability insurance and a portion of condominium fee will be deducted from Gross Occupancy Charges (Rent).

f) NEGLIGENCE/BREACH OF AGREEMENT : Any member found negligent and/or in breach of occupancy agreement could be asked to vacate the housing unit, and he may be suspended from the membership. Any loss caused by this will be recovered from his/her share capital.

3. Major Improvements and Expansions

A member may undertake major improvements and/or expansions in the housing unit after getting the approval from the Board of Directors. The member will be responsible for asking prior permission and/or approval from the municipality regarding the intended improvements. He will also be responsible for complying with any rules and/or By-Laws of the local authority. Any loss sustained by the "Co-op" because of his/her breach and/or negligence will be recovered from his/her share capital.

Appendix B
LEGAL AGREEMENT

ISLAMIC CO-OPERATIVE HOUSING CORPORATION LTD. I

a Co-operative incorporated under the laws of Ontario
hereinafter referred to as "Co-operative"

OF THE FIRST PART
AND MEMBERS/OCCUPANTS OF COOPERATIVE

hereinafter referred to as "Members/Occupants"

OF THE SECOND PART

WHEREAS "Co-operative" is a Corporation having its objects as follows:

- a. To help its members in obtaining and maintaining housing facilities for themselves and their families;
- b. To provide all community facilities and premises that help improving the residential areas of its members;
- c. To buy, own, sell, improve, manage, construct or lease and operate land and buildings for the purpose of providing residential accommodation to its members, who will occupy housing units otherwise than as owners;
- d. To enter into occupancy agreements with its members upon such terms as it may deem advisable;
- e. To become a member of any association or corporation having objects altogether or in part similar to those of the "Co-operative", or

carrying on any business activity capable of being conducted so as to directly or indirectly benefit the "Co-operative".

AND WHEREAS "Members/Occupants" have been certified by "Co-operative" to be qualified to participate in the benefits under the articles of incorporation, by-laws and regulations passed there under;

AND WHERE pursuant to co-operative scheme of "Co-operative" it has acquired the land hereinafter more particularly described as _____ in the City of _____, Province of Ontario, registered as Parcel _____, Section in the _____ Land Titles Division of _____ at _____.

NOW THIS AGREEMENT WITNESSETH that in consideration of \$ _____ the conditions, provisions and mutual covenants contained herein, and the sum of _____ Dollars (\$ _____) and other good and valuable consideration paid by "Co-operative" to "Members/Occupants" the receipt of which is hereby acknowledged by the "Members/Occupants" the "Members/Occupants" agree to occupy the said lands and premises as hereinbefore described.

1. This agreement is governed by the regulations and by-laws made by "Co-operative" and which are within the knowledge of the "Members/Occupants". Occupancy charges for such occupancy shall be determined by mutual agreement by the parties hereto.

2. The parties hereto agree that at the request of either party, "Co-operative" shall sell back and "Members/Occupants" shall purchase back the housing unit at the price of(\$ _____) upon payment in full at any future date, subject to the adjustment of such amount which may be determined pursuant to the regulations made by "Co-operative". The said amount of(\$ _____) is the amount at which the subject property is acquired by the "Cooperative".

3. "Members/Occupants" shall immediately upon the execution of this Agreement and closing of this transaction have the right of occupancy of the said land and continue to reside thereon during the continuance of this Agreement.

4. "Members/Occupants" agree that they will not lease the said land, save and except with the permission of the "Co-operative", and the "Co-operative", its officers, agents and employees, may at any and at all times enter upon the said land or any part thereof to view the state of the buildings and to inspect it upon giving written notice to the "Members/Occupants".

5. It is agreed between the parties hereto that all buildings and appurtenances thereto now on, or which may be erected or constructed on, the said land shall form part of the freehold, and shall not be removed or destroyed without the previous permission of "Co-operative" in writing and the "Members/Occupants" agree that they will keep and maintain the said land, buildings and any and all appurtenances, and all fixtures and things thereto belonging in good and substantial repair and in a tidy and clean condition, damage by fire, lightning and tempest only excepted, and that they will permit any agent of "Cooperative" at any time during the currency of this Agreement to enter and view the state of repair and cleanliness, and further, that they will promptly repair and clean according to notice and fulfil any further requirements which "Co-operative" may deem necessary, and in default of their compliance with any such notice as aforesaid, "Co-operative" may enter upon the property and effect such work as it may deem necessary and all costs so incurred by "Cooperative" shall be repaid by the "Members/Occupants" on demand.

6. The "Members/Occupants" agree that save with the approval of the "Cooperative" during the continuance of this Occupancy Agreement no building or buildings, booth or structure of any kind whatsoever shall be erected on the premises, or additions or alterations made to existing buildings.

- 7.(a) The "Members/Occupants" agree that they will forthwith insure and keep insured the subject property during the continuance of this Agreement, against any loss or damage to third parties and their properties in an insurance Company and will not do or suffer anything whereby any insurance policy or policies may be vitiated, and will pay all premiums and sums of money necessary for such purposes as the same become due, and will assign to "Co-operative" the proceeds of the insurance policy or policies and have attached to the policy or policies the Special Loss Payable clause as prescribed and, when so required by "Cooperative" the policy or policies of insurance and renewal receipt or receipts thereto appertaining. Where the "Members/Occupants" neglect to keep insured the said buildings or any of them or' to attach the Special Loss Payable clauses as above required, or to pay the premiums, or, when so required by the "Cooperative", fail to deliver the policy or policies and renewal receipts to the office of the "Cooperative", then the "Co-operative" may insure the said property and all sums so expended by the "Cooperative" shall be repaid by the "Members/ Occupants" on demand.
- (b) The "Members/Occupants" agree that it will be their sole responsibility for any loss or damage to the said property caused by their negligence or caused by the negligence of their employees, agents, guests, visitors and licensees etc.
8. "Members/Occupants" acknowledge that this Agreement does not confer any proprietary rights or other rights save and except expressly provided in this Agreement and the Regulations made by the "Cooperative".
9. The parties hereto agree and acknowledge this fact that the occupancy of the aforesaid premises by "Members/Occupants" does not create any landlord/tenants relationship.

10. "Members/Occupants" acknowledge that the payment of occupancy cost(rent) by them to the "Co-operative" shall not be considered any subscription by them towards the purchase of shares in the "Co-operative".

IN WITNESS WHEREOF the said parties have hereinto set their respective hands and seals.

(SIGNED/SEALED AND DELIVERED) ISLAMIC CO-OPERATIVE
HOUSING CORPORATION LTD

in the presence of:

**"HOUSING CERTIFICATES" AS AN
INTEREST-FREE FINANCING INSTRUMENT:
THE TURKISH CASE**

A D N A N B U Y U K D E N I Z *

I N T R O D U C T I O N

The housing problem has for long been one of the most important and urgent social problems in Turkey, as in most developing countries. Despite continuous efforts and different housing schemes, factors like high population growth, unhealthy and rapid urbanization, inadequate infrastructure and insufficient financial resources etc., have had the cumulative effect of creating a huge "housing gap" in the country over the decades.

Given the huge size of this gap and the emergence of an unhealthy housing structure, it is now a commonplace conviction that:

- (1) It is essential from the efficiency point of view to utilize public and private sector resources jointly in various combinations, depending on income level, type of social group and similar other factors.
- (2) It is inevitable to shift the emphasis from individual house building into mass housing rapidly and at a growing scale.
- (3) Industrialization of housing production (on the supply side) and mobilization! of fresh funds (on the financial side) are important determinants of successful housing schemes.

• The Al Baraka Turkish Finance House.

In recent years, the Turkish government has introduced a new interest-free capital market instrument, called "Housing Certificates" which aims at promoting house ownership and, at the same time, inducing higher volumes of private financial savings. As such, housing certificates are designed both as a means of acquiring a house and as a financial instrument for relatively shorter-term investment of household savings and excess liquidity of companies.

Main features and working of the housing certificates are outlined below:

(1) Issuance of Certificates

"The Housing Certificates Scheme" is managed by a government body, called Mass Housing and Public Partnership Administration (herein known as Administration). The certificates are issued by the Administration against a specific mass housing project; a single certificate represents (backed by) one square meter of flat ownership in a given project. They are issued for a period of 5 years; this period may be extended by the Administration, in which case the certificates can be used in a subsequent mass housing project.

The certificates are issued as "bearer" and are negotiable in the secondary market.

(2) Assessment of the Cash Value of Certificates

The certificates has an initial (issue) value which is recalculated on monthly basis by the Administration and announced publicly on the 10th day of each month. The announced price is applicable from the 10th day of the current month to the 10th day of the following month. Assessment of the outstanding (cash) value of the certificates is based on demand and supply (cost) conditions prevailing in construction sector (and not on the demand/supply conditions in the market for housing certificates). Thus, the

monthly announced price is sought to reflect the real market conditions and constitutes a kind of 'reference price' for trading in the secondary market.

(3) Encashment of Certificates

Housing certificates are cashed by authorized banks immediately upon demand, at the latest' announced certificate price.

(4) Construction of Houses

The Administration undertakes to complete the buildings constructed under a specific mass housing project, within 5 years following issuance of the certificates related to that project. Houses are built by construction/contracting companies winning the tender.

(5) Purchase of Houses

Those certificate-holders who want to purchase a flat in the buildings accumulate a sufficient number of certificates (presently, 30) corresponding to down payment and pay the remaining balance in cash or again by certificates of equivalent amount. The issued certificate represent ownership of one square meter of a least-valued flat (in respect of location) and an extra premium of up to a maximum of 30% is paid if a flat other than a least-valued flat is requested. Thus, at the outset, certificate holders do not exactly know which flat they are purchasing but they know that it is a least valued flat for which an extra premium must be paid if a better flat is to be purchased.

The Administration undertakes to submit the flat within one year following the purchase application.

Those certificate-holders not-applying for purchase within the sale period declared by the Administration, can use their certificates later, either

in the same mass housing project or in another project, with the proviso that they make up for the emerging price differences.

As for those certificates not used in flat purchase at the end of the project period (i.e. 5 years), their proceeds (cash value of the certificate reached at the end of the period) are kept by the Administration and are disbursed to the certificate-holder at his next application. In the mean time, the proceeds earn no return, and the certificates can no longer be used in house purchases.

CONCLUSION

- (1) Thus far, the Administration has undertaken one housing project in Istanbul, against which some 250,000 certificates were issued. The Administration was able to sell nearly all certificates a part of which was returned subsequently, Houses are now near completion and shall soon start to be handed over to the owners.

As a financial instrument, the certificates have earned a net annual return of around 40% which compares somewhat unfavorably with other investment alternatives, like commercial bank deposits, profit/loss participation deposits of interest-free financial institutions etc. yielding net annual rates of return of around 50%.

- (2) The ultimate stated purpose of the housing certificates scheme is to facilitate widespread house ownership through the use of would be house owners' funds. Taken from this perspective, the relatively slow moving certificate prices thus far may perhaps be justified on grounds of cheap house ownership. However, it is also vitally important to generate and sustain substantial amount of fresh funds during the construction phase, which is largely possible through attractive and competitive rates of return on the certificate as a short-term investment outlet. In the meantime, continual rise in the value of property due to high inflation is certainly to compensate for the rising cost of house ownership.

- (3) The Turkish experience in housing certificates has met some success, thus far. Besides the fact of being a new system, the initially expected success of the certificates was limited partly because of the somewhat improper choice of housing location which created marketability problems and led to weak demand for the houses built under the first project. In this respect, it is recommended from the marketing point of view to choose proper locations in which houses could be built.

Part Three

**CASE STUDIES PRESENTED BY BANKS
AND FINANCING INSTITUTIONS NOT
OPERATING ACCORDING *TO SHARI'AH***

1

THE EXPERIENCE OF THE HOUSING BANK OF JORDAN IN HOUSE BUILDING FINANCING

IBRAHIM MAHMOUD AL ZAHIR*

INTRODUCTION:

In the wake of World War II, the majority of the Arab States, having gained their independence, found themselves confronted with a host of socioeconomic problems and difficulties.

These problems ! have affected all areas, including the housing sector. This sector has been characterized by several negative manifestations, including insufficiency of the existent housing units, accumulating deficiency of the available housing units for years and years (which resulted in the rise of the average number of individuals per room),, shortage in basic services such as water,electricity, and other service facilities, the emergence of slums that are deprived of the least basic services in addition to squatter ownership of lands that are state property.

The housing problem has further been aggravated by the fact that the supply of new dwellings grew in a rate far below the rate of demand for shelter; which raised the cost and rent of these houses to a level that cannot be attained by low-income groups, owing to the continuous fall of the levels of income in most Arab states. The interaction of all these factors gave rise to the housing crisis; which differs in size from one country to another.

Consequently, the issue of providing a suitable shelter for citizens have become one of the most vital problems and challenges that confront planners and policy-makers in most of the Arab countries; and the housing problem

• The Housing Bank, Jordan.

and policy-makers in most of the Arab countries; and the housing problem has thus come to occupy a pre-eminent place in the socioeconomic development plans in these states.

Since tackling the housing problem and promoting the housing sector require huge funding, and due to the meagerness of government resources allotted to the housing sector, planners have conceived the necessity of supporting official efforts through devising new financing means and establishing financial institutions that are specialized in housing finance. Such institutions could mobilize the savings and deposits of individuals as well as institutions in both the private and the public sectors and invest them in the housing sectors, as part of the policy that aims at providing medium and long-term financing to citizens and investors in this sector in order to meet the ever-increasing demand for housing finance from the public.

The experience of some of these institutions has shown that they have managed to effectively and substantially contribute to alleviating the intensity of the housing crisis. The Housing Bank of Jordan ranges amongst these institutions.

CAUSE AND MANIFESTATIONS OF THE HOUSING CRISIS IN JORDAN

A group of social, economic, and political factors have interacted in such a way that gave rise to a severe housing problem from which Jordan has been suffering since the early fifties up till the late seventies. The major causes for this problem can be summed up as follows:

1. Population

The population of Jordan have been increasing in an unprecedented way, due to several reasons including:

- (a) Forced emigrations as a result of the Arab-Versus-Zionist wars and the consequent forced emigrations which took place in the wake of the 1948 and 1967 wars.
- (b) Natural Growth of the Population which is estimated at 3.6% per annum.⁵⁰ This constitutes one of the highest rates prevalent in the globe.

2. Internal Emigrations

Due to the imbalanced regional development and the concentration of development efforts in the urban centers in general and the capital city in particular, there occurred rural-urban migratory movements in search of better opportunities of living. These movements have led to great pressure on the different urban facilities and to overpopulation in these regions.

3. Social Development and its Impact on the Housing Problem

- (a) Increase in the number of independent families and the need of these families for separate dwellings, contrary to the prevalent ancient habits; when customs and traditions used to allow newly risen families to share shelter with ordinal ones.
- (b) Improvement in family incomes in Jordan has resulted in the tendency of the citizens to improve the standards of their housing, with regard to space and availability of facilities in addition to the desire to own a house rather than rent it.

(50) Department of Statistics, Jordan. The Yearly Statistical Bulletin, 1985.

As a result of the aforementioned causes there have emerged certain manifestations of the housing crisis, the most outstanding of which are:

- (a) The increase in the cost of house-building as well as in rent in comparison with the family income in Jordan. The ratio of the family expenditure on housing exceeds 35% of its monthly income. This ratio is very much higher than what is prevalent in developed countries where the ratio ranges between 15% and 20 % only.
- (b) The accumulating deficiency in the number of required housing units for years and years, which at the end of the year 1986, stood at about 45,000 housing units.
- (c) The rise in occupation rate per room and the phenomenon of substantial overpopulation, the average number of people occupying a single room in Jordan being estimated at about 3 persons. This is a high rate compared to the prevalent rates in developed countries which tends to be in the order of 1.5 persons per room.
- (d) The specialized financing institutions have failed to meet the demand for housing finance.

In the light of the peculiarities of the housing problem in Jordan, particularly the insufficiency of long-term housing finance, the need has become urgent for establishing a finance institution specialized in mobilizing savings and deposits from all possible resources and reinvesting them in the housing sector.

THE ESTABLISHMENT OF THE HOUSING BANK OF JORDAN

The major goal for establishing the Housing Bank of Jordan was to produce the provision of the necessary funds to contribute to the solution of

the housing problem and to support and enhance construction activities to meet the diverse housing needs of the society besides contributing to the implementation of the government development plans. As stated in the law, the aims of the bank include the following:

1. Activating construction of houses and commercial buildings, as well as their completion and expansion.
2. Encouraging housing savings with all possible means and ways.
3. Encouraging the constitution of housing cooperatives, housing funds and saving/lending societies for housing purposes.
4. Enhancing the formulation of unified specifications and standards for buildings and their requirements, in order to develop a healthy base for housing industry and lead to reduction of costs of construction.
5. Encouraging the establishment of factories and laboratories for building requirements.

THE BANK'S EFFORTS FOR MOBILIZING SAVINGS AND DEPOSITS

Deposits are considered to be the major and almost exclusive source of funds for the Bank. In this respect, the Bank has adopted a firm policy based on the principle of mobilizing the deposits of individuals, families as well as public and private institutions. In order to put this policy into effect, the Bank entered into strong competition with the other banks and financing institutions and managed to augment its share of the deposits market, which stood at about 434 million dinars by the end of the year 1989. This figure constitutes about 19% of the total deposits of all the banks operating in Jordan, compared to 7% in 1975 and 17% in 1980.

The Bank policy in mobilizing savings and deposits is mainly based on the following aspects:

- (1) Enhancing banking consciousness and enlarging the base of dealers with the bank with emphasis on small savers as well as enhancing and encouraging saving among citizens.
- (2) Offering privileges and easy terms to the deposits and savings that compete with the privileges and terms offered by other banks and financial institutions and continuously developing and improving these privileges.
- (3) Diversifying and promoting the range of services offered by the Bank in order to meet more effectively the developing needs of savers and attract more savings.

The following table reflects the growth of the number of deposit accounts with the Bank during the last 5 years (1985-90):

TABLE No. 13.9

GROWTH OF THE VALUE AND NUMBER OF
'DEPOSIT' ACCOUNTS WITH THE
HOUSING BANK - JORDAN (1985-90)

Year Statement	1985	1986	1987	1988	1989
(Deposit Balances in millions of dinars)	264.5	294.2	338.3	378.5	434
Record of the development of deposits balances, the base year being 1985	100	111	128	143	164
Number of Deposits accounts	271118	307812	331156	354833	413204
Record of the development of the deposits accounts	100	113.5	122	130	152

PROCEDURES AND METHODS ADOPTED BY THE BANK FOR IMPLEMENTATION OF ITS POLICY FOR MOBILIZATION OF FUNDS

Saving Accounts Prize

In order to implement its policy of attracting small savings, the Bank has innovated the system of the saving accounts prizes in 1977 in accordance with which it offers monetary prizes to those fortunate persons who had saving accounts with it.

It is worth noticing that the Bank has introduced several amendments in this system. At the outset, awarding of prizes used to take place twice a year and the number of prizes was 153 and their total value was 10,000 dinars. In other words the number of prizes per year was 306 and their value was 20 thousand dinars.

The number of prizes has grown ever since and the awarding of prizes has become more frequently so that it takes place now monthly. The number of prizes at every award has risen to 5105 prizes, and its total value has reached 71250 dinars. The value of the highest prize being 10,000 dinars, in addition to a special award every month, at which the number of prizes is 5105 and their total value is 86250 dinars and highest prize is 25,000 dinars.

Thus the annual number of saving accounts prizes has become (61260), the value of which is 0.9 million dinars.

The system of saving accounts prizes has proved to be very effective, since the balances of saving accounts of the Bank have reached a level that exceeds the level of these accounts in the other banks in Jordan.

It is worth noting that the Bank offers the depositors competitive interest rates in order to preserve its Share in the banking market and augment it year after year. The following is a table showing the interest rates which the Bank offered to its depositors during the last quarter of the year 1990.

TABLE No. 14.9

**INTEREST RATES OFFERED BY THE
HOUSING BANK - JORDAN (1990)**

Type of Account	Interest Rate
Current j	Zero to 4
Saving	5
Term Deposits	7 to 8.5

LENDING ACTIVITY OF THE HOUSING BANK

Foundations of the Banks Lending Policy

The Housing Bank offers housing finance to all citizens, irrespective of the levels of their incomes, in order to build lodgings of all sorts, and it abides by a clear policy in the field of lending based on the following aspects:

- (1) Defining clear-cut criteria for determining the amounts and terms of the loans. Consideration in this respect is given to the borrower's income, his ability to repay in the shortest possible period, safeguarding speedy circulation of funds and providing opportunities for the largest possible number of citizens to benefit from the Bank's loans and facilities.
- (2) Reliance on the borrower's income and his ability to repay his debts rather than the absolute reliance on guarantees as a basis for determining the amount of the loans. Consequently, the method of repayment (whether monthly, annually, etc.) is determined in a way that is compatible with the nature of the borrower's sources of income.

- (3) Diversification of terms and rates of interest in a way that caters for the capacities of low and medium income groups, through applying the principle of Cross Subsidy. According to this principle, interest-less support offered by the Bank to low and medium income groups is compensated for by the high rates charged on the loans offered to other well-to-do groups.
- (4) In order to encourage borrowers to save money and participate in financing their own projects, the Bank does not provide the entire finance required. Usually, the loan offered by the Housing Bank does not exceed 75 % of the estimated cost of the project.
- (5) When a borrower sells the property, the Bank forces him to repay the full amount of the loan in order to recirculate the funds among the largest possible group of clients.
- (6) Within the frame work of implementing these policies, the Bank takes into consideration the following controls and procedures:
 - i) Making sure of the economic feasibility of the financed project and of the ability of the borrower to repay the debt.
 - ii) Conducting field investigation into the real estate to be financed in order to make sure that the loan is being used for its purpose and disbursing is made at intervals that are compatible with the progress of work in the financed project.
 - iii) Introduction of a thorough and effective system of following the recovery of the loan installments.

The balance of the outstanding loans offered by the Bank by the end of the year 1989 stood at about 334.1 million dinars. The total loans and facilities offered by the bank since its inception up till the end of the year 1988 amounted to about 957 million dinars.

Types of Loans Offered by the Bank

In order to implement the lending policy of the Bank, the housing loans have been diversified according to the diverse parties that benefit from them and the mode of financing used. The terms of the loans vary as to the ceiling of the loan, its duration interest rate and the periods of repayment. The following is a brief account of the types of loans offered by the Bank and the terms according to which these loans were given.

1. Housing Loans for Individuals

The Bank offers loans to individuals in order that they establish, complete, expand, buy or maintain a single house with the view of using it as a lodging for a family.

This type of loans comprises two categories, namely:

(A) Loans to individuals with Low and Medium Incomes

The Bank offers this type of loans to citizens according to the following criteria:

- The borrower's monthly income should not exceed 375 dinars.
- The duration of the loan is 15 years.
- The loan should not exceed 27 times the monthly income of the borrower or 10,000 dinars whichever is less.
- The loan should be utilized for financing one single housing unit.
- The area of the financed housing unit should not exceed 200 square meters.

It is worth mentioning that the Housing Bank receives an annual interest on these loans at the rate of 8%. This rate is far below what the other banks

and finance institutions receive. It is also worth mentioning that the aforementioned interest rate includes a life insurance for the borrower of about 1 %.

In other words, the actual interest rate which the Bank receives from the borrowers does not exceed 7%. This indicates the social role played by the Housing Bank in offering finance with relatively easy terms in order to meet the Housing needs of low and medium income groups.

(B) Loans to Individuals with High Income

The Bank offers these loans to citizens whose monthly incomes exceeds 375 dinars, according to the following criteria:

- The period of the loan is 15 years.
- The loan should not exceed 25 times the monthly income of the borrower or 3,000 dinars whichever is less.
- The Bank receives an annual interest rate of 9% on these loans as well as a commission ranging between 1.5% and 2%.,

The Bank started offering this type of loans during the second half of the year 1983, in the light of the increasing demand from this category of borrowers. The Bank lent amounts exceeding 10,000 dinars, which was the ceiling of the loans offered to individuals with low and medium income.

2. Loans for Real Estate Investment

This type of loans is offered to investors in housing and non-housing buildings (Developers) in varying amounts depending on the areas and cost of the financed project, subject to the following criteria:

- The loan period is 13 years, two of which are the grace period.
- The amount of the loan is determined at the rate of 50 dinars per square meter of the area of the constructions to be financed.

- The amount of the loan should not exceed 75 % of the estimated market value of the financed project.
- The Bank charges interest rates on these loans similar to what is charged by the other banks and finance institutions.

3. Loans to Housing Cooperatives

In order to encourage housing cooperatives and promote their role in establishing housing projects for their members, the Bank offers these cooperatives loans that are compatible with the level of income of their members and the level of the envisaged projects. The Bank adopts in this respect the policies applied in the case of loans to individuals.

4. Loans for the Maintenance of Lodgings

Appreciating the importance of the existent housing units as part of the national wealth which should be preserved and continuously sustained with maintenance, the Bank started during the year 1984 to offer loans for the maintenance of lodgings. A loan of this type was small with an amount not exceeding 10 thousand dinars to be repaid within 10 years.

5. Loans to Promote Urban Development Projects

In order to support the Urban Development Department and enhance its role in providing lodgings for low income groups, the Bank participates in financing all the projects which the Department implements. The total amount of loans offered by the Bank to the Department stood at about 27 million dinars which constitutes 30.5 % of the overall cost of the three projects that were implemented and are being implemented by the Department.

It is worth mentioning in this respect that the contribution of the Bank to financing these projects took place at two stages. At the first stage, the Bank offered loans to the Urban Development Department so as to enable it

to implement these projects. At the second stage, the Bank offered loans to the individuals who benefitted from these projects with terms similar to those of loans offered to low income groups, together with additional concessions in order to enable the beneficiaries to pay the prices of the lodgings allocated to them by the Urban Development Department. Thus the Department enjoys the advantage of fast circulation of funds, whereas the Bank shoulders the load and risks of the slow circulation of these funds as a result of dealing with the beneficiaries of the Department's projects on behalf of the Department.

6. Loans to Public Corporations and Institutions

The Bank plays a national role by contributing to financing the projects of Socioeconomic Development Plans and providing the suitable funds for public corporations and institutions which undertake the implementation of housing and development projects.

7. Syndicated Loans

In order to avoid the risks of lending and mobilize big funds that are needed by certain big development projects and public stock companies, the Housing Bank played a considerable role in participating to the provision of syndicated loans. These loans were offered to a number of companies and institutions that distribute their activities amongst different sectors of the national economy. Some of these loans were offered to institutions that had obtained loans from international market in foreign currencies in order to enable these institutions to repay their loans in foreign currencies. This has led to lowering the cost of loans shouldered by these institutions on the one hand, and savings for the national economy, which amount to the interests that would have been paid on these loans, on the other:

8. Loans for Buying Housing Lands

In 1988, the Bank innovated a new lending program with the view of financing purchase of housing lands so as to enhance the building movement and activate the housing sector. Up till then, the Bank was not used to finance this activity. In accordance with this lending program, the Bank offered two types of loans to individuals: the first was in order to buy a housing piece of land to be built in the future. The second, was offered in order to buy a housing piece of land to be built immediately. These loans were offered on long-term basis with durations reaching 15 years and according to certain conditions aiming at facilitating for the citizens the ownership of these lodgings in a way that was compatible with their financial capacities.

Credit Facilities

The Bank offers credit facilities to its good clients, whether they be individuals, companies or corporations, in order to finance public housing and development projects. The Bank, when offered such facilities, was keen enough to render complete services to its clients. Since its establishment up till the end of the year 1988, the Bank offered credit facilities *amounting* to about 291.1 million dinars.

Loans for the Real Estate Security Program

During the year 1986 an agreement was concluded with the United States Agency for International Development (USAID) according to which the agency made available and guaranteed a long-term loan amounting to 35 million dollars borrowed by the Government of Jordan from the American Capital market. The Government of Jordan was to repay the equivalent value of the loan in Jordanian dinars to the Housing Bank. The Housing Bank was to lend these funds to citizens who were building low-cost houses or who bought them from developers, provided that the price of the housing unit would not exceed 10,155 dinars and the monthly income of the beneficiary

would not exceed 350 dinars. The Bank's efforts in this field aimed at increasing and expanding the sources of housing finance directed towards this category of citizens. These loans were offered with an interest rate of 8 % per year and a 17-year period of repayment.

Administered Loans

As a result of the effectiveness of the administrative and organizational procedures applied by the Housing Bank, the high competency the Bank has shown in recovering the installments of its loans, and in order to avoid duplication of efforts and institutions, certain organizations have authorized the Bank to administer the housing programs which they finance and implement for the benefit of citizens. In this framework, the authorities in the valley of Jordan have undertaken the implementation of a big housing project for settling the farmers in this region. This region of the Jordan valley is one of the most important developed agricultural regions in Jordan. The Bank was authorized to administer the housing loans offered by this project. At present the Bank follows up the repayment of the installments in return for reasonable charges that have been agreed upon. The joint Jordan Palestinian Committee has also authorized the Bank to administer the housing loans which the committee offers to the inhabitants of the Arab occupied territories. The Bank is performing now the procedures of offering these loans and following up repayment of their installments on behalf of the committee.

The following table summarizes the lending activities of the Bank since its establishment till the end of the year 1989.

TABLE No. 15.9

THE MAJOR INDICES OF LENDING ACTIVITIES AND
THE FACILITIES OFFERED BY THE HOUSING BANK - JORDAN
DURING THE YEARS (1974-89)

Statement	1974- 86	1987	1988	1989	Total
1. The Amount of loans in Million Dinah					
a) Housing financing loans ⁵¹	278.5	31.0	44.2	40.0	393.7
b) Loans for financing real estate buildings other than housing buildings	87.9	6.3	5.0	10.6	109.8
c) Total (a + b)	366.4	37.3	49.2	50.6	503.5
d) Credit bans	55.2	26.3	35.5	45.4	162.4
e) Credit facilities offered for housing and different development purposes	202.9	28.0	27.2	33.0	291.1
2. The number of approved loans	34344	2760	2752	3737	43593
3. Number of units which the Bank participated in their financing, classified according to the purpose of the loan					
a) Construction of buildings and/or their completion and/or expansion	62678	2428	2273	1760	69139
b) Buying buildings and/or providing for their maintenance ⁵²	7675	1274	1598	2120	12667
c) Buying piles and constructing buildings on them	-	-	30	311	341
Total number of financed units	70353	3702	3901	4191	82147
4. Housing Units	63872	3636	3826	3683	75017

(51) Including the loans offered to the Housing Corporation whether *form* the Housing Bank or the Central Bank 'of Jordan.

(52) It is possible that the unit which the Bank participated in financing its purchase or maintenance

be the same unit which the Bank participated in financing its construction.

5.	Non-housing Real Estate Units	6481	66	75	508	7130
6.	Areas which the Bank participated in their financing (n thousands of square meters)					
	a) Construction and/or completion and/or expansion	7874	395	412	428	9109
	b) Purchase and/or maintenance	998	193	243	351	1785
	c) Land purchase and construction	-	-	7	46	53
7.	Total of financed areas	872	588	662	825	10947
8.	Areas of housing units	8368	576	646	611	10201
9.	Areas of non-housing real estates	504	12	16	214	746
10.	Ratio of the areas which the Bank participated in financing their construction and/or expansion and/or completion to total areas allotted in the Kingdom	32%	19%	18%	18%	29%

Financial Investment

In order to realize the role the Bank could play in promoting building industry and supporting local development projects in general, as stated in its law, the Bank has worked out a specific policy in the field of investment. This policy is mainly based on establishing and contributing to economically feasible projects in the construction sector as well as other economic sectors such as tourism and finance, especially those projects that are connected with the economic development plans. The Bank in supporting these investments, aspires to achieve the following:

- (a) Diversifying its investment portfolio and the sources of its revenues in order to minimize risks.
- (b) Developing and supporting industry in Jordan in order to enhance exports and achieve foreign exchange savings through import

substitutioⁿ besides creating new job opportunities and increasing manpower productivity.

- (c) Participating to financing certain vital projects that are incorporated in the development plans inspite of its low material gain.

With the aim of implementing these policies, the Bank has participated in establishing about sixty companies and corporations and subscribed to their capital in variable ratios. By the end of the year 1989, the subscription of the Bank to the capitals of these companies stood at about 22.4 million Jordanian dinars.

Real Estate Investments

In order to apply the policy of diversifying investments and sources of income, the Bank has allocated a portion of its financial resources to real estate investments that are capable of rendering a secure and permanent output which helps the Bank to carry on long-term lending operations particularly among persons with limited incomes.

The investments of - the Bank in this field include also building and ownership of its own branches so as to save rent expenditures on the one hand and achieve capital gains on the other.

Other Banking Services

The Bank seeks to develop and diversify its banking services to its clients and to satisfy their different needs, with the view of persuading its clients to intensify their dealings with it. It also aims at diversifying its sources of income, and achieving further revenues that helps it to go on offering loans with concessionary terms to low-income groups. After fulfilling its role in offering loans, the Bank proceeded to render further banking services. It issued guarantees, remittances, letters of credits and travelling cheques. It

also deals with cashing cheques and bills as well as exchange services. The Bank extends all these services with competency, through a network of branches that are spread all over the different regions of the Kingdom.

SHELTER OPTIONS FOR ISLAMIC AFRICA

SAAD S. YAHYA*

INTRODUCTION

There are well over 200 million Muslims in Africa, spread all over the continent. About twenty countries have substantial Muslim majorities. They have until recently managed to meet their shelter needs through a variety of economic and technical arrangements which form a rich and proud heritage worthy of further exploitation and development. Of late, however, a worrying situation has developed. Because of rapid and far reaching changes in sizes, distribution and composition of population, as well as in the countries' resource bases, climatic patterns and income distribution, it is now necessary to look at the problem afresh with a view of identifying viable initiatives - not only in economic and technical terms but also in keeping with Islamic values and world views.

In addressing this topic, we should have three principal concerns. First it is important to have an overview of the general shelter and urbanization situation in Africa. Secondly one must examine what the basic Islamic teachings, in the form of the *Qur'an* and the *Sunnah*, have to say - and they are not reticent - about man's habitat and the basic rules of family life. And the third task is to suggest policies and practical measures which will enable Muslims to house themselves decently within the context of their resources, beliefs and cultures.

* Shelter Afrique, Kenya.

POPULATION, POVERTY AND URBANIZATION

A recent assessment by the World Bank in The World Development Report 1990, estimates that the average annual per capita GDP growth rate in sub-saharan Africa in the decade 1980 - 89 was substantially more negative than had been expected. It was expected to be 2.2 % while an annual average rate of growth of only 0.5% in the period 1989 - 2000 seems to be possible. Even this assumes that the countries persevere with structural adjustment programs. It is also assumed that the countries will receive adequate external assistance including debt relief. Meanwhile the financial situation remains worrisome as it is shown that in 1988 interest payments on external debt of sub-saharan Africa reached US \$2.9 billion, equivalent to 27 per cent of their GDP. Indeed interest payments are rising fast and taking up a large proportion of external receipts. Thus, debt and debt servicing burdens pose major financial constraints to African countries in the years ahead.

The per capita GDP of SHELTER-AFRIQUE⁵³ member countries varies extensively from \$170 for Malawi and Somalia to nearly \$ 3,000 for Gabon in 1988. The spread is wider when all the African countries are considered, ranging from \$ 100 for Mozambique to \$ 5,420 for Libya. However, the majority of Shelter-Afrique member countries, 16 countries, recorded 'per capita incomes below \$ 370 which is the border line of poverty.

GRADATIONS OF POVERTY

The World Development Report (1990) points out that the number of those who live in absolute poverty in the sub-saharan Africa, had risen between 1980 when this condition was reviewed and 1990 when poverty was revisited. As indicated above it is feared that the numbers could rise further in the 1990's in the face of the structural adjustment programs and the unresolved debt crisis unless poverty alleviation policies are pursued. In this connection, it is worth while to distinguish three categories of the poor

(53) An African Development Bank's Affiliate Company engaged in Real Estates Financing..

requiring different approaches. The chronic poor or the ultra-poor are those who have always been poor due to ill-health, poor nutrition or education. They have also been defined as the poorest of the poor or the lowest socio-economic level. The second category is the new poor who were in higher economic category before the structural adjustment programs. This includes the laid-off civil servants and parastatal employees needing assistance for rehabilitation and new employment opportunities. The third category is the broader one of the other vulnerable groups who have been hurt by the recession or the structural adjustment programs. This socio-economic group includes women and children.

When it was realized that the structural adjustment programs intensified poverty and social burden in Africa towards the end of 1980's a program to assist, The Social Dimensions of Adjustment in Africa (SDA), was set up in the World Bank in 1988 and funded by The World Bank, the UNDP, and the African Development Bank. It addressed itself to the requirements of the three poverty categories identified above. The initial objective was to mitigate the social burden but increasingly the strategy aimed at the integration of the groups into the mainstream of economic production of the country. Integration is being achieved by projects targeting the vulnerable groups such as women's groups. For example, a women's project in Nigeria is integrated in an agricultural development program with the objective of recruiting more women as extension officers and providing them with more access to agricultural credit.

POPULATION GROWTH AND URBANIZATION

Not only is the rate of population growth in Africa the highest in comparison with other regions of the world but urbanization has also been much faster. Sub-saharan population growth averaged .3.2 % per annum in 1980-90 compared to a world average of 1.8 % bringing the population of the region in 1989 to 479 million. The average annual growth rate of urban population in sub-saharan Africa (1980 - 88) was 6.2% leading to a high proportion of the :population residing in urban centers by 1988. Most

countries recorded well over a fifth of their population in towns by 1988 and indeed many of them had around half of the people in urban areas. The structural adjustment programs that have been adopted in the late 1980's have strongly shifted the terms of trade between rural and urban areas. This could well slow down rural-urban migration. Nevertheless even assuming a fixed level of urbanization to the year 2000, demand will by far outstrip supply of urban infrastructure, including shelter, that can be made available.

Indeed, we are already faced with a large deficit in the supply of urban infrastructure and shelter and the gap continues to widen. Even the major financiers such as the World Bank have realized their resource limitation in the provision of actual shelter for such large urban requirements. They are therefore changing their strategy and focus. The World Development Report (1990) observes that lending for urban development expanded from \$ 10 million in 1972 to over \$ 2 billion in 1988, geared mainly to site and service schemes benefiting about 13 million families. It notes, however, that the Bank has realized that housing the poor will not be possible as the projects are not easily replicable without improvements at higher policy and institutional environments that would facilitate reduced shelter costs and expanded inflows of financial resources to this sector from various sources. The new approach, therefore, is to focus more on the broader policy and institutional issues and less on projects but still contribute to the provision of urban infrastructure and services at the urban community level.

CURRENT MAGNITUDE OF THE SHELTER PROBLEM

A general over-view of the housing situation in Africa will reveal that there is a serious deficiency in the housing stock in all African countries, especially in the middle and low-income brackets, as a result of the substantial gap between demand and production. The constraints are many and complex. They are financial, political, social, technical and organizational.

The majority of African urban dwellers cannot afford housing that conforms to existing building codes: approximately 40 percent inhabit shanty towns, slums and uncontrolled settlements in urban areas. The private sector has fueled construction of shanties for quick maximum profit; the public sector has in some cases lacked commitment to the provision of low-cost housing and has not had sufficient technical, administrative and financial resources to produce acceptable housing in sufficient quantities. Rent control laws, although well-intentioned, result in serious deterioration in the quality and quantity of housing and considerable reduction in new construction and addition to the housing stock. Building standards and codes are often too high to generate low-cost housing, yet there is a reluctance to compromise standards for fear of accelerated development of shanty towns. Housing, by its very nature, is never cheap and policies directed at achieving affordability end up with contradictions. The importation of building materials can hardly continue to be sustained by limited foreign exchange earnings from exports of primary products.;

HOUSING NEED AND DEMAND-RELATED FACTORS

Recurrent future shelter need in Africa is estimated to be in excess of 10 million units per annum. Almost 60 million people live in squatter and other uncontrolled settlements, under very unhealthy conditions. Sprawling shanty settlements characterize many large cities such as Douala, Addis Ababa, Khartoum, Nairobi, ;Lagos and Dakar. It is reported, for example, that in Morocco, informal settlements have been growing 2-3 times as fast as the overall urban population growth. Also in Kenya it is estimated that urban housing need per annum has been about fourteen times the country's housing production rate. In Zambia, for example, whereas the total shelter need for the period 1979-1983 was 391,000 dwellings, the 15,000 additional dwelling units provided during the same period were for medium and high income groups.

Formal housing' supply has not kept pace with the demographic evolution. In a number of countries resource allocation to the housing sector

has not only been insufficient but has - actually declined. In Kenya, for example, whereas the contribution to total expenditure on housing amenities, social security and welfare was 3.9 % of the total central government expenditure in 1972, this declined to 1.7% in 1987, according to the World Development Report 1989. Similar evidence is available for the same period for Malawi, Tanzania, Burkina Faso, Uganda, Lesotho, Liberia, Morocco and Botswana. Furthermore many international housing development finance institutions have expressed concern that the meager financial allocation to the shelter sector has not been efficiently utilized to facilitate massive housing production. Too much emphasis has been put by government and quasi-government organs on production of a small number of physical housing units rather than facilitating an enabling environment for massive production of housing by the private sector.

On top of finance-related problems there are also problems arising from poor urban management, especially with regard to the provision of infrastructure and social sector projects; problems with policies that do not ensure land conservation or the efficient usage of land; high input of imported building materials in a situation of limited foreign exchange reserves; and poor dissemination of information and research findings. In short, a string of problems have kept the supply of housing to the population below the 50th percentile of the income distribution profile.

Past experience has highlighted some problem areas in lending to the poor, for example the issue of affordability, cost-recovery, designing mortgage packages that suit the poor, mobilization and channelling of domestic resources to housing ear-marked for the poor.

The upgrading of slums has received relatively low priority from aid giving agencies. In many instances, little successful effort has been made to actually improve slums. We have observed the recent trend of international assistance to gradually shift from slum improvement and site and service programs to supporting more rewarding entrepreneurial activities in these localities, in some cases aggravating land-use conflicts in the areas. Planning

has traditionally not incorporated economic development in low-cost house provision. It has become evident that when economic services that will provide employment are incorporated in the wider planning context, low-cost housing schemes have tended to become more successful.

Although no precise figures are available to illustrate the current magnitude of housing demand there is sufficient evidence to indicate deficiency in the provision of all forms of housing and corresponding infrastructure. Considering all the above, the gap between the demand for shelter and the provision of housing has been widening. SHELTER AFRIQUE has attempted to assist African Governments bridge this gap in the past by adopting policies befitting a nascent regional development finance institution.

GAPS THAT SHOULD BE ADDRESSED BY POLICY

It is in view of the above that any future policy considerations should examine the following areas for sustainable shelter sector development

- (1) Continued policy of creating an 'enabling environment' for the development of shelter in Africa, one increasingly less involved in the direct financing of complete housing units.
- (2) Training and acquisition of adequate technical manpower for project preparation and execution.
- (3) Measures geared to the improvement of urban management: a lot needs to be done to improve the local revenue collection machinery, land use planning and development control:
- (4) Strategies which stress not just the sporadic interventions but also cover policy and institutional issues of greater importance to national economics and productivity of cities, extending to urban

administration, municipal finance, land management and regulatory issues.

METHODS

Urbanization is thus seen to be the major contributory factor in the increasing scale of homelessness in the urban areas and will continue to be so if the current trend continues. According to the World Bank, over 500,000,000 people are expected to be living in urban areas by the year 2000. This can only imply increasing homelessness. We need nothing short of political will to counter such adverse consequences as well as an adequate response to the challenge of housing low income groups. It is my firm contention that gradual improvement of housing conditions over time will only emerge if governments muster the political will and set in motion the process that will do this.

A basic issue in urban areas and part of the reason for increasing homelessness is the shortage of land. But this is not the only hindrance. Were the land is available the poor could not build up to the expected standards because of the cost of materials; laws prescribe where people have to build and standards prescribe how they may build. The sum total of all this is to make decent housing unaffordable to the poor who have tended to construct makeshift shacks.

Initially, governments all over the world tended to react by demolishing these structures which were seen as an eyesore and an indication that the government could not provide for its people decently. However, in the past 20 years such demolitions have been discouraged because governments were not able to provide alternatives for those whose shelters had been demolished. Moreover, governments have begun to assist the poor in their quest for housing.

Such assistance programs have been :-

- upgrading of informal settlements by provision of services and regularization of tenure; and
- provision of minimally serviced sites i.e. with roads, water and sewerage facilities and then assisting the plot holders to build their own houses.!

Despite these solutions, the number of the homeless has increased so much that we are still talking about it. The United Nations declared (1987) the International Year of Shelter for the Homeless (IYSH) because it was perceived to be a big problem all over the world. If anything the IYSH reinforced the need! for governments to take low income housing seriously because:

- the housing markets, because of its extreme commercial nature, will not cater for the lower income groups who are unable to bid in it; and
- the cost of construction is far too high on average for the low income groups.

It makes economic and political sense for governments to invest in housing provision whether by state departments or by individuals because of-

- Economics: Creation of GNP by the construction sector is impressive as well as its role in creating employment and incomes for the population.
- Security: For the security of a nation and the political system it is important that the population be housed in a decent environment. Dissatisfaction with, living conditions may spark off dissatisfaction with the rest of the establishment.

- Governments have a moral duty to take care of the inequities of an economic system and the market.
- Governments need to help create this enabling environment so that it may reduce its own responsibility over time.
- Investment in low income housing demands less on skilled labor, which is a scarce resource, and also less on capital and foreign exchange; and it usually utilizes locally available products.

METHODS OF CONSTRUCTION

Exquisite examples of African Islamic architecture are to be found in north, west and east Africa. Each region has its own distinctive style, dictated by history, culture, climate and local materials. But the traditional settlements are rapidly being encircled by modern neighborhoods and shanty towns. Generally, there are four broad approaches or methods of construction. These are :

- (1) Traditional - i.e. with no import content and using traditional craftsmanship; more common in villages and small towns.
- (2) Modern - a mix of both imported and locally available materials; suitable for large-scale production in urban areas.
- (3) Appropriate Technology - Locally developed alternatives to imported materials and improvements of structural capacity of the traditional materials; also scientific improvements to traditional formulae and techniques.
- (4) High-tech solutions involving prefabrication of dwelling components or construction of high rise blocks of apartments using the latest technology and materials; this method is the most expensive and only suitable for the rich.

Construction could be sponsored by

- Individuals responding to their shelter need.
- Government or a public corporation.
- Cooperatives and other types of social groups!
- Private developers who build houses on speculation for sale in the market. This method requires a sophisticated mortgage market to work well.

Recent global experience indicates that it is not feasible to expect governments to develop housing. With current emphasis on the use and integration of the private sector in all aspects of the economy it is advisable that governments create an environment where the private sector, whether formal or informal, meets the housing demand. This may be done by ensuring that there's access to finance for building, provision of infrastructure i.e. on, unserviced sites, adaptation of appropriate building technologies as well as unhindered access to land particularly for low income housing.

HOUSING FINANCE

Housing Development Finance Institutions in Africa

The development of housing finance institutions is strongly related to the general sophistication of a country's financial system, which in turn is closely related to overall economic development. Africa, like other regions of the world has evolved traditional forms of financial intermediation to include: postal savings banks, commercial banks, building societies, insurance companies and to a smaller extent stock exchanges. But the level of financial intermediation and resource mobilization has generally been low and the institutional machinery fairly underdeveloped. It has been observed that in the majority of African countries, there has been a substantial degree of financial shallowness and the formal financial institutions are in a rudimentary stage compared to their counterparts elsewhere. They are also

characterized by low densities, with problems of commercial viability, financial integrity and inability to penetrate the country-side at a pace faster than the rate of commercialization of the non-urban sectors of the African economy.

When it comes to housing finance, few countries in Africa have widespread and successful systems of finance. Rapid inflation, shifting terms of trade and slow growth that have characterized many African economies, have not been conducive to the development of housing finance institutions. Efforts to mobilize domestic resources have been recent. However, such resources have found it easier to go to financing commerce, construction and industry, than to finance mortgages.

. Existing institutions are more urban-based and relate only marginally to the bulk of small holders, especially in non-urban areas. Whereas building societies should normally be attractive because of the combination they offer for easy withdrawals, security and home loans, they have, however, not developed adequately in Africa. This has been partly because of deficiencies in the entire financial institution industry and partly because of the underdeveloped nature of the housing markets, characterized by low property transfer activities and inadequate land registration systems.

There is a whole range of issues that need to be resolved in developing viable housing finance institutions, and especially in determining on who should get housing finance, including:

- lower versus higher income groups
- construction versus long-term financing
- first time owner versus others
- upgrading/renovation versus long-term financing
- the place of housing finance in the development of the financial system as a whole.

Furthermore, housing finance companies have been found to work most efficiently in free market investment situations. If they are encumbered with unrealistic objectives in pursuit of ambitious social goals, these goals will reduce them to state dependency and limited creditworthiness.

When set up properly in the right environment and appropriate viability objectives, housing development companies assist in mobilizing capital, directing it to the housing sector, and emphasizing efficiency in its use to ensure cost recovery and a good return on the investment. This often amounts to mobilization of short term saving funds and committing them into long-term capital investment programs. Whereas the broad objectives are normally to increase the supply of shelter, the focus tends to be on the private sector, emphasizing self-financing schemes covering a broad array of areas including, poor/low-income self-help housing, site-and-services, land development and cooperative housing.

The capital market for housing funds has been poor and unexploited. Whereas the institutional framework of stock exchanges exists only in a few African countries today, hardly any have advanced to a stage of trading in housing bonds. General stock exchanges, where they exist are urban-oriented, insular, nascent, small, confined and they are localized to indigenous populations and make little impact on savings mobilization.

In non-African countries where the housing bonds markets are fairly well developed, short-term and medium term bonds have been found to be more attractive to investors than long-term bonds. Bond markets are very important for mortgage credit institutions' and their ability to grant competitive financing.

Governments in developing countries usually allow interest earned on housing bonds to be tax-free in order to make them attractive and encourage home-ownership.

The Demand for Housing Development Finance Institutions

In the majority of cases in African countries, formal sector institutions specializing in housing finance have lent almost exclusively to middle and high income housing in urban areas. The older institutions in the trade have been selective in their choice of borrowers - e.g. those who have been well-known customers, often developers who are considered safe. Such customers have been advanced large loans.

Institutional sources of domestic non-equity funds have often been divided into the following categories :

- (1) long-term trust, pension and insurance funds; medium-term funds from credit unions and employers
- (2) short-term funds from corporate savers, advocates, accounts, parastatals and so on
- (3) funds, obtained by refinancing of mortgages and in advanced markets
- (4) funds generated by sale of special tax free housing bonds in large denominations to individual savers.

Supply of funds for the lower income borrowers has been left to local authorities, who have done a poor job, mainly because housing units they have sponsored have ended up benefiting allottees in higher income brackets. As a consequence, supply of funds to the low-income housing sector has been left almost exclusively to informal sources. Informal housing finance supply to the market has consisted of lenders who are often individuals, cooperatives, firms (employers), building groups, housing companies, savings and credit societies, or non-bank financial institutions specializing in hire-purchase lending.

The greatest shortfall for funds has inevitably been in lending to the lower percentiles of the middle income category of borrowers and the entire low-income earning sector. In lending to the low-income sector, characteristically, the loans have been short-term, unsecured and often more expensive than loans from formal sector institutions. Interest rates have had to be high because of the increased risk of lending to the poor and the drudgery of administering many small loans; the down-payment expected has been substantial, because of the poor's irregularity of income. In Kenya, for example, the size of loan has not been decisive, and affordability has been based on future income. Loans from various cooperative sources account for 20-25 per cent of informal housing finance. Their lending terms are commonly three to five years at interest rates pegged to deposit rates rather than commercial lending rates. The loan sum is also small being two to three times the borrower's savings balance. It is normal to ask for two guarantors, but no other collateral.

In Africa governments have erroneously forced parastatal housing finance institutions to be excessively concerned with providing subsidies especially in pursuit of 'affordability'; so where housing finance institutions have existed, many have adopted inappropriate lending policies which have jeopardized the efficacy of their operations, and seriously impaired their viability. Many have lowered interest rates, in some instances lending at negative interest rates in order to make housing "affordable".

Policy Gaps

Regional efforts for domestic resource mobilization for shelter projects in Africa are recent and are still in their formative stages. Aid agencies should join hands in co-financing ventures to promote domestic resources for shelter. Steps have to be taken to examine the roles of existing housing finance institutions in selected African countries in mobilizing domestic savings for the shelter sector.

Since the greatest shortfall of funds in the lower middle-income and the low-income categories, there is need to emphasize support for housing finance companies with the potential to finance the lower income category of borrowers, in order to:

- Support the availability of mortgage funds in the form of long-term loans and bridging finance
- Encourage domestic savings as a basis for a fund for long-term investments in the housing sector
- Encourage home ownership and the granting of loans for construction and purchase of houses and land
- Build up the stock of mortgageable assets
- Give some depth to the system.

Supported institutions would preferably be viable in their own right and should not depend on subsidies.

They should therefore be reasonably autonomous in their functions and independent, so as to expect returns on their loan portfolios which are competitive in the overall financial market. Assistance should be extended to mortgage agencies to respond to changes in economic circumstances to mitigate the possibility of lending on negative interest rates and to avoid recapitalization of their assets. The emphasis here should not go merely to initiation of these institutions, but support should also be extended to their sustenance, provided that they adopt policies congenial to institutional viability.

There is no doubt that financing projects within the 50th percentile of income distribution and below is not easy and is fraught with all sorts of problems that put the financier at greater risk than in lending to high income categories. But this is where the greatest demand for funds is today. If a - generation of housing finance institutions geared to lending to the lower income category of borrowers is created, over time, it would overcome many

of the common risk-related problems. These institutions could develop innovative methods and products to suit local conditions.

There are also many other remedies against defaulting mortgagors that could be exploited and whose practical intricacies could be examined and researched on. These^s include the mortgagee's right to sue on the contract to repay; foreclosure; right to sell or to appoint a receiver. Crop lines can be used where produce cooperatives or marketing agencies are concerned. Finally, collective security can be arranged where loans are collectively secured as in the case of co-operatives.

In addition to promoting the development of new housing finance companies, the need arises for investigating national domestic savings capacity and to designing institutions that will channel savings into housing investments.

The Building Materials Sector

The role of human settlements management in promoting sustainable development includes promoting the use of indigenous building materials and appropriate construction technologies *inter alia* by revising building and planning codes and supporting small-scale production processes. Reliable estimates of annual requirements in building materials are difficult to come by but what is certain is that there is a huge market. Where building materials are reckoned to constitute 50-60% of the total building costs the amount needed to meet requirements is enormous. The continued importation of building materials in a situation of limited foreign exchange earnings cannot be further sustained. Although this has been recognized by various observers not much has: been done either due to limited policy options or low technology base and infrastructure. An analysis of the sources of building

materials in a typical low-cost housing project in Kenya revealed the following⁵⁴

- materials of local origin e.g. earth blocks, bricks sand, timber products •
locally fabricated materials using some imported inputs: e.g. bitumen, steel doors and windows, cement, reinforcing rods, paints
- wholly imported materials e.g. water meters.

In the case of (i) above, basic raw materials and labor are sourced locally. The import content in the production of these materials is very low and mainly due to machinery, fuel and transport. It is generally below 20% and in some cases can be as low as 5 %.

For locally fabricated materials using imported inputs as in (ii) above the import content is fairly high since only labor and limited inputs are procured locally. Most of these materials are metal based products such as corrugated iron sheets (CIS), fencing wires, hinges, storage tanks, steel doors and frames, etc. The import content in this category of materials can be as high as 60-80%. The same study showed that in the Kenyan project, the import content for gauge 24 CIS processed locally was 86% while that of a PVC vent cowl was 53%. The local "assembly" of these semi-finished products even where import costs are high assist in employment, and transfer of technology apart from value-added benefits.

Apart from the above two categories, other materials are directly imported from elsewhere as finished products for direct use locally. These materials include plumbing and sanitary fittings, electrical fittings, glass and so on. The contribution of these materials to the cost of a low-income housing varies from project to project and depends on the design standards. It is however significant because of 100% cost paid in foreign currency.

(54) Avevi. E. and Syagga P.M., A survey of import content in construction works in Umoja II low-cost housing project, Nairobi, report prepared for USAID/rhudo, 1988.

Various reasons have been advanced for the continued importation of these materials. These range from lack of technology, comparative cost advantages to better quality.

Thus there is always an import content in most building materials used in Africa. It may be in the form of machinery and tools used in extraction and processing, transportation, raw materials, labor and so on. In Kenya, where deliberate emphasis was placed on the use of local materials, it was found that the import content was less than 20% for walling materials and timber, 21-40% for cement and aggregates (mainly due to explosives and transport) and more than 40% for louvers, glass and CIS. Put together the overall import content for this project was 36%. It is necessary to emphasize that the rate becomes higher where high income housing is involved.

There are few countries that have undertaken a similar study to Kenya's. Generally information on this is limited and figures being quoted are at best estimates.; However, one can extrapolate using the Kenya study.

Our experience in operating in different African countries shows that many import more than 50% of their building materials requirements either as finished products or raw material inputs for production. The so-called conventional materials such as cement are generally import dependent in technology, spares, raw materials, fuel, transportation and even more important, production and management expertise. Although the technology for cement production has been available for decades many production units in Africa have been performing poorly and unprofitably since inception. Some have been placed under foreign management contract at high foreign exchange costs to the countries concerned.

SHELTER-AFRIQUE'S EXPERIENCE IN SOME ISLAMIC COUNTRIES

Shelter-Afrique has been active in the shelter and urban sector since 1986. To date it has some forty projects in the pipeline, of which some are

nearing completion. For the purpose of illustration, we describe below four projects currently being undertaken in Senegal, Djibouti and Guinea, all of them countries with substantial Muslim majorities.

1) Low-Cost Housing Project in Grand Yoff, Dakar, Senegal

The Government of Senegal has adopted a housing policy that aims at developing and improving delivery systems in order to ease the acute housing shortage prevailing in the country due to population growth. According to 1988 Census the country's population was about 6.9 million inhabitants with an average annual growth rate of 3 per cent. The urban population was 38.4% of the total population. This rate places Senegal among the most urbanized countries in West Africa. Dakar and its suburbs currently have a population of 1.5 million or 21.6% of the total population.

With such a high population growth rate and urbanization the need for housing and basic infrastructure is large. It is therefore recognized that the national housing stock must be increased in order to cope with population growth.

The Grand Yoff Low-Cost Housing Project was conceived against this background, the main objective being to improve the living conditions of the residents by developing expandable low-cost housing units, basic infrastructure and community services. About 300 housing units and related infrastructure will be developed. Societe Natinale des HLM is the executing agency. SHELTER-AFRIQUE is assisting through a long term loan to finance about 30% of the total project cost. Proceeds from this project will be reinvested in similar housing projects. Beneficiaries will be actively involved in the financing of the project through down-payment and extension of the core-units.

2) Construction Leans and Social Facilities in Kanifing East, Banjul, The Gambia

The Gambia is a small country in the western part of Africa. According to 1989 projections its total population for 1991. will be approximately 900,000 with 36 per cent living in the urban areas. In 1983 the population was only 700,000 and only 26% lived in urban areas with approximately 180,000 in the Greater Banjul Area, that is the capital. The Government of the Gambia in its 2nd five year development plan proposed to formulate a National Housing Policy. The new national policy was subsequently launched in October 1989 by the Ministry of Local Government and Lands. It is designed to promote an 'enabling environment' by improving access to housing and basic infrastructure services by the low-income groups through provision of land tenure security and serviced land, restructuring and strengthening the housing finance and housing delivery system, greater community participation and production of local building materials among other things.

Shelter-Afrique has lent its support to these positive initiatives of the Government. In 1987, the Kanifing East Site and Service Project in Banjul was started with the support of SHELTER-AFRIQUE, World Bank and the Social Security and Housing Finance Company (SSHFC). The latter, which is the executing agency, is a parastatal responsible for low-cost housing development and finance in the country. The project is designed to provide about 700 serviced plots and building materials credits to low-income earners in Greater Banjul, to strengthen SSHFC in project implementation and to provide community facilities. SHELTER-AFRIQUE is financing the building materials loans, technical assistance to SSHFC and the development of community facilities! Its assistance is in the form of a long term loan extended to SSHFC and guaranteed by the government. The World Bank financed the development of the site.

3) Urban Improvement Project in Salines West, Djibouti

Djibouti is another small country of (23,200 Sq. Km.) with an estimated population in 1984 of 330,000 inhabitants. Over 60% of this population live in the Capital, Djibouti.

In order to ensure that appropriate measures and policies are instituted for managing the country's housing sector, SHELTER-AFRIQUE in 1988 at the request of the Government of Djibouti agreed to co-finance a feasibility study on some housing projects in the country. The study report will assist the Government in formulating a long-term plan for housing and infrastructure development, building materials production, housing finance and land delivery systems in the country. SHELTER-AFRIQUE provided 80% of the total cost of the study while the Government of Djibouti provided the balance. An international consulting firm carried out the study.

4) Site and Service Scheme in Enta Nord, Conakry, Guinea

The Republic of Guinea is a predominately Islamic country in west Africa with an area of 246,000 Sq. Km. and a population of about 6.65 million in 1988, growing at an annual rate of 2.8 per cent. The urban population was then estimated at about 2.13 million, growing at 8 per cent per annum. Conakry, the capital, is the largest town with a population of about 1.1 million in 1988. It is estimated that Conakry, will have a population of about 2.8 million by the year 2010.

The Government's policy for low-income housing is to develop serviced sites and hence attract private sector participation in shelter provision. It is a comprehensive housing policy with emphasis on access to land and basic infrastructure services.

In 1989 the Ministry of Works and Urban Development approached Shelter-Afrique for assistance in the development of a site and service scheme in Enta-Nord, Conakry, Guinea. The scheme will provide 2,000

serviced plots to low-income earners to build their own houses. About 18,000 people will benefit from the project.

Production and use of local building materials will be promoted. Shelter-Afrique will assist the Government of Guinea in the execution of the project through a long-term loan hard currency which will be used to finance part of the total cost of the project. The project promotes active participation of the people in the housing process through their involvement in the production of building materials, financing and construction of houses.

GUIDING PRINCIPLES

Our appreciation of the problem of housing Africa's population can be enhanced by the teachings of the *Qur'an* and the *Sunnah*. For the problem is not merely one of numbers *or* of technology. There are fundamental ethical issues which need to be considered, relating for instance to equity, the freedom of the individual, access to nature's bounty, the respective rights of men and women, responsibility for one another, personal privacy cleanliness and so on. The guidance given is comprehensive and all-encompassing. For our present purpose let us confine ourselves to the following six principles:

1) The Right to Decent Living

There are many verses in the *Qur'an* which enjoin Muslims to take full advantage of God's bounty and enjoy the good life within the limits of the law. Economic well-being is emphasized as a priority for all men

"God intends every facility for you; He does not want to put you to difficulties".⁵⁵

(55) Al Baqarah, Verse No. (185).

"So eat and drink of the sustenance provided by God and do no evil nor mischief on the (face of the) earth".⁵⁶

"And when the prayer is finished, then may ye disperse through the land and seek of the bounty of God".⁵⁷

And there are many other verses with a similar message. The implication is that man is urged to strive for the best while satisfying his needs, but he must guard against corruption, waste and fraud. Science and technology are to be developed for the purpose of exploiting resources for man's well-being.

"Do ye not see that God has subjected to your (use) all things in the heavens and on earth and has made his bounties flow to you in exceeding measures (both) seen and unseen?"⁵⁸

2) Avoidance of Excesses

Whereas decent living conditions and economic well-being are to be striven for as a matter of duty, and the pursuit of prosperity is a virtuous act, excesses, extravagance and ostentation are a serious crime. The Qur'an describes and condemns in graphic language the lofty palaces owned by despots and arrogant tycoons.⁵⁹ An African scholar, Abdullah Saleh Farsi who was later to become the Chief Justice of Kenya, relates in his 1942 biography of Muhammad how the Prophet built his mosque and living quarters in Madina.⁶⁰ He tells us how the Prophet insisted that the land be valued by an independent party and that the owners (who happened to be orphans) be paid compensation; and how all the Companions got together and

(56) Al Baqarah, Verse No. (60).

(57) Al Jumu'a, Verse No.(10).

(58) Luqman, Verse No.(20).

(59) Al Qasas, Verses (38-40) and (76-81).

(60) Abdullah Saleh Farsi, Maisha Ya Nabi Muhammad (The Life of the Prophet Muhammad), Zanzibar Mulla Karimjee, 1942, p.p. 42-43.

built the mosque with their own hands. The houses were simple, with brick walls and earth floors; and each measured about 4 yards square (presumably four steps each way) creating enough space for one or two rooms, kitchen and toilet. From this simple tale we can learn a great deal about the virtues and the practicabilities of forthright land transactions, self-help construction, simple materials and finishes, and the basic necessities.

3) Equity and Social Justice

Islam decrees that all men are equal and responsible for one another's well-being. None should be so deprived as to be forced to beg or live a life of misery and destitution. There are several Quranic verses and traditions which deal with this matter. The Prophet said "A Muslim is the brother of another Muslim; he neither wrongs him, leaves him without help, nor humiliates him".⁶¹ Again, "Whoever humiliates or despises a Muslim, male or female for his poverty or paucity of resources, will be disgraced by God on the Day of Judgement".⁶² The laws of Zakah and other measures for distributing wealth are also designed to ensure that no person lives below a certain minimum standard. Shelter is an important component of that subsistence level.

4) Stewardship of Resources and the Environment

We have already referred to man's custodianship over the earth and its resources. This is a rich endowment which carries certain responsibilities.

Muslims are urged to treasure and preserve this heritage. Destroying both life and property is equivalent to spreading mischief and corruption in the world.⁶³ Environmental considerations should thus be paramount in

(61) Reported by Muslim

(62) Musnad, Imam al-Ride, Beirut, 1966, p.474, quoted in Khurshid Ahmad (ad), *Islam: Its Meaning and Message*, London, The Islamic Foundation, 1975, p.191.

(63) Al Baqarah, Verse No.(205).

human settlements design, especially in the very fragile environments found in so many African countries. This point is connected with the question of environmental health and cleanliness.

5) Privacy

Muslims are expected to follow certain basic rules regarding personal decency, mode of dress and privacy in the home. *Surat al-Nur* is fairly detailed and specific on this matter. Men, women and children have been given specific roles and tasks which have a profound effect on the structure and functioning of the home. And this is reflected in the design and layout of Muslim houses all over Africa. The same principles ought to be extended to the construction of social facilities such as schools, health centers and meeting places.

6) Economic Institutions

The final principle we can use to guide us in our efforts to improve the shelter situation in Islamic Africa is that the Islamic economic regime has tools and concepts which could be exploited for the purpose of making resources available. There are instances where modern economic and financial principles could be used to great advantage without contravening Islamic laws. Market operations, the profit motive, labor relations, land tenure and corporate ownership are only some of the business relationships which are well covered by existing Islamic laws; however the application of the law may need to be adapted to the prevailing economic situation. For instance, interest bearing mortgage loans are strictly speaking not permissible; but is there a way of designing participating mortgages where interest is replaced by profit or equity in the asset? Could waqf in its various forms be used to create land reserves and promote new housing development?

IMMEDIATE PRIORITIES

Although it is not the purpose of this paper to propose solutions or make specific recommendations, it will be worth our while to explore the possibilities for future remedial action and the direction in which further efforts should be moving. Although national governments have their own shelter strategies and some are advocates of the UN Global Shelter Strategy to the year, 2000,⁶⁴ there is nonetheless a case for looking at the problem from the Islamic perspective with a view of supplementing the remedial actions already being taken by governments, individuals, and private commercial interests. The following activities need to be undertaken as a matter of priority

- 1) Monitoring, documenting and analyzing the living conditions of Muslims throughout the continent.
- 2) Formulating an action plan for upgrading the income earning opportunities of the vulnerable such as the pastoralists, fishermen and the urban poor and improving their access to shelter and social infrastructure.
- 3) Developing local capability in designing and implementing sustainable programs including mobilizing the population, enhancing leadership skills and training technical and professional personnel.
- 4) Creating the necessary financial and market structures for mobilizing resources and channelling them towards housing development.
- 5) Designing measures for conserving resources, and protection-worthy areas in Islamic Africa. Human settlements must be planned in the context of sustainable development.

(64) UN, The Global Strategy for Shelter to the Year 2000, Nairobi, 1990.

6) Devising mechanisms for cooperating with UN agencies and regional organizations (including SHELTER-AFRIQUE) to the best advantage. More could be gleaned from these institutions if Muslim communities and their governments articulated their needs more clearly and vigorously.

7) Getting African countries to assist each other on a bilateral basis; this is clearly taking place in a small way but a lot more could be done; assistance could be in the form of expertise, research findings, equipment and so on.

Who, is to initiate and coordinate the actions suggested above? It seems that the Islamic Development Bank is in a unique position to take that leading role. It has the necessary resources and enjoys the confidence of governments and Muslim communities throughout Africa. There are also the Islamic countries of north Africa which are relatively wealthier and better equipped than their sub-Saharan counterparts. They too should offer more assistance. Countries such as Egypt, Libya, Tunisia, Algeria and Morocco possess not only a long history of urbanization and a rich architectural heritage, but also a surplus of trained manpower and well equipped research institutes. They could thus do a great deal to set the pace in tackling the shelter problem.

In conclusion, we can say that current efforts could be strengthened and a new dimension added if inspiration was drawn from Islam and the wide diversity of cultures found in Africa; if there were greater cooperation between countries and regional institutions, if poverty, deprivation and homelessness were seen as challenges rather than end-states.

**COMMENT ON THE PAPER ENTITLED:
"SHELTER OPTIONS FOR ISLAMIC AFRICA"**

MOHAMMAD HASHIM AWAD'

1. The paper of Mr. S.S. Yahya of Shelter Afrique on "Shelter Options for Islamic Africa" presents a comprehensive treatment of this subject. The author provides the reader with a considerable amount of statistics and information on the growing deficit in housing in sub-Saharan Africa, and gives an explanation for this disturbing phenomenon. He also predicts that the problem will be aggravated unless the new strategy, which Shelter Afrique is promoting is widely adopted by African countries. He perceives this strategy, which is strongly advocated by the World Bank, as in line with Islamic values and social traditions of Muslim societies in Africa.

2. Mr. Yahya ascribes the widening gap between the demand and supply of houses in (Muslim) Africa to high rates of population growth and urbanization, coupled with growing internal and external pressures for better habitat. This is on the demand side; on the supply side, he cites numerous factors, which include low and declining per capita income, falling welfare spending, mismanagement of land resources, inadequate infrastructure and trained cadres, direct state involvement in the construction of housing (with a bias for middle and upper income brackets), general lack of financial institutions and instruments for channelling private funds into the housing sector, and the administrative and legal restrictions facing investors in this field.

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3. The solution which the author offers is the one championed by Shelter Afrique. It is based on foreign donor and state-supported private investment, which focuses on low-cost housing for the poor in urban centers and the countryside. Other options which the author mentions in passing include cooperative, state-executed and self-financed housing. In Islamic countries, housing policies should be guided by a number of principles, such as decent living conditions for every family, economy, self and mutual help, equity, cleanliness, privacy and the protection of the environment.

4. Statistics on housing in the developing world, and Africa in particular, are quite scant. Hence the absence of figures on state and private housing expenditure in the paper under review. The limited data available suggests that such spending represents no more than 10% of fixed capital formation and 3% of the GNP in the Third World. Housing has generally received small allocations in the economic plans of most developing countries. However, families are estimated to spend about 40% of their incomes on renting houses and around 50% on acquiring houses on hire purchase. Urban houses are generally 6 to 7 times more expensive than rural ones, whereas urban incomes are only 3 to 4 times rural incomes. One reason for this imbalance is that urban houses have a higher import content than rural ones. Hence the greater demand that urban housing creates for foreign exchange. In contrast, imports for rural housing are more in the form of infrastructural needs than in that of building materials.

5. Sudan's housing problems illustrate quite well the difficulties facing developing countries in meeting fast growing demand for houses, particularly in towns. The Ten, Five and Six Year plans relied heavily on the private sector to build new houses, allocating to this field only 2-10% of private investment, which constituted 40-45% of total investment. House building costs have escalated sharply in the 1980s, and so did rents, specially in the case of high-cost houses. This and falling real incomes have raised (revised) rents to more than wage levels for many state employees, including physicians, judges and university teachers. Commercial banks are not permitted to finance housing, and the Estate Bank shoulders the entire burden

with limited and much tied-up resources. Some banks circumvented the ban by constructing and then selling houses and apartments. These are mostly luxury buildings intended to attract emigrants who are prepared to pay in hard currencies, which are used in importing the needed building materials. Increased allotments of plots at nominal prices (as well as through auctions) are helping to push up building costs - at least in the short run - with the prospect of an eventual fall when the ensuing easing of the housing situation brings down the prices of both houses and building materials. Facing less land and input constraints, rural housing has a more elastic supply. Yet, a case can be established for the allocation of more of the country's foreign exchange earnings to upgrading rural housing and supplying it with infrastructural services since the rural population, which produces almost all exports, receives no more than 30% of their earnings.

6. The housing projects sponsored by Shelter Afrique in countries like Gambia, Guinea and Djibouti suggest that its approach is workable. But the experiments are still very small and young, and they neither confirm the superiority of the approach, nor do they reveal any characteristics that render it particularly suited to societies that are guided by Islamic teachings and values. In fact, the ultimate success of this approach will depend on the creation of a set of integrated institutions, the provision of high-quality management and personnel, the development of appropriate financial organs and techniques, the modification of property laws, the continual flow of substantial foreign aid, and considerable state subsidization. Most of these prerequisites of success will take a long time to satisfy, and some (like foreign aid) may never reach the scale envisaged in the strategy. Indeed, the approach advocated by the author seems to underestimate the urgency and size of the housing problem facing Muslim societies in Africa and elsewhere. The Sudanese case illustrates this quite graphically.

7. Sudan is a sub-Saharan African country with a per capita income of \$480, compared to an average of \$330 in Sub-Saharan Africa (SSA) in 1988. National statistics show that nearly 30% of the people live in towns (versus 21 % suggested by projections from the 1983 Census data), that the average

share of the Sudanese family of the GNP value in 1990 at £. s.202 billion varied from £. s4 thousand in the lowest 10% to £. s 153 thousand in the highest decile, and that the value of the houses varied between £s.50 thousand and £s.6 million. Thus families that allocated on average 40% of their income to purchasing houses required 31 years (for the poorest) and 98 years (in the case of the richest) to acquire houses. Costs of upgrading and expanding houses so as to ease congestion, as well as meeting rapid population growth (particularly in towns) is about double the current GNP. Assuming overall overcrowding in houses which raises inhabitants per house from an ideal 5 to 7 persons in towns and from 7 to 10 in rural areas, Sudan's 8 million town dwellers live in 1.14 million houses instead of 1.60 million, while the 18 million rural people dwell in 2.25 million houses instead of 3 million. This means that there is currently a shortage of 1.21 million houses, the average cost of which is £s.1.34m; the total cost of this item is (at current prices) £s. 1,621 billion. Upgrading the poorest 60% of the present 3.39 houses (i.e. 2.04 million) by spending the equivalent of 30% of their average value of £.s1,230 billion will cost £s.369 billion. New houses needed to accommodate a population growing at 3.2% per annum (at 6% and 2% in towns and rural areas, respectively) number in ten years 1.46 million, and cost £s.1,958 billion. Total costs of congestion relief, house up-grading, and meeting population growth come to £s.3,948 billion, which average £s.395 billion when phased out over ten years. This average is 1.95 times the country's 1990 GNP of £s.202 billion.

8. The enormity of the sums required for improving housing conditions in a developing country like Sudan dictates that all possible means of tackling the problem should be used, including state, corporate, individual and cooperative financing. In fact, Islamic traditions clearly emphasize the role of the state and cooperative housing. Government officials are expressly made entitled to housing by the state in statements on the issue by the Prophet, peace be upon him. As Mr. Yahya states, Al Madina's mosque and the quarters of the Prophet, peace be upon him, were constructed by collective self-help. In the Caliphate of Omar ibn al-Khattab, al Fustat, al Kufa and al Basra were built from scratch by joint state, collective and

individual effort, with the state choosing the site, preparing and planning the towns, and providing state land free of charge to developers, who develop the plots collectively or individually.

9. The Islamic principles stated by Mr. Yahya as guidelines to housing policies in Islamic countries are of immense importance. They should form the basis of Islamic Housing strategies and policies, together with many other principles that can be drawn from Islamic teachings. These principles must guide specifically;

- (a) the choice of habitable sites;
- (b) site planning;
- (c) house structures;
- (d) public services;
- (e) financing of building;
- (f) property rights and obligations;
- (g) state-financier-landlord-tenant relations; and
- (h) protection of ecology.

Islamic literature is rich on the subject. The Khalifa Omer directives to his provincial governors entrusted with establishing new towns emphasized;

- i) choosing of sites with a climate and vegetation that are as akin as possible to the dwellers' original habitat;
- ii) securing access to water and pasture;
- iii) ensuring uninterrupted contact with the central authority (with no river or bridge intervening between the two);
- iv) specifying the width of main and side streets (fixed at 40, 30, 20 and a minimum of seven dhira', (arm-length);
- v) group all (on tribal basis), and
- vi) locating public buildings in accessible sites.

10. A crucial principle laid down by Islam regarding housing is that it is a basic need which the state should provide in an adequate form to all

citizens. The Prophet, peace be upon him, was explicit about the housing of public servants. The Khalifah Omar's insistence that governors' houses should have no gates suggests that such houses were regarded more as public offices than private residences. Scholars, like Ibn Hazm include housing among the basic needs to which every Muslim is entitled; the others are food, clothing, medical care, transportation and house-help for invalids. As such, housing cannot be regarded as an inessential commodity to be supplied by private construction companies through the market. Still, such companies may be actively involved in executing state house-building projects, or in the financing of such projects.

11. On the basis of Mr. Yahya's exhaustive presentation and the observations we have made above, one may suggest the following guidelines for an Islamic housing policy:

- (a) Housing is one of the requisites of a decent living which the Muslim state undertakes to provide to every citizen at reasonable standard cost.
- (b) Zakat-deserving citizens are entitled to housing of a minimum necessary standard of comfort.
- (c) Public servants are to be provided with suitable accommodation which consists of both family quarters and public halls accessible to the public for most of the day. The residence remains in state ownership.
- (d) Zakat-paying citizens with no houses are entitled to a subvention (including a free plot) equal in value to a house provided to zakat-deserving persons.
- (e) Private house-building for self-use, renting or selling is to be encouraged by the Islamic state provided that it is not unduly costly. Lavish housing is taxed in the same way as excessive

jewellery is subjected to zakat. Rents are also subjected to zakat, as is the yield of a housing bond.

- (f) Priority in land allotment, finance and provision of services is to be given to individual and collective self-housing over commercial house construction.
- (g) The financing of housing projects may originate from zakat, taxes, pension, insurance or social security schemes, banks, security markets, or person-to-person lending. Islamic techniques of finance, like *murabahah*, *musharakah* and *ijarah*, as well as *istisna* must be used.
- (h) Property legislation should protect proprietors against trespassers, tenants against wanton eviction, debtors against creditors excesses,¹ creditors against evasive borrowers, and society against wasteful use of land resources in the form of lavish construction, misuse of needed housing space, and destructive resource utilization in housing schemes.
- (i) Observation of Islamic guidelines regarding personal privacy and male-female, old-young and guest-host arrangements in designing houses, as well as social, medical, environmental and security considerations in planning residential areas is imperative.

12. Finally, the author deserves praise for his penetrating and thought provoking treatment of this subject. I am personally indebted to him for alerting me to many aspects of the housing problems of Muslim states and the need for devising appropriate Islamic solutions for them. I am equally indebted to the symposium organizers for availing me the opportunity to comment on Mr. Yahya's illuminating contribution.

ANNEXES

Annex I

THE RECOMMENDATIONS OF THE WORKSHOP

In the name of God, the Beneficent
the Merciful

"It is God Who made your habitations homes of rest and quiet for you; and made for you out of the skins of animals (tents for) dwellings, which you find so light (and handy) when you travel and when you stop (in your travels); and out of their wool, and their . soft fibers and their hair, rich material and articles of convenience (to serve you) for a time.⁶⁶

At the initiation of the Sudanese Estates Bank and in the framework of its efforts to promote appropriate methods of financing housing activities, and in collaboration with the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB), Jeddah, preparations were undertaken to organize an international symposium on "Islamic Banking Methods of Financing Housing".

The objectives of the symposium were to identify the possible modes of financing acceptable from economic, *shari'ah* and financial viewpoints and evaluate the practical experiences accumulated in this field.

With the help of God the Almighty, the Symposium was held at the conference hall of the Grand Hotel, Khartoum, during the period 18-20 Rabi Thani 1412H. (27-29 October 1991).

Eight working sessions, including the closing session, were convened, in which discussions took place on the *Shari'ah* aspects relating to housing

(66) Al Nahl, Verse No.80

financing. The Symposium also reviewed a number of practical experiences and case studies.

The Symposium was attended by scholars and specialists representing regional and international financing institutions involved in housing activities in Jordan, Kenya, Canada, India and Turkey, in addition to representatives from the Islamic Development Bank and local banks and financing institutions in Sudan.

The Symposium highlighted the importance of the issue of housing, being one of the basic human needs, that has been given considerable importance in Islamic thought.

After extensive deliberations on the papers and case studies presented to the Symposium, the following recommendations were adopted :

Annex. 1.1

FIRST : SHARI'AH-RELATED RECOMMENDATIONS

In an effort by the participants to fulfil the duty of identifying methods accepted by *Shari'ah* for house building financing, the following financing techniques were proposed:

I. Instalment Sale

(a) This technique can be applied through construction of houses by government owned institutions (e.g. banks and companies), private investment institutions, or capable individuals and offering them for sale to the public through instalment sale techniques.

In applying this method, the *Shari'ah* controls governing the exercise of instalment sale as stated in the Resolution No.52/1/6 of the Islamic *Fiqh* Academy should be taken into account. These controls include the following:

1. The instalment price of a sold property may be determined higher than its cash price. It is permissible to indicate the cash price together with the price to be paid in instalment during a specific period of time. However, the sale is not rendered valid unless the parties' have decided whether the sale will be in immediate payment or in installments. If the sale is effected while the parties still hesitating between spot and deferred sale, then the transaction, is null and void according to *Shari'ah*.
2. In the instalment sale contract, it is prohibited to separate the return for accepting deferred payment from the cash price in such a way that it becomes directly linked to the duration of the transaction whether the parties agree to calculate this return according to a certain rate or the prevailing interest rate in the market.

3. If the debtor fails to pay the installments as agreed upon, it is not permissible to charge him any amount in addition to the principal, whether or not an advance condition was made to that effect; since such an additional amount constitutes prohibited *riba*.
4. It is prohibited that a solvent debtor delays the repayment of due installments. However, it is not permissible to provide in the agreement for a compensation to be paid in case of delayed payment.
5. In instalment sale, it is permissible for the seller to impose earlier payment of installments if the debtor delays the payment of some installments, despite his agreement to that condition at the time of concluding the contract.
6. The seller has no right to maintain ownership of the sold property after the sale has been effected. He may, however, make a condition requiring the purchaser to mortgage the property as a collateral for payment of deferred installments.

(b) The instalment sale may be concluded on the basis of an agreed price, irrespective of the initial cost incurred by the seller for acquiring the property (i.e. through bargaining). It is also permissible to conclude the instalment sale (as in *murabahah*) by agreement to give the seller a certain profit in addition to the actual cost he has incurred.

(c) This financing technique may be applied for purchasing already built houses or those to be constructed at the cost of the financier; taking into account the preferences of the prospective buyer as regards the specifications of the house. Alternatively, the financier may authorize the prospective buyer to supervise the construction of the house, and then sells the house to him through *musawamah* or *murabahah*.

(d) Among the financing techniques that are based on deferred sale and which should be considered by governments and charitable organizations, is construction of houses to be sold to those in need of them on the basis of the actual cost without any profit added, i.e. through *tawliyah* sale.

II. Hire Contracts on Deferred Payment Basis

This technique is suitable for individuals who have secured the land and the construction materials and want to enter into agreement with contractors willing to render for them the construction service against deferred payment.

III. Decreasing *Musharakah*

(1) As will be seen later, decreasing *musharakah* is composed of partnership, *ijarah*, and sale and it takes place when a financing institution enters into a partnership agreement with individuals who can participate in the construction cost; by providing cash and/or the land. The house, when completed, becomes a joint property of the beneficiary and the financing institution. The latter then sells its share to the former against lump sum deferred payment or installments. With the payment of all installments, ownership of the house is transferred to the beneficiary.

(2) *Musharakah* could also be effected with regard to ownership of the building only while the land is owned by the beneficiary. Each of the financier and the beneficiary could shoulder part of the cost of the building which will be jointly owned by them according to their shares. The financier then sells his share to the beneficiary against lump sum or installed deferred payment.

(3) Another forms of decreasing *musharakah* may proceed as follows:

- On the basis of a partnership agreement, the financing institution and the beneficiary may buy the house which becomes their joint property, according to the rates of their participation to the cost.
- The financing institution then leases its share to the beneficiary for a specified periodic rent.
- The share of the financing institution in the ownership of the house is divided into shares. As the beneficiary, according to the agreed schedule, buys one of these shares at a specified price, the total shares of the financing institution decrease. Proportionately, the rental amount is reduced, and the share of the beneficiary in the ownership of the house increases until he has full ownership of the house; at which point both the partnership agreement and the lease contract come to an end.

(4) In decreasing *musharakah* where partnership, leasing and sale are involved, no contract should be provided for in the context of the other. However, both the financing institution and the beneficiary may reach, through promises, an understanding on the entire process. Furthermore, the piecemeal sale of the institution's share to the beneficiary should not be concluded in one single step beforehand. Rather the sale of each share-part should be concluded at its due time. However, a pledge amounting to final commitment may be given by either party declaring an offer to sell or to purchase according to the Maliki *fuqaha'*. However, such a pledge does not render the sale as completely finalized as the party given the pledge remains free to accept the deal or not. Only when the other party gives a confirmed acceptance does the sale become final, an act which takes place when share transfer the share ownership is agreed upon.

IV. Assistance from Government and Charitable Organizations

Governments should assume the duty of assisting their citizens who are not able to secure houses for themselves. Such assistance may be given

from *Zakah* funds, if those in need are eligible for *Zakah*, or from other public resources.

Similarly, charitable organizations, in addition to providing food, clothing and medication, should include housing and assistance for securing it as one of their concerns.

V. Leasing Ending with Ownership

(1) This technique is similar to that of decreasing *musharakah* with the exception that here there is no prior joint ownership of the property. The technique consists of both leasing and sale. At the end of the lease period, the property is sold, wholly or in installments, to the beneficiary.

(2) *Shari'ah-related* provisions should be observed throughout the lease period. These provisions require that the owner (lessor) bears all the responsibilities relating to the property he owns, such as maintenance and the like, until the lease ends up by selling the property to the beneficiary.

(3) An agreement of this type may also be terminated at any time, provided that the lessee will cover any resultant costs incurred by the owner (financier). It is also possible to agree on terminating the lease agreement in order to enter into an instalment sale contract.

(4) The sale contract which will be the end result of the deal should not be concluded at the beginning of the lease period. But mutual promises and tentative commitments may be made to that effect at the time of concluding the lease agreement. The finalization of the sale contract can only be made on due time.

VI. Interest-Free Loans

(1) Loans are one method of house financing based on cooperation, interdependence and search for God's reward. As such, interest-free loans are not instruments for investment. Governments, institutions and capable individuals should pay attention to this method for the benefit of those who cannot secure houses with their own means.

(2) As a rule, a loan is to be repaid without any additional amount other than the principal. However, if extending a loan entails some administrative expenses, then it is permissible to have those expenses borne by the borrower so that the lender gets back the same amount he had lent. The borrower should not be asked to make any extra payments other than the actual cost incurred as a result of giving him the loan. The *shari'ah* ruling in this connection is that the lender must not derive any benefit in return for extending the loan.

(3) Consideration should be given to the resolution passed by the Islamic *Fiqh* Academy prohibiting interest-based lending exercised by real-estate banks and similar financing institutions. Such interest, whether big or small, explicitly labelled as "interest" or implicitly camouflaged as "service fee", is but a form of prohibited *riba*.

VII *Istisna'* (*Mugawalah*) Contracts

(1) This technique is used when an individual who owns a piece of land wants to enter into agreement with a contractor to build him a house according to certain specifications in return for an agreed cost. That cost may be repaid by the individual in installments or in one sum upon completion of the house. The building materials are provided by the contractor. This technique is suitable for low and middle income groups who own the land but cannot afford to provide the materials and the construction cost in advance.

(2) It is not permissible for the contractor to assign the beneficiary to undertake the construction work on his behalf. Otherwise, this technique would be used as a veil for financing in return for some benefit without actually rendering the expected service by the financier (the contractor).

(3) Institutions involved in house building financing should endeavor to establish subsidiary real-estate companies to provide construction materials and services to beneficiaries at reasonable cost.

VIII. Participation in a Housing Fund on the basis of *Musharakah* or *Mudarabah*

This technique takes place when the beneficiary buys some shares in a house financing portfolio on the basis of either *musharakah* or *mudarabah*. With these portfolio shares, the beneficiary becomes entitled to get a house from the institution. The beneficiary may either pay the remaining amount of the cost of the house or otherwise hire the institution's share according to a formula similar to that of decreasing *musharakah*.

Annex. 1.2

SECOND : GENERAL RECOMMENDATIONS

1. The provision of decent housing facilities for all citizens falls within the domain of an Islamic state responsibilities. Therefore, Islamic *shari'ah* has given much consideration to this subject.
2. Islamic states and institutions should cooperate together and coordinate their efforts, in order to develop modes for house building financing that are compatible with Islamic *shari'ah* without foregoing the proper banking requirements.
3. Attention should be given to the construction of communal buildings, which are less costly than individual houses in terms of infrastructure and maintenance requirements and more safe in terms of environmental health.
4. All the available Islamic financing techniques used in the field of housing, i.e. instalment sale, deferred-payment sale, *musharakah*, *murabahah*, *istisna'* etc. should be examined with the view of selecting those which are more suitable to the economic conditions of the various Islamic countries.
5. The experiences 'of cooperative housing financing institutions should be studied so as to be adopted in the field of Islamic financing of housing activities.
6. Investment certificates should' be introduced as an Islamic method of housing financing and also financial markets should be expanded in order to make these certificates negotiable.
7. Low-cost housing projects that suit the financial conditions of the concerned institutions as well as those of the beneficiaries themselves should be encouraged. Beneficiaries should also be involved in the process of

designing their houses in line with the requirements of *shari'ah* and the prevailing social traditions.

8. The resources of financing institutions operating in the field of housing should be supplemented and these institutions should be encouraged to use Islamic financing techniques in their operations.

9. Housing cooperatives should be supported and encouraged to apply the "housing loan" approach for the benefit of the poor.

10. The construction sector should also be supported in view of its instrumental role in reducing the cost per housing unit.

11. Individual savings and deposits within the framework of housing schemes should be enhanced and encouraged to give priority in, financing and selling houses to depositors.

12. *Shari'ah* permissible contracts should be devised to govern the tripartite relationship between Islamic financing institutions, the clients and the contractors.

13. Research institutions which are active in developing and improving construction materials should be supported and encouraged to establish training centers for low-cost housing.

14. Training opportunities in the field of Islamic financing techniques should be made available for personnel working in the field of housing.

15. Further meetings and seminars should be organized for exchanging experiences among the Islamic financing institutions operating in housing financing at the local, regional and international levels, with the view of identifying other Islamic financing techniques.

Annex II

LIST OF PARTICIPANTS

#	Name	Country	Institution
1.	Dr. Abdin Ahmad Salamah	Sudan	The Sudanese Estates Bank.
2.	Dr. Abdul Sattar Abu Ghuddah	Saudi Arabia	The al Barakah Group.
3.	Justice Muhammad Taqi Othmani	Pakistan	The Supreme Court of Pakistan
4.	Dr. Muhammad Hashim Awad	Sudan	The University of Khartoum.
5.	Dr. Rahmattullah Abdul Ahad	India	All India Council of Muslims Economic Upliftment.
6.	Dr. Muhammad Salih al Farfour	Syria	Member, The Islamic <i>Fiqh</i> Academy
7.	Dr. Saad S. Yahya	Kenya	Shelter Afrique
8.	Dr. Adnan Buyukdeniz	Turkey	al Barakah-Turkish Finance House
9.	Dr. Ahmad Ali Abdullah	Sudan	Supreme Council of Banking and Financing Institutions - Sudan
10.	Dr. Ausaf Ahmad	India	The Academy of the Third World studies.
11.	Mr. Mahmoud A. Mahdi	Saudi Arabia	The Islamic Development Bank
12.	Mr. Pervez Nasim	Canada	Islamic Cooperative Housing Corporation
13.	Mr. Ibrahim M. al Zahir	Jordan	The Housing Bank, Jordan
14.	Mr. Husni A. Yahya	Jordan	The Jordan Islamic Bank
15.	Mr. Muhammad Ali Zumar	Sudan	The Sudanese Estates Bank
16.	Ms. Samya Babikir Ahmed	Sudan	New Horizon Newspaper - Sudan

Annex III

PARTICIPANTS FROM LOCAL BANKS AND FINANCING INSTITUTIONS

No.	Name of Institution	Number of Participants
1.	The Bank of Khartoum	4
2.	The Bank of Sudan	3
3.	The al Barakah Bank, Sudan	2
4.	The International Bank, Sudan	1
5.	The National Development Bank	2
6.	Tadamon Islamic Bank	2
7.	The National Bank for Exports & Imports	2
8.	The Islamic Bank for Western Sudan	2
9.	Faisal Islamic Bank, Sudan	3
10.	The al Nilein Bank	1
11.	The Sudanese Commercial Bank	1
12.	The Unity Bank	2
13.	The Workers National Bank	1
14.	The Sudanese Industrial Bank	2
15.	The Islamic Cooperative Bank for Development	1
16.	The Sudanese Estates Bank	10
	TOTAL	39

Annex IV

PROGRAM OF THE WORKSHOP

SUNDAY 27/10/1991

10:30-11:00 Coffee Break

11:00-13:30 First Working Session

-Presentation of Dr. Ahmed Ali Abdullah's Paper on "Forms of Investment in Real Estates" (11:00-12:00)

-Discussion on Dr. Abuddlah's Paper (12:00-13:30)

18:00-20:30 Second Working Session

-Presentation of Dr. Abdin Salama's Paper on "Housing Finance in Islamic Countries" (18:00-18:30)

-Discussion on Dr. Salama's paper (18:30-19:15)

-Presentation of Dr. S.S. Yahya's paper on "Shelter options for Islamic Africa. -

Discussion on Dr. Yahya's paper (19:45-20:30)

MONDAY 18/10/1991

9:00-10:30 Third Working Session

-Presentation of the Jordan Islamic Bank's Case Study (9:00-9:15) -

Discussion on the Jordan Islamic Bank's Case Study (9:15-9:45) -Presentation

of the Housing Bank's (Jordan) Case Study (9:45-10:00) -Discussion on the

Housing Bank's Case Study (10:00-10:30) 10:30-11:00 Coffee Break

11:00-13:30 Fourth Working Session

-Presentation of the Islamic Cooperative Housing Corporation's Case Study on "Interest-Free Housing Finance (11:00-11:30)

-Discussion on the Islamic Cooperative Housing Corporation's Case Study (11:30-12:15) -

Presentation of the al Baraka Turkish Finance House's Case Study on "Housing Certificates as an Interest'- free Financing Instrument" (12:00 - 12:30).

Discussion of the Turkish Case Study (12:30 - 01:00)

18:00-20:30 Fifth Working Session

-Presentation of the Indian Case Study by Dr. Rahmatullah (18:00-18:30) -

Discussion on Dr. Rahmatullah's Case Study (18:30-19:15)

-Presentation of the al Baraka Bank, London, Case Study (19:15-19:30) -Coffee Break (19:30-19:45)

-Discussion on the al Baraka London Case Study (19:45-20:30)

TUESDAY 29/10/1991

9:00-13:30 Sixth Session

-Shari'ah Roundtable Discussion (9:00-10:30) 10:30-

11:00 Coffee Break

11:00-1330 Recommendations

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ISLAMIC DEVELOPMENT BANK (IDB)

Establishment of the Bank The Islamic Development

Bank is an international financial institution established in pursuance of the Declaration of Intent by: a Conference of Finance Ministers of Muslim countries held in Jeddah in Dhul Qa'da 1393H (December 1973). The Inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the Bank formally opened on 15 Shawwal 1395H (20 October 1975).

Purpose

The purpose of the Bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *Shari'ah*.

Functions

The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms of economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to raise funds in any other manner. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods among member countries, providing technical assistance to member countries, extending training facilities for personnel engaged in development activities and undertaking research for enabling the economic, financial and banking activities in Muslim countries to conform to the *Shad'ah*.

Membership

The present membership of the Bank consists of 48 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference and be willing to accept such terms and conditions as may be decided upon by the Board of Governors.

Capital

The authorized capital of the Bank is six billion Islamic Dinars. The value of the Islamic Dinar, which is a unit of account in the Bank, is equivalent to one Special Drawing Right (SDR) of the International Monetary Fund. The subscribed capital of the Bank is 3,654.78 million Islamic Dinars payable in freely convertible, currency acceptable to the Bank.

Head Office

The Bank's head office is located in Jeddah in the Kingdom of Saudi Arabia and the Bank is authorized to establish agencies or branch offices elsewhere.

Financial Year

The Bank's financial year is the Lunar Hijra *year*.

Language

The official language of the Bank is Arabic, but English and French are additionally used as working languages.

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