

# Innovative Modes of Financing the Development of Waqf Property

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## **1. Introduction**

This paper is based on the presumption that the institutions of waqf (e.g. Majlis Agama Islam) are avoiding dependence on funding from Government, by seeking development financing from private sector. Also it is thought that the waqf institutions are not exposing their assets to liabilities arising from a particular development project and therefore the development financing is a project based funding. Additionally, the paper presupposes the grant of hikr (long lease)<sup>1</sup> by the waqf institutions to their development arm i.e. Waqf Holdings (corporations authorized by law to do business on behalf of the waqf institutions), which in time may incorporate its own subsidiary and sublease a particular parcel of land to the newly formed corporation.

The intended development may be either for the purposes of revivification of waqf property, or advanced in the sense of investment. Where it is a matter of need as in the case of revivification, the institution of waqf possibly has no capital and therefore may seek 100 per cent financing while in the case of investment when the institution acts as a financier it may need financing partners in return for a small share in the completed project. The application of Shariah compliant Financing Instruments is easy in the latter, but a challenge in the former. To deal somehow with this challenge, this paper discusses the new financial schemes, in contrast to the classics, as proposed by modern jurists. The paper also looks at the practicality of such instruments where the nazir (i.e. any one in charge of development for the benefit of waqf) of waqf has zero funds. The paper also has new proposal to complement the existing.

This paper is not about the financing itself but a fiqhi framework that can avoid legal constrains on waqf properties to use them as collateral and show that financing such financing remain attractive to financiers and private investors, while at the same be beneficial to the preservation and better utilization of waqf property. The reader therefore will find financial modes and instruments suitable to Waqf Real Estate Development Investment bodies authorized under Malaysian law as Waqf development corporations.

The writer also takes note of the restraints limiting development finance which may not be so if the institution of waqf intended to invest waqf funds. In such an event, many

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<sup>1</sup> On the concept and applicability of hikr, see self-finance, below.

restraints such as the sale of developed property, as being revenue of the waqf capital, would be easy. Several methods of financial schemes, that are inapplicable to development, would be available to the investment. This study however is not discussing instruments suitable to investment.

In the course of discussion, development finance is divided into three: first, credit based finance, second joint venture or equity and income sharing including institutional and corporate financing, and third self-financing\_ finance raised by waqf institution in ways permissible by all or some ulama and fuqaha in the four schools of Islamic law.

## **2. Credit-based financing**

Debt-based financing refers to the funding obtained by waqf institution through the Islamic modes of financing i.e. sale and purchase, sale by order and leasing agreements. This is called debt-based financing because the sum owed to the financing company would be a debt payable by the waqf institution in lump sum or on installment.

The sale and lease contracts may stand alone or be combined with each other depending on the arrangement made by the parties. Either way, the concept, the legality and practical significance of the transactions of sale by installment (*murabahah* and *bay' bi thaman al-ajil*), forward sale (*Istisna*) and lease called *ijarah* will be discussed below.

### **2.1. Build and Transfer \_ Murabahah / BBA (bay' bi thaman al-ajil)**

*Murabahah* is a mark up sale capable of being a spot sale or on installment. Today, it is associated with a credit sale settled on installments, called *bay' bi thaman al-ajil* (BBA).<sup>2</sup> In *murabahah* transactions, there must be one who orders the financier to purchase (*amir bi al-shara*) and another to execute the order (*ma'mur*). Upon procurement and delivery of the objects ordered by the purchaser, the financier will sell the assets to the purchaser at a price which ensures a reasonable rate of profit to the financier.<sup>3</sup>

The OIC council for fatwa has accepted this financial instrument, if the sale takes place after the object comes within the possession of the seller (*mamur*); the seller does not transfer risks to the purchaser before possession of the object, the purchaser has been given the option to reject the object based on defect, and all other conditions for the validity of a contract under Islamic law are complied with.<sup>4</sup>

In Malaysia, *murabahah* is incorporated in sale with deferred payments (*al-Bay' bi Thaman al-Ajil* (BBA)).<sup>5</sup> Both are the same in terms of effect and payment though *murabahah* may also apply to spot sale. Since BBA is a sale at core, the practice of banks does not comply with the OIC fatwa mentioned above. Saiful Azhar<sup>6</sup> explains that there

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<sup>2</sup> Saiful Azhar Rosly, *Critical Issues on Islamic Banking and Financial Markets*, Islamic Economics, Banking and Finance, Investments, Takaful and Financial Planning, Kuala Lumpur: Dinamas, 2005, pp 88-89, 91.

<sup>3</sup> See Taqi Uthmani,

<sup>4</sup> Fatwa No. 40-41, December 1988.

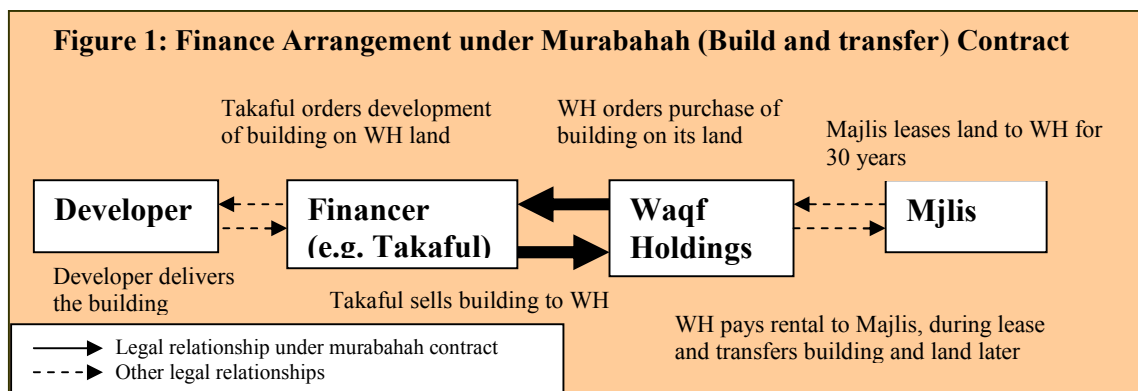
<sup>5</sup> Saiful Azhar Rosly, *Critical Issues on Islamic Banking*, pp 87-88.

<sup>6</sup> Saiful Azhar Rosly, *Critical Issues on Islamic Banking*, pp 88-89, 91.

is no difference between the practice of a conventional and Islamic bank, as the purchaser buys the property first and then looks for finance. The transactions look more like a loan rather than a sale he contends. This presumption was confirmed by the case of *Dato' Haji Nik Mahmud bin Daud v Bank Islam Malaysia Berhad* [1996] 1 CLJ 737 where the presiding judge thought that there was no intention of the parties (customer and bank) to effect the transfer of the property, and that it was merely a device to facilitate the BBA transaction. This decision makes us think that BBA as practiced by some banks should be avoided in case of waqf properties.

Another element of concern is unsubstantiated mark up, as banks sell the property plus mark up together with a premium that reflects time value of the money. The shorter the period of payment the cheaper is the finance. A long term arrangement will increase the purchase price to triple of the spot sale value. This is also true about all debt based instruments including leasing (*tajir*), and the sale by order (*istisna'*).<sup>7</sup> This means that if the conditions set by OIC fatwa are met and the charges are less and fair, the institution of waqf can utilize this financial instrument in any development project.

Kahf believes that this instrument is practical when the waqf institution takes 'the functions of an entrepreneur who manages the investment process and buys necessary equipment and materials through a murabahah contract'. Payment can be on delivery or deferred. 'The management of Waqf becomes a debtor to the banking institution for the cost of the material purchased plus the financing markup which represents the price of the second sale contract in the Murabahah to the purchase orderer.'<sup>8</sup> The purchase price will be paid by the orderer of the goods over an agreed period of time. The project is owned by the waqf completely.<sup>9</sup>



Kahf is silent on the issue of borrowing by waqf. This is not however an issue for such borrowings are in the interest of waqf and hence allowed. Issues such as the capacity of waqf to develop the land, the ownership of the site, and the possibility of security for the sum borrowed, need consideration. At the moment the majority of waqf institutions is

<sup>7</sup> Sudin Haron, *A Comparative Study of Islamic Banking Practices*, <http://www.kaau.edu.sa/CENTERS/SPC/page-092.htm>. Date, 27/7/2006.

<sup>8</sup> Munzer Kahf, *Financing the Development of Awqaf Property*, <http://www.kahf.net/English/finawqf.html>, pp. 22-23

<sup>9</sup> Munzer Kahf, *Tamwil al-Tanmiya*, <http://www.kahf.net/English/finawqf.html>, p 44.

perhaps not capable of entrepreneurship and thus cannot manage development project in many places. They have no resources to pay for operation and labor costs. The alternative is to order the development of the site, and the financier can be either the developers it or can contract it to another party. Once complete, the financier can sell it to waqf based on murabahah. This should make waqf the owner of the completed project, but in practice a Deed of Assignment is executed in favor of the financier, which is a problem. The Fiqh may support it, as such is in the interest of the waqf, but legally this may be doubtful, for under current law waqf land is inalienable. To avoid this, the Majlis can device a long lease granted to a newly formed single project based corporation, and thereby entering into a transaction with financier. Here, the newly formed company can sublease the land to another party within the period of the master lease. In case of security, the financier will have limited right in the land depending on the length of the lease. (See figure 1)

Financer's purchase price	Financer's price in RM	selling	Amount paid at the end of term @ 2.8 % first; 6% second year; and 8% for remaining years	Monthly installments
4800000.00	6182923.80	5 years	5837323	150414.55
	6607601.40	7 years	6262001.40	97327.69
	7282181.86	10 years	6936581.76	49587.55
	8503657.80	15 years	8158057.80	67856.06
	9839613.36	20 years	9494013.36	41998.21
	11279658.72	25 years	10934058.72	38085.72
	12811721.76	30 years	12466121.76	35844.41

Murabahah instrument is practical but its short term requires higher installments while longer term is expensive. Presuming the project is completed by a contracted developer,<sup>10</sup> at RM 4.8 million, and rented at RM 25040.00 per month.<sup>11</sup> The loan is 100% and the financier charges variable fees for its services, and profit. It is obvious that the price of the building after 30 years of repayment of loan will be three times of the costs of the building. In case the Waqf Corporation chooses to pay in a shorter period, the monthly installments will be higher than the income of the building. In either case the Waqf Corporation cannot pay the installments in full, whether or not the corporation deducts its fees and charges. (See Table 1) This therefore, necessitates the reduction in finance which can be at 60 to 80 per cent, to enable the Waqf Corporation to pay installments. But, the question is whether or not it will be able to raise the remaining 20-40 per cent of the financing costs. This problem may be solved if murabahah can be used together with other forms of finance as will be discussed in due course.

<sup>10</sup> Two other ways of practice may be possible: first when the waqf institution requires the bank to deliver a constructed building on its land, the banks can employ an istisna contract with development company and then sell the product to the waqf institution through mark up sale (murabahah) by installment. The second way is to order banks to purchase a constructed site belonging to a third party. Here there would be no need for istisna' contract.

<sup>11</sup> These figures are based on the costs of Bangunan Wakaf, Johor, which was built on proceeds of saham wakaf at 4.8 million and now is rented at RM 25040.00. per month

## 2.2. Forward Sale \_Istisna' / Salam Mode

Istisna' refers to a contract where one offers and a manufacturer agrees to produce and deliver a certain quality of goods in a specified quantity on a given date in the future. For instance when IDB in its normal financial transactions uses istisna' contract with Construction Companies, it undertakes to provide a specific equipment or construction material according to certain specifications requested by the beneficiary, and then sell it to the beneficiary at a determined price to be paid over an agreed period.<sup>12</sup> The beneficiary will be the purchaser of the goods. The price gets fixed in advance but needs not be paid at the time of the agreement. The price may be paid in installments in step with the progress of the work (a house, a building, or a factory) or partly at the front and the rest at the time of delivery.<sup>13</sup>

Istisna' is somehow similar to the contract of salam another form of forward sale. Salam however applies to commodities, where the financier advances a sum as purchase price for agricultural commodities to be delivered in future. This may apply to waqf land if the land is used for agricultural activity.

Istisna' may be used (1) between waqf and developer, (2) between waqf and a financier and (3) between financier and developer for the development of waqf land. The first way is straight forward. The second involve waqf, the financier and a third party. The waqf institution inters into contract with financier, and the financier then enters into another istisna' contract with a construction company or developer. This is termed back-to-back or parallel istisna'. Taqi Uthmani contends that it is not necessary that the financier himself construct [the building]. He can enter into a parallel contract of Istisna with a third party, or may hire the services of a contractor (other than the client). In both cases, he can calculate his cost and fix the price of Istisna. The building will be the property of the financier. The waqf institution will buy the building from the financier after its completion.<sup>14</sup> An istisna' between financier and a developer follows a murabahah and ijarah contract. This can be said about Nazih Hammad and Kahf's proposal, that when the waqf institution allows financier to construct a building on the waqf land.<sup>15</sup> The financier then enters into an istisna' contract with a contractor to provide the same to the order of the bank that will be delivered on the bank's behalf to the Awqaf management.<sup>16</sup> (see figure 2.2)

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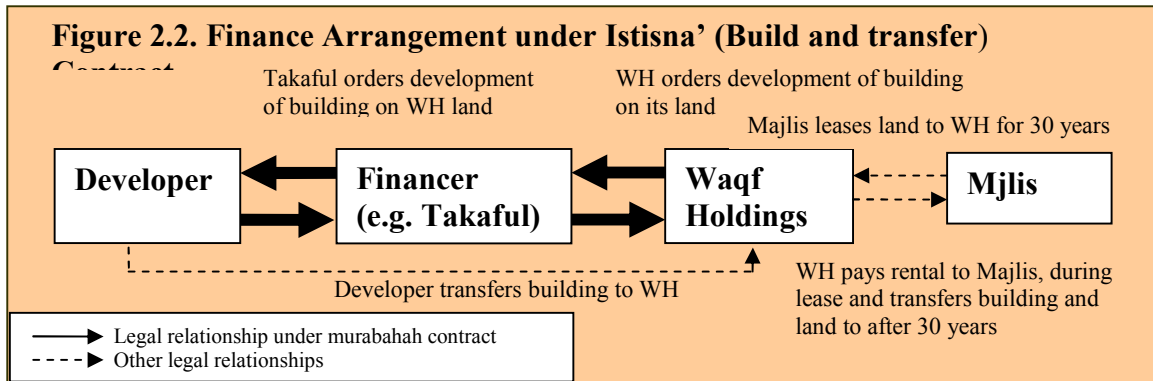
<sup>12</sup> Sheikh Muhammad Mukhtar al-Salami,

<sup>13</sup> M. Umer Chapra, *The Major Modes Of Islamic Finance*, A paper prepared for presentation at the 6th Intensive Orientation Course on "Islamic Economics, Banking and Finance" held at the Islamic Foundation, Leicester, U.K., on 17th - 21st September 1998, p. 22; According to the OIC Islamic Fiqh Academy Resolution, the payment may be deferred by mutual agreement.

<sup>14</sup> Taqi Uthmani

<sup>15</sup> Nazih Hamad, "Asalib Istithmar al-Awqaf wa Ausas Idaratihā", in *Abhath Nadwa Nahw Dawr Tanmiwi*, p. 184.

<sup>16</sup> Kahf, *Financing the Development of Awqaf Property*,



Following the completion of the construction and delivery of the building, in either of the above ways, the financer delivers the said building to waqf, as in the case of back to back istisna' and murabaha followed by istisna', or leases the building to waqf institution under a contract of ijararah. The amount will be a debt on the Waqf management that should be settled from the returns of the expanded Waqf property and the financier will not have a right to interfere in the management of the same.<sup>17</sup> It can be paid on monthly (or annual) installments.<sup>18</sup> The installments should be less than the expected rentals from the building. On the payment of the last installment the ownership of the building will be transferred to the waqf institution. This is what has been practiced in Sudan and Mauritania. It is possible that the title remains with the financer till the last installment.<sup>19</sup>

**Table 2.2 Istisna' (Sale by Order)**

<b>Status :</b>	Back to back Istisna' ( waqf with the bank and bank with the developer)
<b>Operation :</b>	Build and transfer
<b>Financer :</b>	ABC Finance
<b>Builder :</b>	ABC Construction
<b>Property manager :</b>	WH
<b>Nature of dealing :</b>	Single asset development
<b>Site Ownership :</b>	Waqf: leased to WH Corporation for 30 years
<b>Building ownership :</b>	WH after completion
<b>Development :</b>	6 story commercial building
<b>Third party Leasing contract :</b>	Revisable after 3 years
<b>Cost of development :</b>	4.8 Million
<b>Rental receivables :</b>	RM 300480.00 p.a.

**Terms of Sale:** Cost + profit @ 8% + p.a. in RM

Financer's purchase -price	Financer's selling price	Total amount paid after	Monthly installments
4800000.00	<u>6182923.80</u>	<u>5 years</u>	<u>5837323</u>
	<u>12811721.76</u>	<u>30 years</u>	<u>35844.41</u>

<b>Charge on the building :</b>	ABC
<b>Title free of charge :</b>	After 30 years

<sup>17</sup> Kahf, *Financing the Development of Awqaf Property*,?

<sup>18</sup> Taqi Uthmani

<sup>19</sup> Anas al-Zarqa, al-Wasa'l al-Hadithah liltamwil wa al-Istithmar, Idarah wa Tathmir Mumtaakat al-Awqaf (1983-4), Jeddah: IDB 1994, p. 197. Nazih Hamad, "Asalib Istithmar al-Awqaf wa Ausas Idaratiha", in *Abhath Nadwa Nahw Dawr Tanmiwi*, pp. 184-85

The sale by order (istisna') is considered an ideal financial instrument for waqf property, which must be applied.<sup>20</sup> The application of IDB model, however, is suitable for skillful waqf institutions with good cash flow.<sup>21</sup> For a cash-strapped institution the views of Taqi Uthmani, al-Zarqa, Nazih Hamad and Kahf are more practical, but if applied alone waqf either not able to pay installments or incur a higher liability. (See Table 2.2)

This model is practical if the land belongs to waqf but leased to WH Corporation for a period of 30 years, and the building to the financier. The financier, after the completion of the building, may have two options: (1) transfer the building to Waqf Holding Corporation, and have a right to possession of the building, secured by a charge; (2) lease the building to the Corporation for a specified period and transferred to the corporation on payment of the last installment. The first requires a back to back istisna' or istisna' plus murabaha, and the second needs istisna' between financier and developer plus ijarah. The registered charge over the building must extend only up to the tenure of lease. The project should involve a single-asset-based development being transferable to a third party up to the expiry of the lease. Where the Corporation is unable to pay the installments, the financier has the right to possess the building until such a time the sum owed is paid. In such a case the waqf would be required to extend the tenure of lease, so that the financier can cover his costs. The Waqf Corporation, being a trustee of waqf institution, will have to pay land and building income to waqf regularly during leasing time and after its expiry has to transfer the land and the building to the waqf.

### **2.3. Leasing and Hire Purchase Mode (ijarah thumma Bay')**

Ijarah means leasing. The lease of waqf land is enforceable unless the rental is below market except justified by necessity. The Hanafi jurists allow nzier to terminate the existing contract and lease the property to another willing party, if the rental is lower than market rate and the leaseholder does not agree to the desired revision of rent.<sup>22</sup> The Malikis and Shafi'is do not recognize such option for the existing lease holder<sup>23</sup> as they consider the contract a binding nullity. Contemporary ulama hold that the leasing contract of waqf property should include provisions for revisions, and the taxes to be payable by the leaseholder alone, and that the leaseholder should not use the premises for purposes against Shariah, law or against the interest of the society.<sup>24</sup> This is why leasing is considered a flexible type of financing compare to murabahah as the rate of rental can be adjusted according to the market movement.

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<sup>20</sup> Mamud Ahmad Mahdi, "Tajrabah al-Bank al-Islamic liltanmiyah fi Tathmir al-Awqaf al-Islami", in *Abahth Nadwah Nahwa Dawr Tanmiwi al-Waqf*, Jeddah: IDB, 1993, p 88.

<sup>21</sup> It is noted that this scheme lacks a scheme according to which the bank can finance the purchase of the goods and material required by waqf institution. Based on this point, al-Mahdi points that istisna' is more to the mode of execution rather than financing. Al-Mahdi further questions the practicality of this solution for this presupposes the waqf institution to be able to implement the project and have enough cash flow to fund the development work. He reminds the reader that in many instances the waqf institution is cashless: see Mahmud Ahmad Mahdi, "Tajrabah", pp. 81

<sup>22</sup> Ibn Abidin, *Rad al-Muhtar*, vol 4, pp. 371, 404

<sup>23</sup> Al-Dardiri, *Hashiyah al-Dusuqi*, vol. 4, p. 95; al-Sharbini, *Mughni alMuhtaj*, vol. 6, 395.

<sup>24</sup> Mahmud Ahmad al-Mahdi, p 87.



The Maliki and Shafie schools allowed long leases even if they were for a period of 100 years.<sup>25</sup> Other jurist in Hanafi and Hanbalis schools allow leases not exceeding three years. The Hanafis, nevertheless, in addition to long leases such as hikr, ijaratain, mirsad and khulw, allow succeeding three year<sup>26</sup> contracts extending up to 50 years or more. Contemporary jurists however limit the period up to thirty years.<sup>27</sup> Ibn Nujaim did not allow the lease of waqf land near to a city for construction of housing estate used after completion for being rented out.<sup>28</sup> Sheikh Muhammad Mukhtar al-Sulami a former Tunisian mufti, disagreed on the ground that Ibn Nujaim perhaps based his view on the custom of his time. Now, a land close to city might be more productive in term of development of buildings rather than agricultural produces.<sup>29</sup>

Today, lease can be used by waqf institution to finance the development of the given land, and by financial institution to recover the credit extended to waqf institutions. Thus it is divided into build, lease and transfer mode of development (hire purchase al-ijarah thuma al-tamlik), and also sale, leaseback and transfer. Both are discussed below.

### **2.3.1. Build, Lease, and Transfer (Ijarah Thumma Tamlik)**

The modus operandi of Ijarah for the development of Waqf is proposed by Kahf. ‘Nazer issues a permit, valid for a given number of years only, to the institutional financier allowing it to erect a building on the Waqf land. Then the Nazer leases the building for the same period during which it is owned by the financier, and [the nazer] uses it for the benefit of the Waqf objective, being a hospital or a school or an investment property such as rental offices or apartments.’<sup>30</sup> At the end of the permit period, the financier would have obtained its principal and desired profit, and thus transfer the building to waqf either through sale, gift, or mere disposal by way of abandonment. (See figure 2.3.1)

The contract should be reviewable periodically in order to adjust the rentals.<sup>31</sup> ‘Nazer runs the management and pays the periodical rent to the financier.’<sup>32</sup> (See table 2.3.1) This model is practiced by IDB which finances industrial goods construction, including others fix assets, for a certain period of time during which the borrower pays biannual rentals, and at the end, the ownership of the assets is transferred to the beneficiary.’<sup>33</sup>

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<sup>25</sup> Al-Sharbini, Mughni al-Muhtaj, vol. II, p 349; al-Qurafi, *al-Dhakirah*, vol. 6, p 346.

<sup>26</sup> Ibn Abidin, Radd al-Muhtar, vol. 3, 397.

<sup>27</sup> Mahmud Ahmad al-Mahdi, p. 88.

<sup>28</sup> Ibn Nujaim, *Bahral-Ra'iq*, vol. 5, p 223

<sup>29</sup> Sheikh Muhammad Mukhtar al-Sulami, *Istithmar Amwal al-Waqf*, in Muntada al-waqf

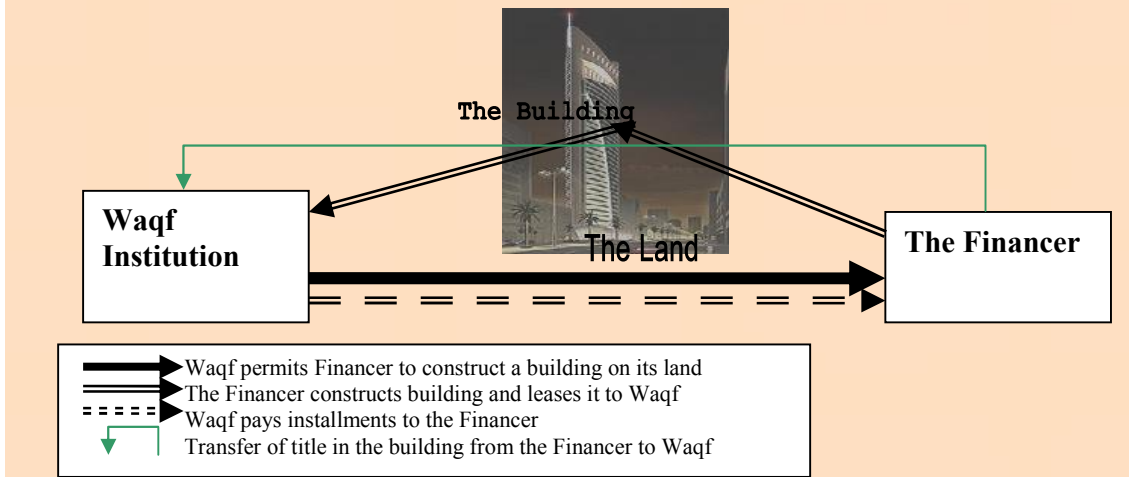
<sup>30</sup> Kahf, *Financing the Development of Awqaf Property*,

<sup>31</sup> Kahf, Tamwil al- Tanmiyah al-Amwal al-Waqf, p 45

<sup>32</sup> Kahf, *Financing the Development of Awqaf Property*,

<sup>33</sup> Kahf, *Financing the Development of Awqaf Property*,

**Figure 2.3.1 Build, lease and Transfer**



**Table 2.3.1. Ijarah thumma Tamlik (hire-Purchase Transactions)**

<b>Status :</b>	Leasing (Ijarah Thumma Tamlik)		
<b>Operation :</b>	Build, Lease and Transfer		
<b>Builder :</b>	ABC Construction		
<b>Property manager :</b>	WH		
<b>Nature of dealing :</b>	Hire-purchase		
<b>Site Ownership :</b>	Waqf: a permit (lease) issued in favor of bank for 35 years		
<b>Building ownership :</b>	ABC Construction, leased to Waqf (WH) for 30 years		
<b>Development :</b>	6 story commercial building		
<b>Third party Leasing contract :</b>	Possible		
<b>Cost of development (finance: 100 %) :</b>	4.8 Million		
<b>Rental receivables :</b>	RM 300480.00 p.a. (RM 25040 per month)		
<b>Terms of Sale: Cost + profit @ 8% + p.a. in RM</b>			
Financer's purchase -price	Financer's selling price	Total amount paid after	Monthly installments
4800000.00	<u>6182923.80</u>	<u>5 years</u>	<u>5837323</u>
	<u>12811721.76</u>	<u>30 years</u>	<u>12466121.76</u>
<b>End of license to the bank :</b>	After 35 years		
<b>Practicality table for the proposal made by Kahf</b>			

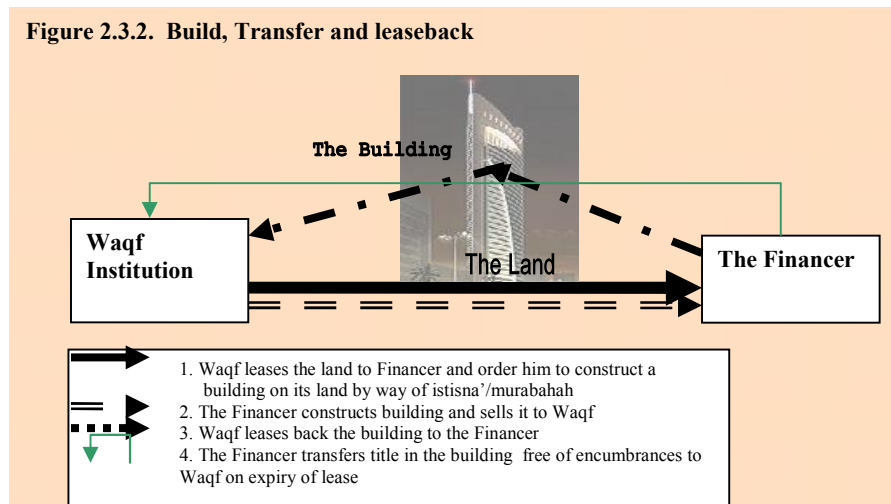
Whereas this instrument of leasing presupposes ownership of waqf in land, land revenue must be specified, and transfer of land to the financer needs to be registered. Kahf is silent and both. This needs to be dealt with. To settle both issues, it is suggested that instead of permit, the land be leased to Waqf Holding and then to the financer, and then the building be leased to a waqf Holdings. This mode of financing is the same as istisna' that if used alone the waqf institution cannot pay installment fees even though it is for a long term basis.

*Ijarah thumma al-bay'* is the same as Hire Purchase, which can be undertaken under the Islamic Banking Act 1983, which allows banks to operate the real leasing business under

one roof.<sup>34</sup> The Banking and Financial Institution Act 1992 of Malaysia, does not provide for, unless the bank establishes a leasing subsidiary registered under Companies Act. Similarly, the Hire Purchase Act 1967 will apply but then the lessor should pay for insurance, taxes, and maintenance. This side of Islamic hire purchase however is not covered by the Hire-Purchase Act 1967. To accommodate this Islamic requirement there is need for amendment of the said Act or the enactment of new legislation.<sup>35</sup>

### 2.3.2. Build Sale and leaseback (Mersad)

This mode of financing is based on the long lease alone. Two methods are proposed. Al-Zaqa and Nazih Hamad have proposed that the leaseholder under the lease contract would be allowed to construct a building on the land. The building will be owned and occupied by the developer, provided the total amount of annual rental is sufficient to discharge purchase price of the building at the expiry of lease. The contract will include two issues: the long lease and the promise by the waqf institution to buy the building. The price of the building should be paid out of the annual rentals.<sup>36</sup> This mode is not



explained well. It is however possible to describe it as lease, build, occupy and transfer. The leaseholder will be the developer/financer.

The second method is explained differently. The administrator or the judge allows the tenant to develop the land and the incurred expenses shall be a loan on the *waqf*, payable by the *waqf* on installment. The building or plantation shall be the property of the *waqf* but the developer would have proprietary rights (e.g. leasee) which shall be transferable and inheritable, provided the transfer to another party is done with the approval of the court or the consent of the administrator of the *waqf*. The developer after the completion of the building would rent the building back and pay monthly market rental to waqf.<sup>37</sup> An

<sup>34</sup> Saiful Azhar, *Critical Issues*, pp 103-104

<sup>35</sup> Id., at pp. 105-106.

<sup>36</sup> Nazih Hamad, "Asalib Istithmar al-Awqaf wa Ausas Idaratiha", in *Abhath Nadwa Nahw Dawr Tanmiwi*, p. 186; Anas al-Zarqa, *Asalib*, p. 199.

<sup>37</sup> Mustafa al-Zarqa, *Nazariyyah al-Iltizam*, pp. 48-51.

example of mersad may be the practice in Sudan where the developer constructs a building, and then rents it out according to the market value.<sup>38</sup> Al-Amin has contended that this is done based on the contract of *istisna'*, and Anas al-Zarqa has added deficient partnership.<sup>39</sup> This can be illustrated as in figure 2.3.2.

Following the mersad model, the waqf institution cannot evict the developer. This is not in line with modern circumstances and perhaps not attractive. The abovementioned right of the developer needs to be limited in time; the shorter period be based on proper study of the project, and market demand, while it should not exceed 30-40 years. (see table2.3.2)

<b>Table 2.3.2. Ijarah, and istisna'</b>				
<b>Status :</b> Leasing (Ijarah + istisna' + ijarah)				
<b>Operation :</b> Lease Build, sell and leaseback				
<b>Builder :</b> ABC Construction				
<b>Property manager :</b> WH				
<b>Nature of dealing :</b> Build, sale, and leaseback				
<b>Site Ownership :</b> Waqf: lease issued in favor of financier for 35 years				
<b>Building ownership :</b> WH, leased to ABC for 30 years				
<b>Development :</b> 6 story commercial building				
<b>Third party Leasing contract :</b> Possible, preferably not				
<b>Cost of development (finance: 100 %):</b> 4.8 Million				
<b>Rental receivables :</b> RM 300480.00 p.a. (RM 25040 per month)				
<b>Terms of Sale:</b> Cost + profit @ 8% + p.a. in RM				
	Financer's purchase -price	Financer's selling price	Total amount paid after	Monthly installments
	4800000.00	<u>6182923.80</u>	<u>5 years</u>	<u>5837323</u>
		<u>12811721.76</u>	<u>30 years</u>	<u>12466121.76</u>
<b>End of license to the bank :</b> After 35 years				
<b>Modified model proposed by Mustafa al-Zarqa, Anas al-Zarqa, Nazih Hamad, and Kahf</b>				

The purchase of building is possible through *istisna'*. This mode of finance is similar to the above mentioned debt based instruments and thus suitable for partial financing of the project. The waqf institution needs to use its development arm i.e. the Waqf Holdings Corporation as mentioned above. The waqf institution can manage the building or it can contract its management to a third party.

### 3. Institutional financing: Joint ventures

The waqf institution plays the role of a land owner and enters into a partnership with a financier or development company. The developer, however, should seek project funding, therefore, saving the waqf land from being used as security for loan. Should the waqf land is needed for loan security, the charge can run along the life span of the lease granted by waqf institution to its development arm i.e. Waqf Holdings Corporation.

<sup>38</sup> Hasan Abdullah Al-Amin "al-Waqf fi al-Fiqh al-Islami", in *Idarah wa Tathmir al-Mumtalakat al-Awqaf*, 1994, p. 135

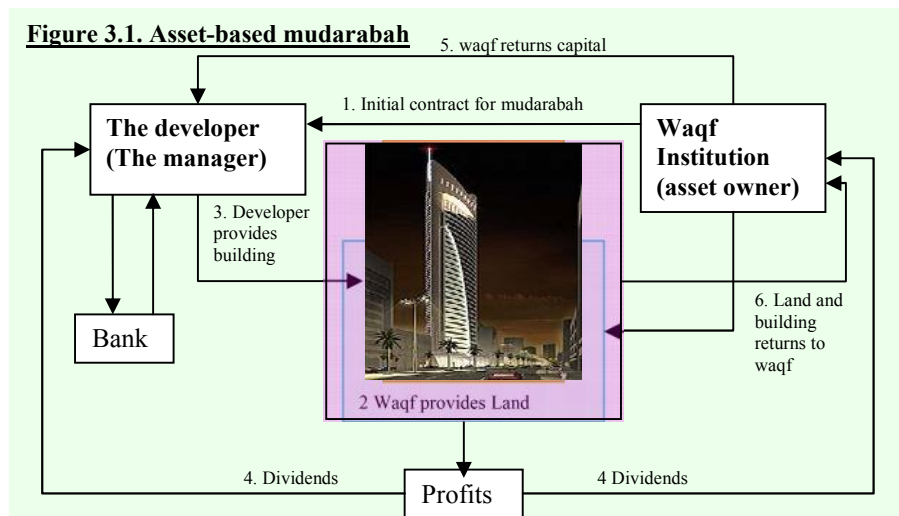
<sup>39</sup> Id., at pp134-5; Anas al-Zarqa, *Asalib*, p. 197.

The manner in which the joint venture between the waqf institution and the development company can proceed is either through *mudharabah* or *musharakah* partnership.

### 3.1. Mudarabah

*Mudarabah* is partnership in which the investor (*rab al-mal*) and the fund manager (*amil*) agree that the former provide capital and the latter manages it (by doing trading) and the profit would be shared according to a predetermined ratio. Once the capital is returned the partnership is dissolved. The Shafi'i and Maliki jurists allow *mudarabah* only in trading provided the investor does not interfere in the management.<sup>40</sup> Imam ibn Hanbal however allowed *mudarabah* between the owner of fishing net and a fisherman where the catch would be shared between them.<sup>41</sup> This would mean that one provides assets and the other provides labor. In the context of waqf two models are proposed: *muzara'ah* based (Asset-based) and capital-based *mudarabah*, as discussed respectively. Both are can be supported by the opinions of Hanafis and Hanbalis.

- a. **Asset-based mudarabah:** Anas al-Zarqa<sup>42</sup> has proposed that waqf institution can let a financier to construct a building on waqf land, and after completion, can rent the building to a third party. The institution and the developer can then share the rental. (see figure 3.1) The institution of waqf has to divide its revenue from the building into two: one to increase its share in the building and second to distribute it among its beneficiaries. The developer should manage the project exclusively. Therefore, the



waqf will provide land, the same as in *muzra'ah*, and the manager will provide services and operational finance.<sup>43</sup> (see table 3.1)

<sup>40</sup> Al-Sharbini, *Mughni al-Muhtaj*, vol. 2, p. 310.

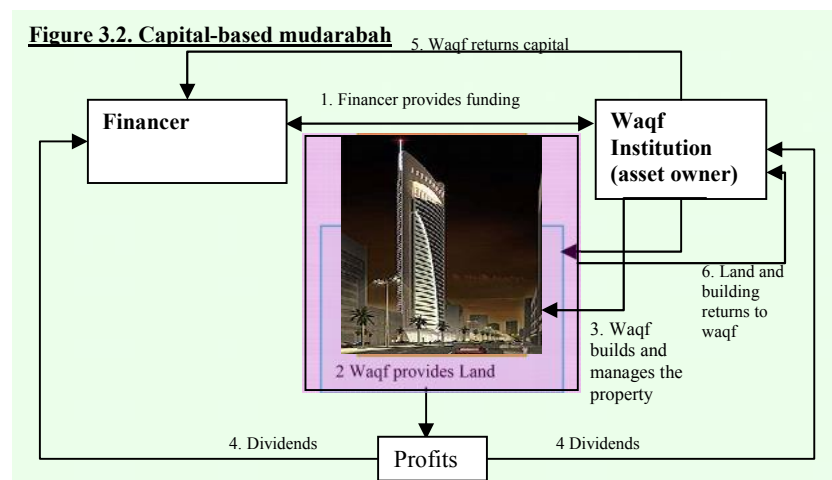
<sup>41</sup> Ibn Qudamah, *al-Mughni*, vol 14, kitab al-Shirkah, fasl fi ma in dafa'a rujul dabatahu; Al-Zarqa, "al-Wasail Hadithah", p. 197.

<sup>42</sup> Anas Al-Zarqa, "Al-Wasail Hadithah", pp. 196-7.

<sup>43</sup> See Munzer Kahf, *Financing the Development of Awqaf Property*, also his *al-Waqf al-Islami*, *Tatawwuruh, Idarathuh, Tanmiyyatahu*, Beirut: Dar al-Fikr al-Mu'asir, 2000, pp. 261-62.

- b. **Capital-based mudarabah:** According to Kahf, the mode of *Mudharabah* can be used when the *Nazer* assumes the role of entrepreneur. He can receive liquid funds from the financing institution to construct a building on the *Waqf* property. The management will exclusively be in the hands of the *Nazer* and the rate of profit sharing will be set in a way that compensates the *Waqf* for the effort of its management as well as the use of its land.<sup>44</sup> The waqf institution does not count the land part of the capital but it is considered part of expenses so that the share of waqf can be extended.<sup>45</sup> (see figure 3.2)

Both models are subjected to fiqhi and practical difficulties: from perspective fiqh, al-Zarqa's<sup>46</sup> view is justified on the opinion of Imam Ahmad Ibn Hanbal as in case of fisherman and the owner of net.<sup>47</sup> Ibn Qudamah, a Hanbali jurist, considered it to be a mudarabah case similar to muzara'ah.<sup>48</sup> Other jurists apparently do not agree. Since the developer provides capital and services, the contract becomes a service-based or asset based thus not a mudarabah that is used for commercial transactions. Hence, Shafi'i and Maliki jurists would not allow it.<sup>49</sup> Al-Sarakhsi considered this mode as bad ijarah amal (ijarah fiasidah) where the costs are not known.<sup>50</sup> Al-Zarqa's proposal is identical to that of al-Sarakhsi, therefore, if the costs of the development are determined and the ratio of



dividend are fixed according to the costs incurred, the Hanafi disagreement may not arise and hence al-Zarqa's proposal will be acceptable according to the views of Hanafi and Hanbali jurists.

Monzer Kahf also seems to have followed Ibn Qudamah when he called this transaction "output sharing mode". His model would be faced with similar disagreement from Shafie and Maliki ulama, as the waqf institution does not carry trading activity.

<sup>44</sup> Monzer Kahf, *Financing The Development Of Awqaf Property*,

<sup>45</sup> Monzer Kahf, *al-Waqf al-Islami*, *Tatawwuruh, Idaratu, Tanmiyyatahu*, pp. 258-59

<sup>46</sup> Al-Zarqa, "al-Wasail Hadithah", p. 197.

<sup>47</sup> Ibn Qudamah, *al-Mughni*, vol 14, kitab al-Shikah, fasl fi wa in dafa'a rujul dabatahu ; la Al-Zarqa, "al-Wasail Hadithah", p. 197.

<sup>48</sup> Ibn Qudamah, *al-Mughni*, vol 14, kitab al-Shirkah, fasl fi ma in dafa'a rujul dabatahu.

<sup>49</sup> Al-Sharbini, *Mughni al-Muhtaj*, vol. 2, p. 310.

<sup>50</sup> al-Sarakhsi, *al-Mabsut*, vol. p. 35. kitab al-Mudarabah

It is to be noted, however, that the restriction of *mudarabah* in trading is a juristic view, which is not accepted by Hanafi and Hanbali jurists, for they identify the transaction as a case of capital and services in general and not a trading activity alone. In simple words the Shafie and Maliki description of *mudarabah* applies to fund management activity as practiced today where the manager is free to invest the funds as he deems it profitable, while the Hanafi and Maliki definition of *mudarabah* is general that applies not only to fund management alone but also to joint venture investments, where the profits are realized from the real property lease payments according to a predetermined ratio.

<b>Table 3.1. Asset based <i>mudarabah</i></b>				
<b>Status :</b> Asset-based <i>mudarabah</i>				
<b>Operation :</b> Build and share				
<b>Builder :</b> ABC				
<b>Property manager :</b> ABC				
<b>Nature of dealing :</b> Single Asset Joint Venture: WH 40% and ABC 60				
<b>Site Ownership :</b> Waqf; leased to WH for 99 years				
<b>Building ownership :</b> WH & ABC				
<b>Development :</b> 6 story commercial building				
<b>Third party Leasing contract :</b> XYZ for 10 year revised after 3 years				
<b>Cost of development (finance: 100 %) :</b> 4.8 Million				
<b>Rental receivables :</b> RM 300480.00 p.a. (RM 25040 per month)				
<b>Terms of <i>murabahah</i> :</b> Cost + profit @ 8% + in RM				
	Financer's purchase -price	Financer's selling price	Total amount paid after	Monthly installments
	4800000.00	<u>6182923.80</u>	<u>5 years</u>	<u>97288.71</u>
		<u>12811721.76</u>	<u>30 years</u>	<u>35844.41</u>
Terms of <i>mudarabah</i> : 40%/60%				
	Financer's costs	4800000.00		Total 4800000.00
	Income receivables	300480.00 p.a.		
	Financer's dividends @ 60%	180288.00 x 30 = 5408640.00		5,408640.00
	Waqf's dividends @40%	120192.00 minus 20% for land revenue = 96153.60 x 30 = 2884608.00		
	Total reinvestment income @ 8% profit after 29 years		<u>6536317.46</u> subtotal total: <u>9228618.18</u>	10208640.00
<b>End of license to the bank :</b>			After 35 years	
<b>Modified model proposed by al-Zarqa and Kahf and its comparison with debt-based modes of finance</b>				

Al-Zarqa's and Kahf's proposals are suitable for a single-asset joint venture between a financier and land owner in the property market. Since rental receivables are divided among the waqf and the financier, Mahmud Ahmad al-Mahdi observes that this mode can be applied to commercial projects in big cities as only then the waqf institution can have sufficient revenue from the development<sup>51</sup> to pay for the costs of the development.

### 3.2. Partnership (*Musharakah*)

*Musharakah* is of two types: contractual and co-ownership. Both can be the basis for a joint-venture, and both are discussed respectively. Contractual Partnership (*Shirkah al-'uqud*) refers to a contractual relationship between two or more persons who have

<sup>51</sup> Mahmud Ahmad Mahdi, "Tajrabah", p. 82.

willingly entered into an agreement for joint investment and sharing of profits and risks. In co-ownership two or more persons are caused to share one piece of property.

Musharakah was proposed, first, by the working committee formed by IDB for the development of waqf properties; that the institution of waqf and bank should join where both should contribute to the development of waqf property. Later the waqf institution should try to purchase the property from the bank. The contribution of waqf would come (a) from the price of land, or (b) the land and minimum contribution to the other costs of the building. The bank would provide funds for the cost of the building. Where the waqf provides land alone, the revenue from the project should be divided into two: one, to pay for the costs provided by the bank, and second should be divided among the bank and the waqf institution as profit. Where the waqf provides land and cash the profits should be divided into two: a portion to pay to the waqf as rental for its land, and the balance of the profits be divided among waqf and bank according to their equity in the project.<sup>52</sup> IDB has implemented this instrument in several multi million development projects. In one of the proposed projects the joint venture was limited to a period of 13 years alone.<sup>53</sup>

Case (a) seems to be like a financial musharakah. It is possible that the bank will accept it. In case (b) waqf owns the land alone, and hence resembles a hybrid joint venture, based on co-ownership (*shirka al-milk*) and contractual partnership (*shirkah al-aqd*) as proposed by Kahf.

Anas al-Zarqa, proposing joint ownership in the land and building, thought that the price of the land and the building should be determined at the time of contract. The agreement should also stipulate that the building would be rented to a third party for a predetermined rental. Such a rental should be shared between the partners based on the same agreement. (Table 3.2) Al-Zarqa admits that through the agreement the developer becomes a co-owner of the waqf land which is not permitted by jurists. But he justifies this by the application of *istibdal*. He thinks that share in waqf land is substituted by the share in the building and since both are immovable properties the substitution is justified.<sup>54</sup> This is true when it is needed or is in the interest of the waqf but it may not be in the interest of waqf because the building is dependent on land and therefore inferior, and in bad time it may expose the waqf to sell the whole building. This risk however may be avoided if the waqf institution can use long lease first, and the owner of a long lease then can enter into joint venture with development financiers.

Al-Amin, Kahf<sup>55</sup> and Nazih Hamad do not allow joint ownership in waqf land and hence have proposed different models.

In alternative to the proposal by al-Zarqa, Nazih Hamad has proposed that the building would belong to the developer and the land would be the property of waqf. The building can be rented out once completed. The revenue from leasing would be distributed among

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<sup>52</sup> Id., at pp. 72-73.

<sup>53</sup> Id., at pp. 77-79

<sup>54</sup> Anas Al-Zarqa, "Al-Wasail Hadithah", pp. 198-99.

<sup>55</sup> Hasan Abdullah al-Amin, "al-Waqf fi al-Fiqh al-Islami", in *Idarah wa Tathmir Mumtalakat al-Awqaf*, p. 137. Monzer Kahf, *al-Waqf al-Islami*, *Tatawwuruh, Idaratu, Tanmiyyatahu*, pp. 261-



waqf and the developer according to the value of the land and the building. He justifies this based on the fatwa of some Hanafi scholars concerning kadak and kerdar, both a type of proprietary rights that would allow the developer of waqf land to occupy it for unlimited time as long as he is not paid for his expenses in return for a fair annual rental.<sup>56</sup> This is not in the interest of waqf, for under this concept the nazir will not be able to evict the kadak holder.

Table 3.2. Joint-venture based on musharakah

Status:	True Partnership (musharakah al-tammah)	
operation	Build and share	
Financer:	ABC Finance, (and waqf)	
Developer:	ABC Construction	
The nature of dealing:	Joint venture: Waqf provides land and ABC construction of building	
Site Ownership:	Waqf and ABC finance	
	Nazih Hamd: waqf leased to developer on kadak basis	
	Kahf: waqf land on co-ownership basis	
Building ownership	Al-Zarqa: Waqf and ABC finance	
	Nazih Hamad et al: Developer	
Maintenance:	Kahf: ABC	
Development:	6 story commercial building	
Leasing contract:	XYZ for 10 year revised after 3 years	
Cost of development:	4.8 Million	
Rental value:	RM 300480.00 p.a. (RM 25040 per month)	
	Operational musharakah	Revenue distribution IDB: Construction costs and dividends
	Hybrid musharakah	Revenue distribution IDB: Rental for waqf land and dividends Kahf: land, cash, and management fees

**Modified model proposed by IDB & al-Zarqa, Nazih Hamad, and Kahf**

It would seem that Nazih Hamad presumes that the mere provision of the site without sharing ownership would be sufficient enough to base the partnership. This will require a longer time which is considered detrimental to waqf. Similar proposal is made by Kahf.

Kahf justified it on the basis of co-ownership (shirkah al-milk).<sup>57</sup> The building can be built on waqf land by a developer at his own costs, or funds being given to nazir to construct the building. In each case the developer would be the agent for the other party, and the building should belong to the financer. The income from the development should be divided on the value of land, cash, and the management fees (fee for management are based on principles of ijarah or mudarabah). According to this principle the maintenance fees would be born by the financer as land is not exposed to depreciation.(table mush) Kahf's proposal can be the object of al-Mahdi's concern that since waqf's contribution to the joint ventures would be minimum, including the rental for its land,<sup>58</sup> waqf may not be able to repurchase the share of the bank in the project in time. This is an element of risk and for this reason the financing institution may not be willing to fund the project as proposed by the jurists.

<sup>56</sup> Nazih Hamad, Asalib Istithmar, Abhath Nudwah, pp. 185-6.

<sup>57</sup> One has to understand that Kahf view is not exclave to shirka al-Aqd for there is another agreement signed by the developer to develop the land.

<sup>58</sup> Mahmud Ahmad Mahdi, Tajrabah, pp. 81-2

To avoid the legal constraints, in Malaysia, Musharakah needs to be carried out by Waqf Corporation to whom the land should be leased on long term. In terms of economics, this mode of financing is not better than the others, except the IDB proposal for operational musharakah where the costs are paid out of joint income. In other cases musharakah may be used only as a supplementary instrument of financing.

To sum, joint venture may be in the form of partnership or a limited liability company. In both partnership and Limited Liability Company the investors have co-ownership of project and entitlement to dividends. Partnership however, is risky due to unlimited liability of the partners, unless the waqf institutions form a single project based limited company, subsidiary to the Waqf Holdings Corporation, and thereby enters into partnership with other investors. Where the joint venture is in form of a limited liability company the need for the formation of a new company subsidiary to waqf corporation may not arise. There the waqf institution and the investors can form a limited liability company for the purpose of development of the given waqf land, where the liability of the directors will be limited to the project alone. In the newly formed limited liability company or the partnership the equity can be divided on 20/60 basis, or otherwise, depending on the contribution of parties and services rendered. Where a hundred percent finance is sought, the waqf institution is advised to lease a piece of land on Hikr basis, discussed latter, to its development arm corporation. The value of the land can be used as capital for the joint venture and the corporation as a vehicle for avoiding the current legal restraint on transferability of waqf land.

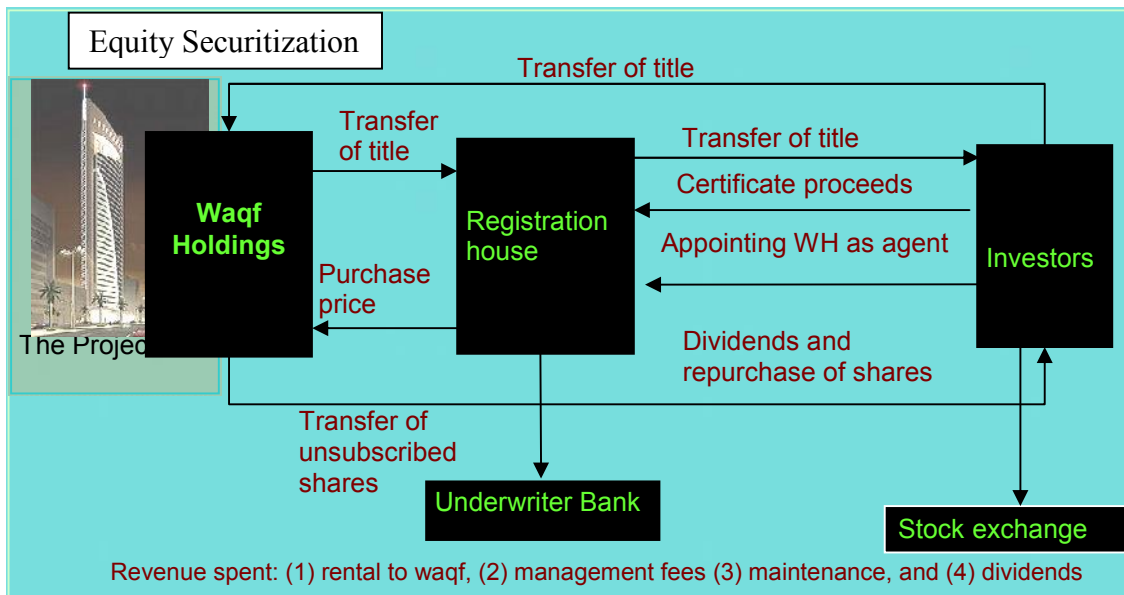
#### **4. Corporate financing: Securitization of project (saham and sukuk)**

Corporate financing refers to the method of financing a development project through individual investors. Securitization refers to a tradable security the return of which is ownership and or a right to the income of assets. In the light of waqf property financing, it means a project-based financing and thus the securitization of the project only. Securitization of a project is permissible when the waqf institution is ready to be in charge of the project management. The institution solicits funds from the public together with an agency agreement so that it can manage the project on their behalf. Few instruments suitable to waqf properties are proposed by contemporary jurists the significant of which are mentioned below.

##### **4.1. Public issue: equity participation**

The waqf institution through its representative, e.g. single project waqf holding corporation, must issue a prospectus that assigns the subsidiary as a project manager. The assets assigned to the waqf holding corporation and the project can be unitized, and each unit would be given a nominal value say RM 1 per unit, representing, not a debt, but a share in the physical assets of the project. Such units will offered to the public for subscription. The title in the prescribed unit would be transferred to the unit-holder upon subscription. The issue of the units will be then listed on the Stocks Exchange, where the units would be a tradable security.

Following the issue, and listing, the shares can be sold and purchased in the open market by the interested public. This provides liquidity in the said investment, and thereby the investors can sell their shares in the project easily. Listing also provides easy and simple mechanism to the waqf institution to increase its equity shares in the project. Other time it can be used to amortize the nominal value of the unit reflecting the realistic value of the shares. The institution can also classify some shares as waqf shares, that either be named so from the very beginning or at a later stage. Waqf shares in this sense are waqf of usufruct tied to the real state.



The capital raised through public issue will be spent on the project. The waqf holding corporation will be the manager of the project. Its task will be to manage the completion of the project and its expenses. Once the project is completed and starts to generate income, the said revenue will be spent on the costs, management, and maintenance fees. In other words the income of the project will be used for three things: (1) payment for the rental of land to waqf institution, (2) management fees to the waqf Holdings Corporation, and (3) actual costs for maintenance. (4) The balance, if any, will be then distributed on share-holders. This will represent the real profit as costs, overheads and operational expenses are deducted.

The advantage of securitized equity for the waqf institution is that it can control the terms of investment which will enable waqf to repurchase the shares easily.

Public issue can be implemented in two Shariah compliant modes of transactions. First mudarabah, and second musharakah. Each of them briefly discussed below

#### 4.1.1. Mudarabah Equity

Kahf<sup>59</sup> proposed that a Shariah compliant mudarabah mode may be achieved if the mudarabah similar to muzara'ah mode of finance is applied. This was discussed early where it was proposed by this writer that if the uncertainty concerning the subject matter of the contract is removed, this mode would be agreeable to Hanafi and Hanbali schools of law. Following this model, Kahf proposed the following procedures:

- 1) A permit from the *Waqf Nazer* of shareholders to construct specific construction on the *Waqf* land.
- 2) An appeal from the *Waqf Nazer* as an entrepreneur/*Mudharib* to the public to buy output shares at a given price and conditions as follows:
  - a) The existence of a permit from the *Waqf* to the share holders to erect the specific construction with all necessary conditions, specifications, etc.
  - b) An agency contract given to the *Waqf* management to utilize resources thus mobilized from the sale of output shares to establish the said project.
  - c) Appointing the *Waqf* as a *Mudhareb* to hold the fixed asset of the project after completion for management and investment.
  - d) An agreement on the ratio of distribution of gross output of the project after completion of construction and beginning of return giving period, between the owners of the construction, as *Rab al Maal*, and the *Waqf* as *Mudhareb*, according to an agreed upon ratio. This distribution does not specify any income to the land since the return on the *Waqf* land should be implicitly included in the share of the *Mudhareb*.
- 3) The *Nazer* takes charge of the construction by virtue of the power of attorney on behalf of the owners of output shares.
- 4) After completion of construction, the *Nazer* receives it and starts investing and managing it as a *Mudhareb*.
- 5) The *Nazer* actually distributes gross returns according to the agreement.

The characteristic of mudarabah shares is that unlike musharakah the dividends are calculated based on the gross income of the project and not the net value of the assets. The basis for such distribution would be the price of land, and the management costs and fees and the liquid capital provided by the shareholders.

#### 4.1.2. Musharakah equity

The musharaka equity has the same procedures as that of mudarabah in issuing stocks to the members of the general public. The basic feature of musharakah which distinguishes it from mudarabah is that in the former the dividends are determined based on the net value of the profit. This is because musharakah entitles shareholder to the asset and also to the income of the asset including net profit and capital appreciation. For this the management shall ascertain the market value of the assets and amortize the value of the shares. Another distinguishing feature of musharkah is that, unlike mudarabah shares where the maintenance fees were not deducted from the revenue before distribution, in

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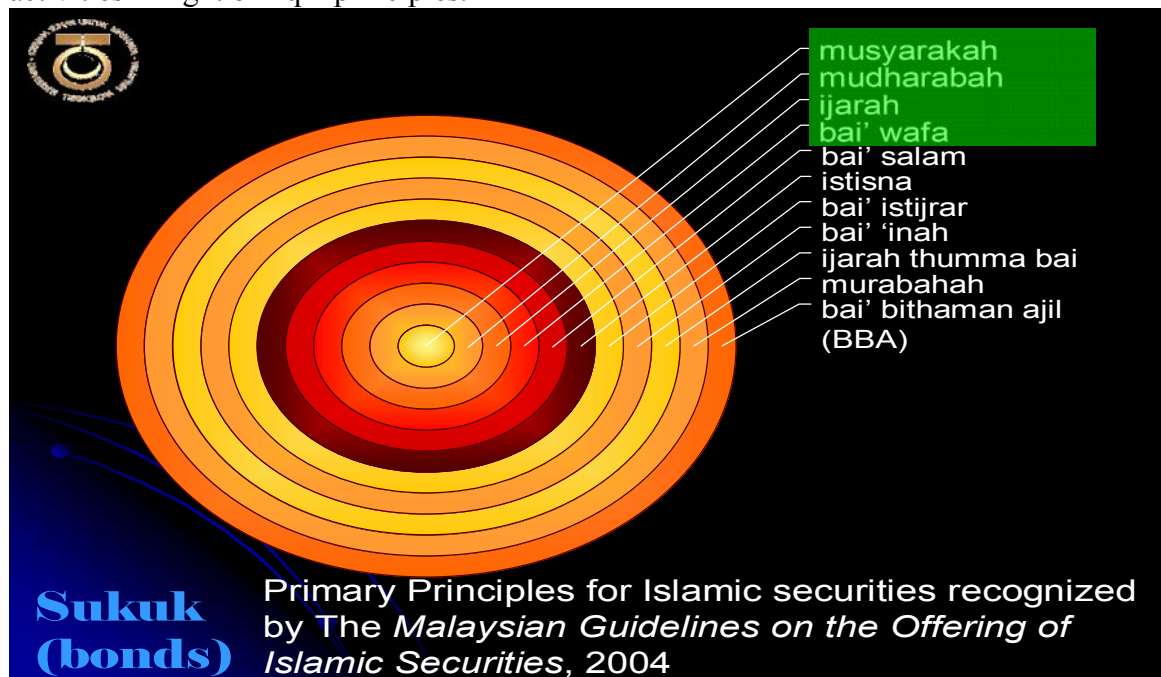
<sup>59</sup> Monzer Kahf, *Financing The Development Of Awqaf Property*

musharakah all costs including management, land use, and maintenance are deducted first and the balance is then distributed according to the share in the equity.

#### 4.2. Islamic bonds (Sukuk)

Sukuk is an Islamic bond issued by Islamic banks and financial institutions. Sukuk have similar characteristics of a conventional bond, the difference being that it is asset-backed and represents proportionate beneficial ownership in the underlying asset. The return on the sukuk is derived from the yield generated by the client's asset.<sup>60</sup> Bonds are representing the ownership of usufruct (manfa'ah) and therefore compliant with the nature of waqf law.

The Malaysian Guidelines on the Offering of Islamic Securities, 2004 recognizes acceptable Syariah concepts and principles for Islamic securities. The primary principles for such securities are bai' wafa, bai' salam, bai' istijrar, bai' 'inah, bai' bithaman ajil (BBA), ijarah, ijarah thumma bai', istisna', mudharabah, murabahah and musyarakah. But the same as equities, bonds or sukuk cannot represent debt for purposes of tradable security in a secondary market. Though such a bond may be issued, as in the case of Malaysian BBA (murabahah) etc, such bonds are rejected by the majority and therefore it will be neither economically prudent nor suited to the nature of waqf development activities in light of fiqhi principles.



Following the established principles of fiqh, two asset-backed bonds namely muqaradah, and ijarah certificates are discussed below.

<sup>60</sup> Definition offered by Dubai Islamic Bank [http://www.alislami.ae/en/corporatebanking\\_prdsukuk.htm](http://www.alislami.ae/en/corporatebanking_prdsukuk.htm) Date: 8/8/06

#### 4.2.1. Muqradah or mudarabah bonds

*Muqaradah* bonds<sup>61</sup> are based on the idea of *muqaradah* / mudarabah contract similar to the investment deposit contract in Islamic banks, but with the addition of securitization of their value, by backing them by assets. In *muqaradah* bonds, the nazir as mudarib (fund manager), accepts cash deposits against issuance of certificates given to the financier (*rab al-mal*), thus making him the shareholder in the project. But, unlike the mudarabah shares, bonds do not entitle the bondholder to the capital appreciation but instead give them the right to usufruct (benefit/manfa'ah) of the attached assets.

Under this mode of finance the *waqf* management utilizes the proceeds for the development of the *waqf* land as agreed upon with the investors. The distribution of profits should commence once the project is productive. But where the rentals are secured due to an existing lease agreement with a third party, the payment of profits may commence early on advance basis. The net return would be proportionate and periodical until the end of the *mudharabah* agreement which could be for short, medium and long term. It must be noted that the distribution of profit and repurchase of bond may be guaranteed by a third party who is not signatory to the contract of *muqarada* bonds, e.g. the government. In case the *waqf* institution is unable to pay to the bond holders the government will pay the amount on a basis of benevolent loan.<sup>62</sup>

On maturity of the bond, say after 5 years, the *waqf* management would be required to return the principal cash to the bond holders and retrieve the bonds they had. *Muqaradah* bonds may also come to an end by either transferring the property into a *waqf* or buying it from the market by the *waqf* management.

#### 4.2.2. Ijarah bonds

Sukuk can be structured on a bundle of *ijarah* transactions especially where the ability to trade on a secondary market is required.<sup>63</sup> This can be used for *waqf* property developmental finance as well.

Under this model a sukuk certificate will be issued by *waqf*'s incorporated company (Waqf Holding Corporation) to investors. The proceeds will be used by the said company to develop a rental generating real property or other cash generating asset. The incorporated company will then lease the asset, either to a third party or to *waqf* institution, for a period corresponding to the duration of the tenure of the Sukuk certificate. The asset would be held in trust for the sukuk holders either by the issuing company or a separate trustee. The payments to the bondholders may be fixed or calculated with reference to the inter bank offered rate plus a margin which represents the

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<sup>61</sup> There is a wide range of literature on *muqaradah*, and *mudarabah* bonds. At a time it was controversial. It seems that they have been accepted generally, except that based on *murabahah* and *istisna*. See Walid Khairullah, *Sanadat al-Muqaradah Ma'a Halat Tatbiqih*, in *Idarah wa Tathmir*, p. 149, Hasan Abdullah, *al-Waqf fi al-Fiqh al-Islami*, *Idarah wa Tathmir*, p. 136; Nazih Hamad, *Asalib Istithmar*, *Abhath Nudwah*, p. 178 Monzer Kahf, *al-Waqf*, p 275. Some views of Kahf are incorporated here.

<sup>62</sup> Nazih Hamad, *Asalib Istithmar*, pp. 187-189.

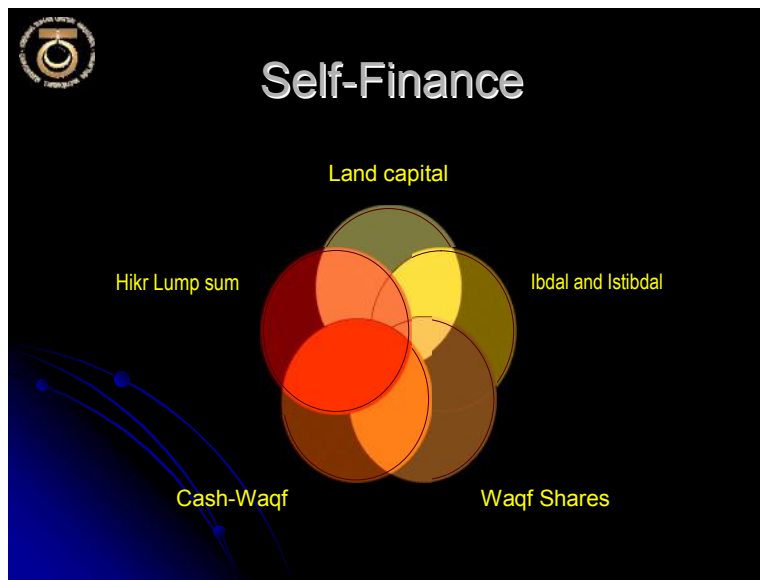
<sup>63</sup> Lovells's *Client note on Islamic Finance, Shariah, Skuk & Securitisation*, Internet edition, 2004.

market rate for rental payments. The waqf institution will be under obligation to repurchase the bonds from the bondholders after maturity of the certificates.<sup>64</sup>

The above models represent simplified facilities that can be easily understood and implemented in the current Malaysian Islamic financial market. They can be used with other modes of finance in order to minimize the costs of financing. However it would be more profitable if these instruments are used with one of the self financing methods. Few of these self-finance modes are discussed in the next section.

## 5. Self-Finance

By self-finance we mean the cash or land contributed to the costs of development by the institution of waqf. There are several methods whereby the institution of waqf can reduce the costs of financing. These are the use of land, its securitization, and obtaining advanced rentals under the concept of hikr. In addition, the institution can also resort to substitution of one land with value to be used for the development of another resulting in amalgamation of different waqfs. The institution can also use cash waqf, saham waqf, usufruct waqf and waqf amal (probably by providing professional advice and supervision by professionals). All these will be discussed below.



### 5.1. Land as capital

Land is an asset and valuable and should never be used for free in the development. It should be value in terms of costs and revenue, otherwise, waqf will loss a substantial portion of income due to this miscalculation. The subject land can be used as partial financing contributing to the cost of a project. The price of the same land can be furth[er] used in the exercise of securitization thereby enabling waqf to contribute substantially to the costs and henceforth own a larger share in equity.

<sup>64</sup> See ibid.

## 5.2. Lump sum rentals obtain through Long lease (Hikr)

The term *Hikr* means monopoly or exclusivity. Instead of selling the *Waqf* property the *Nazer* can sell a right for a long lease, for a large lump sum, the equivalent of the value of the *waqf* property, paid in advance to be followed by a nominal periodical rent. The purchaser of the right of long lease can then develop the property using own resources and at own risks as long as she/he pays the periodical rent to the *Nazer*.

In return for the development undertaken by the leaseholder, he has an exclusive right over the property for a long period that usually goes beyond his life time or it may be permanent. This right can be marketed, transferred and inherited,<sup>65</sup> as it can be sold, subleased, made gift inter-vivos or through will, donated.<sup>66</sup> The building or plantation developed on the land would be the property of the lessee.<sup>67</sup>

This mode is allowed by Shafi'i and Hanbali jurists. This is also permitted by Hanafi *fuqaha*. Contemporary Arab jurists and Sharia advisers to financial institutions have also approved it. Mustafa al-Zarqa considered it as tool that can be used for the development of waqf land or for the investment of its assets.<sup>68</sup>

As a mode of self finance, hikr can be used in two ways: for the development of the same site or another waqf property.<sup>69</sup> In the first, use the lump sum for the development of the same site, and in the second, let a piece of land on long lease in return for a lump sum. Use the said lump sum as capital in a joint venture for the development of another land.

The classic law demands perpetual grant of rights in waqf property. This is not in the interest of waqf. A hikr granted for a maximum of 99 years<sup>70</sup> as recognized by Shafi'is may be in the interest of waqf. This is the same as the current leasehold land alienation practiced under the Malaysian National Land Code 1965. This could be perhaps further modified by the economic life of a development project i.e. 30 years where the investor can get his capital plus reasonable profits.

## 5.3. Substitution (ibdal and istibdal) of Waqf

The term substitution stands for two Arabic words, ibdal and istibdal. The lexicons and jurists use them interchangeably, but, covenant writers of waqf have used ibadal to indicate the substitution of a piece of land with another piece, and istibdal to show the sale of one piece of land and purchase of another with the proceeds of the sale.<sup>71</sup> The permissibility of both concepts of substitution are discussed by classic and contemporary jurists.

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<sup>65</sup> Ibn Abidin, *Hashiyah* vol. 4 p. 391. This shall be the last resort of development. In case amount is big, it shall be used to finance other developments: Anas al-Zarqa, p. 194.

<sup>66</sup> Monzer Kahf, Financing The Development Of Awqaf Property; Anas, "Al-Wasail Hadithah", p. 192

<sup>67</sup> Anas al-Zarqa, "Al-Wasail Hadithah", p. 195

<sup>68</sup> Mustafa al-Zarqa, al-Madkhal ila Nazariyyah al-Iltizam al-Ammah, Dimashq: pp. 40-41.

<sup>69</sup> Monzer Kahf, Financing The Development Of Awqaf Property

<sup>70</sup> *Al-Mawsu'ah al-Fiqhiyyah al-Kuwaitiyah*, vol. 18, madah Hikr, Hukm al-Ijarah al-Tawilah.

<sup>71</sup> *Mawsu'ah al-Kuwaiti*, term 'ibdal' vol. 1.



The substitution of one waqf, with another (Ibdal, munaqalah, mu'awadah) according to Ibn Rushd (a maliki jurist) is permitted if it is ruined and there is no means to reconstruct; provided the exchange is with permission of court and be recorded and witnessed in the court.<sup>72</sup> Some jurists in Shafi'ies school allowed the change of waqf land, except for a mosque even if it is ruined and its rebuilding is impossible,<sup>73</sup> provided that the substitution does not contradict the conditions of the settler<sup>74</sup>.

Istibdal as the sale of all or part of a waqf land and to purchase with its proceeds another piece of land dedicated as waqf for similar purposes<sup>75</sup> is not allowed by Imam Malik at all.<sup>76</sup> Nevertheless it is reported that Rabi'ah from Malikies allowed the sale of waqf property, called *mu'awadah*, provided the proceeds of the sale are used to purchase another piece of land and then declared as waqf, the same as the previous.<sup>77</sup> Shafi'i jurists allowed the exchange of piece of land,<sup>78</sup> a horse for jihad can be sold, and according to Ramli from the same school, the mosque if impossible to rebuild, can be broken, the items sold, and kept the proceeds if there is hope for its reconstruction, otherwise the proceeds can be spent on another mosque.<sup>79</sup> According to Hanbalis, if the benefits of waqf are not obtainable, such as where a house is ruined, a land is turned barren, or a mosque, for some reason, is not used by people for prayers,<sup>80</sup> and cannot be developed due to lack of finance, the land can be sold provided the purchased land is considered *waqf* too in the same category as the first, or the money is used to improve another waqf. The Hanafi jurists have unanimously approved the process of *istibdal*.<sup>81</sup> Ibn Nujaim and Ibn Abidin, however, prohibited the sale of waqf without substitution by another for the reason that it is open to abuse and misappropriation by the nazir.<sup>82</sup>

Nazih Hamad sums the discussion on permissibility of ibdal and istibdal as he writes that in principle, the majority of jurists<sup>83</sup> allow both ibdal and istibdal, if they are needed and benefit waqf. Jurists however differ on the flexibility and rigidity of their application, among whom the Hanafis are liberal as they allow substitution in both forms if that is needed, or is in the interest of waqf or its beneficiaries, whether conducted by the waqif, nazir, or government, irrespective of whether the property is productive, ruined, immovable or chattel, as long as the transaction is not below market price.<sup>84</sup>

<sup>72</sup> *Al-Taj wa al-Iklil*, vol. VI, p 42

<sup>73</sup> *Mughnial-Muhtaj* vol. p. 392.

<sup>74</sup> Al-Subki, *Takmila al-Majmu'*, vol. 15, p. 345

<sup>75</sup> Kahf, *Tamwil al-Tanmiyah al-Awqaf*, p 36

<sup>76</sup> *Al-Taj wa al-Iklil*, vol. VI, p 42; *al-Mi'yar*, vol. VII, p 258

<sup>77</sup> Al-Bayan wa al-Tahsil, vol. 12, 204

<sup>78</sup> Al-Sharbini, *Mughnial-Muhtaj* vol. p. 392.

<sup>79</sup> Al-Subki, *Takmalah* vol. 15, 361

<sup>80</sup> Ibid.

<sup>81</sup> Ibn Abidin, *Radul Mukhtar*, vol. IV, p. 387.

<sup>82</sup> Ibn Nujaim, *Bahr Rai'q*, vol. 5, pp 222-223; Ibn Nujaim, *Radd al-Mutar wa Durr al-Muhtar*, vol. III, pp 387-389.

<sup>83</sup> The majority of malikis disallow istibdal. A small minority allows it; some shafis disallow and others gives permission. The Hanbalis allow ibdal including mosque if ruined, and it is needed; the Hanafis allow ibdal liberally.

<sup>84</sup> Nazih Hamad, Nazih Hamad, *Asalib Istithmar al-Awqaf wa daratuha*, Abhath Nudwah Nahw Dawr Tanmiwi li al-Waqf, p 182.

Substitution, therefore, may be divided into two forms: substitution of one waqf with a similar (ibdal), and the sale of a piece of land and purchase of another with the proceeds from the said sale (istibdal).<sup>85</sup> Ibdal may not be so significant for financing except when a town land is exchanged for another and the higher price of the town land being used in costs calculation. Therefore, istibdal alone will be discussed here.

### **Istibdal as a means of financing**

Istibdal can be used in two ways: the conventional method as understood from the predominant juristic thought, and also a new way by redefining the concept of istibdal. The first involves waqf mushtrak by conversion of sale proceeds to the purchase of a new waqf land or at least using the funds for the improvement of another existing similar waqf. The second method is the conversion of fixed waqf asset to a liquid and investment of the liquid waqf asset in the improvement of another waqf. The benefit of this distinction is relevant to those who are concerned with a necessity for liquid waqf assets. In terms of finance the result is the same.

Despite Kahf's misgiving about this mode as a financial means for development<sup>86</sup>, there are two modes of financing through istibdal.

1. Nazih Hamad proposes a joint waqf (waqf mushtarak) where different waqfs of similar or different objectives have small estates in the city, the development and management of which is not within the capability of waqf institution or its management is not economical, istibdal can be used. That is all of the small estates could be sold, the proceeds of which can be used to purchase another piece of land [perhaps in a strategic area] and building be erected on the land. Similarly the proceeds can be used for purchase of another estate [perhaps a building] with a potential for higher income. The new property can be a substitute for all the sold estates, and the income of the new property should be distributed according to the capital generated by the old estates.<sup>87</sup> This proposal is practiced in Singapore.<sup>88</sup>
2. The sale of a portion of a land and using the proceeds for financing the development of the remaining portion of the waqf land<sup>89</sup>. This partial substitution is a mode allowing liquidity that is needed for the operational activities of a *waqf*. It is 'a means of financing, especially, in case of urban lands whereby the price of a part of the property may be sufficient to construct a building on the remaining land and therefore increase its revenues.'<sup>90</sup>

The above is possible if one accepts the views of Hanafies, provided the donor allow exchange and change of the *waqf* property or it is so due to necessity which is also the

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<sup>85</sup> This difference is recognized by Nazih Hamad, "Asalib Istithmar al-Awqaf wa daratuha", *Abhath Nudwah Nahw Dawr Tanmiwi li al-Waqf*, p 182; cf. Abu Zahrah, *al-Muhadarat fi al Waqf*, p. 161: *Ibdal* means to sell the property. *Istibdal* mean to sell one piece of land and buy with its purchase price another property

<sup>86</sup> Monzer Kahf, *Financing The Development Of Awqaf Property*

<sup>87</sup> Nazih Hamad, *Asalib al-Istithmar*, pp. 186-187

<sup>88</sup> Monzer Kahf, *Financing The Development Of Awqaf Property*

<sup>89</sup> Muntaha al-Iradat, vol. II, pp 514-515; Ibn Qudamah, *Al-Mughni*, vol. 6, p. 225.

<sup>90</sup> Monzer Kahf, *Financing The Development Of Awqaf Property*

view of Hanbalies, and an opinion in the Malikies and Shafi'ies with an exception of mosque.<sup>91</sup>

#### 5.4. Waqf shares

Waqf shares or Saham wakaf is the best product so far suitable to the development of waqf property. Though originated in Malaysia, the practice is accepted in some Arab countries. The basic idea is that to accept cash as waqf from public and convert it to a share in a fixed asset.

Nothing should be said about this except that compare to cash waqf, this method ultimately tie waqf donation to fixed asset and henceforth is not liquid. In other words its usefulness is limited to the development or purchase of a new property alone. A minor observation can be made that its practice and the procedure for it may have slowed down its success. There are the requirements of sighah and therefore going to the Majlis to execute such a waqf. Should there be no such a requirements, it is presumed, more individuals could have contributed to. There is need to promote this novel idea through various ways and with an easy way of performance. An aggressive campaign may provide waqf institution with good source of financing.

#### 5.5. Cash and usufruct waqfs

Despite a tremendous effort made by waqf institution to minimise the costs of development by adopting various strategies for obtaining development finance, financing through market players is expensive in times and reduces waqf revenues. As the majority of waqf properties are fixed assets, partial financing of development project may not be sufficient through hibr or istibdal. It is this reason, beside saham waqf, another avenue of finance is necessary to be considered. A cash waqf should be accepted in Malaysia, and therefore joining the long list of countries who recognised cash waqfs.

Recognition of cash waqf is not new. Imam Zufar has allowed cash<sup>92</sup> without attaching any condition. The majority of Malikis<sup>93</sup> allowed cash and food stuff<sup>94</sup> as *waqf* though some held to be *makruh*.<sup>95</sup> The Hanbalis<sup>96</sup> are deemed to have not allowed cash but according to Ibn Taymiyah the various rulings on the invalidity of cash *waqf* are based on the opinions of al-Khiraqi and those who followed him. There is no opinion of Imam Ahmad on the point, and hence according to Ibn Taymiyah cash may be a valid subject of *waqf*.<sup>97</sup> Some Shafi'i jurists allowed the dedication of dog for purposes of *waqf*. This

<sup>91</sup> Al-Amin "al-Waqf fi al-Fiqh al-Islami", in *Idarah wa Tathmir al-Muntalakat al-Awqaf*, p. 135

<sup>92</sup> Sayed Khalid Rashid, "Current Waqf Experiences and The Future of Waqf Institution", *5 Awqaf* [2003] at 16; Shawqi Ahmad Dunya, "al-Waqf al-Naqdi: Madkhal li Taf'il Dawr al-Waqf fi Hayatina al-Mu'asirah", in *3 al-Awqaf* [2002] p 57 at 66-70; Hussain Hussain Shihatah "Istithmar Amwal al-Waqf", in *Muntada Qadaya al-Waqf a*, Kuwait: al-Amanah Ammah li al-Awqaf, 2004, p 157. Al-Qurafi, *al-Dhakhirah*, vol. 6, pp 312-3: According to Imam Shafie and Ahmad anything that can be used and utilized recurrently is suitable for *waqf*.

<sup>93</sup> *Jawahir al-AKlil*, vol 2, p 306, <http://feqh.al-islam.com/Books.asp>; al-Qurafi, *al-Dhakhirah*, vol. 6, p 313

<sup>94</sup> Al-Kashnari, Abu Bakr bin Husain, *Ashal al-Madarik Sharh Irshad al-Salik fi Fiqh Imam Malik*, vol 2, Bierut: Dar al-Kutub al-Ilmiyah, 1416 AH, p 221

<sup>95</sup> Al-Hattab, Muhammad bin Muhammad bin Abd al-Rahman al-Maghribi, *Mawahib al-Jalil fi Sharh Mukhtasar al-Shaikh al-Khalil*, vol. 6, Dar al-Fikr, 1992, p.22 also on <http://feqh.al-islam.com/Books.asp> and <http://www.islamweb.net/ver2/library/Books.php>.

<sup>96</sup> Ibn Qudamah al-Mughni, vol. 5, p. 373

<sup>97</sup> Ibn Taymiyah, *Majmu al-Fatawa*, vol. 31, p. 234.

according to al-Subki<sup>98</sup> is permissible because of its use and benefit (*manfa'ah*). Thus, according to al-Subki, *manfa'ah* or benefit might be the object of *waqf*, and therefore as long *something can be used recurrently* and a benefit can be received, that can be the subject matter of *waqf*.<sup>99</sup> At present countries which accept and practice cash *waqf* are Egypt, Iraq, Syria, Iran, Turkey, India, Pakistan, Burma, and Singapore.<sup>100</sup>

This writer has proposed somewhere else that a new approach is needed to the concept of waqf properties. Under the said proposal all revenue generating properties are valued and such a value is considered the capital of the waqf. This is proposed because contemporary waqf needs cash as much as it needs fixed assets.<sup>101</sup> Assuming the ulama agree with this proposal, i.e. the recognition of cash and usufruct waqf as well using cash proceeds from other waqfs, the waqf institution can have liquid resources whereby it would be able, initially, to finance part of development costs on their own. In a long term it is hoped that the institution of waqf would not only be self-sufficient but also can establish its own investment funds that can participate actively in the Malaysian Islamic capital market. It is possible if cash waqf is promoted properly, and the cash capital of existing waqf are not converted to fixed assets, the institution of waqf can establish a waqf bank, attracting investment deposits from public including corporate investors, and at the same investing waqf capital in a more Islamic and socially responsible manner.

## 6. Conclusion

The above discussion shows that waqf development projects apart from government and semi governmental bodies can be financed through banks, developers, and also by waqf institutions by way of self financing. The fundamental point to be highlighted here is that all the above modes except self financing, need to be operated by a body incorporated by the Majlis. The majlis would lease the land to the said corporation for a period of 99 years. The corporation will owe the Majlis a market price of the land plus annual rentals. The corporation can develop the land in either of the above mentioned modes. As time passes, and the corporation has to develop more lands to develop, it can form new limited liability companies with a single asset and a single project (holding a single piece of land) to avoid the risk of losing other properties. This company will be in charge of the project. Where the banks and other financial institution refuse to enter into a joint venture, the development company can raise finance putting the leased asset as a security. If accepted by financier, the rights of the financier would be secured by a 99 years lease, the same as the government alienation of leasehold titles. Throughout the lease period, the Majlis would be a shareholder and hence entitled to a share in the revenues of the project according to the invested amount. The corporation will be a leaseholder and would be able to sublease the property without legal restrictions.

The Majlis (waqf institution) can invest the lump sum credited to the corporation on the development of the same land by being a partner in the project. With this the

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<sup>98</sup> Al-Subki, *Takmalah*, vol 15, p. 320 (kitab al-Waqf)

<sup>99</sup> This is also mentioned by al-Qurafi above (note 50).

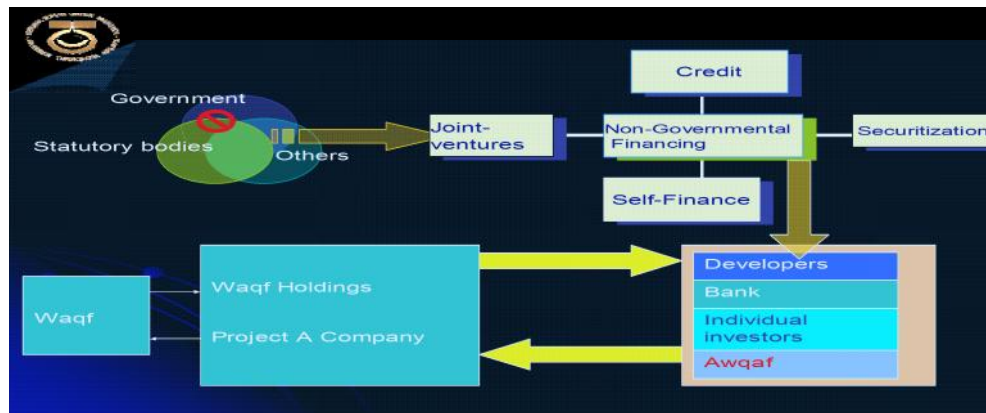
<sup>100</sup> Sayed Khalid Rashid, "Current Waqf Experiences and The Future of Waqf Institution", *5 al-Awqaf* [2003] at 16.

<sup>101</sup> Ibid

disadvantages of Hikr that it does not benefit waqf substantially will be avoided. At the same time, since the land is leased on the basis of Hikr, the ownership of waqf land by other parties does not arise. Under law the building will follow the land according to the terms of the lease. In Fiqh, once land is leased, building belongs to the leaseholder and the land to its title-holder. Hence the waqf institution and others would be partners. Both would share the equity as well as entitlement to the dividends.

All the above modes of financing if taken alone or in combination with others, may prove to be difficult to get or expensive to take. An easy way out would seem to be dependence on government and baytul mal. But dependence on government results in delayed development and therefore loss of revenues. Thus an expensive finance may be better than delayed. Another alternative may seem to be self-financing. Though this is an ideal way to develop waqf land, for an organization which has limited resource, it is wise to do the job with some one else's funds.

A cheaper finance may be obtained if one shops with a variety of the financial instruments, for some of them have hidden advantages to the financial institutions. Despite availability of cheaper financing it is not advisable to use one of the instruments alone.



Having regard to the current market trends, only partial financing may be obtained from financial institutions\_ at 60- 90 per cent. Some Islamic institutions do offer 100 per cent finance, but since Islamic banks unfortunately use conventional benchmarking for their charges and fees, this may result in high charges especially when the term is for a longer period of time. This would not be in the interest of the beneficiaries of the waqf. A prudent practice, therefore, will be to take short or medium term finance and try to get the balance through securitization if the project involves larger sum of funding, and self financing which would be cheaper and easy to pay.