OAK INVESTMENT MANAGEMENT GROUP

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Sharia Financing and Real Estate

Sharia literally means the way or the path. This term refers to the way in which things should be regulated to be in accord with the edicts and teachings of Islam. Sharia financing, therefore, is just one aspect to which sharia applies, but it has profound consequences as to how money is made available to assist purchasing commercial real estate.

Islam teaches that money has no intrinsic value but is purely a medium of exchange. Money should not be made from money itself, rather through acceptable trade in goods and services. A Muslim cannot lend, or receive money and expect to benefit with interest (riba). Sharia financing, therefore, is an Islamic way of avoiding the use of interest.

There are three main ways of doing this: Ijara is essentially a leasing arrangement where the bank buys the target for their client, a portion of the instalment payment goes toward the final purchase thus allowing a bank sponsor to receive their required return. Musawama is an option held by the sponsor bank with an agreed strike price in excess of its day one value, in this way the client can buy back the asset with a premium for the bank consistent with its required return. Musharaka is a joint venture arrangement where the bank and the client share returns and risks in pre-agreed proportions. There are many other point and techniques of sharia financing but suffice to say as long as participants are clear about their underwriting there is absolutely no reason why sharia compliant financing cannot be as good as traditional Western financing.

It is also important to remember that sharia does not only relate to how a building may be financed it is also to do with how a building is used. There must be no investment in unsuitable buisnesses such as armaments, pork, tobacco, drugs, alcohol or businesses themselves that deal predominantly with interest such as Western insurance businesses or banks.

As with traditional financing, ancillary services can be charged by Islamic banks for a fee. Indeed buying and selling of approved goods and services somewhat displaces the notion of 'risk' capital accruing interest in a passive way. This makes the issuance of Islamic financing intrinsically and systematically less risky than Western financing. But it is not also the issuance but it is also the funding of issuance that is also less precarious than western lending: There is a clear injunction of Islamic financing is to retain a clearly differentiated status between shareholders' capital and clients' deposits in order to make sure profits are shared correctly. Non-Islamic banks have profited from non-segregation in good times for which they have paid dearly in bad times. With the vast following of Islam in the world it is clear that sharia financing has a big and growing role to play in commercial real estate. It offers a useful counter-balance to other funding models and there are some very valuable lessons to be learnt that provide a more congruent alignment of interests between all the stakeholders in a transaction.

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