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Sustainable Property Financing for Malaysia Madani

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Abstract
Purpose: This article aims to address the deficiencies within Malaysia's Islamic property financing system, focusing on social justice and sustainability, in alignment with Shariah principles.
Design/methodology/approach: Employing a comprehensive analysis, this study proposes a sustainable property financing model grounded in trade principles, emphasizing fairness, transparency and Shariah compliance.
Findings: Several existing Islamic property financing practices in Malaysia fall short of Shariah principles, resembling conventional loans. The proposed model centers on property trade, ensuring genuine ownership transfer and adherence to Islamic tenets.
Research limitations/implications: This article calls for a paradigm shift in Malaysia's Islamic property financing landscape, emphasizing the need for real trade transactions and legal ownership transfer. Further research should explore practical challenges and global adaptability.
Practical implications: Implementing the proposed refinements could lead to a more equitable and sustainable financing ecosystem, addressing social justice concerns and fostering Shariah compliance.
Originality/value: This study introduces a novel perspective, blending traditional values with modern financial practices, offering a promising framework for reshaping Malaysia's property financing trajectory. The proposed model aligns Shariah principles with social justice and sustainability goals.

Keywords: Malaysia Madani, Ownership, Property Financing, Shariah, Social Justice, Sustainability

Introduction

The inception of Bank Islam Malaysia Berhad in 1983 marked a significant milestone in the evolution of Islamic banking and finance in Malaysia. Over the years, Malaysia has emerged as a global leader in the implementation and advancement of Islamic banking and finance, earning recognition for its accomplishments and contributions in this domain. Furthermore, Malaysia has established itself as a hub for research and education in Islamic banking and finance, solidifying its commitment to the growth of this sector. This trajectory of progress has been supported by successive administrations, underscoring the nation's dedication to nurturing Islamic banking and finance.

Nonetheless, despite the impressive strides made, the financial sector in Malaysia has yet to fully harness its value-based potential to address contemporary economic and social imperatives. This concern was spotlighted by Malaysian Prime Minister; Datuk Seri Anwar Ibrahim (PMX) in Malaysia's recent budget announcement. PMX emphasized the misalignment of the current Islamic financial ecosystem with the ideals advocated by pioneers such as Professor Dr. Muhammad Nejatullah Siddiqi (PDMN), who underscored the significance of justice and morality congruent with maqasid Shariah (objectives of Islamic law). PDMN stressed that Islamic banking and finance, as a facet of Islamic economics, is inherently a quest for justice and morality in ordinary business affairs. Echoing this sentiment, the late Sheikh Yusuf al-Qaradhawi (SYQ), during his visit to Malaysia in 2009, expressed grave concerns about the existing Islamic financial system and called for more effective strategies in socio-economic development rooted in people-centric principles and social justice. In light of these imperatives, PMX called for practical policies to enhance the capabilities of the Islamic financial system, prioritizing inclusive growth and equitable wealth distribution while avoiding overemphasis on corporate profitability.

Nonetheless, certain deficiencies persist within Malaysia's Islamic banking system and practices from a Shariah perspective. These issues arise partly due to a disparity in expertise between the management of Islamic banks and the scholars and experts who comprise the banks' Shariah Advisory Boards. Management often lacks a comprehensive understanding of Shariah teachings on Islamic banking and finance theories, while Shariah Advisory Board members lack practical banking experience. Addressing these challenges requires not only assessing the contractual validity of financial products but also delving into broader factors that need refinement (Hassan, 2011). The appropriateness of charging profit based on a floating rate, such as the Base Financing Rate/Islamic Base Rate, is an example of a critical issue. Islamic property financing, as practiced by Islamic financiers, largely mirrors conventional property loans, with the financiers assuming the role of the financier rather than the seller, as advocated by Islamic muamalat. In this article, we propose a sustainable property financing package, accompanied by an in-depth analysis and discussion of practical issues associated with the Malaysian Islamic property financing landscape, emphasizing comprehensive sustainability and the viability of Islamic financiers.

Shariah Viewpoints

Islam advocates for trade and commerce while vehemently forbidding usury or riba', as highlighted in the Quran: "And Allah permits trade but prohibits riba'" (Quran, 2:275). Profit derived from trade transactions is deemed permissible, while profiting from loans, or riba', is strictly prohibited. Islam recognizes only one form of loan, known as Qardhul Khassan (Benevolent Loan), wherein the lender does not charge interest on the borrowed amount. However, the borrower may choose to offer an additional amount as a gift (hibah) to the lender, acknowledging their assistance and goodwill. The underlying purpose of Qardhul Khassan is to aid borrowers facing financial difficulties and requiring assistance.

In Malaysia's context, Islamic scholars generally concur that Islamic financiers can impose administration and processing fees to cover their administrative costs and expenses. Presently, lenders are allowed to levy a nominal processing fee for loan transactions, following the National Fatwa Council of Malaysia's decision to permit a 1% processing fee on study loans disbursed by the National Fund for Higher Education of Malaysia (Perbadanan Tabung Pendidikan Tinggi Nasional or PTPTN). This fee aims to offset the administrative and processing costs incurred from loan application to full settlement.

However, the prevailing focus of Islamic banks in Malaysia primarily centers around profit generation rather than assisting borrowers in need. Their emphasis is on profit maximization, expanding their market presence, and increasing their Islamic loan portfolio, given the resilience demonstrated by Islamic banking during the 2007 financial crisis compared to conventional banking systems. Additionally, borrowers often opt for Islamic financing due to more attractive features, such as minimal or no overdue charges, and fixed selling prices.

While Islam encourages trade-based transactions, property financing packages in Malaysia that claim to be grounded in trade often fall short of these principles. For instance, property financing using the Ijarah or rental concept does not truly mirror a rental transaction. In an Ijarah arrangement, the Islamic financier does not hold legal ownership of the property as a landlord. The same issues arise with other types of supposed trade-based Islamic property financings, such as *Bay' Al-I'nah* or *Bay' Al-Bithamin Ajil*. In the former, the property initially belongs to the Islamic financier and is sold to a customer on an installment basis, with the customer later reselling it to the financier at a lower price. However, the property is never legally transferred to the customer, and transactions are conducted using Asset Purchase Agreements (APA), Asset Sale Agreements (ASA), and Deeds of Assignment (DOA), rather than traditional Sales & Purchase Agreements (S&P).

In reality, Islamic property financiers in Malaysia do not assume the risk of property non-completion or other risks associated with property transactions. The S&P is solely executed between the developer/vendor and the customers of Islamic financiers. Consequently, Islamic financiers generate profits without bearing any property-related risks. Moreover, these Islamic property financings in Malaysia closely resemble conventional property loans, albeit with different terminology. Despite their claims of being trade transactions, they inherently contain elements of riba' (interest) and gharar (uncertainty).

According to Islamic Shariah, even a transaction with a negligible amount of riba' or gharar, such as 1% or less, is deemed haram (prohibited). An exception is made only in cases of emergencies or "dharurah." To create a system rooted in Shariah principles, a steadfast commitment is necessary to uphold justice, aid customers, and ensure profitability for Islamic financiers.

Legal Transfer and Documentation

In adherence to Islamic principles, which only permit trade and Qardhul Khassan (benevolent loan), the most viable alternative to conventional property financing involves the sale of property from Islamic financiers to their customers. When a customer expresses interest in purchasing a property, they approach an Islamic financier with details about the property, including the developer's information, price, and location, among other factors. The Islamic financier may require a deposit (e.g., 10% of the property's selling price) from the customer, which is refundable after factoring in any applicable costs if the customer cancels the purchase. Next, the Islamic financier signs a Sales & Purchase Agreement (S&P) with the developer/vendor. The Islamic financier fully pays the selling price specified in the S&P after a mutually agreed-upon period. Upon completion of the payment, an application to change the landowner's name is submitted to the Land Office, resulting in the execution of a Memorandum of Transfer (MOT) to formally transfer ownership. Once the Land Office issues a presentation number for the ownership transfer, the Islamic financier sells the property to the customer at a higher price, payable in installments over a specified fixed period.

Similarly, an S&P is executed between the Islamic financier and the customer, with the last installment's period coinciding with the S&P's expiry period. While the purchase price is only settled after this period, the customer can opt to make an early settlement through a gift (hibah). The Asset Purchase Agreement (APA) and Asset Sale Agreement (ASA) are also signed, though the landowner's name transfer application is held until the full purchase price is paid by the customer. This application is submitted to the Land Office immediately after the customer completes the full purchase price payment. Prior to the complete settlement of the property's purchase price from the Islamic financier, the property is leased to the customer by the bank, and the terms and conditions of the lease are specified in the relevant agreements. Any payment toward interim rent will be deducted from the Selling Price.

Regarding Islamic property financing under Al-Musyarakah Mutanaqisah, the existing procedures can be retained, with the stipulation that Islamic financiers must genuinely purchase the property from the developer/vendor. As recommended earlier, all requisite legal documents must be diligently executed and submitted to the relevant authorities and the Land Office. Islamic financiers must acquire ownership of the property before entering into any partnership agreement under Al-Musyarakah Mutanaqisah and subsequently leasing it to their customers.
In the prevailing practices of most Islamic financiers in Malaysia, the public's perception is that Islamic financiers buy a property from developers and then sell it to customers at a higher price. However, the reality is that Islamic financiers do not acquire the property from the developer; instead, ownership transfer occurs from the developer to the financiers' customers. No Sales & Purchase Agreement (S&P) or transfer of ownership in the land title (via Memorandum of Transfer or MOT) occurs between the developer and the Islamic financiers. This arrangement fundamentally constitutes a loan, with the property serving as collateral for the financier, rather than a genuine property trade or sale. Consequently, Islamic financiers do not bear risks associated with purchasing from vendors or developers. Risks could arise from property non-completion (for properties under construction), damage to the property, or a sudden decline in its market value (for completed properties). The transaction as currently structured is not permissible in Shariah, as exemplified by the following Hadith or sayings and actions of the Holy Prophet Muhammad (peace be upon him):

Ibn Abbas (*Allah be pleased with them*) reported Allah's Messenger (*peace be upon him*) as saying: “He who buys food-grains should not sell it until he has taken possession of it”. Ibn Abbas (*Allah be pleased with them*) said: “I regard everything like food (so far as this principle is concerned)” (Sahih Muslim: Book 010, Number 3642). Abu Huraira (*Allah be pleased with him*) is reported to have said to Marwan: “Have you made lawful the transactions involving interest?” Thereupon Marwan said: “I have not done that”. Thereupon Abu Huraira (*Allah be pleased with him*) said: “You have made lawful the transactions with the help of documents only, whereas Allah's Messenger (*peace be upon him*) forbade the transaction of food grains until full possession is taken of them”. Marwan then addressed the people and forbade them to enter into such transactions (as are done with the help of documents). Sulaiman said: “I saw the sentinels snatching (these documents) from the people”. (Sahih Muslim: Book 010, Number 3652)

Based on the above Hadith, a transaction without complete and valid ownership transfer is prohibited by the Holy Prophet Muhammad (*peace be upon him*), even if formal documents are executed to legitimize it. Despite the approval of Shariah councils for Islamic financiers' property financing documentation based on APA and ASA, these agreements merely serve to legalize the process in Malaysia. In reality, the transaction does not entail a genuine property trade between the Islamic financiers and their customers. If a legitimate trade were to occur, ownership transfer and legal documentation should mirror those in a standard property sale and purchase transaction. However, in the existing arrangements, including *Bay' Al-I'nah, Bay' Al-Bithamin Ajil*, and *Al-Musyarakah Mutanaqisah*, both contracts under APA and ASA are executed simultaneously, and no payment is made from the Islamic financier to the customer when acquiring the property from them. It appears that the customer, who has purchased the property, has not fully settled the purchase price of the property as per the related S&P. They may have only paid a fraction, such as 10% or 20%, of the purchase price, with the remaining balance stipulated in the S&P yet to be paid to the developer or vendor. Consequently, it raises the question of how the purchaser can sell a property that does not entirely and legally belong to them. Qayyum et al. (2023) also raised concerns on the Shariah compliance of contemporary musyarakah financings that offered by banks in Pakistan as the financings are not really genuine musyarakah practices according to Shariah.

The Islamic Financial Services Act 2013 is a federal law that falls under the jurisdiction of civil courts, not Shariah courts, even though it addresses some Shariah-related issues. While it regulates and licenses Islamic banks in Malaysia, it is not exhaustive and requires continuous improvement. As such, APA and ASA serve as cosmetic adjustments to present Islamic property financing as a trade, while still resembling conventional property loans, albeit with terminology changes (e.g., "loan" to "financing," "bank" to "financier").

Repayment and Selling Price

As previously proposed, the Islamic property financing model, centered around the trade of property from Islamic financiers to customers, is grounded in the principles of buying and selling property without the inclusion of interest (riba') or excessive uncertainty (gharar). Operating under the *Bay' Al-Bithamin Ajil* concept, the Selling Price is structured for repayment through installment payments. The installment amount is computed by dividing the Selling Price by the number of future installments, as depicted in Figure 1 below. Determining the Selling Price involves the addition of a profit component to the initial Purchase Price of the property. For instance, consider a scenario where a customer approaches an Islamic financier to purchase a property valued at RM150K. Following the Islamic financier's acquisition of the property from the developer/vendor, which involves a full payment of RM150K, the property is then sold to the customer at a higher price of RM200K, payable in 120 installments. In this case, an S&P agreement is established, outlining a Purchase Price of RM150K and a Selling Price of RM200K. The installment amount is calculated at RM1,667 per month, which is derived by dividing the Selling Price of RM200K by the total number of installments (120).

Under the *Al-Musyarakah Mutanaqisah* arrangement, similar principles apply to determine the complete value of the partnership between the Islamic financier and the customer. Calculations should not involve concepts such as annuity factors, Time Value of Money (TVM), or Net Present Value (NPV), which rely on time-based considerations. For instance, if the total partnership value amounts to RM200K (as calculated for Selling Price), and the partnership ratio between the Islamic financier and the customer is 90:10, the respective partnership values would be RM180K (90% x RM200K) for the Islamic financier and RM20K (10% x RM200K) for the customer. The Islamic financier's partnership value diminishes gradually through periodic rental or leasing payments made by the customer.

This model ensures the absence of riba' elements, and both parties engage in the transaction with prior knowledge of the selling price, profit amount, partnership value, and other pertinent details. It is important to note that Islamic financiers are permitted to levy minimal overdue charges or administration fees on late payments, with the aim of covering the costs associated with reminders (e.g., phone calls, mail reminders) to ensure the profitability of Islamic banks and financiers, all while remaining in line with Islamic Shariah principles. These follow-up costs are necessary to maintain profitability without imposing any hidden charges, in accordance with Shariah.

Currently, the methods employed to calculate profit amounts for Islamic property financings in Malaysia closely resemble those used to calculate interest for conventional property loans. Typically, profit rates are determined based on concepts like Time Value of Money (TVM) and Net Present Value (NPV). Annuity factors are utilized to calculate installment amounts or rental figures. The duration of the financing influences the value of the annuity factor; the longer the tenure, the higher the factor's value. Consequently, a financing with a shorter tenure results in a lower total profit amount compared to a financing with a longer tenure. For example, a RM200K financing with a 10-year tenure and an 8% profit rate may entail monthly installments of RM2,427, leading to a total profit amount of about RM91K. Conversely, a RM200K financing with an 8% profit rate and a twenty-year tenure could feature lower monthly installments of RM1,673 and a higher total profit amount of approximately RM202K. The total profit amount on Islamic property financing depends on the financing's tenure, with longer tenures resulting in higher total profit figures. Presently, the formula used to derive the Selling Price for Islamic property financing in Malaysia involves multiplying the monthly installment amount by the financing period, expressed in months. For instance, if an Islamic property financing involves a Purchase Price of RM150K, a 5% profit rate, and 120 repayable installments, the monthly installment would amount to RM1,591. Consequently, the Selling Price would be approximately RM190,918 (RM1,591 x 120). In this existing approach, the Selling Price is determined based on the installment amount, rather than vice versa. This method still involves elements of interest (riba’), particularly riba’ al-Nasiah (due to deferred repayment), in the calculation of installment amounts and Selling Price.

Moreover, Islamic financiers in Malaysia frequently utilize the Base Financing Rate (BFR) in their property financing offerings, which are based on variable profit rates. The BFR is analogous to the Base Lending Rate (BLR) used in the global conventional banking industry. By incorporating the BFR in their property financing models, Islamic financiers indirectly introduce an element of uncertainty (gharar) to their schemes. This is due to the fluctuating nature of the BFR rate, which is subject to change based on economic and political developments, guided by the monetary policy of Bank Negara Malaysia (BNM). Although a fixed ceiling price may exist, capping the maximum Selling Price, the use of floating rates like the BFR contradicts the principles of Shariah compliance in a truly Islamic property financing model.

Redemption and Early Settlement

In the proposed financing model, as shown in Figure 1, customers who choose to sell the property, settle the financing, or refinance with another institution before the conclusion of the designated installment period (e.g., before the 120th installment) will be able to easily calculate the redemption amount themselves. If a customer decides to sell the property after making two years' worth of installment payments, the total amount paid thus far would be RM40,008 (= RM1,667 x 24 months). The redemption sum would then be calculated as the Selling Price minus the total amount paid in installments, and potentially adding any administration or processing fees. For example, if the processing fee amounts to RM350, the redemption sum would be RM160,342 (= RM200,000 – RM40,008 + RM350).

This transparent method of calculating the redemption sum eliminates any elements of uncertainty and aligns with Shariah principles. It ensures fairness and prevents the redemption sum from being significantly higher than what the customer should actually pay. The financing model, in this case, treats the customer as a tenant of the property until they fully settle the agreed-upon rental payments. A proposed Mortgage/Tenancy Term Takaful could be introduced to cover rental payments should the customer pass away or become permanently disabled. If such events occur, the remaining rental payments would be covered by the Takaful company, and ownership of the property would be transferred to the customer or their heirs in accordance with Shariah regulations. These arrangements should be clearly outlined in the S&P, APA, and ASA. The proposed Mortgage/Tenancy Term Takaful model mirrors the existing Mortgage Term Takaful, with necessary adjustments to accommodate tenancy arrangements instead of financing arrangements.

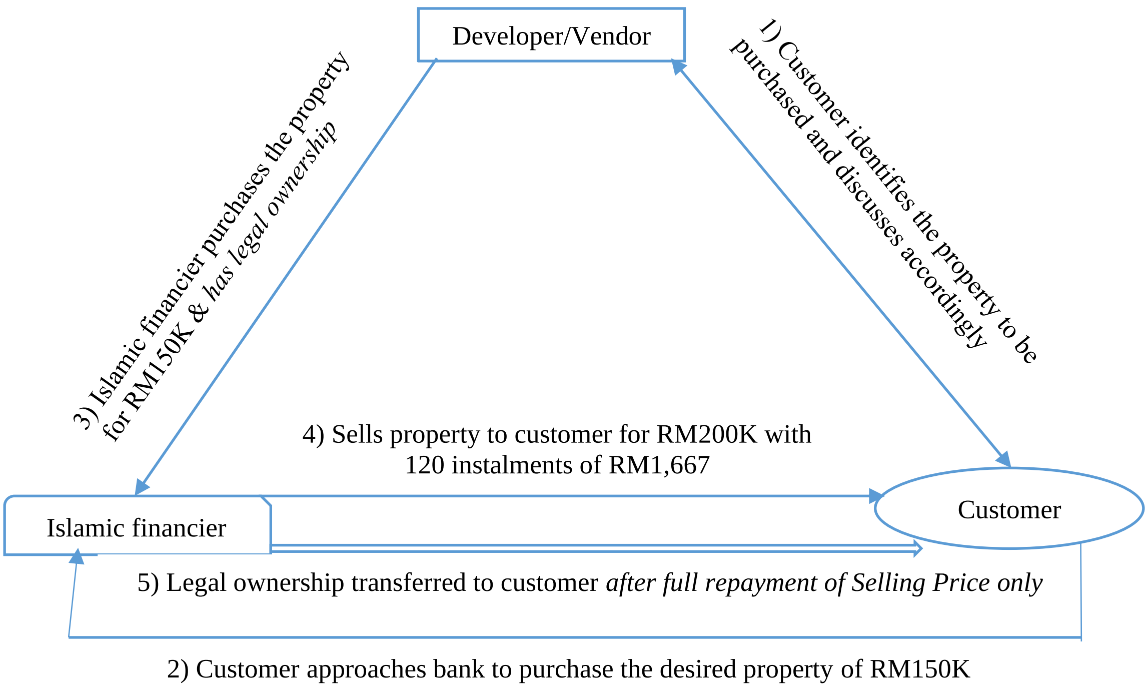

Figure 1: Proposed workflow of Sustainable Property Financing

In the event that a customer is unable to repay the installments or rentals as agreed upon, Islamic financiers possess the right to vacate possession of the property or sell it. However, a compassionate approach should be taken, with ample reminders and negotiations to assist customers rather than oppress them. If a customer communicates their inability to make full payments and requests lower installment amounts, the Islamic financier should consider such requests to ease the customer's financial burden and ensure continued repayment until full settlement. The financing's tenure may be extended accordingly, and if this affects the Selling Price (or the latest partnership value for Al-Musyarakah Mutanaqisah financings), a Supplementary Letter of Offer, revised APA, and ASA should be executed between the Islamic financier and the customer.

Existing recovery procedures, including civil and foreclosure proceedings after reminder(s) issued by the Islamic financier, namely Notice of Demand, Notice of Termination (Notice of Recall), Writ of Summons, Originating Summons, Form 16D, Form 16 G, Notice of Foreclosure just to name a few, should be sustained to ensure that customers entering into agreements with Islamic financiers fulfill their contractual obligations, such as prompt repayment. While Islam encourages leniency in trade transactions and the retrieval of money, Islamic financiers should extend leniency to customers who genuinely face unexpected delays or financial difficulties, while adhering to contractual obligations for others. Recovery actions are not meant to punish but rather to educate on the consequences of not adhering to contractual agreements.
Muslims are advised to exercise flexibility in commercial dealings and when seeking repayment, as as per the following Hadith of The Holy Prophet Muhammad (*peace be upon him*):

Narrated by Jabir bin 'Abdullah:
Allah's Apostle said, "May Allah's mercy be on him who is lenient in his buying, selling, and in demanding back his money." (Sahih Bukhari: Volume 3, Book 34, Number 290)
Nevertheless, even though Islam encourages leniency, Islamic financiers should extend their leniency primarily to customers facing genuine issues, such as unforeseen delays in property sales to buyers, late withdrawals of savings from the Employees Provident Fund to reduce or pay off their financing, or delays in receiving their salaries. However, when it comes to customers intentionally delaying their repayments, it becomes necessary to initiate all legally prescribed recovery actions. It's important to emphasize that these recovery actions are not punitive in nature but serve as educational tools, highlighting the consequences of not adhering to contractual agreements, as previously mentioned (Hassan & Yahya, 2020).

Customers will receive any remaining funds after property redemption, refinancing with another Islamic financier/bank, or property foreclosure. This comes after Islamic financiers have deducted all applicable expenses, including legal costs, reminders and related call expenses, administration fees, and payments to Land Offices. Both parties—the Islamic financier and the customer—receive their due amounts reasonably and fairly.

As per current practice in existing Islamic property financings, when a customer seeks to settle their loan early, sell the property, or refinance with another bank or Islamic financier, the Islamic financier will provide the redemption sum based on their computerized financing systems. Typically, the redemption sum is calculated as the Selling Price minus a rebate amount or Ibra'. This redemption sum tends to be higher than the actual outstanding balance of the property financing, as it incorporates a potential processing fee. Additionally, redemption sums for property financing models that utilize the Base Financing Rate (BFR) as their base profit rate can introduce uncertainty and elements of gharar. This is due to the fluctuating nature of the BFR rate, which can lead to a discrepancy between the redemption sum and the actual unpaid balance. While Islamic financiers may offer a rebate or Ibra' on the redemption sum, the use of BFR introduces uncertainty and complexity into the model.

Moreover, existing arrangements in Islamic property financing involve the discharge and re-charging of properties under financing, particularly when refinancing with other institutions. This practice mirrors conventional property loans' arrangements and may not fully align with the principles of trade transactions. This suggests that many of these arrangements do not constitute true trade transactions, as ownership of the properties remains with the borrowers or customers of Islamic financiers.

Conclusion

The urgent need for comprehensive enhancements in Malaysia's Islamic property financing system is evident, aiming to address prevailing deficiencies in social justice and sustainability aspects, which are fundamental to achieve Malaysia Madani visions. By advocating for a system that closely adheres to Shariah principles while prioritizing social justice and sustainability, this study introduces a fresh perspective to the ongoing discussion on Islamic finance. The proposed refinements, aligned closely with Shariah principles, have emerged from a rigorous approach blending variable qualitative and experimental aspects. The suggested modifications emphasize the imperative shift required in Malaysia's Islamic property financing landscape. By advocating for a system harmonizing Shariah principles with social justice and sustainability goals, this study introduces a novel perspective to the ongoing discourse on Islamic finance. The proposed framework amalgamates traditional values with modern financial practices, showing promise in reshaping Malaysia's property financing trajectory. This holds significance for diverse stakeholders, from financial institutions and policymakers to individual borrowers, as it establishes a more equitable and sustainable financing ecosystem. While this study provides a robust foundation, further research avenues beckon. Deeper exploration into the practical execution of suggested refinements, including potential challenges and viable strategies, is warranted. Additionally, the adaptability of the framework to global contexts beyond Malaysia presents intriguing prospects for comparative studies. Subsequent research could delve into evaluating the long-term impact of implementing these enhancements and gauging their efficacy.

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