Islamic home finance in the social mirror

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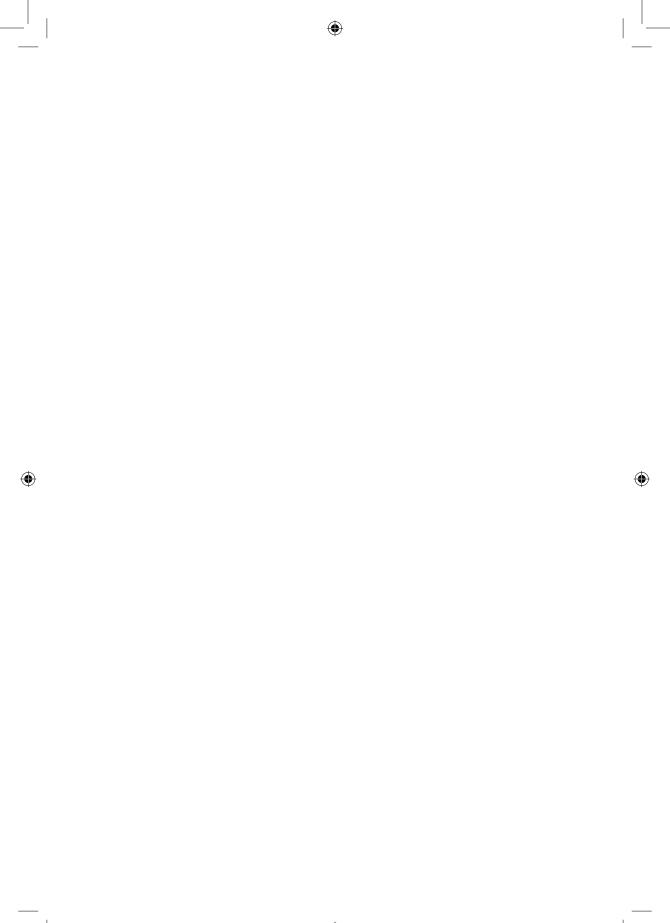INCEIF: The Global University in Islamic Finance

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ISLAMIC HOME FINANCE IN THE SOCIAL MIRROR

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Abstract

Shelter is one of the basic needs for human beings. Its availability for the people is an Islamic imperative. In view of the appalling living conditions of a substantial proportion of the population in most countries around the world, especially Muslim, Islamic banks have entered the field with various schemes for home financing. In this infant industry, this effort is understandably guided by the profit motive, but a social dimension has to surface in the course of time. Unfortunately, the models banks currently use for home financing remain under the juridical gaze, more so as the practice is not always found to be transparent. This paper looks at Islamic home financing models in a broader societal context. It evaluates the efficacy of the current financing structures practised and suggests a new approach. The proposed model is shown as superior to the existing ones. It meets the norms of equity, fair play and openness and does not, presumably, violate any other Islamic norm. Finally, the paper makes some policy suggestions to integrate Islamic home financing into the broader social goals of an Islamic economy.

Keywords: Housing problem, basic needs, resource allocation, rural-urban migration, conventional model, BBA in housing, the MMP model, diminishing balances, planning.

I. INTRODUCTION

Among the basic necessities of civilised living, shelter ranks only next to food and clothing.[1] Housing affects health, culture and civility of people. Poor and inadequate housing breeds crime, creates unrest, lowers productivity and slows down growth. Yet a multitude of the world's population has no roof worth the name over their heads. The problem of housing insufficiency has assumed alarming proportions across the world. It is not so acute in the developed countries as in the developing ones but persists everywhere. The UN House Settlement Program (UN-HABITAT) estimated that 600 million urban and 1 billion rural residents in developing countries live in overcrowded homes with poor water quality, lack of sanitation and safe food preparation or storage (Brown, 2003). Population growth unceasingly tends to frustrate solutions.

The shortage of homes is especially scary in and around the metropolitan centres; their expansion rarely knows any limits.[2] The Zabbālīn and the City of the Dead are both well-known squatter colonies in Cairo. Kibera in Nairobi and the post-apartheid Inner City of Johannesburg have long been problematic squatter centers. In India the population of Mumbai was estimated at 13.8 million on March 22, 2011, and nearly 6 million of them are squatters living in horrible conditions (India Online, 2011). The Indian movie *Slum dog millionaire* partly won its Oscars for highlighting the seamy side of the commercial capital of the country. Given this sort of background, is it not ironical that the housing market collapse in the US should have been the initiator of the worst ever economic crisis, one that continues to afflict the world today?

In Islam, the fulfillment of their basic needs, including housing, is the individual's own responsibility but to make up deficiencies is a

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1   Ibn Hazm, the celebrated Islamic jurist, regarded food, clothing and shelter as the basic human needs in that order (Hasan 1986). Abraham Maslow's hierarchy of needs which is much referred to in modern times is on an entirely different plane - psychological. At the bottom of his hierarchy pyramid appear only breathing, food, water, sex, sleep, homeostasis and excretion. Shelter is nowhere mentioned (Simons et al 1987).

2   "Cities in developing countries are growing at extraordinary rates, often compressing into decades the urbanizations process that has taken centuries in developed countries". Malpezzi and Mayo (July 1987, p.3).

state obligation (Hasan, 1997). The governments in Muslim countries are, therefore, under faith compulsion to promote the construction of affordable residential houses for people in need. The home financing schemes of banks–Islamic or conventional–have to be somehow made commensurate with societal requirements. This effort may include the promotion of cooperatives, group housing schemes and even private contributions. Tax concessions, subsidised land allocation and its long term leasing can be a few strategic elements for consideration. The efforts of Islamic financial institutions in redeeming societal deficiency can possibly be seen as a sort of *farḍ kifāyah.* Home financing schemes in Muslim countries lack the thrust and linkage to reflect this awareness. It would be fatal to view banks as just 'for-profit businesses'.[3] Private business can in no way be de-linked from social business, all the more in an Islamic order.

In evaluating the current modes of finance that Islamic banks generally use to provide credit for housing, one can hardly ignore the overall scenario. But we resist this digressive temptation for the moment and proceed to evaluate the more popular models for home financing in the following Section 2. Here, the discussion focuses essentially on operational aspects as explained in the literature on the subject. Since the present financing practices are steeped in confusion and controversy, we shall present for the readers' consideration a new model in Section 3 and show its efficacy for Islamic home financing relative to other models. In Section 4 we revert to the bigger picture alluded to above. We make a few policy suggestions in that context. Finally, Section 5 contains some concluding remarks.

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3   Iqbal and Salman (2007, p.14) say that "Islamic banks as any other private business in an Islamic system are for profit organizations". The authors are not alone. Many scholars, especially with Western orientation, tend to promote this as gospel in their writings on Islamic finance.

II. SOME POPULAR MODELS

A. Bayʿ bi-thaman ājil (BBA) variants

The BBA contract in practice has two variants. In Malaysia, it has an embedded buy-back (ʿīnah) provision. The customer books the house with a developer with some earnest money, committing to pay the balance within an agreed period, and the ownership is transferred to him. During this period, he sells the house to a financing bank at cost price with a simultaneous contract to buy it back from the bank at the cost plus a mark-up he agrees to. The house is pledged with the bank as collateral. The amount becomes a debt payable to the bank as per an agreed installment payments scheme. The BBA model has found much favour with the banks in Malaysia for safety reasons (Rosly 2010, p. 536.). In Bahrain murābaḥah replaces ʿīnah.

In either case, the banks face little risk in this structure. In case of default, they are amply covered by the pledge, and the down payment may be forfeited. In contrast, the customers are entirely on the receiving end. In the case of installment delays, there is a penalty clause that can be invoked, even though under the regulations the amount must go to a charity fund each bank has to establish for the purpose. The main source of difficulty is the treatment of the whole buy-back amount as debt.[4] Banks insist that whatever be the point of time of default the remaining debt has to be cleared in full.[5] More disquieting than default is the situation when the debt is all cleared before maturity but the banks still do not waive the profit component for the remaining period. The waiver, they argue, would

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4　A court judgment in 2007 took note that the sale element in the BBA was not a bona fide sale and brought into question the profit portion of the facility. Later, a Bank Negara circular advised banks to review the use of BBA.

5　"Due to arbitraging activities, the BBA has converged to the conventional mode where the computational formulas are similar to the conventional and where the profit rate tracks the market interest rate. Instead of charging the customer interest, financiers charge a profit rate that is dependent on the market interest rate". (Meera & Razak 2009, p.4. See also p.6). In this context the authors also reject the plea of Usmani & Yaqubi (1998) for bench marking the profit rate on LIBOR (P.8). To me, their reasoning is tenable. Factors determining rates of interest and their variations are certainly different from those that should influence profit margins in Islamic finance.

deprive them of the profit they would have otherwise booked from the transaction. Such situations turn out worse than may arise under interest financing where the banks do not charge interest on the balance for the remaining period.[6] Rules on rebates in such cases are underway in Malaysia,[7] and the banks already seem to be moving away towards a new structure taking the form of a joint venture. It is now the much-lauded *mushārakah mutanāqiṣah* partnership *(*MMP) or the Diminishing Partnership Model. Its modus operandi was first illustrated by Tlemsani, Issam and Mathews, Robin (2003).

B. Conventional Model vs. the MMP Model

It may be helpful to use illustrations for making the features and workings of the conventional model and the new Islamic model (MMP) clearer for comparison. Suppose a person wants to purchase a house worth RM 100,000. He pays RM 20,000 as earnest money to the seller to grant him three months' time to pay the remaining amount. During the intervening period he evaluates the terms for borrowing the amount from a conventional bank (the CB) compared to an Islamic bank (the IB) operating on a *mushārakah mutanāqiṣah* partnership (MMP) principle. He plans to clear the debt in 10 years, paying 20 six-monthly installments. The conventional bank charges 8% interest per annum plus a loan redemption factor of 6.71%. The loan redemption factor can be found for a given interest rate and payment period from the readily available table of present value (PV).

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6   If the interest rate charged was lower on the loan for the entire period that on loans for the shorter period when full payment is made, conventional banks sometimes claim the amount lost due to that difference.

7   The juristic basis of granting such discounts is the Islamic concept of *ibrā'*. In the context of finance it refers to granting waiver by the creditor of his debt to some person partially or in full to provide relief in case of default. For details see the research note of Marjan (2010).

Table 1: Details of loan repayment to the conventional bank

S. No.	Full financing				80% financing			
	Installment	Interest	Principal	Balance	Installment	Interest	Principal	Balance
1	7355	4000.0	3355	96643.0	5884	3200	2684	77316
2	7355	3865.8	3489.2	93155.8	5884	3093	2791	74525
3	7355	3726.2	3628.8	89527	5884	2981	2903	71622
4	7355	3581.1	3773.9	85753.1	5884	2865	3019	68603
5	7355	3430.1	3924.9	81828.2	5884	2744	3140	65463
6	7355	3273.2	4081.8	77746.4	5884	2619	3265	62198
7	7355	3109.9	4245.1	73501.2	5884	2488	3396	58802
8	7355	2940.0	4415	69086.2	5884	2352	3532	55270
9	7355	2763.4	4591.6	64494.4	5884	2211	3673	51597
10	7355	2579.8	4775.2	59719.2	5884	2064	3820	47777
11	7355	2388.8	4966.2	54753	5884	1911	3973	43804
12	7355	2190.1	5164.9	49588.1	5884	1752	4132	39672
13	7355	1983.5	5371.5	44216.6	5884	1587	4297	35375
14	7355	1768.7	5586.3	38630.3	5884	1415	4469	30906
15	7355	1545.2	5809.8	32820.5	5884	1236	4648	26258
16	7355	1312.8	6042.2	26778.3	5884	1050	4834	21424
17	7355	1071.1	6263.9	20494.4	5884	857	5027	16397
18	7355	819.8	6535.2	13959.2	5884	656	5228	11168
19	7355	558.4	6796.6	7162.6	5884	447	5437	5730
20	7355	286.5	7068.5	20	5884	229	5655	75
Total	**147100**	**47194.4**	**99885.6**		**117680**	**37757**	**79923**	

Source: Author's own

The installment amount is calculated on cost at the interest + redemption rate. In our case, it would be RM 100,000 (.08 + 0.0671) = RM 14,710 a year. The amount will be half of that amount, i.e. RM 7,355, for a six-monthly payment. Table 1 provides the operational details. It also contains the workings for a less than 100% financing case to remove a possible doubt that different financing amounts could result in different effective rates of returns so as to vitiate the comparisons this paper rests on. Table 1 shows that this is not true: the rate will remain unchanged even when financing is, say, 80%.

It comes about that in the total payment made to the bank (RM 147,120 including residual amount = 20) the interest component is 147,120 – 100,000 = RM 47,120 in 10 years. Thus, the effective rate charged is 4.72% per annum. This is experience, not fiction. Members of the various cooperative group-housing societies in Delhi obtained loans under such a plan (author joining in 1980) from the

Housing Development Finance Corporation (HDFC) of India Ltd., now a leading private sector bank of the country. Interest rates varied according to amount borrowed and the time dimension involved.

The customer later approaches an IB to finance the house purchase,[8] other details remaining unchanged. The bank offers to provide the remaining RM 80,000 to the seller. Thus, the bank would acquire an 80% share in the ownership of the house. The remaining 20% will be the share of the client. The rental for the house is proposed to be fixed at 8% a year. The bank must receive RM 80,000 + its share of rent in six-monthly installments over the next 10 years.

The client would surrender his share in the rental to the bank until the bank's share in the house is completely liquidated. As this part of the rental will not be enough to redeem the amount, a redemption factor of 6.71% would be added to the 8% rental, giving an overall six-monthly charge of 14.71 / 2 = 7. 355%. Note that the annual rate – rent plus redemption – is to be halved for half-yearly payments. This would fix the installment at 80,000 x 0.07355 = RM 5,884. The client is satisfied and opts for the contract. Since the entire rental goes to the bank, the redemption component in the installment will be 5,884 – 4,000 (rent) = RM 1,884. The entry in column C of Table 2 can be viewed as the price of one unit of the bank's ownership that the customer is obliged to buy, so to say, each six months. Note that the installment has two components: a rental and a redemption element, determined so that the ownership of the house will completely pass on to the customer by the stipulated date.[9]

It is clear from the above illustration that there is little difference in the operational mechanism of the conventional model and the much-lauded Islamic MMP in the literature. In both cases, the payable amount diminishes as identical installments are paid and both have the advantage of regular cash inflows for the bank which enhances the turnover of resources, improves liquidity and mitigates risk in some measure. But we shall see that there is more in the MMP model that goes against the client despite the apparent departure from the conventional interest-based finance model. He may discover that

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8   Islamic banks in the models they use cannot provide 100% finance because they co-own the property and have to share the rental with the client. Conventional banks can as they lend on interest.

9   The procedure of its calculation has been derived from the same formula as indicated in n. 5 above.

the conventional bank's terms are more specific and straightforward. In the MMP model the rental will always be a bone of contention between the customer and the bank due to conflict of interests.[10] Evidentially, an upward revision of the rental would not always or easily be acceptable to the bank in a volatile property market as it would only be notional. Notice that here the bank gets the return on its investment via the rent accruals to the client. Full financing is not possible. There are other difficulties too with the model.

Table 2: Working of a Mushārakah Mutanāqiṣah Partnership (MMP) Model

Installment Number	Components of a six-monthly installment			Customer's Ratio	Rental Division		Customer's Equity RM	Bank's Equity RM
	Rent RM	Redemption RM	Total Payment		Customer	Bank		
	A	B	$C = A + B$	D	E	F	G	H
0				0.2000			20000.0	80000.0
1	4000	1884	5884	0.20000	800	3200	22684.0	77316.0
2	4000	1884	5884	0.22684	907	3093	25475.4	74524.6
3	4000	1884	5884	0.25475	1019	2981	28370.4	71629.6
4	4000	1884	5884	0.28370	1135	2865	31389.2	68610.8
5	4000	1884	5884	0.31389	1255	2744	34528.8	65471.2
6	4000	1884	5884	0.34528	1381	2619	37793.9	62206.1
7	4000	1884	5884	0.37794	1512	2488	41189.7	58810.3
8	4000	1884	5884	0.41190	1648	2352	44721.3	55278.7
9	4000	1884	5884	0.44721	1780	2211	48386.1	51613.9
10	4000	1884	5884	0.48386	1935	2065	52205.5	47794.5
11	4000	1884	5884	0.52205	2086	1912	56175.7	43624.3
12	4000	1884	5884	0.56176	2247	1753	60306.7	39693.3
13	4000	1884	5884	0.60301	2412	1588	64602.7	35397.3
14	4000	1884	5884	0.64602	2584.1	1416	69070.8	30929.2
15	4000	1884	5884	0.69071	2763	1237	73717.6	26282.4
16	4000	1884	5884	0.73718	2949	1051	78565..3	21449.7
17	4000	1884	5884	0.78565	3143	857	83591.9	16408.1
18	4000	1884	5884	0.83592	3344	656	88819.6	11180.4
19	4000	1884	5884	0.88820	3553	447	94256.4	5743.6
20	4000	1884	5884	0.94256	3770	230	99910.6	89.4
Total	**80000**	**37680**	**117680**		**42243**	**37757**		

Source: Author's own

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10   The data on area-specific rental published by town halls is too general and time intervals are usually substantial. It is not at all suitable for application in individual cases. Market rates seldom match them. Each house in a locality or building is a separate case for negotiation. Things like level, location, open areas and parking cause rental differences even in the same building complex.

In one of his recent articles on *mushārakah* and *muḍārabah* as modes of financing, Taqi Usmani (2010) a leading jurist devotes a section to a broad discussion of MMP (pp.70-76). He discusses the different shapes the contract has taken in various sorts of transactions, housing being mentioned as the dominant one. Here, he recounts (p.73) the three main steps involved:

(i) Creation of a joint ownership in property, which all schools of *fiqh* expressly allow;

(ii) The financier leases his share in the house to the client on rent. On this too there is no difference of opinion among the classical jurists unless it is leased out to a third party; and finally,

(iii) The client purchases different units of the undivided share of the financier; again there are no differences among the jurists on the validity of *ijārah* **if** the lease is granted to the co-owner.

Even if individually each one of the three steps listed above is permissible, it can be a moot point if they can be combined into a single arrangement. The position of Usmani can briefly be stated as follows:

1. The three transactions cannot be the linked conditions for an enforceable contract. The Islamic legal system does not allow one transaction to be a precondition for the other.

2. The promise of the client to buy the share units of the financier is one-sided without any quid-pro-quo.

3. A promise to do something creates in general only a moral obligation, which cannot be enforced through courts of law, albeit there *are* juridical differences on the point. For example, the Ḥanafī position is that promises can be enforced in cases of need on the principle of *bayʿ al-wafāʾ*.

Another difficulty is that the house buyer must take out an insurance (*takāful*) policy for the building with a clause covering the risk also of the bank – the co-owner. How the share of the bank in the premium will be adjusted to the installment payments is not clear. (See also Harding 2010, p.3).

These are valid reservations. The proposed model as we explain it below takes care of most such concerns.

III. DIMINISHING BALANCE MODEL (DBM)

The inspiration, rather the urge, to develop this model came from two sources: firstly, the proliferating econometric studies on Islamic finance have often claimed that Islamic banks are more efficient on cost-profit criteria than their conventional counterparts. Secondly, there is a judicial opinion on record in Malaysia that Islamic banks fleece their clients at times more than the interest-charging institutions. The two views are contradictory and prompt investigation. Hence, the introduction of a new approach which we think is tenable in the first instance on the principle of: What we cannot prove as un-Islamic is Islamic, although we shall indicate the juridical basis for the model.

Table 3: Working of the Diminishing Balance Model

Installments	Return of capital	Diminishing balance	4% Mark-up on C	Installment Payments
A	B	C	D	E = B + D
0	0	80000		
1	4000	76000	3200	7200
2	4000	72000	3040	7040
3	4000	68000	2880	6880
4	4000	64000	2720	6720
5	4000	60000	2560	6560
6	4000	56000	2400	6400
7	4000	52000	2240	6240
8	4000	48000	2080	6080
9	4000	44000	1920	5920
10	4000	40000	1760	5760
11	4000	36000	1600	5600
12	4000	32000	1440	5440
13	4000	28000	1280	5280
14	4000	24000	1120	5120
15	4000	20000	960	4960
16	4000	16000	800	4800
17	4000	12000	640	4640
18	4000	8000	480	4480
19	4000	4000	320	4320
20	4000	0	160	4160
Total	**80,000**		**33,600**	**113,600**

Source: Author's own

Let us continue with our example to explain the new model. The bank proposes to the client as follows: you have already paid RM 20,000 to the seller as earnest money. The remaining RM 80,000 the bank

shall pay for acquiring a *constructive* ownership in the house. For getting back the amount in six-monthly installments over a period of 10 years, we shall put a yearly mark-up of 8% for our share in the cost of the house. However, the mark-up amount will be reduced proportionately to the return of our money. That would help reduce your liability to the bank. The registration of the house in the court will be in your name, but you will have to sign simultaneously a mortgage deed pledging the property with the bank as security until installments as per Table 3 have all been cleared in full. Table 3 provides the calculation for your six-monthly installments. The terms offered are simple. In case the payments were spread over a long period of say 25-30 years, payments may tend to align with the lifecycle hypothesis of personal incomes.

The following linear function is derived to facilitate the calculation of installments for the Table and highlight the features of the Diminishing Balance Model for home financing.

$$I_n = A \left[1 - \beta (n-1)\right] M$$

Where,

I_n = nth installment amount
A = Financier's investment
β = The ratio of investment component in installments to A
n = The time points relevant to the study
M = Mark-up ratio used.

In our illustration for calculating I, we have used A = 80,000; β = 0.05 i.e. 4,000 / 80,000; n = 0, 1, 2, 3 ......20 and M = .04 for six-monthly payments. If we want to know, for example, the amount of the I_n installment where say n = 7, we may find it out by using n -1 = 6 as below:

$I_{n=7}$ = 80,000 [1- (0.05) (7– 1)] 0.04 = RM 2240, the same as in Table 3.

Even though the model does not seem to attract any adverse comment from the juristic point of view, one may legitimately ask for the spelling out of positive support from the Sharīʿah sources to be on firmer ground. The model uses the concept of what is known as *constructive ownership* in legal parlance and combines on that basis the features of *murābaḥah* and *rahn*, which are faultless. The

legislative recognition of constructive ownership may not be quite clear. If so, Islamic banking laws can be suitably amended to remove uncertainties and mitigate risks.[11]

A. Comparison

In the three models explained above we have used the same explanatory example so that we can compare at some stage their features under certain criteria. Table 4 now helps us make such comparison: we kept the rate of return on the money the financier offered to provide the client for purchasing the house at 8% in each case. The final result on the basis of effective profit rate the client has to pay is in favour of the Diminishing Balance Model.[12] The conventional interest-based model and the MMP interestingly give identical results. Why should then the latter attract public attention?

Table 4: Comparison of competitive home financing models

Name of Model	% of finance provided	Nature of installments	Residuals RM	Profit of the financier
Conventional	100%	Uniform	20.0	4.72%
Conventional	80%	Uniform	75.0	4.72%
Diminishing partnership	80%	Uniform	89.4	4.72%
Diminishing balances	80%	Diminishing	00.0	4.20%

Source: Author's own

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11 Constructive ownership refers to implied or virtual ownership of something tangible for the benefit of another person. For example in many countries a broker may have an effective ownership of company shares owned by an ordinary investor because the broker alone can buy and sell shares on the stock market that the investor directly cannot. Likewise civil laws allow spouses to be in constructive ownership of each others' property or of their children. Islamic jurisprudence too allows such ownerships. Orphans, persons weak of understanding and children are specifically mentioned. The principle is much in use in the management of *awqāf*.

12 The effective rates have been calculated as follows: The conventional bank gets RM 47,142.8 as interest for 10 years on an advance of RM 100,000. Thus, 47,142.8 / 10 = 4,714.28 is the yearly interest. Divided by 100,000, it gives 4.72% as the effective rate. Through the same process one can get 4.72% as the effective interest rate in the 80% conventional finance case. In the MMP model the bank gets from installments RM 5,880 x 20 = 117,600 plus RM 89.4 the residual, i.e. RM 117689.4 This amount minus RM 80,000 = 37,689.4 is the net revenue of the bank for 10 years i.e. RM 37,689 a year. This divided by 80,000 equals 4.72% return a year. Finally, the mark-up totals as RM 33,600 over 10 years. Thus, the rate for the year will be 3,360 / 80,000 = 4.2% a year.

A comparison of what happens in each case if the contract is breached after, say, the 10th installment has been paid may be no less interesting. This we can check from Tables 1, 2, and 3 from row number 11 of each. In the case of interest-based conventional finance, the liability of the client will be the unpaid loan amount of RM 54,753 plus interest until the amount is cleared. In the MMP model, the client has to pay RM 43,624 plus the rental share of the bank at the rate of RM 1,911.8 every six months as long as the default continues. He has to pay the remaining RM 36,000 only in the Diminishing Balance Model, the mark-up no longer having any relevance. Here too, the Diminishing Balance Model scores over the other models from the viewpoint of the customer. Being cheaper, it will have a competitive edge over the conventional interest finance model and will bring in more business, diverting customers, especially non-Muslims, to its fold.

It follows from the foregoing analysis that the seeking of finance from an IB operating on DBM is more advantageous for the client, both from the viewpoint of cost and in the case of default or premature clearance of liability, compared to both CB and the MMP. The latter is complicated for the client to understand and also raises juristic issues as explained earlier. Under these circumstances, the Diminishing Balance Model based on a *murābaḥah-rahn* mix looks preferable.[13] It is simple to understand, involves neither buy-backs nor ties transactions together. The case we have presented here is just illustrative of the principle and its modus operandi. Refinements are possible and welcome. The non-delivery of Islamic finance in housing, as elsewhere, takes us back to the bigger picture.

IV. SOCIAL MIRROR: SOME SUGGESTIONS

A candid view is that Islamic finance is at present playing no significant role in home financing although one comes across much 'noise' in the literature. Even a cursory glance through the Global

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13   Bankers may be apprehensive about cost recovery with reduction in the effective rate of return. But conventional banks too get a lower effective interest return and not only recover costs but make handsome profits. Islamic banks may gain more due to increased business vis-à-vis their conventional counterparts.

Islamic Finance Forum (GIFF) 2010 compilation report of country-specific information on Islamic finance would testify to the validity of this observation. Take for example the position of Malaysia and Bahrain, currently the two leading Islamic finance hubs. The direction of finance chart for Malaysia in the GIFF (p. 165) shows that the share of construction in total finance is just 5.7%. Out of this paltry sum, not even half is spent on real estate. The situation in Bahrain looks better. Of the total funds the share of construction is 29% of which 5.7% goes to real estate (GIFF, 2010). But expenditure on real estate in either case is certainly not entirely on residential housing.

The situation is no different in Indonesia, Pakistan, Bangladesh or Egypt–the most populous countries in the Muslim world (Hasan 1997). Everywhere the state effort seems to have been casual, patchy and inadequate. Thus, any reference to Islamic banks for this current state of affairs would be misplaced; it is the failure of public policy to address the problem and channel finance, including from the banks, into the housing sector. It is to this wider issue that we now briefly turn.

The difficulty with the Muslim countries is that they have not yet been able to free themselves fully of the Western thought process, value system and cultural ethos that they perforce acquired during colonial rule. They did talk of Islamic finance and wanted to move in that direction but could not go far on the road for reasons not always of their own making. Islamic economics and finance took off well but now charter the unchosen course. Islamic institutions cannot find roots and deliver in a set-up dominated by alien ways and ends. Islamic finance could not show up during the long colonial occupation of their lands. After independence too, Islamic institutions could not loosen the strangulation. The concern for housing because of Islamic insistence on the fulfillment of basic needs does not form the core of planning in Muslim countries. The rivers of finance flow down to fertile lands; they do not climb up into the ivory towers of idealism. Some suggestions for improving the contribution of Islamic finance in the housing sector we offered in the introduction; a few more may be added here.

1. Assign a high priority to poverty reduction in national plans, a good part of the allocation going to the promotion of low cost housing (Amott, 2008).

2. Establish National Housing Foundations with regional offices; provide seed money and encourage people to register and make deposits to own a home in the future. Let media play a role in creating consciousness. People should know and feel that something is really being done for providing a roof over their heads.

3. Issue housing *ṣukūk* to mobilise funds, open even to international subscriptions.

4. Persuade and, if need be, instruct banks to support the national priorities. They may find it beneficial to combine in bigger units to meet the challenges (Nannana, 2010).

5. Granting property rights to slum dwellers and squatters over the structures where they have been living for decades may help. That would provide them with confidence, political clout and the means to raise funds through, say, mortgaging.

6. Muslim countries can establish an apex body for integrating various country programmes and support research in designing and construction of cheap yet comfortable homes.

We believe that if steps were taken in the indicated direction, Islamic banks will be encouraged and enabled to play a more proactive role in facilitating the private and public effort to enhance living accommodation in urban and rural areas alike. This will contribute much in keeping the masses pacified and improve political stability in Muslim countries currently in turmoil. Notice that in the package Saudi Arabia recently announced to that end, construction of millions of houses is a major element. In Malaysia also, the 10th plan for economic development highlights fresh steps for accelerating housing construction (New Straits Times, B.S. p.7, February14, 2011).

V. CONCLUDING REMARKS

An atmosphere conducive for Islamic finance created by public action cannot be taken advantage of unless banks employ for home financing a model that is easy to understand, transparent and cheaper, compared to the conventional interest-based instruments. The Diminishing

Balance Model (DBM) of our construct has already been proved as cheap and simple. Let us explain where it additionally scores over the MMP model.

To reiterate, in the MMP we create a co-ownership of the house involving the bank and the client through its joint purchase by them. Next, the bank leases its share in the house to the client at a pre-agreed rental. Finally, the client has to purchase periodically the units of the bank's share in the house. The jurists uphold each of these steps as valid separately but express reservations to their being combined in a single arrangement. In fact, the combination brings in interest from the back door. For evidence, compare the interest column in Table 1 of the 80% finance section with the rent column F of Table 2 showing the working of the MMP model. The difficulties MMP may face in addition to what we have mentioned in Section 2B are indeed no less serious, given the social environment of the Muslim countries. In case of a review of the rentals and the price of the bank-share-units, the bank is likely to have the upper hand, to the disadvantage of the ill-informed and need-pressed client.

In contrast, the DBM contract is simple and straightforward; it short circuits the complexity of multiple contracts. Resting as it does on the concept of constructive ownership, the model avoids the registration of the house twice and seeks no favour in the matter over conventional financing. Civil law recognises the principle explicitly. Even Islamic contracts imply it. Most agency-based Islamic contracts contain elements of constructive ownership. Again, an investor cannot buy or sell shares on the stock market except through a broker because there is an implicit recognition of constructive ownership of the client on his part. Finally, in the case of pure *muḍārabah*, the entrepreneur has only the constructive ownership of assets he uses in business. For, if the contract terminates prematurely, all assets with the entrepreneur should be surrendered to the financier. Why? One can say because the entrepreneur was merely an agent. But another can say with equal validity that the reason lies in the financier having the real ownership of the goods, the entrepreneur only constructive. It is advisable to grant formal recognition to what is implicit through appropriate amendment of the Islamic law of contracts.

The crucial point of departure in the DBM from the MMP is that the bank does not seek in the former the co-ownership of the house and then redeem it through a buy-back contract forced on the client.

It grants the ownership of the house to the client immediately while securing itself against default through a mortgage cover. This model sees the banker off the scene through a gradual reduction of the mark-up amount (not the rate) to zero. This also makes DBM a cheaper model: compare column F of Table 2 with column D of Table 3. We believe that the DBM is going to be the future mode of Islamic home financing.

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