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## **Catering to the Muslim Market Shariah-compliant financing opens the door to new clients**

Until recently, about one in 50 Canadians was unable to consider taking out a mortgage on a new home or borrowing money to buy a car: not because of low income or credit problems, but because of their religious beliefs. Under Shariah (Islamic religious law), it is forbidden to charge or pay interest, a tenet based on interpretation of a handful of passages in the Koran like Chapter 2, verse 275, which says, in part "Allah has permitted trade but forbidden usury."

At the time of the prophet Mohammed, it was common practice for unscrupulous moneylenders to charge high interest to merchants and traders whose business could depend on the exchange of goods over long distances. If trade ship or caravan was robbed or otherwise prevented from reaching its destination, the lender was often entitled to take the defaulting debtor into slavery.

Thus, for the past 1,400 years or so, most practicing Muslims around the world have made other arrangements to finance large purchases. In some cases, religious scholars have compromised and ruled that a mortgage could be permissible when there was no viable alternative. But most Muslim borrowers would prefer to use Halal Shariah-compliant financing, if it is available.

### **A Trade Partnership**

"If you offer both, and if all costs and features are the same, they'll take the compliant one," says Omar Kalair, Chief Executive Officer with UM Financial Inc., a pioneer of Shariah-compliant financing in Canada. Traditionally, he explains, "Instead of a loan mechanism, you would have a trade partnership mechanism."

One model is the Mudarabah contract, an investment partnership in which the terms of profit sharing are precisely laid out, and under which the investor usually absorbs any losses. Another model is called Musharakah; this is an arrangement in which losses are shared in proportion to investment. UM Financial currently manages a Musharakah real estate portfolio of nearly \$200 million, and has secured a \$150 million Mudarabah facility from the Credit Union Central of Ontario (CUCO), as well as a \$12 million facility from a Gulf-based bank to structure commercial property financing in Canada.

According to Statistics Canada, the number of Canadians identifying themselves as Muslim in the Census more than doubled between 1991 and 2001 (from 253,300 to 579,600) and "these individuals represented 2% of the total population in 2001."

In Toronto, the Muslim population numbered 254,110 or 5.5% of the overall population in 2001, a jump of 139.8% since 1991. The figures for Vancouver were 52,590 (2.7%), showing a gain of 125.4%. It is likely that the next Census will show another population jump, especially in cities like Toronto. In fact, Statistics Canada estimates that Canada's Muslim population could reach 1.2 million within 10 years.

Internationally, Muslims represent about one quarter of the world's population, and financial institutions in other parts of the world have already begun to accommodate the needs of their Muslim clientele. It is generally estimated that there are about 300 Islamic financial institutions around the world, with more than \$300 billion US in assets and \$400 million in investments. Among non-Islamic countries, the U.K. is a leader in this area. "Not only do domestic U.K. banks offer a range of Islam-compliant products, but London is also the home to a multi-billion-dollar market in Shariah-compliant bonds, known as the Sukuk market," reported Duncan Mavin in the Financial Post (May 22, 2007).

In North America, U.S. financial institutions are ahead of Canada in recognizing and responding to the needs of Muslim clientele. "The United States is far advanced. We actually took two models from the U.S. and started showing them around here about four years ago. HSBC came out with products for home financing that were Shariah-compliant in the U.S. back in 2001 [the product is no longer being offered]. Guidance Financial came out with one, and they just broke \$1 billion in financing since its inception," says Kalair, one of few Canadians working in this potentially important market.

### **Diverse Clientele**

"Usury is prohibited in all three Abrahamic religions," Kalair points out (referring to Judaism, Christianity and Islam). In fact, although it is designed with the Muslim client in mind, there is nothing exclusive about Shariah-compliant financing; clients of any faith could use the arrangement. Even within the Muslim community, the clientele is extremely diverse. Kalair's current client base includes people whose family origins lie in Pakistan, India, Afghanistan, Somalia, the Middle East, Bosnia, Malaysia and Turkey.

UM Financial launched its first mortgage product in 2005, and the company is now operating out of Toronto with a total of eight Ontario offices. "Right now they're only in Ontario, but we have a plan to open up five more across Canada," says Kalair.

Although UM initially worked with the Mudarabah style of contract, they now principally use the Musharakah model, which is essentially a rent-to-buy arrangement. "The funds are released by us, and there's a silent investor and a managing investor. Before we take this money, we agree on a ratio to share the profits. For example, right now with the credit union [CUCO], 97% of the investment we collect in homes is given back to the credit union, and we keep 3% for our management work with them," Kalair explains. "The main thing is that this arrangement is an equity investment, and any profits are shared on an agreed ratio."

So far, UM Financial Inc. is the main Canadian source for Halal financing. There are also small partnerships like the Islamic Co-operative Housing Corporation Ltd., "but it's only available to a small niche market ready to pay the extra fees," says Kalair. "Our goal is to bring about 5,000 households onto our product in the next one to two years. We have close to 500 now."

### **Obstacle Course**

There are obstacles to introducing Shariah-compliant financing products. First of all, in order to be considered Halal, the terms of the arrangement must be examined and approved by an official Shariah board. Since there are relatively few Shariah scholars worldwide, there can be delays in the approval process. Also, there is ongoing debate in the Islamic world as to the legality of various types of systems, so not all scholars will agree on the acceptability of any given product.

Apart from the religious restrictions, Canada also imposes regulatory limits on this type of

financial arrangement. Normally, says Kalair, "Banks and credit unions aren't allowed to enter into equity partnerships on a house. In the U.K., HSBC product is mainly lease-to-own, where the bank actually holds the house on their books," but this is not currently a valid arrangement under Canadian regulations. However, "there's nothing preventing them from giving financing directly to our company, and we can make the investment into the properties. We're just a corporation that does equity partnerships in homes and collects rent on that, and that's the company's profits."

And the incentives are high, since Muslim clients are typically willing to pay a little more for a Halal product. "Right now, our product is about 60 basis points higher than conventional, but over the long term we want everything to be at par," says Kalair, who points out that U.S. companies like Devon Bank in Chicago and University Bank in Detroit are now offering Halal financing "at the same costs as other kinds of mortgages."

Canadians may have been slow on the uptake, but demographics suggest that wise companies will soon be moving into the field of Muslim financing. In late May of 2007, some 200 delegates met in Toronto at Islamic Finance World 2007, one of the first gatherings of its type in North America. The conference was organized by Terrapinn, Singapore with Anchor Finance Group USA as one of the key sponsors. At the time of the event, iTrust Partners Inc. announced the launch of a \$400 million Shariah-compliant income fund for Middle Eastern and European investors with an interest in Canadian assets. "BMO is the prime brokerage and CIBC is providing administrative services," reported Tavia Grant (The Globe and Mail Business, May 25, 2007). Bank of Nova Scotia and Toronto-Dominion Bank indicated that they were also considering the market.

Meanwhile, says Kalair, "We are actually in discussion to mimic the same sort of contract that we have set up with the credit union with three of the top 10 banks. And we plan to have our product on the mortgage brokerage system with one of these banks before the end of this year."

Kalair's official announcement may well end up being the tipping point for a general move towards offering more Halal financing products in Canada. In any case, it's clear that for Canada, this is an idea that's already overdue.