How to Finance Awqaf Development – I

Waqf is a unique mechanism with distinct rules of the game. It involves assignment of assets to address a social need on a sustained basis. Therefore, the assets under Waqf must be in a state so as to provide a continuous flow of benefits. However, all physical assets have a finite life in a technical as well as economic sense. Land and buildings appear to be the only exception to this general rule and therefore, account for a large proportion of assets that were historically donated under Waqf. While land and building either do not depreciate in value or depreciate at a fairly low rate, the benefits flowing from them depend on how they are put to use. It is the responsibility of the Waqf management not only to maintain the assets, so that they are in continuous state of providing benefits, but also to maximize such benefits. The latter is possible through development of the assets, which requires additional investment of resources. Needless to say, that the need, importance, scope and potential for investment is greater in case of investment awqaf as compared to direct awqaf. It is greater in case of philanthropic awqaf as compared to religious and family awqaf. It is greater in case of general purpose awqaf as compared to awqaf that are constrained by the will of the donors. It is also greater in case of cash or monetary awqaf as compared to real awqaf involving physical assets where the manager must ensure that the corpus of the awqaf is not only maintained and is not depleted, but also grows with sound investment decisions that maximize returns at acceptable levels of risk.

Investment requires financing or raising funds. Traditional scholars did not visualize the possibility of raising funds through financial markets. Yet they offered some solutions through which investment activity may be undertaken for development of a Waqf. This is the subject matter of the present module. The module also includes some innovative variations suggested by contemporary jurists. As we shall see later the involvement of financial institutions and markets will facilitate awqaf development with much greater efficiency.

At the outset, it will be useful to reaffirm a fundamental general rule. Shariah considers Waqf as sacred and does not allow for sale of the Waqf property. Therefore, financing modes for awqaf development cannot admit the possibility of a sale of whole or part of the Waqf asset. Exception to this general rule exists however. In a situation where the income from the asset is too low even to meet the expenses required to keep the Waqf property functional and there lies no other alternative to enhance its income, then the asset may be sold and replaced with a more beneficial and profitable property. However, this will require the consent of the donor, if present, and compliance of legal procedures for approval by courts.

Funds may be raised for awqaf development in two distinct ways:
NOT-FOR-PROFIT FINANCE:

This may involve raising new Waqf resources/assets that may be added to the existing asset to make it more beneficial. Common examples may adding a new Waqf of a piece of land or building to an existing land or building to substantially improve its potential to provide the intended benefit. A simpler and more flexible option is to raise new cash Waqf and develop a pool of Waqf assets with both real and monetary assets. The combination has much greater potential to provide the intended benefits.

The Waqf management may also take recourse to simple borrowing, e.g. a qard hasan loan that may be invested in the Waqf asset to substantially enhance its earnings potential. The qard may be repaid from the additional earnings generated.

Cash Waqf Deposits and Certificates

Cash Waqf instruments are an ideal mechanism of raising new Waqf resources. These instruments in the form of deposits and certificates may be offered by Islamic banks and insurance companies. The nature of these deposits is different from that of return-seeking deposits offered by Islamic banks. The depositor-waqif in case Waqf deposits makes a non-refundable deposit with the bank under a clear understanding that the returns on the deposits will be used in designated ways for the benefit of identified beneficiaries.

FOR-PROFIT FINANCE:

Jurists are less comfortable with mingling for-profits funds with Waqf resources as this may possibly lead to claims of ownership in Waqf assets. Since ownership in Waqf assets is non-transferable, an acceptable mode must be free from this feature. Innovative solutions however, ensure that return-seeking private capital may be raised without involving transfer of ownership.

The basic principle which determines the selection criterion of the most appropriate mode to finance the development of Waqf properties is its ability to strike a balance between two competing claims: (a) that of the financier who would naturally like to secure a proprietary right in the developed property to serve as a collateral for the amount invested, and (b) that of the Waqf manager (mutawalli) who is duty-bound to ensure that no proprietary interest may be acquired by anyone on long term basis in the Waqf ownership, which vests in Allah. Thus, it poses a challenge to strike a balance between these two competing interests. If we fail to satisfy the lender/financier, he will refuse to provide the funding; if we fail to safeguard the

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interest of Waqf, it would not be legally correct. Thus, any financing technique which is Shariah compliant and also possesses the ability to strike a balance between the conflicting interests of the lender/financier and the borrower Waqf institution shall become the appropriate financing technique.

Some solutions offered by classical jurists are highlighted below.

**Indefinite-Lease (Al-Hukr)**

A hukr involves an indefinite lease of the Waqf asset against payment of a large rental upfront that is almost equal to the market value of the asset, and periodic (annual) rentals that is quite insignificant. Hukr provides the lessee for an indefinite period a right to use the asset in any manner he deems fit. This right may be sold and transferred to a third party and may even be bequeathed to one’s heirs.

In hukr the Waqf management transfers and cedes all rights of utilizing the assets in future for a price. Large part of this price is paid upfront and the periodic rentals constitute an insignificant part. A simple arithmetic exercise may help calculate this ratio of present to future price. Assume a perpetual rental stream of X per percent of the market value of the asset. Its present value, assuming that similar property rented normally gives an annual return of say K percent is \(\frac{X}{K}\). If the market value of the asset is \(P\), then the price to be paid upfront is equal to \(P - \frac{X}{K}\). The ratio of present to future price will be equal to \(\frac{P - X}{X/K}\). For instance, if \(X\) is half percent and \(K\) is 10 percent, then the present value of future rentals is equal to 5 percent of the market value of the Waqf property. A fair deal for a hukr contract on a Waqf land which is worth, say 1000 dinars should provide the Waqf administration a down payment of 950 dinars, plus a perpetual annual "drip" rental of 5 dinars.

Essentially the hukr contract has similar outcome as that of a sale. This enables the concerned parties to get around the Shariah restriction on sale of Waqf asset. As in a sale, the Waqf management in hukr loses the asset for all practical purpose. However, there are several factors that distinguish hukr from a sale. Should the owner of hukr rights die with no heirs, the land reverts freely to Waqf management. It is not rare for the Waqf management to reclaim hukr lands through this process. Further, the significance of the nominal rental is not its amount, but rather the fact that it serves as perpetual legal reminder that the land is a Waqf property. The source of discomfort for hukr among jurists however remains. Consequently, some jurists have opted for an extended hukr with a finite maturity (say fifty years) rather than the perpetual hukr. The extended hukr would be in operation over the maturity period, after which the asset automatically reverts back to Waqf management.

An important consideration in assessing the advisability of resorting to hukr contract in any particular instance is to ask: what is the Waqf management going to do with the large down payment that will be received? Shariah and economic considerations both call for investing the down payment to generate future income, either by improving another Waqf asset, or by
acquiring new asset. What is not desirable is to use the same to defray current expenses. This would be tantamount to liquidating a significant proportion of existing awqaf, without a compensating future income flow.

Hukr was in use in countries which were under the Ottomans, like Egypt, Iraq, Syria, etc. However, due to its pronounced negative effect on awqāf, hukr was disallowed by the laws enacted during the 1950s and 1960s in Egypt, Syria, Iraq, Jordan, Libya, etc.²

**Dual-Lease (Ijaratain)**

A dual lease, similar to the indefinite lease (hukr), requires the lessee to make large payment upfront that is almost equal to the value of the Waqf asset followed by very small and nominal annual rentals. Unlike the indefinite lease, however, in the dual lease the initial large payment is invested by the Waqf management to enhance the value of the asset (e.g. repair a highly debilitated building), which the lessee is then free to use as long as it pays the nominal annual rent. The renovated high-value asset is now the rightful property of Waqf (whereas in the indefinite lease the Waqf does not invest in the asset, but the lessee does so, and owns what it invests). However, the Waqf ownership in the dual lease is of little significance because it can generate nothing but the nominal annual rent. The lessee has a perpetual right to rent or sell the right to a third party.

The dual lease method owes its genesis to a catastrophic fire that severely damaged many awqaf buildings in Istanbul in year 1020H. The annual rentals of the damaged buildings could not suffice for their repair, and the city looked shabby. The dual lease method was then devised, on lines not far from the indefinite lease contract, to repair the awqaf properties and restore the city's looks.

If we are to compare the two contracts: hukr and ijaratain, the former seems the better for awqaf. This is so because the initial large payment in hukr may be used by the Waqf management in any manner it deems fit. The funds may be invested in improving another Waqf, or acquiring a new one. In contrast, the initial payment in al-ijaratain is confined specifically for repairing the same Waqf, which may not be the best investment.

**Mursad Loan**

This is a loan to the Waqf management by a lender to develop a Waqf asset. After the legal approval is obtained, the asset is given on lease to the lender for a period deemed long enough to assure the lender of the definite possibility of the repayment of the loan. It is argued that such a long lease may be unavoidable as it alone may prompt a lender to advance a substantial amount of money as loan. By holding the asset as lessee, the lender also has in

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possession valuable collateral. Once the loan is repaid, the lease comes to an end. The lease period usually turns out to be quite long.

The mursad as in case of hukr is transferable to a third party through sale and can be bequeathed. Historically, mursad was widely used in Syria during the 18th and 19th centuries, but was slowly phased out. Generally scholars frowned on the extraordinary long lease period, which may not be in the best interest of the Waqf. In a long lease, neither the lessee takes proper care of the property nor does the Waqf. The Waqf property suffers due to this dual apathy. Hence, mursad loan should be avoided as far as possible, as it tends to favours the lender more at the expense of the Waqf institution.

Zarka (1994) in a seminal paper suggested a number of possibilities for financing the development of awqaf. These are presented below.

a. Assume a Waqf Trustee who is administering a Waqf land which is a suitable building site. He may call for bids by contractors to build, say an office block on the site, and to sell it to the Waqf on fixed installments. The offices would be let, and the contractor paid from the rental income. This formula is an Istisna' contract for a building, on a deferred price basis. To be sustainable, prudence dictates that the expected rental income is more than the deferred price installments, by a safe margin, to allow for possible vacancies and fluctuation in rents.

b. One variation on the above formula is for the Waqf to give part of the land it owns, as down payment (or even full payment) to the contractor. This, in fact, is an exchange (barter) of a piece of land for a building. Fuqaha permit in principle such an exchange, subject to the approval of a shari'ah court. What they emphatically disapprove of is an exchange of real Waqf property for a movable asset, which (as stated earlier) is more prone to misappropriation or embezzlement.

c. A third formula is for the Waqf to permit construction of a building on its land, for a share in the rental income of the building. Ownership of the land remains with the Waqf, and that of the building with the other party.

d. A variation on (c) above which, perhaps does not raise much juristic reservation is for the Waqf permission (to the builder) to take the form of a long term lease of the building site. The rental of the site goes to the Waqf, and that of the building goes to its owner.

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We now discuss how to finance the development of awqaf with the involvement of financial institutions and markets. A financial institution as an intermediary - a dedicated awqaf bank or any Islamic bank - may raise funds in the form of cash Waqf deposits and other return-seeking deposits and invest the same in the development of awqaf assets. While return-seeking deposits will be similar in nature to those of any standard Islamic bank, the nature of cash Waqf deposits will have certain unique characteristics reflecting the Shariah rules of Waqf. The financial institution may now channelize these deposits into the financing of awqaf development through a variety of modes, such as, istisna, ijara and diminishing musharakah all of which are for-profit modes. Composite modes, such as, build-operate-transfer and its variants may also be used. The returns generated on the invested funds may now lead to a growing cash Waqf corpus or may be used for servicing the return-seeking deposits. Financing of awqaf development may also involve a process of securitization in financial markets. While we deal with the simpler structures in this module, the more complex ones, e.g. BOT along with securitization is discussed in the next module.

Istisna-Ijara

An istisna is a contract of manufacture widely used in construction industry. A builder (seller) under an istisna agreement with the Waqf management (buyer) undertakes to develop a facility with clear specifications for an agreed price and deliver after an agreed period of time. The unique feature of istisna is that nothing is exchanged on spot or at the time of contracting. It is a pure and perhaps the only forward contract where the obligations of both parties relate to the future. The Waqf management (buyer) makes payment of price in parts over the agreed time period or in full at the end of the time period. In an istisna, the seller and the actual builder may be different entities. This allows financiers or intermediaries like Islamic banks to engage in istisna by assigning the job of development, or construction to a third party under a parallel istisna arrangement. Istisna thus, is now transformed into a financing product. The simplified structure of istisna is presented in Exhibit below. The difference between the price received from the Waqf management and the price paid to the builder constitutes profit for the Islamic bank.

Istisna involves various construction-related risks and risk of non-conformity to specifications. In order to mitigate such risks (save for cases of force majeure) the agreement may contain a penalty clause. Another alternative for the bank is to nominate the Waqf management as an agent to oversee satisfactory completion of the job. If considered necessary, the bank may hire the services of an independent surveyor to monitor the progress of the project.
Activity: Waqf-Manager asks Bank to develop or construct an asset X with clear specifications;
1. Bank asks Builder to develop or construct asset X with same specifications
2. Builder develops or constructs or manufactures asset X, receives progress payments from Bank as per agreed terms during different stages of manufacturing;
3. Builder gives delivery of asset to Bank;
4. Bank gives delivery of asset to Waqf-Manager;
5. Waqf-Manager pays in full or in parts over agreed period of time

Exhibit Istisna Financing Structure

Parallel Istisna may be very useful in undertaking development of Waqf property. Here, the Waqf institution is not a loser in any way, because the bank bears the responsibility for the quality of work, and compliance with the specifications initially agreed upon.

The developed property in turn is given on lease or ijara to the bank or a third party that generated periodic lease rentals. The Waqf management pays the istisna debt from out of the lease rentals. Therefore, adequate care must be taken to ensure that the Istisna payments (cash outflows for the Waqf management) are pegged below the lease rentals (cash inflows for the Waqf management).

Diminishing Musharakah - Ijara

A declining musharakah (mushārakah mutanāqisah) is a recent innovation that may be used for development of awqaf assets. Its popularity originates from the fact that classical musharakah aims to involve the financier as a permanent partner in the venture. This may not be a desirable idea for a financial intermediary. A financial intermediary likes liquidity in its investments or at least a finite maturity of its investments. Nor is it a desirable idea for the Waqf management who are constrained not to transfer the ownership of the Waqf assets to a
private party. In a declining *musharakah*, the bank’s share in the equity is diminished each year through partial return of capital. The bank receives periodic profits based on its reduced equity share that remains invested during the period. The share of the client in the capital steadily increases over time, ultimately resulting in complete ownership of the developed assets.

This special type of partnership between the *Waqf* institution seeking funds for development and the institution providing funds for development of the assets may be made more attractive by adding *ijara* to the structure. The developed asset is given on *ijara* and the *ijara* rentals constitute a steady and predictable income for the partners. It is agreed that the bank’s share would be bought back by the *Waqf* institution over a specified agreed upon period of time, thus extinguishing the ownership of the bank in the *Waqf* asset. The *Waqf* institution will make periodic payments from out of its share in the rental income that will enable the bank to get back its investment and a reasonable profit. The entire cash flow stream could be predicted with reasonable degree of certainty.

Diminishing musharakah or *mushārakah mutanāqisah* is now being widely used by Islamic banks, including IDB, to finance the development of *Waqf* properties. The best attribute possessed by this is the progressive reduction of bank’s equity interest in the developed *Waqf* property. The full ownership of the property slowly passes on from the bank to the *Waqf*, without causing any loss to either party. It is literally a win-win situation for both the parties. This is presented in the following Exhibit. An interesting variation of this is documented by Zarqa (1994) in Mauritania and the Sudan, where the *Waqf* pays back (to) the builder only his cost. The builder’s profit takes the form of permission to use freely part of the structure he built on the *Waqf* land.\(^5\)

It is important to highlight some fiqhi issues here. A major issue with declining *musharakah* is related to the forward nature of some activities that are part of the mechanism. While a financier would prefer a forward “commitment” and certainty about the price at which it could offload its share of investment, this may not be permissible in the framework of Islamic finance. The common view is that *Shariah* does not permit forward purchase or sale involving commitment from both parties, but allows a unilateral promise. As such, the client may make unilateral promise(s) to purchase or redeem the bank’s share on specific dates in future. Or, the bank may make unilateral promise(s) to sell its share on specific dates in future. Such promise(s) will be binding on the promisor.

Another related issue is the pricing or valuation of such shares. In this matter, the general view is that the redemption should be undertaken at the prevailing market price of the property. While the promise to redeem the shares at “known” or predetermined prices is more convenient, it is more controversial too. If prices are predetermined, this may involve a “certain” return for the financier or open the doors of *riba*. The counter view is that a promise to buy in future already involves uncertainty. A promise to buy at an unknown (market) price

involves still greater levels of uncertainty. Hence, a predetermined price such as cost price may be desirable.

Activity 1. Bank forms a partnership with the Waqf Manager based on musharaka with Waqf Manager providing the Waqf asset (land) and Bank providing funds for development of property; Bank may appoint itself as agent-manager of the partnership; subsequent activities are undertaken in this capacity;

2. Bank on behalf of the Musharaka develops the property;

3. Property is given on lease; generates rental income over future time periods;

4. Bank apportions the rentals among both parties, one portion flows back to bank as its share in rental income;

5. Another portion – the share of the Waqf Manager in rental income is used to redeem part of Bank’s stake in partnership; Bank transfers ownership of asset to Waqf Manager when its stake is reduced to zero.
Standard texts of *Fiqh* mention about inadmissibility of “two contracts in one” on grounds of excessive *gharar*. This essentially stresses the need to avoid unduly complex contractual mechanisms and structures involving multiple interdependent and interrelated contracts. Combining several contracts, such as, adding sale contract(s) or promises to the original *musharaka* contract may cause such complexity. However, in a structure where the sale or option (promise) is in the nature of a separate or side agreement, not linked to the *musharaka* agreement, there is no room for *gharar* caused by interdependence.