

A Re-Examination of *Musharakah* Bonds and *Waqf* Development: The Case of Singapore

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Abstract: This research re-examines the structured financing involving two *waqf* real estate development projects in Singapore and the issuance of *musharakah* bonds in 2001 and 2002. This study seeks to address how and why the financing was structured. Moreover, the research had no influence over the behavioural events surrounding these transactions and that the projects are both contemporary in nature. The methodology involves case study research, including documentary and content analysis of selected materials. In terms of analytical generalization and external validity, we adopt the framework of the Islamic normative theory of profit. The study finds that despite the noble intention of the Islamic Religious Council of Singapore (MUIS) to issue *musharakah* bonds in developing the *waqf* properties in assessing substance over form, they do not satisfy the conditions relating to a valid contract and lawful income. Accordingly, we recommend an alternative mechanism for the future development of *waqf* projects, structured on the basis of a real estate investment trust.

Keywords: *musharakah* bonds, *waqf*, Islamic theory of profit, Islamic finance

Abstrak: Penyelidikan ini mengkaji semula pembiayaan berstruktur yang melibatkan dua projek pembangunan hartanah wakaf di Singapura dan penerbitan bon *musharakah* pada tahun 2001 dan 2002. Kajian ini bertujuan untuk menangani bagaimana dan mengapa pembiayaan itu distruktur. Selain itu, kajian ini tidak mempunyai pengaruh atas peristiwa-peristiwa tingkah

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laku sekitar urus niaga ini dan projek-projek ini adalah bersifat kontemporari. Metodologi kajian melibatkan penyelidikan kajian kes, termasuk dokumentari dan analisis kandungan bahan dipilih. Dari segi generalisasi analisis dan kesahihan luaran, kita menerima pakai rangka kerja teori normatif keuntungan dalam Islam. Kajian ini mendapati bahawa walaupun hasrat murni Majlis Ugama Islam Singapura (MUIS) untuk menerbitkan bon musharakah dalam membangunkan hartanah wakaf, dalam menilai isu bahan atau bentuk, mereka tidak memenuhi syarat-syarat yang berhubungan dengan kontrak yang sah dan pendapatan yang sah. Oleh itu, kami mencadangkan satu mekanisma alternatif untuk pembangunan projek wakaf di masa hadapan, distruktur atas dasar amanah pelaburan hartanah.

Kata Kunci: bon musharakah, waqf, teori keuntungan dalam Islam, kewangan Islam

1. Introduction

This case study research is essentially concerned with the validity surrounding the structured financing of two projects involving *waqf* development in Singapore in 2001 and 2002. The research seeks to, therefore, define and understand assumptions relating to the projects and the underlying Islamic contracts of *musharakah* and *ijarah*. Ultimately, it is concerned as to whether the financing meets the criteria of a lawful contract and whether it satisfies the risk, liability and reward in relation to the normative theory of profit in Islam. As far as possible, the study includes a review of modern and classical opinions with references to classical *fiqh* and modern scholarship, the *Majallah* and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), in order to attain a broad opinion relating to a valid contract and income from an Islamic perspective. The study evaluates the primary materials relating to the financial information memorandum issued by the Islamic Religious Council of Singapore or *Majlis Ugama Islam Singapura* (MUIS) in Oct. 2002, various MUIS annual reports (in particular, 2001 and 2002) and secondary material from real estate consultants (hired by MUIS), Debenham Tie Leung (DTZ), contained in Rating Agency of Malaysia (RAM) reports of 2003 and 2004.

In terms of the broader background, *waqf* (pl. *awqaf*), or *habs* (pl. *ahbas*) means to “stop”, “prevent”, or “restrain” by detaining or preserving, in the form of *sadaqah* (charity), the usufruct of property, for the purpose the property is dedicated, in the way of Allah (*fi sabil*

Allah). Thus, a *waqf* involves a pious endowment of assets, irrevocably dedicated by its founder (*waqif*) to be administered (by a *mutawalli*) in perpetuity, in order to provide for the *waqf* beneficiaries. Accordingly, ownership is transferred from a private individual to Allah (s.w.t.). Economically, a *waqf* diverts funds (and other resources) from consumption and invests them in productive assets that provide usufruct or revenues for future consumption by individual(s) as beneficiaries. Historically, under the Ottomans, the *waqf* was a fundamental institution for the development of the economy under the *dar al-Islam* (Islamic caliphate). In Singapore by 1968 only six *awqaf* were registered with MUIS, but with contemporary development of the *waqf* projects, there were 99 *awqaf* registered with MUIS with more than 187 properties with an estimated value of about SGD 473 million (Abdul Karim, Nov. 2010, p.80). The first known *waqf* was the Omar Mosque of Kampung Melaka, endowed by Syed Omar Aljunied in 1820, an Indonesian trader whose origins was from Yemen (Ibrahim, 1965, p.54).

Most of these *waqf* properties had been bequeathed by Indian and Arab traders and were managed by appointed trustees, mostly family members of the *waqf* founders (*waqif*). Most of the *waqf* properties remained in their original states, with little maintenance and upkeep. As a result, the properties degenerated to substandard conditions and could not command competitive rental revenue. In Singapore, the Muslim community's affairs are under the purview of MUIS, which is a statutory body under the Ministry of Community Development and Sports. Sections 58-64 and 73 of the Administration of Muslim Law Act (AMLA) regulate the administration of *awqaf* in Singapore. In 1999, MUIS proposed an amendment to AMLA, through which all *waqf* properties would be vested to and centrally managed by MUIS. Whilst this may have contradicted the original *waqfiyah* (*waqf* deed) in terms of family *waqf* managers (*mutawallis*) designated by the founder (*waqif*), nonetheless this milestone paved the way for a more efficient control and development of the *waqf* properties in Singapore, hence starting the rejuvenation process.

The organization of this study involves the introduction and background to *waqf* rejuvenation and development in Singapore in this first section. In relation to the structure of the financing facility, section two presents a review of literature concerning the applicable Islamic contracts involving the *musharakah* partnership, the *al-ijarah*

rental contract, and also the Islamic normative theory of profit. Section three presents our methodology in relation to case study research and documentary analysis. Section four presents our findings and discussion of the structured financing, whilst section five provides some concluding remarks and recommendations.

2. Literature Review

In this section, it is important to clearly understand the concepts of *musharakah* and *ijarah* in the Islamic law of transactions (*fiqh mu'amalat*) if we are to evaluate the validity of the structure of *Musharakah* Bond financing. Accordingly, we have included a mix of contemporary and classical sources to ensure that the research includes a broad opinion. We have also included in this section a summary of the Islamic normative theory of lawful profit in order to present a framework to test the validity of the MUIS structured financing.

2.1. Defining *Musharakah*

Al-Musharakah refers to a general partnership (*al-Sharikah*) in a specific business with a profit motive, whereby the distribution of profits will be apportioned according to an agreed ratio. In the event of losses, both parties will share the losses on the basis of their equity participation. AAOIFI defines the contractual partnership (*shariqat al-'aqd*) as “an agreement between two or more parties to combine their assets, labour or utilities for the purpose of making profits” (AAOIFI, 2004, p.200). With respect to the *mazhab*, the schools differ in classification of the contractual partnership (*shariqat al-'aqd*) and in implication of terms used (Nyazee, 2002, p.39). The Hanbali jurist, Ibn Qudamah, in *al-Mughni* classified five types of contractual partnership (Nyazee, 2002, p.39-41): *al-'inan*, *al-mufawada*, *al-abdan* (or *a'mal*), *al-wujuh* as well as *al-mudharabah* (trustee partnership). Shafi'i jurists theoretically considered *sharikat* (Ibn Naqib, 1994, pp.417-419) to consist of only the co-operative partnership (*inan*), and along with Maliki jurists deemed *mudharabah* an independent contract. The Hanafi school was, and is, more widely adopted in commerce, perhaps given Imam Hanafi's (r.a.) own trading background, but it also has a structure of legal analysis and a developed system of law facilitating comparison to classical and modern opinion relating to the law of partnerships (Nyazee, 2002, p.45).

Reflecting the Hanafi opinion, the *Majallah* defines the types of partnerships (*Sharikat*) in terms of *sharikat al-mulk* or *sharikat al-'aqd* (*Majallah*, no.1045). *Sharikat al-mulk* is a non-contractual co-ownership partnership (voluntary, *al-ikhtiyar*; or, involuntary, *al-jabr*) involving the undivided ownership of an asset (*musha'*) with each partner's share governed by the rules of *wadi'ah* (deposit) in which a co-owner cannot sell his joint-share without the permission of the other (*Majallah*, no.1088). *Sharikah al-'aqd* is a contractual partnership (*Majallah*, no.1332), which according to the Hanafis, had two categories. The first category of *sharikat al-'aqd* is classified by three types of participation and by two types of legal format (Nyazee, 2002, p.43) including *sharikat* (partnerships) in *al-mal* (wealth), *al-a'mal* (work) or *al-wujuh* (credit-worthiness) by way of *mufawadah* (full) or *inan* (ordinary). The second category involves *qirad* or *mudharabah* (trustee partnership), *muzara'a* (share-cropping) and *musaqat* (cultivation) which are deemed by the Hanafis as forms of *mudharabah*. The *musharakah* agreement, as reflected in the information memorandum issued by MUIS (18 Oct. 2002, p.12), at first glance reflects *sharikat al-mal* by way of *inan*, including the profit-sharing ratio reflecting the Shafi'i *mazhab* opinion. In this regard, the *ex-ante* determination of profit and loss sharing for *musharakah* involves factor pricing of capital and entrepreneurship that is based on justice. The income distribution for *musharakah* is equitable, since each partner receives a share in the profit on the basis of the partner's contribution to the production process.

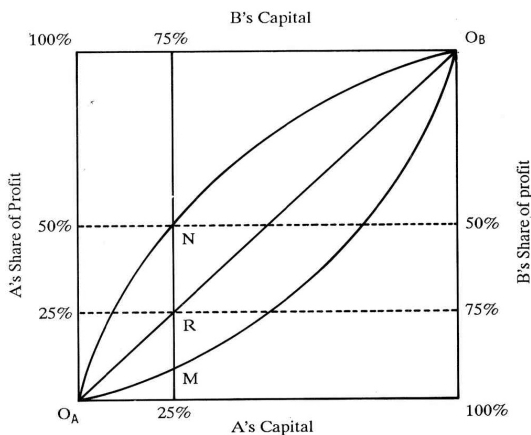


Figure 1. Ex-Ante Determination of Profit-Shares in Musharakah

Source: Sadeq (1990, p.56)

In Figure 1, the upper and lower horizontal axes represent capital provided by two partners A and B, whilst the left and right axes depict their respective profit-shares. The *mazhab* differ on the ratio of profit in relation to capital contributed (Ibn Qudamah, 1946, 5, p.140; Usmani, 2012, p.24). In the case of the Shafi'i or Maliki *mazhab*, the partners should share profits according to their respective contribution of capital, given by the curve O_A-R-O_B , assuming A contributes 25% of the capital and thus A receives 25% of the profit. In the case of the Hanafi or Hanbali *mazhab*, the partners may vary their profit share reflecting entrepreneurial ability, either by O_A-N-O_B , or by O_A-M-O_B . The distribution of any losses is based on the share of capital contributed, since the share of entrepreneurial services will go unrewarded, and thus O_A-R-O_B would apply. On closer inspection of the *musharakah* agreement, in terms of profit distribution, it technically conforms to the opinion of Ibn Taymiyya (1983-1989), who stated that, "profit is an increment (*nama'*) gained from the use of one man's labour (*badan*) and another man's capital (*mal*). So it should be divided among them as any increment resulting from these two factors" (Ibn Taymiyya, 1983-1989, 30, p.87). However, we learn from Ibn Qudamah that, "it is not permissible to guarantee for any partner a pre-specified number of *dirhams*. If one partner's profit amount is specified in *dirhams*, or if a specified increment over his profit-share is pre-specified, the partnership is thus invalidated" (Ibn Qudamah, 1946, 5, p.140; Usmani, 2012, p.23). In this case, the *musharakah* agreement deserves closer analysis in our findings, since the Bond Investors have pre-specified the amount of their return.

2.2. Defining Ijarah

AAOIFI has summarized the legitimacy of *ijarah* (AAOIFI, 2004, p.151) as derived from the *Qur'an*, "said one of them 'Oh my father, engage him on wages" (*Al-Qur'an*, 28:26) and "if you had wished, surely you could have taken wages for it" (*Al-Qur'an*, 18:77); and also from the *Hadith*, "whoever hired a worker must inform him of his wages" (Ibn Majah) and "give a worker his wages before his sweat has dried" (Ibn Majah). AAOIFI states that, "the subject of a lease is its usufruct and not the asset itself" (AAOIFI, 2004, p.153); and so, *ijarah* involves the rental of a finished item. The *Majallah* defines *ijarah* as "hire to be paid for a thing, i.e. the price for the benefit, and *ijar* is to give for hire and *istijarah* is to take on hire" (*Majallah*, no.404). Interestingly, the *Majallah*

also defines it more closely as “the sale (*bai*) of a known benefit in return for its known equivalent” (*Majallah*, no.405). Hence, the price of the usage must have an equivalent counter-value (*iwad*). In this context, the *Majallah* viewed *ijarah* in terms of an operational and not a financial lease, with the lessor accepting market risk, liability, including ownership and maintenance.

AAOIFI does not permit an asset which has been leased by the lessor to the lessee to be leased back to the lessor, wherein the rent or the period varies, as this would lead to *‘inah* (AAOIFI, 2004, p.140). In the case of *ijarah* followed by a subsequent sale or transfer of the asset for a nominal sum (*ijarah muntahia bittamleek* or *ijarah wa iqtina*) (AAOIFI, 2004, pp.146-147), AAOIFI argues that this avoids *‘inah* since sufficient time during the lease period has been observed which alters the physical and thus economic characteristics of the asset (AAOIFI, 2004, p.154). Although, if the asset has been written down to zero, the lessor’s cost of insurance built into the rental, and ordinary maintenance paid directly by the lessee (AAOIFI, 2004, pp.142-143), one might ask where is the depreciation and market risk to the financier? And in the case of termination, if the lessee defaults in punctual payments, foreclosure and recovery of rentals from the security (AAOIFI, 2004, pp.144-145) is no different to the risks associated with secured lending.

However, whilst *awqaf* historically extended financing to the community on the basis of *mudharabah*, risk aversion became apparent in Ottoman *awqaf* in similar ways as modern Islamic Financial Institutions (IFIs), which also currently engage in risk-free transactions (Abdullah, 2016). For example, Cizakca (1995) investigated 1,563 *awqaf* in the city of Bursa from 1667-1805 and discovered they were engaged in *istiqlal* transactions, combining pawning and rental, which typically achieved rates of return of 10% (Cizakca, 1998, p.58). In an *istiqlal* transaction, the borrower supposedly sold real estate, which could be redeemed after a year, during which time the lender leased the asset back to the borrower (who continued to use it) and the rental payment was often typically 10% of the sale amount. Thus, it was essentially a simple interest bearing loan with real estate as security. Nonetheless, traditional methods of financing *awqaf* during the Ottoman period involved long terms leases based on the *ijarah* contract. The *hikr* (meaning “exclusivity”) and *ijaratayn* (“dual lease”) were long-

term leases designed to develop or reconstruct *waqf* properties (Abdul Karim, Nov. 2010, pp.41-42).

Indeed, Abdul Karim (Mar. 2010, pp.150-151) stipulated that *hikr* had been historically applied for refurbishing *waqf* in Singapore. It is also functionally equivalent to a 99-year lease used by the Housing Development Board (HDB) of Singapore for transacting the sale and purchase of HDB apartments, with the difference that the HDB does not permit estate distribution according to the rules of Islamic inheritance (*fara'id*). Sadique (2010, pp.81-82) explained that the *hikr* (otherwise referred to as *ihitkar* or *istikar*) involved a large advanced rental payment followed by nominal rental payments over the period of a long-term lease. Any development was performed by the lessee, such that, any structure erected by the lessee, with the permission of the *mutawalli* and with the right of using the property, belonged to the lessee. It could be sold by him to a third party and was inheritable (Sadique, 2010, pp.81-82). The advance rental would reflect the value of the property or the cost of required refurbishment and would be prorated over the lease period by discounting the periodical rentals, which also could be adjusted to take into account the market value. Sadique also mentioned that the *ijaratayn* was similar in nature to the *hikr*, and emerged when large-scale fires resulted in the destruction of a number of *waqf* structures in Istanbul. The difference was that *ijaratayn* long-term lease involved two parts: the first was an advance rental that was sufficient to restore the damaged property, which was performed by the *waqf*. The second gave the right of the lessee to occupy the restored property under a long-term lease, involving a nominal periodic rental. The lease could be transferred to another and was inheritable (Sadique, 2010, pp.82-83). Essentially, in the case of both the *hikr* and *ijaratayn*, the lessee achieved the right of long-term occupation that could be transferred and bequeathed, which deprived the *waqf* of exploiting the land through any better opportunities that might subsequently become available. Kahf (1998, p.21) also identified the *mursad*, which was another similar transaction, although the advanced lump sum was not considered part of the rent, but an advance payment made by the lessee. As a debt it would be credited towards the agreed periodical rental applicable after reconstruction. In terms of the broader responsibility of fiscal policy, public finance and government expenditure, Cizakza (1998, p.47) argued that this was shouldered by the distribution of

revenues from *awqaf*, and we may thus appreciate the important role that *awqaf* had in the Ottoman society involving *ijarah*.

2.3. Islamic Normative Theory of Profit

An important Islamic legal maxim (*al-qawaid al-fiqhiyyah*) states that, “In contracts, attention is given to the objects and meaning, and not to the words and form” (*Majallah*, no.3). This allows us to evaluate financial transactions in terms of economic substance over legal form. This enhances the ability to block the legal means to an unlawful outcome (*sadd al-dhara’i*), thereby avoiding harm (*al-darar*) attributed to usury (*riba*) and upholding what is in the public interest (*maslahah*), in order to fulfill one of the objectives of the *Shari’ah* (*maqasid al-Shari’ah*), which is to protect wealth (*hafiz al-mal*). Accordingly, regarding the Islamic theory of lawful profit, Ibn al-‘Arabi (1957) (d.1148) said, “Every increase which is without an equal counter-value (*’iwad*) is *riba*”, and the components of *’iwad* are: (1) risk (*ghunm*), (2) liability (*daman*), and (3) earnings (*kasb*) (Ibn al-‘Arabi, 1957, 1, p.242; cited also by Ziaul, 1995, p.10; Rosly, 1999, p.1249; Rosly, 2005, p.30; Rosly, 2001). As reflected in Figure 2, the necessary components of *’iwad* must be present for profit (*ribh*) to be lawful (*halal*), and if any of the components of *’iwad* are not present in a transaction, then the income is unlawful (*haram*). In terms of risk (*ghunm*) it refers to market risk; earnings (*kasb*) imply to strive to earn or gain wealth, thus implying work and effort (*amal*), whereas, liability (*daman*) includes ownership (*milkiyyah*).

The *Majallah* reaffirms this with a number of important maxims: “Reward begets risk” (*al-ghurm bi al-ghunm*) (*Majallah*, no.87), “Benefit begets liability” (*al-kharaj bi al-daman*) (*Majallah*, no.85), and “burden is proportional to benefit, and benefit is proportional to burden” (*Majallah*, no.88). Indeed, the *Majallah* also affirms that under the rules of contractual partnership (*shariqat al-’aqd*), “if [property, work and responsibility] is not found, there is no right to the profit. Therefore, if one says to another, “Trade with your property and let the profits be shared between us,” there, partnership does not follow, and he cannot take a share in the profit, which arises in this case” (*Majallah*, no.1348).

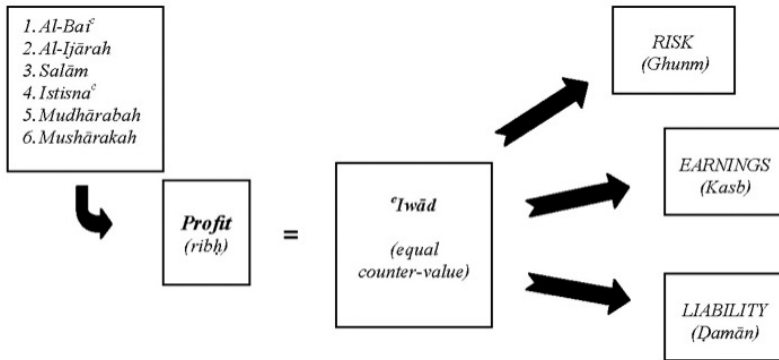


Figure 2. The Islamic Theory of Profit

In summary, in this section, we have identified three important aspects: (i) that in *musharakah*, it is not permissible that one partner pre-specifies the amount of profit to himself without risk; (ii) in *ijarah* it is not permissible to lease to oneself; (iii) and that in Islam, market risk must exist for profit to be deemed lawful. The advantage of documentary analysis is that we are selecting data, not collecting it, and this ensures a clear framework in our research to detect any elements that would invalidate the *musharakah* bonds.

3. Methodology

Case study research is one of several forms of social science research, and according to Yin (2014, p.2), it would be the preferred method over other forms, including surveys or statistical modeling, particularly if the research questions involve “how” or “why”. In this type of research, the researcher has little or no control over behavioural events and the focus of the study is a contemporary rather than purely historical phenomenon. In this study, we seek to clarify how and why the financing was structured. It also had no influence on any of the behavioural events surrounding the *musharakah* bond transactions, and both projects are clearly contemporary in nature.

Document analysis involves a systematic procedure for reviewing or evaluating documents, including both printed and electronic materials (Bowen, 2009, p.27). It requires that material and data be examined and interpreted to gain meaning and understanding, in order to develop empirical knowledge (Corbin and Strauss, 2008). The MUIS information memorandum to the bond investors (Oct.

2002), MUIS annual reports (2001, 2002) and DTZ analysis in RAM's Islamic Finance Bulletin (2003, 2004) have all been clearly identified and contain text that has been recorded without our intervention. The documents provide stable, reliable and sufficient material and data for the purposes of this study was culled in an efficient manner, since the data was selected and not collected. The systematic evaluation adopted in this study also involved a review of prior literature, which in this case served to support the overall research (Bowen, 2009, p.28). Moreover, this study yields excerpts, quotations and selected passages that require discovery, selection, appraisal and clarification, which were organized through content analysis (Labuschagne, 20013) to detect the lack of contractual validity, the presence of usury, and absence of market risk in the financial structure of the *musharakah* bonds. In terms of analytical generalization (including numerical analysis) and external validity, we can test the validity of the financing through the Islamic normative theory of profit to confirm our findings.

4. Findings and Discussion

Following the issuances by MUIS in 2001 and 2002, the press hailed the issuance of these *Shari'ah* compliant *Musharakah* Bonds "as a sign of the growing diversity" (Finance Asia, 2001) of the bond market. The background to these issuances was that, the religious authority had "more than twenty dilapidated *waqf* properties (identified properties) located in non-prime areas. These are mainly old shop-houses with relatively low rental yields... As such the only sound alternative... [involved] the migration from such low-yielding *waqf* properties to higher-yielding *waqf* ones" (DTZ, Sept. 2003, p.2). Both tranches of *musharakah* bonds were issued in denominations of SGD 250,000 each (MUIS, 18 Oct. 2002, p.7), over a tenure of 5 years and with a bullet repayment. The issuance was 100% subscribed with institutional investors, as MUIS was a statutory board, which carries a sovereign rating for its certificates issued (Abdul Karim, 2007, p.5).

4.1 *Musharakah Bond Structure for 11 Beach Road*

The first issue involved a *Musharakah* joint venture between MUIS and the Bond Investors for the acquisition and refurbishment of a 6-storey commercial property adjacent to Raffles Hotel, comprising a ground floor retail/showroom and offices on the upper floors. The investment would be capitalized and purchased under a single purpose

vehicle (SPV1), Fusion Pte Ltd (Fusion) costing a total of SGD 34.0 Mn, funded by SGD 9.0 Mn from the *Waqf* Fund and SGD 25.0 Mn by the Investors; a capital ratio of 26.5% to 73.5%, which was also the agreed profit-sharing ratio. SPV1 (Fusion) in turn rented the property to another special purpose vehicle (SPV2), Freshmill Pte Ltd (Freshmill), a wholly owned subsidiary of the *bayt al-mal* (MUIS). Freshmill would manage the property and its tenancies and guaranteed an annual *ijarah* rental income of SDG 1,190,000 p.a. (paid semi-annually) to Fusion for 5 years, so that the Bond Investors receive SGD 875,000 and MUIS was entitled to receive SGD 315,000 per annum. Therefore, MUIS was essentially shouldering all the risk and guaranteeing SGD 875,000 p.a. over 5 years, yielding a simple rate of return of 3.5% p.a. ($= 875,000 / 25,000,000$) in interest to its risk-free partners, the Bond Investors. The flow of resources and obligations is presented in Figure 3.

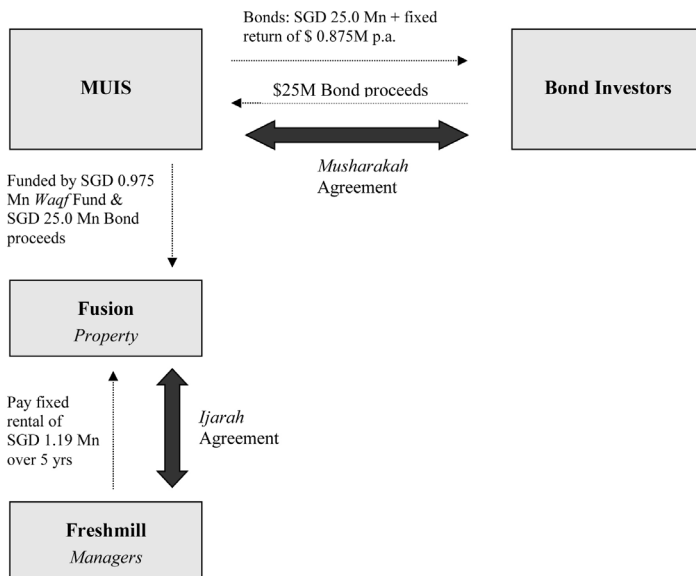


Figure 3. Financing of 11 Beach Road

Source: DTZ (Sept. 2003)

4.2 Musharakah Bond Structure for Bencoolen Street

The second issue was a *Musharakah* joint venture (MJV) between MUIS, a project management company fully owned by MUIS, Warees Investments Pte Ltd (Warees), and the *Waqf* Fund. The MJV was to re-

develop a piece of land known as Lot 19 Town Division at Bencoolen, where an existing mosque has been located, into 3-storey commercial property and a 12-storey service apartment complex together with a new mosque. The development cost was SGD 39,719,000, which was funded by SGD 1.00 from Warees, SGD 4,719,000 (comprising SGD 4,200,000 in property and SGD 519,000 in cash) from the *Waqf* Fund and a capital contribution of SGD 35,000,000 in the form of Musharakah Bonds issued by MUIS to the Bond Investors. This structure reflected a capital ratio between MUIS and the Bond Investors of 11.88% to 88.12%. Technically, according to the financial information memorandum, the MJV agreement included the Bond Investors (MUIS, 18 Oct. 2002, p.11), that relinquished their share in the profits, which was attributable to them, and MUIS was to pay them SGD 1,060,500 in arrears, payable in two installments on a semi-annual basis (MUIS, 18 Oct. 2002, p.13). In terms of security, MUIS had to assign all rights, title and interests associated with the sales of the service apartments, proceeds under the management agreement, the construction contracts and all insurances over the service apartments (MUIS, 18 Oct. 2002, p.6). In the Information Memorandum to the investors, the flow of financial resources explained the transaction and the distribution of returns, which is illustrated in Figure 4.

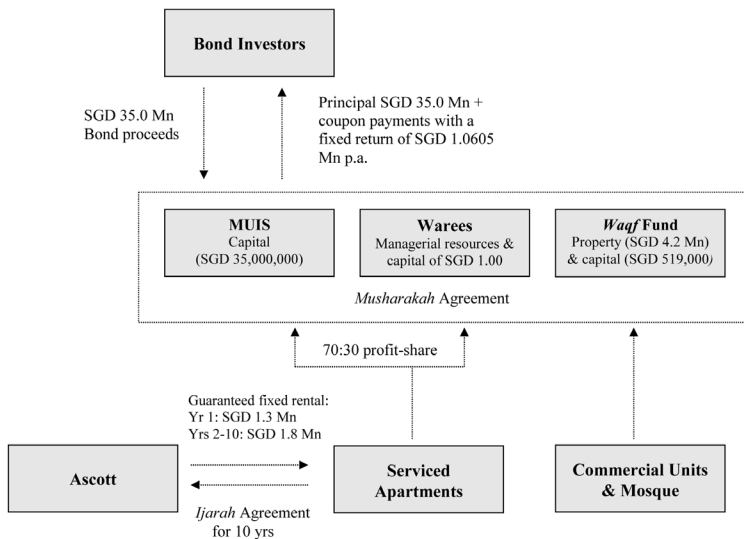


Figure 4. Financing of the Bencoolen Street

Source: MUIS (Oct. 2002)

The *Waqf* Fund would “take possession of the mosque and the 3-storey commercial building immediately upon completion. MUIS will also retain the rental income that will accrue from the commercial building. DTZ had valued the mosque and 3-storey commercial building at \$8,440,000, which corresponds to 11.88% of the estimated completed development of \$71,060,000. On the other hand, the 12-storey apartment complex, with an expected value of \$62,620,000 (or 88.12%), will be vested with Warees” (MUIS, 18 Oct. 2002, p.13).

Warees then entered into a 10 year *Ijarah* agreement with a service apartment manager, Ascott International Management Pte Ltd (Ascott) (DTZ, Mar. 2004, p.22), that guaranteed rental income of SGD 1,300,000 in the first year, and SGD 1,800,000 p.a. from the second year onwards. This was, of course, sufficient enough for MUIS to pay a fixed return of SGD 1,060,500 p.a. over 5 years in the form of coupon payments, yielding a simple rate of return of 3.03% p.a. ($= 1,060,500 / 35,000,000$), to the Bond Investors (MUIS, 18 Oct. 2002, p.13). The balance rental, after deducting the cost of financing, would be split according to a profit-share ratio of 70% to MUIS and 30% to Warees (DTZ, Mar. 2004, p.23).

4.3 Re-Examination of the Financing Structure

With the Beach Road financing, the Bonds Investors as partners have pre-specified the amount of their return. Ibn Qudamah (1946) said that, “it is not permissible to guarantee for any partner a pre-specified number of *dirhams*. If one partner’s profit amount is specified in *dirhams* or if a specified increment over his profit-share is pre-specified, the partnership is thus invalidated” (Ibn Qudamah, 1946, 5, p.140; Usmani, 2012, p.23). Additionally, by capitalizing the investment into Fusion, which leased it to Freshmill, a wholly owned subsidiary of MUIS, the Bond Investors evaded all market risk (*ghurnm*), liability (*daman*) and did not participate in striving for lawful earnings (*kasb*) given the interest coupon, thus ensuring no equitable counter-value (*iwad*).

With the Bencoolen Street financing, in effect, MUIS established a joint-venture between itself and Warees, an entity it owns and controls, and the Bond Investors relinquished their share in the profits under the MJV agreement, where as creditors, they were simply involved in a conventional debt obligation involving MUIS as their debtor. Just as the bonds are a risk-free transaction, so was the rental agreement with

Ascott, since the rental from individual tenants (i.e. Ascott's customers) of the service apartments reflects the actual market risk on income earned. The Information Memorandum disclosed that the returns from the religious authority to the Bond Investors were "coupon payments on bonds", and that MUIS "...has agreed to regard the return to the Bond investors on capital employed in the Development Business and the Leasing Business as interest under the Bonds for all purposes, whether legal, accounting, taxation or otherwise" (MUIS, 18 Oct. 2002, pp.12-13). Indeed, the treatment of the bonds in the MUIS annual report were deemed "borrowings", involving a "fixed interest rate", "effective interest rates", and "a discount rate based upon the borrowing rate" (MUIS, 2002, *Annual Report*, pp.73-74). Hence, MUIS and the Bond Investors were combining their capital with the *waqf* property to re-develop an existing mosque into a mosque and service apartments plus commercial units. Before the development, the Muslims had access to a mosque on landed property, which afterwards, was replaced by a prayer-hall in the basement of a 3-storey commercial office block (with the *wudu* area in the car-park), and a 12-storey service apartment complex. Meanwhile, the investors obtained their risk-free, pre-determined return, involving a loan with interest, and MUIS and the *Waqf* Fund were left with new assets and income generated from unlawful transactions.

In summary, in the Beach Road transaction, the Investors pre-determined the amount due to them under a *musharakah* contract, which is thus *batil* according to Ibn Qudamah. They also evaded market risk by leasing the property from Fusion to Freshmill, as technical and commercial managers of the property: MUIS was not entirely leasing to itself, but entered into the lease to guarantee a rental to the Investors. In the Bencoolen transaction, the Investors required a fixed return under the *musharakah* agreement, and Ascott had to accept the market risk of the service apartments for 10 years. In both transactions, MUIS agreed to assign all rights and title of the property during the tenure of the financing as security: *waqf* property is owned by Allah (s.w.t.) and can not be encumbered and foreclosed resulting in a change of ownership or title, that is, in the case of default given the alienability of the *waqf* asset. This was echoed in a *fatwa* dated 5 Mar 1992 from the MUIS *Fatwa* Committee, which stipulated that *waqf* assets cannot be mortgaged for a loan because an asset, which does not have the characteristic of sale and purchase, cannot be mortgaged, given the alienability of *waqf* assets (Abdul Karim, Nov. 2010, p.144).

MUIS claimed they had a number of challenges, in particular, the treatment of interest given the structure of the financing (Abdul Karim, 2007, p.5). First, they had to accept that the return on capital employed was to be recorded as interest. This was done in order to obtain the Qualifying Debt Concession (QDC) on securities. Therefore, a tax concession would be granted on income received from such an investment, which would otherwise be subject to income tax. The alternative might have been to accept prevailing Islamic banking modes of finance, but these might have attracted a costly double stamp duty. However, no formal legal application to the Singaporean authorities in this regard was made, and even if it was accepted, avoidance of double stamp duty is not a prerequisite for lawful income in terms of *bai' bithaman ajil* (BBA) based on *bai' al-'inah*. Indeed, when *ijarah wa iqtina* and *murabaha asset financing* were introduced into the U.S., the Federal Reserve Bank of New York noticed the "OCC's analysis was that, because the purchase and sale transactions occurred simultaneously, the bank would be acting as a riskless principal" (Rutledge, 2005). A similar conclusion was reached by the U.S. Department of Revenue with regard to double stamp duty on *musharakah mutanaqisah*. The U.S. authorities looked at economic substance over legal form, and all of these transactions were accordingly approved as risk-free debt transactions, as a function of the business of conventional banking and secured lending (Abdullah, 2016).

In fact, soon after the second tranche of *musharakah* bonds were repaid in 2007, the Singapore government amended the treatment of income earned applicable to *waqf* institutions, in line with real estate investment trusts (REITs), such that income earned was tax-exempt as per Section 13(1) of the Income Tax Act. Indeed, this similar treatment was already afforded to *waqf* properties by Muslim governments. Interestingly, by migrating the sale of low-yielding *awqaf* and consolidating the proceeds through migration (*istibdal*), MUIS created an internal REIT (Abdul Karim, 2007, p.6) involving the shareholding of 43 *awqaf* with total capital resources of SGD 30.76 million for the purchase of the 11 Beach Road property (Abdul Karim, Mar. 2010, p.145). This implies that the REIT could have been externalized and resulted in more appropriate capital market product to develop Singaporean *waqf*. Indeed, this was later acknowledged to have been the case (Abdul Karim, 2007; Nov. 2010), and certainly, the *waqf*-REIT forms the basis of our recommendation, with regard to this research.

The inherent feature of a *waqf* is that its assets should be held in perpetuity. The assets can be sold on a leasehold basis with no issues relating to *istibdal*. Notwithstanding, the inalienability of *waqf* assets, a sale through a long-term lease (*hikr*) is permissible. When a *waqf* enters into a *waqf*-REIT structure, its ownership title of *waqf* assets are transformed into shares held within the *waqf*-REIT, which is created in perpetuity. The *waqf*-REIT would be comprised of jointly owned freehold or leasehold assets, and alienability issues would be addressed through *istibdal* and long-lease (*hikr*). When *waqf* properties are placed in the *waqf*-REIT in the form of leasehold properties, the *waqf* would hold the freehold title and lease the properties to the *waqf*-REIT. The value of assets can be reinvested as a shareholder of the *waqf*-REIT or the *waqf* may monetize the assets and used the proceeds to invest elsewhere.

Within a REIT structure, the manager acquires properties, and must operate in accordance with *Shari'ah* principles and prevalent guidelines on real estate investment trusts, such as those issued by the Securities Commission (2012). In this regard, according to the revised quantitative screening methodology, the Securities Commission requires that rental incomes must be permissible according to *Shari'ah* principles, and if the existing tenant has mixed activities, then non-permissible activities should not exceed more than 20% (SC, 2013). Furthermore, in order to avoid stock market volatility and costs associated with running a public company, the *waqf*-REIT can be constructed as a private *waqf*-REIT rather than a public *waqf*-REIT via an IPO.

The beneficiaries can still be private family *waqf* (*waqf ahli*, *waqf awlad*, *waqf zurri*), public *waqf* (*waqf khayri*) or combined private family and public *waqf* (*waqf al-mushtarak*). The *waqf*-REIT can appoint individual (not corporate) professional managers (*mutawallis*), which may include members of the *waqf*-REIT shareholders or indeed family trustees from the original *waqfiah* (*waqf deed*). Those shareholders can include foreign or domestic investors, Muslim and non-Muslim individuals or institutions, property management companies, *bayt al-mal* and *WaqfFund* assets, and also NBFIs or investment banks, whether conventional or Islamic.

Our re-examination has therefore highlighted that in terms of a capital market product, MUIS chose an invalid debt-based issuance rather than lawful equity-based financing. Furthermore, "in contracts,

attention is given to the objects and meaning, and not to the words and form” (*Majallah*, no.3). This allows us to not only evaluate financial transactions in terms of economic substance over legal form, but also recommend that in evaluating the structure of all Islamic financing products, *Shari’ah* committees should incorporate this approach in terms of determining validity.

Conclusion

In the preceding sections we have demonstrated through case study research and documentary analysis, that MUIS issued two tranches of structured financing in 2001 and 2002 in the form of *musharakah* bonds to develop *waqf* real estate in Singapore. We have demonstrated that the Bond Investors were risk averse. In fact, no special pleading can circumvent a usurious transaction, which is devoid of all blessing (*barakah*), and deemed not only a sin but also a crime in Islam. The end does not justify the means: “when a thing has become void (*batil*), all that follows from it is also (*batil*)” (*Majallah*, no.52). Both of the MUIS transactions were financed by investors that insisted on a guaranteed compensation for the time value of their money; a risk free return on their money, which was treated as a commodity that came at a price. In this sense, the provision of money was a rental contract that includes a risk free profit.

With regard to determining unlawful income in Islam, it is easier to evaluate a transaction as to whether it satisfies the criteria of what is lawful income. Lawful income necessitates risk and if an investor or financier has acted merely as a riskless principal more akin to the role of secured lending by a conventional bank, then to pre-determine income without risk is not permissible in Islam. In terms of differences of opinion relating to validity, the Prophet (s.a.w.s.) stated that,

- “The differences of opinions among the learned in my community are a blessing” (As-Suyuti, *al-Jami’ as-saghir*).
- “My community shall never agree on an error” (Ibn Majah, no.3950).

Furthermore, contracts in Islam are designed to ensure that harm (*darar*) and injustice (*zulm*) should be eliminated. As mentioned earlier, Ibn Qudamah clarified that, “it is not permissible to guarantee for any

partner a pre-specified number of *dirhams*. If one partner's profit amount is specified in *dirhams* or if a specified increment over his profit-share is pre-specified, the partnership is thus invalidated" (Ibn Qudamah, 1946, 5, p.140; Usmani, 2012, p.23). In summary, contemporary capital market transactions, conducted in the name of Islam, continue to fail the basic benchmarks of validity. The Prophet (s.a.w.s.) foresaw that the widespread prevalence of *riba* would reflect a minor sign of the impending *Qiyamah* (Day of Judgment):

- "Abu Hurairah (r.a.), reported from the *Rasulullah* (s.a.w.s.) that, "There will come a time, he said, when you will not be able to find a single person in the world who will not be consuming *riba*. And if anyone claims that he is not consuming *riba* then surely the dust of *riba* will reach him" (Abu Dawud, no.3325).
- *Rasulullah* (s.a.w.s.) said, "A time is certainly coming to mankind when they legalize *riba* under the name of *bai*" (Ibn Qayyim, 1991, 1, p.352; Rosly, 1999, p.9).
- Hadhrat Huzaifah (r.a.) narrated that *Rasulullah* (s.a.w.s.) said, "When this *ummah* regards liquor as a beverage, interest as a profit and bribery as a gift, thereby attempting to legalize it, and when they conduct business with *zakat*, then they will be destroyed as a result of increasing sin" (Al-Hindi, *Kanz al-Ummal*).
- Narrated Aisha (r.a.): "Allah's Apostle (s.a.w.s.) used to invoke Allah in the prayer saying, "O Allah, I seek refuge with you from all sins, and from being in debt." Someone said, O Allah's Apostle! (I see you) very often you seek refuge with Allah from being in debt. He replied, "If a person is in debt, he tells lies when he speaks, and breaks his promises when he promises" (Bukhari, 3, 41:582).

Endnotes

1 AAOIFI reflects the Middle Eastern attitude towards '*inah* (as distinct from Malaysia), although Ibn Taymiyya condemned both *tawarruq* and specifically '*inah*, such that a merchant whom, (1) purchases goods in order to consume them, which is *halal*, (2) purchases goods in order to trade with them, which is *halal*, (3) if the reason is not (1) or (2), then the reason must be that he does not have *dirhams* (money) so he purchases goods on credit (with increased

dirhams) in order to subsequently sell them and take that price [i.e. the goods are bought with a higher credit price], then this is *'inah* which is *haram*. This practice was prevalent in Medieval Europe under the name of *mohatra*, and also included a third party to disguise the circumvention of interest under the name of *tawarruq*, meaning to obtain silver (money) by trickery (Islahi, 1996, pp.134-136).

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