بسم الله الرحمن الرحيم

Islamic Mortgages

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BAFIN Konferenz Islamic Finance
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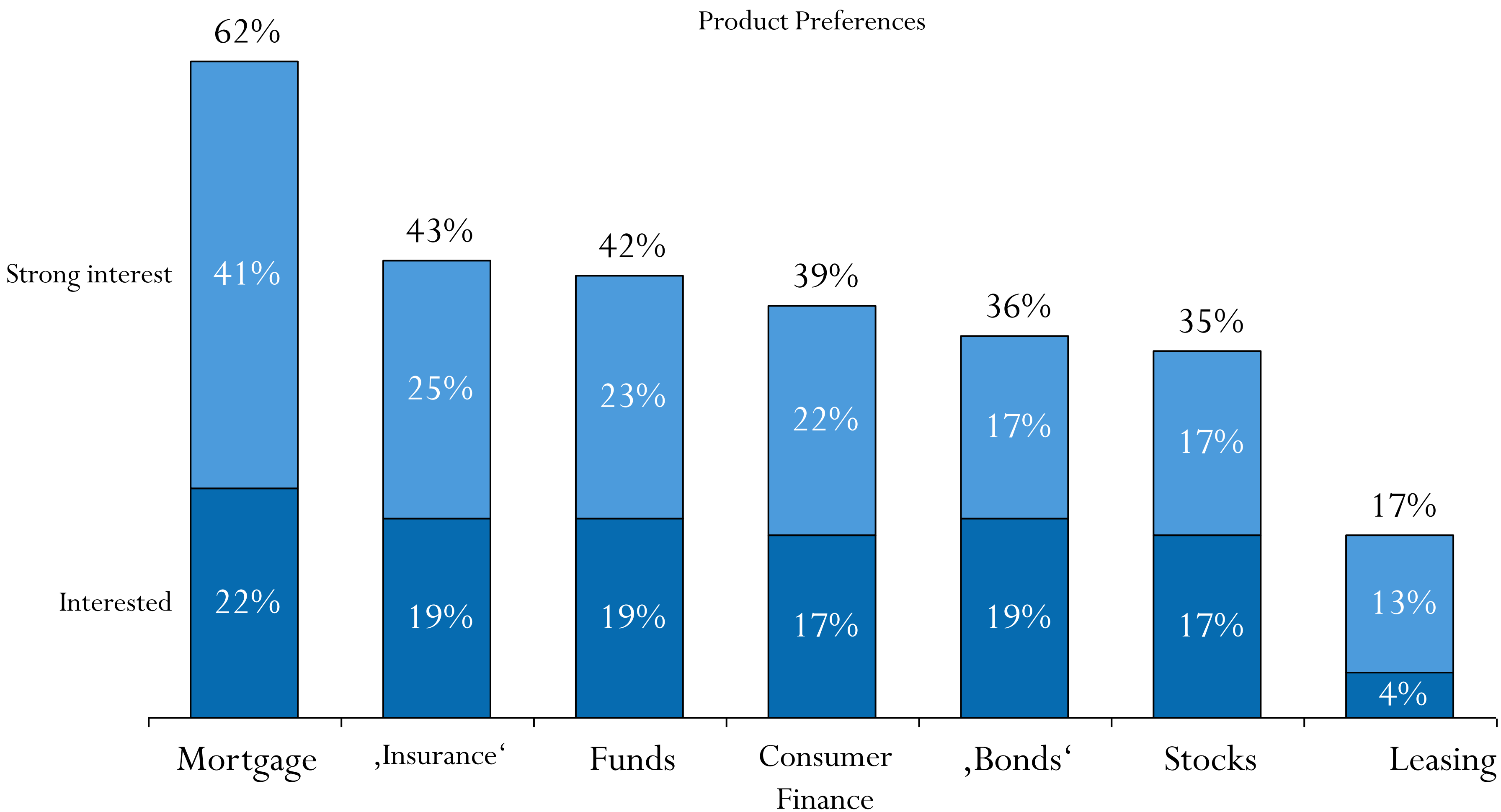
Overview

- Why? - Market Potential for Islamic Mortgages in Germany
- How? Equity Based Mode for Islamic Mortgage
  - Equity oriented Diminishing Musharaka
- How? Debt Based Modes for Islamic Mortgage
  - Debt oriented Diminishing Musharaka
  - Murabaha
- What is diffent to loans?
- Is there a Tax issue?
- Call for Action

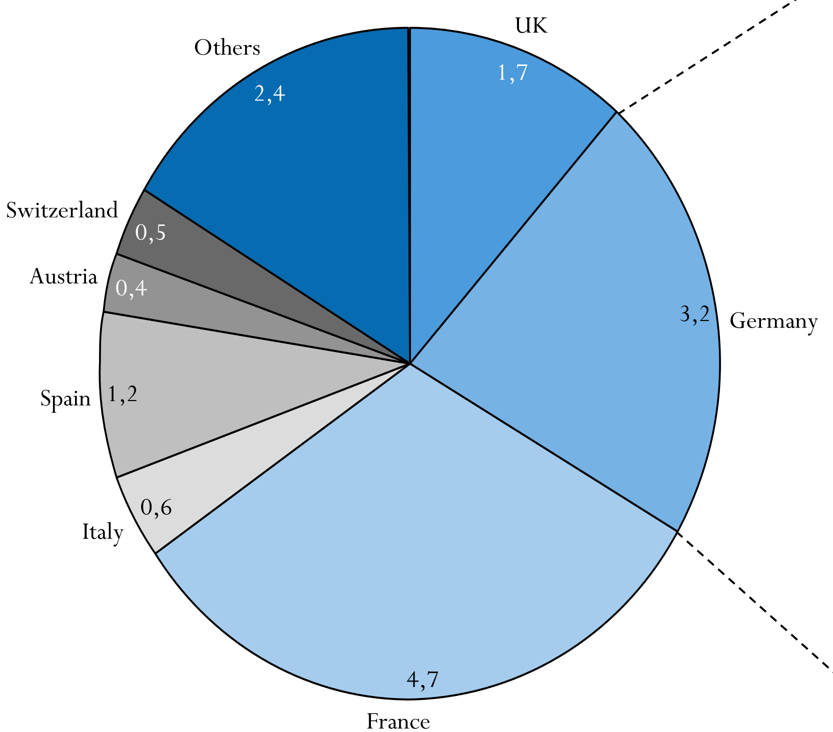
Mortgages are the most sought after product according to Booz & Company



Quelle: Booz & Company Analyse

Potentials of the German Market

Muslim Population in Western Europe in mn



Total: ca. 15 Million

Market Potential Islamic finance products in Germany

- Muslim Population: ca. 3,2 Mio. (about 2,4 Mio. turkish/ turkish-origin)
- Average Muslim household income ca. 71% of average
- Saving ratio of Muslim households substantially higher (ca. 18% vs. ca. 10%)[1)]
- Estimated potential market share of Islamic financial products in the Muslim population: ca. 15%
- Market potential for Islamic

– **Mortgages:**	**ca.**	**400 Mio. € p.a.**
– Consumer Finance:	ca.	220 Mio. € p.a.
– Savings :	ca.	590 Mio. € p.a.
Total	ca.	1.210 Mio. € p.a.

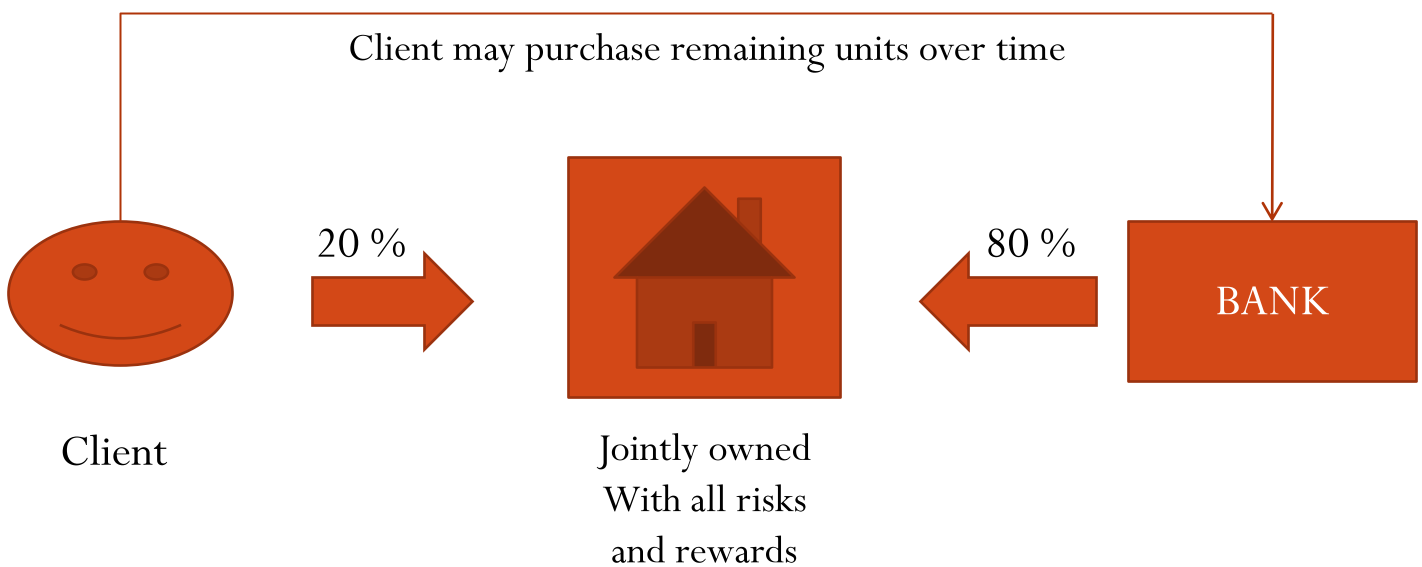
Quelle: Economist Intelligence Unit, Zentrum für Türkei-Studien, Booz & Company Analyse

Selected Models:

1. Equity based diminishing musharaka
2. Debt based diminishing musharaka
3. Murabaha
4. Modified Murabaha

Equity based Diminishing Musharaka

- Financer and Client owns jointly the property according to their contribution
- Financer offers Client right to purchase the property at market value (appraisal)
- Client pays rent for outstanding units
- Client will *never* face *negative equity* as he has no obligation to purchase
- Ansar Finance, Manchester operates such an equity based mortgage concept



Debt based Diminishing Musharaka

Debt based Diminishing Musharaka

- Client and Financer build joint venture similar to equity based model
- Client commits to purchase the outstanding units at prefixed price and does lease payment to the Financer for the outstanding units
- Financer commits to sell the outstanding units at prefixed price
- Scholars differ in opinion, market acceptance can consequently be limited
    - Because: matching commitments similar to prohibited forward contract
    - And: Joint venture partner shall bear liabilities such as major maintenance as well

Debt based Murabaha

- Does **Murabaha** fit better than debt based Diminishing Musharaka?
- Financer purchases property and resells at fixed mark up to the client
- Challenges:
    - Per se no variable rates, fixed rate for 25 years in Germany expensive for client
    - Double real estate transfer tax is widely expected

Bank buys house and sells it with a profit on installment basis
e.g. 25 years monthly 1000 Euro

Adjusting Murabaha for Germany

- Financer purchases property, then
- on-sells it to the client except 25 years of right of use (Nutzungsrecht)
- Price of ‚Nutzungsrecht' (right of use) is negotiated every 5, 10, or 15 years
- Closest proxy for the German standard mortgage offer
- Not yet applied in the markets globally
- Debt modes may result in negative equity and financial problems for the client

Bank buys house withholding 25 years usufruct
and sells it with a profit on installment basis
e.g. 25 years monthly 800 Euro

Client undertakes to rent the right of use
Client pays related rent (200 Euro monthly) fixed for 5 years

What is different then to loans?

If the cash flow looks alike, then what is the difference?

What is different to loans???

- **Equity based mode**
- Obviously different – no debt, but possibly longer purchasing period
- Less prone to asset price bubbles
- Closer to the ideals of Islamic Economics

- **Debt based modes**
- Could have identical cash flow
- In Murabaha: If the sale is void, so is the financing – one contract; contrary to "Schrottimmobilien" (credit to be repaid because fraud is only with property not with loan)
- Late Payment Penalty for charity; no penalty interest if default is due to difficulties

TAX

It is often claimed that double real estate transfer tax occurs.

Is that for sure?

Do we need law amendments like in UK and France?

Or would clarity on the tax treatment be good enough?

TAX ? Is it a problem?

Diminishing Musharaka models transfer the ownership over 15-25 years. Does this required to pay real estate transfer tax twice as much as standard loans?

The Tax Authority of Lower Saxony rules regarding transfer of shares in property:

> “[…] der Übergang von mindestens 95 v.H. der Anteile am Gesellschaftsvermögen einer grundbesitzenden Personengesellschaft auf neue Gesellschafter innerhalb von fünf Jahren,"
>
> http://www.ofd.niedersachsen.de/master/C3201972_N9684_L20_D0_I636.html

It basically says that real estate transfer tax is due if the transfer occurs during 5 years in partnership. Could this mean if it is more than 5 years Diminishing Musharaka could be exempted or materially reduced regarding the second (not the first) real estate transfer tax?

What if the Financer is silent partner of the Client?

Be it in the Diminishing Musharaka Model or regarding the purchase in the modified Murabaha Model.

Immediately after the complete sale the silent partnership, will be ended. The outstanding debt is in each case collateralized in the registry (Grundbuch). The silent ownership will not be registered in the Grundbuch.

Would this require necessarily a second real estate transfer tax?

In either case:

Clients and Financers need clarity! The Central Council of Muslims urges the authorities and the financial institutions to study the models to come to a conclusion! Any questions / requests in this regard are welcome!!!

Call For Action

Central Council of Muslims:

1. Urges Financial Institutions to introduce equity and debt based Islamic mortgages to foster financial inclusion of German Muslims

2. Calls for a clarification of the related tax issues

3. Asks financial institutions to find solid ways to prevent customers from negative equity applying highest standards for responsible credit; and asks consumers to remain modest and prudent in using debt!

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