

I. The Contract of Ijarah

I.1 Definition and Concept

Ijarah in Islamic banking and finance can simply mean leasing or hiring. These two interpretations are used interchangeably in the literature, but the focus in this section is on the former definition. The term *ijarah* originates in the Arabic verb 'ajara' which denotes 'rewarding' or 'recompensing'. Literally, *ijārah* is derived from the noun 'al-ajr' which means compensation, reward, consideration, return or counter value (al-'iwad) against the use of an object. From a juristic (fiqh) definition, *ijarah* refers to a contract to utilize a lawful benefit against a consideration (Al-Zuhayli 2002). In *ijarah*, the right to use the object is transferred to the hirer, not its ownership. Hence, *ijarah* is a sale of usufruct not of a physical entity.

Technically, *ijarah* is an agreement between two parties, one being the owner of the asset, who gives possession of the assets for the use of the other party, the hirer, on an agreed rental over a mutually agreed period. It is also defined as transferring the usufruct of a particular property to another person in exchange for a rent claimed from him (Usmani, 2002).

In general, Muslim scholars define *ijarah* as owning a specific benefit of an asset against a consideration (Al-Sanhuri, undated). In particular, there are various definitions of *ijarah* cited by the Muslim scholars as the four schools of jurisprudence have given different explanations to the meaning of *ijarah*, which are illustrated as follow:

- The Maliki¹ School defines *ijarah* as a transfer of ownership of permitted usufruct for a known period in exchange for compensation (price).
- The Hanbali² School has described *ijarah* as a contract where the subject matter is lawful and for defined use (manfa'ah); corporeal object ('ayn) is also lawful and determined; and for a specific period of time.
- The Hanafis³ define *ijarah* as a contract intended to give ownership of a determined and legitimate usufruct (manfa'ah) of a rented corporeal object ('ayn) against a consideration.
- The Shafi'i⁴ view *ijarah* as a contract where the subject matter is the determined, legitimate, assignable and lawful usufruct of an object against a fixed consideration.

The above definitions vary in their wordings but they are actually unanimous in the substantial meaning of *ijarah*. All four schools of jurisprudence are in agreement that *ijarah* is a contract for utilising the usufructs (manfa'ah) of a defined object against a determined consideration.

Al-Sanhuri (undated) asserts that the above juristic definitions lead to three significant aspects of *ijarah* contract. Firstly, *ijarah* contract is well-understood as a contract to give the ownership of a particular usufruct. In this instance, the hirer has a complete freedom to utilise the usufruct of an asset within an agreed period of time. Secondly, the definitions comprise three essential pillars of an *ijarah* contract, namely, consent of the contracting parties, a specific asset to be

¹ This is the opinion of Al-Dardīr and Al-Qarāfi from the Maliki School

² This definition is given by 'Ibn Qudāmah, Al-Buhūtī and 'Ibn Qayyim Al-Jawziyyah from the Hanbali School

³ 'Ibn Al-Humām, Al-Kāsānī and 'Ibn 'Ābidīn from the Hanafi School provide this definition.

⁴ This is the definition provided by A-Khatīb Al-Shirbīnī from the Shafi'i School

leased out and rental payments. Thirdly, the usufruct which is the subject of ijarah contract must be identified and capable of being legally and reasonably utilised.

In the Islamic commercial context, ijarah refers to a contractual relationship between an owner of a property and a person who wishes to lease the property. Both parties will enter into a lease contract or is also referred to as a hire contract. For example, Al-Rajhi Bank (2001) defines ijarah as a process by which usufruct of a particular property is transferred to another person in exchange for a rent claimed from him. In the context of Islamic banking, Salleh (1986) views it as a lease contract under which the bank or financial institution leases equipment or a building to one of its clients against a fixed charge. The bank will usually put the property up for rent every time the lease period terminates, so the property will not remain unutilised for a long period of time. The title of the property remains with the bank; hence it assumes the risk of recession and other risk associated with ownership.

From the above-given definitions, ijarah has been well understood as a contract in which the owner of a property transfers a legal right to use and derive profit from the property, to another person, for an agreed period, at an agreed consideration. In this instance, the owner is called a lessor (mu'ajir); the person who uses the property is known as a lessee or hirer (musta'jir); the subject matter is the usufruct of the property (manfa'ah); and the consideration refers to a rent (ujrah).

1.2 Types of Ijarah

Ijarah can be divided into two types, namely operating lease and financial lease

1. Operating lease (Al-ijarah 'ain)

Traditionally, the only kind of ijarah that was only operating lease, whereby one owns an asset or equipment and leases it to others for rental for a specified period. This form of ijarah is known in Islamic banking and finance as operating lease. In this form of lease, the ownership of the leased assets will remain with the bank at the end of the lease period.

In operating lease, the bank may already own a property which it wants to lease it out. In other words, operating lease is not preceded by a promise to lease or the concept is not based on prior promise.

2. Financial lease (Ijarah Muntahia Bittamleek)

The evolution of modern Islamic banking and finance has created another form of ijarah known as Ijarah Muntahia Bittamleek (IMB) or financial lease. The IMB is defined as a form of transfer of ownership of usufructs of some assets, such as buildings or equipment, for a particular period in consideration for a defined rent which is usually higher than the normal rental to encourage the lessor to transfer the leased assets to the lessee at the end of the lease period after the lessee has paid all instalments without delay.

In a financial lease, it is necessary to clearly state the method of transfer of ownership in the agreement. The final transfer will occur at the end of the lease period. The manner of transfer must be put separately in a different document attached to the lease agreement. The transfer of ownership could take place in one of the following manner:

- Promise to transfer the ownership on the basis of ordinary or conditional gift: The financial lease attached to the concept of gift is the most applied method by Islamic financial institutions. The difference between ordinary and conditional gifts is that gift without payment condition is not strong by law as opposed to gift with a condition on payment of all rental instalments. The conditional gift is similar to a contract which makes it stronger. This is because once the client pays the last installment, the bank is obliged to transfer the property.
- Promise to transfer the property through sale: In this form, the financial lease agreement is concluded with an understanding that the lessor or the bank will sell the property to the client. The sale may take place through a nominal value because the major part of the selling price has been paid in the form of rental. It must be noted that the sale may also take place prior to the maturity of the lease agreement. In this case, the sale price may be the market value of the property or the outstanding rental. The parties may also agree on sale price that will be paid on instalment.

Ijarah can also be classified in terms of its delivery schedule into spot ijarah and forward ijarah. In the latter, the usufruct of the leased asset is to be made available in the future based on specifications (known in fiqh as ijarah mawsufah fi al-dhimmah). This classification is applied to both operating lease and financial lease.

In this form of lease, the usufruct is to be delivered in the future and hence it is the liability of the lessor. Ijarah mawsufa fi dhimma is a lease contract on non-existent assets that will be provided in the future, as the case of Istisna' and Salam.

Islamic banks and financial institutions apply forward Ijarah for securing liquidity for construction and development. The concept may be applied in construction and technology. An Islamic bank which needs liquidity to produce goods or develop a project that is subject to lease principles may use the concept of forward Ijarah. In this concept the bank secures liquidity for providing subject matter that will be used by the client. The liquidity will be used to manufacture the potential leased property. However, the payment of the rental is done in advance until the subject matter is delivered. In other words, the bank is liable to reimburse the advance rental if it fails to provide the subject matter of the contract in the future.

1.3 Legitimacy of Ijarah

The majority of Muslim jurists based their permission of the ijarah contract on the Qur'an, the Sunnah and the consensus of Muslims. There are several Qur'anic verses which are frequently quoted as evidence for ijarah contract. Among these verses are:

قَالَتْ إِحْدَاهُمَا يَا أَبَتِ اسْتَجِرْهُ إِنَّ خَيْرَ مَنِ اسْتَجَرْتَ الْقَوِيُّ الْأَمِينُ (٢٦) قَالَ إِنِّي أُرِيدُ أَنْ أُنكِحَكَ إِحْدَى ابْنَتَيَّ هَاتَيْنِ عَلَى أَنْ تَأْجُرَنِي تَمَنِي حَجَّجًا فَإِنْ أَتَمَمْتَ عَشْرًا فَمِنْ عِنْدِكَ وَمَا أُرِيدُ أَنْ أَسْأَلَكَ عَلَيْهِ سَتَجِدُنِي إِنْ شَاءَ اللَّهُ مِنَ الصَّالِحِينَ (٢٧)

One of the two women said: O my father! Hire him! For the best (man) that thou canst hire is the strong, the trustworthy. He said: Lo! I fain would marry thee to one of these two daughters of mine on condition that thou hirest thyself to me for (the term of) eight pilgrimages. Then if

thou completest ten it will be of thine own accord, for I would not make it hard for thee. Allah willing, thou wilt find me of the righteous. (Al-Qasas: 26-27)

أَسْكِنُوهُمْ مِّنْ حَيْثُ سَكَنْتُمْ مِّنْ وَّجْدِكُمْ وَلَا تُضَارُّوهُمْ وَلَا لَنْ يُضَارُّوكُمْ إِن كُنَّ أُولَاتٍ حَمَلْنَ فَأَنْفِقُوا
عَلَيْهِنَّ حَتَّىٰ يَضَعْنَ حَمْلَهُنَّ فَإِن أَرْضَعْنَ لَكُمْ فَآتُوهُنَّ أُجُورَهُنَّ وَأَمْرُهُمْ بَيْنَكُمْ بِمَعْرُوفٍ وَإِن
تَعَاسَرْتُمْ فَسُدُّوا لَهُنَّ آخَرَىٰ

Lodge them where ye dwell, according to your wealth, and harass them not so as to straighten life for them. And if they are with child, then spend for them till they bring forth their burden. Then, if they give suck for you, give them their due payment and consult together in kindness; but if ye make difficulties for one another, then let some other woman give suck for him (the father of the child). (At-Talaq: 6)

The above verses stress that it is legal and common to do something in consideration of a payment. According to al-Shāfi'ī, the above verses show clearly that the *ijarah* contract is lawful in any permissible transactions. Even the first verse indicates that the *ijarah* contract had been used in the time of Moses.

Besides the clear evidences from the Qur'an, there are also several hadith that support the practice of leasing.

أعطوا الأجير أجره أن يجف عرقه

“Give a worker his fee before his sweat dries up.”⁵

من استأجر أجيرا فليعلمه أجره

“He who hires a person should inform him of his fee.”⁶

It was also reported that the Prophet s.a.w. and Abu Bakr hired a man from the tribe of Bani Ad-Dil as an expert guide who was a pagan. The Prophet s.a.w. and Abu Bakr gave him their two riding camels and took a promise from him to bring their riding camels in the morning of the third day to the Cave of Thaur.

The above-mentioned hadith provide evidence for the legitimacy of *ijarah*. It has been practiced by the Prophet s.a.w. himself and his companions. The Prophet s.a.w. has also laid down some guidelines and manners of conducting *ijarah*.

It is also known that the Muslim jurists during the time of the companions that the Prophet s.a.w. reached a consensus on the permissibility of *ijarah* (Al-Zuhayli, 2003). The practice of *ijarah* has been allowed at that time, because there was a need for such transaction. *Ijarah* is an important contract like sale. If sale is permitted for the purpose of acquiring a property, thus, *ijarah* is necessarily allowed for purpose of using a usufruct of the property (Sulaiman, 1992).

1.4 Necessary Conditions of *Ijarah*

⁵ Hadith narrated by Abu Ya'la, Ibnu Majah, At-Tabrani and At-Tirmizi.

⁶ Hadith narrated by 'Abd-ar-Razzaq and al-Baihaqi.

A valid *ijarah* contract must be formed from required pillars and satisfy several conditions attached thereof. Majority of Muslim scholars have agreed on four essential pillars⁷ for the formation of an *ijārah* contract:

I. The Two Contracting Parties

There must be at least two parties entering into an *ijarah* contract; a person giving a lease or lessor; and a person accepting the lease or lessee. Both contracting parties should be fully qualified and possess legal capacity to execute the contract. They must be sane, adult and free, thus, a mentally-incapacitated person like a child and insane person cannot enter into an *ijārah* contract. Except when such transaction is conducted by a legal representative or wali, or guardian in case of a child, then the contract will render valid. In addition, both contracting parties must voluntarily consent to enter into the *ijārah* contract without any coercion. When one of the parties executes the contract against his free will, then the contract will become voidable.⁸ The lessor must fulfill the following conditions:

- He must have full possession and legal ownership of the object before an *ijārah* contract is made effective.
- After the conclusion of the *ijārah* contract, he must give the possession of the leased object or property to the lessee, while he still holds the ownership title of the property.
- He must deliver the property on time, i.e. on the date of commencement of *ijārah* together with all essential accessories which can be fully utilised by the lessee.
- It is the duty of the lessor to maintain the leased property in order to retain its benefit which is to be used by the lessee.
- As an owner, he will bear all liabilities arising from the ownership. For example, in a case of renting a house all taxes concerning the house such as Council tax, insurance expenses, and other major maintenance expenses that are related to ownership risks must be borne by him.⁹
- In the event of any damage that occurs to the leased object due to the lessee/hirer's negligence, the owner shall have a right to claim compensation.
- The owner must respect the lessee's right for quiet possession and enjoyment in the leased property.

For the lessee, he must abide the following conditions:

- He shall act as a trustee of the lessor in treating the leased property properly.
- He must take reasonable care of the leased property and cannot use it in a harmful way.

⁷ However, the Hanafis affirms on one pillar only, i.e. offer and acceptance. Other essentials such as the contracting parties, subject matter and consideration are included in conditions of a valid *ijarah* contract, not its pillars.

⁸ This rule is based on surah al-Nisā' (4) verse 29 which means:

"O ye who believe! Eat not up your property among yourselves in vanities; But let there be amongst you traffic and trade by mutual good-will; ..."

⁹ Al-Rajhi Bank (2001) asserts that the lessor also bears most liabilities attached to the leased object such as damage to the object, cost of replacement of durable parts and other costs of basic maintenance. The lessor can authorise the lessee to undertake all the above liabilities, but the costs must still be borne by the lessor.

- If the lessor damages the property, he shall be responsible for the repairs and putting the property in a good condition.
- In the event of negligence or misuse on part of the lessee, which may have damaged the leased object, he shall be liable to indemnify the lessor.
- It is the lessee's duty to bear any cost of ordinary routine maintenance, such as in case of renting a car, he shall pay for the petrol and engine oil.
- Unless the contract stipulates otherwise, the lessee can only use the property according to the prescribed purposes.¹⁰ Thus, if he rents a house for personal use as stipulated in the contract, he cannot turn it into a shop or school or motor vehicle workshop.

2. Offer and Acceptance

This is the same in any kind of contract. In *ijarah* the *ṭjab* and *qabul* refer a situation where one party offers to give an object on lease and another party accepts such offer. The general rules of contract have laid down some guidelines for perfecting a valid offer and acceptance. Firstly, an offer and acceptance must be expressed clearly to show the party's intention. Such expressions may be indicated orally, or by writing, or signal etc. Secondly, a definite acceptance is made in response to a definite offer in the same session. Thirdly, acceptance must correspond exactly with an offer. For example, a person said, "I lease this house to you", the other party must pronounce his consent by saying, "I accept the leased house" or "I accept".

3. Subject Matter

A subject matter of an *ijārah* contract refers to a usufruct or *manfa'ah* derived from a specific object, thus, a usufruct will only exist when the object in which such usufruct is attached to, is in existence. For example, in the case of renting a house, the house must physically exist, because the benefit of renting the house will not be obtained if there is no house in existence (except in forward *ijarah*). The usufruct to be leased out must satisfy certain conditions, namely, it must be legitimate in *Shari'ah*; it is known by both lessor and lessee; it is a benefit that is capable to be handed over to the lessee; it has no defect which could make it incompetence to give intended benefit to the lessee; and its use is limited to certain agreed period. The object in which the usufruct is attached to must be in the form of tangible asset or property. It must comply with certain conditions as follows:

- It must have a valuable use, thus, a thing having no usufruct at all cannot be leased (Usmani 2002).
- It must not be perishable for the whole period of lease (Sulaiman 1992).
- It must be actually and legally attainable, thus, to lease something which cannot be delivered is not permitted (Al-Sanhuri undated).
- It should be precisely specific.

¹⁰ If no such purpose is specified in the contract, the lessee can use it in a reasonable and ordinary manner. If he intends to use it for an uncommon purpose, he must obtain the owner's express permission in advance.

- It is necessary to make known the purpose for which the asset is rented. It must be free from ambiguity (jahala) and uncertainty (gharar).
- In commercial sectors, it is not permitted to lease a property to a company that will use it for Shari'a prohibited activities, such as to convert it into a gambling centre or bar.¹¹
- The period for using it must be fixed and agreed upon by both parties. Renewal terms must also be stated clearly and should not be left to the lessor's discretion (Usmani 2002).

4. Considerations

Ijārah contract is executed between the contracting parties against a consideration which is known as rent. The conditions of rent are:

- The amount of rent must be specified in order to avoid deceit and dispute in the future¹² (Al-Jazairi 1976).
- There must be a clear term stating whether the rent will be flat for the whole period of the agreement, or it will be renewed depending on the prevailing market condition. In the later situation, the renewal terms must be stated as to when such action will be taken (i.e. annually or in every 6 months) and the percentage of the probable increase or decrease (e.g. 5%) (Usmani 2002).
- It should be certain and known to both parties (Al-Zuhayli, 2003).
- The rent money has to be legal in Sharī'ah. Thus, it is not permissible to pay the rent with illegal things such as wine and pork (Kharofa, 1997).
- The manner of paying the rent has to be agreed by both parties (Sulaiman 1992). It must be clearly specified whether the payment is to be made on daily, weekly or monthly basis.
- In addition, they must also agree on methods of paying the rent, either by cash, or cheque, or standing order through the bank account. If there is no such agreement, then the local custom that governs such transaction will be referred to¹³.
- The rent shall fall due from the date of delivery of the leased object, not the date of signing the contract.
- The rent must be paid on an agreed time, failure to do so will amount to a default which will lead to a termination of ijārah.
- At the expiry of the lease agreement any new term cannot be pre-determined, but the parties can enter into a new agreement to this effect. This includes continuation of the lease, or sale of the leased asset to the lessee. So if the owner intends to sell the leased

¹¹ However, according to Al-Rajhi Bank (2001), it is permissible to lease the property to those whose major activities are *halāl* or permissible even they involve some secondary prohibited activities.

¹² The Prophet (ﷺ) commanded, "He who hires a person should inform him of his wages"]

¹³ For example, in the case of renting a house, the local people usually pays in cash at the beginning of every month, so the parties of an ijārah contract may adopt such practices.

object after the lease period has expired, the price can only be fixed under the new agreement. Thus a pre-determined sale price is not permitted.¹⁴

- If the lessee pays the rental for the total period of lease and the lease agreement is terminated prior to maturity; the lessor is entitled to the rental for the period in which the lessee used the property. The rental for the period that is not utilized by the lessee should be returned to the lessee provided that the lessor agrees to the termination of the lease agreement.
- The parties are entitled to amend and vary the rental provided that this is related to the remaining duration which agreement is yet to be signed or effected.

Among all conditions listed above, three principal conditions must be applied to the *ijārah* contract; firstly, the nature of the usufruct must be precisely defined; secondly, the consideration i.e. rental must be of fixed value; and thirdly, the leasing period must be precisely determined (Coulson, 1984; Al-Sanhuri, undated).

5. Termination and consequences of lease arrangement

In the case of financial lease, the Islamic bank may not be able to transfer the ownership of the property to the client due to a certain condition, even though the client has been paying rental of more than market rate in order to own the property. In this circumstance, a question arises as to how the bank and the client will treat the rental that has been paid. The Islamic bank is obliged to review the rental and adjust the rental accordingly. For example, if the client is paying £ 1,500 as monthly rental instalment in finance lease attached with conditional gift or normal gift. The £1,000 is the normal market rental for such kind of the property but the client agrees to pay additional £500 as purchasing price. Once the Islamic bank is not able to transfer the property, all of the £500 part of payments that has been paid should be returned to the client from the first instalment.

In certain circumstances, the leased property may be impaired prior to the maturity. In this case, the interest of the client in the property is affected. The client is entitled to reject the property in which case all additional rental instalment paid by the client in order to own the property should be returned to the client.

6. Right of Subleasing

By entering into lease agreement, the lessee owns the benefit of the leased property. As a principle, an owner of usage is entitled to sublease it to another party. The requirement for subleasing is that the sub lessee's usage of the property should not be more than the usage of the current lessee or sub lessee's usage detrimental to the leased property. However, the right of the lessee to sublease is subject to the terms of the agreement. If the agreement indicates that subleasing is not permitted, then the lessee must comply with this condition.

1.5 Application of Ijarah in Islamic Banking and Finance

¹⁴ The rationale is to avoid *gharār* or uncertainty in the transaction. The price must be fixed by taking into account certain factors, i.e. market price, condition of the property and mode of payment (cash or deferred).

One of the products offered by Islamic banks is the Islamic hire-purchase or Al-Ijārah Thumma al-Bay' (hereafter AITAB) facility which is designed to meet the current demand and avoid certain risks in the financing of consumer durables and motor vehicles. Most literatures refer AITAB to ijārah wa iqtinā' or al-ijārah al-muntahiyah bit-Tamlīk. These terms are used interchangeably.

According to Wahbah al-Zuhayli (2002), AITAB refers to owning the benefit of certain assets for a specific period of time, by paying an agreed sums of rental, with an agreement that the owner will transfer the rented asset to the hirer at the end of the agreed period or during the period, provided all rental payments or instalments have been made in entirety. The transfer of ownership is affected by a new and independent contract, either by giving the asset as a gift, or selling it at an agreed price. Al-Sanhuri asserts that this arrangement comprises an ijarah contract which is then followed by contract of sale, thus, each contract is independent and not combined in one agreement¹⁵.

In a commercial context, ijarah wa iqtinā' or AITAB is a mode of financing adopted by Islamic banks and other financial institutions offering Islamic products. It is a contract under which the bank finances an asset such as equipment, building or other facilities for the customer against an agreed rental together with an undertaking from the customer to make additional payments in an account which will eventually enable him to purchase the asset. The rental and the purchase price are fixed so that the bank gets back its principal sum along with some profit which is usually determined in advance

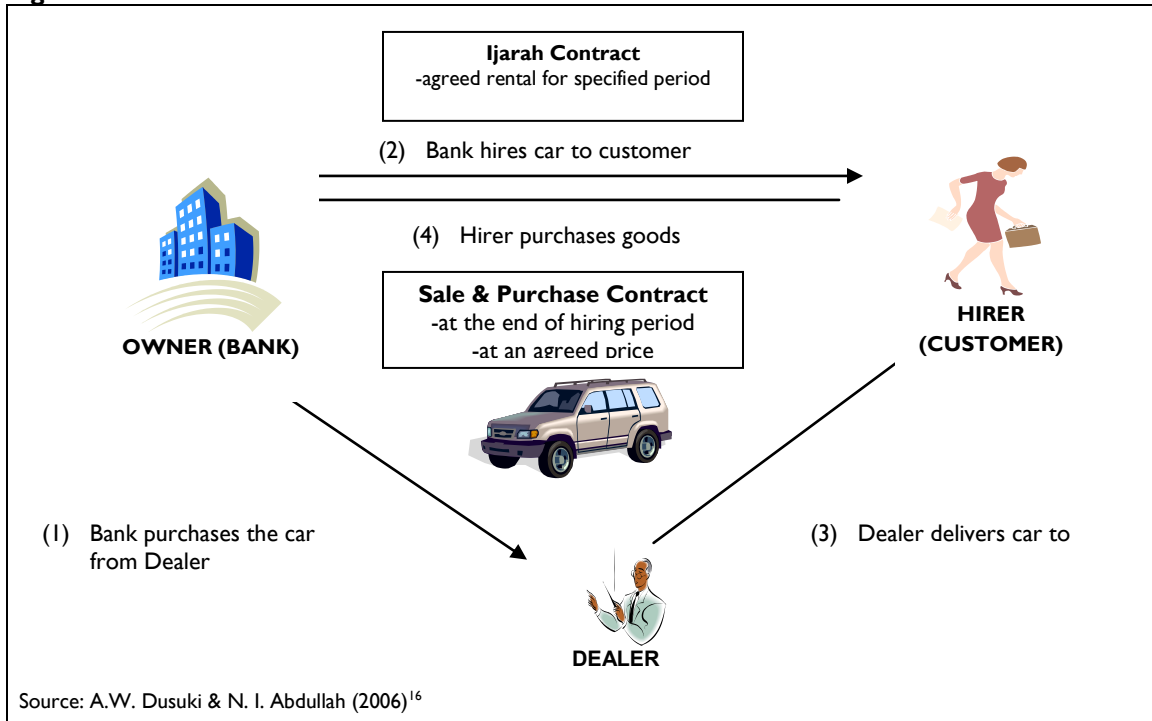
Like any other contracts, AITAB has to fulfill all conditions of a valid contract stipulated by the Shari'ah. The contract should be executed by mutual agreement, responsibilities and benefits of both parties should be clearly spelt out, and the agreement should be for a known period and against a known price. In particular, AITAB has to adhere to both principles of leasing (ijārah) and sale (bay') contract in respect of conditions imposed onto the contracting parties, offer and acceptance, consideration and subject matter of the contract.

Under the first contract, the lessee leases goods from lessor at an agreed rental over a specified period. Upon expiry of the leasing or rental period, the lessee enters into a second contract to purchase the goods from the lessor at an agreed price. In the current practice, AITAB involves three main parties: customer, financing company, and vendor. As seen below:

- (a) Finance Company buys the vehicle from Vendor or car dealer, based on the order of the Customer.
- (b) Finance Company rents the vehicle to the Customer at a rate agreed upon for a specified period of time. The Customer (hirer) agrees to pay for road tax and insurance coverage. He also will be responsible for its maintenance.
- (c) At the end of the period the Finance Company and the Customer will sign the sale and purchase agreement.

¹⁵ Refer to Al-Zuhaili, W. (2002). Al-Mu'amalat Al-Maliyah Al-Mu'asarah (Contemporary Financial Transactions). Damsyik, Syiria, Darul Fikr.

Figure 14. Mechanism on AITAB



Currently, AITAB is limited to the financing of certain items such as motor vehicles, due to their popularity in the present customers' demand. Some banks also offer this facility to finance industrial goods like equipment, machinery, building, transport and other durable article. The facility has been actively promoted by the banks in view of the low risk involved, high return on the investment and tax benefits derived

Today, Islamic hire-purchase is viewed as one of project financing and technical assistance. This facility can be used to finance many activities, which include those in trade and commerce, industry, agriculture and fisheries, housing and personal advances other than those for business purposes and housing. It is significant to note that this facility has been operated in several manners by different banks and regions. In fact, it has been one of the most popular modes of allocating funds by almost Islamic banks, not only in Malaysia, but also in Jordan, Sudan, Qatar and even Islamic Development Bank (IDB).

The table below provides some important distinctions between Islamic Hire-Purchase and Conventional Hire Purchase as practised in conventional banking and finance institutions today.

Differences between AITAB and Conventional Hire-Purchase

	AITAB (ISLAMIC HIRE-PURCHASE)	CONVENTIONAL HIRE-PURCHASE
Definition/ Concept	<ul style="list-style-type: none"> ▪ 2 contract (<i>âqđ</i>) in sequence ▪ interest-free 	<ul style="list-style-type: none"> ▪ hire then option to purchase ▪ 1 contract; 2 <i>âqđ</i> in one

¹⁶ Abdullah, Nurdianawati Irwani and Dusuki, Asyraf Wajdi (2006) Customers' Perceptions of Islamic Hire-Purchase Facility in Malaysia: An Empirical Analysis. *IIUM Journal of Economics and Management*. Vol. 12 No. 2.

	AITAB (ISLAMIC HIRE-PURCHASE)	CONVENTIONAL HIRE-PURCHASE
Eligible Customer	<ul style="list-style-type: none"> ▪ those who do not involve in immoral activities which against <i>Sharīh</i> eg. Gambling, drug and prostitution. 	<ul style="list-style-type: none"> ▪ No such limitation as AITAB ▪ Individual and non-individual who have good credit rating
Type of Goods	<ul style="list-style-type: none"> ▪ similar to conventional hire-purchase ▪ non-Act goods; industrial goods 	<ul style="list-style-type: none"> ▪ refer to 1st Schedule of HPA ▪ non-Act goods
Profit Margin/ Term Charges	<ul style="list-style-type: none"> ▪ flat rate, similar to conventional ▪ lower margin for non-Act goods ▪ 3 – 4% ▪ rental based on profit ▪ <u>cost price + profit</u> no. of instalments 	<ul style="list-style-type: none"> ▪ Maximum 10% ▪ <u>cost x interest rate</u> Year ▪ based on interest
Period of Financing	<ul style="list-style-type: none"> ▪ same with conventional hire-purchase ▪ Maximum: 7 years, Minimum: 1 year 	<ul style="list-style-type: none"> ▪ Maximum: 84 months, Minimum: 12 months
Calculation of Instalment	<ul style="list-style-type: none"> ▪ Fixed rate 	<ul style="list-style-type: none"> ▪ Fixed rate
Ownership	Asset purchased in the name customer	Remains with owner (bank)- asset purchased in bank's name
Transfer of Ownership	<ul style="list-style-type: none"> ▪ bank gives release letter after full settlement ▪ a document evidencing the transfer 	<ul style="list-style-type: none"> ▪ After payment of the last instalment or upon early settlement ▪ gradual retirement
Maintenance Responsibility	<ul style="list-style-type: none"> ▪ similar to conventional hire-purchase ▪ hirer bears the responsibility 	<ul style="list-style-type: none"> ▪ Maintenance responsibility not put on Owner because it is not pure lease
Documentation	<ul style="list-style-type: none"> ▪ Follows standard hire-purchase but add <i>Aqd</i> letter. ▪ 2nd Schedule, AITAB Agreement, AITAB Guarantee Agreement, AITAB Purchase Agreement, <i>Aqd</i> Letter (if applicable), Release letter 	<ul style="list-style-type: none"> ▪ Hire-Purchase Act 1967 ▪ 2nd Schedule, HP Agreement, Guarantee Agreement, Release letter
Governing Law	<ul style="list-style-type: none"> ▪ Hire-Purchase Act 1967 ▪ <i>Sharīh</i> law ▪ Guidelines from Bank Negara Malaysia 	<ul style="list-style-type: none"> ▪ Hire-Purchase Act 1967
Taxation	<ul style="list-style-type: none"> ▪ treated as leasing expenses ▪ Nominal RM10 ▪ In certain circumstances, Government exempted stamp duty for Islamic products 	<ul style="list-style-type: none"> ▪ RM10
Early Settlement (Rebate/ Ibra')	<ul style="list-style-type: none"> ▪ rule 78-Sign <i>aqd</i> letter after fully settlement ▪ similar to conventional hire-purchase ▪ Bank's right, looking into current practice ▪ Bank's discretion, cannot declare, if so obliged to give 	<ul style="list-style-type: none"> ▪ Rule 78 ▪ 3 months notice ▪ Statutory calculation
Penalty for Late payment	<ul style="list-style-type: none"> ▪ 1% of outstanding amounts ▪ charged on principal, example: Instalment=\$300, next month, must pay \$600.30 (300+300+1%) ▪ binding by BNM circular ▪ treatment of penalty after maturity ▪ discretion of bank 	<ul style="list-style-type: none"> ▪ impose late charges ▪ 8% (Hire-Purchase Act 1967) ▪ If 2 successive defaults, instalment are calculated again and charged. Total amount will be different and exceed original amount in agreement
Insurance responsibility	<ul style="list-style-type: none"> ▪ Same to conventional in respect of responsibility to bear insurance cost ▪ Islamic insurance (<i>Takāful</i>) ▪ Comprehensive- not 3rd Party 	<ul style="list-style-type: none"> ▪ bank's responsibility during first year ▪ hirer's responsibility in subsequent years ▪ Third-party insurance

¹⁷ Abdullah, N.I., Tag El-Din, S. (2007), Issues of Implementing Islamic Hire-Purchase in Dual-Banking System. *Thunderbird International Business Review*, Volume 49, Issue 2 (March/April 2007)

Case Study I - The Kuwait Finance House Ijarah Card: A credit card alternative

The following case study is adopted from the Kuwait Finance House web site.

KFH has taken the Ijara financing vehicle to the next level, introducing a “New Era in Card Finance” through the development of the Ijara Card. The Ijara Card is a Shari’a compliant product that introduces a new concept in Islamic Banking and Financing. The Ijara card is the first financing card of its kind that allows the user maximum credit, up to six times their salary, at 0.7% the lowest profit rate around. And, because we give two years to pay and there are over 250 outlets accepting the card, shopping for durable goods has never been easier! KFH’s Ijara Card was designed to enable our customers to own goods and commodities that they may otherwise not be in a position to access on a cash – and – carry basis. Customers can now own goods or commodities and pay for them inconvenient monthly instalments using the Ijara Card on a “lease to own” basis.

Features

- Sharia’a compliant.
- Maximum credit of up to six times your salary.
- Minimum profit rates of only 0.7% per month.
- Enhanced flexibility and speedy processing times
- Easy pay back with a choice of financing period of up to 2 years.

How does it work?

- The Ijara Cardholder identifies the products that he desires to “lease to own” from the list of merchants and durable goods that are pre-approved by KFH-Bahrain.
- The Merchant will “swipe” the Ijara Card through a point of sale machine and obtain authorization on the transaction.
- The Ijara Cardholder is then eligible to receive the relevant product on behalf of KFH -Bahrain.
- A repayment schedule is structured for the client to repay the total amount including the rental expenses over a period of up to 24 months.
- Ijara Installments can be debited on a monthly basis from the Ijara Cardholder’s account with KFH-Bahrain.
- The Ijara Card can be used to “lease to own” more than one product provided that the total amount of the relevant durable goods which will be “leased to own” does not exceed the predefined credit limits as set by KFH-Bahrain.
- Ownership of the durable goods is transferred to the Ijara Cardholder after repayment, in full, of all rental installments and dues owed to KFH-Bahrain are completed

The Kuwait Finance House (KFH) Ijarah card can be categorized as a type of credit card due to the similar functions that both hold, mainly to give more purchasing power to the card holder.

As seen above, there are indeed significant differences, and it is these that makes it a Shari'ah compliant product. The pure usage of the contract of ijarah, more specifically Ijarah munthai bit tamleek, in the structure of the card makes the product almos free from any misconceptions and possible scrutiny from those concerned. Something that can not be seen in other cards that use different Islamic commercial contracts, as seen in the case for Bank Islam Malaysia's Credit Card that uses the controversial Bai al Inah.

Case Study 2 - Shari'ah Compliant Home Financing in the US

The dream of homeownership is at the core of American society. While the dream of homeownership remains one of the core values of American society, there's a new and growing segment of the society for which expanding homeownership will take innovative thinking. For devoted Muslims, financing a home presents a challenge to the housing finance industry. Homeownership is one of the primary methods by which American families accumulate wealth. Over 68% of American families own their own homes. The pride of owning a home and the opportunity to build wealth through appreciation and federal tax incentives explains why housing drove an estimated 40 percent of annual economic growth back then in 2001, which still continues until now.

The outlook for mortgage origination continues to be very strong in the coming decade. The Federal Reserve Board and Freddie Mac expect the mortgage finance market to grow to \$11 trillion by 2010. The factors driving this growth include: 1) growth in the number of households; 2) house price appreciation; 3) growth in the overall homeownership rate in the United States and; 4) better leveraging of housing debt by consumers. Taken together, the Residential Mortgage Debt Market is likely to grow by an annual rate of 8% in the coming decade.

The United States home financing process is among the most progressive in the entire world. The secondary markets finance more than 50% of homes in the United States, more than any other country. Banks and mortgage lenders play the traditional role of sourcing borrowers, processing, underwriting, closing and servicing loans in collaboration with the capital markets. The capital markets in turn auction mortgage backed securities to individual/institutional investors and attract capital to finance the home financing industry in the United States. Three Government Sponsored Entities (GSE's) Freddie Mac, Fannie Mae and Ginnie Mae facilitate the securitization of mortgages. This process has created significant liquidity for the home financing industry. In addition, the process enables banks to recover their capital from home financing while maintaining relationships with consumers. From a consumer's prospective, the availability of abundant low cost financing has enabled them to finance their homes using 30-year repayment terms.

The case below will show the three available alternatives of home financing for Muslim community in the United States.

<i>1. Al Manzil Islamic Financial Services</i>	
<i>Features</i>	<i>Description</i>
Company Structure	Company is a business unit of the United Bank of Kuwait PLC. It operates out of New York City.
Source of Funding	Seed capital is provided by United Bank of Kuwait, PLC. Parent company.
Model	Ijara wa Iqtinaa (rent to own).
Availability/Waiting Period	Company's products are available in California and Connecticut at date of this paper. There is no waiting period for qualifying.
Title Ownership	Property is registered in the name of Al-Manzil until the Home Buyer pays off has paid the original purchase price; at which time, the title is granted to the Buyer for a nominal fee.
Monthly payments	Payments include two components a rental portion and a portion representing a contribution towards the purchase price. The later amount is held in a separate account until it reaches the original purchase price of the property.

<i>Features</i>	<i>Description</i>
Payment Calculation	Payments are calculated using a regular amortization schedule as in conventional mortgages. Payments can be fixed for 1, 3, or 5 years and then readjusted based on an agreed upon spread over the London Interbank Offered Rate (LIBOR) which is used as a bench marks for rental value.
Financing Term	Financing can be made for up to 30 years
Down Payment	20%
Selling Property/ Prepayment	Home Buyers may sell the property and buyback the remaining share with mutual consent of Al-Manzil. In addition, Home Buyers may prepay a portion of the purchase price at any time with such proceeds to be held in a separate purchase account until it reaches full purchase price.
Upfront Fees	Initial expenses associated with the financing include application, credit report, processing and arrangement fees as well as other traditional real estate costs such as escrow, title, attorneys, etc. are for account of the Home Buyer.
Maintenance Costs	Ongoing ownership expenses such as insurance and taxes are for the account of the Home Buyer. Insurance is required to be obtained from an Islamic Insurance Company "First Takaful".
Tax Deduction	Company issues IRS Form 1098 to allow for tax deduction of the rental portion of the payments based on an opinion letter from the Internal Revenue Service (IRS.)
Share of Gain/Losses	In event of sale of property ahead of financing tenor, any gain realized is for the account of the Home Owner. Any losses are deducted from the Home Buyer's deposits against the purchase price.
Process	Home Buyers can apply through designated brokers or by contacting the company directly.

2. American Finance House Lariba

<i>Features</i>	<i>Description</i>
Company Structure	An independent company headquartered in Pasadena, California. Company was formed in 1987 and licensed as a finance lender in the State of California. Company provides financing for automobiles and small businesses in addition to its home financing activities.
Source of Funding	Individual shareholders and investors from the American Muslim Community who wish to participate in the profits generated by the company provide funding through share ownership or investment.
Model	Lease to Purchase with Declining Equity, (Ijara –wa- Iqtinaa).
Availability/Waiting Period	Company is registered in 12 states including Arizona, California, Colorado, Georgia, Illinois, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, Texas and Virginia (as of January 2000). No waiting period is required for qualifying.

<i>Features</i>	<i>Description</i>
Title Ownership	Property is registered in the name of Home Buyer with company holding a lien on the property as collateral.
Monthly payments	Payments include a rental component and an installment purchase (loan repayment) component. Home Owner pays taxes and insurance independently.
Payment Calculation	The rental component is a function of the fair rental value of the property as determined by both company and Home Buyer's research of rental values in the area of financed property. Rental value is agreed upon with the Home Buyer at the start of transaction on an ad/hoc basis. Home Buyer pays a percentage of the fair rental value based on the equity share of the company. This component is referred to as Return on Capital ("R-ON-C" pronounced ronsee). The installment purchase component represents the amount required each month to purchase back the amount advanced by the company over the life of the financing with NO ADDITIONAL INCREASE OR INTEREST. This component is referred to as Return of Capital ("R-OF-C" pronounced rofsee). Although monthly payments are fixed for the term of the financing, the rental component decreases each month as the company's equity share declines.
Financing Term	Financing can be made for up to 15 years. Company recommends from 7 to a maximum of 10 years.
Down Payment	20-40% depending on availability of funds.
Selling Property/ Prepayment	Home Buyer may sell the property at any time and buyback the remaining shares of company (balance of financing amount). Partial prepayment (purchase) may also be made at any time. Partial payments will be applied against the purchase installments in inverse order of maturity, and rental component is reduced proportionately. A prepayment fee of approximately 2% of remaining balance and is calculated based on actual out of pocket expenses associated with the process.
Upfront Fees	Initial expenses associated with the loan including credit report, processing and arrangement fees as well as other traditional real estate costs such as escrow; title, attorneys, etc. are for account of the Home Buyer.
Maintenance Costs	The Home Owner pays ongoing ownership expenses such as insurance, maintenance, etc. Company requires that Property be insured for value of its equity with any reputable insurance company of Home Buyer's choosing.
Tax Deduction	Company issue IRS form 1098 to allow for deduction of rental portion of the payments which is calculated at the beginning of the transaction and converted to an implied interest rate on the promissory note.
Share of Gain/Losses	In event of sale of property ahead of financing tenor, any gain or loss realized is for the account of the Home Owner.
Process	Home Buyer can apply through the Internet, fax or by contacting the company directly.

3. MSI Financial Services Corporation

Features	Description
Company Structure	A financial services corporation founded in 1985. Company started its operation in Beverly Hills, California and later moved to Houston, Texas. Company provides financing for homes, automobiles and businesses.
Source of Funding	Company establishes and manages private limited partnership funds (Mudharrobah basis) which are marketed to accredited investors (high net worth and annual income) from the American Muslim Community. The proceeds of the funds are used to finance the various activities.
Model	Shared Home Appreciation in Rent and Equity (rent to own).
Availability/Waiting Period	Available in major US cities pending availability of partnership funds. Home Buyers must invest 20% of purchase price with company for at least 6 months in order to qualify for consideration.
Title Ownership	Property is registered in the names of both MSI's housing fund and the Home Buyer.
Monthly payments	Monthly payments consist of two components—rental amount and amount to buy back MSI's share. Payments also include taxes and insurance, which is shared by MSI based on its ownership share. Payments are adjusted annually based on the value of the house, which is determined by an independent appraisal.
Payment Calculation	MSI calculates the monthly payment every year to take into account the appraised value of property, amount of taxes and insurance and rental value in the area.
Financing Term	Financing can be made for 5-15 years
Down Payment	20% of the purchase amount must be invested with the fund for a period of 6 months prior to participation in the program. After qualifying, there is a waiting list for funding of several months.
Selling Property/ Prepayment	Home Owner may sell the property with mutual consent of the fund. Gains/losses are divided between the Home Owner and housing fund. Home Buyer may elect to prepay up to 20% of the property purchase amount annually.
Upfront Fees	Initial expenses associated with the financing include application, and credit report, processing and arrangement fees as well as other traditional real estate costs such as escrow, title, attorneys, etc. are for account of the Home Buyer estimated at 1-2% of financing amount.
Maintenance Costs	Ongoing ownership expenses such as insurance and taxes are shared with MSI and included in the monthly payment. Maintenance repairs are to the account of the Home Buyer. Large uninsured repairs are shared with MSI in accordance with each party's ownership percentage.
Tax Deduction	Monthly payments do not benefit from a tax deduction.

Share of Gain/Losses	In event of sale of property ahead of financing term, MSI and the Home Buyer in accordance with their ownership percentage share gains or losses at time of sale.
Process	Home Buyer can apply through company or its regional representatives. Home Buyer must become members of the fund by investing at least 20% of the property cost (minimum \$10,000) for a period of 6 months to become eligible for borrowing from the fund.