

## How ICFAL SER property finance works?

*Purpose of this document is to summarise the core principles of ICFAL SER financing model and lists some frequently asked questions and their answers. It is only valid at the time of publication and not considered as a legally binding contract. For latest full terms and conditions of the finance or further clarification, the reader is welcome to contact ICFAL office. However legal documents are not handed to public until they become member of ICFAL and qualify for finance or nominated for Sharia transparency scheme under a non-disclosure agreement.*

Al Quran: Surah Al-Baqara, Verse 275:

*“Those who swallow down usury (Riba) cannot arise except as one whom Shaitan has prostrated by (his) touch does rise. That is because they say, trading is only like usury; and Allah has allowed trading and forbidden usury...”*

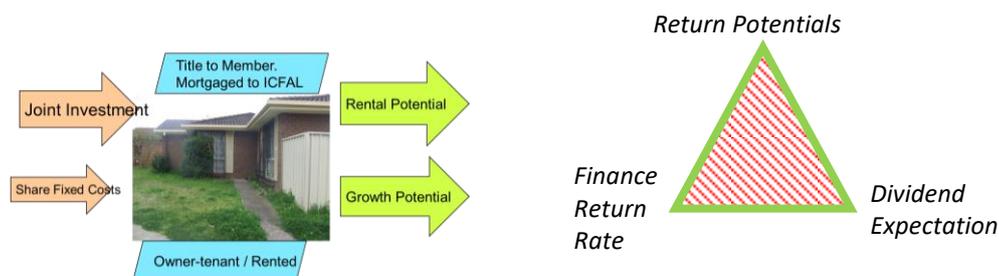
### 1. A Real-World Investment Model for Islamic Property Finance:

ICFAL property finance is purely based on the concept of *Trading*. The model of trading reflects the real-world return on a property investment. A property investment has two **return potentials**,

- Net *rental income* and
- Long term *capital gain*.

ICFAL seriously assesses these return potentials before engaging into the investment. Naturally, like any trading, when an investment is found to have un-viable return, the investment is possibly avoided. However, after engaged with the investment, if natural and unavoidable loss occurs then the loss is shared in compliance to *Sharia* practice.

In financing such an investment, ICFAL also considers the other two market forces namely the *Dividend Expectation* of the investing members and the competitive *Finance Return Rate*. The connection between *Return Potentials*, *Dividend Expectation* and *Finance Return Rate* are demonstrated in the triangle below. The actual return on this investment thus can sit inside the triangle, *negotiated* and set prior to the contract. It must be *affordable, reasonable* and *sustainable* purely depending upon the actual living condition of the property making it trustworthy trading for both the parties.



### 2. The Share and Equity Rental (SER) Process:

The term **SER** stands for Share Equity Rental. It is a partnership between ICFAL and the applicant member to co-own a property on shared equity basis. In Islamic term it is called **Musharaka**. Member contributes a minimum 20% of the property value at the time of purchase and ICFAL contributes the rest, but maximum \$A750,000<sup>1</sup>. Legitimate costs, including stamp duty (if any) of initial purchase are included in the project then the total project investment is allocated to equities of the parties decided prior to the settlement of purchase. As the member is intended to be the final owner, the property title is registered in member's name. In return and to give a security, member mortgages the property to ICFAL.

<sup>1</sup> Current value may be different. Please contact ICFAL for latest values.

## 2.1 The Capital Gain and Equity Sell Price

Intention of the parties is that the member purchases ICFAL's equity over a *term period* and becomes the full owner at the end. This makes the process a *diminishing partnership*. Maximum term is 30<sup>1</sup>years. A *profit* based on agreed *property value growth rate* is pre-set for each unit sale of ICFAL equity which normally occurs monthly. Member may be entitled to purchase additional equities at pre-set "ICFAL balance unit target sell Price" shown in the contract.

## 2.2 The Net Rental Income and Tenancy Provisions

Objective of ICFAL is to help it's members acquire property for living in halal way, therefore, the *SER* is prioritised for members who are the first home buyer and who intend to live in the property. Member pays ICFAL's share of agreed *Weekly Rental* as a tenant. The rental, which reasonably represents the market and negotiated based on location, size and condition of the property and the term etc., is pre-set with a *Starting Rental* and a *Rental Growth Rate*. The rental growth rate represents change of rental over time due to economic inflation or specific to rental market trend of the region concerned.

During the co-ownership, both parties share the actual fixed costs of ownership. Shared fixed costs are council rates, fixed service fees, mandatory insurances and strata fees. Thus the *Net Rental* is the rental minus the refund of fixed cost.

ICFAL is not being a property manager, it relies on the member, as the final owner and a tenant, to manage and pays for the ordinary property maintenance. In any unavoidable circumstances, should the co-owner cum tenant move out of the property, the member can rent it out to a third party with pre-agreement of ICFAL.

## 2.3 The Review Process

The return potential is reviewed based on potential of rental and value growth over time at an interval of 3, 5 or 10 years as agreed in the contract. This allows fair adjustment of the entire investment process reflecting real world impact on property market and economy. Shorter the review interval, this finance represents more accurately to the real world. However, there is no perfection in the real world thus ICFA relies on reasonable effort and resources available to agreed review interval. Additional share purchase can be made after the first year of contract.

## 2.4 The Financial Contract and Terms and Conditions

In complying with the Islamic Sharia and rules of the co-operative in accordance with the Co-operative Act 1992, both parties will sign *financial accommodation contract* and a *Terms and Conditions*. A typical financial plan is shown below as an example only. Actual values of a plan are dependent on evaluated *rental*, *rental growth*, *value growth rate* and *terms*. Plan can be revised at pre-agreed *review interval*.

### Financial Plan (Rental and Musharaka Unit Purchase Schedule)

ICFA Ltd	Vs.	Sample Member 92888888	
		Finance Term	<b>05.0 years</b>
		Total Cost of Acquisition of the Property:	<b>\$100,000</b>
		Agreed weekly Rental to be shared by ICFAL and member	<b>\$110</b>
		Monthly Payments for Rental and Musharaka Unit Purchase are varying with an average	<b>\$1,584.4</b>
		First Regular Payment: <b>1-Oct-17</b>	Last Regular Payment: <b>1-Sep-22</b>
		Administrative charges to be deducted from Member's a/c with 1st regular payment.	<b>\$600</b>
		Agreed Rental and Growth review interval	<b>1.00 years</b>

Date	Member Actual payment ( $P_{in} = P + R_{in} + P_{fn}$ )	Member's purchase of Musharaka Units (P)	Share of Rental		ICFAL Profit on Musharaka Unit sell ( $P_{fn}$ )	Balance of Musharaka Units		ICFAL balance unit target sell Price (a)	Member balance unit target sell Price (b)	Property Target Net Sell Price (a+b)
			ICFAL ( $R_{in}$ )	Member		ICFAL ( $I_{sn}$ )	Member ( $M_{sn}$ )			
1-Sep-17		Property Musharaka Settlement		-		<b>80,000</b>	<b>20,000</b>			
1-Oct-17	1716.81	1,333.33	381.8	95.5	1.67	78,667	21,333	78,765	21,360	100,125
1-Nov-17	1712.58	1,333.33	375.9	101.9	3.34	77,333	22,667	77,527	22,723	100,250
1-Dec-17	1708.35	1,333.33	370.0	108.5	5.01	76,000	24,000	76,285	24,090	100,375
1-Jan-18	1704.09	1,333.33	364.1	115.0	6.68	74,667	25,333	75,041	25,460	100,501
1-Feb-18	1699.83	1,333.33	358.1	121.5	8.35	73,333	26,667	73,793	26,834	100,627
1-Mar-18	1695.55	1,333.33	352.2	128.1	10.03	72,000	28,000	72,542	28,211	100,752

Total	95,063	80,000	11,937	17,781	3,126	Balance of Musharaka Units		-	-	-
Date	Member Actual payment (Ptn = P + Rln + Pfn)	Member's purchase of Musharaka Units (P)	Share of Rental		ICFAL Profit on Musharaka Unit sell (Pfn)	ICFAL (Isn)	Member (Msn)	ICFAL balance unit target sell Price (a)	Member balance unit target sell Price (b)	Property Target Net Sell Price (a+b)
			CFAL(Rln)	Member						

- Note - 1** Unless otherwise reviewed upon request from either party after the completion of the 1st year from the Musharaka Settlement, this financial plan will remain firm for the full term. Minimum past 10 years of market data of similar property of the same locality must be taken for the valuation to avoid short term market speculation (gharar).
- Note - 2** The Balance of Musharaka Units are at the original unit price. At the early termination or when purchase of additional units has to occur, the sell price of ICFAL Musharak units will be as per the column "ICFAL Units Sell Price". If a sell has to occur prior to the finance term is complete, the target sell price of the property is to be determined by the value listed as "Property Target Net Sell Price" after all selling expenses.
- Note - 3** The purchaser agreed to purchase ICFAL Musharaka Units at nominal annual property value growth rate of 1.50%. Agreed annual average Rental growth rate is 1.50%. All the profits on unit sale and Rental to be paid to ICFAL over the entire term as scheduled without any additional unit purchase will equate to an Equivalent Annualised Rate of 6.68%.
- Note - 4** An estimated average monthly fixed cost of \$30.00 covering council rates, water and sewerage service and insurance will be shared in proportion to the balance of units at the middle of billing period by ICFAL. This may equate to approximately \$732 over the entire finance period during when ICFAL share diminishes from 80.00% to 0.00%. Actual amount will differ from this estimate based on actual bills.

In the financial schedule, the *Member Actual Payment* of a month is the sum of the *Member's Purchase of Musharaka unit*, *ICFA share of rental* and the *ICFA Profit on Musharaka Unit sell* as listed in the row of that month

## 2.5 Contract Non-compliance

The contract includes terms to protect the rights of and execute the responsibilities of ICFAL (actually representing all it's member) and the applicant member in a fair and just basis. When a member is at fault of not paying regular payments or breaches other terms, the contract allows ICFAL to consider the case in lenient manner as much as possible for a genuine case of natural hardship and difficulties. Hardships are determined based on immediate family and financial situation. A member requires presenting such situation may be undertaken asset test and income test. Member at fault will be notified in advance before any action is taken. Maximum three short of payment is allowed in difficult situations. A maximum 6 months is allowed for paying the rental component and not purchasing any ICFAL Musharaka units. After this period, subject to further consideration by the board of directors, ICFAL may choose to take over the property and member may be asked to leave the property for renting outside or sale the property in the open market.

When member initiates a sell of the property outside market, naturally when the property can be sold at the possible best market price with profit same or more than the *target sell price*, it is assumed to be a good sale. If member initiate a sell at market downturn or at loss, the interest of sell at loss is **questioned severely**. This is to protect the rights of ICFAL investing members from any unfair distribution of financial or family situation of the concerned member. When all parties find selling at loss is the best option or the loss is due to any unavoidable natural situations, parties will share the loss as per the equity.

## 2.6 Property Improvements

Any improvement or changes in the property must be informed to and approval is taken from ICFAL. Minor improvements those do not increase property value will not be included in the Musharaka Unit calculation when the property is sold. Musharaka unit adjustment for major improvements is considered after industry standard de-rating factors.

## 3. Application Processing

In application processing, member must wait for at least 6 months after becoming member, however, the board of directors has right to except this requirement for the broader benefit of ICFAL and its member without unjust to any individual members. When there is shortage of funds, normally applications are processed on the "first come first serve" basis for only valid applications. Further factors such as length of membership, type of investment, social and legal factors are also considered at the discretion of the board of directors for the best outcome for the co-operative and member. Member must bring his/her intended worth of property share to ICFAL account, at least 10% of the property price kept for minimum 6 months and remaining of the minimum 20% as soon as the *preparatory notice* is served to member for getting ready. This money does not earn dividend for the

period it is held inactive from the date the member advises his/her readiness. At this point ICFA will engage a coordinator to take care of the project. Coordinator will collect latest documents, conduct credit check, assess the full application and offer a pre-approval. The final approval for finance and investment is only given after a target property is evaluated for price and security qualification. From the date of pre-approval, typically up to 8 weeks is allocated for settlement of the property purchase.

### **FAQ on ICFAL Property SER (Musharaka) Finance:**

**Q: How ICFAL Musharaka Finance Contract Document is halal and absent of contract in contract?**

The SER Diminishing Musharaka process used in ICFAL real market model is approved by the Sharia Advisory committee of the Meezan Bank of Pakistan. The finance approval process, the terms and conditions and the contract documents were severely vetted by the nominated scholars of Meezan Bank. The contract documents are clearly broken into four main stages namely,

1. The Musharaka Deed which consists of the purchase of the target property under the Musharaka provision.
2. The Musharaka Undertaking which ensures the purchasing member takes an undertaking to regularly purchase ICFAI Musharaka units to finally acquire the full property by the diminishing Musharaka unit owning process
3. The Lease Undertaking which ensures the purchasing member also undertakes to pay rent while live in the property when the property will be acquired under the Musharaka Deed.
4. The Lease Deed which ensures that after the property is purchased under the Musharaka Deed, the tenant cum member continues to pay rent and other payments as per agreed financial schedule.

Therefore, there is contract in contract

**Q: Is the monthly repayment changes in existing finance contract like banks or other institution when market rate changes?**

**A:** ICFA is unable to compare others' product because ICFAI may not have detail and accurate knowledge of those products.

We call *payment* instead of *repayment* as the term "*repayment*" represents a cash return on borrowings typically used in traditional banking system. The monthly payment does not change over the term unless it is reviewed at the agreed review interval. After the 1st year of contract, member can purchase additional Musharaka Units and renegotiate the monthly payment to reduce contract period if wanted. But any change of payment must reflect the real property value and rental potential, not the financial market interest rates.

**Q: What would be my monthly payment for SER finance and how it is determined?**

**A:** A fixed monthly payment is taken to cover the payment of the rental of the ICFAI share of the property and a sell price of ICFAI share purchased by the member. A payment schedule is generated when a property rental value and a schedule of share purchase with a negotiated price is determined. Determination of rental value and share sell price depends upon the type, quality and location of the property and their rental and growth potentials and based on independent valuation. Cost of competitive and equivalent market finance also considered so that Islamic finance does not become an unreasonable method that may potentially hinder the promotion of Islamic values. Following table gives a *net payment potential* for a scaled finance amount of \$100,000 as an example. This includes an estimated return of ICFAI fixed cost share to the member.

Finance amount \$100K, property price \$125K, NSW Torense Title Experience: Dec 17. *Indicative only.*

Term of finance (years)	10	15	20
Average Monthly net payment (after fixed cost	\$1140	\$875	\$745

refund)			
Expected starting weekly rental	\$130	\$130	\$130
Potential growth rate per annum	2.0%	2.0%	2.0%
Potential rental growth rate per annum	1.8%	1.8%	1.8%

**Q: If the property was purchased at \$400k for instance, and the property value declines to \$350k, can the share buyback be negotiated at a loss i.e would ICFAL accept a loss for their shares rather than a profit as the shares represent the value of the underlying asset?**

**A:** We do not call "buyback". Buyback is not applicable in Musharaka process. Member is not buying back from ICFAL. ICFAL paid for ICFAL equity and member is purchasing ICFAL equity at a negotiated sell price. At time of settlement an agreed sale and profit is negotiated with the member based on anticipated growth of the property value over the term. Over a longer term it is rare to see property price drops, in average despite short term rises and falls. If one knows at the beginning that one would sell a property at loss over the entire period, then one would not get engaged in a loss concerning trade, which is natural. ICFAL will share a loss when an unavoidable situation occurs which is out of control of both parties. If parties agree to sell at loss, instead of selling to market, ICFAL would hold the property until when the price turn back to normal. It is also impractical to value a property sale price every month. A particular property is only good for its own price when sold. At downturn, any property may be sold at profit if some attractive minor changes occur to the property or to its neighbourhood. And vice-versa a property may be sold at loss despite good market average due to fall of its quality or damage or neighbouring living environment. However, if a selling at loss is driven by the member then the initiative is **questioned severely** and genuine need for sell is established to avoid any unfair passing of member's interest to a loss to all the cooperative members.

**Q: If the member decides to sell at a loss or profit, with ICFAL's consent, does ICFAL share the loss or profit with the member?**

**A:** We will agree to take loss, if and only if the sale at loss is due to a genuine need and there are no other alternatives to avoid a loss. If member wants to sell at a time when it becomes a loss, we may buy from the member and hold until it becomes a profitable to sell. Unless there is a negative motive, no member would like to sell at loss in normal circumstances. We will also assess if member is intending to sell at loss due to his personal or commercial gain somewhere else. This would not be justified to convert one's personal gain into a loss to the members of the cooperative at any time. At ICFAL we would try to ensure fairness in our dealing with all the parties always.

**Q: Can I purchase a land only with ICFA finance?**

**A:** Yes. The purpose of the land should be, either to build an income generating project such as home or rentable property, agriculture or farming etc. So that the Musharaka process can be applied by allowing a process of *leasing to build* or *leasing for farming* etc. The land must be mortgaged to ICFAL.

**Q: Can I build a home only on a pre-purchased land with ICFA finance?**

**A:** Yes. The building will be financed under Istisna-Musharaka process. Construction must be supervised by ICFA representative. Project can be broken into few stages. Every stage can be maximum one month long so all expenses for that stage is captured and a stage financial schedule is signed off. Once building is complete a combined full SER will be prepared including all stages. The land must be mortgaged to ICFA. If the land is pre-purchased using ICFA finance under Musharaka SER then the land SER can also be combined with building.

**Q: Will ICFA share stamp duty?**

**A:** We expect the stamp duty is fully borne by the purchasing member. However, when member is unable to bear part or full of this cost, the amounts paid by each party are included in the equities.