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Weaknesses of Current Capital Raising, Financing, and Investment Methods of Awqaf (Islamic Trusts)

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***Abstract*- the issue of Idle or underdeveloped properties of awqaf (Islamic Trusts) is often discussed by scholars, jurists and social scientist. If the issue continues to happen, the objective of Islamic Trust may be defeated. Overall, the institutions of Islamic Trust may also fail to deliver a socioeconomic utility to the community. Does it mean the various innovative methods developed in the last three decade did not succeed? This paper analyses such methods i.e. that of raising working capital, financing, and investment. It is found that the majority of these methods are either ad-hoc, or have resulted in assets which are non transferable, incapable for investment, limited, dedicated for specific purpose, refundable and expensive to redeem. Over all, it seems that these methods have neither completely solved the problem of illiquidity nor inadequacy of Islamic Trust assets. This paper therefore suggests search for alternative methods that can further minimize the problem of illiquidity and inadequacy of Islamic Trust assets in hope to resolve the problem of idle or underdeveloped of Islamic Trust properties and enabling Islamic Trustee institution play effective role in the development of underprivileged communities.**

Keyword: Illiquidity, Inadequacy, Capital Raising, Financing, Investment

I. INTRODUCTION

Waqf (hereafter referred to as Islamic Trust or trust) in general restrains the object of trust from being transferred, gifted, or transmitted; the benefit or income of the object is dedicated for the welfare of Muslims and non-Muslims. Islamic Trust has benefited Muslim communities from the outset of Islamic civilization. In Malaysia and some other countries, Religious councils or Islamic Trustee Institutions are sole trustees, who strives to manage and develop Trust properties, whether public Trust or family Trust (Tahir Sabit, 2006).

Islamic Trusts contribute to the socio-economic welfare of people including religious, educational, poverty eradication, health, etc. Nevertheless, this broader contribution will be impracticable if trust properties are idle or underdeveloped. If unresolved, these problems may have negative effect on Islamic Trustee Institutions who would fail to fulfil their duties of realizing the objective of the donors.

During the last decade several innovative methods were developed and claimed to be effective in the financing the development of Islamic Trust properties. These methods were tailored for capital raising, development financing, and investment. They included, long term Lease (hukr), Exchange or Substitution (Istibdal) (Monzer khaf, 1998), Built And Sale (Murabahah), Forward Sale (Istisna'), leasing (Ijarah), Profit Sharing (Mudharabah), Profit/Loss Sharing (Musharakah), Output Sharing (Mu'amalah) (Monzer Khaf, 1998; Tahir Sabit 2006), cash endowment, Islamic Real Estate Trust Units (Saham waqf), Services, income/profit, copyrights (Tahir Sabit, 2006), and Corporate Share Units (Waqf saham) (Siti Mashitoh 2008).

Surprisingly, Islamic Trust properties are still idle or underdeveloped (Mohamad Salleh, 2009; Norhaliza and Mustafa). There could be several reasons. This paper, however, analyses the above methods in order to find the reason for the ineffectiveness of the above methods if any.

The paper outlines the defining basics of a given method first followed by its analysis in order to find weaknesses that makes them less effective in the development of trust properties. The paper is divided into three main sections and a conclusion. The first section will address methods of capital rising, the second will touch on financing methods and section three will include investment methods.

II. CAPITAL RAISING METHODS AND THEIR ANALYSIS

Islamic Law recognises trusts to consist of immoveable and moveable property as long they can be recurrently used. However early Islamic Trusts, according to some schools of law, comprised only immoveable properties such as land, building, plantation, fruit tree, fixtures or attachments. This was in strict compliance with the two characteristics of Islamic trusts: perpetuity, and inalienability. Moveable property included goods such as book, animals, equipments, and to an extent the donation of cash. Currently, the capital of Islamic Trusts is raised not only through landed property but also through donation of cash, equity shares and bonds, as well as cash to be converted to immoveable property.

A. Landed and Goods

According to a group of Shafi'e, Hanafi and Hanbali scholars of Islamic law the characteristics of trust property should be to exist in perpetuity which is not transferrable or revocable. They preferred donation of lands as the object or capital of Islamic trusts for three reasons: the donated land could be used by the beneficiaries, the beneficiaries could receive income generated by the donated lands, and the use or income of the donation could be long lasting. As a trade off the lands could never be sold and transferred to another unless exceptional circumstance dictate otherwise.

Perpetuity may benefit to guarantee the historical accumulation of the Islamic Trust properties (Monzer Kahf, 2003); however, due to the non transferability and inalienability of these assets, this concept may limit attracting more funds as land is not cheap and not many people have land. Due to the inalienability factor, the donated land neither can be used to create liquidity in order to solve the problems of other trust properties, nor could they be used for a purpose which was not defined by the donor. For example, land can be used as collateral to obtain finance from financial institutions. But the above restriction as well as the prohibition of transfer of trust lands or fixed asset makes Islamic Trustee Institution helpless in the financing of the development of awqaf properties (Tahir Sabit and Abdul Hamid, 2006).

Trust lands may generate income through short term or long term leasing (hukr) which may help in the development of one or two idle trust assets; such is limited, and even more due to the low rental yields the accumulated income from leasing will most probably be just enough to spend it on the beneficiaries of the trust.

Unless a solution to the inalienability of trust assets is found landed trust assets cannot assist Islamic Trust institutions to develop idle and underdeveloped properties. To solve the above difficulty the views of Maliki School may be useful. A new reading in line with that of some Maliki scholars, about non-perpetuity and alienability of Islamic trust assets, and of Hanafis scholars, regarding the validity of donation of cash, is needed.

B. Islamic Real Estate Trust Units (IRETUs)

Raising trust funds through IRETUs is one of the innovative methods established by Muslim jurists in order to help Trustees finance the development of their properties. The Fatwa Committee of the National Council for Islamic Affairs Malaysia in 1982 discussed and decided that ITREUs is permissible. Funds are raised from public through an issue of certificate of Islamic Trust unit valued at RM 10. The public pays the specified amount in cash, and the Trustee will use it in financing a development project. This method seems to be the best way for resolving the problem of idle or underdeveloped of trust lands. However, it is only used for one time and then it reverts to fixed sets. It may help in attracting more funds but its utility is limit to one project. Once the project is completed the developed asset will remain landed which cannot be used for the development of other assets. This if not offered on regular basis will have limited effect in terms of development trusts.

C. Corporate Share Units

Muslim scholars recognised the dedication of company shares by a unit-holder for a specified purpose. Only the dividends or income of shares units can be used for the benefit of persons or bodies named in the deed of the trust (Fatwa International Islamic Fiqh, 2009).

It is currently practiced by JCorp, the development arm of the government of Johor, Malaysia, through their corporate social responsibility (CSR). This entity has dedicated a substantial amount of stocks in its subsidiary companies as trust, where the income earned from these shares is spent by the entity on social services such as building mosques and establishing and maintaining the An Nur Clinics. These are for the benefit of the poor from all ethnic and religious backgrounds.

Though this method of raising capital is a good initiative, the concept however does not go beyond solving the problem of raising new capital. The benefit of it is limited to the interest it serves. Since the amount raised is in the form of shares or equity of the company it neither can be used for other purpose, nor it can be sold in the market and use its proceeds in another investment scheme. It is not therefore useful for the development of idle lands.

D. Cash Endowment

Cash Endowment was firstly adapted in Ottoman era in Egypt (Majid Khademolhoseini, 2010) and other areas of their jurisdiction. In Malaysia this was done around 2007, but it is not fully practiced yet. Cash endowment is one of the permissible trusts that can be used for raising capital by trustee institutions. This mode is different from others because it can be freely used by trustees for any purpose including developing idle lands as long it is on investment basis. It is considered in-house-financing product and the best method to have capital liquidity which eventually can resolve the problem of idle or underdeveloped properties.

Cash endowment can increase capital and its liquidity; if it is raised unrestrictedly and on a regular basis.

Due to the limitation of the above methods, trusts may not have adequate cash at hand. Therefore, Muslim scholars have developed alternative methods for financing the development or redevelopment of idle lands. Post modern scholars in the late part of the 20th century introduced new methods. These methods are analysed next.

III. Financial Methods And Their Analysis

Due to need and urgency several financials methods have been developed by early and contemporary Muslim jurists. The funds raised through these methods are categorized into two: of Islamic trusts and others. Both have been explained below:

A. Financing Development through Assets of Conventional Financial Institutions

Development funds are obtained from conventional financial institutions. Several modes of financing commonly utilized by conventional Islamic banks are tailored specially for trust properties. These methods are explained below.

B. Built and Transfer

Through Built and Transfer method the manager on behalf of the Islamic trust will buy equipments and materials needed for a development project. The trust will be the borrower and the institution will be the creditor. The trust will owe the price of the equipment plus profit margin agreed by both parties. This debt will be paid by the trustee from the profits earned from the project. Upon the full settlement of the debt, the trust can have exclusive right to the profits earned from the project.

The weakness of this method is that makes the trust a borrower, which is not encouraged by some jurists under normal circumstances. Further, it is possible that the trust may purchase goods at a higher price. Additionally, there could exist not many institutions willing to enter into transactions with Trustee Institutions. Furthermore, it is risky. The trust property may be lost if the trustee intended to rent the building and tenants are not found, and the trustee Institution is unable to pay the principle and the mark up.

C. Forward Sale

Forward sale mode is usually used for the purpose of financing a construction project on trust land. It involves two different contracts: first between Trustee Institution and a financial institution. Another contract will be between a financial institution and a contractor, whereby the latter will be obliged to complete the project. Upon completion the project will be handed over by the financial institution to the trustee Institution (Khaf, 1998; Tahir Sabit, 2006). Therefore the project will be the property of the financier. The Trustee Institution will buy the completed building from the financer after its completion (Tahir Sabit et. al, 2005). This method is also credit based and has the same weakness as mentioned above under Built and Transfer financial method.

D. Leasing

Through leasing mode, a financial institution may construct a building on a trust land, such as hospital, school, rental office, or apartment. After completion, Trustee Institution may lease the building for a certain period of time. The trustee will pay the principal and the predetermined profit to the financier (Kahf, 1998). At the end of the leasing period, the financier will have no exclusive right to the trust property (Tahir Sabit et. al, 2005) which thereafter could be surrendered to the trustee Institution. This method is the same as Built and Transfer and Forward Sale, mentioned above.

Over all this methods can solve the problem of idle lands, but it seems both the trustees and financial institutions are reluctant to use them. One main reason for trustees not using these methods could be low income from the project and a longer time to repurchase the building. This could be true too about the following methods.

E. Profit Sharing

Generally, in Profit Sharing method a financier provides cash capital to a trader to carry out business. The profits will be divided between them. In the context of Trust, financial institution may deposit cash to the Trust manager and he will act as entrepreneur to construct a building on the trust property (Khaf, 1998; Tahir Sabit, 2006). The profit will be shared between them on a ratio 50:50, 60:40, and 70:30, etc as agreed by the parties.

The weakness of this method is the same as in the abovementioned financial methods. In addition the risk is higher as the losses can be borne by the financer alone.

F. Profit/Loss Sharing

Usually trustee institutions make the partnership contract with the financial institution to construct the building. After completion of the building the income earned will be shared and distributed among trust and the bank.

This method has similar weaknesses as mentioned above.

G. Output Sharing

Output sharing means sharing the returns from a development project between the trust and the bank. In output sharing, usually the trust will provide land, if the assets are owned by the trust, and financing institution will provide all expanses to develop and manage the property (Khaf, 1998).

The weakness of this method is similar to that of Profit/Loss Sharing mode.

H. Financing Development Projects through Trusts Assets

Unlike the abovementioned financial methods, those discussed below are method of raising cash through liquefying fixed assets or raising fresh funds for purpose of financing a development project. These include long lease, exchange or substitution of trust land with cash, cash endowment, and IRETUs.

I. Long Lease

Islamic trusts can raise finance for a project through long term lease of its existing land. The institution may offer its land to public for long term and demand a large lump sum equivalent to the value of the given land (Tahir Sabit et. al, 2005). In return, all rights will be transferred to the leaseholder who may also pay periodical rent. This leaseholder will have exclusive right on the property and he/she can develop as well as manage the property, sublease, and has the right to transfer and inherit, gift, and donate his rights in the land. The lump sum can be used to finance development on the same site or on another trust land (Kahf, 1998).

This is an ad hoc measure. The trust property remains in possession of the leasee for centuries. There is no provision for revision of rentals and therefore can be detrimental to the interest of Islamic trust and its beneficiaries. Islamic trusts may be reluctant to do transactions in this manner.

J. Exchange or Substitution

It is permissible to substitute all or part of Islamic trust lands with another land or cash, either through substitution, sale and purchase, or any other way that is approved by Shari'ah (Tahir Sabit, 2009; Zulkifli and Najib, 2008). The substitution of trust land with cash can be used to finance the development of another land.

This method exposes Islamic trust to loss of assets if this rule is abused by some unscrupulous administrators (Tahir Sabit et.al, 2005). This method can be used if land is substituted with cash and used for the development of another land. It is an ad hoc measure. The cash becomes part of the land after its use; that is the developed land becomes a joint Islamic trust and henceforth it cannot be sold and the money cannot be returned. It neither adds to funds nor the liquidity of assets last longer.

K. Cash Endowment and IRETUs

Both cash endowment and IRETUs form Islamic trust capital. Cash endowment can also be seen as one of the financial resources collected from public and used by trustee institutions to finance the development of trust property. The Cash endowment can have wider financial application as it can be used not only to finance specific projects but also to finance various trades, carry out different investment and business activities including construction project, administration and management fees, maintenance cost, and others. Cash endowment is considered the best financial method both for capital raising purpose and financing the development of the trust property. However it is very new in Malaysia.

IRETUs look like Cash endowment, because Trustee Institution solicits cash from public. The public pay in cash. The cash is then used for financing a development project.

It looks to be the next best financial product after cash endowment, compared to other modes of financing (Tahir Sabit, 2009). Tahir Sabit et. al, (2005) however have considered it to be on *ad hoc* basis. Its effect is limited to its usefulness for development purposes. The accumulated funds are used once, because after they are used to purchase a land with or use it for construction cost, the said funds are converted to inalienable and illiquid property.

To sum, both forms of financing methods discussed above have little impact on resolving the problem of developing idle and underdeveloped trust lands. Therefore another alternative method is needed. Investment is one of the methods that can generate income. This method has been explained in the next chapter.

IV. Investment Method And Their Analysis

Islamic trusts are at core revenue generating enterprises. Investment of trust funds is in harmony with the nature of these trusts. Nevertheless not all trust properties are investable. Assets such as schools, hospitals, mosque, and orphanage are not investable while others intended for investment are (Kahf, 1998).

For the purpose of developing idle or underdeveloped land, the investment of trust funds and assets is useful. It can generate income some of which then can be distributed on the beneficiaries, and a portion of which can be reserved. The reserves are investable funds and overtime they increase. Such funds then can be used to finance the development of idle lands.

There are several Islamic trust assets that have potential to be used for investment purposes which are discussed below:

A. Long Lease and Substitution

Both Long Lease and Substitution in addition to their financing capability, mentioned above, can be invested. This is possible only if the proceeds of Long Lease and Substitutions are used to finance a development project with a condition that a share in the income generated by the project will be assigned to the invested trust funds. No study has been conducted to show whether such a method is ever applied.

B. Cash

Cash is the best capital of Islamic trusts, as it can be used by many needy and can be invested in any Shari'ah compliant businesses. This includes investment in the development of Islamic Trust properties, provided the returns and revenue of the investment are shared between investing and borrowing Islamic Trust accounts.

As mentioned early the above three methods are limitedly applicable, therefore their effect is very minimum in the development or redevelopment of idle and underdeveloped lands.

V. Conclusion

The analysis of the weaknesses of the methods discussed above indicates two core problems: the inadequacy of liquid funds and illiquidity of assets.

The inadequacy can be inferred from the types of the funds currently trustee institutions manage. They are trust capital, and borrowed. While the borrowed assets cannot be considered trust assets they however can contribute to the adequacy of trust funds if they are frequently used. But due to the nature of cost and risk involved few trusts lands can be financed in this way and therefore the chance of generating an income that can enhance adequacy is slim, not to mention the length of time involved before such income can be realised.

Adequacy of fund cannot be achieved by other capital assets too. Goods and fixed assets being the condition for validity of trust limit the attraction of extra funds. Only few can afford it. Lands, buildings, and goods can be used among others to generate income which then can be used by the beneficiaries. Little cash can be spared. Services, income/profit, Islamic real estate trust units (IRETUs) and the endowment of corporate share can be in cash form. But, with exception of the trust units all others are not popular in Malaysia. This means there is less chance for raising capital in this way. Even the trust units so far have not shown effectiveness in the attraction of funds. As there is less chance of collecting cash, one needs not be serious about having income through investment of these funds. This can be therefore the reason why there still exist idle and underdeveloped waqf lands.

Inadequacy of trust fund and hence trust's development funds can also be caused by illiquidity of assets. All non-cash capital raising methods, restricted by the condition of perpetuity and inalienability, generate less cash. Since lands and goods should exist in perpetuity they are illiquid. They cannot be collateralized by the trustees in order to raise finance for the development of trust assets. They also cannot be sold so the proceeds can be used for the purpose of development. Only in limited circumstance the properties can be allowed to be substituted for cash, and even though these assets are leasable but as mentioned early the method of long term leasing is ad hoc and generates less cash. Therefore it will have limited application. In brief, these assets are illiquid and consequently or otherwise they limit the chances of having liquid funds.

Liquid assets in the form of corporate share and IRETUs are not really liquid. The Trust units can be used for one time only. After it has been used to finance the specific project of Islamic trust property, it will revert back to illiquid assets. As long the endowed corporate shares are concerned they are inalienable and hence one cannot consider them liquid.

Due to the illiquidity and inadequacy of trust assets, it is suggested that there is need for developing new methods or enhancing the existing ones, in order to reduce illiquidity and increase adequacy of funds. The methods of capital rising should be reviewed so that these institutions can have more investable funds. With this they will need no longer to seek outside finance or merge one Islamic Trust with another for no apparent good reason. Eventually, Islamic trust can provide better socioeconomic services to the community.

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