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A Higher Law for Lending

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Business is up at Islamic finance firms, which don't charge interest and weren't part of the mortgage debacle.

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The mortgage industry may be in meltdown, but at least one class of lender appears to be flourishing: Islamic finance companies that offer Muslim home buyers alternative arrangements such as lease-to-own deals so they can avoid making the sort of interest payments that many believe their religion forbids.

Officials at Guidance Residential, a Reston company that has financed more than 5,000 home purchases since it began in 2002, said the company is having its best year yet, with business up 7 percent in the first quarter of 2008 from the first quarter of 2007.

At University Islamic Financial, which began in Ann Arbor, Mich., and expanded its operations to Maryland, Virginia and five other states last year, officials said the number of home-financing applications quadrupled from last March to this March.

Representatives of the four major Islamic home-finance institutions in the United States said they do not track the reasons customers choose them over conventional mortgage brokers. Several speculated that it was due to the natural growth of what is still a fledgling retail industry, as well as two side effects of the mortgage crisis: The drop in prices in many regions has brought homes back within reach of first-time buyers, who make up a sizable chunk of Islamic financiers' customers. And the drumbeat of negative publicity about the practices of subprime mortgage lenders has amplified the distrust and discomfort the conventional mortgage industry already inspired in many Muslims.

"Folks have to be questioning the methods used by conventional mortgage companies over the last three or four years based on what's happening today," said Hussam A. Qutub, a spokesman for Guidance. "And I think that makes more people think, 'Well what about the emergence of this [Islamic-] compliant financing industry? Let me give it a look and educate myself about it to see if it could perhaps be more beneficial to me.' "

That was the prevailing sentiment among potential customers who approached an advertising booth staffed by Guidance representatives at the annual spring fair held by the All Dulles Area Muslim Society in Sterling on a recent weekend.

Nabila Zerrarka, an Algerian-born woman wearing a white-and-green headscarf and pushing a stroller, wanted to find out if Guidance's home-finance options were more straightforward than those offered by traditional mortgage brokers.

"Deep down, I don't feel comfortable paying interest because it is against my beliefs," said Zerrarka, 29, who is searching for her first home and has already obtained a prequalification letter for a conventional loan from [Bank of America](#). "But I also feel it's against my financial interests to pay interest. . . . What we've seen is that with interest-bearing loans, there are all these gimmicks and hidden costs and tricks that they can surprise you with. . . . If there is a possibility of doing it the Islamic way, we'd like to explore it."

Mounir Elhaj, 45, a native of Sudan who works at a moving company, wanted to know how Guidance deals with customers who fall behind on their payments. He said he recently helped move a woman whose house was foreclosed on after she missed payments.

"She had been paying her mortgage for 17 years, and the bank still took her house," Elhaj said to the Guidance sales representative. "So I want to know if I bought a house and then fail to pay, can you help me?"

The representative, Amr Mohamed, smiled magnanimously. "Yes, we can," he said, adding that Islamic law, known as sharia, forbids businesses from profiting from a customer's financial hardship. So if a customer is late on payments, Guidance charges him or her a flat administrative fee to cover processing costs but none of the percentage-based penalties and additional fees that conventional mortgage companies can pile on.

Islamic home financing aims to offer Muslim buyers the same opportunities as conventional lenders but with a twist that gets around sharia's prohibition against the payment of riba. Generally defined as excessive gain, riba has over the years come to be considered the equivalent of making money by renting money -- in other words, charging interest -- because the borrower shoulders risk while the lender is guaranteed a return.

In one of the alternative arrangements offered by Islamic finance companies, the company buys the house, then sells it to the home buyer in fixed monthly installments at an agreed-upon marked-up price. The markup rate is kept competitive with the prevailing interest rate on a conventional mortgage. So apart from a few additional transaction costs from the atypical nature of the arrangement, the buyer's monthly payment is roughly equivalent to what it would be with a conventional mortgage.

A second option is for the financier and the home buyer to enter a lease-to-own contract similar to those used to buy cars. Once again, the

rental portion of the monthly payment is kept equivalent to prevailing interest payments. The third model, which is favored by Guidance, is also based on a lease-to-own arrangement, except that the buyer and the finance company form a limited-liability entity to own shares of the property.

All three arrangements got a major boost in 2001 when [Freddie Mac](#) agreed to begin buying them on the secondary market, ultimately including not just Guidance and University Islamic, but also Devon Bank in Chicago and American Finance House Lariba of Pasadena, Calif. Last year, Freddie Mac bought more than \$250 million in Islamic home loans -- a tiny fraction of the corporation's \$1.77 trillion business but nonetheless a slight increase over previous years, according to spokesman Brad German.

While Islamic finance companies have convened boards of prominent scholars to certify that their finance arrangements comply with sharia, not all Muslim thinkers are convinced that they are necessary.

Mahmoud Amin el-Gamal, an economics professor at [Rice University](#) specializing in Islamic finance, noted that even in Muslim countries, sharia-based financing was developed in only the past several decades. And he argued that because conventional mortgages are secured by a physical good, namely the home, that is usually the only asset the lender can repossess if the borrower fails to repay, such loans should not be considered the equivalent of making money by renting money.

In any case, el-Gamal maintained, Islamic home-finance products are so closely modeled on conventional mortgages as to constitute a distinction without a difference.

"This is an industry that preys on people's religious insecurities by selling them a product that they claim is different when it's not. It's false advertising, and it's a case of supply creating demand," El-Gamal said.

But Hirsi Dirir, a Somali-born technology analyst who recently obtained financing from Lariba to buy a townhouse in Annandale, said such objections pale in comparison with the peace of mind he has gained from making the extra effort to adhere to his faith.

"I wish I could avoid everything that Islam doesn't allow, but I can't," said Dirir, 32. "So if I have the opportunity and the choice to avoid interest, then it's very important to me not to mess with it."

Rizwan Jaka, 35, president of the All Dulles Area Muslim Society and one of the first to buy a home with Islamic financing in the Washington area, also said the emergence of such arrangements constitutes an important milestone in the integration of Muslims in the American mainstream.

"It definitely marks a coming of age for us. . . . It's part of the whole process of being a part of this country while being able to have our faith accommodated," he said. "The American dream is to purchase a house, and the American Muslim dream is to be able to do so in an Islamic manner."

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