HOME/OFFICE ACQUISITION FINANCE AND THE ISLAMIC BANKING SOLUTION: WHY DECLINING CO-OWNERSHIP PARTNERSHIP(DCP) CAN NO LONGER BE IGNORED.

Imagine how greatly surprised was the British banking giant HSBC Group (HSBC) that about half of its customers were Non-Muslims when it commenced the offering of Islamic home financing in Malaysia in 2004. HSBC has been offering Shariah-compliant home finance for five years through its Islamic finance arm, HSBC Amanah, while the Arab Banking Corporation has its own Islamic home partnership plan called Al buraq, which is also available through Lloyds TSB (underwritten by Bristol & West). The United National Bank also offers declining co-ownership partnerships in the United Kingdom. In East Africa, the Gulf African Bank of Kenya launched its Shariah compliant home ownership program dubbed Musharakah Partnership in 2009. What is so different about this financial structure and how does it offer a solution in the face of our debt ridden and lender focused economic system?

Indeed, one may imagine a Mortgage Lender who permits you to take full advantage of the increase in the price of your home when you sell, but is prepared to share losses if the property has fallen in value. This may seem too good to be believed in the current world of conventional finance and real estate, but this is exactly what Islamic finance presents under the concept of Diminishing Musharakah (Declining co-ownership partnership).

Unlike a conventional mortgage, declining co-ownership partnership allows customers to purchase a home (property) in an ethical and Shariah Compliant manner. To achieve this, the customer identifies the property and brings in an Islamic financial institution as a co-owner. This partnership is established by the use of a co-ownership agreement rather than the conventional loan documentation. The right and responsibilities of both parties while they own the property together are spelt out in the agreement.

Furthermore, the customer as joint owner is expected to gradually buy the Bank's share of the property while paying monthly rents on the Banks share not yet owned. The share of the Bank is divided into a number of units known as Musharakah units and it is understood that the customer will purchase the units of the share of the Bank until the customer becomes the sole owner of the property. The more shares the customer owns, the less rent payable to the Bank and the cost of a unit share in the property is based on the property's original cost price and not its market value. As an illustration, a home is appraised at **N10, 000, 000**. The customer may provide **N2,000, 000 (20%)** of the cost of the property while the Bank provides **N8,000, 000 (80%)** of the cost.. The banks **80%** share is divided into 20 Musharakah units at a value of **N400,000** (Four Hundred Thousand Naira)per unit spread into 20 months. The Customer will pay an agreed rental fee on the use of the Bank's 80% share of the property. As the banks share reduces monthly by the Customers purchase of the Musharakah units, the rental payment will be adjusted downwards since the Customer now enjoys less of the shares of the Bank in the property.

A benefit of the Declining co-ownership partnership (Diminishing Musharakah) over the conventional mortgage is the customer's opportunity to take advantage of the property's appreciation upon a sale in the event of default. Where the Customer is unable to buy the Bank's equity share and pay rents, the Islamic Bank will not be entitled to charge interest or default fees, but rather oblige the Customer with a time frame to continue consistent payment after which it may proceed to sell the property at Market Value. Upon such a sale, the customer would be entitled to earn as much as his interest now stands in the property.

However, one may anticipate that declining co-ownership partnership will provide a potent ground for double taxation. It is believed that taxes are payable on the first transaction -between the bank/ Customer as one party and the Vendor (property seller) and on the second transaction – formal transfer of the bank's interest(shares) in the property to the Customer. In 2012, the Federal Inland Revenue Service (FIRS) in assuaging the fears of the general public on double taxation, pursuant to **Section 61** of the **Federal Inland Revenue Service (Establishment) Act 2007** issued a Regulation for the Taxation of Institutions offering Non-interest financial services in Nigeria titled: **"Non Interest Finance Regulations No 1. 2012"**. **Part II, Paragraph 4 (1)(g)** of the Regulation provides that any agreement executed between the financial institution and the vendor of a house under this section, shall be subject to stamp duties. But **Part II, Paragraph 4 (1) (h)** provides that any agreement executed between the financial institution and the customer under this section, transferring all interests of the financial institution to the Customer as the beneficial owner shall not be subject to stamp duties. Furthermore, **Part II, Paragraph 4 (1)(i)** provides that any proceeds between the financial institution and customer under this section, transferring all interest of the financial institution to the customer as the beneficial owner shall not be subject to **Value Added Tax (VAT)**.

From face value, the declining co-ownership partnership (DCP) seems similar to a conventional mortgage. Its fixed rental payments resemble the interest rates on conventional borrowing. How then does it differ? Conventional mortgage is based on the idea that the Customer is loaned the lump sum to purchase the house. Thus, the Customer in a conventional mortgage retains not only the rights to the property but also the risks of the property. If the Customer fails routine payments, the bank is legally allowed to repossess the house and recover the debt. The Customer does not share in the proceeds from the repossessed sale of the property. Under DCP however, the same situation would result in the proceeds of sale being shared between the Customer and the bank according to their share of ownership.

Another difference is that of an **'exit penalty'**. Under a conventional mortgage, If a Customer wishes to pay the mortgage off early, he/she will be charged an 'exit' penalty to compensate the bank for the early termination of the agreement and loss of future mortgage payments. Under DCP, exit penalty clauses are completely disallowed.

An Islamic bank providing a DCP is required to take the extra step of ensuring that the customer's use of the property is sharia-compliant. This is termed as 'usage screening'. The Bank must be wary of the reputational risk of providing a DCP to a customer who intends to use the property for purposes that are unethical under Islamic law (brewery, piggery, casinos e.t.c.)

Again, a Customer under DCP pays rent to the Bank for the right to occupy the property. If the Customer's use of the property is impaired, particularly if the property is destroyed, the Customer **cannot be compelled to continue to pay rent for the period of non-use**. This is in contrast with a conventional loan where the customer continues making payments under the loan if the property is destroyed until the insurance proceeds are received. The Shariah requires the Bank to be responsible for major maintenance and repair and insurance in respect of its share of the property. Such responsibilities are not undertaken by financiers of a conventional mortgage. Under Islamic commerce, the Customer is responsible for ordinary maintenance and repair only of the leased property and for remedying major defects caused by his/her deliberate or reckless acts on the property.

The declining co-ownership partnership (DCP) is no doubt a uniquely ethical version of home financing structures and moreso relevant in developing economies like ours. Though emerging in our conventional world of finance, it is a growing home financing structure embraced by conventional financial institutions like Bristol & West, Citigroup, UBS and HSBC. Whether the Central Bank of Nigeria (CBN) will approve this product under the current Non-interest banking regime or Nigerians accepting to gracefully embrace this ethical mode of home finance amidst our acutely popular conventional structures will be a policy-driven, ethical and commercial decision .