FINANCING AND INVESTMENT IN *AWQAF* PROJECTS: A NON-TECHNICAL INTRODUCTION

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1. INTRODUCTION

"*Awqaf*" (plural of *waqf* meaning endowment or trust, usually charitable) has been known in civilized human societies since antiquity. Islam approved this sublime tradition and gave it an enduring religious motive. As a result, *awqaf* flourished in all Muslim communities throughout history and provided important social services especially in the form of mosques, schools, hospitals, potable water sources, and support for the poor. Some *awqaf* were even dedicated to the welfare of animals.[1]

2. SOME CHARACTERISTICS OF *AWQAF* ASSETS AND THEIR IMPLICATIONS

The first characteristic deserving mention is the *permanence* of *waqf*, i.e. it should be of a lasting nature. The main consequence of this feature is that the first priority in the spending of *waqf* revenues should go to its upkeep and maintenance so as to ensure continuation of its services.

Jurists assert that this priority of spending on *waqf* upkeep should be observed whether or not the *waqif* (the establisher or donor of *waqf*) has stipulated it. This is an application of the juristic rule that: "Whatever is required for the accomplishment of a duty is also a duty".

By the same logic, payment of "wages" for the *waqf* trustee (manager) is the second priority. What remains of *waqf* income after these two priority items is expended as the waqf establisher dictated when he originally endowed the *waqf*.

The second characteristic of *awqaf* is that their assets are almost wholly in the form of real property, i.e. land and buildings. Generating services and/or income from such property is an economic activity that usually requires all kinds of factors of production and inputs: management, labor, real capital beside property, some liquid assets, etc. *Awqaf* administrations are characteristically lacking in all inputs except real

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property. Generally speaking, it is not juristically permissible to sell part of the waqf property to obtain the other inputs. Rather, only *income* from such property can be used for that purpose. Thus it is generally true that *awqaf* have one plentiful factor which is real property, and much less of all other inputs including management.

Consequently, it is not suitable for *awqaf* management to undertake investment projects that use, intensively, inputs other than real property. This has historically limited *awqaf* almost exclusively to one economic activity, namely, rental of land and buildings.

We should look forward to more innovative activities that generate income for *awqaf*. This could come only if we are willing to either (a) diversify *awqaf* assets to include non-property assets, or (b) design modes of partnerships where *awqaf* can be part of a larger project that is shared by owners of other inputs.

Historically, Muslim jurists have favored real property as the most suitable for endowment as *waqf*. This, they rightly thought, was the most durable (conforming to the perpetual nature of *awqaf*) and the least likely to suffer misappropriation and embezzlement. Movable property, in juristic eyes, is not suitable for endowment, with few exceptions.[2]

There is scope as well as need for *ijtihad* in this regard, and clear signs of this process are fortunately evident. Thus, recently in Saudi Arabia, an important *waqf* established by the Muslim World League (that of Sanabil al-Khayr) is an investment fund not confined to real property. A similar *waqf* was established about a decade ago in the Sudan by an organization for Islamic Call.

3. *AWQAF* PROJECTS

Awqaf projects may conceptually be divided into two categories for the purpose of our present discussion. There are (a) service-providing projects, such a school providing free education to needy students; and (b) income-generating projects, such as a shopping center that was made a *waqf* (= endowment) by its owner, with the rental income from the shopping center spent on maintaining the school.

For the remainder of the paper, I am basically addressing category (b) of *awqaf* projects.

3.1 Project Choice

By what criterion (or criteria) should one select *awqaf* projects? This is a basic question to start with. On narrow economic grounds, the answer is: choose that project which maximizes the present value of net profits from the investment. The reader, I guess, would not expect me to endorse such a criterion, for two reasons at least.

First, it seems axiomatic that *awqaf*, being socially oriented in the first place, should give much consideration to other social objectives besides pecuniary profits.

Second, a subjective reason. Some readers may remember an earlier paper by me where I argue strongly for taking several Islamic objectives besides profit into consideration in project choice.[3] I, an economist, may be forgiven for being incorrect, but hardly so far being inconsistent.

But wisdom must prevail; and I am afraid I have to disappoint the reader and argue for giving preponderant weight to pecuniary profitability of *awqaf* projects, *within* the *binding* rules of *shari'ah.*

My argument is that *awqaf* administrations in most, if not all, Muslim countries lack sufficient income to properly carry out their major functions in society. This, in turn, leads to low quantity and quality of *awqaf* services. For instance, *awqaf* in many Muslim countries cannot pay competitive salaries to the *imams* of mosques, hence cannot attract well qualified people to this very important activity. Under this state of affairs, I see that burdening *awqaf* projects with objectives other than profitability would adversely affect the ability of *awqaf* to fulfill its other social responsibilities.

Awqaf administrations should manage *awqaf* projects on financial profitability basis and should seek investments that yield the highest financial returns within limits that are Islamically permissible.

3.2 Economic Feasibility Studies

(A) Definition

A project's economic feasibility study can be generally defined as the study which answers the following question: Is it advisable, in the light of the objectives we set for ourselves, to undertake a particular investment?

Importance of a project's feasibility study is easily understood once we note that any investment project starts with "losses" i.e., with outlays that are incurred to initiate the project. Revenues are a hope in the future after the project starts. Running the project throughout its life involves further costs. Feasibility studies estimate both investment and running costs as well as the expected revenues. Only when revenues are expected to be *sufficiently larger* than costs is a project deemed economically attractive. How much larger? How to validly compare costs and revenues that occur many years apart? These and similar technical questions are what economists and other experts are trained to answer.

(B) Stages

Full feasibility studies are costly, and may end up finding the proposed project unacceptable. That is why it is wise to start by a "pre-feasibility study" which is preliminary in nature, less accurate but also much less costly. Only if the results of pre-feasibility study are promising is a full-fledged feasibility study undertaken.

(C) Information and Reliability

The main types of information (data) on which feasibility studies are built are:

(a)Technological: the available techniques of producing the project's output, for different levels of output (scale). Such information is usually easily available and quite reliable. So are the capital costs of different techniques and scales of output.

(b)The running costs, especially when they involve significant labor and maintenance components, are more difficult to estimate and less reliable than those in (a) above.

(c)Expected revenues from the project are usually the hardest to estimate and the least reliable. They usually depend on several variable factors beyond the control of management.

Consequently, feasibility studies can never assure us *for certain* that a particular project will in fact succeed or fail economically. The inherent uncertainty in economic life cannot be overridden. But good feasibility studies are highly educated guesses that significantly improve our chances of selecting good projects and avoiding bad ones.

I would like in this context to point out an important matter that is often overlooked by the *users* of feasibility studies. A feasibility study is related to a specific time. A study conducted in a particular year can be positive, but when the project is started, say, three years later than scheduled, the economic outlook may have significantly changed in the meantime to make the project undesirable. We should remember that a feasibility study may become useless if there is a long time span between conducting the study and implementation of the project. In such cases, conducting a fresh study is definitely in order.

Another important cause of potentially good projects turning into bad ones is excessive delay in finishing off a project once started. Extended implementation coincides often with increasing costs and always with delayed revenue generation.

4. SOME ISLAMIC FINANCING MODES FOR *AWQAF*

I discuss, first, two old financing modes that were improvised by Muslim jurists *(fuqaha)* in response to unusual circumstances that faced *awqaf* properties. Then I present tentative proposals of some promising modes of financing that are suitable for *awqaf* investments.

4.1 *Al-Hukr* or Indefinite-Lease Right

A practical problem that may face any *waqf* administrator is to have a piece of land, endowed as *waqf*, which cannot generate income unless some further investment is made to develop it. One may think of selling such land and using the proceeds to buy a different, perhaps smaller, real property that generates some income without further investment. But selling of *waqf* property is frowned upon by *fuqaha*, except under extraordinary circumstances, and then only after approval of the *Shari'ah* judge. *Fuqaha* from about the middle of third century of Hijra solved this problem by an innovative contract called *hukr* or Indefinite-Lease.

In *hukr*, the lessee makes a large down payment nearly equal to the total value of the leased land, and is obliged to pay annually a very small rental, say three per thousand of the land's value. In return, the lessee gets the (virtually) perpetual use of the land as he sees fit. He may plant it or build on it. He can sell that right to others, or bequeath it to his heirs.[4]

Clearly the *hukr* contract enables *awqaf* to get a sum of money which is almost the equivalent to the value of *waqf*, overcoming the problem of the *waqf* invendibility from Islamic juristic point of view. *Awqaf*, in return, virtually cede all rights of utilizing the *waqf* in future. Since the annual rent is quite insignificant, one may well wonder whether that "drip" rental-stream is worth much to *awqaf*. Economists can provide a ready, albeit approximate, answer. Assume a perpetual rental stream of three per thousand of the market value of land now. How much is this worth (i.e. what is its present value)? If similar property rented normally (without *hukr*) gives an annual return of say 5% on its market value, that perpetual rental stream should be worth 6% of the market value of the *waqf* property.[5]

A fair deal for a *hukr* contract on a *waqf* land which is worth, say 1000 dinars should <u>roughly</u> give the *waqf* administration a down payment of 940, plus a perpetual annual "drip" rental of 3 dinars. One may still argue that *awqaf* have practically relinquished the land. Erudite *shari'ah* scholars are quick to point out two counter facts:

(a) The significance of the admittedly nominal rental is not its amount, but rather the fact that it serves as *perpetual* legal reminder that the land is a *waqf* property, *and*

(b) Should the owner of *hukr* rights die with no heirs, the land reverts freely to *awqaf*. *Awqaf* longevity is phenomenal; and it is not rare for *awqaf* to reclaim *hukr* lands through this process.

I was informed that in some Muslim countries they have favored an extended rather than the perpetual *hukr* contract I just described. The extended *hukr* would run for say 50 years, after which the land automatically reverts back to *awqaf*.

An important consideration in assessing the advisability of resorting to *hukr* contract in any particular instance is to ask: what is the *waqf* administration going to do with the large down payment that will be received? *Shari'ah* and economic considerations both call for investing the down payment to generate future income, either by improving another *waqf* property, or by acquiring new property. The worst thing to do is to use that money to defray current expenses. This would be tantamount to liquidating a significant proportion of existing *awqaf*, without a compensating future income flow.

4.2 *Haqq al-Ijaratain* or the Dual-Lease Right

Another practical problem that may face any *waqf* administration is to have a debilitated *waqf* building whose rental is not sufficient for its repair or renovation. The dual lease, just like the indefinite lease (*hukr*), requires the lessee to make (a) large down payment almost equal to the value of the *waqf* building; and (b) a nominal annual rental of about 2 to 3 per thousand of the value. Unlike the indefinite lease, however, in the dual lease the down payment is used by the *waqf* administrator to repair the building, which the lessee is then free to use as long as he pays the nominal annual rent. The renovated building as well as the land is the rightful property of *waqf* (whereas in the indefinite lease the *waqf* does not build or plant on the land, but the lessee does so, and owns what he builds or plants). However, the *waqf* ownership in the dual lease is of little significance because it can generate nothing but the nominal annual rent. The lessee has a perpetual right to rent or sell his dual-lease right.

The dual lease method owes its genesis to a catastrophic fire that severely damaged many *awqaf* buildings in Istanbul in year 1020H. The annual rentals of the damaged buildings could not suffice for their repair, and the city looked shabby. The dual lease method was then devised, on lines not far from the indefinite lease contract, to repair the *awqaf* properties and restore the city's looks.

If we are to compare the two contracts: *hukr* and *ijaratain*, the former seems the better for *awqaf*. This is so because the large down payment in *hukr* is money the *awqaf* administration can use as it sees fit. In particular, it can invest it in improving another *waqf* or acquiring a new one. In contrast, the down payment in *al-ijaratain* is confined specifically for repairing the same *waqf*, which may not be the best investment. Aside from this point, the two contracts are quite similar.

Let me now present tentatively some promising modes of financing that are worth consideration. I say "tentatively" because some of the suggested modes may need further scrutiny from *fiqh* point of view.

4.3 Some New Modes

(a)Assume a *waqf* trustee who is administering a *waqf* land which is a suitable building site. He may call for bids by contractors to build, say an office block on the site, *and* to sell it to the *waqf* on fixed installments. The offices would be let, and the contractor paid from the rental income. This formula is an *Istisna'* contract for a building, on a deferred price basis.[6] To be sustainable, prudence dictates that the expected rental income be less than the deferred price installments, by a safe margin, to allow for possible vacancies and fluctuation in rents.

(b)One variation on the above formula is for the *waqf* to give <u>part</u> of the land it owns, as down payment (or even full payment) to the contractor. This, in fact, is an *exchange* (barter) of a piece of land for a building. *Fuqaha* permit in principle such an exchange, subject to the approval of a *shari'ah* court. What they emphatically disapprove of is an exchange of real *waqf* property for a <u>movable</u> asset, which (as stated earlier) is more prone to misappropriation or embezzlement.

(c)A third formula is for the *waqf* to permit construction of a building on its land, for a *share* in the rental income of the building. Ownership of the land remains with the *waqf*, and that of the building with the other party.

This formula raises some subtle juristic objections that are too detailed to discuss here, but I am confident that it has a sound *shari'ah* basis, especially in the Hanbali school.[7]

(d)A variation on (c) above which, I guess, does not raise much juristic reservation is for the *waqf* permission (to the builder) to take the form of a <u>long</u> <u>term</u> <u>lease</u> of the building site. The rental of the site goes to the *waqf*, and that of the building goes to its owner.

(e)To encourage financial institutions to finance a building such as described in (c), provision must be made for the financier of the building to gradually sell his equity in the project for a profit. The simplest way to do this is for *awqaf* to earmark some (or all) of its rental income to buy gradually the equity of the financial institution. This leads us back to some formula similar to (a) above, or to the following (f).

(f)One last formula I wish to present, shares with (c) the advantage of being participatory, and with (a) the advantage of allowing the other party to sell its equity gradually to *awqaf*.

Start with formula (c), but earmark a large *proportion* of awqaf's share in the rent to pay off gradually the other party's equity, i.e. the cost of the building plus a profit.

Remember that in (c), the building is owned by the other (financing) party. The present formula raises even more juristic reservations than (c). It also has one economic drawback, namely, that it necessarily leaves indeterminate the "pay back period", i.e., the years it takes the other party to recoup its capital and earn a profit. This uncertainty about the "pay back period" (which may extend to infinity if the project fails to generate enough rentals) is what makes this a truly participatory formula.

I am told that in Mauritania and the Sudan a variation of (f) has long been in use. But the *waqf* pays back the builder only his cost. His profit takes the form of permission to use freely part of the structure that he built on the *waqf* land. In Jordan, an innovative formula close to (f) has actually been introduced in the 1980's. It has been developed by joint efforts of *Awqaf* Administration and the Jordan Islamic Bank, and is regulated by special legislation. Certain aspects of it are still debated from the *fiqh* point of view.

5. CONCLUSION

The *waqf* in Muslim societies had a great history. It can have an equally great future in promoting social and economic welfare if sustained efforts are made to revitalize its administration and economics. The present brief paper has suggested ways for improving the selection and financing of *awqaf* income-producing projects.

NOTES AND REFERENCES

1.See, Al-Sibai, Mustafa (1956): Damascus: *Min Rawa'i Hadaratina*, 1956.

2.This is the position of the Hanafi School of jurists. The other three major schools permit the endowment of non-movable property, provided it is durable. See Dr. Al-Siddiq M. Al-Amin Al-Darir: *Muharadat an Nizam al-Ahwal al-Shakhsiyyah*, Cairo, *Mahad al Buhuth wa Aldirasat al Arabiyyah*, (1378H = 1968 AC).

3."Islamic Values and Criteria in Project Evaluation", in Arabic, *Al-Muslim Al-Muasir*, Kuwait:1982, No.31, pp.85-105.

4.For fuller juristic discussion see: Mustafa A. Al-Zarqa: *Al-Madkhal ila Nazariyyat Al-Iltizam Al-Ammah Fi Al-Fiqh Al-Islami* (in Arabic), Damascus, (1388H = 1964 CE), para 23

5.The present value of a perpetual annual income stream (L) with a discount rate of (r=5%) is: L÷r. Hence (3/1000) ÷ (5/100) = (3/50) = 6%. The apparent exactness of the answer is based on some rigid assumptions. Realistically, we better consider it only approximate.

6.Three schools of *fiqh* require the price in *Istisna'* contract to be paid in advance (just like in *Salam* contract). The Hanafi school however clearly approves of deferring the price in *Istisna'*. A recent fatwa of the *Fiqh* Academy of OIC, Jeddah, (1412H = 1992 AC, Resolution No. 66/3/7) approved price deferment.

7.For supportive *shari'ah* discussion of such "partnership", see Rafic al-Masri : "Participation of Capital Goods in the Produce or the Profit" in Arabic, *Journal of Research in Islamic Economics*, vol.3, No.1 (Summer 1405 H = 1985 AC), pp.3-56.