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## Purists' Reservations

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Daoud Hawa felt a bit guilty after he bought his three-story Colonial in Herndon about three years ago.

That's because Hawa, a Muslim, used a conventional mortgage even though Islam forbids followers from paying or earning interest. He had shopped around for non-interest options and found a few financing programs that catered to Muslims. But none could lend him more than \$360,000 and he needed \$415,000.

So his practical side chose the conventional loan. He hoped that living not far from his mosque would make up somewhat for the way he bought the house.

Still, his unease festered. Over the years, the amount of money available increased. Now, he is negotiating to refinance his house -- the Islamic way.

"I'm doing it because it gives me peace of mind," said Hawa, 32, who is of Palestinian descent. "It's a burden lifted off my shoulders and I feel better."

For decades, American Muslims who believe that the Koran forbids mortgages have struggled to reconcile their faith with their finances. Like Hawa, some went the conventional route despite misgivings. Others bought homes for cash if they could afford to do so. And many stuck to renting even if it made little financial sense.

But as the number of Muslims has surged in this country, driven by immigration and conversions, so have their home financing options. Today, at least half a dozen companies are chasing after the potentially lucrative U.S. Muslim market, promising non-interest-bearing mortgages that comply with Islamic law, or *sharia*.

The intertwining of the religious and the economic brings with it plenty of controversy. Islamic jurists all over the world continue to weigh in with opinions on which models they deem acceptable, if any. That's left some American Muslims confused, and even skeptical, about their choices, and others feeling empowered.

"For some, it's become an expression of Muslim identity in a way that's distinctively American," said Bill Maurer, author of the book "Pious Property: Islamic Mortgages in the United States."

"After all, homeownership is the ultimate American dream. People around the world generally don't own their homes."

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Islamic law encourages investment and profitmaking. But it instructs Muslims not to engage in what is called *riba*, generally described as illegitimate or excessive gain -- a concept also discouraged in early Judeo-Christian lending.

Over time, *riba* has become synonymous with interest or the act of making money by renting money. That type of lending is prohibited because it exposes borrowers to undue risk, creating a societal imbalance that harms the have-nots.

Instead, Islam promotes financial transactions tied to goods -- that is, making profit off trade in real assets rather than by moving cash around.

"It is viewed as more responsible and just for the lender to share the risks so that the lender is not simply loaning money and getting money back regardless of whether that borrower's venture is a success," said Isam Salah, a partner at King and Spaulding in New York who heads that law firm's Middle Eastern Islamic Finance practice.

Meeting that criteria without violating state and federal regulations and tax laws is the challenge for firms trying to break into the Islamic mortgage business. Not all states allow these contracts.

In those states that do, there are a few different models. Some contracts are structured as installment plans, in which a firm buys a house and then sells it to an individual for the sale price plus an agreed-upon profit. Others are lease-to-purchase contracts that work much like a car-leasing arrangement but over a longer time.

For his part, Hawa is most comfortable with the co-ownership arrangement offered by Guidance Financial Group, a Reston-based financial services firm that says it has completed almost 4,000 transactions worth about \$815 million since its creation more than four years ago.

If Hawa's refinancing goes through, he and Guidance would form a limited-liability corporation that buys the house. He has offered about 20 percent for the down payment, which means he would own 20 percent of the house, he said. Guidance would put down the rest and thus own the rest of the property.

Hawa would then pay each month to buy Guidance's share of the house at cost plus a fee to cover his use of the company's share of the property, which is how Guidance makes money. Hawa's share in the house keeps increasing until he owns it.

If a natural disaster destroys the house, and insurance does not cover the entire cost, Hawa receives the insurance money and any remaining loss is divided between Guidance and Hawa based on their respective shares of the house at that time. If there is a foreclosure and proceeds from the sale do not cover Guidance's share, the company takes a loss and does not seek to seize other assets.

No matter what the contract arrangement, the profit made or the rent collected under all these models is often tied to the prevailing mortgage rate.

"Yes, it looks like a loan even though it's not a loan," said Hawa, who is a real estate agent and music promoter. "I understand that and I'm okay with it."

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But others are not, including Majid Anwar, who moved to Herndon from North Carolina with his wife about a year ago and recently began house-hunting.

"I looked into Islamic financing a while back when it was just catching on. But, to me, it still seems like they're charging interest but calling it by another name," said Anwar, 30, who is considering a conventional mortgage -- an option some Islamic scholars say is permissible if no viable alternatives exist.

Other scholars, such as one that Desiree Kazimi and her husband consulted in Egypt, say that there's always an alternative: Rent.

That's what Kazimi has been doing since 1991. She and her husband live in a three-bedroom apartment in Annandale with their son, 9. The couple refuses to sign any contract that contains the word "interest," a term that for secular legal purposes appears in the documents for Islamic mortgages in this country.

Instead, she hopes to save enough money to buy a home with cash, even if it means moving out of the Washington area to do so.

"I would love to have a house with a yard and a porch and an area for my son to play basketball and ride his bike," said Kazimi, 36, a convert to Islam. "Maybe the only way to do that is to move to another state where the homes are cheaper."

Purists would be disappointed by Islamic financing at this point, said Mahmoud El-Gamal, chair of Islamic economics, finance and management at Rice University in Houston.

Bankers, lawyers and scholars have devised financing tools that change the structure, but not the underlying economics, of a conventional mortgage, El-Gamal said. Therefore, either both types of financing are permissible or both forbidden, he said. He sees problems because these deals are trying to fit a modern transaction into the framework of medieval contracts.

"They have to come up with a better argument as to why conventional mortgage is forbidden. Once they do, that's going to destroy the alternative they're creating," said El-Gamal, author of the book "Islamic Finance: Law, Economics and Practice."

### **Bridging Two Worlds**

Yusuf DeLorenzo, one of six Islamic scholars who helped Guidance Financial develop its model, argues that if the models weren't working, demand for them would not be growing and they would not be attracting so much attention and support from U.S. regulators.

"It's not all hocus-pocus," he said.

"A great deal of time, attention and money is spent ensuring that the transaction complies with Islamic law at every step of the way. There's a huge groundswell in favor of this kind of financing and people are putting their money where their beliefs are. The devil really is in the details."

Rehan Dawer, a senior vice president and head of marketing and distribution at Guidance, said he understands consumer trepidation, especially because so many of the faithful seek guidance from Islamic leaders who are pious and trusted but not necessarily well-versed in finance.

"It's no different than going to the eye doctor for a toothache because I trust the eye doctor," said Dawer, who joined Guidance from Morgan Stanley, where he was a senior vice president. "We're aware that our number one challenge today is educating the community about how our Islamic mortgage works because Islamic financing is still very new to this country."

Even though Islam has been around since the 7th century, colonialism wiped out the practice of Islamic finance and trade for 300 years, several experts on the topic said. The concept reemerged in the post-colonial era, starting with the creation of Islamic banks in Egypt in the 1960s and focusing mostly on high-worth institutional investors.

Estimates on the size of the Islamic finance industry vary from \$500 billion to \$750 billion worldwide. A report by the International Organization of Securities Commissions found that there were more than 265 Islamic banks in at least 39 countries outside the United States as of two years ago.

In this country, that type of financing has trickled down to the retail level with the advent of Islamic mortgages, which gained more acceptance when the Office of the Comptroller of the Currency in the late 1990s issued some rulings that made them easier to integrate into the U.S. regulatory framework.

Then mortgage giant [Freddie Mac](#) entered the Islamic market in 2001 followed by [Fannie Mae](#) in 2003, creating more liquidity for this type of financing. Fannie Mae does not disclose how much business it does with Islamic firms, except to say it works only with American Finance House Lariba in Pasadena, Calif., which operates in 29 states. Freddie Mac bought more than \$100 million in Islamic single-family mortgages last year, a tiny fraction of the \$382 billion in purchases it made that year. It has worked with American Finance as well as Guidance Financial, Devon Bank in Chicago and [University Bank in Ann Arbor, Mich.](#)

"We were able to do that because the contracts were written on standard real estate documentation," said Brad German, a Freddie Mac spokesman. "So we felt legally protected if there was a default or foreclosure."

The maximum size of any single-family mortgage Fannie Mae and Freddie Mac can buy in most parts of the country is currently \$417,000, based on a government formula. As with the broader mortgage market, Islamic firms that work with other investors can offer more money than that, as Guidance does.

The Reston company, a subsidiary of the global privately owned investment firm Capital Guidance, said it can now finance a transaction of up to \$1.25 million, far more than the \$360,000 it offered Hawa three years ago.

That means Hawa believes he can now make a pilgrimage to Mecca with a clear conscience.

"One of the criteria is to be debt-free when you go," Hawa said. "If I can refinance the Islamic way, I will be debt-free."

*Staff writer S. Mitra Kalita contributed to this report*

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