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Contemporary Issues Related To Buying Real Estate

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"الأراء الفقهية في هذا البحث تعبر عن رأي الباحث و ليس بالضرورة عن رأي أمجا"
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In the name of Allah, the Most Merciful, the Grantor of Mercy

Introduction

Despite the fact that AMJA already held an annual conference back in 2014, exclusively to cover the issue of Islamic mortgage companies in the US and the status of dealing with those companies and followed that by publishing an official declaration in this regard, yet, questions about real estate business in general did not stop! This is because such an industry in the US is a very dynamic and innovative one, where new ways of conducting business arise and new methods of buying real estate occur, consequently, practicing Muslims ask about the permissibility of conducting those new ways of trading and dealing in real estate business.

This paper is a humble effort to introduce those contemporary issues related to real estate business in the US and their status from I Fiqh perspective, whether they are Sharia compliant or not.

It is worth mentioning that this work is not meant to be an academic research that complies with research methodology, rather only the conclusion and the summary of an academic research that has been done already. So, readers should not expect an evidence for each and every ruling the writer adopts. Specialized students of knowledge who want to learn more can enroll in the Master's in Islamic Finance program offered by Al-Huda University www.GuidanceCollege.org

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First: Federal Housing Administration Loan (FHA Loan)

A Federal program that helps low income people to buy their homes by offering them loans with nominal interest. Some states even pay the 5% down payment on behalf of the beneficiaries.

- Benefitting from this program is permissible as long as necessity is proven- which is most probably the case- either because it is difficult to rent due to having a big family, or because rent is expensive, increases rapidly and become unaffordable, or because of lacking an Islamic mortgage to buy a house.
- Necessity does not have to be an existing or current one, rather it is sufficient to be expected to occur to permit borrowing with interest.
- Once they borrow and purchase their homes, beneficiaries of this program do not have to refinance with Islamic mortgage companies, because the dispensation of borrowing with interest applies till the fulfillment of their necessity.
- However, beneficiaries have to pay as much as they can- on top of the monthly payment-because extra payments go toward the principal, consequently, eliminate interest.

Second: Financing with Construction Companies Directly

A property buyer finances the purchase directly through the person or entity selling it. This often occurs when the prospective buyer cannot obtain funding through a conventional mortgage lender or is unwilling to pay the prevailing market interest rate. The seller may agree to owner financing if he or she is having difficulty selling the property. Practicing Muslims prefer this option to stay away from mortgage companies and to avoid Riba.

- Owner financing in itself is allowed, however, many of the entities that offer owner financing usually have their own mortgage company, so they mortgage the property and sell the debt to a creditor or a bank to maintain a cash flow to fund other projects.
- This transaction is identical with buying a foreclosed property that will be discussed later. As long as it is proven that the owner and the lender are both one and the same, then this is not actually a loan, but is referred to as such for other causes. It is an installment sale in reality. The loan agreement is a nominal contract that has no reality, thus, the transaction is permissible.

- It is well established that “what matters in transactions is the reality and essence, not the wording and formality”.
- Even if the buyer knows that the debt will be sold to a third party, that doesn’t diminish the permissibility of this transaction. A Muslim is liable for the validity of his own dealings, not the dealings of others; no individual will carry the burden of another.

Third: Buying Mortgaged House Directly from its Owner

Transferal of mortgaged properties from one person to another goes through two stages that don’t necessarily relate:

- Purchasing the property
- Purchasing the debt

There is no problem in purchasing a home from someone who bought it via an unlawful mortgage if he is only purchasing the property, not the debt. That is, if it is written as a separate transaction with his name on the deed as the new owner. The mortgaging company will not object because it is not concerned with the name on the deed as long as the original borrower makes the payments on time. Hence, there is no issue with paying the balance to the mortgaging company on behalf of the previous owner. All of the payments required of the new owner are assessed in Islamic law as the price of the home, even if the previous owner was in an interest-bearing transaction.

- It would be more religiously precautionous to pay the amount to the seller and have him deal with paying off the mortgage to avoid assisting another in sin.
- After two-years’ time, law allows the new owner to take the place of the initial borrower and apply for a mortgage. The prohibition of this transaction is evident because it involves interest.

Fourth: Buying Commercial Properties Leased for Businesses Engaged in Forbidden Practices

It is allowed to purchase properties for rent, even if the tenants at the time of purchase use it for matters that are forbidden (i.e. a bank or bar). Since it is allowed to purchase such properties, the rent money would be Halaal earnings because the buyer didn’t directly rent the property out to these individuals; rather, he purchased the whole property. So, the main transaction is concerning the sale of the property, and the ongoing rental agreements

are peripheral to the transaction. The legal maxim states: "*Leeway is afforded to matters peripheral to a transaction more than they are given to the main issue of the transaction*". However, when those rental agreements end, it is forbidden to renew those agreements because that would mean directly renting a property for forbidden practices. It is best for a Muslim investor to avoid such properties in general and to seek better alternatives.

Fifth: Buying Houses via Paying off the Remaining Mortgage Payments, Commonly Known as Non-Performing Loan (NPL)

NPL is a loan that is in default or close to being in default. These types of loans become mostly none performing, once 90 days have passed without payments made by the borrower to the lender, according to the lending agreement.

- In the event of a default declaration, the loan is considered a bad loan. Banks are required to classify NPLs as substandard category, doubtful to collect category and eventually a loss assets category. Institutional lenders like Fannie Mae intend to reduce the number of such loans on their balance sheet by selling such loans to 3rd party buyers to meet their reduction targets to meet specific requirements.

- This transaction is not permissible under the maxims of Islamic rulings for it is considered Riba transaction due to buying loans. The Fiqh Council stated in this regard "Selling undue debts to a party other than the debtor is not permissible, whether paying upfront with the same currency or a different one, as this leads to Riba.

- Delaying the payment or part of it is not permissible as well, whether using the same or different currency, as this is the prohibited credit-for-credit, sale where there is no submission of any of the traded items. No difference acknowledged whether the debt is a result of a loan or credit sale".

Sixth: Buying Houses via Paying off the Outstanding Property Tax, Commonly Known as Real Estate Tax Sale (RETS)

When homeowners fail to pay property taxes, the governing authority starts a legal procedure to collect these taxes. Once the property taxes are delinquent for a sufficiently long time, the taxing authority will initiate a tax sale. Some jurisdictions sell the property at a tax sale to highest bidder. In other jurisdictions, the purchaser does not buy the property itself, but receives a certificate of purchase, and once the redemption period expires, the purchaser obtains title to the property.

This type of transaction has two concerns;

- It is clearly an unjust transaction since the homeowner actually loses all his equity, and the sale is reflective of a stressed sale, where the price is not reflective of the real value of the property. Although this is true, but the new buyer is not responsible for the wrongdoing of the county.
- It is a suspended and not an immediate sale. Some scholars have allowed a suspended sale, contrary to the majority's opinion, as in a narration on Imam Ahmad's opinion and a supporting opinion by Imam Ibn Taymeyah.
 - Further, this opinion states that if the original owner is to come back to redeem his property, the new buyer/investor has to take only the principal amount and not any additions on top, for the additions are considered Riba.

Seventh: Buying Houses via Short Sale

After the 2008 financial crisis, the federal government passed a law allowing homeowners still paying a mortgage to sell their houses to a third party. A short sale is any sale of real estate that generates proceeds that are less than the amount owed on the property. It occurs when a lender and borrower decide that selling a piece of property, thereby absorbing a moderate loss, is preferable to having the borrower default on the loan. It is therefore an alternative to foreclosure, and it helps a borrower avoid having a foreclosure appear on his credit report.

- In theory, a Muslim is well within his right to benefit from this law, whether they are the buyer or seller, because it serves the best interest of all parties involved. However, if he is the buyer, the ruling differs based on the way the transaction is financed. If it is an outright purchase, then clearly there is no issue. But, if he applies for a loan from the same financial institution that loaned the original client, i.e. the current owner, then this transaction is forbidden because on one end it's an interest-bearing loan, and on the other, the bank is the lienholder on the house, not the owner. This is a clear distinction between short sales and buying foreclosures.
- Another issue that needs to be addressed is if the buyer secretly agrees with the current owner to short sell the property without notifying the bank. This short sale would not really be for the buyer to assume ownership but would rather be in the interest of the current owner.

- Modern Fiqh Councils and fatwa committees view that it is allowed for both parties in a transaction to willingly change the clauses in an agreement or sale if there are special circumstances arose, especially when the special circumstances are beyond the control of the buyer and seller and heavily impact the interests of either party. In Islamic finance law, this is referred to as "Special Circumstance Theory", and in the US commercial law, it is called "Force Majeure"
- I emphasize that this change must either be done by mutual agreement or court order. The US courts do not currently recognize this legal theory. In the US, the homeowner does not have the right to initiate a short sale for himself. The mortgage issuing bank has the exclusive legal right to initiate a short sale at its discretion.
- Hence, Muslims are expected to comply with the laws of the land and therefore shouldn't secretly arrange with others to short sell their property for themselves.

Eighth: Buying Houses Directly from the Banks, Commonly Known as Buying Foreclosed Houses

The need to address this concept from an Islamic legal perspective became evident in the most recent economic crisis in 2008. The economic crisis impacted many countries, especially the United States, and the housing industry was dealt the heaviest blow.

A foreclosure is a situation in which a homeowner is unable to make full principal and interest payments on his/her mortgage, which allows the lender to seize the property, evict the homeowner and sell the home, as stipulated in the mortgage contract.

Essentially, this agreement comprises two transactions, a sale and a loan. The sale element is self-evident. As for the loan, the bank loans the cost of the house to the client with interest, and the repayment of the debt remains. The house is the bank's collateral, and the bank is both the seller and loaner until the debt is fully paid off.

The nature of this transaction is different from a normal mortgage because the seller is also the lender. The loan is included in the agreement as dictated by the standard financial practices in the US, even though the bank is not legally compelled to do that. The bank is a financial institution that profits off of interest-bearing loans and all relating services. It is not a business limited to buying and selling properties. Banks usually sell the debts to Federal Home Loan Mortgage Corporation (Freddie Mac and Freddie Mae). This would not be possible if it did not include mortgage loans in its property sale model.

However, it is noteworthy that in terms of Islamic law, this is merely a literal contract, even though it has practical implications from the business and legal aspects. The following reasons support this claim:

- The so-called loan is specifically for the house that is the subject of their negotiations. It is not the main subject of the agreement.
- The bank is paying the loan to itself.
- The 'borrower', i.e. the buyer of the property, never actually receives the money for the loan and does not have the freedom to spend it as he sees fitting.
- The buyer and the lender are both one and the same, and hence, the financial responsibility for these two roles is not carried by different parties.
- Banks issue mortgage loans in this case to keep in line with the standard practices of the industry, even though they are not legally bound to do so. Technically, they could agree to a payment plan with a higher price instead.
- Since the bank assumes full ownership of the property, above all, it wants to sell the property not give a loan.

Considering the two legal maxims that state: "*Objectives and meanings are given precedence over wording in transactions*" and "*Hardship must be alleviated*", the preponderant opinion is that this transaction is allowed. This transaction is essentially an installment sale, even if it is referred to as an interest-bearing loan. The loan with its interest amount comprise the total sale price for the property.

Hence, the following considerations need to be given in order for the transaction to be allowed:

- The bank legally assumes full ownership of the property, which would entail the bank's personal liability in case it is damaged or ruined.
- Reselling the property would entail an interest-bearing loan along with the sales agreement.
- The lender and seller are one and the same (i.e. the bank), and there isn't a third party involved.
- The funds for the loan are designated for purchasing the home that is the subject of their negotiations.

- The buyer does not have the freedom to use the loan in any other way, and in fact, is not actually given the funds. This would free him from any financial liability towards the actual funds dedicated to the loan.

Ninth: Repenting from Purchasing a House via Interest

If a Muslim got a mortgage through unlawful means and wants to repent, he is not required to immediately get rid of his home or default on his payments to the bank, which would essentially mean losing all that he invested into the property. God willing, his repentance will be accepted, even if he does not do that because guarding his investment is a necessity, and necessities allow one to do that which is forbidden, among which is to pay interest.

However, the repentant has to take some measures to rectify the situation and prove his sincere repentance. Those remedies are in order:

1- Refinancing with a Sharia compliant mortgage company.

2- If he cannot, then selling the property and paying off the loan in full is the solution.

3- If he cannot, then keeping the ownership of the house and paying monthly as much as he can is the solution. This is because the amortization system divides the monthly payment into two parts; a large portion goes toward the interest, and a small portion goes toward paying off the principle. Whatever extra amount the lender makes should go toward the principle, consequently, reduces the accrued interest.

A prepayment penalty is a clause in a mortgage contract stating that a penalty will be assessed if the mortgage is prepaid within a certain time period. The penalty is based on a percentage of the remaining mortgage balance or a certain number of months' worth of interest. If the homeowner prepays the mortgage, the bank loses out on the interest, and hence, the prepayment penalty clause is imposed in the agreement.

Even though the prepayment penalty has been recently removed from the mortgage contract by the lawmakers, and even though it is similar to interest - if it still exists -, but it is still allowed to be paid because it is the only way to get out of the interest-bearing loan with least harm befalling the homeowner. Choosing the lesser of two evils is a well-known concept in Islamic law.

Tenth: Refinancing

Refinance is the replacement of an existing debt obligation with another debt obligation under different terms. Some Muslims resort to refinancing as a means to atone for previously dealing with interest, so they refinance their homes via Islamic banking.

- Refinancing follows the same Islamic rulings for financing. So, if a Muslim enters into an agreement with Islamic refinancing, such as using a *Murabahah* agreement, partnership (*Musharakah*) or a rent-to-own agreement, and the new agreement is truly shariah compliant, then the transaction is allowed. Otherwise, it would be forbidden.
- If he enters into an agreement with conventional mortgage company, then it is prohibited.
- If he financed initially with Islamic mortgage, then refinanced with the same company, then there is no new contract, rather a modification of the original agreement that entails debt reduction, or low profit rate, or adding more equity to the client due to the market value increase, ...or so.

Eleventh: Home Equity Conversion Mortgage (HECM), Commonly Known as Reverse Mortgage

This is a type of loan for senior citizens above the age of 62 that allows them to pull out an interest-bearing loan that does not exceed their equity, or the total amount paid off on their home. This loan is taken out by the borrower as a monthly payment until he dies or decides to sell the house.

If the price of a home is \$200K, for example, and \$100K has been paid off as an equity, the homeowner cannot take a loan that exceeds \$100K after factoring in the interest rate. As a collateral, a lien is placed on his equity in the home, and this is why the loan doesn't need to be repaid if the owner is alive. The mortgaging company has full right to sell the home after the owner's death as payment for the balance of the loan.

Regardless of the regulations and the ways that this loan may be repaid, for the purpose of this research, this type of loan is prohibited by Islamic law because it is interest-bearing.

Twelfth: Buying a Rental Property while Tenants Have Prohibited Businesses

It is allowed to purchase properties for rent, even if the tenants at the time of purchase use it for matters that are forbidden (i.e a bank or bar). Since it is allowed to purchase such properties, the rent money would be Halaal earnings because the buyer didn't directly rent the property out to these individuals; rather, he purchased the whole property. So, the main transaction is concerning the sale of the property, and the ongoing rental agreements are peripheral to the transaction. The legal maxim states: "*Leeway is afforded to matters peripheral to a transaction more than they are given to the main issue of the transaction*". However, when those rental agreements end, it is forbidden to renew those agreements because that would mean directly renting a property for forbidden practices. It is best for a Muslim investor to avoid such properties in general and to seek better alternatives.

Thirteenth: Financing with Conventional Banks who Have Sharia Compliant Options

It is allowed to deal with a Shariah compliant branch in a bank that deals with interest as long as the actual transaction is allowed such as a profit and loss sharing contract (*Mudharabah*), partnership (*Musharakah*), *Murabahah* or other financing options that are valid according to Islamic law. These transactions would not be tainted by the fact that the bank's funds are from unlawful means. The Prophet PBUH did business with the polytheists of Makkah and the Jews of Madinah, and in fact, he even ate from the food offered by the Jewish tribes, fully aware that they engaged in interest.

Fourteen: Selling a Property to a Buyer who Mortgages Traditionally

The seller is allowed to follow through with the sale of his property to any buyer he chooses, even if he knows the buyer will take out an interest-bearing loan for the purchase. The seller is in no way liable for the actions and decisions of others.

Fifteenth: Purchasing on Behalf of Another who is not Able to Buy

Mortgage companies usually do not lend applicants with bad credit or no credit history. There is no issue if a Muslim is requested to buy a house on behalf of another with no or insufficient credit as long as it is being financed in a Halaal way. Otherwise, that would be assisting in sin and aggression, thus, prohibited.

And that will be the end of the contemporary issues I was able to collect in this brief paper.
May Allah bless and accept.