Murabaha
From Contract to Closing

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Murabaha in Real Estate Transactions

- **Definition:**
  - The word Murabaha is derived from the Arabic word Ribh which means profit.

The Use of Murabaha

- Originally, Murabaha was a contract of sale in which a commodity was sold for a profit. The seller was obliged to tell the buyer his cost price and the profit he was making.

The Use of Murabaha (cont.)

FORMS OF MURABAHA

- Presently banks provide financing in many diverse sectors:
  - **Consumer Sector:** for the purchase of consumer durables such as cars and household appliances.
  - **Production Sector:** to finance the purchase of machinery, equipment and raw material etc.
  - **Short-Term Trade:** letters of credit and to provide financing to import trade.
  - **Real Estate Sector:** as an alternative to the conventional mortgage financing

Murabaha in Real Estate Market

- A contract between the financial institution and the buyer for the sale of real property at a price, plus, an agreed profit margin for the financial institution.
- The contract involves the purchase of real property by the financial institution which then sells them to the client at an agreed mark-up.
- Repayment is usually in installments.

How does it work?

- **First stage:**
  - The buyer requests the financial institution to undertake a Murabaha transaction and promises to buy the property.
  - The financial institution buys the real property.
- **Second stage:**
  - The buyer purchases the property acquired by the financial institution on a deferred payments basis and agrees to a payment schedule.

How does it work? (cont.)

- Another important requirement of Murabaha sale is that there are two sale contracts:
  - One by the financial institution which acquires the property from the original seller (through assignment).
  - The other contract is between the original seller and the buyer in a separate real estate transaction.

Shariah Compliant Transactions

- The buyer locates the property.
- After signing the contract with the seller, the buyer contacts finance institution and request that institution purchase the property on his or her behalf.

How does it work in practice?

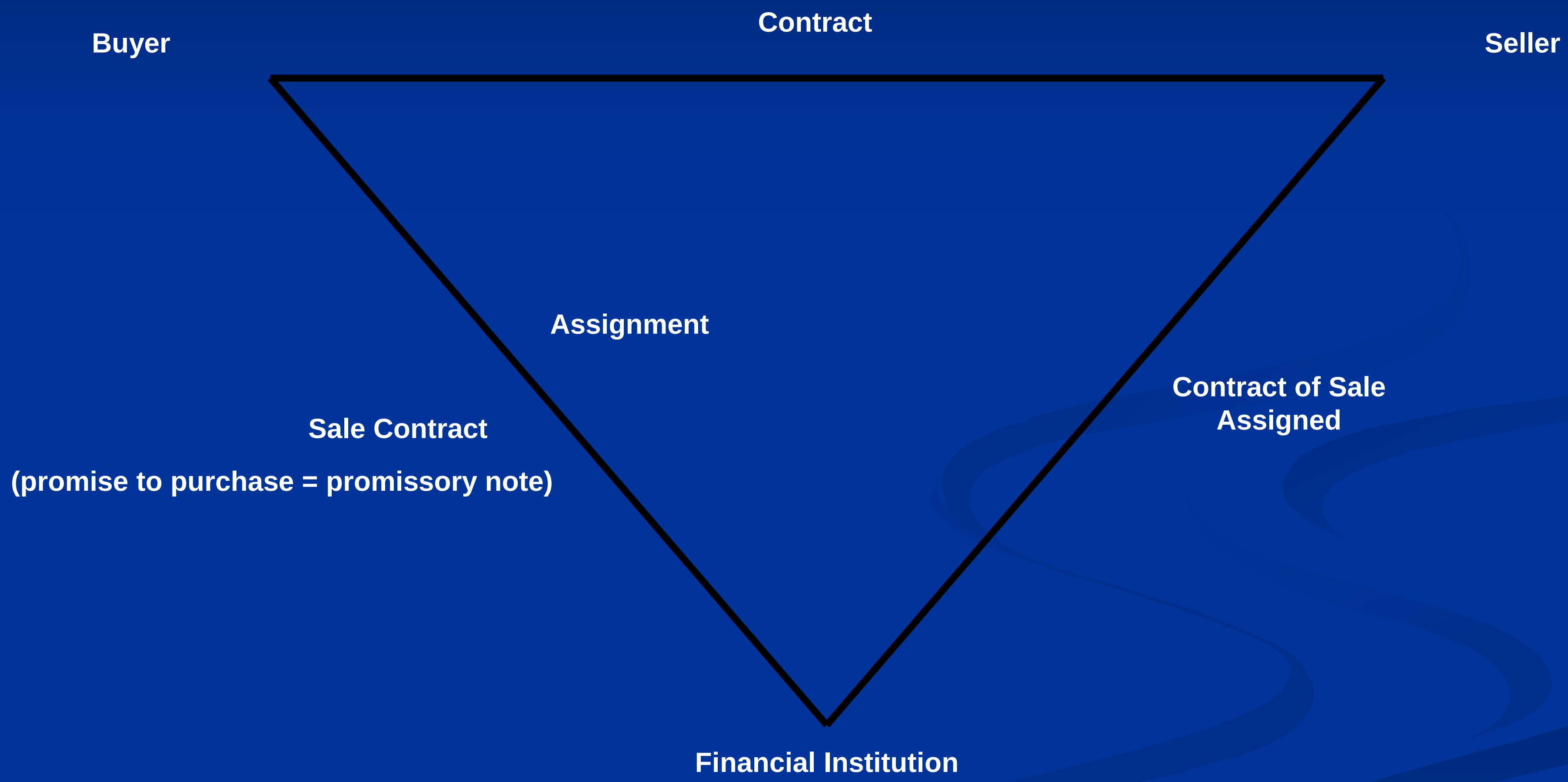
First Contract & Assignment Agreement

- Contract between original seller and buyer:
  - The assignment agreement is made by the buyer in favor of the financial institution of the premises sold by the original seller.
  - The assignment agreement describes the contract of sale that was originally entered between buyer and the seller, including all provisions and covenants in the contract between original seller and the buyer.

First Contract & Assignment Agreement (cont.)

- Ownership is with original seller before closing.
- Before acquiring ownership, buyer assigns the contract to the financial institutional.
- Financial institution buys the property and resells it to the buyer on <u>a deferred payment basis</u>.

Contracts Execution at Closing



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Second Contract
Purchase Agreement Between the Financial Institution and the Buyer

Financing Agreement

- The Financial Institution agrees to sell and the Buyer will purchase the property described in the original contract between the original seller and buyer.
- The agreement describes the purchase price which is the total of:
  - **Based Purchase Price agreed upon by original seller and;**
  - **Profit at a percentage**
- At closing, the financial institution will arrange for delivery to the buyer the deed and all related rights in the property.
- The purchase agreement describes the monthly Installment starting the date of closing until the maturity date.

Payment Terms

Prepayment

- The buyer pays in full before the maturity date.
- The buyer will be entitled a rebate of the profit determined at the time , which is determined by the named “Rebate Disclosure Statement”).

Payment Terms (Cont.)

- If payments are not made on time:
  - The buyer will pay the financial institution a late charge in certain percentage.
  - The financial institution will deduct all expenses resulting from the overdue monthly payment and donate the rest to the public charity that is exempt under section (501(c)(3) of the Internal Revenue Code.
  - At the end of the year, the financial institution provides a statement showing the sum donated to the charity on behalf of the buyer.

Payment Terms (Cont.)

- To protect itself from the buyer's default the financial institution files with the proper records the security instrument signed and agreed to by the buyer
- The financial institution instrument discharges the security instrument by delivering a certificate stating that security has been satisfied (the buyer paid in full the purchase price and the profit).
- The discharge is recorded in the proper official records.

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