

Islamic Housing Finance

Opportunity & Challenges

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GUIDANCE FINANCIAL GROUP



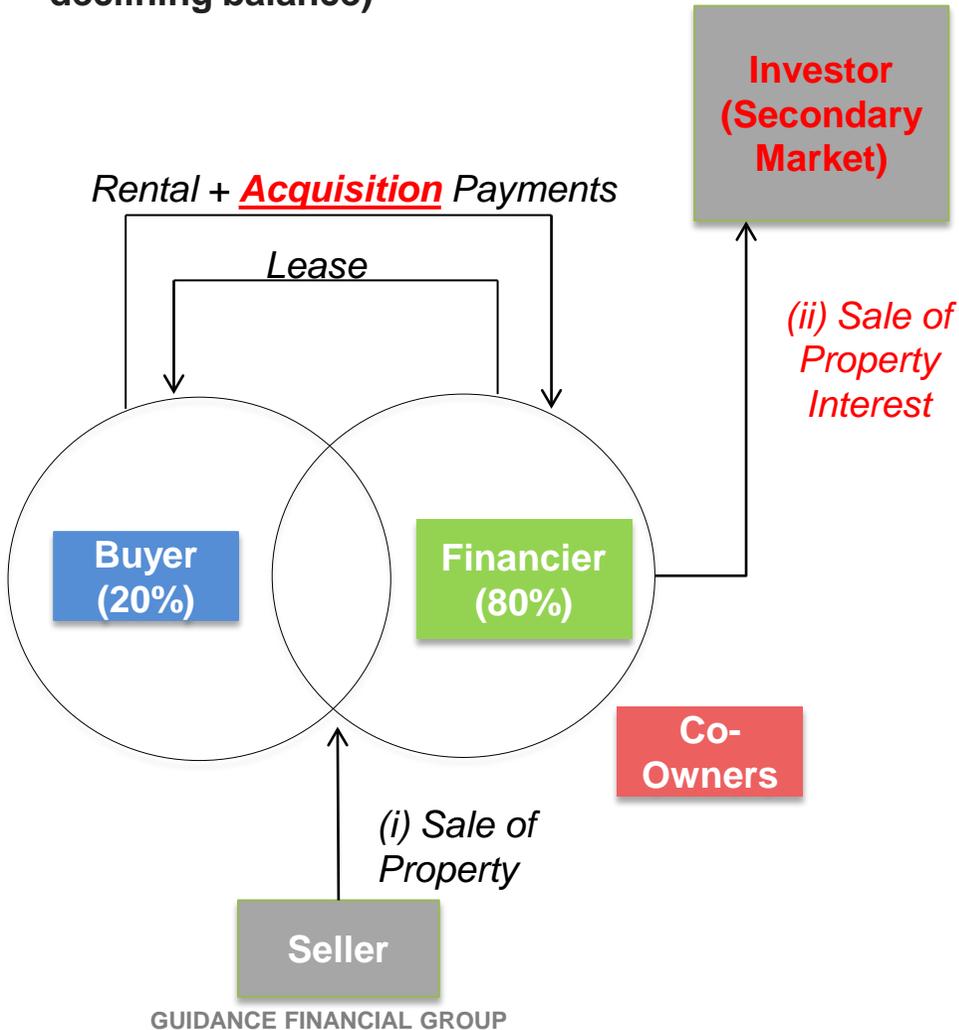
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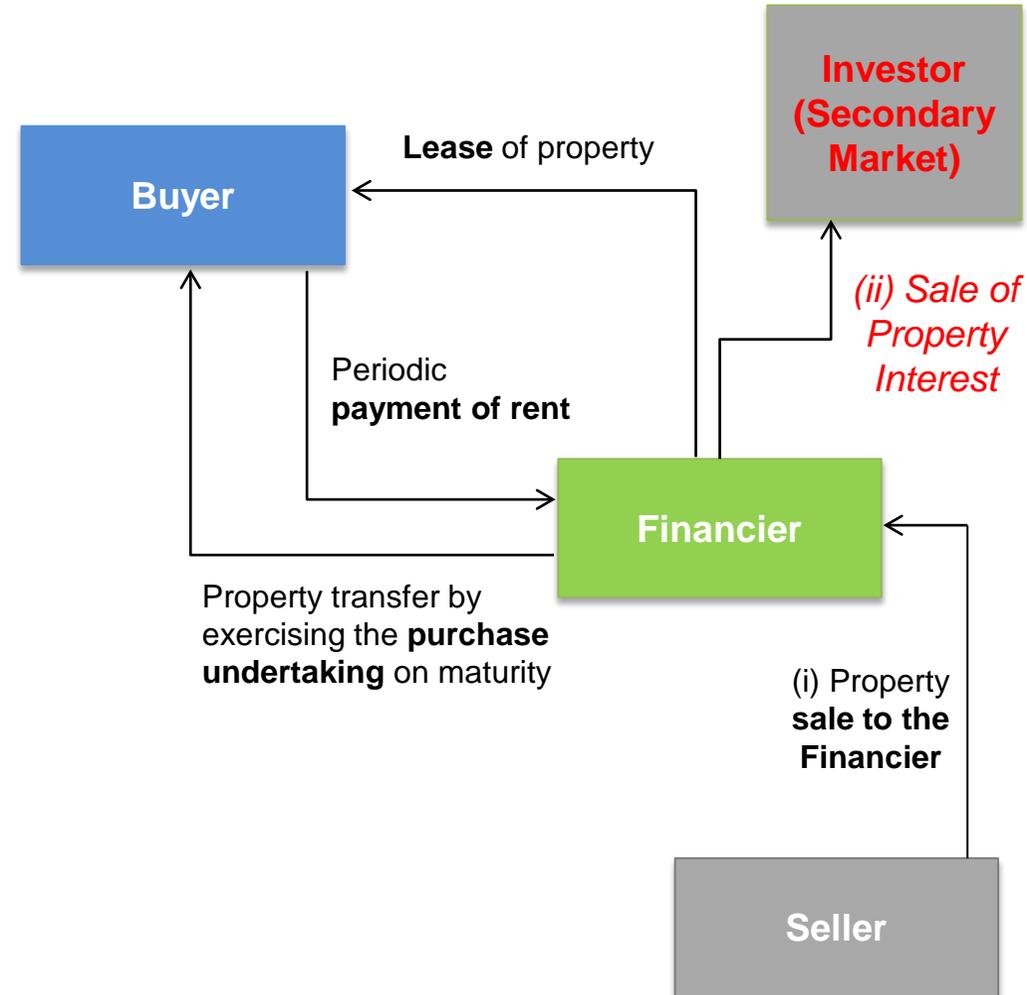
Islamic housing finance products – not very different from conventional

Islamic housing finance is typically structured as either an *Ijara* or a **diminishing *Musharaka***, both of which are asset based and can be securitized (prohibition on making money from money - *riba*)

Musharaka(co-ownership – cash flows akin to a conventional mortgage – i.e. declining balance)



Ijara (akin to a finance lease: sale/lease-back)



DEMAND: About a quarter of the world's population is Muslim – by default creating a demand for Islamic finance products in many countries globally

▶ **There are about 1.6 billion Muslims (23% of the world's population)**

- 62% in Asia-Pacific
- 20% in MENA
- 13% in Sub-Saharan Africa
- Remaining in Europe (3%) and the Americas (about 2%)

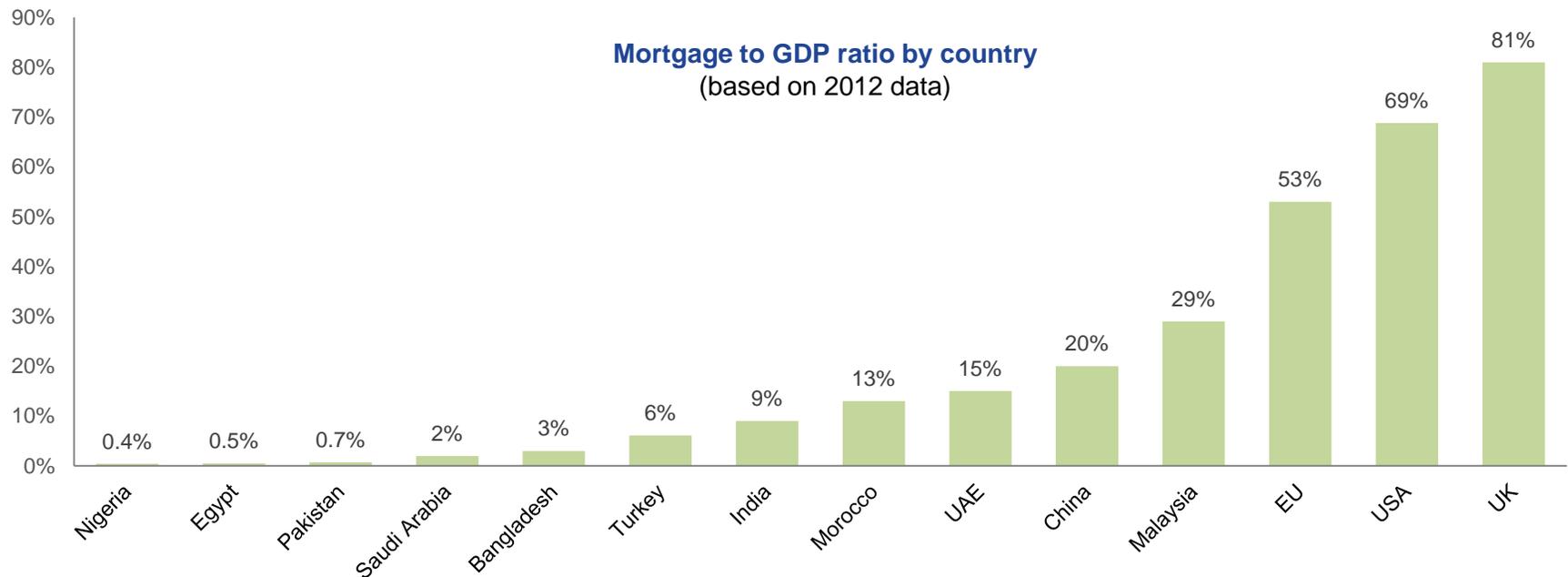
▶ **The top 10 countries by Muslim population are:**

1. Indonesia (13%) 209.1 million
2. India (11%) 176.2 million
3. Pakistan (11%) 167.4 million
4. Bangladesh (8%) 133.5 million
5. Nigeria (5%) 77.3 million
6. Egypt (5%) 77.0 million
7. Iran (5%) 73.6 million
8. Turkey (5%) 71.3 million
9. Algeria (2%) 34.7 million
10. Morocco (2%) 31.9 million

Housing finance penetration is low, despite positive drivers

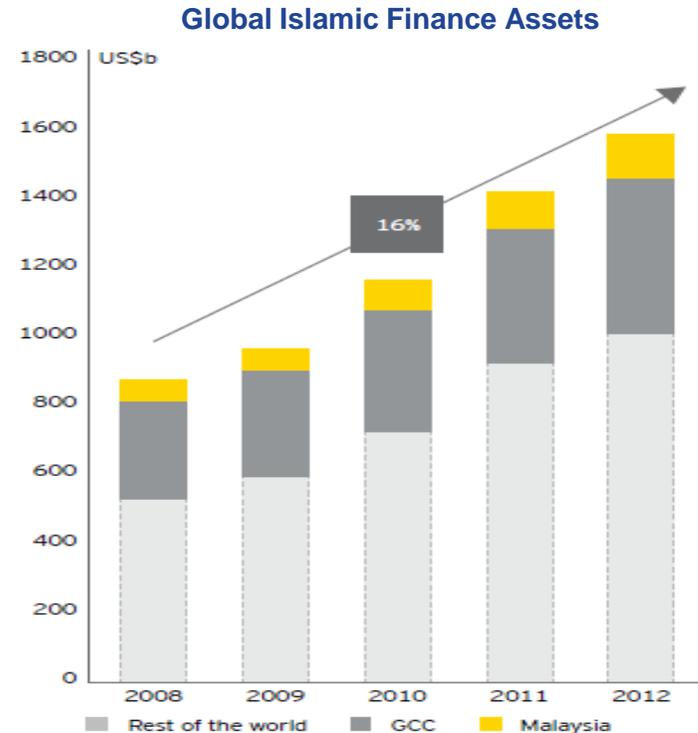
Majority of countries with substantial Muslims populations share several common features, which outline their strong potential for housing finance:

- ▶ **Attractive demographics and population size** (large populations with two-thirds under the age of 30)
- ▶ **Growing GDP**, with double digit growth rates, resulting in a growing middle class, increased urbanization and stronger demand for home ownership
- ▶ However, the **Mortgage to GDP ratios in these countries remain very low**



But Islamic finance is an exciting growth story - ASSETS

- ▶ Islamic finance is growing rapidly in Asia and MENA led by **Malaysia**, followed by several emerging financial markets: **Indonesia, Saudi Arabia, UAE, Egypt** and **Turkey**, where the main growth engine is the **large, young, fast-growing Muslim demographic**
- ▶ Several countries have initiated **legal & regulatory reforms to introduce Islamic finance**:
 - **Morocco** introducing Islamic banking law
 - **Libya** requiring the entire banking system to convert to Islamic financing
 - **Oman** recently licensed three new Islamic banks, and is considering a sovereign Sukuk issuance
 - **Pakistan** has closed high profile sovereign and corporate Sukuks with more in the pipeline
 - **Qatar** and **Bahrain** are introducing reforms to streamline and standardize the sector



- **Islamic financial assets estimated at US\$ 1.7 trillion, growing at 15-20% in core markets**
- In Malaysia Saudi Arabia and UAE, Islamic finance has overtaken conventional finance, particularly in capital markets (majority of debt capital market instruments are **Sukuks**, rather than conventional bonds).

Sukuks – Islamic Bonds (Asset Based)

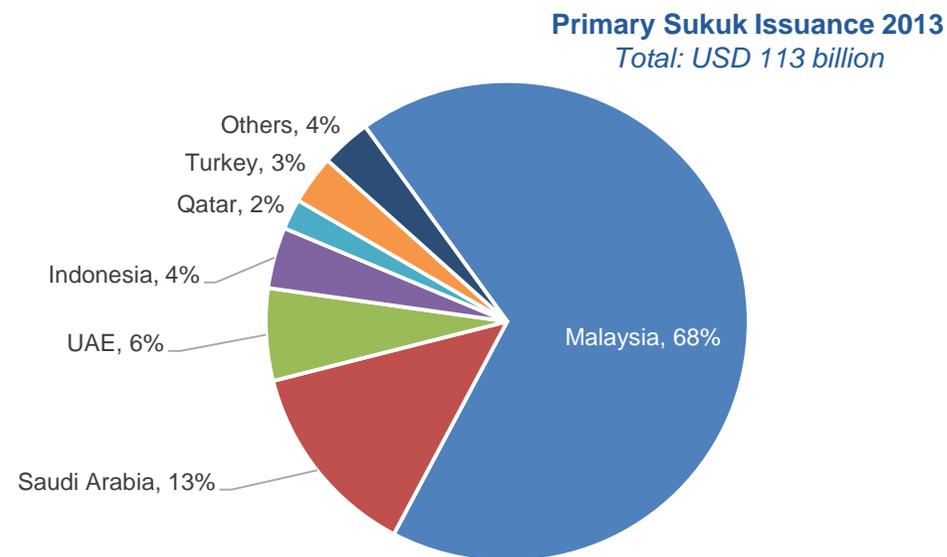
DEMAND (primary markets):
Large Muslim population base with significant demand for Islamic housing finance products

ISLAMIC HOUSING FINANCIERS
(“BRIDGE”)

SUPPLY (secondary markets):
Substantial pool of Islamic finance assets (deposits/institutional)

	Saudi Domestic (SAR) Market	Offshore / RegS (USD) Market	Malaysian (MYR) Market
2013 market size	USD 15 billion (20 issues)	USD 18 billion (28 issues)	USD 80 billion (616 issues)
Sukuk market share	13%	16%	68%
Placement	Saudi Arabia	GCC, Asia (selective) and non-resident US and European accounts	Malaysia, Singapore, and Brunei-Daressalam
Typical Issuer	Quasi sovereigns, FIs and handful of heavyweight corporates	Government, FIs and heavyweight corporates	Government, quasi-sovereigns, FIs and corporates
Primary investors	Primarily banks (limited pool of investors)	Banks and other FIs (limited pool of investors)	Diversified pool of banks, insurance cos, wealth funds and asset managers
Rating	Unrated / unlisted	International rating required, but difficult to obtain investment grade rating for non-sovereign / non-FIs	Investment grade Malaysian credit rating (RAM or MARC rating)

OVERVIEW: SUKUK MARKETS



Challenges for Islamic housing finance (or even conventional)

▶ PRIMARY MARKETS

- Large portions of the **population are unbanked** (not in the formal sector); **informal real estate transfers**
- **Shortage of housing supply**, due in part to lack of bank financing for developers
- High interest rate environment (**affordability issues**)
- Lack of clear mortgage laws – **enforcement/title & registration**

▶ SECONDARY MARKETS (MALAYSIA IS A SOUND MODEL)

- Lack of clear **Islamic finance or capital markets framework** to address issues such as double stamp duties and transfer fees and other taxation
- Clarity on **enforcement issues** (mortgage laws)
- Lack of **domestic credit rating agencies** – (**MAJOR ISSUE**) – **can be key in developing bond markets**
- **Sovereign bond issuances** – **to set the benchmark**
- Enabling environment to facilitate **diversification of investor pool**

Case Study: Dar Al Tamleek, Saudi Arabia

Despite several market challenges, Dar Al Tamleek (DAT), an Islamic housing finance company in Saudi Arabia, has achieved tremendous success. In the 5 years since its establishment, has **financed over 4,300 customers and mortgages of over SAR 3.3 billion** –

- ▶ **KSA Market Challenges:** No mortgage law (until recently) – perceived enforcement issues; Sukuk (bond) markets in infant stage
- ▶ DAT was established with a capital of SAR 1 billion with private and public sector shareholders, including the Public Pension Agency (PPA) and the General Organization for Social Insurance (GOSI). Initially, DAT used its equity to finance the Islamic mortgages it originated; Guidance was the founder and technical advisor
- ▶ **Three keys to DAT's Success:**
 - a) **Public/Private Partnership:** In 2010 DAT launched the first Saudi “correspondent” housing finance program with Saudi Arabia’s Public Pension Agency (PPA) – SAR 10 billion program – **DAT went directly to a long-term funding source**
 - b) **Mortgage Portfolio Sale** – first one ever to a bank in Saudi Arabia (thus, creating a secondary mortgage market)
 - c) **Islamic Product (Ijara)** – positive for DAT from a risk perspective as title held in name of financier
- ▶ **CONCLUDING REMARK:** DAT’s success in KSA highlights the potential for Islamic housing finance companies to prosper, even in markets where significant market challenges are prevalent!

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