

## *The House Building Finance Corporation Limited Pakistan: A Sharia'h Appraisal of Ghar Aasān Flexi Scheme*

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### **Abstract:**

*The main purpose of this paper is to examine the Sharia'h appraisal of House Building Finance Corporation Limited. The House Building Finance Corporation was established in 1952 under the act of parliament to finance construction of houses in the urban areas of Pakistan. In this research Ghar Aasān (Flexi) product of HBFCL is examined from Sharia'h perspective and a comparison is made with Islamic Banking (Meezan Bank Limited) and Conventional Banking United Bank Limited (UBL). This study also comprises the opinion of Sharia'h experts for the shariah compliance of Ghar Aasān (Flexi) scheme.*

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### **Introduction:**

The House Building Finance Corporation Limited (HBFCL) was established in 1952 under the act of parliament<sup>1</sup> to finance construction of houses in the urban areas of Pakistan. Its operations started in the city of Karachi and were later on extended to other cities and towns. The Objective of the House Building Finance Corporation was to facilitate the low income people of Pakistan. The House Building Finance Corporation Limited is the oldest housing finance institution in Pakistan. HBFCL is a Government designated financial institution, provides financing facilities for construction, reconstruction, renovation and purchase of houses.<sup>2</sup>

The House Building Finance Corporation was incorporated on July 25, 2007; the House Building Finance Corporation Limited is an unlisted public company. The Government of Pakistan (GOP) and the State Bank of Pakistan (SBP) jointly hold the capital of HBFCL with 62.50 percent and 37.50 percent,

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shares respectively. As of February 18, 2011 and pursuant to the provisions of section 39 of the Companies Ordinance 1984, the name of House Building Finance Corporation has been changed to House Building Finance Company Limited.<sup>3</sup>

### **Role of HBFCL in Economic Development:**

As a matter of their mandate, HBFCL has focused on providing house financing for the housing needs of the lower and middle income socio-economic sectors. To date, HBFCL has financed over 450,000 houses. Over the years they have developed and offered housing finance products based on the needs of the customers.

Presently, nearly 51 percent of HBFCL's customers are of the lower income demographic with loan amounts of less than Rs. 100,000. Nearly 93 percent of customers have loans below Rs. 500,000, and maintain a monthly income between Rs. 3,500 to Rs. 5,000. Understanding that a large portion of customer base can only afford to pay installments of Rs. 1,000 to Rs. 1,200 per month, HBFCL has actively developed products to accommodate this market to include repayment plans over a 15 to 20 year period.

To date, HBFCL has financed around 456,256 units for Rs. 47.82 billion, successful recoveries of Rs. 64 billion (inclusive of markup) and has a housing portfolio of Rs. 14.6 billion. At present the HBFCL is handling over 77,666 operative accounts with a work force comprising of 951 officers and other support staff. The Company operates throughout Pakistan including Azad Kashmir and Northern areas.<sup>4</sup>

### **Islamization of HBFCL:**

Prior to 1977 the House Building Finance Corporation used to run its business on interest based means and methods. Later on the Government of Pakistan requested to the Council of Islamic Ideology (CII) for preparing a detailed scheme for establishing a Sharia'h compliant financial system in the country. The Council of Islamic Ideology submitted two reports on elimination of Riba. The first report recommended changes in the operations of non-bank financial intermediaries including House Building Finance Corporation Ltd. In compliance with recommendation of report, the House Building Finance Corporation started providing Islamic house financing on the basis of Diminishing Musharakah from 1st July, 1979.<sup>5</sup>

### **Models of House Building Finance Corporation Limited:**

The House Building Finance Corporation Limited developed its Islamic House Finance products during 1979-1987. The first model of Islamic house financing was introduced and notified by the HBFCL was on Profit and Loss Sharing (PLS) or income sharing basis. Later-on during 1988-1990 the next product of HBFCL for Islamic house financing i.e. "Simplified Scheme" introduced. This scheme was launched on the basis of income sharing. New Simplified Scheme was the third product of HBFCL, which was introduced during 1990-2001. After the Supreme Court's Judgment on Riba, the HBFCL introduced a new product named Ghar Aasān on the basis of Diminishing Musharakah during 2002-08.<sup>6</sup> HBFCL introduced a product for financing contractors/builders in 2003 with the name Shandar Ghar. This product was on the basis of Murabahah lil-amiri bi-al-shira i.e. murabaha to the purchase orderer.

The current product of the House Building finance corporation is Ghar Aasān (FLEXI). This product was introduced by HBFCL late in 2007.

### **Ghar Aasān Flexi Scheme:**

The House building Finance Corporation introduced a comprehensive scheme after Ghar Aasān late in 2007. This facility is based on diminishing Musharakah and is only being practiced for providing house financing in House Building Finance Corporation. Other schemes like Ghar Aasan, Shandar Ghar etc. have been closed by HBFCL.

This scheme offers the following categories to meet different needs of the customers, however here we will focus only on construction case:

Construction of residential property

Renovation of an existing residential property

Purchase of a residential property

### **Primary Conditions of Ghar Aasān Flexi Scheme:**

In this scheme, the HBFCL facilitates customer to construct a residential property on previously owned land by customer, or to add on current domestic property. HBFCL assists up to 60 percent of total estimated cost of construction (Land cost + Cost of construction)<sup>7</sup>. HBFCL only facilitates for construction and the land must be bought from customer's side.

### **Main Conditions/Characteristics of Ghar Aasān Flexi Scheme:**

Rental Rate KIBOR + Spread<sup>8</sup>.

Rental Fix for one year.

Re pricing after every year.

3% penalty on outstanding principal (In case of default)

Pre-payment charges 3% (In case a customer wants to purchase units in advance).

### **Documentation of the Scheme:**

Islamic House Finance Agreement:

This agreement sets out the terms and conditions upon and subject to which the HBFCL and the customer agree to enter into a Musharakah. It is understood between the parties that regardless of the proportion of each party in the Musharakah, the entire Musharakah property will be occupied and used by the customer against payment of the monthly payment. Through this agreement the customer buys out the company's share in the Musharakah from time to time.

### **Monthly Payment Agreement:**

This agreement sets out the terms and conditions upon and subject to which the customer agrees to pay monthly rental of HBFCL's share.

Understanding to Purchase Musharakah Units:

In this agreement the customer applies for purchasing HBFCL's shares. This agreement set out the terms and condition for purchasing of Musharakah units.

#### Letter of Undertaking to Sell Musharakah Units:

The letter of undertaking to sell Musharakah units is generally taken by HBFCL from its customers, by this undertaking the customer agree to purchase Musharakah units.

#### Penalty:

The House Building Finance Corporation charges penalty for an initial period of two months on the following rate on account of dishonoring of postdated cheque of debit advice.

Per dishonored postdated cheque, a penalty of Rs. 500 will be imposed and charge for a maximum period of two months.

In case of Non Materialization of debit advice, a penalty of Rs. 500 will be charged for an initial two months period.

If the postdated cheques /debit advice are cleared within the same month, no penalty will be charged.

If the customer remains in default even after two months, then penalty will be imposed according to investment slab as under.

Investment up to Rs. 500,000	Rs. 500 P.M
Rs. 500,000-1500,000	Rs.1,000 P.M
Rs. 1500,000-2500,000	Rs.1,500 P.M
Above Rs. 2500,000	Rs. 3,000 P.M

#### Insurance:

In the interest of the company and the customer, the HBFCL arranges life insurance<sup>9</sup>, which is equivalent to the amount of the investment. The HBFCL resorts to practice due to unavailability of Takaful. The life of the customer is insured with the reputable insurance company on whose income the investment application is accepted by the company. The sum assured of the insurance policy is equal to the original amount of the investment disbursed by the company. The claim, if any, received against the policy from the insurance company in excess of the outstanding balance of total dues shall be refunded to the legal heirs of the customers. The customer shall pay the insurance premium along with the monthly payment of rent and purchase price of Musharakah unit. The company shall also arranges property Takaful for a reputable Takaful company, against all relevant insurable risks such as loss, damage or destruction of Musharakah property.

In the event of claim being lodged, the proceeds are shared between the company and the customer in accordance with their respective share in the Musharakah. All costs and expenses incurred in respect of the insurance of the Musharakah property are borne by the customer.

### **Procedure of Ghar Aasān Flexi Scheme:**

A customer applies for house financing in HBFCL and submits an application with required documents. HBFCL accepts application of customer after necessary process. The HBFCL gives approved amount in installments on following schedule during the agreed period of construction which is normally nine months. In this period the customer will construct house.

1st	30% of approved amount
2nd	30% of approved amount
3rd	30% of approved amount
4th	10% of approved amount

After disbursement of facility the HBFCL will start charging amount of rent. As compared to Ghar Aasān scheme in which during construction period the HBFCL does not charge any amount, the HBFCL charges only amount of rent for the period of fifteen months.<sup>10</sup> After completion of moratorium period customer can purchase units of HBFCL's share, the monthly payment will be changed and included the price of units.

### **Sharia'h Appraisal of Ghar Aasān Flexi Scheme:**

Ghar Aasān Scheme has designed on the basis on Diminishing Musharakah. Diminishing Musharakah (Musharakah Mutanaqasa) is the combination of three contracts which are Shirkah (Partnership), Ijarah (Lease) and Bay (Sale)<sup>11</sup>.

In this contract Islamic financial institution and the customer participate in the joint ownership of a property on the basis of Shirkah tul Milk. The share of the financier is divided into a number of units and the customer purchases those units one by one periodically until he becomes the sole owner of the property.<sup>12</sup> The Customer pays the rent to Islamic financial institution for his part. As the customer purchase units of the Islamic Financial institution, his payable amount of rent decreases, finally the payable amount of rent becomes zero. Same is the case in Ghar Aasān Scheme launched by HBFCL, customer contributes land and HBFCL contributes in shape of financing (for construction of house) in Shirkah tul Milk. After the lockout period customer pays rent of HBFCL's share and will purchase one unit annually.

### **Sharia'h Scholars debate on the legitimacy of HBFCL's Product:**

Majority of ulama (Sharia'h Scholars) are of the opinion that the House Building Finance Corporation limited is not Sharia'h Compliant.

House Building Finance Corporation Limited is working on interest based system. The HBFCL is financed by the Government of Pakistan and State Bank

of Pakistan who lend money on interest and in return HBFCL lends money to their customers on interest.

Jabir RA said 'Allah's Messenger PBUH cursed the acceptor of Interest, and its payer, and one who records it, and the two witnesses, and he said: They are all equal'.<sup>13</sup>

(Darul Ifta Noor Ul Irfan Muharram Al Haram 1427 A.H. , February 2006 )

Even if the product of HBFCL is considered Sharia'h compliant then the issue of check and balance is another concern. The Ulama raised the objection that there is no check and balance by the Sharia'h experts.

The purchase and construction of property with the partnership of House Building Finance Corporation does not involve Riba (Interest). However there are few terms and Conditions exist which are not permitted in Sharia'h. (Daru Ifta Darul Uloom Karachi, Jamadi al Thani 1403 A.H.)

### **Islamic House Financing in Meezan Bank Limited:**

Meezan Bank Limited (MBL) is the first scheduled bank in Pakistan, which has been licensed by the State Bank of Pakistan to operate as an Islamic commercial bank. Meezan Bank offers house financing through their product namely "Easy Home" on the basis of diminishing musharakah.

### **Sharia'h Compliance of Easy House Facility:**

As discussed above that Meezan Bank offers this facility on the basis of diminishing musharakah. In this contract, MBL and the customer participates in the joint ownership of a property or equipment on the basis of Shirkah tul Milk. The share of the Meezan Bank Limited is divided into a number of units and the customer purchases those units one by one periodically. The customer purchases units of Islamic financial institution until the customer becomes the sole owner of the property.<sup>14</sup> The customer pays the rent to Islamic financial institution for his part. As the customer purchases units of the Islamic Financial institution his payable amount of rent decreases, finally the payable amount of rent remains zero. Same is the case in Easy Home Scheme launched by Meezan Bank Limited. The customer and MBL make a pool on the basis of Sharikah tul Milk. The customer pays rent of MBL's share and purchases one unit annually.

As mentioned that the total cost of house is Rs.1, 000,000, the MBL has invested Rs. 600,000 on the basis of Shirkah tul Milk. The Meezan Bank charges rental for his share and customer purchases units of MBL until he becomes the sole owner of that property.

Table 1. Differences and Similarities between Meezan Bank Limited, House Building Finance Corporation Limited and United Bank Limited:

Difference	Meezan Bank Limited	HBFCL	United bank Limited	
Mode of Financing	Diminishing <i>Musharakah</i>	Diminishing <i>Musharakah</i>	Interest Based	
Sharia'h Audit	Yes	No	N/A	
Sharia'h Advisory Board	Yes	No	N/A	
License from SBP for Islamic House Financing	Yes	No	N/A	
Max Facility Amount	40000000/-	7500000	300000000/-	
Duration	3-20 Years	3-20 Years	3-20 Years	
Rental Rate	KIBOR+3.5% approximately	KIBOR+2.5% To 3.5%	KIBOR+3.5% To 4.5%	
Life Insurance	Compulsory	Compulsory	Compulsory	
Property Insurance	Optional	Optional	Optional	
Pmoratorium Period	N/A	A period of 12 months as a moratorium period. In which HBFCL will charge only rental.	N/A	
Late Payment Charges	Rs.500 flat+20% p.a.	Investment	Penalty	Rs.1000 per installment
		UP TO 500000	Rs.500	
		500001-1500000	Rs. 1000	
		1500001-2500000	Rs. 1500	
		Above 2500000	Rs. 3000	
Use of Late Payment Charges	Charitable Purpose	Income of HBFCL	Income of Bank	

**Conclusion:**

The findings of this research conclude that the product Ghar Aasān Flexi of House Building Finance Corporation is based on diminishing musharakah (A Sharia'h compliant mode for house financing). There are some issues in this Flexi scheme, some of them, but not exhaustive, as follow:

In Ghar Aasān Flexi product, the late payment charges include in their income while it is considered as charitable fund in Islamic financial institutions.

There is no concept of Sharia'h supervisory board which may guide them about Sharia'h regulatory framework for a specific product. The corporation do not follow the rule and regulations which are essential for the contract e.g. in murabahah lil-amiri bi-al-shira they provide the required amount to their customer, who purchases the goods and starts to use the goods. Then both the parties , the customer and the corporation sign the contract is being signed between HBFCL and customer which make no difference between conventional and Islamic product.

Such issues can be resolved by taking some steps which have been discussed below in recommendations.

**Recommendations:**

Sharia'h Advisory Board & Sharia'h Audit:

As discussed above that the House Building Finance Corporation finances through diminishing Musharakahbut there are a number of problems in its application. The HBFCL must appoint a Sharia'h Advisor as State Bank of Pakistan has issued a circular for all Islamic Banking institutions on March 25, 2008, who is responsible to ensure that all products and services and related policies and agreements of HBFCL are in compliance with Sharia'h rules and principles. Before launching any new product and services the related procedure, rules and agreements shall be duly examined by the Sharia'h advisor.

The Sharia'h advisor should also conduct Sharia'h audit on annual or by annual basis. In this regard the management of House Building Finance Corporation shall be responsible to provide him all the required information. Sharia'h advisor will thoroughly review operation of the House Building Finance Corporation's products on periodic basis in coordination with officials responsible for Sharia'h compliance to ensure that all the products and services offered by the House Building Finance Corporation are Sharia'h compliant.

**Deficiency of Islamic Orientation Regarding Islamic Finance:**

It has been observed that the management of HBFCL does not have sufficient knowledge regarding Islamic finance. The employees of House Building Finance Corporation do not know about Islamic financial products. The HBFCL is providing house financing on diminishing musharakah basis but the employees do not know what diminishing musharakah is. They cannot convince their customers about their product's Sharia'h compliance. It is necessary for providing Sharia'h compliant products that the House Building Finance Corporation should arrange training programs for their employees on regular basis. Moreover, House Building Finance Corporation is using conventional life insurance but they should use Takful instead of conventional insurance.



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