

Shari'a-Compliant Financing Structures and the Development of an Islamic Economy

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ABSTRACT

This article notes that the disruption in the equity markets has resulted in a renewed interest in investments in real estate assets, with many Middle Eastern investors seeking *shari'a*-compliant investment in United States properties. In that connection, the article addresses an *istisna'-ijara* structure that has been used in construction and mini-perm financing of United States residential real estate projects and is currently being used in construction, mini-perm and long-term financing of commercial and industrial projects in the United States, Europe and the Middle East. *Fatawa* have been obtained for the on-going use of the structure in individual transactions and for groups of transactions that will constitute investments by Islamic investment funds. The article first surveys some of the assumptions underlying, and constraints to, the development of the *istisna'-ijara* structure, including (a) *shari'a*-compliance, (b) foreign investment criteria, (c) the extensive regulatory environment in the United States and the variations in law among the 51 legal jurisdictions that comprise the United States and its states (and the virtually unlimited number of other governmental entities having regulatory and statutory control over United States real estate projects), and (d) the nature of standardization in the construction and banking industries in the United States. *Shari'a* precepts applicable to *istisna'* contracts and *ijara* contracts are reviewed and summarized. The article then surveys the development of the *istisna'-ijara* structure in two transactions that have implemented the structure, the Maconda Park Project (a *de novo* Islamic financing) and the Truman Park Project (a take-out of a conventional interest-based financing using the *shari'a*-compliant structure). The survey includes consideration of factors that influenced the choice of structure at each step and the effect of those factors on each of the major documents comprising the structure (the site lease, the construction (*istisna'*) agreement, the lease (*ijara*), the agreement to lease, the put option, the call option, the managing contractor agreement, and the tax matters agreement, each of which is discussed with specificity). Finally, the article considers some of the further applications of the *istisna'-ijara* structure, with observations on how acceptance of *shari'a*-compliant financing, such as those discussed in the article, in the United States is advancing the development of a true Islamic economy that interacts with the Western interest-based economy without sacrifice to Islamic principles or faith, and observations on how the *shari'a*-compliant structure may actually be more economically efficient and competitive than existing conventional loan structures.

I. INTRODUCTION

Variations in the economic and investment cycles have been pronounced over the last two years. Strong equity markets and the dotcom enthusiasm reigned for a prolonged period, showing a marked and abrupt downturn only two years ago. Product development follows economic cycles. This resulted in the development of many equity-based investment products during the long period of escalation in the equity markets. This was as true in the search for *shari'a*-compliant investment products as for non-Islamic products, perhaps more so, as the period coincided with an accelerated demand for financing and investment in compliance with *shari'a*. The strong performance of equity investments provided both the need for products, and the profitability to make investment in their development economically palatable: a self-perpetuating cycle. Islamic financiers and *shari'a* advisors responded admirably, exploring and developing a wide range of *shari'a*-compliant equity funds and financing techniques. Creativity abounded within the bounds of *shari'a* precepts.

The booming equity markets and the dot.com mania have both passed, at least temporarily. Investor interests have shifted to other instruments, including a broad range of real estate investments. Financiers have, and will, turn their creative efforts to the development of products to meet these investor desires. There are many reasons to believe that Islamic financiers and *shari'a* advisors will respond as any market participant would, and that they will continue the creative exploration and development process into and through this new business cycle. The result will be a broader range of investment products and investment opportunities for Islamic investors. Among those reasons are (a) the growth of Islamic finance as an industry, (b) the increased awareness of Islamic finance and its

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potential by non-Islamic financial institutions, (c) the current strong cash position of many Middle Eastern institutions and investors, (d) the long-standing favoritism shown by Middle Eastern investors to real estate investments, and (e) the continuing growth of new construction in the United States real estate markets and the strong need for developers of real estate projects for both equity and debt or debt-equivalent financing.

This article considers one aspect of this current developmental process. It examines the development of a *shari'a*-compliant construction financing structure that has been developed for Islamic investment in the United States real estate markets. Specifically, the article focuses on such construction financing in the residential real estate markets over the last two years. The primary areas of focus are (i) how the determination was made to develop such a structure; (ii) how the structure was actually developed and implemented, including the documentary and economic risk considerations of the structure; and (iii) the prospects for use of the structure in various markets. The structure that is discussed in this article is an "*istisna'-ijara*" (construction contract-lease) structure. The structure (including variations for different market environments) has received various *shari'a* board approvals, as has the detailed documentation for the transactions implementing the structure. The structure has been implemented in two transactions that are discussed in this article, and has been implemented in other transactions that are currently in various stages of completion. Use of the structure is considerable and growing at the present time, not only with respect to residential real estate projects, but also for commercial and industrial real estate projects. The structure is being used for "one-off" investments and for a broad range of transactions that will be pooled for real estate fund investments.ⁱ

II. CONTEXT OF THE TRANSACTIONS

The *istisna'-ijara* construction and mini-perm financing structure that is discussed in this article was developed to enable *shari'a*-compliant investments in real estate projects throughout the United States by Islamic investors who are not U.S. citizens for purposes of the Internal Revenue Code of 1986 (as amended) of the United States of America (the "Internal Revenue Code"). That simple statement implies a broad range of constraints and incorporates a broad range of assumptions, a few of which are noted in this article.

First, the investments must be compliant with *shari'a* precepts. Many are now aware of the basic elements of *shari'a* compliance, such as the avoidance of *riba*.ⁱⁱ Other aspects of *shari'a* compliance as they pertain to *istisna'* and *ijara* contracts are discussed in this article.

Second, the Islamic investors are not U.S. persons for purposes of the Internal Revenue Code; they are foreign persons. This fact necessitates substantial tax structuring to minimize the imposition of United States federal income and withholding tax on the yields made available to the Islamic investor. Imposition of such taxes would render the investment totally unattractive. Similarly, foreign persons are subject to the limitations of various laws of the United States that limit ownership of real property by such persons.ⁱⁱⁱ

Third, the structure was developed for investments in real estate projects throughout the United States. One set of laws applicable to the transaction and the participants in the transaction is the federal law of the United States of America. Businesses in the United States are among the most heavily regulated in the world, or at least subject to the most extensive pattern of legal requirements of any businesses in the world. Among the many laws applicable at the federal level are (a) tax laws, (b) bank regulatory laws, including in respect of bank ownership of real property, (c) environmental laws, including liability based on property ownership, and (d) bankruptcy laws. Each of these categories of laws, and many others, influences the structuring and implementation of the *istisna'-ijara* structure. And the United States is comprised of 50 separate states, each having an extensive legal structure applicable to property, transactions and participants in transactions. Further, each city, county, township, borough and similar political subdivision of a state has extensive regulatory authority over real property and the participants in transactions involving real property. None of those legal systems is identical, and many are widely divergent in their requirements and peculiarities. Real property is almost exclusively the province of state and local law and particular state and local law requirements pertain to ownership, zoning, use, licensing, enforcement of remedies in respect of real estate, environmental and a lengthy and bewildering list of other topics. Transactions are subject to a similar range of legal constraints. Similarly, transactional participants must satisfy a broad range of legal requirements, including in respect of the nature of the entity, licensing, qualification to do business and taxation. Conventional real estate financing in the United States fails to easily comply with these widespread variations in applicable law, and an Islamic structure is surely less likely to comply than a conventional structure, if only because of the difficulty of making compliance determinations for a new structure.

Fourth, the construction industry in the United States is relatively standardized in a large number of aspects. This standardization is designed to achieve a precise and pre-defined allocation of each and every risk in the transaction, and, in a highly competitive industry, to achieve that allocation and completion of the project at the

lowest possible cost. For example, developers of United States real estate projects, particularly residential housing projects, operate with relatively thin margins. Because they also bear the risks of transactional costs, developers seek to standardize their transactions to the greatest possible extent. This includes standardization of financial structures and documentation. They attempt to develop financing relationships that minimize transactional costs in every regard, including through multiple transactions involving the same structures and parties. Payment of transactions costs for a unique structure or one that is more complicated or difficult to implement might well render the transaction uneconomic. And, in the current market, any Islamic structure is fairly said to be both unique and more difficult to implement.

Bankers and other financial institutions also achieve economies through standardization. To give just two examples, they have relatively standardized credit requirements and means of implementing those credit requirements, including standardized documentation. When first viewing a structural chart and the documentation for an Islamic structure such as an *istisna'*-*ijara* transaction, it is difficult to ascribe credibility to the Islamic financier and his lawyers when they assert that there is really very little difference between a conventional construction loan financing and an *istisna'*-*ijara* construction financing.

General construction contractors almost uniformly use an absolutely standardized form of construction contract on each and every transaction. One commonly used model is the form that has been prepared by the American Institute of Architects. Variations from the form, particularly the standard form and the general conditions, are not entertained or accepted. Asking such a general contractor to modify its customary form flirts heavily with rejection, and if the general contractor should acquiesce, will entail significant transactional cost in educational and examination time. The risk allocations required by an *istisna'* arrangement fit the mold for rejection and extreme implementation cost in every particular.

And then there is the notion of convincing a title insurance company that the Islamic structure is in substance something that is familiar to them and insurable by them. One can only say that, at first blush, such a claim seems without any basis in reality and sympathy should lie entirely with the title insurance company.

In developing the structure and documentation for, and implementing, the *shari'a*-compliant transaction each of the foregoing, and many other factors, had a profound influence. This article will attempt to provide an indication of how some of these factors were addressed in the *istisna'*-*ijara* structure and the transactions discussed herein.

III. GENESIS OF THE STRUCTURE

A limited number of United States banks provide the predominant share of construction financing for residential housing projects in the United States. They develop strong relationships with developers that meet their credit criteria and often have the first opportunity to look at, and provide financing for, those developers. One such United States bank is KeyBank, National Association ("KeyBank"). An affiliate of KeyBank, Key Global Capital, Inc. ("Key Global Capital") has relationships with a range of Middle Eastern investors. And those Middle Eastern investors have a preference for using structures that are compliant with Islamic *shari'a* precepts. One such investor is Gulf Investment House ("GIH") of Kuwait. These relationships, and market trends in late 1999 and early 2000, gave rise to the desire to develop a *shari'a*-compliant investment structure for the financing of the construction of United States residential properties. Key Global Capital turned to the law firm of King & Spalding to assist in the development of that structure. The result was the *istisna'*-*ijara* structure that is the subject of this article. The first two transactions to implement the resultant structure were a residential housing project in Austin, Texas (the "Maconda Park Project")^{iv} and a residential housing project in Largo, Maryland (the "Truman Park Project").

The Maconda Park Project reached financial closing in June of 2000. It involved a *de novo* construction financing. The Truman Park Project closing occurred in April of 2001 and involved the take-out of a conventional interest-bearing construction loan and conversion of the financing to a *shari'a*-compliant structure.^v The variations in the Truman Park transaction were that (a) the structure was used to take out an existing conventional construction loan, (b) an "orphan" special purpose vehicle was introduced to enter into the two construction contracts in the transaction (the Construction (*Istisna'*) Agreement and the Construction Contract, each as hereinafter discussed), and (c) various aspects of the structure were modified in an effort to reduce transactional costs and expedite the documentation process.

The structure used in the Maconda Park and Truman Park transactions was designed for project financing of all types, and was then modified for the real estate transaction.^{vi} The structure has been designed to accommodate construction, mezzanine, and long-term project financing, including take-outs of conventional loan financing (as in Truman Park). Modified versions of this structure have been, and are being, implemented in various European and Middle Eastern jurisdictions.

IV. SOME BASIC PRINCIPLES OF *ISTISNA^c* AND *IJARA*

The Maconda Park and Truman Park transactions may be characterized as an “*istisna^c-ijara*” structure.^{vii} An *istisna^c* is a type of sale of assets to be constructed or, more correctly, manufactured^{viii} according to designated specifications and for a specific determined price. An *ijara* is a type of simple hire, or lease, of an object or services.

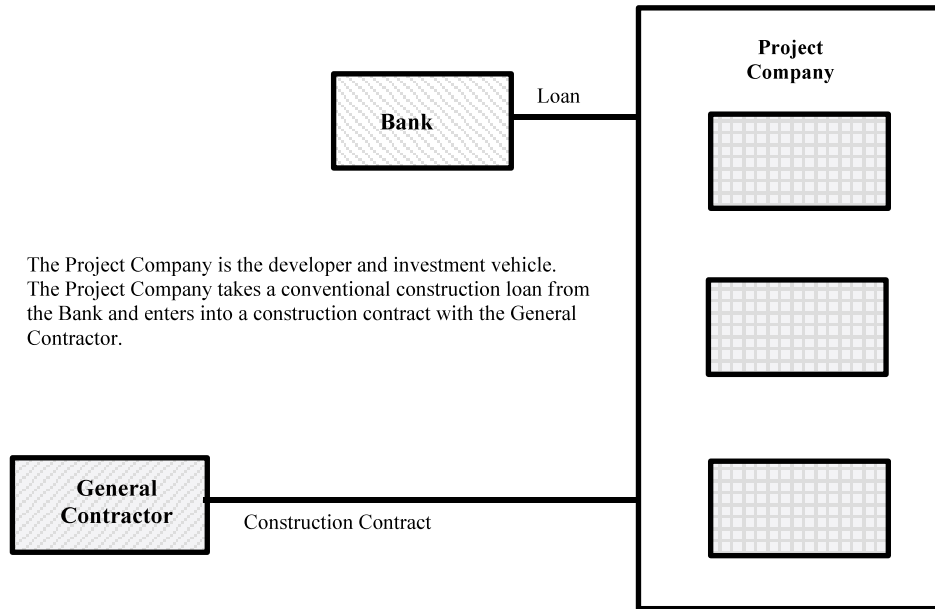
It is helpful to review a few of the *shari^ca* principles applicable to *istisna^c* (construction or manufacturing) agreements.^{ix} An *istisna^c* is a sale of assets to be constructed involving a transaction in which a bank finances the construction of permissible assets. The assets must be precisely determined by description and specifications. Although the liability to pay for the construction, and deliver the constructed assets, will be that of the bank providing the financing, the bank does not have to itself construct the assets. The financing bank (*sani^c*) may contract with a third party (*mustasni^c*) to construct the assets so long as this arrangement entails no contractual obligations between the bank client that ultimately desires to purchase the constructed assets^x and the construction contractor. Payment by the bank client to the bank may be made up front or pursuant to periodic installment payments. The *istisna^c* amount payable by the bank client to the bank, and by the bank to the construction contractor, must be fixed and known to both parties. The bank client is permitted to inspect and supervise the construction activities to insure compliance with the specifications and for other purposes. The bank client may accept delivery of the constructed assets on behalf of the bank.

It is also worthwhile to summarize certain relevant *shari^ca* principles relating to *ijara* (lease or hire) arrangements.^{xi} The *ijara* is a lease of an object or services involving the transfer of the usufruct or *manfa^ca* (the use of an object or the services of a person) for a rent consideration. The nature of the *manfa^ca* must be precisely defined and the rental consideration must be for a fixed value, whether payable in a lump sum or installments,^{xii} and the term of the *ijara* must be precisely determined. The lease arrangements may be such that the lessee acquires ownership upon the termination of the lease. Both the rent and the term must be clearly ascertained and designated in the *ijara*.^{xiii} The rent will commence immediately upon execution of the *ijara* if the *manfa^ca* has sufficient economic value, substance and benefit at that time, meaning that it can be, and is, put to the use for which it is intended with benefit to the lessee.^{xiv} If it does not then have such economic value, substance and benefit, the rent will commence when such value, substance and benefit do exist. If the rent is reviewed during the term of the *ijara*, each such review and any agreement (if reached) changing the rent results in the creation of a new lease for *shari^ca* purposes. The rent must be specified as a fixed sum for each *ijara* and the related rental term. However, the rent may escalate or diminish during the rental term so long as the amounts of such escalation and/or decrease are specified and known to both parties.^{xv} The lessor of assets is permitted to claim compensation from the lessee for misuse of the leased assets, but may not make claims in respect of ordinary wear and tear of the assets. The lessor is responsible for structural maintenance of the assets and this obligation may not be passed to the lessee pursuant to the *ijara*.^{xvi} The lessor is entitled to rent as long as the lessee has the enjoyment of the leased assets as specified in the *ijara*. If the lessee does not have such enjoyment, as upon destruction or condemnation of the *manfa^ca*, the lessee may rescind the *ijara* and any contrary provision will be invalid.

V. METHODOLOGY OF DEVELOPMENT OF THE *ISTISNA^c-IJARA* STRUCTURE

A “conventional” construction financing in the United States involves three primary parties: a project company, consisting of a real estate developer and its equity investors (the “Project Company”); a bank or other financial institution (the “Bank”); and a general construction contractor (the “General Contractor”) that will build the improvements. The Project Company obtains an interest bearing loan from the Bank which is evidenced by a standardized loan agreement (and a note). The proceeds of that loan are disbursed against the satisfaction of various conditions precedent, including completion of construction milestones, and are used to pay the General Contractor for construction of the improvements pursuant to a standardized construction contract. Figure 1 provides a diagrammatic summary of these relationships.

FIGURE 1: CONVENTIONAL LOAN FINANCING



Analysis of a conventional lending transaction reveals immediately that the Bank has no relationship with the General Contractor (other than pursuant to conventional consents to assignment and exercise of rights). The Bank's relationship is exclusively with the Project Company, its borrower. The General Contractor's relationship is exclusively with the Project Company (again, except for such consents). The Project Company is generally a special purpose vehicle, such as a limited partnership or a limited liability company, formed exclusively to effect the construction and subsequent sale of the project. The project is usually sold soon after it has reached stabilization (i.e., a given level of occupancy), whereupon the developer and the investors are paid and the developer moves on to a new project.

As noted above, the entire construction process in the United States is quite standardized. Most importantly, the risk allocations among the various parties to the transaction are standardized and well defined. Variations from these risk allocations are rare, and where such variations do exist they are made at substantial cost, usually to the developer and the Project Company.

One of the greatest challenges in the development of the *shari'a*-compliant construction finance program was to effect that program in such a manner as to place each of the parties in the same risk-allocated position such party would have occupied in a conventional loan financing. Another critical requirement was to develop the structure so that it could be implemented at essentially the same cost as a conventional loan financing. Failure to achieve these results would render the transaction prohibitively expensive to one or more parties, usually the Bank or the Project Company, and would render the financing structure non-competitive in the United States market. The diminution in return resulting from increased transaction costs or significant pricing adjustment as a result of reallocation of risk (as compared with a conventional loan financing) would decrease yields and deter necessary equity investment.

Various Islamic financing techniques were considered in the early stages. Some of the considerations related to the inherent merits and shortcomings of the relevant contractual device and its use in a structure in the United States. Other considerations related to the flexibility of a given Islamic contract or structure in the United States legal environment. For example, *istisna'*-parallel *istisna'* structures (and variants) were considered and ultimately rejected. Use of an *istisna'* (or related agreement) was appropriate given the nature of the undertaking to be financed (i.e., construction), but was fraught with difficulties in the United States legal environment. Some of the types of legal difficulties relate to United States bank regulatory provisions that prohibit a bank from owning real property, except for very limited purposes, and the provisions of environmental laws in the United States that provide for liability for an "owner" or an "operator" of real property (and the limited nature of the safe harbor from those liability allocation provisions).^{xvii} Use of an *ijara* (lease) as the primary document for repayment of the financing was thought desirable from the early stages of the developmental effort because of (a) the flexibility of leases in both the Islamic and the United States legal systems, (b) the widespread use of leases in both Islamic

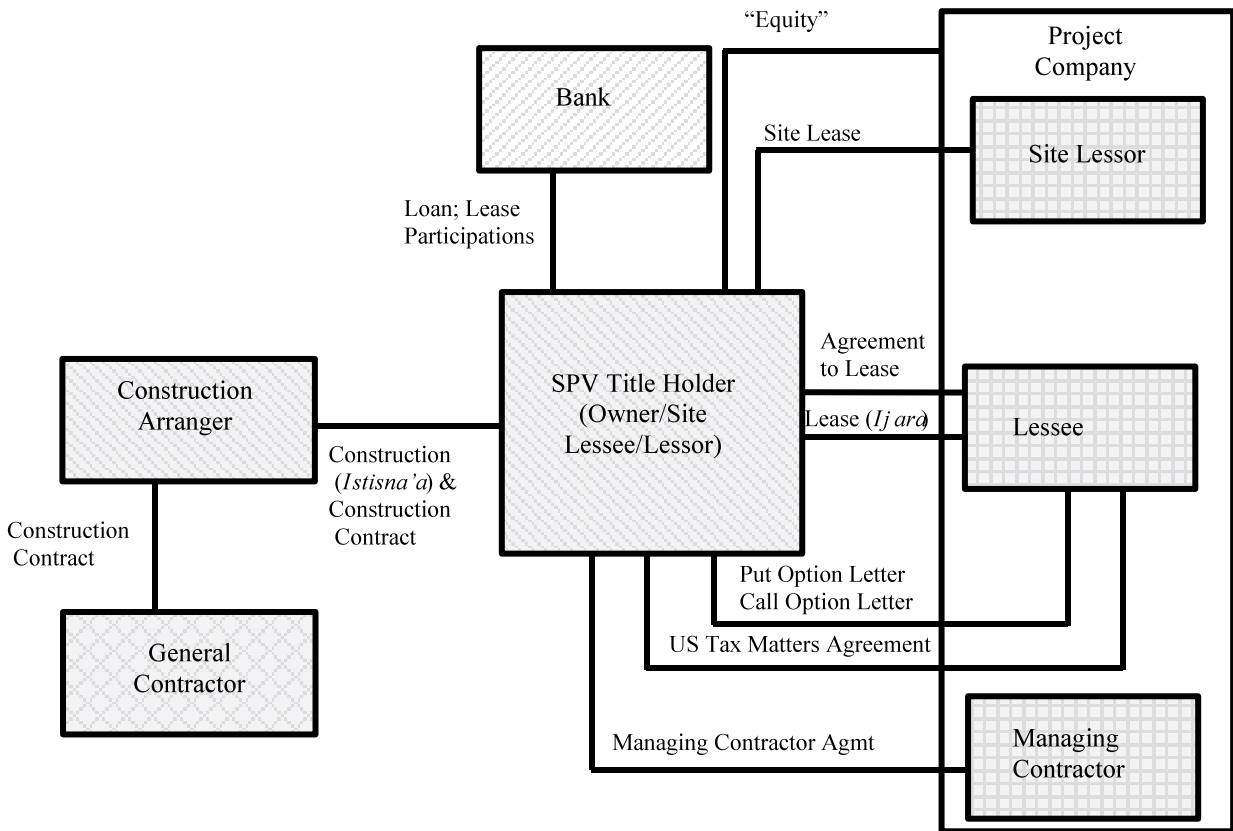
jurisdictions and the United States, (c) the relative standardization of leases in both jurisdictions, and (d) investor familiarity with leases in both jurisdictions.

Consideration was given to a variety of structures that would implement different Islamic contracts, and to the use of a variety of entities that would give effect to the risk allocations required under *shari'ah* precepts in connection with each of the Islamic contracts. The result of those deliberations was that a structure incorporating both an *istisna'* (construction contract) and an *ijara* (lease) would provide the greatest flexibility and would result in a risk allocation that best approximated a conventional loan financing.

VI. DEVELOPMENT OF THE STRUCTURE AND DOCUMENTATION

This section of this article describes the evolution of the *istisna'-ijara* structure. An overall diagrammatic summary of the structure is set forth in Figure 2.

FIGURE 2: ISTISNA'-IJARA OVERALL TRANSACTION



A. General Regulatory Considerations

The first major regulatory issues that arose in development of the structure related to prohibitions on Bank ownership of real property and to environmental liability exposures attendant upon ownership of real property. There are two primary means of addressing this issue: either the Bank has or obtains regulatory approval to own a given project for financing purposes and effects a structure that provides isolation of environmental liability and other adequate environmental liability protections or a structural mechanism is effected to remove the Bank from direct ownership. In the transactions that have been effected, both means have been implemented. In some transactions, the Bank has obtained the requisite approval. In other transactions, a structure has been implemented whereby the Bank does not directly own the improvements; rather, a special purpose vehicle is inserted to own the improvements and lease them to the Project Company.

B. Site Lease

Market and economic constraints were also initial considerations. These types of construction financing are relatively short-term, usually one and one-half to two and one-half years in the residential housing market. Because they are construction financing, there is no income to the project during the construction period and there is no repayment of the financing during the construction period (with capitalization of interest during construction in most transactions). At the end of the construction period the project is sold and the investors cash out, with the developer moving on to other projects. Recordation and transfer taxes upon any transfer of the real property, if incurred more than frequently than upon acquisition of the undeveloped land and upon a sale of the improvements and the land to a third party, would make the transaction uneconomical. As a result, for example, it is economically advantageous to have land ownership stay with the Project Company (rather than being transferred to the Bank affiliate which is the title owner of the improvements on the land).

This led to the creation of a site lease (the "Site Lease") whereby the land is leased by the Project Company, as the site lessor, to the Bank affiliate that owns the improvements being constructed (the "Owner"), as the site lessee, to allow the Owner to construct those improvements on the land. The Islamic structure that may or may not continue upon a default by the Project Company or a sale of the project to a third party. Thus, the site lease was constructed as a unique document with each provision being bifurcated to provide for the situations where (i) the Islamic structure is in effect, and (ii) the Islamic structure is not in effect. The Site Lease is unusual in other aspects as compared to a customary United States ground lease for a project financing or real estate financing. The differences from a conventional ground lease relate to applicable Islamic *shari'a* precepts and to risk allocations that must be made to accommodate use of the *istisna'-ijara* structure in the United States with parties that are accustomed to a specified pattern of risk allocations. As examples of such differences, in the *istisna'-ijara* structure, the site lessor, as owner of the site, retained responsibility for environmental liabilities, the state and condition of the site, unforeseen circumstances pertaining to the site, compliance with legal requirements by the lessee under the Lease (*ijara*) (as hereinafter defined), and payment of taxes and other amounts, among other things. In addition, the site lessor has the obligation to prevent unlawful use of the site, unlawful conditions on the site, and other uses of that site that may give rise to damages or liabilities pertaining to use or occupation of that site, including compliance with environmental laws. The Project Company, as the site lessor, also provided indemnities to the Owner and other indemnities in respect of such matters. This allocation of risks and responsibilities, while variant from United States practices, is more harmonious with *shari'a* precepts.

C. Construction (*Istisna'*) Agreement and Construction Contract

The development of the primary financing documentation began with a consideration of a conventional loan agreement and a customary construction contract. Specific attention was devoted to (i) how such an agreement allocates risks, and varies the risk allocations over time (for example, during the draw-down period and during the repayment period), and (ii) the mechanics of effecting those risk allocations. Various provisions of a conventional loan agreement relate to the "lending" portion of the financing transaction. These include, in whole or in part, the commitment to lend, the disbursement mechanics, the conditions precedent, the representations and warranties, and the covenants. Other provisions of a conventional loan agreement relate to the "repayment" portion of the financing transaction. These include, in whole or in part, rate calculations, amortization provisions, representations and warranties, covenants, events of default, remedies, indemnities, mandatory prepayments, and voluntary prepayments. The analysis of the customary construction contract revealed a range of provisions that would be incompatible with an Islamic construction contract (an *istisna'*) and these were identified.

It was determined that, for analytical and drafting purposes, the conventional loan agreement should be torn down the middle, with the "lending" half going into the *istisna'* and the "repayment" half going into the *ijara*. Drafting commenced with the *istisna'* (the "Construction (*Istisna'*) Agreement"). There were two main tasks to give effect to preservation of conventional risk allocation and compliance with *shari'a* precepts. The first was to incorporate the "lending" half of the conventional loan agreement into the Construction (*Istisna'*) Agreement, and the second was to purge the transaction of elements of the customary construction contract that are offensive to *shari'a* precepts. The various "lending" elements in a conventional loan agreement were considered one-by-one and modified for incorporation in the Construction (*Istisna'*) Agreement. Thus, the lending commitment became a commitment to pay for construction milestone payments in the requisite amount of the total construction cost for the improvements (the "Total Construction Cost"). The conditions precedent to advances on the loan became conditions to payment of milestone payments in respect of construction, although this requires various modifications to reflect *shari'a* precepts. Incorporation of appropriate loan agreement representations and warranties and covenants, each in modified form, was a much easier task, and these were combined with the customary representations, warranties and covenants of a customary construction contract. Finally, the Construction (*Istisna'*) Agreement became a two-part

document comprised of (a) standard Islamic *istisna*^c provisions plus the incorporated and modified loan agreement provisions, and (b) the customary construction contract used by the General Contractor for that transaction (the “Construction Contract”). One section of the Construction (*Istisna*^c) Agreement was then developed expressly to sanitize the offensive provisions of the Construction Contract for Islamic purposes.

Realizing that the Bank^{xviii} and the General Contractor^{xx} would each be different for each transaction led to further structural decisions. Each Bank has its own standard requirements pertaining to documentary provisions. It has standard lending mechanics that relate to the operational organization and procedures of that Bank. It has its own standard representations, warranties and covenants that relate to its own credit requirements and its own business practices and methods. Similarly, each General Contractor has its own standardized construction contract.^{xx} This led to development of the Construction (*Istisna*^c) Agreement in modular form, which allows for substitution of modules depending upon the identity and requirements of specific Banks and General Contractors. It also allows each General Contractor to use its customary form of Construction Contract without modification, and without the necessity of involving the General Contractor in the Islamic structure. The project developer will then negotiate the Construction Contract directly with the General Contractor, as it would in a non-Islamic transaction. The project developer will not execute the Construction Contract, however. Instead, the Construction Contract will be executed by a special purpose vehicle that is established to act as the construction arranger for the transaction (the ‘Construction Arranger’). The Construction Arranger will then cause the General Contractor to build the project for a fixed amount, the Total Construction Cost. The Construction (*Istisna*^c) Agreement, in turn, will be executed by the Construction Arranger and the Owner.^{xxi}

Payments under the Construction (*Istisna*^c) Agreement are made in the same manner, on the same schedule and subject to the same conditions that advances would be made in connection with a conventional construction financing arrangement. Those conditions precedent that would be conditions precedent to the initial advance and all subsequent advances in a conventional construction financing are conditions precedent to the making of payments under each Construction (*Istisna*^c) Agreement. Conditions precedent for subsequent advances are addressed through the construction payment request mechanism, which, in turn, incorporates a milestone completion payment mechanism. Thus, for example, the General Contractor, the Construction Arranger and the Managing Contractor (as hereinafter defined) will prepare payment requests and milestone completion certificates that will resemble advance requests in a conventional construction financing. The obligation of the Owner to make such payments will be conditioned upon compliance with performance of matters relevant to the payment request.

In the event that a payment request cannot be given due failure of the Project Company to satisfy one or more of the relevant conditions precedent, the General Contractor and the Construction Arranger will continue to be entitled to pursue their respective rights to payment, but only against the relevant Project Company. However, as discussed later in this article, it will have to do so under the Managing Contractor Agreement and certain other documents. The amount of damages that a General Contractor and the Construction Arranger will be entitled to collect will be limited to amounts obtainable from the Project Company and other amounts payable through performance bonds, warranties, completion bonds, insurance proceeds and similar arrangements. Neither the General Contractors nor the Construction Arranger is entitled to pursue remedies against an Owner for failure to perform a funding condition.

D. Lease (*Ijara*) and Agreement to Lease

Drafting of the *ijara* (the “Lease (*Ijara*)”), with incorporation of the “repayment” half of a conventional loan agreement, was simultaneously undertaken. A standard triple-net financing lease was chosen as the base model because of its familiarity to the investment community and its comprehensive treatment of most lease financing issues. It was relatively easy to incorporate the repayment half of the conventional loan agreement into the Lease (*Ijara*), although significant issues arose with respect to capitalization of profit amounts during the construction period, which proved to be one of the most difficult issues in the transactions. And the Lease (*Ijara*) had to be modified to address *shari*^ca precepts pertaining to, among other things, retention of structural maintenance by the bank entity that owned the improvements and the doctrines pertaining to adequacy of sufficient value and benefit to the lessee to permit leasing of the improvements.^{xxii}

The Lease (*Ijara*) is the primary financing document on the repayment side of the transaction. The Project Company, as the lessee (the “Lessee”), repays the financing amounts made available by the Owner through the payment of periodic basic rent (the “Basic Rent”). Commencing upon an agreed date, the Lessee will be required to begin paying Basic Rent in installments over the agreed rental period (the “Rental Term”).^{xxiii}

The Lease (*Ijara*) was executed at the same time as the other financing documents. However, the Lease (*Ijara*) cannot become fully effective at such time due to a *shari*^ca principle that prohibits the payment of rent for an asset until that asset has sufficient economic value, sufficiency and benefit for *shari*^ca purposes, i.e., until the asset

can be, and is, put to the intended use and the Lessee derives the intended benefits from the leased property. Different *shari'ah* boards take different positions as to when an asset has sufficient economic value, sufficiency and benefit. This determination is dependent upon the specific facts of the project being considered. For example, each of the Maconda Park Project and the Truman Park Project is comprised of numerous buildings, including common buildings, and with each apartment building containing many units. Construction commences with the common building and then the first apartment building and moves in sequential fashion through each of the buildings. As a result, the first building will be completed and occupied prior to completion of construction on the last building. Rental activities with respect to the buildings will thus commence substantially before the entire project is constructed.^{xxiv}

Under one of the strict interpretations of relevant Islamic principles, *shari'ah* boards may allow an *ijara* to become effective only on a building-by-building basis as construction nears completion. Such an interpretation might require the use of a dozen lease (*ijara*) agreements (assuming a eleven buildings and common property), and twelve construction (*istisna'*) agreements, to provide financiers with required certainties of repayment and perfected security interests over all funds advanced in respect of construction.^{xxv} This, in turn, might require twelve filings under local law of memoranda of leases, mortgages and other security agreements. Filing and recordation fees, and title insurance costs, alone might make such an approach prohibitively expensive. Such a transaction would be complicated and difficult to implement. Other *shari'ah* boards acknowledge the practical difficulties of multiple filings of mortgages and have taken a pragmatic view of the financing process in Europe, the Middle East, Southeast Asia, and the United States. Those *shari'ah* boards have allowed a single lease (*ijara*) to become effective as to all provisions other than the Basic Rent (and related) provisions at the inception of the transaction. The boards have allowed the Basic Rent (and related) provisions to become effective at the time that marketing and rental activities commence with respect to any part of the project or some other similar date that relates to commencement of binding activities in respect of rent generation. The date of effectiveness of the Basic Rent provisions ("Full Effectuation Date") for the projects is then determined in accordance with relevant *shari'ah* principles as specified by the *shari'ah* board. This concept was embodied in a separate agreement to lease (the "Agreement to Lease") which activates the Basic Rent provisions when the relevant *shari'ah* criteria in respect of value, sufficiency and benefit have been met.

The GIH *shari'ah* board that considered the structure of, and documentation for, the Maconda Park Project and the Truman Park Project was intimately involved in defining and implementing the mechanism for determining the Full Effectuation Date. The GIH *shari'ah* board took a rigorous position with respect to the determination of sufficient economic value, sufficiency and benefit (as have subsequent *shari'ah* supervisory boards that have approved this *istisna'-ijara* structure). However, based upon the factual configuration of each project and its development, the GIH *shari'ah* board also allowed each of the transactions to be structured using a single Lease (*Ijara*), a single Construction (*Istisna'*) Agreement, and a single set of Security Documents (subsequent *shari'ah* boards have also allowed the single document structure). If the Full Effectuation Date has not occurred by a stated date, then the Owner may cause the Project Company to purchase the project in accordance with the Put Option (as hereinafter discussed).

Pursuant to the Lease (*Ijara*), the Owner, as the lessor (the "Lessor"), leases the improvements, and subleases the site, to the Project Company, as the Lessee. The improvements and the site will be leased and subleased, respectively, as-is, where-is, as the same is constructed or otherwise provided to the Owner.^{xxvi} Property becomes subject to the Lease (*Ijara*) on a continuous on-going basis as construction is completed and, as hereinafter discussed, the project is inspected and accepted by the Managing Contractor. Except as prohibited by applicable *shari'ah* precepts, the Lease (*Ijara*) is a triple net lease, with all costs associated with the use and operation of the relevant Project being payable by the related Lessee,^{xxvii} and with broad indemnity provisions similar to those found in triple-net financing leases, although such indemnity provisions must themselves be modified to comply with *shari'ah* precepts.^{xxviii} The Lessee has and will have the right to operate and use the project and the obligation to maintain the project (except, for example, that structural maintenance will remain the responsibility of the Owner as the Lessor).

The Basic Rent payable under the Lease (*Ijara*) has been structured to include a profit to the Lessor. The profit amount is determined on the basis of a weighted group of LIBOR reference rates for different time periods and advance allocations (the "Lessor Profit").^{xxix} The Basic Rent is due and payable on the leased assets (i.e., the relevant improvements) commencing upon the Full Effectuation Date or a later scheduled repayment commencement date thereafter. The Basic Rent payable at any given time is a pro rata portion of the Total Construction Cost paid to the Construction Arranger at such time, plus the Lessor Profit on such amount. Thus, the Basic Rent will be re-determined on a time schedule (for example, a monthly basis) in lock step with the payments by the Owner to the Construction Arranger. This arrangement keeps the Basic Rent Payments in harmony with the

on-going partial payments in respect of the Total Construction Cost and the increase in the portion of the project that has been completed, inspected, and accepted. The mechanism for achieving this recalculation of Basic Rent, which involves change orders accepting completed work, has been structured so as to comply with relevant Islamic *shari'a* precepts and does not involve an uncertain rent amount under such precepts.^{xxx} Change orders for each transaction will become effective only when agreed upon by the Construction Arranger, the General Contractor, the Managing Contractor, the Owner, and the Lessee. Part of such approval process will include an addition of such items to the leased asset base under the Lease (*Ijara*) in the relevant period (i.e., for future periods).

The standard supplemental rent provision is used to provide for payment of costs of use and operation of the project above and beyond the Basic Rent (the "Supplemental Rent"). Supplemental Rent includes taxes, impositions, third-party payments, and indemnity payments. Pursuant to the sublease arrangement for the site under the Lease (*Ijara*), the Lessee is responsible to pay the rent under the Site Lease directly to the site lessor. Basic Rent, Supplemental Rent, and such site rent are collectively referred to as "Rent."

In the event that the Lease (*Ijara*) is terminated during the Rental Term, and in a case where no long-term financing takes out the construction financing pursuant to the Lease (*Ijara*), all Rent due to such date of termination or otherwise permissible under relevant *shari'a* precepts will be immediately due and payable. In addition, the Owner will be entitled under the Put Option Agreement to cause the Project Company to purchase the project at such time.^{xxxii}

Various *shari'a* precepts pertaining to leases resulted in the Lease (*Ijara*) being structured differently from customary United States leases. For example, under *shari'a* precepts, a lessor must retain responsibility for structural maintenance of the leased property. The obligation for structural maintenance cannot be passed to the lessee under an *ijara*. Similarly, some *shari'a* boards require the lessor to retain the obligation to provide property casualty insurance. The Lease (*Ijara*) for each of the Projects was structured in compliance with these, and other similar, *shari'a* precepts.

The events of default in the Lease (*Ijara*) are those that are customary for a lease of such type, and include most of the events of default usually found in a conventional construction financing. Certain other events constitute events that permit the purchase and sale of the project under the Put Option (as hereinafter discussed). As with a conventional construction financing, an event of default will allow the Lessor a broad choice of remedies, including the ability to terminate the Lease (*Ijara*) and related arrangements, to sell the project, and to collect the purchase price in respect of such sale. The remedies provisions have been structured to reflect those available to a lender in a conventional loan financing. The overall structure also allows the Owner to exercise its right under certain of the financing documents to suspend or cease making payments to the Construction Arranger (and thus the General Contractor) upon the occurrence of events of default under those documents, assign rights under the Lease (*Ijara*) (and/or related documents) to the related General Contractor in certain circumstances, and be relieved of further liability to the General Contractor, the Construction Arranger and the Lessee.

E. Put Option and Call Option

It proved difficult to incorporate some elements of the conventional loan agreement in the Lease (*Ijara*) due to the application of *shari'a* precepts. This was particularly true of the mandatory prepayment and voluntary prepayment provisions. It was determined that these provisions would not be incorporated in the Lease (*Ijara*). Instead, certain of these would be incorporated in a put option agreement (and the Lease (*Ijara*) (the "Put Option") and a call option agreement (the "Call Option") that complied with *shari'a* precepts applicable to sales of property. The Put Option allows the Owner to compel the Project Company to purchase the project in certain circumstances. The Call Option allows the Project Company to purchase the project from the Owner at any time in order that the Project Company may effect a sale of the project to a third party, and use the proceeds of that sale to repay the financing. Circumstances in which a sale will be permitted under the Put Option include defaults under the Lease (*Ijara*) or the other financing documents, including the failure of the Project Company to make payments or to accept any property that is required to be subject to the Lease (*Ijara*) or the other project documents, termination of the Lease (*Ijara*), the Site Lease, the Managing Contractor Agreement, and certain other agreements prior to the last day of the stated Rental Term, certain agreed termination events, illegality, and certain termination events relating to excess payments in respect of the Project. There are significant *shari'a* issues with respect to any Put Option as put options are generally considered to be executory agreements that are cancelable by either party to the options. With the assistance of the GIH *shari'a* board, the Put Option (and the Call Option) for the Maconda Park and the Truman Park transactions were structured to comply with *shari'a* precepts applicable to valid sale and purchase agreements.^{xxxiii} Subsequent reviews by other *shari'a* boards have resulted in variations on this aspect of the structure for different types of transactions.

A range of *shari'ah* precepts are applicable to irreparable damage or destruction of assets and to the application of insurance, condemnation, or similar payments that are received in respect of destroyed assets. These precepts require termination provisions to be structured quite differently than conventional construction and project financings. However, within the ambit permitted by applicable *shari'ah* precepts, the transaction must be structured to insure full repayment of all financing amounts and put the financiers in the same position they would occupy in a conventional financing. In the *istisna'-ijara* structure, including the financings for the Maconda Park Project and Truman Park Project, upon destruction or total condemnation of the relevant project, the Lease (*Ijara*) will terminate immediately as required by *shari'ah* precepts, the Rent then due and payable (but not future rents) will be paid to the Lessor, the Project Company will be required to purchase the project and pay the purchase price therefore, and the proceeds of such insurance, condemnation, and other payments will be applied to the payment of the purchase price for the project (and related transfer costs) and any excess thereafter remaining will be paid over to the Project Company. Difficult issues arise in connection with the determination of the relevant purchase price as *shari'ah* principles generally restrict payments to the fair market value of the project after the event of destruction or condemnation.

Upon any purchase by the Project Company of the project, the Construction (*Istisna'*) Agreement (and related rights and agreements) will be assigned to the Project Company and the Project Company will assume all of the obligations of the Owner thereunder. Similarly, all insurance policies and warranties will be assigned and assumed such that the Project Company is afforded complete ownership rights.

F. Managing Contractor Agreement

Other elements of the conventional loan agreement, and a variety of risks that are allocated to the Bank (through the Owner) in one form or another (and which would not be so allocated in a conventional financing), were addressed in a separate agreement, the managing contractor agreement (the "Managing Contractor Agreement") between the Owner and the Project Company acting as the managing contractor (the "Managing Contractor"). As previously noted, Islamic *shari'ah* precepts require an Owner to retain obligations in respect of structural maintenance of the improvements. Other *shari'ah* precepts pertain to inspection of property being constructed, responsibility for latent defects, acceptance of leased (or purchased) assets, and operation and maintenance of leased assets. In order to achieve, as closely as possible, the risk allocations found in a conventional financing, it was necessary to structure the transaction in reliance upon a body of *shari'ah* principles that allows an owner of property to contract with other entities to perform activities on behalf of the Owner. Generally, these principles pertain to concepts of agency and contracting for services under the *shari'ah*. Those principles also incorporate certain of the doctrines of Western jurisprudence applicable to the retention of independent contractors to perform activities on behalf of a property owner.

It is permissible under applicable *shari'ah* precepts for the Owner to retain the Managing Contractor to perform certain of the activities retained by the Owner under the Lease (*Ijara*) and accept responsibility for them in connection with the performance of its duties. The *istisna'-ijara* structure (and the Maconda Park and Truman Park transactions) have been structured to allow the Owner to hire and appoint the related Project Company as the Managing Contractor for the primary purposes of (a) supervising and managing the design, engineering, and construction of the project by the General Contractor and the Construction Arranger, (b) inspecting the project, (c) accepting delivery of the project, (d) enforcing the rights of the Owner as against the related General Contractor and the Construction Arranger, and (e) operating and maintaining the project, all pursuant to the Managing Contractor Agreement.^{xxxiii}

This Managing Contractor Agreement has been structured such that the Managing Contractor bears the risks (i) of construction of the relevant Improvements in compliance with specifications and other terms and conditions of the Construction (*Istisna'*) Agreement (including the Construction Contract) to the extent permissible applying *shari'ah* precepts pertaining to the options of inspection and defect, and to precepts applicable to supervision and acceptance, and (ii) for maintaining the structure of the project and certain related matters throughout the Rental Term. The arrangement facilitates immediate and continuous inspection and acceptance by the Project Company of the work and assets comprising the project and insures on-going maintenance of the project, including in respect of its structural integrity. In accordance with *shari'ah* precepts, the Owner, as the title-holder of the improvements, retains some of the exposure on these items. The liability exposure of the Owner for such defects and conditions will be limited by express substantive provisions and by provisions that limit the payment obligation of the Owner to amounts actually collected under applicable warranties, performance bonds, completion bonds, guarantees, insurance policies and similar documents and instruments. Similarly, claims of the Project Company under the Lease (*Ijara*), and other documents, against the Owner, including as the Lessor and the owner of the project, are limited to amounts collectible from the Managing Contractor, the General Contractor, the Construction Arranger, and relevant

insurance policies, performance bonds, completion bonds, warranties, guarantees and similar documents and instruments.

The Managing Contractor also has responsibility for enforcing the insurance agreements, condemnation award proceedings, performance bonds, completion bonds, warranties, and similar documents and instruments in respect of the project, although these obligations and related rights are restricted in various situations (such as default scenarios) and are subject to defined parameters. This arrangement removes the Owner from involvement in the enforcement process to the greatest possible extent. The Managing Contractor Agreement extends to enforcement, on behalf of the Owner, of any claim under the Construction (*Istisna*^c) Agreement that the Owner may have against the General Contractor or the Construction Arranger. As a corollary, in any circumstance where the claim of the Project Company relates to any matter covered by insurance, bonds, warranties, or similar arrangements, the Project Company's damage recovery will be limited to amounts recovered thereunder or otherwise from the relevant General Contractor and the Construction Arranger.

G. Tax Matters Agreement

The Tax Matters Agreement has been designed to afford legal recognition to the fact that the *istisna-ijara* structure is a financing arrangement under applicable United States law. Various characterizations are also made under relevant state law (for example, New York law for the financing, and the relevant state law for mortgage and other real property purposes). These characterizations may be somewhat different than those appearing in the Construction (*Istisna*^c) Agreement or the Lease (*Ijara*). For example, the Tax Matters Agreement clarifies that the entire transaction is, for purposes of United States tax law and applicable state law, a loan financing, and that all amounts (other than costs and expenses) payable to an Owner in excess of the Total Construction Cost are to be treated as interest for United States tax and bank regulatory purposes. This is important in order to allocate tax benefits (such as depreciation, interest deductions, and various project expenses) to the Project Company (and thus to the investors, including the Islamic Investors). It additionally allows payments to Islamic Investors that are not United States persons to be made without tax withholding in accordance with the relevant portfolio interest provisions of Internal Revenue Code. Environmental matters are also addressed in this agreement, with the Project Company having all risks in respect thereof as regards any exposure of the Owner.

H. Miscellaneous Documents

Various consents and other documents have been structured to specifically address structural matters, including *shari'a* principles. For example, payment obligations of the Owner under the Construction (*Istisna*^c) Agreement cannot be conditioned on the status, actions, or omissions of the Lessee under the Lease (*Ijara*). Thus, a default by, or bankruptcy of, the Lessee will not relieve the Owner of its obligation to make payment to the Construction Arranger under the Construction (*Istisna*^c) Agreement, except in certain circumstances. Documents have been structured to address this difference from a conventional construction financing in a manner that puts the various parties, as nearly as possible, in the same position they would occupy in such a conventional financing. This is effected in part by documents that provide for agreed methods of enforcement of claims and agreed limitations on damage amounts and sources of damage awards or compensation in delineated circumstances. For example, in certain situations awards and damages are limited to amounts collected in respect of insurance policies, warranties, performance bonds, completion bonds, guarantees, other similar documents and instruments, and other security and amounts available from the estate of the bankrupt entity. In other situations, mandatory and voluntary assignments of rights and assumptions of liabilities, temporary and permanent, are operative to reallocate risk and responsibility to effect the allocations that would exist in a conventional financing.

I. Summary of Primary Documents

In summary, the primary documents for the construction and mini-perm financing of each of the Maconda Park Project and the Truman Park Project are, in each case:^{.xxxiv}

- "Site Lease": The lease of each of the site (and assignment of related easements) and the remainder of each of the relevant premises from the Project Company, as the site lessor, to the Owner, as the site lessee, to allow the Owner to occupy the site and cause construction and leasing of the improvements thereon;
- "Construction (*Istisna*^c) Agreement": The *shari'a*-compliant construction contract between the Owner and FF Development, L.P., as the general contractor (in the Maconda Park Project) and between the Owner and the Construction Arranger (in the Truman Park Project), in each case for the construction of the improvements for the relevant project, having attached thereto the Construction Contract (with FF

Development, L.P., in the Maconda Park Project; and with Bovis Lend Lease, Inc., in the Truman Park Project), including the specifications and details of the cost of construction;

- “Construction Contract”: A standard construction contract^{xxxv} between the General Contractor and the related Owner (in the Maconda Park Project) and between the Construction Arranger and the General Contractor (in the Truman Park Project) with respect to construction of the improvements for the relevant project, including all specifications for such improvements;
- “Lease (*Ijara*)”: A lease of the improvements constituting part of the project, and a sublease of the site and the remainder of the premises for the project, from the Owner thereof to the each of the relevant Project Company;^{xxxvi}
- “Put Option Agreement”: An agreement allowing each Owner to cause the related Project Company to purchase the project at various times and under various circumstances at the election of such Owner;
- “Call Option Agreement”: An agreement allowing the Project Company to purchase the project from the Owner at various times and under various circumstances at the election of the Project Company;
- “Managing Contractor Agreement”: An agreement between the Owner and the Project Company pursuant to which the Project Company performs various construction and operation activities as the representative of the Owner; and
- “Tax Matters Agreement”: An agreement to clarify the characterization of the transaction for United States tax and other laws.

J. Taking it to the Bank, the Board and the Market

Having arrived at a general structure that was thought workable and compliant with *shari'a* precepts, there remained a critical issue of convincing the relevant parties that the structure worked to cover all risks covered in a conventional loan financing and allocate those risks as they would be allocated in a conventional loan financing. The first tasks in this regard were to make that demonstration to the KeyBank credit committee and the GIH *shari'a* board. With regard to KeyBank, we determined to make the demonstration by taking each provision of the conventional loan agreement (and the other documents used in a conventional loan financing) and itemizing it on a spreadsheet. We then noted on the spreadsheet where and how that risk was addressed in the *istisna'-ijara* documentation. As one might imagine, this was a long and arduous process. But it successfully proved the point that there is near identical coverage and equivalency in risk coverage and allocation in the conventional loan financing and the Islamic financing.^{xxxvii} KeyBank, N.A. and, in particular, Key Global Capital, Inc., made a substantial and creative effort in developing the *istisna'-ijara* program (and other Islamic financial products) and deserve the highest of accolades for their efforts. Without them, this type of Islamic financing would be purely theoretical at this time in the United States of America.

After receiving the approval of the Islamic structure from the KeyBank credit committee, we were prepared to undertake the first transactions, which is also where the structure and the documentation were considered in detail by the GIH *shari'a* board. Islamic religious law as applied to commercial activities is comprised, for purposes of this article, of two parts: *shari'a* (literally, “the Way”), or perfect, immutable, divine law, as revealed in the Qur'an and the Sunna; and *fiqh* (literally, “understanding”), or the sum of human comprehension of that divine law. While there is dispute among Islamic scholars as to the precise manner in which Islamic law is to be determined, those who determine Islamic law are religious scholars (*ulama'*) skilled in interpreting the revealed sources of the *shari'a* and in financial and economic disciplines. The primary methodology used in this determinative and interpretive effort is *ijtihad* (literally, “effort”), or legal reasoning. *Ijtihad* observes a particular methodology, called the “roots of the law” (*usul al-fiqh*).^{xxxviii} According to one formulation, the roots (*usul*) upon which Islamic jurisprudence is based are (a) the Qur'an, the holy book of Islam, (b) the Sunna of the Prophet Muhammad, which comprises the binding authority of his dicta and decisions, (c) the *ijma'* or “consensus” of the community of scholars, and (d) *qiyas*, or analogical deductions and reasoning.

The GIH *shari'a* board was the first to approve the *istisna'-ijara* structure discussed in this article. The structure was presented to them in connection with the financings of the Maconda Park Project and the Truman Park Project, and the structure was modified and refined with their assistance. Subsequently, the *shari'a* boards of ABC Islamic Bank, Abu Dhabi Islamic Bank and Saudi Economic & Development Company have also considered and approved this structure, with slight variations, and with insightful modifications and refinements. Given that *shari'a* board determinations are *fiqh* (human comprehension of *shari'a*, the divine law), there can be variations in interpretation and implementation from one *shari'a* board to another, with a multiplicity of views on a specific issue. These variations occur even though *shari'a* scholars in this period strive to achieve a consensus on difficult and novel issues, such as those involved in the development of new financial instruments and products.^{xxxix} Islamic investors, be they financial institutions or individual investors, rely heavily on the involvement of *shari'a* boards in

the structuring and documentation of a transaction or financial product, and may request that the *shari'ah* board's fatwa of approval be provided before an investment is made. In developing and implementing the *istisna'-ijara* structure discussed in this article, we have attempted to retain the flexibility to adapt the structure to the requirements of different *shari'ah* boards and the precepts of the different schools of Islamic jurisprudence.^{xi}

All of us who are actively involved in Islamic finance are grateful for the wisdom, insight and interest that these *shari'ah* boards have provided and for the assistance the members of these *shari'ah* boards have provided in making new investment opportunities available to Islamic investors and new sources of financing available to United States developers. We have moved one more step in the direction of establishing an Islamic economy that works in harmony with a Western interest-based economy without sacrificing compliance with Islamic principles.

We are also grateful to the developers and the arrangers who have shown a willingness to pioneer the use of these *shari'ah*-compliant structures in the United States of America. As this article indicates, the documentation and structure of the *istisna'-ijara* transaction is substantially different from that of a conventional loan financing. In an industry where standardization is a refined and near-immutable concept, these entrepreneurs have shown a willingness to blaze a new path and facilitate the introduction of Islamic financing techniques in the United States market. Particular praise must go to the people who comprise Fairfield Residential Properties, Inc. and The Dolben Company, Inc. and their respective affiliates and attorneys. Without their willingness to expend considerable time and effort, structures such as that discussed in this article would remain entirely theoretical goals. Because of them, we have achieved a first-instance implementation of the *istisna'-ijara* structure in the Maconda Park Project and demonstrated that this *shari'ah*-compliant structure can be refined and used to take out a conventional loan financing, as in the Truman Park Project.

VII. CONCLUSION

The *istisna'-ijara* structure discussed in this paper is one of the early efforts to develop Islamic financial products that are competitive in the United States markets with conventional Western financial products. The Maconda Park Project and the Truman Park Project demonstrate that a *shari'ah*-compliant structure can be acceptable to United States banks, real estate developers and construction contractors. And this Islamic product can compete with conventional financing techniques in the United States market. Further, the acceptance and use of this type of structure significantly expands the investment opportunities for Islamic investors. It allows those investors to participate in United States transactions without a compromise in their faith and beliefs. As such, it is an early step in the development of a true Islamic economy. The transactions described in this article, and others, are efforts to lay the critical base and explore the use of a variety of Islamic techniques within a framework that must acknowledge the critical security, credit, economic, cultural, religious and legal concerns of both Western and Islamic participants. These techniques and structures will be further refined to achieve greater simplicity, increased economics of implementation, and a smooth interface between a Western interest-based system and an Islamic interest-averse system. New structures are being developed as more and more Western financial institutions move into Islamic banking, which is an accelerating trend.

The *istisna'-ijara* structure is being widely used at this time. It is being applied in the financing of residential, commercial and industrial real estate projects throughout the world. The availability of a practical Islamic structure of this type has also given rise to the development of a range of related Islamic financial products. Consider, for example, Islamic investment funds. The author is currently working on a number of real estate funds, both closed-end and open-end funds, that will use this structure (and a similar acquisition structure). Two of those funds will pool investments in residential properties in the United States, with all of such investments being made pursuant to the *istisna'-ijara* structure. Two other similar funds will invest in properties and projects in Europe, Southeast Asia, Australia, New Zealand, Canada and the United States. Those funds will use the *istisna'-ijara* structure for new construction and a similar acquisition structure for recently-completed and seasoned commercial and industrial properties. The transactions involving commercial and industrial properties will incorporate *shari'ah* screens similar to those applied to equity investments in order to screen tenants of the properties.^{xii} All of these funds will contain diversification elements heretofore not seen particularly as to geography, tenant base, and other characteristics. The funds will be sold to Islamic investors, primarily in the Middle East and Europe.

The *istisna'-ijara* structure is also being applied to equipment and vessel financing, including *shari'ah*-compliant *ijara* charter parties for liquefied natural gas tankers. This will enable Islamic construction financing for those vessels and the development of related financial instruments to allow Islamic investment in those financing, a particularly pertinent development in light of the fact that most growth in this market over the next decade will relate to gas sales between the predominantly Muslim countries of the Middle East and the predominantly Muslim countries of Southeast Asia.

To date, most of the investment by Islamic investors in United States transactions has been of “equity.” In the Maconda Park Project and the Truman Park Project, GIH made equity investments in the Project Company. But there are significant opportunities to expand the range of Islamic financial products deriving from the existing *istisna'-ijara* structure. For example, the “debt equivalent” or “financing” portion of the transactions can also be sold, individually or in a pool. These are essentially participations in the Lease (*Ijara*) and the Basic Rent that is paid thereunder. These can be, and are being, structured in a *shari'a*-compliant manner for sale to a different group of institutional Islamic investors. Other opportunities exist, as well. As pools are built of these leases, *shari'a*-compliant instruments can, and are being, structured for sale at the retail level in the Middle East. These instruments can be structured as very short-term *shari'a*-compliant instruments and sold to Middle Eastern Islamic retail investors that are presently receiving little or no return on their investments. The yield to such investors can be substantially lower than to other investors, with great benefit to those investors (in terms of a much greater yield than they presently obtain), and a great benefit to United States developers (because the cost of funds is substantially lower than can be obtained from other more traditional sources). If these investments are properly structured, Middle Eastern Islamic investors should have a competitive edge in the United States markets for some time to come.

The future for *shari'a*-compliant project financing is bright. The structures discussed in this article, and many others, involve joint participation by both Western and Islamic investors and transactional participants. This is true at all levels of the project cycle, and as to both equity and the “debt equivalent” financing. This is leading to greater familiarity of Western financiers with the Islamic market and its significant opportunities and Islamic investors and their sensitivities. And that, in turn, is resulting in enhanced interest and involvement of Western financial institutions in the development of not only Islamic project financing techniques, but a wide range of other Islamic financial products. From the vantage of both financiers and legal practitioners, there is a marked movement toward the development of an Islamic alternative to each Western financial product and the development of a true Islamic economy that interacts seamlessly with the Western interest-based economy, without compromise of principle or faith.

ⁱ This article will not examine collateral security aspects of the transactions that are discussed, nor will it consider the collateral security aspects of the structure in general terms. The structure provides for mortgages, deeds of trust, security interests and other forms of collateral security, and all such devices were used in the transactions that are discussed in this article. For a general discussion of *rahn* and collateral security concepts in *shari'ah*-compliant transactions, see Michael J.T. McMillen, *The Proceedings of the Third Harvard University Forum on Islamic Finance: Local Challenges, Global Opportunities* (2000): 111-31 ("Third Harvard Islamic Forum"), and Michael J.T. McMillen, "Islamic *Shari'ah*-Compliant Project Finance: Collateral Security and Project Finance Structural Case Studies," *Fordham International Law Journal* 48 (June 2001) (this structure was also discussed in that article). A general description of the financing of the *rahn-adl* structure in the Saudi Chevron petrochemical project financing appeared in Michael J.T. McMillen, "Special Report, Saudi Arabia, Briefing: Project Finance, Reconciling New Funding with the *Shari'ah*" *Middle East Economic Digest* 38 (1999): 36-39. A general description of the financing of the Maconda Park Project *istiṣna'ah-ijara* transaction, one of the two transactions discussed in this article, appeared in Michael J.T. McMillen, "Special Report U.S., Briefing: Islamic Finance: Breaking the Mould," *Middle East Economic Digest* 38 (2000): 28-29.

ⁱⁱ *Riba* is traditionally translated as usury. However, Islamic jurists have a more expansive concept which addresses not only prevention of the exploitation of those in a weak bargaining position, but also "the illegality of all forms of gain or profit which were unearned in the sense that they resulted from speculative or risky transactions and could not be precisely calculated in advance by the contracting parties." Noel J. Coulson, *Commercial Law in the Gulf States: The Islamic Legal Tradition*, (1984) 11 ("Coulson, Gulf States Commercial Law"); Frank E. Vogel & Samuel L. Hayes, III, *Islamic Law and Finance: Religion, Risk and Return*, (1998) 71-95 ("Vogel and Hayes"); Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2nd ed., (1992), 11-43 ("Saleh"); Nayla Comair-Obeid, *The Law of Business Contracts in the Arab Middle East* (1996), 43-57; Mahmoud A. El-Gamal, "An Economic Explication of the Prohibitions of *Riba* in Classical Islamic Jurisprudence," in *Third Harvard Islamic Forum*, 29-40. See more generally: J.T. Noonan, *Scholastic Analysis of Usury* (1957), which provides an interesting perspective on the Islamic concept of *riba* and a good history of usury in medieval Europe, including canon law positions at different periods). See also Don Babai, "Islamic Project Finance: Problems and Promises," in *Proceedings of the Second Harvard University Forum on Islamic Finance: Islamic Finance into the 21st Century* (1999) (the "Second Harvard Islamic Forum"), which notes other limitations.

ⁱⁱⁱ Substantial tax structuring and property ownership structuring, as well as structuring to address other laws applicable to foreign persons, was undertaken in developing and implementing the *istiṣna'ah-ijara* structure. None of those topics is addressed in this article.

^{iv} At the time of the writing of this article, the Maconda Park Project is being replicated in a transaction in the San Francisco Bay area of California.

^v Insightful and creative contributions to the implementation and refinement of the *istiṣna'ah-ijara* structure have been made by Andrew M. Metcalf, Esq. and Jawad I. Ali, Esq., both Associates at King & Spalding who spent many long hours on this project. These transactions, and similar creative Islamic financing, could not have been achieved without the entrepreneurial vision, patience and persistence of the people at each of the institutions involved, most notably those at Key Global Capital, Inc., KeyBank, National Association, Gulf Investment House, Fairfield Residential Properties, Inc., The Dolben Company, Inc., ABC International Bank p.l.c., Abu Dhabi Islamic Bank and their respective law firms. Particular acclaim in this regard goes to James M. Godec, Esq. of Key Global Capital, Inc., Bader A. Al-Ali of Gulf Investment House, Duncan R. Smith and Robbie Morrison of ABC International Bank plc, the *shari'ah* supervisory boards of Gulf Investment House, ABC Islamic Bank (and Arab Banking Corporation) and Abu Dhabi Islamic Bank, W. Donald Knight, Jr., Esq. and Isam Salah, Esq., my Partners at King & Spalding, W. James Conrad and Glenn D. Jones of Fairfield Residential Properties, Inc., Dana G. Pope and Andrew K. Dolben of The Dolben Company, Inc., David M. Tatum, Esq. of Geary, Porter & Donovan, and Andrew J. Ley, Esq. of Jager, Smith & Stetler.

^{vi} The structure was designed to implement financing of, among other things, other real estate projects (including commercial and industrial construction and project financing), vessels, manufacturing equipment of all types, and a broad range of other assets.

^{vii} The transaction could have been structured as a pure *istiṣna'ah*, in which the bank enters into a construction contract (*istiṣna'ah*) with the construction contractor and the bank client enters into an agreement with the bank to make payments for the constructed asset on an installment basis. Alternatively, it could have been constructed as an *istiṣna'ah-parallel istiṣna'ah*, in which (a) the bank client entered into a construction contract

(*istiṣnaʿ*) with the bank pursuant to which the bank will construct, or cause construction of, the asset and (b) the bank entered into a construction contract (parallel *istiṣnaʿ*) with the construction contractor. The *istiṣnaʿ-ijara* structure was used as an alternative to the foregoing for numerous reasons, including those pertaining to United States bankruptcy considerations, the status of leases under state laws in the United States, and flexibility of payment alternatives. A portion of the *istiṣnaʿ-ijara* structure does include an *istiṣnaʿ*-parallel *istiṣnaʿ* arrangement, i.e., that portion pertaining to the Construction (*Istiṣnaʿ*) Agreement and the Construction Contract.

Kuwait Finance House implemented a financing lease (*ijara*) structure as part of combined conventional-Islamic financing of the Equate Petrochemical Company project in Kuwait in 1997. Mohammad S. Al-Omar, "Islamic Project Finance: A Case Study of the Equate Petrochemical Company," *Third Harvard Islamic Forum* 259-64 describes financing for Equate Petrochemical Company project in Kuwait.

A range of legal and tax issues pertaining to cross-border Islamic transactions, particularly those implemented in the United States, are discussed in Isam Salah & W. Donald Knight, Jr., "Practical Legal and Tax Issues in Islamic Finance and Investment in the United States," in *Second Harvard Islamic Forum* 155-58. Tax aspects of a cross-border lease (*ijara*) structure with structural aspects in common with the *istiṣnaʿ-ijara* discussed in this paper are discussed in Robert W. Toan, "Cross-Border *Ijara*: A Case Study in the U.S. Taxation of Islamic Finance," in *Third Harvard Islamic Forum* 191-197.

^{viii} This article focuses on, and refers to, construction of assets, although the principles applicable to manufacturing of assets are identical.

^{ix} See *Majalat al-Aḥkam Al-Adliya* (as hereinafter defined), articles 338-92; Abdul-Rahman Abdullah bin Aqueel, "Shari'a Precautionary Procedures in *Murabaha* and *Istiṣnaʿ*: A Practical Perspective" in *Second Harvard Islamic Forum* 127-30 ("bin Aqueel").

As with most Islamic structures, development of the *istiṣnaʿ-ijara* structure was based upon both oral discussions and written materials. *Shari'a* advisors and *shari'a* supervisory boards of Islamic institutions provide invaluable knowledge, advice and assistance in elucidating *shari'a* principles and effecting the application of those principles in Islamic financial products. Of the written materials, many are available only in the Arabic language. The most widely available summary of *shari'a* precepts in the English language is the *Majalat Al-Aḥkam Al-Adliya*, a summary of certain principles of the *shari'a* as applied by the Hanafi school of Islamic jurisprudence in the Ottoman Empire and countries that were formerly part thereof; it was officially adopted in portions of the Ottoman Empire. Throughout this article, footnote references are made to the translation of the *Majalat Al-Aḥkam Al-Adliya* by Judge C. A. Hooper, *The Civil Law of Palestine and Trans-Jordan*, vol. I & II (1933), reprinted in *Arab Law Quarterly* (Aug. 1986): 4.

^x The bank client would be the *mustaṣniʿ* in the agreement between such bank client and the financing bank if a parallel *istiṣnaʿ* structure were used, and the bank would be the *saniʿ*.

^{xi} *Majalat al-Aḥkam Al-Adliya*, articles 404-611.

^{xii} *Majalat al-Aḥkam Al-Adliya*, articles 466-79.

^{xiii} *Majalat al-Aḥkam Al-Adliya*, articles 450, 454, 464, 484-96.

^{xiv} *Majalat Al-Aḥkam Al-Adliya*, articles 443, 470-472, 477, 478. As noted in the text of this article, this is a difficult structural and documentary issue in any project financing involving construction of an asset and is the subject of considerable debate among *shari'a* scholars.

^{xv} There is substantial discussion of variable rate rental arrangements in *shari'a*-compliant leases of equipment and real property. Many such leases make reference to the London Interbank Offered Rate ("LIBOR") as a referential base from which to compute periodic rentals. Given the absence of reference rates based on Islamic financial instruments, most *shari'a* scholars allow the use of LIBOR as a reference rate. However, most *shari'a* scholars object to the direct determination of rental rates by reference solely to variable or floating rates in the body of an on-going *ijara*. See, e.g., M.A. Elgari, "Some Recurring *Shari'a* Violations in Islamic Investment Agreements Used by International Banking Institutions," in *Second Harvard Islamic Forum*, 153 ("M. A. Elgari"). Other methods have been used to structure an *ijara* that have the practical effect of allowing the implementation of a variable rate structure (one such structure being that used in the Maconda Park Project and the Truman Park Project). The mechanics of that structure are not discussed in this article.

^{xvi} *Majalat Al-Aḥkam Al-Adliya*, articles 513-21 (pertaining to the concept of an option for defect). These provisions, and the *shari'a* precepts implementing these principles, are a major factor in structuring financing leases, particularly in the United States and Europe where financing parties rely heavily on triple-net leasing concepts. This article refers to "structural maintenance" and similar concepts. These references are a shorthand, and one often used by *shari'a* boards as well, to those elements of structure, maintenance, and

integrity of the project that pertain directly to the benefits sought to be obtained through leasing of the leased assets, and thus may include items beyond pure structural maintenance. Those items will be determined on a case-by-case factual analysis of the leased assets and the purposes of the *ijara*.

^{xvii} Consider, for example, the Resource Conservation and Recovery Act of 1976 (42 U.S.C. Section 6901 et seq.), as amended, and the regulations promulgated thereunder (“RCRA”), and the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (42 U.S.C. Section 9601 et seq.), as amended, and regulations promulgated thereunder (“CERCLA”).

^{xviii} KeyBank, N.A., provided financing for both the Maconda Park Project and the Truman Park Project. The financing was provided through affiliates of KeyBank, N.A. that acted as the Owner in the two transactions. The structure is presently being used, in various modified forms, for other transactions and a different bank is providing the financing in each of those transactions.

^{xix} FF Development, L.P. (“FF Development”), an affiliate of Fairfield Residential Properties, Inc. (“Fairfield Residential”), was the general contractor for the Maconda Park Project. Bovis Lend Lease, Inc. was the general contractor for the Truman Park Project.

^{xx} The customary practice is that each construction contractor (i.e., each General Contractor in the *istiṣnaʿ-ijara* transaction) dictates the form of construction contract that it uses. Many construction contractors use a widely recognized standard form (such as those of the American Institute of Architects, which was used, in modified form, by Bovis Lend Lease, Inc. as the General Contractor in the Truman Park transaction). Others use their own forms, which are precisely tailored to that individual construction contractor, such as in the Maconda park transaction.

^{xxi} The Construction Arranger format was used for the Truman Park Project, but not for the Maconda Park Project. In the Maconda Park Project, Fairfield Development executed the Construction (*Istiṣnaʿ*) Agreement, which had the customary FF Development Construction Contract attached to it. Various affiliates of Fairfield Residential (including FF Development) were involved in the Maconda Park Project, all of which used the services of a single law firm. Thus, no extra transactional costs were incurred by involving a separate counsel, and other advisers, for the General Contractor. In most transactions, such as the Truman Park Project, an unaffiliated General Contractor is involved. The Construction Arranger format is then appropriate in order to eliminate consideration of the Islamic structure by the General Contractor and its legal counsel and other advisers.

^{xxii} The *ijara* contains a sublease of the land back to the Project Company to allow the Project Company to possess the land as lessee and operate the project.

^{xxiii} The documentation for each of the Maconda Park Project and the Truman Park Project is for a construction financing. As such, the Rental Term is likely to be in the range of one to four years, with a permanent long-term financing take-out contemplated during, or at the end of, such period. The structure could be extended to cover a long-term financing of the projects. In other transactions, a long-term lease (*ijara*) has been used.

^{xxiv} Significant construction or expenditure may be completed or made at the time of entering into, or very shortly after execution of, the Lease (*Ijara*). This is likely in most projects because approximately 20-25% of the total costs already have been incurred prior to the execution of the Lease (*Ijara*). The 20-25% represents the equivalent of the equity investment in the project that must have been spent on approved expenditures before the Owner thereof will make payment advances under the Construction (*Istiṣnaʿ*) Agreement. As a result, the site will have been acquired, much of the site preparation work may be completed, and the related site may already contain sewers, roads, water, and other infrastructural improvements. Some *shariʿa* boards have indicated that this degree of expenditure upon a project is sufficient to cause the Basic Rent provisions to become effective because the value of the related site will be substantially, and sufficiently, increased by this time. Further, and as noted in the Lease (*Ijara*), construction of certain blocks and segments of the improvements for the project will be completed before completion of other blocks or segments. Certain blocks and segments will have considerable lease value, and units will actually be rentable (and rented), prior to completion of other blocks and segments. Thus, significant rental income will already be generated prior to completion of the entire project. This, in turn, allows full effectuation of all provisions of the Lease (*Ijara*) at a relatively early time.

Although the determination of sufficient economic value, sufficiency and benefit to permit the intended use are significant and vexing *shariʿa* issues, they are not difficult issues in a practical sense in projects such as the Maconda Park Project and the Truman Park Project. This is because the transaction is a construction financing in which no Basic Rent is payable during the construction period, i.e., for approximately two or two and one-half years from commencement of the financing. Construction is complete for the entire project by the end of that period and the project is fully rented by the end of that period.

Although no Basic Rent is payable during that period, most construction financing include a feature that capitalizes interest (in a conventional financing) or profit (in an Islamic financing) during the construction period. The capitalization method used in the Maconda Park Project and the Truman Park Project, and in similar projects, is particularly complex and has received the approval of various *shari'a* boards. That capitalization method is not discussed in this article.

^{xxv} The author has worked on transactions in which multiple leases were used, one for each phase of the project. This approach permits different leases, and financing arrangements, for different aspects of construction, and allows each lease to be tailored to a different intended use. Given that the *shari'a* precept focuses on the intended use, effectuation of the leases under *shari'a* precepts can be obtained at an earlier point in the overall financing transaction, and the various leases can be closely tailored to construction milestone completion and funding.

The author is presently working on an *istiṣna'–ijara* transaction that poignantly raises the effect of factual variation on the *shari'a* determination of full effectuation of the lease. The transaction involves the acquisition of a large farm. An Islamically acceptable joint venture has been formed to subdivide the farmland, obtain certain permits for construction and related activities, and construct infrastructure (roads, sewers, lighting, and the like). Each parcel will be sold off to another residential or commercial developer, or a commercial enterprise, which will construct the housing or commercial facilities for that specific parcel. The entire purpose of the joint venture is so limited. Clearly, the intended construction activities are limited, and substantial economic value and sufficiency, especially when considered from an "intention" perspective, is obtained at a very early stage in the business cycle. Another factor affecting substantial economic value, sufficiency and benefit issues, particularly in the United States of America, is the fact that obtaining a permit or zoning approval, without more, will frequently substantially enhance the value and sufficiency of the land (without regard to any physical construction).

^{xxvi} As noted in the text of this article, a Managing Contractor, among other things, supervises construction activities, inspects construction of the project on an on-going basis, accepts the project, and provides for maintenance (including major and structural maintenance), pursuant to the Managing Contractor Agreement.

^{xxvii} Certain modifications to the triple net lease concept that are necessary for compliance with *shari'a* precepts are discussed below.

^{xxviii} See M.A. Elgari, at 151-54.

^{xxix} *Ibid.*

^{xxx} See, for example, Dow Jones Islamic Market Indexes, at <<http://indexes.dowjones.com/djimi/imiinvest.html>>; Islamic Business & Finance Network ("IBFNET"), at <<http://islamic-finance.net/islamic-equity/equity1.html>>; Abdul Hamid, "Investing in Equities: Some Issues from the Islamic Perspective," in *Third Harvard Islamic Forum*, 91-101.

^{xxxi} The form of lease (*ijara*) that served as the structural basis for the Lease (*Ijara*) has been used in numerous Islamic financings and the adjustment mechanism has been approved by several *shari'a* boards. Analytically, the Lease (*Ijara*) can be thought of as a lease for a specified period (for example, one month). The Basic Rent payable under the Lease (*Ijara*) is determined by dividing the absolute amount of the Total Construction Cost paid to the first day of such month by the overall payment period, and then adding the applicable Lessor's Profit. Analytically, the Lease (*Ijara*) will then terminate on the last day of such month unless the parties agree to extend for another period (say, another month). If the Lease (*Ijara*) is so extended by virtue of a new and otherwise identical lease, the Basic Rent is recalculated to increase by the amount of Total Construction Cost advanced to the first day of such second month, and, again the weighted reference rate analysis is applied to determine the applicable Lessor's Profit for the new lease. This process is repeated with respect to each subsequent rental period. Payment of some or all of the Rent is deferred during the construction period so long as there is a continuous and contiguous series of leases.

If the Lease (*Ijara*) is not renewed at the end of any month or other rental period, the Lease (*Ijara*) terminates and the total amount of Rent accrued to such date becomes immediately due and payable and can no longer be deferred. Pursuant to the Put Option, the Owner is entitled to cause the Project Company to immediately purchase the project in its then-existing state and condition for a specified amount.

In practice, the Lease (*Ijara*) is written such that it automatically renews each period (for example, each month) unless there is a cancellation. These, and other structural elements, are designed to minimize the administrative and financial burden on the parties (especially the Project Company as the Lessee) and streamline the renewal and recalculation process and to avoid various complications of various United States laws, including bankruptcy laws, mortgage recordation laws, and recordation and taxation requirements in different jurisdictions.

^{xxxii} See *Majalat Al-Ahkam Al-Adliya*, articles 101-403 (addressing concepts of sale); Ray 38-59; Vogel & Hayes 117-20 and 140-43; bin Aqueel, in *Second Harvard Islamic Forum* 127-30; Yusuf Talal DeLorenzo, "Murabaha, Sales of Trust, and Money-value of Time," in *Second Harvard Islamic Forum*, 151-54 (discussing nature of *murabaha* transactions and, as a general references); and Yusuf Talal DeLorenzo, ed. & trans., *A Compendium of Legal Opinions on the Operations of Islamic Banks: Murabaha, Mudaraba, and Musharaka* (1997), 219-61 ("DeLorenzo Legal Opinions") (containing a good collection of *fatawa* regarding various sales-related concepts in different structures and transactions).

^{xxxiii} See *Majalat Al-Ahkam Al-Adliya*, articles 320-35 (pertaining to the option to inspect, which provides a purchaser certain rights to inspect assets to be purchased and to reject such assets in certain circumstances) and articles 336-55 (addressing related option for defect). These doctrines also have significant application to construction (*istiṣnaʿ*) and lease (*ijara*) arrangements. Other types of options that are applicable in similar transactions are the contractual options (articles 300-09), options for misdescription (articles 310-12), options as to payment (articles 313-15), and options as to selection (articles 316-18).

^{xxxiv} The mortgage (*rahn*), security agreement, and other collateral security documentation, including guarantees of payment, completion of construction, and environmental matters (collectively, "Security Documents") are not discussed in this article, nor are the various consents and similar documents between and among the parties to the transaction that allow for assignment of documents in connection with the Security Documents and which also make provision for the exercise of remedies in various default scenarios and provide for damages in such scenarios.

^{xxxv} Such a standard construction contract might be the American Institute of Architects Form A111, Standard Form of Agreement Between Owner and Contractor, and Standard General Conditions and Special Conditions Relating Thereto, as was used in the Truman Park transaction. In the Maconda Park transaction, the Construction Terms were the General Contractor's own customary form of construction contract and conditions.

^{xxxvi} The obligations of the Lessee under the Lease (*Ijara*) are evidenced by a Basic Rent Note.

^{xxxvii} Many *shariʿa* advisors have argued that a well-developed *shariʿa*-compliant documentary structure covers every risk that is addressed in the documentation for a conventional loan financing. In the author's personal experience, Nizam Yaquby and Mohamed A. Elgari have been the most adamant. It is the author's conclusion that they are correct and that the spreadsheet technique demonstrates that quite elegantly.

^{xxxviii} See generally Noel J. Coulson, *A History of Islamic Law* (1964); Joseph Schacht, *An Introduction to Islamic Law* (1964); Vogel & Hayes; Nicholas Dylan Ray, *Arab Islamic Banking and the Renewal of Islamic Law* (1995) ("Ray"); Saleh; Coulson, *Gulf States Commercial Law*; see also *Second Harvard Islamic Forum* and *Third Harvard Islamic Forum* (containing articles covering current issues in Islamic finance).

While, as a precise matter, all discussion of Islamic jurisprudence is one of *fiqh*, this article, in keeping with convention, refers to precepts and principles of *shariʿa* without further reference to *fiqh*.

^{xxxix} See Nizam Yaquby, "Islamic Finance in View of the *Shariʿa*," in *Second Harvard Islamic Forum*, 159-61 (summarizing these and other responsibilities of modern *shariʿa* boards).

^{xl} The four major schools of Islamic jurisprudence are: (1) the Hanafi school, which is predominant in the countries of the former Ottoman Empire, and emanates from the disciples of Abu Hanifa (d. 767 CE) in the Iraqi center of Kufa; (2) the Hanbali school, which is predominant in Saudi Arabia and a few other jurisdictions and was formed by Ahmad b. Hanbal (d. 855 CE); (3) the Maliki school, which emanated from the Arabian center in Medina through the followers of Malik b. Anas (d. 796 CE); and (4) the Shafi'i school formed by the followers of Shafi'i (d. 820 CE). The four major schools differ in many respects in their interpretation of certain *shariʿa* precepts. Most scholars from medieval times until modern times aligned themselves with one of the four major schools of Islamic jurisprudence. However, in modern times many scholars do not believe it necessary to belong to any single school of Islamic jurisprudence. See Vogel & Hayes, 34-41 (describing methods of elaboration of law).

^{xli} See, e.g., Dow Jones Islamic Market Indexes, <<http://indexes.dowjones.com/djimi/imiinvest.html>>; IBFNET, <<http://islamic-finance.net/islamic-equity/equity1.html>>; Abdul Hamid, 91-101.