

IB 1006 Islamic Capital Market

Ijara Sukuk

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In 2002 the Malaysian Global Sukuk Incorporated issued a USD\$600 million Islamic bonds known as *Global Sukuk Al-ijarah* in Labuan. It is an attempt to motivate market players to raise funds via the bond market using instruments readily accepted by Islamic investors, especially from the Middle-East. The sukuk is listed at the Luxemborg Stock Exchange.

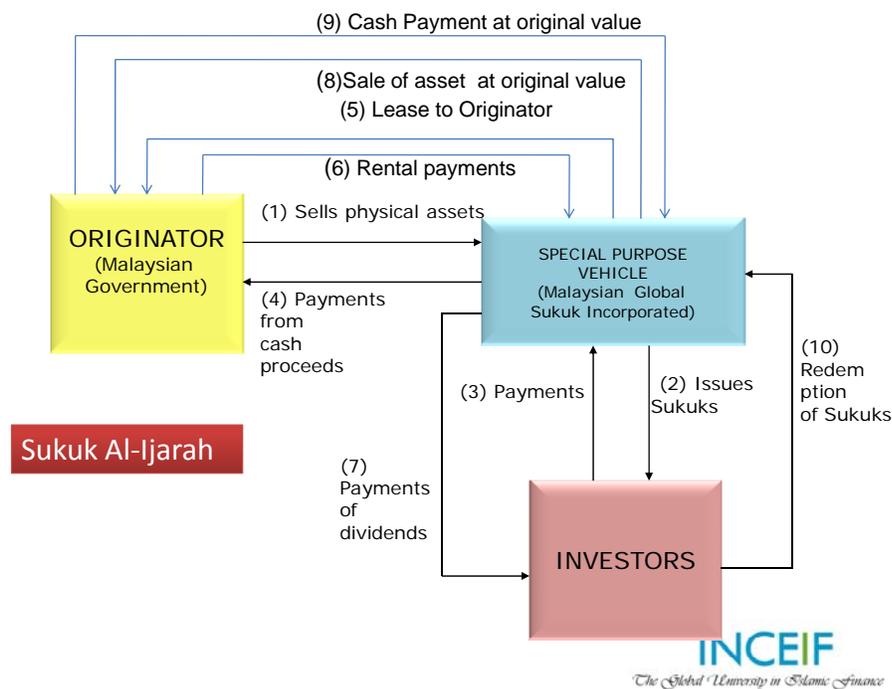
The Global Sukuk does not apply *bay' al-'inah and bay' al-dayn*. No *fictitious goods* exist in the contract. The Sukuk is structured and arranged by Dubai's Hong Kong and Shanghai banking Corporation (HSBC) and issued in Labuan. It uses the asset-backed securitization model. The assets being used in this structure are not financial assets such as mortgage and rental receivables but physical assets. The Shariah advisory council consists of three prominent Shariah scholars (*Fuqaha*).

To raise the USD\$600 million fund, a special purpose vehicle (SPV) called the Malaysian Global Sukuk Incorporated was set up as the issuing party. An *al-ijarah* contract (operational/true lease) is applied. The structure is based on the sale with a repurchase agreement and leasing contract. The government of Malaysia as the Originator sells underlying assets (i.e. hospital and government office complexes) to the SPV. Using the contract of *al-ijarah*, the SPV then leased the property to the government. Rentals payments are then collected by SPV and passed on to the investors as dividends. Through w repurchase agreement, the government will buy back the property at the expiry of the lease-term and pay SPV in cash equivalent to the size of the facility. The cash proceeds will be used by the SPV to pay investors upon full redemption of the trust certificates at maturity.

On the supply side, SPV markets sukuk to prospective investors and provide full disclosure about the structure of the Sukuk, its risk and return profile. Investors received trust certificates which provides income arising from the rental (*ujrah*) payments. Capital protection is assured when the government purchases the property from the SPV at par value.

The Global Sukuk bond is still not free from juristic disputes. One issue concerns the application of *bay' al-wafa* i.e. a sale contract where the buyer promises to sell the subject matter only to the original seller. The government sells the property with a condition that the SPV will sell it back to the government at the same price. This is one form of legal device (*hiyal*). In general the Middle-East investors accept the Global Sukuk bonds since the disagreements among jurists are not considered serious. The other issue concerns the ownership of underlying assets. The Shariah requires the SPV to pass complete ownership to the investors. A brief summary of the sukuk is given below:

Figure 1 Malaysian Global Sukuk *Ijarah*



The Sukuk is essentially a trust certificate. It serves to mobilize funds which are then used to purchase the said properties. It is like a property trust fund. The money pooled from investors is used to purchase the property like office and residential properties. In the case of the Malaysian Sukuk, government properties were sold by the government to the SPV. Unlike property trust fund where incomes are derived from capital gains, the Sukuk focus on the leasing of property to generate income.

It is common practice to assume that property trust fund is equity in nature. No apparent guarantees are given to income and capital protection. Likewise, the Malaysian Sukuk is expected to adopt similar risk-return features.

Finally, transaction documents include the followings:

- 1) Purchase agreement: Sale of properties by the Malaysian government to the SPV
- 2) Lease agreement: Leasing of properties to the Malaysian government
- 3) Seller's declaration of trust: Trust deeds to protect the interest of investors
- 4) Service agency agreement: To undertake maintenance of properties by the Malaysian government.
- 5) Insurance/takaful agreement: Indemnity against loss due to pure risks.
- 6) Purchase undertaking deed: Agreement to buy back the property at original value.

