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*A COMPARISON BETWEEN ISLAMIC AND
CONVENTIONAL HOME FINANCING IN
KUWAIT: CLIENT PERCEPTIONS OF THE
FACILITES OFFERED BY THE NATIONAL
BANK OF KUWAIT AND KUWAIT FINANCE
HOUSE*

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**A COMPARISON BETWEEN ISLAMIC AND CONVENTIONAL
HOME FINANCING IN KUWAIT: CLIENT PERCEPTIONS OF
THE FACILITES OFFERED BY THE NATIONAL BANK OF
KUWAIT AND KUWAIT FINANCE HOUSE**

By

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**A thesis submitted for the degree of Doctor of Philosophy in
Islamic Banking and Finance**

**School of Government and International Affairs
Institute for Middle Eastern and Islamic Studies**

2010

ABSTRACT

This study determines the awareness of the Islamic home finance products compared with conventional home financing, as well as clients' perceptions of home financing, with the National Bank of Kuwait represented as a traditional Bank and the Kuwait Finance House as an example of an Islamic Bank. This comparison is important since it is new in this area and gives the clients an overview about available home finance. In addition, new students can benefit from this study to build on and start from where I finished.

The empirical research was conducted utilizing both quantitative and qualitative methods, as well as a case study and interviews, which is a method known as the triangulation technique. Questionnaires were distributed to 200 clients who had applied for home financing from both banks, using 100 clients from each bank. To sum up, it can be argued that an examination of Islamic banking as symbolized by the Kuwait Finance House has revealed that this type of financial institution has experienced a boom and has been successful in establishing itself as a practical substitute to conventional banking, in spite of what have been seen as authoritarian and nonflexible rules and regulations governing the activities of this type of financial institution. Islamic banks have experienced a boom and have been successful in developing alternative methods for attracting and utilizing funds in money-making outlets, regardless of the fact that they are comparative beginners in the field. Future prospects for the banks are even more promising, as experience is likely to improve the capability of these institutions to compete and to improve their performance.

DECLARATION

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LIST OF ABBREVIATIONS

AAOIFI	: ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCE INSTITUTIONS
ARM	: ADJUSTABLE RATE MORTGAGES
CBK	: CENTRAL BANK OF KUWAIT
CPI	: CONSUMER PRICE INDEX
CPS	: CURRENT POPULATION SURVEY
FHA	: FEDERAL HOUSING ADMINISTRATION
FICO	: FAIR ISAAC CORPORATION
GCC	: GULF COOPERATION COUNCIL
HSBC	: HONG KONG AND SHANGHAI BANKING CORPORATION
HUD	: HOUSING AND URBAN DEVELOPMENT
IBK	: INDUSTRIAL BANK OF KUWAIT
IDB	: ISLAMIC DEVELOPMENT BANK
IFS	: ISLAMIC FINANCIAL SERVICES
IFSI	: ISLAMIC FINANCIAL SERVICE INSTITUTION
KFH	: KUWAIT FINANCE HOUSE
KSE	: KUWAIT STOCK EXCHANGE
MCB	: MUSLIM COUNCIL OF BRITAIN
NBK	: NATIONAL BANK OF KUWAIT
NDC	: NEIGHBOURHOOD DEVELOPMENT CENTER
OFHEO	: OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

PACI : PUBLIC AUTHORITY OF CIVIL INFORMATION
PLS : PROFIT LOSS AND SHARING
ROE : RETURN ON EQUITY
SCB : SAVINGS AND CREDIT BANK
UBK : UNITED BANK OF KUWAIT
UMO : UNION OF MUSLIM ORGANISATIONS
UNDP : UNITED NATIONS DEVELOPMENT PROGRAMME

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GLOSSARY OF ISLAMIC TERMS

Source for Islamic Law:

Islamic law is based on the *Quran*, which address economic justice and rights. The second source is the Hadith, the sayings and deeds of the prophet as recorded in the *Sunnah*, or Tradition.

Gharar (Uncertainty):

Gharar One of three fundamental prohibitions in Islamic finance (the other two being *Riba* and *Maysir*). *Gharar* is a sophisticated concept that covers certain types of haram uncertainty in a contract. It is an exchange in which one or more parties stand to be deceived through ignorance of an essential element of the exchange. Gambling is a form of *Gharar* because the gambler is ignorant of the result of the gamble. The prohibition on *Gharar* is often used as the grounds for criticism of conventional financial practices such as short selling, speculation and derivatives.

Halal = lawful, permissible: The concept of *halal* has spiritual overtones. In Islam there are activities, professions, contracts and transactions that are explicitly prohibited (haram) by the Quran or the Quran. All other activities, professions, contracts and transactions are *halal*. This concept differentiates Islamic economics from conventional economics. In western finance all activities are judged on economic utility. In Islamic economics, spiritual and moral factors are also involved – an activity may be economically sound but may not be allowed in Islamic society if it is not forbidden by the *Shari'ah*.

Qard: A *Qard* is a loan, free of profit. This is used by arrangement for current accounts. In essence, it means that your current account is a loan to the bank, which is used by the bank for investment and other purposes. Obviously, it has to be paid back to you, in full, on demand.

Riba: *Riba* means interest, which is prohibited in Islamic Law. Any risk-free or guaranteed interest on a loan is considered to be Usury." Those who devour usury will not stand except as stands one whom the Evil one by his touch hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury. Those who receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are Companions of the Fire; they will abide therein (forever).
Surah Name: AL Baqarah, Surah 2, Verse 276

Ijara: *Ijara* is a form of leasing. It involves a contract where the bank buys and then leases an item to a customer for a specified rental over a specific period of time. The duration of the lease, as well as the basis for the rental, are set and agreed in advance. The Islamic bank retains ownership of the item throughout the arrangement and assumes possession of the item at the end of the lease period. *Ijara* entails the existence of two parties to a contract: the lessor (owner of asset) and lessee (user of the asset).

Murabahah = cost-plus financing: *Murabaha* is a contract for purchase and resale and allows the customer to make purchases without having to take out a loan and pay interest. For example, the Islamic bank purchases the goods for a customer, and re-sells them to the customer on a deferred basis, adding an agreed profit margin. The customer then pays the sale price for the goods over installments, effectively obtaining credit without paying interest. Examples of *Murabaha* include Housing *Murabaha*, Car *Murabaha*, Building *Murabaha*, and Furniture *Murabaha*.

Musharaka: (joint venture, profit and loss sharing) *Musharka* means partnership. It involves the placing of capital with another person and both sharing the risk and the reward. The difference between a *Musharaka* arrangement and normal banking is that it can set any kind of profit sharing ratio, but losses must proportionate to the amount invested.

The two main forms of *Musharakah* are:

Permanent Musharakah: an Islamic bank participates in the equity of a project and receives a share of the profit on a pro rata basis. The length of contract is unspecified, making it suitable for financing projects where funds are committed over a long period.

Diminishing Musharakah: this allows equity participation and sharing of profits on a pro rata basis, and provides a method through which the bank keeps on reducing its equity in the project, ultimately transferring ownership of the asset to the participants. The contract provides for payment over and above the bank's share in the profit for the equity held by the bank. Simultaneously the entrepreneur purchases some of the bank's equity, progressively reducing it until the bank has no equity and thus ceases to be a partner.

Zakat: means "blessing, purification, increase and cultivation of good deeds." In *Shari'ah*, it is an obligation relating to funds paid for a specific purpose and for specific categories.

Shari'ah = Islamic jurisprudence: A "*Shari'ah* compliant" product meets the requirements of Islamic law. A "*Shari'ah* board" is the committee of Islamic scholars available to an Islamic financial institution for guidance and supervision in the development of *Shari'ah* compliant products. A "*Shari'ah* advisor is an independent Islamic trained scholar that advises Islamic institutions on the compliance of the products and services with the Islamic law

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Chapter 1: INTRODUCTION

1.1. INTRODUCTION

For the majority of people, the purchase of a home is the single largest financial transaction of their lives, and since most people are not able to fund the price of a home with their own personal funds, a loan from either a conventional bank or an Islamic bank is normally required. Home financing is usually a large and long-term transaction.

Few people today hold their financial wealth in cash, but still a minority of people have at its disposal large quantities of notes and cash stored in their homes, while a very small group of people usually keeps their wealth safe in the bank. Numerous people have wealth stored in the form of property, such as open land, plots ready for housing or in a constructed apartment.

The United States and the United Kingdom are two major countries that have sophisticated economies, comprising of fine and well-urbanized and extremely superior monetary segments. By tradition, these countries present only conventional housing finance to their general public; however, more recently, there has been a rising interest in introducing this type of financing into Islamic housing finance. It has been observed that, as well as the current rise in the number of conventional financial organizations, there has also been a simultaneous rise in the number of Islamic financial organizations which present Islamic housing finance to members and citizens of states in which they operate. Islamic housing finance suppliers are interested in capturing a possible marketplace for *Shari'ah* compliant products to Muslim inhabitants in the United States and the United Kingdom.

In Kuwait, there are different financial institutions which act as finance providers and offer Islamic housing financing. These financial institutions consist of companies, banks and government entities, which provide the appropriate funding to facilitate the purchase of property by a bank client,

Business Corporation or a government worker. Housing finance providers offer both Islamic and conventional housing finance to their customers and employees. Many financial institutions in Kuwait have also come to understand the potential of Islamic housing finance. Financial institutions in the United Kingdom and the United States have also been observing the way Islamic finance has been operating in Kuwait, which offers a variety of Islamic housing financial products.

1.2. RESEARCH QUESTIONS:

The research questions which were taken into consideration are listed below:

1. Does religious belief have any impact on the choice of mortgage products?
2. Is there a significant difference in the pricing of home financing through Islamic and conventional banks?
3. Is the structure of home finance different between Islamic and conventional banks?
4. Are there differences between Islamic and conventional banks in terms of the availability of home finance to the customer?
5. Do the terms of home finance differ between Islamic and conventional banks?
6. What is the perceived level of customer satisfaction with Islamic and conventional home financing?

1.3. RESEARCH AIM

The aim of the present study is to determine the availability and awareness of Islamic home financing products in Kuwait and to conduct a comparative analysis of the benefits of Islamic home financing. The study also aims to compare Islamic and traditional home financing. To reach its aim, a survey in the form of a questionnaire was initially filled in by Kuwaiti nationals. The survey method was supplemented by interviews with officials working in the housing finance department of various financial institutions. Some of the following perspectives are linked to this research:

- Structure
- Pricing
- Term
- Availability
- Customer satisfaction
- Customer knowledge and brand awareness
- Supplier's knowledge of both his and his competitor's products.

1.4. RESEARCH OBJECTIVES

The objectives of the questionnaire are to measure Muslim customers' consciousness of Islamic housing finance; to measure their anxiety with regard to Islamic housing finance; and to measure their vision concerning the strategy of their housing mortgage supplier regarding the product that they have access to. It also aims to measure the full spectrum of property that customers buy; to sketch out their awareness of extra Islamic products available to them; to provide a better understanding regarding any cases of non-payment among customers; to sketch out customers' views on how their mortgage provider and the government can improve the practices already in place in Islamic housing finance; and to sketch out the effectiveness of the product at hand. Finally, the questionnaire aims to provide a better understanding of the respondents' own views and sentiments concerning their awareness of the prohibition of *Riba*.

By contrast, the qualitative method used in the study, i.e. the interview method, seeks to understand the concerns that those in charge of Islamic housing finance harbour concerning the organization of Islamic housing finance products. It also seeks to sketch out product awareness and the need for Islamic housing finance among this group, especially regarding the continuation of a *Shari'ah* council of scholars or a committee of *Shari'ah* scholars to advise the organizations on *Shari'ah*-related matters; the organization of security and non-paying clientele; as well as the re-mortgaging of Islamic housing finance. This council would also assist financial institutions on the appropriateness of housing finance products from an Islamic point of view; to regulate the scholars' relationship with the general public; and provide analysis on finance-related issues, as well as the seizure of assets in the case of non-repayment.

1.5. STUDY PLAN

This thesis is organized into eight chapters, which comprise the following:

Chapter 1: Introduction. This chapter reviews the state of housing finance in the United Kingdom, the United State and Kuwait. It is also a focal point of this research, as it outlines the main research questions that subsequent chapters seek to answer. The chapter also outlines the aims and objectives of the study that this research seeks to accomplish.

Chapter 2: Conventional and Islamic Housing Finance. This chapter gives an overview of conventional and Islamic housing finance in the United Kingdom and the United States, as well as developing countries. The chapter compares and contrasts between significant aspects of these two markets, as measured by customers purchasing a house, and the instruments utilized in that process. These instruments consist of government strategy, the costs to customers, monetary support, and securitization of possessions and *Shari'ah* compliance of Islamic housing finance products. Further, the chapter also discusses and reviews the principles of Islamic finance and the product theory of Islamic housing finance. The chapter also compares and contrasts Islamic

housing finance and conventional housing finance and outlines the advantages and disadvantages of both systems.

Chapter 3: Kuwait Housing Market This chapter discusses and evaluates the housing market in Kuwait, in order to provide an overview of the state of the housing market in Kuwait. The chapter also outlines the various components of the housing market in Kuwait, in terms of the private sector, the investment sector, housing prices, and housing prices in the private sector, housing prices in the investor sector, the population and the labour force.

Chapter 4: Introduction to the Case Study: The National Bank of Kuwait and Kuwait Finance House. The chapter provides background information on the case study, reviews the financial system in Kuwait in terms of banks and other financial institution. This involves the two major financial institutions in Kuwait. It also reviews the history of the National Bank of Kuwait and the Kuwait Finance House. In addition to holding a comparison between these two banks and their financial practices, the chapter reviews the financial performance of these two banks, the availability of banks in Kuwait, and the types of services and products provided by the National Bank of Kuwait and the Kuwait Finance House. In this connection, the interview method is utilized to determine the strength and weakness of these two banks and a comparison is held between the two banks.

Chapter 5: Research Methodology. The chapter provides an in-depth analysis of the research methods used to test the main hypotheses and which support and validate the main findings of the study. This involves a discussion of the approach used in the data collection process and statistical analysis. The chapter also discusses the manner in which the data was extracted from the questionnaire and offers an analysis of the interviews.

Chapter 6: Perception Analysis Questionnaire. This chapter provides an analysis of the perceptions of respondents who participated in the questionnaire concerning the National Bank of Kuwait and the Kuwait Finance House. An analysis of the responses received from the 100 customers who had obtained home financing from the National Bank of Kuwait, as well as from the 100 customers who obtained home financing from the Kuwait Finance House, indicates that Islamic banks are poised to dominate the Kuwait home financing market and prevail over conventional banks in the State of Kuwait in the future.

Chapter 7: Interview of Service Providers (National Bank of Kuwait and the Kuwait Finance House).

This chapter gives in depth studies of differences between Islamic and conventional systems progress, functions and their future in Kuwait.

This chapter gives outcome of information concluded after conducted 10 semi-structured interviews from personnel working in housing financial sector. A set of 3 questionnaires containing 12 questions each is prepared and presented to the conventional and Islamic banks and financial companies, and *Shari'ah* scholars. Some of those personnel work for Conventional banks and private companies and others for Islamic banks and private companies. 2 Interviews also conducted from the scholars who are working for Islamic *Shari'ah* board as advisors.

Chapter 8: Discussion and Conclusions. This chapter provides a detailed analysis of the results of the study. It analyzes the results of the quantitative and qualitative data obtained from the distributed questionnaire and the interviews conducted with the bank executives. The results are also used to make recommendations for the improvement of the functionality of Islamic housing finance and the offering of products, as well as suggestions for future work.

Chapter 2: CONVENTIONAL AND ISLAMIC HOUSING FINANCE

2.1. INTRODUCTION

As we all know, human beings have basic needs for living, which comprise food, clothing and shelter. All three aspects join together and fulfil the human desire and wish. The subject of this study, however, is shelter, which means “A habitable covered living space, providing a secure, healthy living environment with privacy and dignity to those within it.”¹ For proper shelter and to cover the desired requirements of humans in an economic developed country, the housing finance market solves this problem and provides the finance to its customers. However, for many people, their expenditure on housing is usually much higher than on food and clothing.

People fulfill their needs in terms of shelter through various ways: by leasing from other people; building their own home by their own necessity and facility; or purchasing a new or already refurbished house according to the location the person desires. This all depends on the individual’s necessities and his or her financial status. In certain cases, a person fulfils his wants as a result of strong financial assets; however, a less financially well-off person has to take out some form of housing finance because the properties are generally very luxurious and costly. Even with housing finance, the repayments comprise the majority of his monthly earnings.

People have various needs and, in order to fulfill those needs, they approach the various financial institutions which are available in their country. There are numerous financial institutions which offer interest-based loans (the conventional housing finance institutions), but these are not allowed in Islam. All Muslim people know the interest (*Riba*) is prohibited (*Haram*), so they

¹University of Cambridge shelter project, Retrieved 15 Nov. 10, from http://postconflict.unep.ch/liberia/displacement/documents/Corsellis_Vitale_Transitional_Settlement_Displaced_Populatio.pdf

move towards *Shari'ah*-based financial institutions. There are different Islamic housing finance institutions available worldwide.

In order to present a detailed background to housing finance, this chapter discusses the conventional housing finance as well as the Islamic housing finance. This includes the types and products made available for both conventional and Islamic housing finance. Comparison is also made between these products. An attempt is also made to discuss the housing markets in the United States of America and the United Kingdom for conventional and Islamic housing finance.

2.2. Housing Finance and Markets of Developing Countries

Most of the early theory and ideas for the development countries were written as a response to the realities of unlawful tenant settlement or to the unsuitability of public housing, an idea which was often transplanted inconsistently from the developed to the development countries. New, more suitable housing knowledge was steadily gathered from the experience of specialists in UN missions sent to give advice to governments in development countries during the 1950s, as well as the 1960s. Other important contributors were some highly-dedicated researchers seeking on-location sympathetic self-build and self-help squatter housing. Another significant author of the newly evolving literature, John F.C. Turner,² was a more in-depth viewer of self-help housing than Abrams³. Turner lived in Peru and other Latin American countries, recording the details of unlawful tenant and formulating theories aimed at modifying housing policy.

The theories were influenced by different scholars and social idealists who lived and wrote in the late 19th and early 20th centuries. Patrick Geddes (1854–1932) saw privileged urban development in housing as an accepted, participatory activity, rather than one dominated by a remote profession. Peter

² Turner, John F.C. "Housing as a Verb," in Turner, John F C and Fichter, Robert, Freedom to Build, Macmillan, New York, 1972. The Reeducation of a Professional, op. cit.

³ Abrams, C. (1964). Housing in the modern world. London: Faber and Faber.

Kropotkin (1842–1921) advocated independent economic development limited to a small area, while Martin Buber (1878–1965) required civilized and co-operative joint action, rather than centralized, dictatorial impositions of socialism. Along with Turner's on-location research, these scholarly themes guide Turner to view self-help housing in terms of deep human ambition, spoken in phrases such as 'freedom to build', 'housing by people', and 'housing is a verb', a process of active self-fulfillment (Turner, 1972, 1976). In self-help relational contracting, Turner found that households improved their housing incrementally, using better materials and adding space over periods of some 15 years or so (Turner, 1966, 1967, 1968, 1971, 1972, 1976, 1978). For Turner, self-help instrumentalism was superior to centralized public housing in terms of affordability, flexibility, and the fundamentally human creativeness in seeking value in life. Of course, incremental improvement is dependent upon long-term employment and economic growth; without these supporting conditions, self-help housing would remain meager and, from time to time, substandard.⁴

Regarding the experience of the World Bank in terms of developing countries, Since 1983 the World Bank has lent almost US\$5 billion to support housing finance in 40 different projects in developing and transitory economies. Of the 27 projects that have been subjected to ex facto evaluation, 20 (or 74 per cent) were found to have had a satisfactory outcome, a figure somewhat higher than the 68 per cent realized by other World Bank projects, and considerably higher than the performance of loans the World Bank has made to financial intermediaries.⁵

⁴ *The Theory and Practice of Housing Sector Development for Developing Countries, 1950–99.*

CEDRIC PUGH *School of Urban and Regional Studies, Sheffield Hallam University, Sheffield, UK [Paper first received March 1999; in final form November 1999] Housing Studies, Vol. 16, No. 4, 399–423, 2001 Carfax Publishing.*

⁵ *Robert M. Buckley, HOUSING FINANCE IN DEVELOPING COUNTRIES, A review of the World Bank's experience, Retrieved 15 November 2010 from <http://www.questia.com/PM.qst?a=o&docId=102855268>*

The kind of transactions that occurs in financial sectors, borrowers and savers are required to freely enter into the contracts on a voluntary basis. To do otherwise is to penalize other borrowers or savers, who will ultimately be discouraged from providing resources for further borrowing to take place. This view does not mean that subsidies are inappropriate. Subsidies and their effective targeting is the subject of the next chapter on financial concerns. Here, the concern is with establishing approaches that can sustain a return that exceeds the inflation rate on savings, as well as a return that reflects the risks involved in getting investors' money back. Therefore, positive interest rates (lending rates in excess of the inflation rate) are viewed as a requirement for successful, sustainable finance. In addition, servers must be able to expect this return after the cost of paying off arrears is subtracted from the returns paid.⁶

On a worldwide basis, housing finance is growing at an unprecedented rate. In the last decade, the outstanding mortgage debt increased by more than \$7 trillion; that is enough to finance at least an additional half trillion dollars' worth of housing investments per year. The increase is almost universal in developed economies where it is showing rapid increases. There is a significant number of emerging markets that are also experiencing rapid increases; however, what it does not show is that this increase is highly concentrated in a limited number of countries. That is, while most people in the world now have access to market-based housing finance, most countries do not.⁷ Two basic indicators of financial development are the total volume of financial assets to reflect scale and financial assets per capita to reflect financial depth. By these two measures, many emerging financial systems are quite small and shallow in that they lack economies of scale and scope. Furthermore, larger financial systems and larger banks are more efficient and more profitable than smaller ones for three basic reasons. Firstly, a larger financial system will have lower fixed costs relative to its assets. Secondly, it will have greater overall liquidity and its larger individual banks will also have

⁶ *Housing finance in development countries: a review of the World Bank's experience* by Robert M. Buckley the World Bank USA. Book.

⁷ *Mortgage Information Service*. Retrieved 18 April 2006 from <http://mortgage-x.com/library/loans.htm>

less internal need for liquidity. Thirdly, the system will be able to use its capital more efficiently through better pooling of risks without increasing the probability of insolvency and instability. For an individual bank or other financial intermediaries, a larger scale and a stronger reputation also enhance each other. While economies of scale result from doing more of the same activity, economies of scope result from carrying out different but related activities. Financial innovation is more likely to arise in larger markets where the necessary instruments, tools and know-how are already available or can be more easily developed. The smaller a financial system, the more incomplete its range of financial instruments and services are likely to be for risk management and for funding. The most recent year for which global comparative data on financial systems from the IMF's International Financial Statistics, together with the demographic and economic structure of their economy from the World Bank's Development Indicators, are available is 2000.⁸

2.3. PRIMARY AND SECONDARY MORTGAGE MARKET

The Housing Finance Group aims to raise the accessibility and affordability of residential housing in developing countries. It does so by commencing a stable source of new housing finance product ideas, considered formulations, policy, dealings and effectiveness measures to improve client necessities and influence. This multinational authorization spans the whole method, from guarantee and sufficient supply of suitable housing stock to sustainable mobilization of capital. Numerous challenges must be confronted if the housing finance sector is to carry out its intent of increasing the accessibility and affordability of residential housing in developing countries.

As far Lending Restrictions, mortgage lending is often narrowly restricted to a single sector, such as government-owned lenders or highly regulated private institutions. Emerging markets often lack the infrastructure that is fundamental to the support of home ownership, such as untargeted subsidies and

⁸ *Conference: Mortgage finance in emerging markets constraints and feasible development paths. By Bertrand M. Renaud 8 March 2005, Vol.3.*

disincentives for the financial sector. Another thing to consider is regulatory environment which reforms that are crucial to the development of a healthy private sector housing system are a prerequisite to the sector's growth. These include lien registrations, property rights and foreclosure practices. Other issue is the pool of skilled managers and field staff experienced in housing finance is limited in most countries. Numerous institutions have learned how to profitably serve the housing finance sector; they have yet to rise to the challenge of massive outreach, except in a few countries.⁹

2.3.1. *Primary Mortgage Markets*

- Financial support to primary mortgage market players (e.g. banks expanding their housing loans)
- Specialized housing finance instigators through equity participation, loans, credit lines and warehouse lines
- Development of standardized and practical credit underwriting, mortgage commencing and servicing standards, and information on the use of technology to put into practice such standards
- In conjunction with the World Bank, advice on legislation/regulation regarding commencing, standardization or servicing of mortgages
- Development of mortgage insurance or other secondary services such as credit reporting, property appraisal and evaluation.

⁹ <http://www.bridgemortgages.com/100-financing.html>. Retrieved date on 15 April 2008.

2.3.2. Secondary Mortgage Markets

- Financial assistance to secondary mortgage market entities and means of expression lenders through equity investments and warehouse lines
- Creation of Multi-Seller Conduit Vehicles for issuing Mortgage Backed Securities (MBS) or other bonds
- Credit Enhancement of MBS or other bonds such as guarantees & credit enhancement facilities. Advice on legislation/regulation regarding MBS issuance/investment.

2.4. CONVENTIONAL HOUSING FINANCE PRODUCTS

The housing finance market is among the most important in the economy. It accounts for a sizeable portion of the production activity of a country, through its backward linkages to land markets, building materials, tools, durable goods, and labour markets. Housing markets also have significant forward linkages with financial markets. Mortgage debt accounts for a large proportion of household debt and, through secondary markets and securitization, supports the efficient functioning of domestic and international financial markets.

Housing markets are routinely monitored as an important leading indicator of overall macroeconomic activity. The housing finance sector has a tremendous developmental impact, both in terms of providing social stability and in promoting economic development. It is worth noting that there are quite a few complementary dissimilarities as well as resemblances in the finance instruments and their methods between countries like the United Kingdom and the United States. So, this section attempts to provide a review on the conventional housing finance in the United Kingdom and United States of America. The underlying principal of adding two countries to this part is that these countries are both developed and are moving ahead in the financial

sector. However, we shortly be discussing the housing and finance in development countries. The reason behind is that Kuwait is, the author believes, in this same grouping.

2.5. Different types of mortgages in the United Kingdom

There are various mortgages available in the United Kingdom. All are significant for capital borrowing and interest.

2.5.1. *Variable rate mortgage*

This is the most common type of mortgage. It means a customer's monthly repayments will be related to standard rates set by the Bank of England. Thus, if interest rates go up customer mortgage payments will increase accordingly. In order to be accurate, the customer's mortgage payments will depend upon his/her lender's SVR (Standard Variable Rate). This is strongly linked to the base rate set by the Bank of England. However, SVRs do differ between various lending institutions so it is important to look around to find the most competitive SVR.¹⁰

- **Advantages of Variable Mortgages**

They are the most common type of mortgage and consequently the most aggressive. Frequently they can work out the cheapest.

Long-term interest rates look to be enjoying a period of stability. It is very improbable we will return to the high interest rates of the early 1990s.¹¹

- **Disadvantages of Variable Mortgages**

There is a high constituent of doubt. Even though interest rates have been low just recently, there is no guarantee they will continue to stay low.

If base rates rise considerably, then borrowers may not be capable of meeting their monthly mortgage repayments.

¹⁰ *Mortgage guide*, Retrieved 14 April 2007, from http://www.mortgageguideuk.co.uk/mortgages/variable_mortgage.html.

¹¹ *ibid*

2.5.2. Fixed rate mortgage

As the name proposes, this is a mortgage where the reimbursement levels are fixed for a definite number of years. This means that if the Bank of England Base rate goes up or down, the customer's mortgage will be unchanged.

- **Advantage of Fixed Rate Mortgage**

Condition: customers desire the confidence of a fixed monthly payment. Customers want to be able to budget for the next 5 years.

A significant rise in interest rates could mean that customers are not capable of meeting their mortgage payments and consequently may lose their house.

- **Disadvantages of Fixed Rate Mortgages**

It is clear that, if interest rates fall, the customer will not gain and will be locked into higher payments.

Frequently, lenders charge a higher premium for a fixed level of interest, as fixed rate agreements work out more costly than variable rate mortgages.

It is observed that fixed rate mortgages acquire a charge if the customer wishes to leave earlier than the agreed time period.

2.6. Interest-based mortgages

Interest-based mortgages are fixed for a period time, normally 25 years. Customers merely pay the interest payments on the mortgages. Frequently with a mortgage, the customer pays the interest on the loan as well as an additional amount to decrease the capital.

The interest-based mortgage means that the customer needs to have a separate savings plan in order to save money so that he or she can reimburse the capital on the mortgage at the end of the 25 years.

The major difficulty and problem arising with an interest-only mortgage is that there is no assurance or guarantee that the customer will be able to pay off the mortgage at the end of the mortgage period.

- Advantages of Interest-only mortgages

Client's monthly repayments will be considerably less as client is not paying any supplementary payment to the mortgage equity.

It gives client additional flexibility to spend in another system and schemes and obtain a potentially enhanced return on investments.

It could be helpful for those who anticipate important financial expenditure during the commencement of their mortgage period (e.g. tuition fees) but are also willing to wait to receive increased income.

It may be the only way for first-time buyers to get on the property ladder and to make their mortgage payments affordable.

Even though, at the end of the 25-year period, the client will be obliged in the same way as when the mortgage started, it is important to bear in mind that inflation will have made the real cost of housing cheaper, making it comparatively easier to pay back

- Disadvantages of Interest-only Mortgages

It is somewhat hazardous. The Client's substitute investment scheme may be unsuccessful in delivering the essential amount in order to pay back the loan.

Clients will pay more over the course of the mortgage term. This is because the client continues paying interest payments on the complete amount. For example, client will be paying 5 per cent of £200,000 for 25 years. With a normal mortgage, the client is paying the principal. By the

end of the client's mortgage term, the client will be paying interest on only, say, £10,000 so it is much cheaper.

It acquires a great deal of discipline to save money. It is much more difficult than one may think.

There is no assurance to the client that income may rise in the future so that the customer would be in a position to pay back the mortgages

As soon as interest rates increase, it has a proportionally greater effect on a client's mortgage (even though, when interest rates fall, there will be a proportionally greater fall).

2.7. Different Types of Mortgages in United State of America

There are numerous and famous unenthusiastic consequences of poor access to housing finance. On the other hand, international knowledge and research in high income economies shows that a well-performing mortgage market will offer large external benefits to the national economy: well-organized real estate development, construction sector employment, easier labour mobility, capital market development, more efficient resources allocation, and lower macroeconomic volatility. There are many different types of mortgages available in today's market. We examine some of the more common types that customers are likely to come across; however, as with different types of mortgages, there are different needs for mortgages and some of the more flexible lenders will accommodate and arrange the more difficult ones. In the US there are different types of customers and a large variety of customized home loans. In this section we will be discussing the types of home loans available in the United State of America.

In this section, we will attempt to analyse the various characteristics of many types of home loans and determine the best kind of loan available in the United State of America.

2.7.1. Adjustable Rate Mortgages

An Adjustable Rate Mortgage (ARM) has a preliminary interest rate that is set as fixed for a determined period of time; then, at the end of that period, the rates change for the remaining term of the loan. This often has lower monthly payments, and it also has a ceiling above which payments cannot go.

2.7.2. Fixed Rate Period

The fixed rate period can last for a diversity of changed time periods: 1, 2, 3, 5, 7 or 10 years depending on what loan best suits the customer's situation. The rate at which the loan starts at (start rate) is also the lowest that the rate will ever go over the life of the loan (floor rate). Most ARMs have a total term of 30 years.

There is an Index which is also defined as the variable, which the interest rate is tied to during the adjustable rate portion of the loan term. Any change in the interest rate can be attributed to a change in the index assigned to the loan.

There are a couple reasons why a customer would want an adjustable rate mortgage:

- Borrower wishes to stay in his/her home for a short period of time:

The proprietor may have a job that relocates him/her from time to time

The proprietor has bought a starter home

The proprietor plans on refinancing in the future

Everything else being equal, an ARM has a lower starting interest rate than a Fixed Rate Mortgage, which will allow a proprietor a lower monthly payment or a higher loan amount.

- Borrower has damaged credit and needs to refinance

A proprietor who has damaged credit can secure all of his/her debt into one mortgage. If the borrower agrees to an ARM he/she can get a relatively lower interest rate and make payments during the fixed rate portion of the loan and then refinance.

An ARM is considered riskier than a fixed rate mortgage because your payment may change significantly. In exchange for taking this risk, you are rewarded with an initial rate that is significantly below market rates for 30-Year Fixed Rate Mortgages. The more frequent the rate adjustments through the life of the loan, the lower the initial rate. Even after the loan adjusts, new rates will typically be below rates being offered to new borrowers for the 30-Year Fixed Rate program. Obviously, it's best to have an ARM when interest rates are predicted to fall (not rise) because in periods of rising interest rates, it is possible that you will ultimately pay much more for an ARM than for a 30-Year Fixed Rate Mortgage.

Adjustable-rate mortgages (ARMs) are loans with interest rates that change. ARMs may start with lower monthly payments than fixed-rate mortgages, though it is advisable to keep the following in mind:

- Client monthly payments might change. They could go up from time to time, even if interest rates don't change.
- Client payments may not go down much, or at all, even if interest rates go down.
- Client could end up owing more money than they borrowed, even if the client makes all of his/her payments on time.
- If the client wants to pay off ARM early to avoid higher payments, he might have to pay a penalty.

2.8. Federal Housing Administration (FHA) Loans

Home loans covered by the Federal Housing Administration (FHA). An FHA loan is frequently accessible at an attractive lower rate. It is open to all qualified borrowers. FHA loans are underwritten from with the standards established by the Federal Housing Administration and are fully insured by the Department of Housing and Urban Development (HUD).¹²

In FHA loans, the FICO¹³ score is not calculated, but a twelve-month payment record can be conventional using non-traditional methods of payment (e.g. phone bill).

Despite the consequences of the lending standards for FHA financing, the interest rates accessible may be equivalent to those offered to compliant borrowers.

The reasons behind choosing an FHA mortgage are many, but the main advantage to an FHA home loan is that the credit criteria for a borrower are not as exacting as conventional loans sold to Fannie Mae (FNMA) or Freddie Mac (FHLMC). Somebody who may have had a few credit problems or no traditional credit may not have a problem obtaining FHA financing.

In addition, FHA loans are assemble, allowing a person to take over the mortgage without the additional cost of obtaining a new loan. In addition, the lender must pay for part of the closing costs, while a borrower's permissible costs can moderately be added to the loan. The monthly mortgage insurance premium is less expensive for an FHA loan verses a conventional loan with 3 per cent down. Ultimately, FHA loans may have need of less income to be eligible as they will exceed the conventional debt ratios of 28/36 per cent, as their standard is 29/41 per cent.

¹² <http://www.americanequity.com/Mortgage-Basics/Home-Loans.aspx>. Retrieved on 14 April 2006.

¹³ The acronym FICO stands for Fair Isaac & Company. The actual company who pioneered this mathematical calculation, during the late 1950's. It is the credit model used to determine one's credit score and dependability. The term 'FICO score' is just another way of referring to a credit score
<http://www.capital-connection.com/what-is-fico.html> Retrieved on 06 November 2010

Many people presume that FHA loans are only available for first-time homebuyers. This is not true. FHA loans are available to anyone, whether it be a customer's first or fifth home; also, this loan can be used to purchase or refinance a home.

2.8.1. Fixed Rate Mortgages in United State of America

Fixed rate mortgages offer a loan where the interest rate will remain the same throughout the entire term for the borrower. When a borrower agrees to a fixed rate mortgage, the joint principal and interest payment does not change. However, the amount is focussed towards principal increases from month to month, causing the amount paid towards interest to decrease. The proprietor will pay the most interest with their first mortgage payment and the least amount of interest with their last mortgage payment.

The reason for choosing a fixed rate mortgage is that the customer's interest rate does not change and therefore the customer's monthly payments do not change. Conventionally, this has been the most popular mortgage when interest rates are low. With a fixed rate mortgage, customers can calculate how long it will take to pay off all the principal and interest, and therefore arrive at a monthly payment.

The major advantage of fixed-rate mortgages is that the bank charges the same rate for the entire life of the loan. If customer likes the peace of mind that comes with a stable interest rate payment, then a fixed-rate mortgage may be the ideal choice.

Commonly, customer finds that fixed-rate mortgages are the right choice condition:

- If interest rates are low
- If customer can afford the payment for the house he/she desires
- If customer need to budget for and foretell monthly payments

- If customer will keep his/her home for a relatively lengthy period of time.

2.8.2. Interest-only Mortgage Loans in USA

An interest only mortgage loan is most popular with homeowners who have homes that are rapidly appreciating in value and who want the lowest payment possible. Accepted or qualified borrowers make interest-only payments with the choice of making higher payments in order to decrease the principal. There are a range of alternatives, together with making interest-only payments during the first 3, 5, or 7 years of these mortgages.

For most proprietors, lowering their mortgage debt is the most effective way to build wealth. However, some may build wealth more rapidly by investing surplus cash flow rather than paying their mortgage faster. For this to succeed their return on investment must go beyond the mortgage interest rate, in view of the fact that rate is what they earn when they repay their mortgage.

The reason for choosing the interest-only loan is that for many people it means lower monthly payments. Especially for homeowners in expensive housing markets, the lower payments increase their home purchasing power.

In various housing markets where home positive reception is great, it may not be attractive to the proprietors to decrease their principal. The added levels of approval will be sufficient to build enough equity for their subsequent refinancing.

The biggest advantage with an interest in the United State of America is that the interest-only mortgage payment is flexibility. Any amount added to the interest-only payment is applied straight to the principal, allowing the proprietors more control. This approach requires discipline but is a better option for some proprietors. Also, the entire payment qualifies as tax-deductible interest during the interest-only period.

2.9. ISLAMIC FINANCE

The name of the religion is Islam, which comes from an Arabic root word meaning "peace" and "submission." Islam teaches that one can only find peace in one's life by submitting to Almighty God (Allah) in heart, soul and deed. The same Arabic root word gives us *Salaam alaykum* ("Peace be with you"), the universal Muslim greeting. Many Muslims, especially those living in non-Muslim countries, give up on the idea of ever owning their own home. Many families choose to rent for the long-term rather than participate in a bank loan, which involves the taking or paying of interest. In recent years, however, the market has opened up to Islamic mortgage offerings which are compliant with Islamic law. As Islamic finance had reached the high streets of many countries, the challenge would be to operate the equity thoughtfulness of the *Shari'ah* and make this mode of financing widely available amongst a constituency which exceeds Muslim communities. To make this section more descriptive and easier to understand, it follows an explanation of Islamic finance and Islamic Home Finance.

In defining the term 'Islamic finance', Islamic finance covers all financial movements that facilitate Muslims being able to invest in agreement with Islamic law, or *Shari'ah*. In practice, Islamic finance involves using traditional investment techniques, procedures and structures that comply with *Shari'ah* to create arrangements that work in ways that are analogous to modern conventional finance. Islamic banks and conventional banks that invest some of their capital in Islamic finance through an Islamic finance have a religious board or committee composed of *Shari'ah* scholars (the *Shari'ah* committee). The *Shari'ah* committee examines proposed transactions and, in the case of Islamic banks, reviews the overall activities of the bank, for compliance with *Shari'ah*.¹⁴ Islam does not permit the investing in businesses that are considered unlawful (*haraam*) and contrary to Islamic values such as those related to illicit drugs, weapons, alcohol, pornography and terrorism. Moreover, Islamic law prohibits borrowing money by using collateral and

¹⁴ *An introduction to Islamic finance: theory and practice* By Zamir Iqbal, Abbas Mirakhor
Edition: illustrated Published by John Wiley & Sons (Asia), 2006

selling account receivables, which are commonly used financial practices by companies.

Any Islamic instruments transaction, with any distribution of proceeds, can be conducted as a lease, a sale, a partnership, a fee-generating transaction, or a loan. Islamic instruments generally avoid loans. Though the scheduled distribution of proceeds may be the same as for a conventional loan, the legal risk in case of default is often different in the different forms of financing.

Islamic finance is growing so fast, which came into existence to satisfy the financial needs for dedicated Muslims (1.6 billion Muslims around the world) who observe the prohibition of *Riba* (usury). Many economists have studied the macro-economic properties of the banking institution in the framework of an isolated and ideal Islamic economy. In the age of included global financial markets, the immediate alteration of an entire financial sector to profit-and-loss sharing is very unlikely so there are different outlooks for Islamic finance.¹⁵

The number of product modernizations, increase in the number of institutions offering Islamic financial services (IIFS), the coverage of recruitment and human resource development of Islamic finance professionals, the licensing of institutions operating in new jurisdictions – all these are a strong sign of the growth and development of the Islamic financial services industry (IFSI). At the same time that this growth has been noticeable in the Middle Eastern and South East Asian regions, there is increasing interest in the industry, diagonally the globe spanning South Asia, Europe, North America and the Far East. IIFSs at present operate close to 50 World Bank member countries, Muslim-subjugated or otherwise, as well as developed nations such as the United States and United Kingdom.

For the last ten years, Islamic finance has increased rapidly in size and, according to some estimates, there are now more than 300 IIFS worldwide

¹⁵ *Islamic Finance Robin Matthews / Issam Tlemsani / Aftab Siddiqui* - Centre for International Business Policy, Kingston Business School.
<http://www.islamicmortgages.co.uk/index.php?id=272> Retrieved 17 April 2008.

managing assets with a surplus of US\$300 billion. These figures are likely to be amended in light of the unparalleled rise in oil prices, which have resulted in high levels of liquidity in the Gulf and other oil-producing countries. These developments appear to have fuelled the demand for Islamic finance and we are now witnessing a development of establishing IIFSs which are much bigger in size than those established five years ago, as well as the reaction from existing IIFS to increase their equity to match the new generation of IIFS.¹⁶

2.9.1. PRINCIPLES OF ISLAMIC FINANCE

The principles of Islamic finance are put down in the *Shari'ah*, or Islamic law. Islamic finance consists of financial transactions from banks and non-bank financial institutions and non-formal financial institutions, and is based on the theory of a social order of brotherhood and solidarity, unity and harmony. The participants in banking transactions are considered business partners who jointly accept the risks and profits. Islamic financial instruments and products are equity-oriented and based on different forms of profit and loss-sharing (PLC). As Islamic banks and their customers are partners, both sides of financial intermediation are based on contribution risks and gains: the reassignment of funds from clients to the bank (depositing) is based on revenue-sharing and frequently considered ex post on a monthly basis; the transfer of funds from the bank to the clients is based on profit-sharing (lending, financing), either at a commonly agreed-upon ratio, as in the case of *Mudarabah*, or at a mutually agreed-upon predetermined rate. Such ratios and rates differ between institutions and may, moreover, differ between contracts contained by the same institution, dependent upon apparent business projection and risks. Islamic banking finances only deal in business with fundamental assets; approximate investments such as margin trading and derivative transactions are expelled. Lending, or financing, is backed by guarantee; guarantee-free lending would normally be measured as containing an uncertain element, or moral hazard. In the same way, to prevent rumour

¹⁶ Islamic finance outlook 2006 By Professor *Rifaat Ahmed Abdel Karim*, Secretary General, Islamic Financial Services Board.

and moral hazard, usually only investors with numerous years of effective business understandings are financed. The paying or taking of *Riba* interest is prohibited. The similar principle of partnership is applied to Islamic insurance. It is based on a combined sharing of risk by a group of individuals whose payments are of the same kind and quality provided by the Islamic banking institution in a *Mudarabah* understanding for the benefit of the group. The elementary principle of commonality at the collective level finds its appearance in a special category of financial products with no compensation, *Qard*. Investors lacking sufficient business knowledge and who are thought as high risk may receive a sensible amount of financing on *Qard-Hasan* terms, without charge of any profit-sharing margin, but frequently repaid by instalments and backed by guarantee. Correspondingly, depositors may save in an Islamic financial institution without receiving payment, frequently with the expectation that the funds are used for social or religious purposes. In inflationary economies, *Qard* (loan) deposits and financings are used to help in unresolved problems.¹⁷

The principles of Islamic finance derive from *Shari'ah* law. *Shari'ah* law comprises the divine law prescribed in the *Qu'ran* and is established by a literal exposed text together with the sayings and actions of the Prophet Mohamed (*Sunnah*). The *Fiqh* is the human understanding of that law. The prohibition on interest means that a lender cannot provide advantage from a pre-determined guaranteed profit; therefore, the subject of the business deal is money for money. On the other hand, under a contract for sale (that is, other than money) a lender can earn a predetermined guaranteed profit, which would be justifiable.

¹⁷ University of Cologne Development Recerch Center, Principles and Products of Islamic Finance by *Omar Imady & Hans Dieter Seibel*.

2.9.2. Islamic Housing Structure

Islamic finance has to obey the rules and principles of *Shari'ah* law, which consists of *Qu'ranic* sanction and the sayings and actions of the Prophet Mohammed S.A.A.W (*Sunnah*). From a reasonable viewpoint, it is significant to note that there are a number of schools of *Shari'ah* consideration. Which school is most important in relation to an Islamic finance structure is important and due consideration should be given to that reality. With regard to financing structures, the ban against debt financing has changed the importance in Islamic philosophy in the direction of partnership perception, which is scattered relative to operating routine and profits are held to plough back into expansion. Investors participate in collaboration and share in the accomplishment and failure of the company.

2.9.2a. *Ijarah*

Ijarah is a term of Islamic finance. Usually, it means 'to give somewhat on rent'. In the Islamic jurisprudence, the word *Ijarah* is used for two different conditions. In the first place, it means 'to make use of the services of a person on wages given to him as a deliberation for his appointed services'. The employer is called *musta'jir* while the employee is called *ajir*.

Consequently, if A has given work to B in his office as a manager or as a clerk on a periodical salary, A is *musta'jir*, and B is an *ajir*. Correspondingly, if A has hired the services of a concierge or a loader to take his luggage to the airport, A is a *musta'jir* while the loader is an *ajir*, and in both cases the deal between the parties is termed as *Ijarah*. This type of *Ijarah* contains every business deal where the services of a person are hired by an important person as well. He may be a lawyer, a doctor, a labourer, a teacher or any other person who can provide some valuable services. Any one of them may be called an *ajir* according to the terms of Islamic law, and the person who hires their services is called a *musta'jir*, while the wages paid to the *ajir* are called their *ujrah*.

Let us now discuss the second type of *Ijarah*, which refers to the material goods and properties, and not to the services of human beings. *Ijarah* in this

logic means 'to transfer some of an exacting property to another person in swap over for a rent assert from him.' In this case, the term *Ijarah* is similar to the English term 'leasing'. Here, the *lessor* is called *Mu'jir*, the lessee is called *musta'jir* and the rent payable to the *lessor* is called *ujrah*.

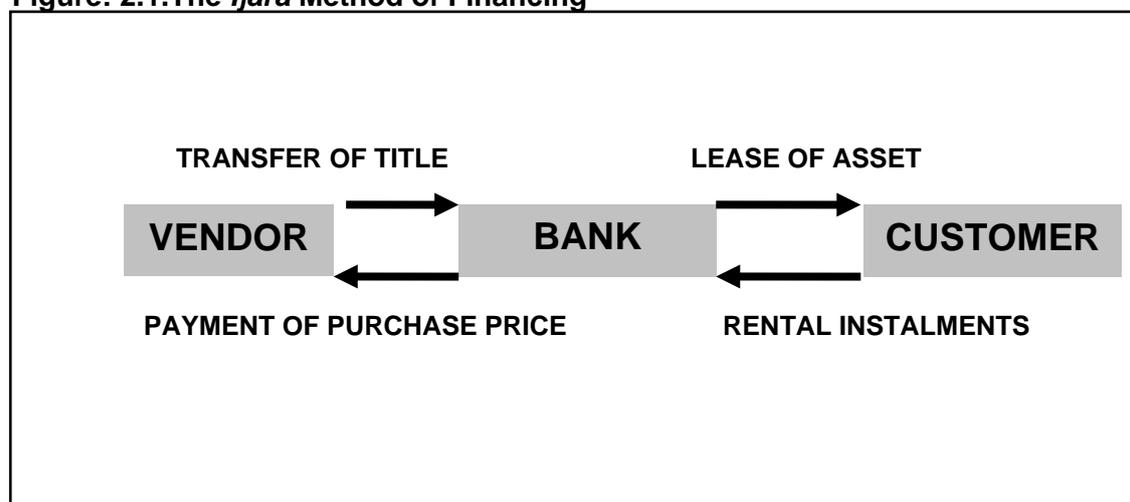
The systems of *Ijarah*, in the sense of leasing, are equivalent to the rules of sale, in that in both of the cases the goods are assigned to another person with charging profit margin. The dissimilarity between *Ijarah* and sale is that the quantity of the property is reassigned to the consumer, while in the case of *Ijarah*, the quantity of the property residue is in the ownership of the transferor, but merely it's the right to use it, is reassigned to the lessee. Consequently, it can easily be seen that *Ijarah* is not a method of financing. It is a standard business movement, like a sale. On the other hand, due to tax allowance reasons, this business deal is used in the Western countries for the reason of financing also.

As an alternative for giving an effortless interest-type loan, some financial institutions lease equipment to their clients. At the same time as fixing the rent of this equipment, they work out the total cost they have acquired in the purchase of these assets and add the predetermined interest they could have claimed on such an amount throughout the rented period. The collective amount consequently calculated is separated on the total months of the lease period, and the periodical rent is fixed on that basis.¹⁸

¹⁸ *An Introduction to Islamic Finance*, By Muhammad Taqi Usmani, Publisher Kluwer Law International, 2002

Ultimately, the use of leasing is represented by the *Ijara* contract in Islamic law. The contract represents a transaction in which a known benefit (usufruct) associated with a specified asset is sold for a payment. In the course of this sale of usufruct, ownership of the asset is not transferred – the bank maintains ownership of the asset. The *Ijara* contract can be designed to return the fixed assets to the lessor at the end of the lease period, in which case the lease takes on the features of an operating lease in which the bank takes title of the asset at the end of the lease term. The other mechanism would be to allow the lessee to agree, at the outset, to buy the assets in question at the end of the lease period.

Figure: 2.1. The *Ijara* Method of Financing



Source: Professor Rodney Wilson, Durham University, UK, Islamic Banking and Finance Key Legal and Regulatory Issues

2.9.2b. Murabahah

Throughout the world, the majority of the Islamic banks and financial organizations use *Murabahah* as an Islamic method of financing, and many of their financing procedures are founded on *Murabahah*. Therefore, this term has been used in economic circles nowadays as a technique of banking operations; at the same time, the original concept of *Murabahah* has diverted from this supposition.

Murabahah is, in detail, an expression of Islamic *Fiqha* and it refers to an exacting kind of sale that has nothing to do with financing in its unique sense. If a seller consents with his buyer to make available to him a specific product on a profit in excess of his cost, it is called *Murabahah* dealing. The fundamental component of *Murabahah* is that the vendors reveal the definite cost he has incurred in obtaining the product, and then adds some profit thereon. This profit income may be in more sums or may be based on a percentage.

Murabahah is often referred to as 'cost-plus financing' and frequently appears as a form of trade finance based upon letters of credit. In its simplest form, this contract involves the sale of an item on a deferred basis. The item is delivered immediately and the price to be paid for the item includes a mutually agreed margin of profit payable to the seller. In this contract, the market cost price (true cost) of the item is shared with the buyer at the time of concluding the sale. According to Tarek al-Diwany (Islamic-finance.com), *Murabahah* is a form of 'trust sale' since the buyer must trust that the seller is disclosing his true costs. After discussing the true costs, a profit margin may be agreed either on a percentage of cost basis or as a fixed amount. It is very important to remember that the amount of profit earned in this transaction is not a reward for the use of the financier's money. In other words, a financier cannot take money if he/she does not perform any service other than the use of his/her money for the transaction. Such an occurrence would cause this type of deal to resemble the charging of interest. Today, *Murabahah* is used most to assist short-term trade transactions.

If a person sells a product for an average price without any indication to the cost, this is not a *Murabahah*. However, if a person earns some profit on their cost because the deal is not based on a 'cost-plus' idea, then, in this case, the sale is called *Musawamah*.¹⁹

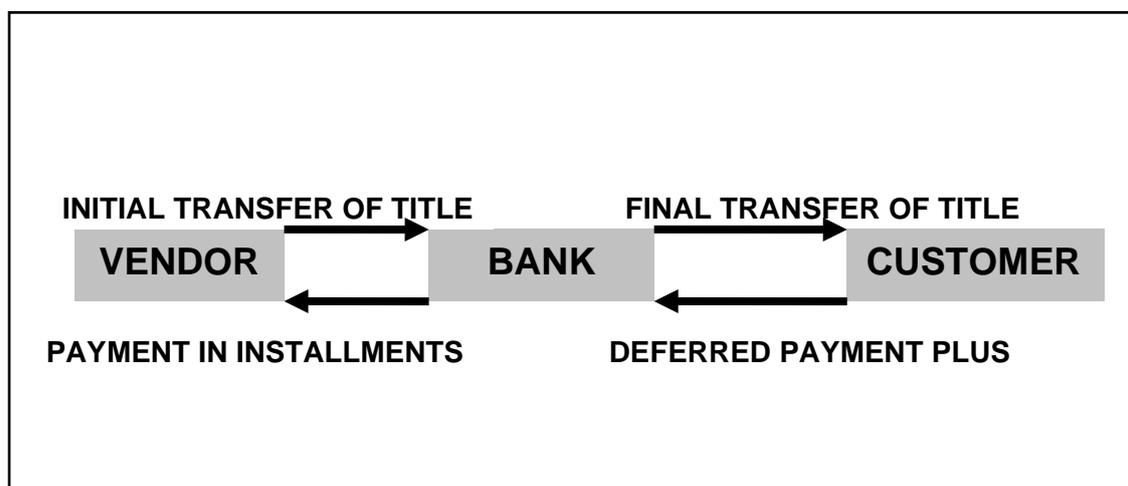
This is the definite logic of the term *Murabahah*, which is a deal, clean and straightforward. On the other hand, this kind of sale is used by the Islamic banks and financial organizations by adding some supplementary idea to it as

¹⁹ *ibid.*

a method of investment. The legitimacy of such dealings depends on various circumstances, which are supposed to be appropriately experimental to make them satisfactory in *Shari'ah*.

Murabahah is a deal with all its inference, and that all the fundamental components of a suitable deal should be available in *Murabahah* as well. Consequently, this conversation will begin with some essential elementary rules of a deal, without which a deal cannot be in protection as applicable in *Shari'ah*. This chapter will also discuss some unique systems leading up to the deal of *Murabahah*; also, in the closing stages, the accurate method for using the *Murabahah* as a satisfactory method of financing will be clarified. An effort has been made to simplify the comprehensive ideology, so that the main points of the topic may be easily grasped and thus give a better understanding of the subject.²⁰

Figure 2.2: The *Murabahah* Method of Financing



Source: Professor Rodney Wilson, Durham University, UK, Islamic Banking and Finance Key Legal and Regulatory Issues

In the *Murabahah* function, explained according to figure 2.2, the customer selects the home he desires to purchase and agrees the price with the vendor in the standard way. Then the customer approaches the bank for financial assistance; subsequent to that, the bank commences standard guarantee measures and a self-determining assessment of the property. The bank

²⁰ *ibid*

passes it to the solicitor to examine the home physically in the common way. Once these preliminaries are completed and the bank's solicitors have issued to the bank a satisfactory certificate of title, then the bank contracts to buy the home from the vendor at the price agreed between the vendor and the customer. The customer then gives a form of deposit which is lodged with and charged to the bank, followed by exchange of agreement. The bank uses its individual funds to pay the deposit. After that, the bank will trade the home to the customer beneath a change purchase agreement by way of sub-sale at the upper agreement value. The *Murabahah* agreement records the trade between the bank and the customer. The customer formulates regular monthly payments until the purchase price is finally paid.

2.9.2c. *Musharakah*

The word *Musharakah* is derived from Arabic and means 'sharing'. In the area of business and trade, it means a combined venture in which all the associates contribute to the profit or loss of the joint venture. It is a perfect option for the interest-based financing with far reaching effects on both manufacture and sharing. In the contemporary entrepreneur economy, interest is in the solitary instrument arbitrarily used in the financing of each type. Since Islam has prohibited interest, this instrument can never be used for providing funds of any type. Consequently, *Musharakah* can play a very important role in an economy based on Islamic ideology.

'Interest' predetermines a fixed rate of return on a loan advanced by the financier irrespective of the profit made or loss undergone by the nonpayer, while at the same time *Musharakah* does not foresee a fixed rate of return. Somewhat, the return in *Musharakah* is based on the definite profit making by the joint venture. The banker in an interest-bearing loan cannot undergo loss at the same time as the financier in *Musharakah* who undergoes loss, if the joint venture be unsuccessful. Islam has termed interest as an unfair instrument of financing since it results in prejudice, either to the creditor or to the nonpayer. If the nonpayer undergoes a loss, it is seen as excessive on the part of the creditor to assert a fixed rate of return; and if the nonpayer earns a

very high rate of profit, it is deemed unfair to the creditor to give him only a small amount of profit, leaving the rest for the nonpayer.²¹

In the contemporary economic organization, it is the banks which precede the depositors' money as loans to manufacturer and dealer. If industrialists have only ten million of their own and acquire 90 million from the banks and proceed on an enormous gainful scheme, it is understood that 90 per cent of the project would have been shaped by the funding of the depositors, while only 10 per cent would have been shaped by their own capital. If this project brings enormous profits, only a small percentage, such as 14 or 15 per cent, will go to the depositors through the bank, whereas all the rest will be increased by the entrepreneur, whose real contribution to the project will be no extra than 10 per cent. This minute percentage of 14 or 15 per cent is given back by the manufacturer, since this percentage is incorporated by them in the course of their manufacture.

The result is that all the profits of the venture are produced by the persons whose own capital does not go beyond 10 per cent of the total investment, whereas those owning 90 per cent of the savings get no more than the fixed rate of interest, which is often repaid by them through the augmented prices of the products. On the contrary, if the manufacturer becomes insolvent, their own loss will be no more than 10 per cent, whereas the remaining 90 per cent will be borne by the bank and, in some cases, by the depositors. Therefore, the rate of interest is the most important reason for differences in the system of sharing and allocations, which has a steady propensity in favour of the wealthy and against the interests of the poor.

On the other hand, Islam has an understandable, already defined principle for the banker. According to Islamic principles, a banker has to agree on whether he is advancing a loan to support the nonpayer on compassionate grounds or whether he needs to share his profits. By stipulating that he wants to help the nonpayer, he should resist from claiming on the principal of its loan, since its aim is to help out. On the other hand, if he requires a share in the profits of his

²¹ *ibid*

nonpayer, it is necessary that he must also share in its losses. Consequently, the incomes of the banker in *Musharakah* have been expressively concerned with the real profits accrued through the venture. The better profits of the venture the higher the rate of return to the banker. If the venture earns massive profits, every part of it cannot be reasonable by the entrepreneur wholly, excluding they will be communal by the ordinary people as depositors in the bank. In this way, *Musharakah* have a propensity to goodwill the general people somewhat than the rich only.

This is the basic point of view which explains why Islam has optional *Musharakah* in financing. No doubt, *Musharakah* symbolizes a number of practical problems in its complete execution as a worldwide mode of financing. It is occasionally acknowledged that *Musharakah* is an old instrument which cannot keep pace with the ever advancing need for immediate dealings. On the other hand, this statement is due to the required needs of appropriate awareness with reference to the principles of *Musharakah*. In reality, Islam has not arranged a definite form or procedure for *Musharakah*. Somewhat, it has put some broad principles which can contain numerous forms and dealings. A new form or process in *Musharakah* cannot be discarded just because it has no example in the past. In truth, every new form can be good enough to the *Shari'ah* in so far as it does not break any basic principle put down by the Holy *Qur'an*, the *Sunnah* or the agreement of the Muslim jurists. Consequently, it is not essential that *Musharakah* be implemented only in its usual old form. The current section includes a discussion of the basic principles of *Musharakah* and the method in which it can be executed in the context of present business and trade. This discussion is intended to commence *Musharakah* as a contemporary mode of financing without violating its basic principles in any way. It is anticipated that this concise discussion will realise the thoughts of Muslim jurists, economists and scholars and might assist to put into practice a correct Islamic economy.

2.9.2d. Diminishing Musharakah

Another form of *Musharakah*, developed in the recent past, is 'Diminishing *Musharakah*'. According to this concept, a financier and his client participate either in the joint ownership of a property or equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units and it is understood that the client will purchase the units of the share of the financier one by one over a period of time, thus increasing his own share until all the units of the financier are purchased by him so as to make him the sole owner of the property, or the commercial enterprise, as the case may be.

The Diminishing *Musharakah* based on the above concept has taken different shapes in different transactions. Some examples are given below.

It has been used mostly in house financing. The client wants to purchase a house for which he does not have adequate funds. He approaches the financier, who agrees to participate with him in purchasing the required house. Twenty per cent of the price is paid by the client and 80% of the price is paid by the financier. Thus the financier owns 80% of the house while the client owns 20%. After purchasing the property jointly, the client uses the house for his residential requirement and pays rent to the financier for using his share in the property.

At the same time, the share of the financier is further divided into eight equal units, each unit representing a 10% ownership of the house. The client promises to the financier that he will purchase one unit after three months. Accordingly, after the first term of three months, he purchases one unit of the share of the financier by paying 1/10th of the price of the house. It reduces the share of the financier from 80% to 70%. Hence, the rent payable to the financier is also reduced to that extent. At the end of the second term, he purchases another unit, increasing his share in the property to 40% and reducing the share of the financier to 60% and consequentially reducing the rent to that proportion. This process goes on in the same fashion until, after the end of two years, the client purchases the whole share of the financier,

thus reducing the share of the financier to 'zero' and increasing his own share to 100%.

This arrangement allows the financier to claim rent according to his proportion of ownership in the property. At the same time it allows him a periodical return of a part of his principal through purchasing the units of his share.²²

There are financial institutions that use the same concept of Diminishing *Musharaka* as their mode of financing. These are the Bank Al Habib, Meezan Bank, ABC International Bank, Bristol and West, Lloyds TSB and Ansar Finance Group. The way in which the Bank Al Habib does this is by purchasing the property together with the customer.

2.10. DIFFERENCE BETWEEN CONVENTIONAL FINANCE AND ISLAMIC FINANCE

A contemporary commercial banking movement is based on the creditor debtor relationship between the borrower on the one hand and the bank on the other. Interest is viewed as the price of credit, reflecting the opening cost of money. The Islamic view about loans is that they should not give or take any benefit from the borrower.

One must abstain from making a straight assessment between Islamic banking and conventional banking. This is because they are tremendously different in many ways. The key difference is that Islamic banking is based on *Shari'ah* organizations. Therefore, all business dealing, transactions, business move toward, product feature, investment focus, and responsibility are derived from the *Shariah* law, which leads to significant differences in many parts of the operations as well as to the conventional.

The foundation of the Islamic bank is based on the Islamic faith and must stay inside the limits of Islamic Law or the *Shari'ah* in all of its actions and performances. The original meaning of the Arabic word *Shari'ah* is '*the way to*

²² Mufti Taqi Usmani, Retrieved date 05 December 2009, from http://www.beautifulislam.net/finance/intro_to_islamic_finance.htm

the source of life' and is now used to refer to a lawful system in keeping with the code of behaviour called for by the Holy *Qur'an*. The governing principles of an Islamic bank are:

- The absence of interest-based (*Riba*) transactions.
- The avoidance of economic behavior between domination (*zulm*).
- The avoidance of economic activities involving conjecture (*Gharar*).
- The introduction of an Islamic tax, known as *zakat*,
- The discouragement of the production of goods and services which contradict the Islamic value (*haram*).

On the other hand, conventional banking is basically based on the debtor creditor relationship between the depositors and the bank on one hand, and between the borrowers and the bank on the other. Interest is the same as the price of credit, reflecting the opportunity to pay the price of money.

Islamic law considers a loan to be given or taken, free of charge, to meet any possibility. Thus, in Islamic Banking, the creditor should not take advantage of the borrower.

The other principle pertaining to financial transactions in Islam is that there should not be any reward without taking a risk. This principle is applicable to both labour and capital. As no payment is allowed for labour, unless it is applied to work, there is no reward for capital unless it is exposed to business risk.

Thus, financial intermediation in an Islamic framework has been developed on the basis of the above-mentioned principles. Therefore, financial relationships in Islam have been participatory in nature. In Table 2.1 below there are some unique features of conventional finance and Islamic finance.²³

²³ *Ust HJ Zaharuddin Hj Abd Rahman*, <http://www.zaharuddin.net>

TABLE: 2.1- CONVENTIONAL BANKING AND ISLAMIC BANKING

CONVENTIONAL FINANCE	ISLAMIC FINANCE
The function and operating mode of conventional banks are based fully on manual or a manmade principle	The functions and working modes of Islamic banks are based on the principles of Islamic <i>Shari'ah</i> .
The investor is guaranteed a determined rate of interest.	In dissimilarity, it promotes risk sharing between provider of capital (investor) and the user of funds (capitalist).
It aims at maximizing profit without any limitation.	It aims at maximizing profit, but subject to <i>Shari'ah</i> limitations.
It does not deal with <i>Zakat</i>	In the modern Islamic banking system, it has developed into one of the service oriented functions of the Islamic banks to be a <i>Zakat</i> Collection Centre; they also pay out their <i>Zakat</i> .
Lending money and getting it back with compounding interest is the fundamental function of the conventional banks.	Participation in partnership business is the fundamental function of the Islamic banks. We therefore have to appreciate our customer's business very well.
It can charge additional money (penalty and compounded interest) in case of defaulters.	The Islamic banks have no stipulation to charge any extra money from the defaulter. Only small amount of reimbursement and these proceeds are given to charity. Rebates are given for early settlement at the bank's discretion.
Very often it results in the bank's own interest becoming prominent. It makes no effort to ensure growth with equity. For interest-based commercial banks, borrowing from the money market is comparatively easier.	It gives due significance to public interest. Its final aim is to ensure growth with equity. For Islamic banks, it must be based on a <i>Shari'ah</i> -accepted fundamental business deal.
The conventional banks give greater emphasis on credit worthiness of the clients.	The Islamic banks, on the other hand, give greater emphasis on the viability of the projects.
The status of a conventional bank, in relation to its clients, is that of creditor and debtors.	The status of Islamic bank in relation to its clients is that of partners, investors and trader, buyer and seller.
	An Islamic bank can only assure deposits for current and saving accounts, which are based on the principles of <i>al-wadiah</i> , thus the depositor is assured reimbursement of his funds. However, if the account is based on the <i>Murdaraba</i> concept, the client has to share in a loss position.

Source: <http://www.zaharuddin.net>.

The difference between conventional banks and Islamic banks virtually vanish, while both conventional and Islamic banks finance the same dealings and the development for the same customers. But the difference is in the concept. The key difference is that Islamic Banking is based on *Shari'ah* foundation. Thus, all dealing, transaction, business approach, product feature, investment focus, responsibility are derived from the *Shari'ah* law, which lead to the significant difference in many part of the operations with as of the conventional. On the other hand, conventional banking is essentially based on the debtor-creditor relationship between the depositors and the bank on one hand, and between the borrowers and the bank on the other. Interest is considered to be the price of credit, reflecting the opportunity cost of money.

Islamic banking is a comprehensive financial concept where principles and core values of Islamic Banking are originated from religion is very important. The core concept of Islamic Banking contains much more than its prohibition of usury (Impose a fee for transacting money - "interest" or "excessive interest"). Islamic Banking priority objective is that ethic and finance can be dedicated to serve the society. The main idea behind the banking system is to eliminate the widespread economy injustice in society. Prohibition of interest (*Riba*) is not only limited to Islam but it is also clearly forbidden in Judaism and Christianity.

The Islamic banking system is based on Equity, while the conventional banking system is based on money owing. Money owing instruments function as money alternate, while equity-based financial instruments do not. Islam prohibits the earning of money through unfair trading practices and other activities that are communally harmful in one way or another, which is why prearranged interest or *Riba* is forbidden.

The creditor/debtor relationship is viewed as unfair as it gives more influence to the creditor as opposed to the debtor. But such a thing cannot be seen in Islam participatory relationships of banker and entrepreneur.

2.11. The Development of Islamic Finance

Islamic financial institutions are comparatively modern creations; one of the first Islamic banks was set up in Egypt in 1963. Even though the origin of modern Islamic banking was in Egypt, it perhaps would not have developed as an important financial force exclusive of Saudi investors. The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah, Saudi Arabia corresponding to December 1973. The Bank was formally opened on 20 October 1975. IDB gave momentum to the Islamic banking movement. It was the first time in modern Muslim history that an international financial institution conducted its own activities and behavior in conformity with the *Shari'ah*. As a substitute of working on the source basis of interest, the bank was approved to charge a service fee to cover its administrative everyday expenditure. From the time of the creation of the IDB, various numbers of Islamic banking institutions have been established all over the world and several countries have taken the necessary steps to manage their banking systems along Islamic lines. The first private Islamic commercial bank, the Dubai Islamic Bank, was founded in 1975.²⁴ The Gulf Cooperation Council (GCC) of Islamic financial institutions are now taking an increasingly global perspective.

Al Rajhi Bank is one of the largest Islamic banks in the world with total assets of US\$33 billion, a paid-up capital of US\$4 billion and an employee base of over 7,452 associates. With over 50 years of experience in banking and trading activities, the various individual establishments under the Al Rajhi name were merged into the umbrella 'Al Rajhi trading and exchange corporation' in 1978 and it was in this year that the bank was also established as a Saudi shareholding company. Deeply rooted in Islamic banking principles, the *Sharia*-compliant banking group is instrumental in bridging the gap between modern financial demands and intrinsic values, whilst spearheading numerous industry standards and development.

²⁴ *Freshfields Bruckhaus Derringer* Islamic finance: Basic Principal and structure. *A focus on project finance*. January 2006.

With an established base in Riyadh, Saudi Arabia, Al Rajhi Bank has a vast network of over 550 branches. The first branch was opened in Aldirah, Saudi Arabia, in 1957. Kuwait is the second foreign Gulf country where the Islamic lender is set to expand into after Malaysia (where it has a network of 19 branches). Kuwait Finance House (KFH) has expanded into Turkey, where it has the country's largest Islamic bank, with 88 branches – more so than in Kuwait. KFH started retail, commercial and investment banking operations in Malaysia in 2006 and it has opened representative offices in Singapore and Melbourne. Dubai Islamic Bank is rapidly expanding its branch network in Pakistan, where it has purchased the Bank of Khartoum in Sudan as well as three real-estate companies in Egypt. Other governments have been much more supportive in recent years, notably Kuwait which, in 2004, passed an amendment to the Central Bank Law 32 of 1968 bringing KFH under the regulatory authority of the Central Bank of Kuwait. The new legislative framework aimed to ensure that competition within the Islamic financial sector was opened up, with other banks permitted to apply for Islamic banking licences. As a result, the Kuwait Real Estate Bank converted to an Islamic bank, changing its name to Kuwait International Bank. A new Islamic financial institution, Bubyank Bank, was also awarded an Islamic banking licence. The legislation also contained provisions on Islamic financial governance²⁵

2.12. Islamic Finance in United Kingdom

The worldwide Islamic Finance market has grown to over US\$200 billion. London is one of the main comprehensive transacting centres external to the Middle East for this market. Yet, it is ironic that little by the way of Islamic financial products are presented to the Muslims in the UK. This community, of "between" 1.5 to 2.0 million Muslims and some 350,000 households, is a considerable market.

²⁵ Wilson, Rodney, *The development of Islamic finance in the GCC*, 2009

2.12.1. Islamic Housing Products in United Kingdom

In the UK, Islamic financial institutions are becoming popular because of the products and payback systems they are offering. Al-Ahli United Bank, ABC International Bank, Bristol and West, Lloyds TSB, Islamic Bank of Britain, HSBC, United National Bank and Ansar Finance Group are the most famous

2.12.2. Islamic institutions in the UK.

As far as market potential is concerned, according to a research by Datamonitor, the Islamic mortgage market is now worth USD 250.4 million, implying an average annual growth rate of 68%.²⁶ There is an even bigger market potential emanating from the 1.8 million Muslim populations if they do not take up conventional mortgage products, but instead go for the mortgage products which are *Shari'ah* compliant.

²⁶ Datamonitor. (2006). *UK Islamic Mortgage 2005*. Retrieved 13 March 2007, from http://www.researchandmarkets.com/reportinfo.asp?report_id=305547

Existing home finance products being used in UK are *Murabaha*, *Ijarah* and *Diminishing Musharakah*.

TABLE: 2.2 ISLAMIC BANKS AND INSTITUTION PRODUCTS IN UK

Banks / Institutions	<i>Murabaha</i>	<i>Ijarah</i>	<i>Diminishing Musharakah</i>
Al-Ahli United Bank	Yes	Yes	
ABC International Bank			Yes
Bristol and West			Yes
Lloyds TSB			Yes
Islamic Bank of Britain	Yes		
HSBC		Yes	Yes
United National Bank		Yes	
Ansar Finance Group			Yes

In the UK, the Al Ahli United Bank of Kuwait provides Islamic mortgages based on the *murabaha*. This bank offers to customers the ‘Manzil Murabaha Plan’ and ‘Manzil *Ijara* Plan’ related to home finance. The Manzil *Murabaha* Plan is based on the principle of trading, buying and selling goods at a profit where the customer chooses the property and agrees on the price with the vendor. The bank then buys the property from the vendor and then sells it to the customer with a mark-up price. The customer would then pay the higher price by fixed and equal installments over a term of up to a maximum 15

years. In this kind of finance, the property is registered in the customer's name and the bank holds security over it in the form of a legal charge.

Financial institutions in the UK that use the *Ijara* mode of financing are HSBC Amanah Home Finance, Al Ahli United Bank and United National Bank. It is based on the principle of leasing whereby the customer chooses a property and agrees on the price with the vendor. The financier then buys the property and agrees to sell it to the customer for the same price, which is spread over a term of up to 25 years during which the customer would pay rent for living in the property that the financier owns. The rent would be agreed annually and adjusted to reflect the payments the customer makes to the financier.

HSBC is also offering 'Diminishing *Musharakah*' to its customers under the name of their products "Amanah Home Finance". With this product possibility is there to for *Sharia's* compliant Diminishing *Musharakah* method of financing. One can finance up to 65% of the value or the purchase price of the property (whichever is lower). Finance is based on one's individual circumstances and what can be afforded.

There are also a number of financial institutions that use the concept of '*Diminishing Musharaka*' as their mode of financing. These are ABC International Bank, Bristol and West, Lloyds TSB and Ansar Finance Group. In this kind of transaction, ABC International Bank and his client participate in the joint ownership of a house. The share of the ABC International Bank is further divided into a number of units and it is understood that the client would purchase the units of the share of the ABC International Bank one by one periodically, thus increasing his own share until all the units of the ABC International Bank are purchased by him so as to make him the sole owner of the house. The client would have to make monthly repayments over a certain tenure period in which the ABC International Bank sells its share of the home to him. The monthly repayments will diminish the ABC International Bank's share in the house and correspondingly increase the client's share. It also consists of rent, which the ABC International Bank charges for the use of its

share of the property. The rent is calculated according to the respective shares owned by the ABC International Bank.

The various numbers of modern developments point to important changes in the market place. Suggestions have materialized from the UK regulators that they do not have any protestation in principle to *Sha'ria*-compliant financial products. As a result of these major high street players like HSBC, some building societies are considering moving towards the inside of the market with a corresponding group of products. They have teamed up with Muslim institutions to try and address the authoritarian issues which have so far hindered the commencement of Islamic housing finance and other products. A working party, comprising of practitioners and representatives of the Muslim Council of Britain (MCB) and Union of Muslim Organisations (UMO), has been created with the blessing of the Governor of the Bank of England. This party has organized a report on the issues of apprehension and has met several of the officials, regulators, departments and ministries to work out satisfactory clarification.

The meeting of representatives for the working party included Ruth Kelly, MP, and the Financial Secretary to the Treasury. In this gathering, the issue of charges of stamp duty was discussed. The way *Shari'a* compliant housing finance product is planned would mean that stamp duty would be charged twice on a single property purchase. This supplementary levy would therefore make the product uncompetitive. The government is considering making changes to the stamp duty legislation and facilitating the levying of a solitary charge on what in consequence would be a single purchase. In a comparable way, many other issues have been taken up by different departments and officials to allow a like-for-like reasonable product to be launched, as the next gathering of the working party is programmed to be with the Governor of the Bank of England in early December. It is suggested that, if the some of the required changes are integrated in the 2003 Finance Bill, then one might see one or more of the high street financial institutions in the UK introducing *Sha'ria*-compliant products in the second half of 2003. In a short space of time one may see an overabundance of *Sha'ria*-compliant financial products on UK

high streets. A lot of people have disputed and argued that Muslims have availed of existing products and are unlikely to discard them for the new *Sha'ria*-compliant products. On the other hand, subjective confirmation suggests that many people would switch to *Sha'ria*-compliant products if they are appropriately structured and competitively priced. Certainly, new buyers would sincerely explore these facilities. As the range and possibility of these products builds up, the entire saving and borrowing patterns of UK Muslims is likely to change. At that point, many non-Muslims would also be interested in these products. In time, these products may provide a precious and valuable bridge between different communities and interested groups within the United Kingdom.

2.13. ISLAMIC FINANCE IN THE UNITED STATES OF AMERICA

According to the authorities, there are 10 million Muslims currently living in the USA and the rate of growth is forecasted to be 15 million within the next 10 years. Beside distinguished students, the community also comprises very highly-esteemed professionals, including a large number of doctors, engineers, businessmen, professors and scholars. In such a large people don't want to violate their basic faith requirement and don't want to involve their selves in the kind of transactions or contracts which leads them towards *RIBA* which is forbidden as per their *faith*.²⁷

In 1987, taking into account the high demand for Islamic financial products and services, the American Finance House (LIBRA) commenced their operations in the financing sector, particularly dealing according to *shari'a*-compliance, encouraging the Muslim community to acquire their financial needs without violating their faith. It was the first Islamic financial system the Muslim community ever had in USA. It is evident that this system became popular not only in the Muslim community but others also appreciated the way the system functioned.

²⁷ The American Muslim Community, retrieved date Nov. 10, 2010 from <http://www.lariba.com/knowledge-center/articles/us-islamic-financing.htm>

The increasing demand of mortgage financing products has a direct and indirect impact on the economy, especially in USA, Germany and the UK.

It is difficult to state an exact figure of the Muslim population in the United States. The figures presented here are based on available data. In the United States, there are essentially three categories of Muslims:

- 1) Immigrants
- 2) American converts/reverts to Islam
- 3) Those born to the first two groups as Muslims.

Towards the end of 1992, a survey published by the American Muslim Council (AMC) shows the estimated Muslim population in USA range between 5 million to 8 million²⁸, but the most recent estimation shows the Muslim population at approximately 10 million. California has the largest population of Muslims compared to all other states. The estimation is around 1 million alone for this state. New York is estimated at 4.7%, Illinois 3.6%, New Jersey 2.5%, Michigan 3.2% and Texas 2%. Other states like Indiana, Maryland, Ohio and Virginia also have a considerable Muslim community.

It is observed that a large number of Muslims living in USA are engaged with the conventional systems for their financial needs, which are not *shari'a*-complaint. They are using FDIC-insured bank deposits, taking loans from the banks for buying houses; they use credit cards and take home equity lines of credit, all part of the conventional system which is purely *Riba*-based.²⁹

A number of wealthy businessmen from the Muslim community are using conventional banking systems in the USA and making a reasonable profit out of this system. They don't have any feeling or religious aspect in this regard so ultimately it becomes difficult to convince such members of the community

²⁸ *Fareed H. Numan*, December 1992, Retrieved 15 November 2010 from http://www.islam101.com/history/population2_usa.html

²⁹ The American Muslim Community, retrieved date Nov. 10, 2010 from <http://www.lariba.com/knowledge-center/articles/us-islamic-financing.htm>

to change over from *Haram* to *Halal* systems according to faith and *Shari'ah* complaint.

However, there are a number of justifications raised by the Muslim community members against *Sharia's* complaint financing products in order to continue using the traditional style of financing product.

They also come up with the justification that *Riba* is Usury but not interest, as it is purely dependent upon the choice of the customer. He or she is not forced to do so, particularly if the interest rate changes and is not excessive, so this can not be considered as *Riba*.

These community members say that *Riba* (interest) and profits offered by the Islamic systems are all the same. Islamic financial institutions changed only the name of the terms, such as the word 'Profit' instead of 'Interest'; they also carry out their transactions in the same way.

Another justification is based on the ineligibility of the Islamic financial systems providers, as they faced problems in the beginning which weren't correctly sorted out. They pointed out that countries like Egypt, Dubai, Denmark, Belgium and Malaysia initially failed to correctly apply all the products due to lack of resources, mismanagement and inexperience resulting in frauds, insufficient disclosure of risk, lack of transparency and regulatory supervision.

In the United States, they operate the most organized, developed and sophisticated financial systems in the world. So it was a big challenge to operate a new financial system as an alternative and avail success. It became, for a time, near impossible to persuade the community to avail an Islamic financial system and change their interest and thoughts unless they were motivated by the strict Islamic jurisprudence (*Quran* and *Sunnah*; system based on Islamic laws). It was hard to motivate them as they were already used to that system (conventional) which the rest of the world had already been using.

In fact, during an in-depth study of the middle-class Muslim community, it was revealed that they were using the conventional system of financing and banking services just because there was no alternative available to fulfill their mortgage and banking needs. They were using that part of the conventional system against their will.

In the United States, those Muslims who acquired Islamic systems of banking and financing were the segment of the community who had already refused to participate in the conventional system of financing under any circumstances. Although many of them had a considerable amount of savings with them, it was not enough to purchase a house. They were all clear from any debt and they belonged to the professional segment of the Muslim community. This segment of the community can be represented as 2-5% of the whole Muslim community, equalling approximately a quarter of a million. This segment is religious and they want to live their lives exactly according to their faith and don't want to become part of any system which is not governed accordance to the ruling of Islam. They are extremely pious. It is the moral responsibility of the Islamic bankers to cater for the needs of this 'Puritan' segment of the community.

The term 'Puritan' is used here deliberately. It conveys the core principles of American democratic participatory freedom and virtue through industriousness and property ownership. In-depth calculation shows that, if we presume that 5-10% of the Muslim community doesn't want to be involved into the conventional banking and financial systems, then the number of houses which is needed in Islamic financing is estimated to be 7,500 to 15,000. To be on the safe side, let us estimate that the market size of around 10,000 houses represents the professional segment of the community. They demand an Islamic model validated by their respected and trusted religious scholar (usually back in Pakistan or other Muslim countries). The profile of this market segment is unique. They normally do all of their daily transactions in cash and use banks for safe depositing of their funds only and they are not ready to avail any money that is being offered them against their funds as interest.

They carry no debt. They have a very clean history of fulfilling their obligations on time. They are honorable and extremely successful and reputable. They are very particular about details of *Halal* and *Haram*. They are the best credit-worthy members of the community. They can only be recognized if those Islamic banks are true community workers on a grassroots level.³⁰

The prices of houses in the US, varies from state to state (as with every part of the world). For example, a medium-size house in California can be estimated at 250,000 dollars, whereas in Texas the price for the same house would be 150,000 dollars. If we assume that 60% of the value of the house is to be financed and the cost of the house is 200,000 dollars, it can be said the financed amount would be 120,000 dollars. A market of 10,000 houses represents a demand of about 120 million. As the Islamic financing and concepts gain credibility with a proven track record, then it can be expected that there will be a huge growth in this segment of the Muslim community.³¹

However, it is not only the Muslim community but also the non-Muslims who are looking for a new concept or want to change their financial transactions and concepts. Another important point is the growth rate in the Muslim community, which is expected to reach 15 million in the USA by the end of 2010; this is mainly due to the growth in the number of children born to the first generation Muslims. This new generation will assume better and more affluent positions in the USA. It is believed that the market potential for Islamic home mortgages could reach at least 3,000 million dollars.³²

The most popular companies in USA offering Islamic home financing to the Muslim and non-Muslim community are as follows:

³⁰ Rahman, Y.K. A. and A. S. Tug (1999). Towards a *lariba* (Islamic) Mortgage Financing in the United States. Providing an Alternative to Traditional Mortgages. International Journal of Islamic Financial Services Vol.1 (No. 2).

³¹ The American Muslim Community, retrieved date Nov. 10, 2010 from <http://www.lariba.com/knowledge-center/articles/us-islamic-financing.htm>

³² Rahman, Y.K. A. and A. S. Tug (1999). Towards a *lariba* (Islamic) Mortgage Financing in the United States. Providing an Alternative to Traditional Mortgages. International Journal of Islamic Financial Services Vol.1 (No. 2).

1. Al-Manzil Islamic Financial Services (“Al-Manzil”), a business unit of the United Bank of Kuwait PLC. New York, New York.
2. American Finance House LARIBA (“AFHL”), Pasadena, California.
3. MSI Financial Services Corporation (“MSI”), Houston, Texas.
4. Guidance Financial Group in Reston, Virginia.

2.14. CONCLUSION

Modern Islamic finance began in the early 1970s. Most large financial institutions are involved in Islamic finance as they supply financial tools in over 75 countries. There also exists a Dow Jones Islamic Market Index that tracks companies that operates in a manner compatible with Islamic law.

In this chapter, we covered information, discussion and the principals of financing traditionally compelled in various developed countries, especially the UK, USA and GCC and the types of financing which are not conventional. Some parts of the chapter covered information about the impact, awareness and progress of Islamic financing and how it differs from the conventional one. Furthermore, the discussion of the *Shari’ah*-complaint products made available by Islamic financing as compared to conventional financing products. The main and basic difference among Islamic and conventional financing is obviously that Islamic financing is *Sharia*-compliant and, according to Muslim’s faith, *Riba* is prohibited (*Haram*) and they cannot involve themselves in any kind of transactions that lead them towards *Riba*. Islamic finance refers to a system of finance or banking that is consistent with Islamic law (*Shariah*) principles. As a result, usury (the collection and payment of interest), in addition to any forms of speculation trading in financial risk, is prohibited because it is considered gambling, which is also forbidden.

The main emphasis is on Housing Finance and the market of developed countries and the types of mortgages that customers traditionally aware of, i.e. mainly fixed rate mortgage and variable mortgages.

The study also covers the norms and ethics of Islamic housing finance, with prohibition of *Riba* being central to Islamic financial ethics and law. There is also a discussion on the types of products that are being widely used internationally, namely *Murabaha*, *Ijara Musharakah* and *diminishing Musharakah*, including the principle and the comparisons between them.

As awareness is growing, there is rapid demand for Islamic banking and financial services. The developments of new regulations and standards for Islamic financial services over the years have helped in this rapid growth. It can be estimated through our rough analysis of the housing market in the US that those 10,000 households in the USA would not participate in conventional financing because they are not *Shari'ah*-complaint.

There are at least twice as many that would seek out an Islamic alternative if one were available at competitive costs. This translates into a huge demand for financing services for homes, automobiles, businesses, etc. We also can not dismiss the unknown number of non-Muslims who would choose to participate in an Islamic system based on the fairness of such a system.

In form rather than substance Islamic finance is familiar. Many of its instruments are the same as those used by other financial institutions leasing, advance purchase, etc. The difference lies in the first instance in the social impulse for sharing responsibility, risk, and property. Consequently, fixed-interest transactions in which risk is assigned entirely to the borrower are avoided. More important for participants, Islamic finance represents part of a divinely sanctioned economic gestalt into which they fit.

In summary, to deliver Islamic financial services to a large number of clients the positive approach is through the establishment of a separate section in order to offer Islamic services within the traditional banks. This will facilitate access to Muslims as well as grant the regulators the desired access to

ensure the system is sound. There are already precedents for the delivery of nonbanking products by banks, which can be used for allowing Islamic banking. It should be made clear that such products are alternatives to the existing system and complement each in order to reach a significant underserved segment of population.

Chapter 3: KUWAIT HOUSING MARKET

3.1. INTRODUCTION

In this chapter, the Kuwait housing market is discussed first, so as to give a background study on the state of the housing market in Kuwait. This is followed by a discussion on the financial system of Kuwait, which will further discuss the conventional housing finance in Kuwait and Islamic housing finance in Kuwait.

Kuwait is an oil-rich country. It is located at the top of the Gulf border with large or powerful neighbors like Saudi Arabia to the south, Iraq to the north and Iran to the east. Its oil fields were first browbeaten in 1930s, and since the development of the petroleum industry and other sectors after World War II and independence in 1961. Oil has focused the economy, making up around 90% of export revenues.³³

Kuwait's 83.5% literacy rate, amongst the highest in the Arab world, is the result of wide-ranging government support for the education system. Public school education, including Kuwait University, is free for the nationals of Kuwait, but access is controlled for foreign inhabitants. The government supports the foreign study for the best qualified students for higher studies and degrees.³⁴

With the help of oil and investment revenues, the Kuwait government sponsors many social welfare and public works, for the development of state of Kuwait. Moreover for the development and benefits to the Kuwaiti citizens there are retirement incomes, marriage bonuses, housing loans, virtually guaranteed employment, free medical services, and education, all provided by

³³ http://news.bbc.co.uk/1/hi/world/middle_east/country_profiles/791053.stm Retrieved 10 April 2007

³⁴ <http://www.infoplease.com/country/profiles/kuwait.html> Retrieved 10 April 2007.

the AMIRI decree. Foreign nationals residing in Kuwait do not have access to these welfare services. The government had made it easy for the citizens of Kuwait to obtain housing loans by different means of the financial system. The right to own stock in publicly-traded companies, real estate, and banks or a majority interest in a business is limited to Kuwaiti citizens, and citizens of Gulf Cooperation Council (GCC) states under limited circumstances.³⁵

The trade and industrial environment was distorted in the GCC financial system dramatically in 2008. At the beginning of the year, financial markets were healthy with high self-reliance. High oil prices, vigorous economic growth, record budget and trade surpluses, and a financially sound banking sector had mainly protected the region from the economic confusion originating from the west. Since the development, on the other hand, a sharp decline in the worldwide economy started to infuse the calm state of the Gulf's economies. Considerably tighter credit circumstances, oil prices that are at present near a third of their summer peak, failing equity markets and falling real estate values are all taking their toll on the region's economy.

At the very beginning of the year, the main concern of the GCC and Kuwait was an increasing rate of inflation. Averaging low single digits for all six countries as late as 2004, inflation by year end 2007 had risen to double digit rates in all but one nation (Bahrain). Kuwait's rate of inflation during the year was at 9.5% (year/year) and then increased to 11.3% by mid-year before leveling off.

In reaction to these inflationary pressures, all central banks in the region began taking important measures early in the year to cut the growth rates of domestic credit. Given that rapid credit growth was made possible by the inflow of liquidity from foreign investors and currency speculators, central banks moved to discourage such inflows by making it less rewarding to hold local currencies. This involved a grouping of declare the currency pegs to the US Dollar and cutting benchmark interest rates on deposits, built but for loans.

³⁵ <http://www.infoplease.com/country/profiles/kuwait.htm>. Retrieved on 10 April 2006.

At the same time, they used quantitative boundaries to limit credit growth. In Kuwait, for example, the Central Bank frequently cut its benchmark repurchase rate to bring down interest rates in the interbank market below similar dollar rates in an effort to chase away liquidity from the system. It also moved up the risk weightings on loans for real estate and securities trading used in the regulatory capital requirements, constricting its definition of the loan-to-deposit ratio ceiling, and imposed quantitative controls on the growth in total credit. Other GCC central banks adopted similar measures as well as raising reserve requirements.³⁶

3.2. POPULATION AND LABOUR FORCE

More than 90% of the inhabitants of Kuwait live inside a 500-square kilometer area nearby Kuwait City and its harbor. Even though the majority of people residing in the State of Kuwait are of Arab derivation, less than half are originally from the Arabian region. The innovation of oil in 1938 drew many Arabs from nearby states. Subsequent to the liberation of Kuwait from Iraqi occupation in 1991, the Kuwaiti Government undertook an effective effort to minimize the expatriate population by preventing the entry of workers from nations whose leaders had supported Iraq during the Gulf War. Kuwait later discarded this strategy and at present has a sizable foreign labor force (about 68% of the total population is non-Kuwaiti).

Of the total Kuwaiti population of 3.1 million, about 80% are Muslims, which also include nearly all of its 1.023 million citizens. While the national census does not differentiate among Sunni and *Shi'a* believers, about 70-75% of citizens, including the ruling family, belong to the Sunni branch of Islam. The outstanding Kuwaiti citizens, with the exception of about 100-200 Christians and a small number of Baha'is, are *Shi'a*. The number of immigrant Christian population is predicted to be more than 400,000 residents. There are also communities of Hindus, Buddhists, and Sikhs.

Kuwait's 83.5% literacy rate, one of the Arab world's highest rates, is the result of widespread government assistance for the education organization.

³⁶ Population and Labour Force, NBK Annual Report 2008.

Civic school education, as well as Kuwait University, is at no cost, but admission is limited for overseas inhabitants. The government supports the foreign education of capable students overseas for qualifications not accessible at Kuwait University. In 2004, about 1,720 Kuwaitis were registered in US universities, down 6.8% from the earlier year.³⁷

The Kuwaiti population decreased by 6.5% per year through 1990-95, due in part to the Iraqi attack and Gulf War of 1990-91. The inhabitants of Kuwait in 2003 was predicted by the United Nations at 2,521,000, which placed it at number 137 in population among the 193 nations of the world. This number comprises more than one million non-nationals who live and work in the country. In that period of time, about 1% of the inhabitants were over 65 years of age, with another 26% of the inhabitants under 15 years of age. There were 151 males for every 100 females in the country in 2003. According to the UN, the yearly population growth rate for 2000–2005 was 3.46%, with the predictable population for the year 2015 at 3,352,000. The population mass in 2002 was 127 per sq km (330 per sq mi). The huge mass of the population exists along the shoreline.

It was predicted by the Population Reference Bureau that 98% of the population exist in city areas in 2001. The capital, Kuwait City, had a population of around 165,000 in that year. According to the United Nations, the urban population growth rate for 2000–2005 was 2.3%.³⁸

According to the most recent demographics and workforce statistics issued by the Public Authority of Civil Information (PACI), Kuwait's total population scored 3.442 million by the end of 2008, which is 1.2% more than the figure registered by the end of 2007. The population attained a positive growth by 6.8%, 6.4%, 8.6%, and 8.1% in 2007, 2006, 2005, and 2004 respectively. The absolute increase in 2008 stood at 42.2 thousand. The Kuwaiti numbers increased by 33 thousand (3.1%) to become 1.088 million. The Kuwaiti percentage of the total population also increased from 31% by the end of last

³⁷ <http://www.infoplease.com/country/profiles/kuwait.html>

³⁸ <http://www.nationsencyclopedia.com/Asia-and-Oceania/Kuwait-POPULATION.html>

year to 31.6%. Females (555 thousand) outnumber males (532.6 thousand). On the other hand, the number of non-Kuwaitis increased by 9.2 thousand (0.4%) and their total stood at 2.354 million. This increase is the lowest annual growth rate in the current century. The growth rate of non-Kuwaitis during 2001-2007 stood between 11.2% and 4.6%. The current total population is the highest, up from 2.125 million in mid-1990.³⁹

The total number of workers in Kuwait scored about 2.88 million (60.7% of the total population). This percentage was 30.9% of the total Kuwaitis. It is to be noted that the percentage of the non-Kuwaiti workers scored about 74.4%. The Kuwaiti workforce in the total Kuwaiti workforce rose from 15.5% in 2007 to 16.1% in 2008. The female workforce from the total Kuwaiti workforce increased to 44.6% by the end of 2008, up from 43.7% by the end of 2007. Females to total workforce in Kuwait represent about 25.1%. The number of Kuwaiti laborers increased by 12 thousand in 2008 and thus became 336.3 thousand. A total of 262.7 thousand of them work for the government (78.1%), up from 255.3 thousand by the end of 2007. A total of 7858 jobs were secured for Kuwaitis outside the public sector, a growth rate of 16%.⁴⁰

Kuwait has a little, comparatively open economy as a result of the oil industry and government sector. Just about 90% of the Kuwaiti citizen labor force works in the public sector, and 90% of private sector workers are non-Kuwaitis. Kuwait's proven crude oil reserves of about 100 billion barrels — 9% of world reserves — account for nearly 45% of GDP, 95% of export revenues, and 90%-95% of government income. Kuwait puts 10% of its annual oil revenue in a Fund for Future Generations in preparation for the transition to the period after its oil resources are depleted. Kuwait's economy has benefited from high oil prices in recent years, as well the economic activity generated following Operation Iraqi Freedom (Kuwait is a major logistical and transit hub for alliance operations in Iraq). Non-oil sectors such as banking, financial services, logistics, telecommunications, and construction have enjoyed strong growth in the past three to four years. The global financial

³⁹ The public Authority of civil information (PACI).

⁴⁰ Alshall .Consulting, Vol 19 Issue 10 Date 15/ 03/ 09.

crisis affected Kuwait in late 2008, with the Kuwait Stock Exchange — the region's second-largest — losing almost 40% of its market capitalization during 2008. High oil prices in recent years have resulted in a large additional budget in 2005-2008.

3.3. THE HOUSING MARKET IN KUWAIT

For centuries, housing in Kuwait comprised small cottages, mud huts, and a very few larger dwellings built of coral and plastered with cement and limestone. Better housing and living style for the general population has been a main government intention. The National Housing Authority built about 50,000 residential houses in 1977–85. Between 1989 and 1994, about 25,213 applications were presented for the housing distribution program. According to the 1995 census, there were 255,477 households in Kuwait. The total number of dwellings that year was 251,682, of which 234,153 were private and 17,529 were shared dwellings. Including vacant dwellings and those under construction, the total number was 287,574 in 1995. About 50% of all housing units were apartments, 19% villas, 15% traditional dwellings, 10% annexes, and 4% were shacks, i.e. mud house and other unimportant dwellings. In 2000/2001 there were 8,875 government housing projects and 3,118 new dwellings constructed.⁴¹

Kuwait has a small, comparatively open economy subjugated by the oil industry and government sector. Approximately 90% of the Kuwaiti citizen labor force works in the public sector, and 90% of private sector workers are non-Kuwaitis. Kuwait's established crude oil reserves consist of about 101.5 billion barrels - 9% of world reserves account for nearly 60% of GDP, 95% of export revenues, and 80-90% of government income. During the 1970s, Kuwait benefited from the rise in oil prices, which Kuwait actively promoted through its membership in the Organization of Petroleum Exporting Countries. The economy survived from the triple shock of the 1982 securities market crash, the mid-1980s drop in oil prices, and the 1990 Iraqi invasion and

⁴¹ <http://www.nationsencyclopedia.com/Asia-and-Oceania/Kuwait-HOUSING.html> Retrieved on 17 May 2007.

occupation. The Kuwaiti Government-in-exile depended upon its \$100 billion in overseas investments during the Iraqi occupation to help pay for the rebuilding. Thus, by 1993, this balance was cut to less than half of its pre-invasion level. The wealth of Kuwait is based primarily on oil and capital reserves, and the Iraqi occupation severely damaged both, although both have been restored as reconstruction has continued and world oil prices have risen. Kuwait enjoyed an economic boom following Operation Iraqi Freedom, as many companies working in Iraq established offices in Kuwait and procured goods through Kuwaiti companies. The banking, financial services, logistics, telecommunications, and construction sectors, in particular, have grown in the last two years. The continuing high oil prices also provided the Kuwaiti Government with windfall revenues in 2005 and 2006.

In the closing hours of the Gulf War in February 1991, the Iraqi occupation forces set ablaze or damaged 749 of Kuwait's oil wells. Kuwait spent more than \$5 billion to repair oil infrastructure damage. Oil production was 1.5 million barrels per day (bpd) by the end of 1992, and pre-war capacity was restored in 1993. Kuwait's current production capacity is estimated to be 2.5 million bpd. Kuwait plans to increase its capacity to 3.5 million bpd by 2015 and 4.0 million bpd by 2020.⁴²

3.3.1. *Kuwait Laws for Property owning*

With relevance to the economic growth, the housing market in Kuwait is flourishing, though property title in Kuwait is restricted to nationals only. This principle is obviously adopted and known to all for the limited area of Kuwait and fears of ownership transfer to Non-Kuwaitis. Article (5) of the law decree No. 5 of 1959 in relation to the real estate registration provides that property ownership in Kuwait is restricted to Kuwaitis. However, ownership deeds may be granted by the government to whom it may be considered by the government to bear such title of other Arabic nationals in such conditions and equal dealing terms imposed by the government.

⁴² <http://www.infoplease.com/country/profiles/kuwait.html>

The law decree No. 74 of 1979 as amended by law No. 119 of 1986 in Article (1). It provides that the property ownership is restricted to Kuwaitis only including the general title, private ownership and the usufruct. The Uniform Economical Agreement among the members of GCC, as approved by their governments in line with the by-rules of GCC, was made for close cooperation, strong links and the desire to develop, promote and sustain the mutual economical relations on a firm basis for the best of their peoples as well as for coordination and integration of the economical, financial and monetary policies, commercial and customs regulations prevailing as well.

Paragraph (2) of Article (8) related to the property ownership of the Agreement, which was approved in Kuwait by the law No. 58 of 1982 for consent of the Uniform Economical.

Agreement of GCC includes the following provisions:

1. GCC natural nationals shall be authorized to own one property, whether land or building, at the regular residential areas in any member state by means of any inter-individuals dealing way or through will, provided that the land area shall not exceed 3,000 Mtr².
2. Ownership shall be intended for residing of the owner or his family, and he has no right to exploit the property for other purpose unless otherwise the country acts so permit.
3. In the event that the property is a piece of land, the owner shall commence building within 3 years from the date of registration in his name. The construction shall be completed within 5 years of such date, otherwise the concerned state may possess and sell the property to his account and compensate the owner for the same rate of property at purchase or the price at sale time, whichever is the lesser.
4. The owner of the property has no right to make any action for title transfer until 8 years after registration in his name have passed. In

the maximum necessity, the owner may be accepted to act before the elapse of such period provided that he has obtained permission in advance from the competent authorities.

5. If the cause of ownership is by means of inheritance, the owner shall be dealt with as a citizen of the country wherein the property is based.
6. If the person who desires to own under this regulation has been made a citizen to either member in the GCC by naturalization, ten years after his naturalization should have passed as a condition.
7. The regulation permits the natural or corporate nationals of GCC to lease and use the lands at any member state for the economical projects wherein they are authorized to practice with the right of free action to in this concern to sell and mortgage under the laws of country.⁴³

The news from the Kuwaiti property sector is already strong and the recent economic and developmental updates all point to a sustained and long-lasting growth.

There are five property sectors in Kuwait as listed below, referring to different types of land for sale allotted by the government.

1. Residential, private housing (villas)
2. Investments (apartments and residential complex)
3. Commercial (malls, shopping complex and shops)
4. Storage (store and warehouse)
5. Industrial (factories)

Residential properties are normally villas, and represent over 70%⁴⁴ of real estate transactions in Kuwait. They are defined as private residences, single family per plot. All residential homes are single family properties. However, it has been noticed lately the survival of private multi-family house leasing

⁴³ Ministry of Justice Legislation & Law Department, Housing Registration Department, April 2007.

⁴⁴ Ministry of Justice Legislation & Law Department, Statistics Department, April 2007.

market with house prices being prohibitively expensive for a single family to afford in a sensible location.

Investment properties are one type of income-producing real estate, specifically the residential, income-producing properties such as residential apartment buildings which comprise flat types 1BHK, 2BHK, and 3BHK.⁴⁵ They consist of about 20-25% of the real estate transactions in the state of Kuwait.⁴⁶

Commercial properties are observed as two types: one is the typical commercial property utilized for pure commercial use, such as office buildings, shopping centers and big malls, while the other is known as the multifunctional commercial property, which permits the owner to lease space for commercial purposes on a previous apartment building. Commercial properties represent 5% of the real estate transactions. Multifunctional commercial properties are also called “investment buildings with commercial fronts”.

Storage properties are composed of two types:

- (i) Properties with a name deed.
- (ii) Properties borrowed from the government.

Again, the second type allows the owner to sell the right to utilize. Historically, the storage sector transactions were minimal. Recently, the storage market has had a major increase in activity. The reason being is with “Iraq’s operation freedom” and the increase in military presence in Kuwait. Storage space has become a vital requirement since Kuwait became the strategic gateway for investments and transport into Iraq, hence the booming local business environment, especially storage and logistics industries.

⁴⁵ BHK: Bedroom, Living hall, and Kitchen.

⁴⁶ Ministry of Justice Legislation & Law Department, Statistics Department, April 2007.

3.3.2. HOUSING SALES

The private sector includes houses which are being purchased and sold by Kuwaiti nationals for their means of living. There is nothing to concern investors who purchase houses for their business purposes. In this section we have collected data from different sources to compare the growth and decline in the Kuwait housing market with respect to Sales and Purchase. In the data we considered both kinds of houses comprising old houses, which are being sold by their owners, as well as the new houses in developing areas provided by the government itself.

The targeted data is from the year 1997 to 2008 and shows the complete and exact number of houses from Capital government and the corresponding five governances of Kuwait.

3.3.2a. HOUSING SALES UNITS FOR ALL KUWAIT (PRIVATE SECTOR)

Kuwait is not a big country. In fact, it is one of the world's smallest countries, occupying 17,818 sq km (6880 sq mi). The greatest distance from north to south is 200 km (120 mi) and from east to west 170 km (110 mi).

In 1997, Kuwait had an estimated population of 1,834,269. The average population density was 103 persons per sq km (267 per sq mi). Most of the population is concentrated in cities near or along the Gulf coast. Slightly fewer than 40 per cent of the people are native Kuwaitis and the rest are foreigners.⁴⁷

⁴⁷ Kuwait location Retrieved on 09 November 2010 from <http://e.gov.kw/sites/kgoarabic/portal/Pages/Visitors/FrequentlyAskedQuestions.aspx#Q2>

Table 3.1 below shows the distribution of 40% of natives living in different capital government areas and rest of the five governances.

Table 3.1: Overview the Total Number of Home Sale Units for All Kuwait during 1997-2008

Years	CAPITAL	HAWALLY	FARWANIYA	MUBARAK AI KABEER	AHMADI	JAHRA	TOTAL
1997	784	2266	3426	0	1215	705	8396
1998	821	1633	3613	0	1159	625	7851
1999	572	936	2325	0	750	177	4760
2000	519	1146	2175	0	786	162	4788
2001	757	1690	1205	569	555	183	4959
2002	932	1829	1539	663	1021	185	6169
2003	798	1509	1447	949	1233	145	6081
2004	690	1266	1945	827	1048	176	5952
2005	645	1221	1942	827	1048	171	5854
2006	705	1396	1045	1266	1719	149	6280
2007	715	1269	1838	1393	2426	168	7809
2008	369	658	768	458	2136	188	4577
<i>Total number of home sales units for all Kuwait during 1997-2008•</i>							73476

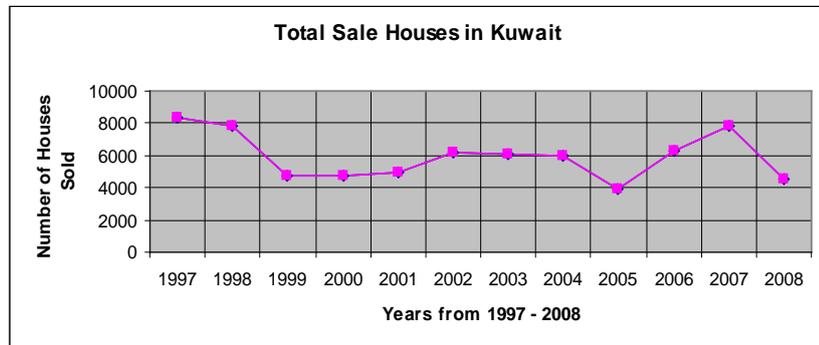
Source: Real Estate Registration and Authentication Department (1997 – 2008)

Figure 3.1 below shows the extract from Table 3.1, showing only the houses sold during 1997–2008 in Kuwait. In each row is shown the total number of houses sold within the corresponding year. For example, in 1997 a total of 8,396 houses were sold in Kuwait.

The line chart trend is showing upward and a downward trend of houses sold during 1997-2008. When we look carefully, it reveals that the number of houses sold in 1997 was 8,396 and in coming years the numbers of houses sold kept declining till the end of 1999. Then again in 2001, it started to grow, according to our trend, and kept increasing till the end of 2007. A big decline can be seen 2008 as a result of the Global crisis.

Figure 3.1: Sale of Houses in Kuwait during 1997-2008

Years	TOTAL
1997	8396
1998	7851
1999	4760
2000	4788
2001	4959
2002	6169
2003	6081
2004	5952
2005	3913
2006	6280
2007	7809
2008	4577



Source: Real Estate Registration and Authentication Department (1997–2008)

Figures 3.1, 3.1a, 3.1b, 3.1c, 3.1d, 3.1e and 3.1f below show the transactions made of sold houses in governances separately. In above chart the houses sold during 1997 – 2008 are presented only. Each bar in the chart denotes a separate year of sale starting from 1997 and ending with the year 2008.

Figure 3.1a: Home Sales Units in Capital Government during (1997–2008)

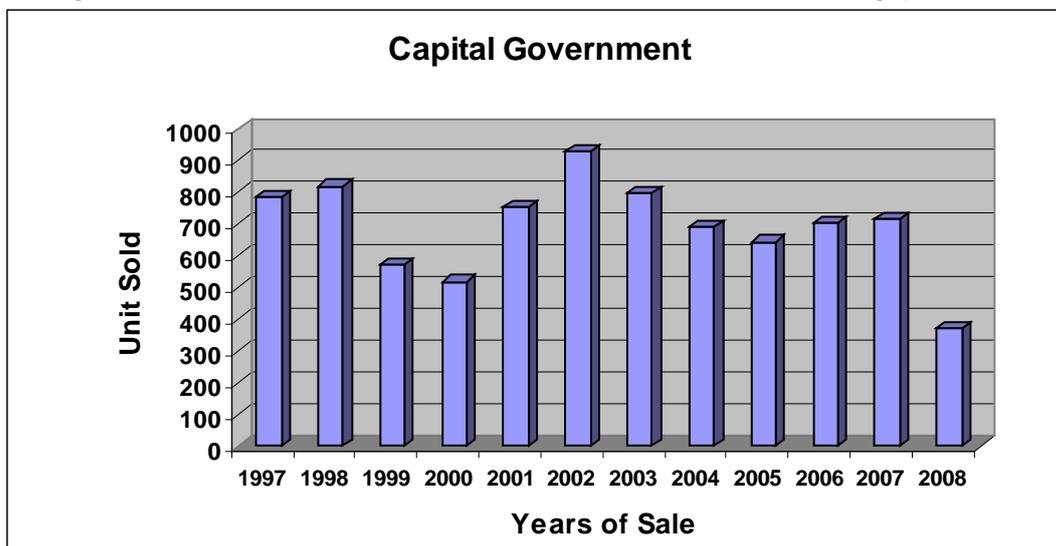


Figure 3.1b: Home Sales Units in *Hawally* Governance during (1997–2008)

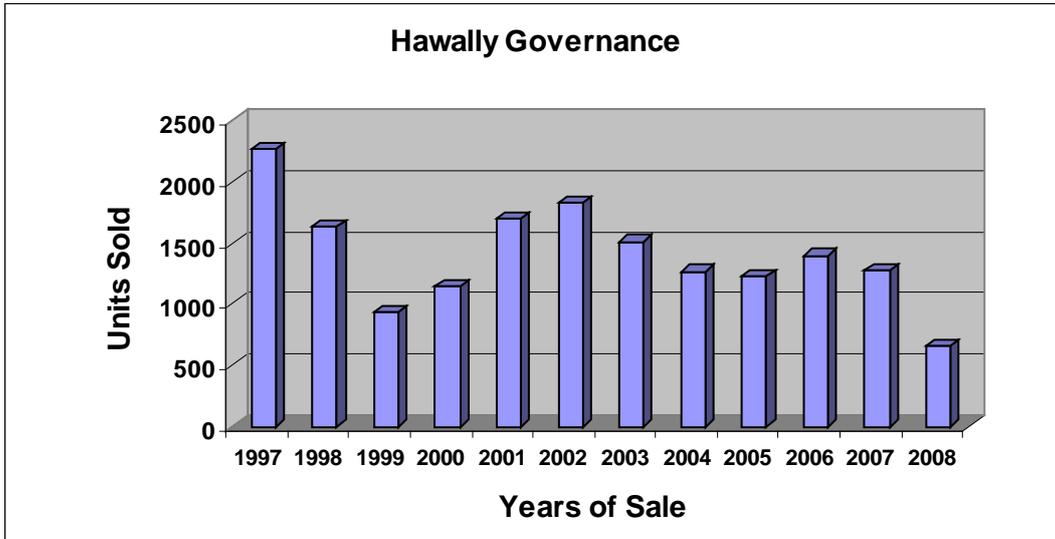


Figure 3.1c: Home Sales Units in *Farwaniya* Governance During (1997–2008)

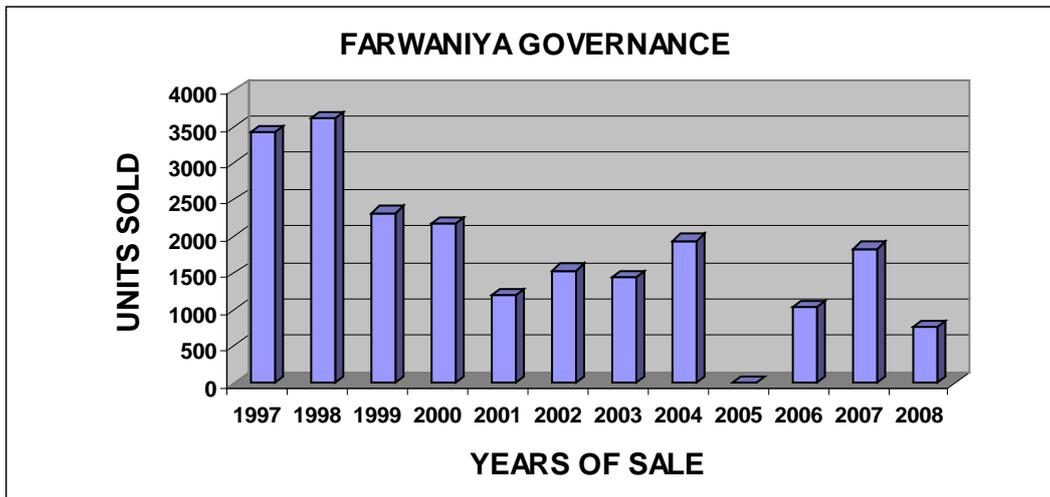


Figure 3.1d: Home Sales Units in *Mubark Al- Kabeer* Governance during (1997–2008)

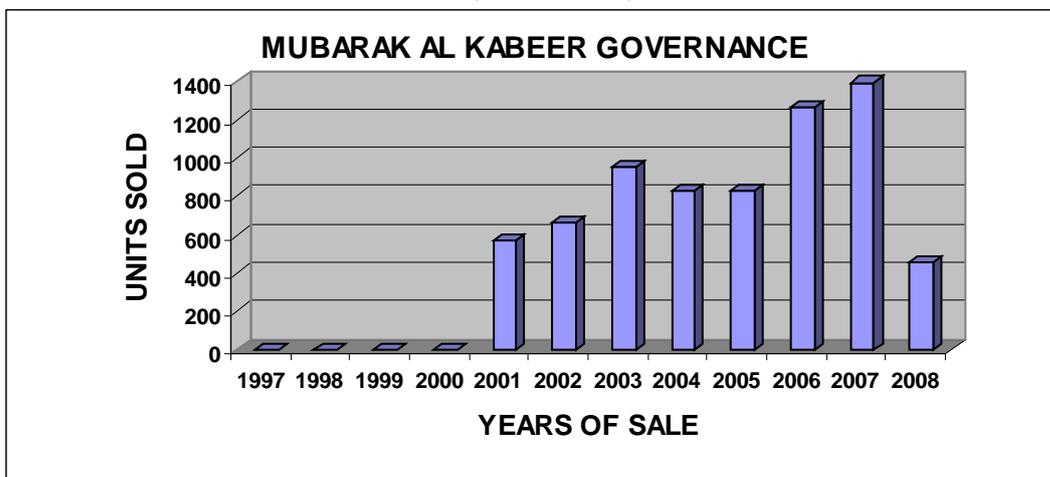


Figure 3.1e: Home Sales Units in *Ahmadi* Governance during (1997–2008)

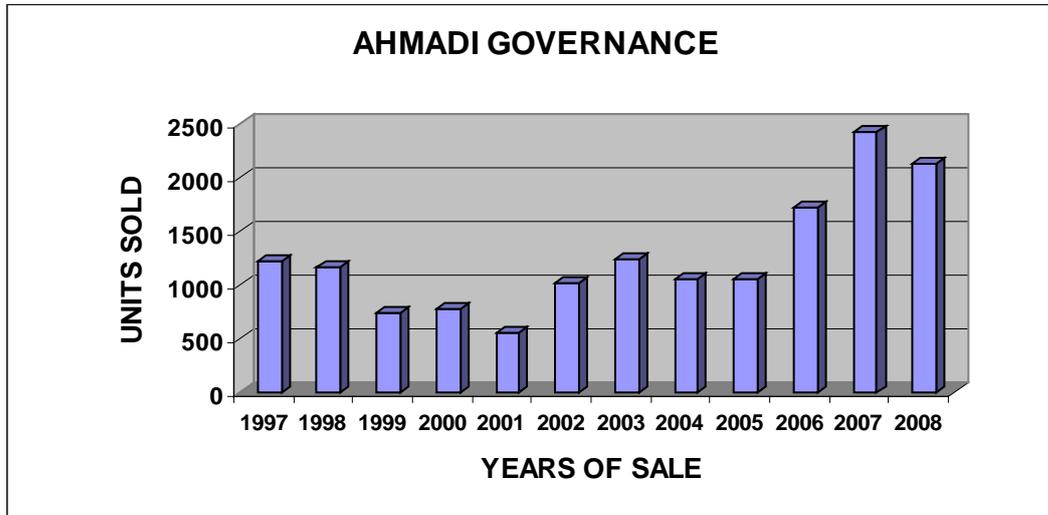


Figure 3.1f: Home Sales Units in *Jahra* Governance During (1997–2008)

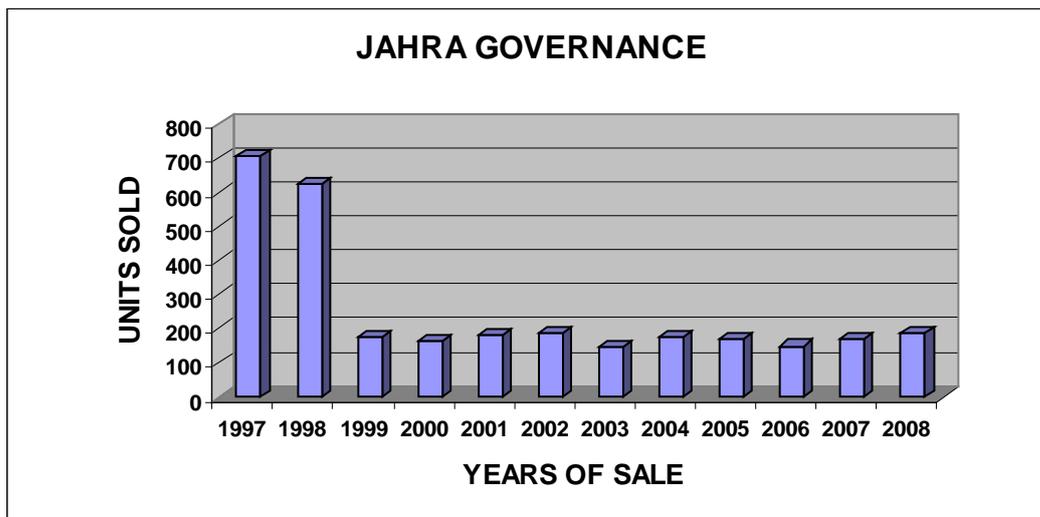


Table 3.1 and the figures above contain information about houses purchased during 1997-2008. The figures were obtained from Real Estate Registration and Authentication Department governed by Ministry of Justice. However, the data had been taken for 1997–2008. We described in the table the purchases for all the years separately according to the areas we denoted as Capital government and five sub-governances, i.e. Capital, *Hawaly*, *Farwanya*, *Mubarak Al Kabeer*, *Ahmadi* and *Jahra* respectively. Until the end of the year 2000, Mubarak Al Kabeer government was not present as it had only been announced by the Capital government and came into operation in 2001. So,

before 2001 the houses belonging to this area were part of *Hawally* and Ahmadi governance.

3.3.2b. PRICE OF HOUSES (KD)

Table 3.1a below shows the prices of houses been sold in each governance and in the capital government. The first column shows the years from 1997-2008, the second column shows the capital government, while next five columns represent all five governances. In the last column, a total is made showing each year's entire sale price. Therefore, in the 'Total' column, each year's sale price for the entire state of Kuwait can be seen.

Table 3.1a: Overview about the Total Price (In Million KD) Of Houses Sold In Kuwait from (1997-2008)

Yrs	CAPITAL	HAWALLY	FARWANIYA	MUBARAK AL KABEER	AHMADI	JAHRA	TOTAL	Avg
1997	110.565	257.984	235.871	0	73.710	58.968	737.097	122.8497
1998	137.928	202.836	283.970	0	121.702	64.907	811.343	135.2238
1999	85.615	102.738	279.676	0	85.615	17.123	570.767	95.12783
2000	98.237	125.525	234.678	0	70.949	16.373	545.762	90.96033
2001	120.622	186.964	156.809	54.280	66.342	18.093	603.111	100.5183
2002	146.915	231.971	201.042	54.127	115.986	23.197	773.237	128.873
2003	154.794	299.913	270.889	77.397	145.119	19.349	967.462	161.2435
2004	154.678	261.019	319.023	77.339	135.343	19.335	966.736	161.1228
2005	161.752	272.957	313.395	70.767	171.862	20,219	1,010.952	3534.956
2006	162.506	357.512	238.341	119.171	184.173	21,667	1,083.370	3788.117
2007	231.538	509.383	339.589	169.794	262.409	30.872	1,543.584	257.2642
2008	134.742	296.431	197.621	98.811	152.707	17.966	898.278	149.713

Source: Real estate registration and authentication Department (1997–2008)

The six charts below show the prices of houses for Capital government and the five governances individually. They all show figures from 1997-2008.

Figure 3.2a: Total Price for *Capital* Government during (1997– 2008)

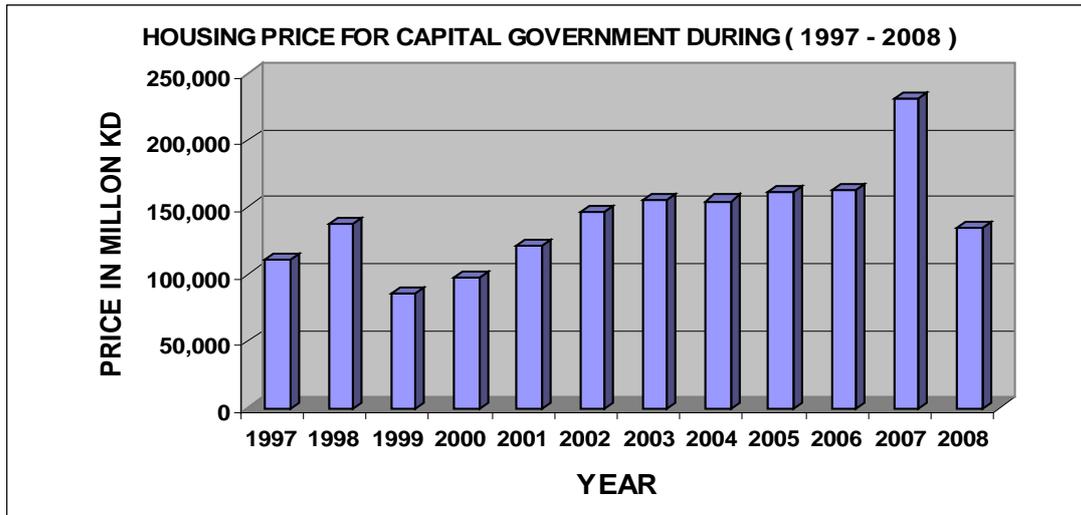


Figure 3.2b: Total Price for *Hawally* Governance during (1997 – 2008)

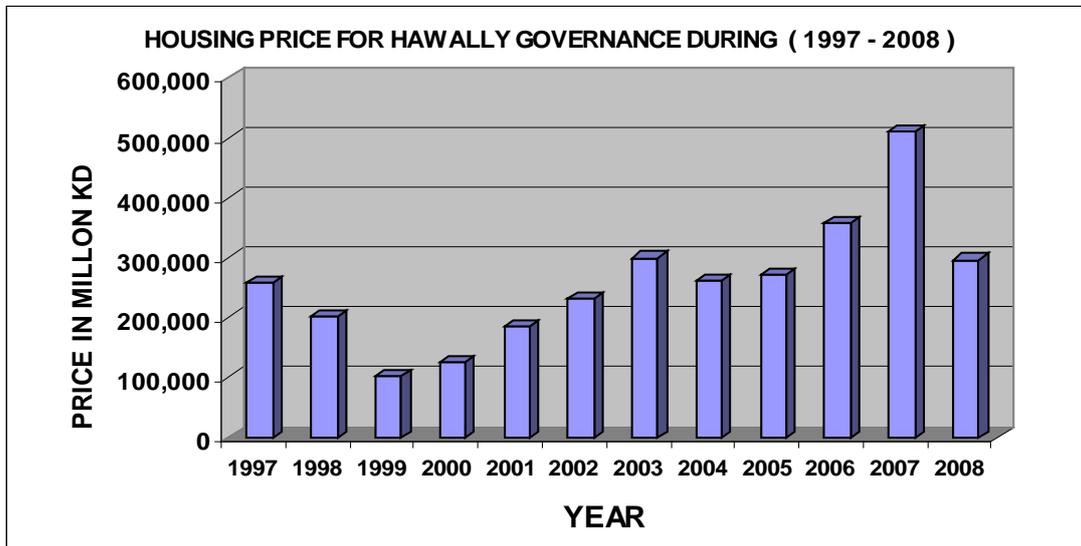


Figure 3.2c: Total Price for *Farwanya* Governance during (1997 – 2008)

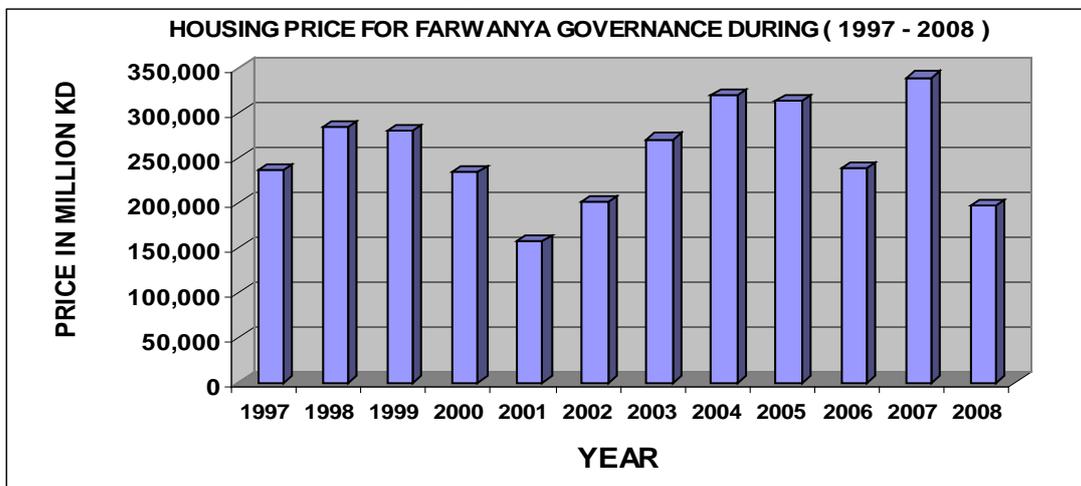


Figure 3.2d: Total Price for *Mubarak Al- Kabeer* Governance during (1997 – 2008)

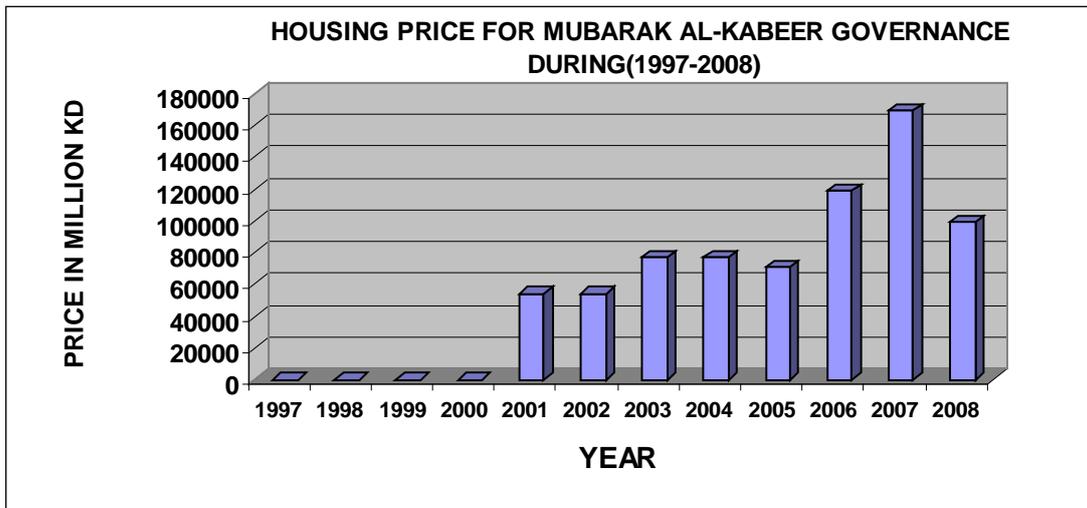


Figure 3.2e: Total Price for *Ahmadi* Governance during (1997 – 2008)

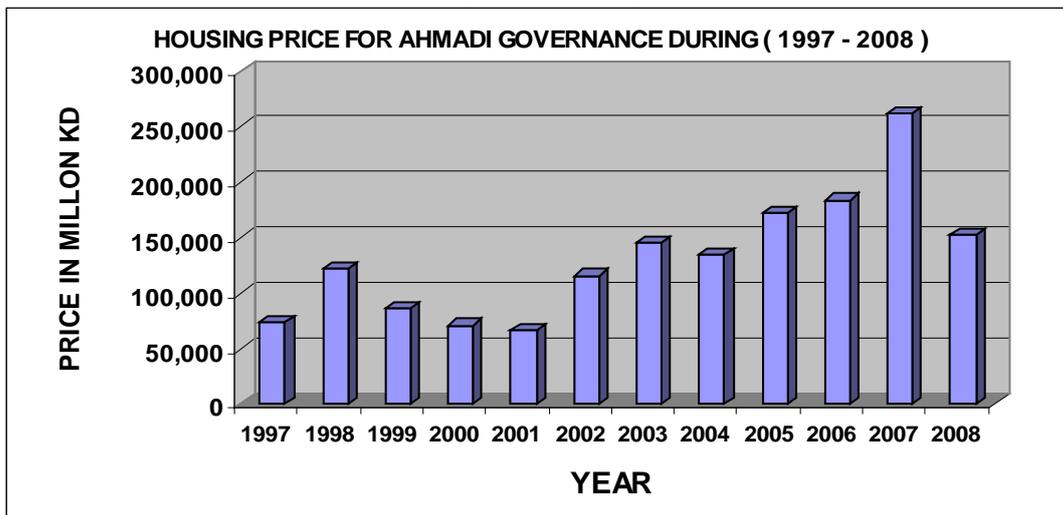
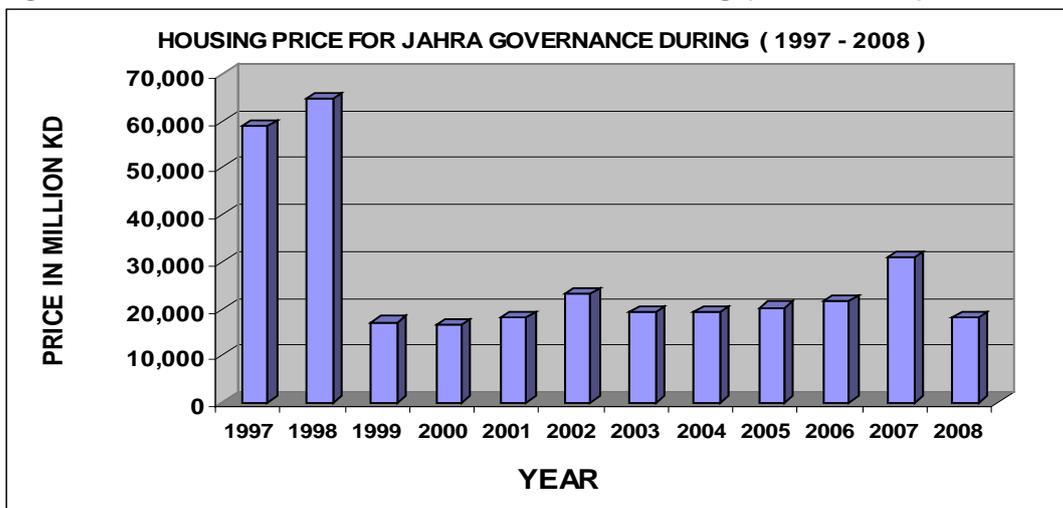


Figure 3.2f: Total Price for *Jahra* Governance during (1997 – 2008)



As has been observed, both Tables 3.1 and 3.1a are dependent and co-related with each other, as 3.1 shows the number of houses sold in the region while table 3.1a represents their prices as a whole and individually according to the governances.

Prices in the area of Capital government are always high. Only a small amount of houses are sold and purchased in this area. The availability of houses being sold in this area are very old houses. So, once anyone purchases a house in this area, they have to demolish the house and re-build it. Therefore, the cost of the new house has to be added into the price. In this way, this area becomes the most expensive in the region.

The second expensive area is the *Hawally* governance, where prices are stable and, when compared to the rest of the governances, is a very expensive area.

In Kuwait, those areas with average prices can be considered as *Farwaniya* and *Mubarak Al-Kabeer* governances. But if we look back on the prices and growth, it can be seen that *Mubarak Al-Kabeer* governance is becoming more expensive when compared to other governances. The inexpensive governances can be defined as *Ahmedi* and *Jahra*.

3.3.2c. Housing Average Price

Table 3.1b below gives a clear idea of the average housing price transactions being made in governances separately. The addressed year in table is from 1997 to 2008 only. Each column in the table denotes a separate governance of average housing price according to the booklet of registered properties in the ministry of justice (“Real Estate Registration and Authentication Department”) starting from 1997 and ending with the year 2008.

From table 3.1b we can see that the total average housing price is always continuously increasing for capital government and rest of the governances during 1997–2008.

Table 3.1b: Overview about the Average Price for House Sold (in Kuwaiti Dinnar) For All Kuwait areas during (1997 -2008)

Yrs	CAPITAL	HAWALLY	FARWANIYA	MUBARAK AL KABEER	AHMADI	JAHRA	TOTAL	Avg
1997	141,027	113,850	68,847	0	60,667	83,643	468,034	78005.67
1998	168,000	124,211	78,597	0	105,006	103,851	579,665	96610.83
1999	149,677	109,763	120,291	0	114,153	96,740	590,624	98437.33
2000	189,281	109,533	107,898	0	90,266	101,068	598,046	99674.33
2001	159,342	110,630	130,132	95,395	119,535	98,869	713,903	118983.8
2002	157,634	126,829	130,632	81,640	113,600	125,389	735,724	122620.7
2003	193,977	198,750	187,207	81,556	117,696	113,441	892,627	148771.2
2004	224,171	206,176	164,022	93,518	129,144	109,858	926,889	154481.5
2005	250,778	223,552	300,763	85,571	163,990	118,240	1,142,894	190482.3
2006	230,505	256,097	228,078	94,132	107,140	145,416	1,061,368	176894.7
2007	323,829	401,405	184,760	121,891	108,165	183,762	1,323,812	220635.3
2008	365,154	450,503	257,319	215,745	71,492	95,564	1,455,777	242629.5

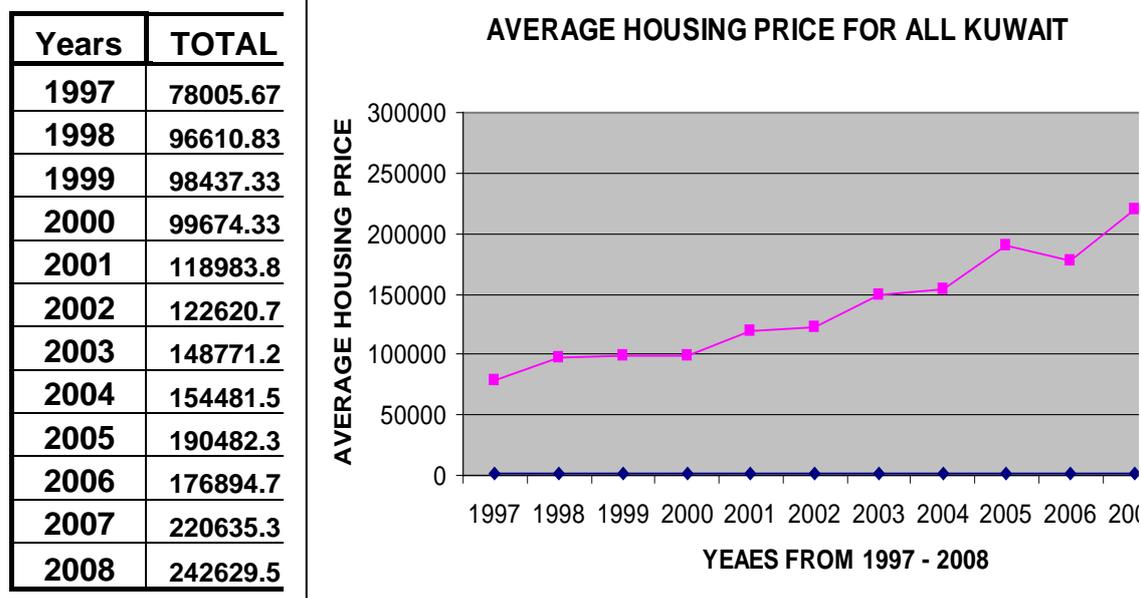
Source: Real Estate Registration and Authentication Department (1997–2008)

Figure 3.3 shows the average housing market price for the whole of Kuwait during 1997–2008. From Table 3.1b we extracted the ‘Years’ and ‘Total’ columns for the information and figures and made a Figure 3.3 showing the trend chart increasing the average prices during 1997–2008.

From figure 3.3, the total average price for the years 1997-2008 (12 years) is approximately 0.875 Million/year.

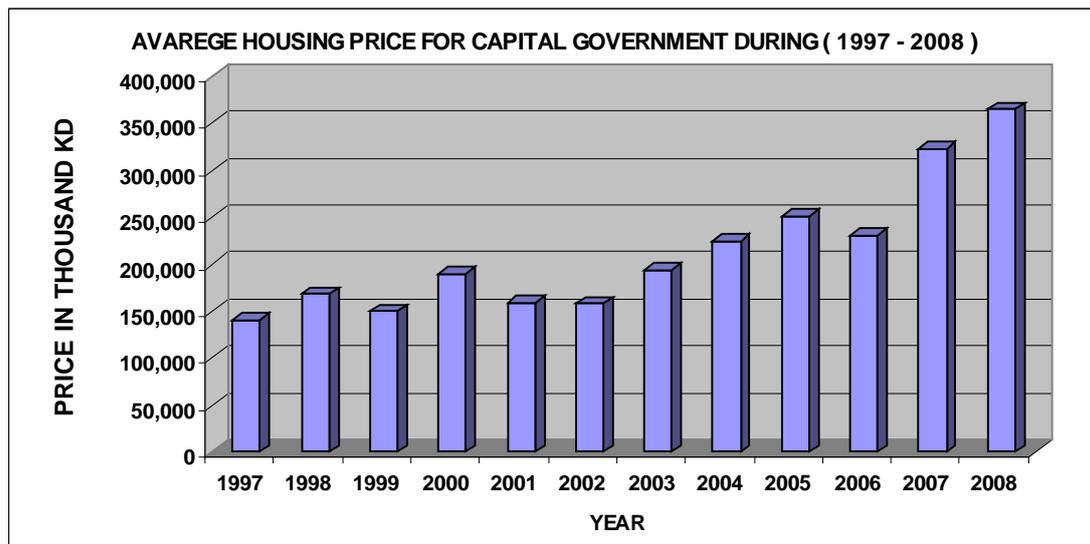
The area and place which is geographically located near the commercial area, such as within the capital government, *hawally* governance, and *farwanyia* governance, the average housing market price is higher than the other governances. However, the column for *Mubarak al-kabeer*, which is new governance, the sales and purchasing growth of price can be seen when compared with other governances.

Figure 3.3: Overview about the Total Average Housing Price in Kuwait during 1997-2008



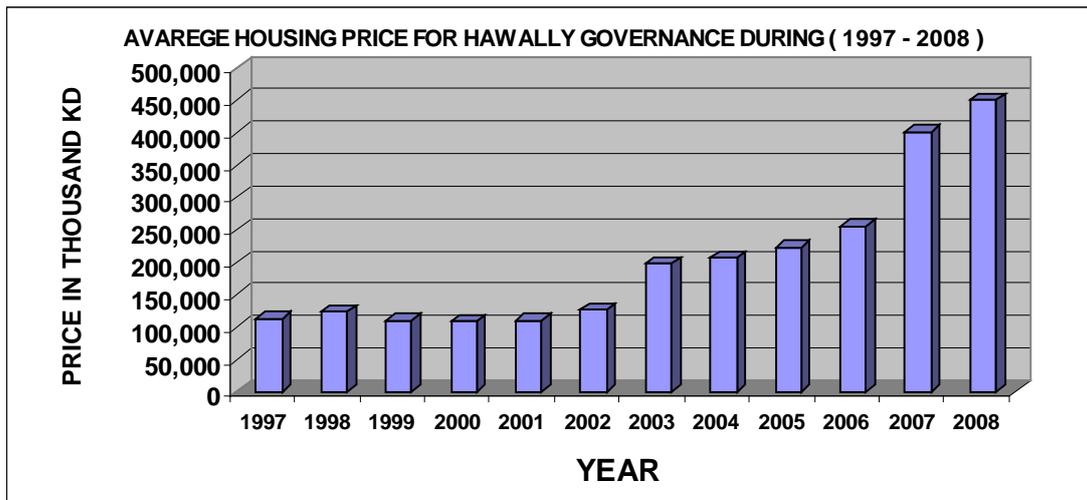
Figures 3.3a, 3.3b, 3.3c, 3.3d, 3.3e, 3.3f are as a result of the six charts supporting the discussion above. The charts below show the price increases in capital government and all governances individually.

Figure 3.3a: Average Housing Price for *Capital Government* during (1997–2008)



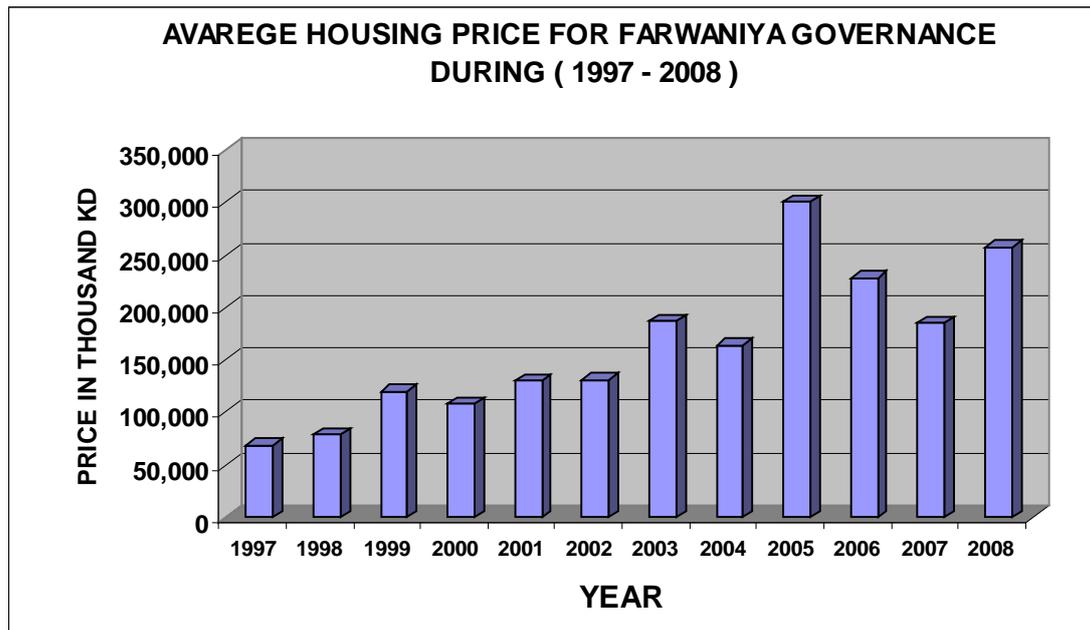
As far as the houses in the capital government area, the figures for selling and purchasing remain almost the same. The reason behind that is; since 1997, there have been no new development for private houses at all. The capital government area is specifically considered in Kuwait as a governmental authority, commercial and business area. There are very few areas available to live for the nationals. The size of the plots in the capital government area was huge compared to other governances. At the end of 2002, those plots began to be sold; however, instead of being sold as one plot, they were divided into two or three plots after seeking the government authorities' permission. As a result, three new houses could be built instead of one. The normal size of those plots before sale was 1000-2500 sqm² while, after the sale, the sizes were converted into 350, 400 and 600 sqm².

Figure 3.3b: Average Housing Price for *Hawally* Governance during (1997-2008)



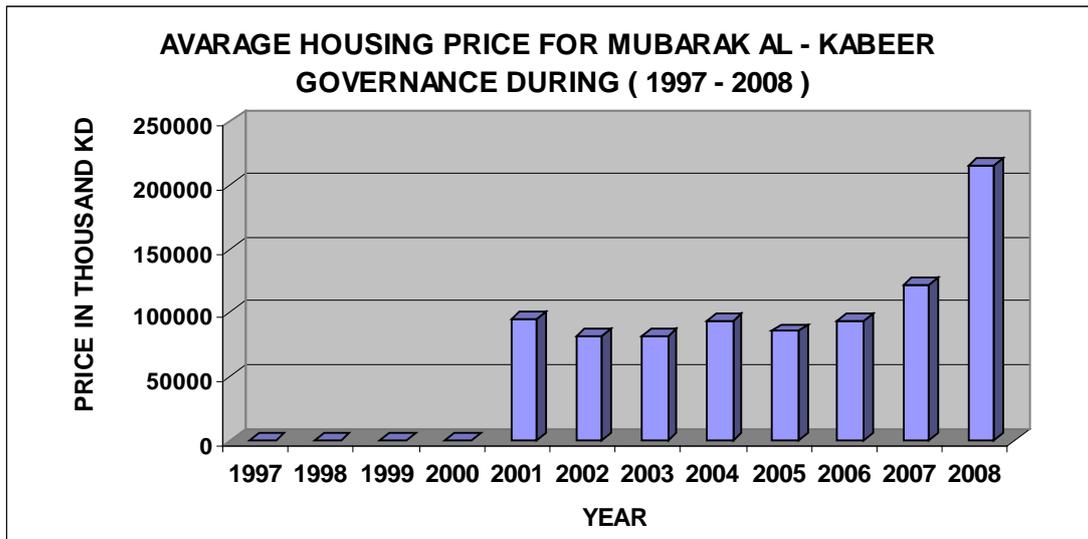
In *Hawally* governance, there was always some form of development; new developed areas were included as part of this government and was known as 'South *Surra*'. This is a big area. In 2001, people began purchasing plots and kept building houses. A reasonable change can be seen in the above chart from 2001.

Figure 3.3c: Average Housing Price for *Farwaniya* Governance during (1997 – 2008)



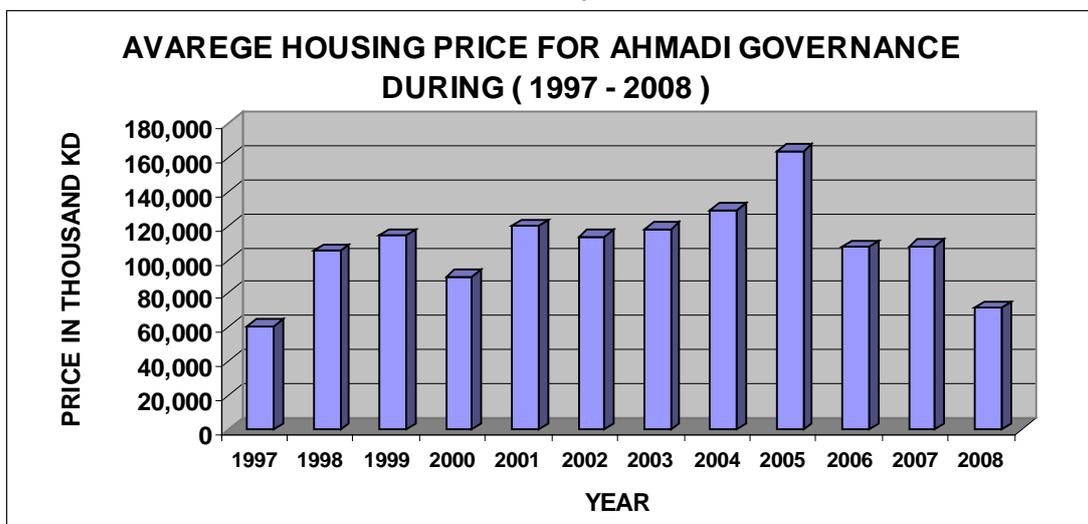
Farwaniya governance has always remained the biggest populated area of all the time. This is the main area where not only nationals but also foreigners reside. There is no room for further development but the rate of selling and purchasing of existing houses is always high. Two new areas were introduced in this governance, which were '*Ashbiliya*' and '*Abdullah Mubarak Suburb*', in 2002. The effect is reflected in the above chart for 2003. At the end of 2004, two very old areas were demolished and the residents were compensated almost double the valuation of their houses by the government. Those demolished areas are within the *Farwaniya* governance. The people, who were compensated with a very handsome amount of money, started purchasing the houses in different areas within this governance and, as a result, prices soared.

Figure 3.3d: Average Housing Price for *Mubarak Al - Kabeer* Governance during (1997 – 2008)



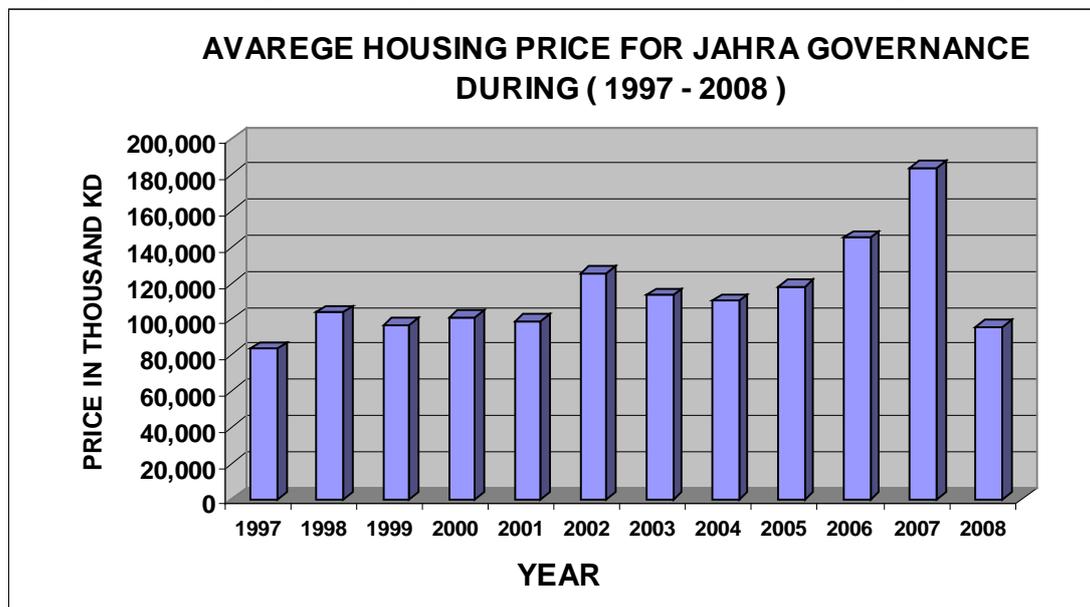
Mubarak Al Kabeer, as mentioned above, came into operation in 2001. In this governance, a large amount of houses were included from the *Hawally* and *Ahmedi* governances and formed the new governance. In 2006, this area was fully functional with respect to all the facilities and became very popular; property was purchased in this area by those who wished to move from their existing areas. However, by 2008, there were only a few house purchases as compared to 2007. The amount of units purchased or sold was less than half. As a result, the average price for 2008 went up.

Figure 3.3e: Average Housing Price for *Ahmadi* Government during (1997 – 2008)



Ahmadi governance is also a semi- governance area where we have the oil companies and professionals working for oil fields. By time to time, in this governance some new residential areas been added. So purchasing of new houses particularly provided by the governance is always there. In this governance the prices went down and sale of houses went up due to the reason because this area is very far away from the Capital government area. Normally this area is in less demand to live in. In this governance only those people purchase houses that have fewer budgets.

Figure 3.3f: Average Housing Price for *Jahra* Governance during (1997 – 2008)



The *Jahra* governance has always remained the same. It is a small area and there has not been any new development in this area for a long time. In 2002, the government distributed new houses in this governance permitting them to be sold after five years. A plunge in sales can be seen in 2007. This area is very far away from capital government. Although the people living there were given their houses by the government, they don't actually wish to live there and therefore try their best to sell their property and move to other governances according to their budget. This area is about 70 km from the Iraq border. In this governance, prices went down almost 45% in 2008.

3.3.3. Kuwaiti real estate market fluctuations and their causes

According to Jason J. Nash,⁴⁸ Kuwait's population increase, which hovers around 4.5% annually, combined with high levels of liquidity, burgeoning regional markets and relative political stability, has created an ideal environment for property investment, attracting both locals and foreign expatriates to buy residential villas and apartments.

The lack of available land has also driven up prices and the value of transactions. The vast majority of the land in Kuwait is owned by the government, with estimates ranging as high as 95%. The scarcity of supply has sent costs skyrocketing. Land accounts for over 50% of the cost of a finished project, far higher than the standard 15 to 25% range.

Particularly in 2008, the selling and purchasing of houses in Kuwait real estate market went down. The decline was due to the global crisis also affecting the Gulf region. The inflation rate went up by 5.6% in 2008, thus affecting the real estate market (being 5.5% in 2007) and was double in 2008 (10.5%).

The above figures for average housing prices for capital government and each governance shows the full details of the housing price market in the state of Kuwait during 1997-2008. During this period, the average housing price was not stable and kept varying all the time. There are various reasons for the changes in housing prices during 1997–2008. The main factors were supply and demand, interest rates, legislation, Ministry of Housing Authority itself, availability of land and willingness of people to live in particular areas etc.

There has been a steady increase in demand for private housing but the availability has been limited and banks have been unable to complete this demand. This situation remained the same from 1997 to 2003. In this period, private companies started their operations to fulfill the increasing demand for housing loans requirement in the region, resulting in a change in demand and

⁴⁸ Oxford Business Group. Issue on Monday, 30 July 2007

stimulating the market. Such companies are Al Imtiaz Investment with a capital of approximately USD 125 million, Ritaj USD 86 million with a broad spectrum of Islamic Investment Services, Iskan Housing Finance Company with a capital of USD 104 million, Damac Kuwaiti Holding Co. with approximately USD 63 million and Rasameel Structured Finance Company with a capital of USD 104 million.

The Kuwait Credit and Saving Bank is considered to be one of the cornerstones of the government of Kuwait. It provides loans for citizens to enable them to contribute to the construction of this generous country.

The crises in September 2001 impacted specifically the lower interest rates, which resulted in an increase in local property prices by converting private capital to the Arab countries.

From 2004–2005, the Ministry of Housing and Authority distributed lands according to the applications and process duration. There was shortage of liquidity in Kuwait Credit and Saving Bank, which led to a decline in the prices of real estate and trading in the housing sector.

During 2003–2004, Saddam's regime was removed, thus contributing to the psychological stability of the area. Also, the municipality of Kuwait increased the area of non-construction investment of the former regime (1.40 + 35%).

3.3.3a. Commercial Sales Units for All Kuwait (Investment Sector)

The investor sector includes those buildings for commercial and residential, shopping complexes and malls. In this section we have collected data from different sources to compare the growth and decline in the Kuwait investment market with respect to Sales and Purchase. In the data we considered both kinds of entities comprising old, which are being sold by their owners, as well as the new entities in developing areas announced by the government.

The targeted data is from the years 1997 to 2008 and shows the complete number of commercial entities from the capital government and the corresponding five governances of Kuwait.

Table 3.2 below shows all the investments made within Kuwait from the capital government to its five governances. A total is made for the number of entities being sold for each year.

Table 3.2: Total Number of Units Sold for Investment throughout Kuwait during (1997-2008)

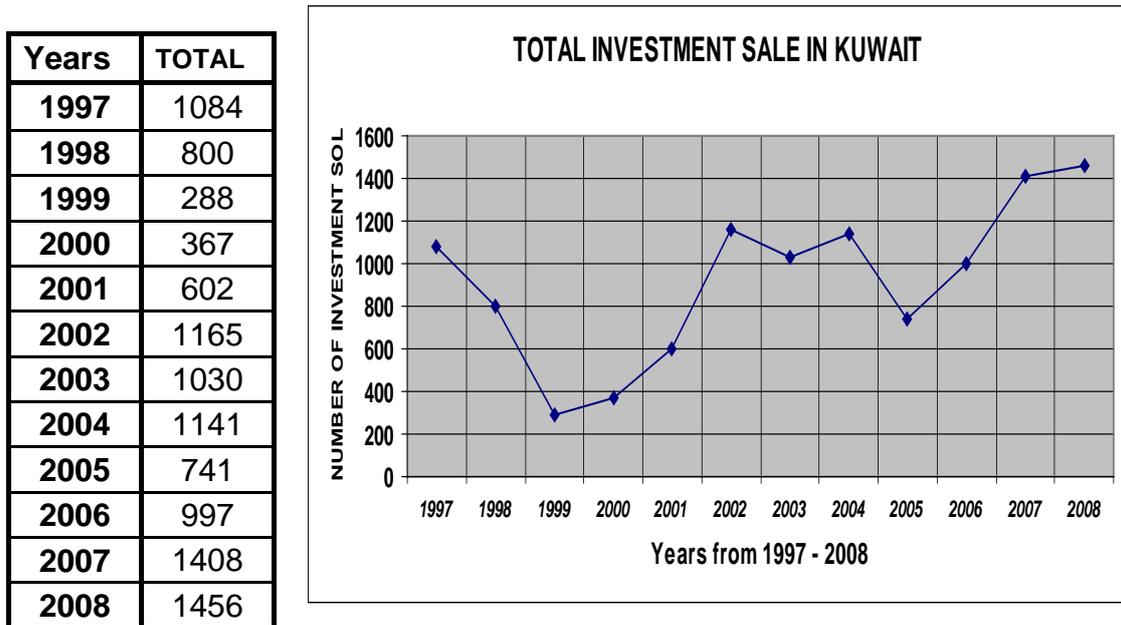
Years	CAPITAL	HAWALLY	FARWANIYA	MUBARAK AL KABEER	AHMADI	JAHRA	TOTAL
1997	26	422	303	0	305	28	1084
1998	39	396	180	0	157	28	800
1999	14	139	67	0	58	10	288
2000	11	180	96	0	75	5	367
2001	21	311	137	14	107	12	602
2002	37	601	264	11	230	22	1165
2003	46	565	227	25	158	9	1030
2004	71	525	250	10	270	15	1141
2005	40	358	150	34	150	9	741
2006	78	388	211	9	302	9	997
2007	64	574	380	11	367	12	1408
2008	36	574	269	8	561	8	1456

Source: Real Estate Registration and Authentication Department (1997 – 2008)

Figure 3.4 shows the total investments made for unit sales and purchases within each year against each year for the whole of Kuwait during 1997–2008. From Table 3.2 we extracted the ‘Years’ and ‘Total’ columns for the information and figures and made a Figure 3.4 showing the trend chart increasing/decreasing and the units sold during 1997–2008.

In the trend line we can see there is a big decline in the Kuwait investment sector in the year 1998. Kuwait was in a state of war in 1998 and American alliances were attacking Iraq while residing in Kuwait. The effect of this was reflected in the future years.

Figure 3.4: Sale of *Investment* in Kuwait during (1997-2008)



Source: Real Estate Registration and Authentication Department (1997 – 2008)

The charts below (3.4, 3.4a, 3.4b, 3.4c, 3.4d, 3.4e and 3.4f) show the individual data of Capital government and its governances related to the investment sector. Investment was made from 1997-2008.

Figure 3.4a: Overview about the Total Investment Unit in *Capital Government* during (1997 – 2008)

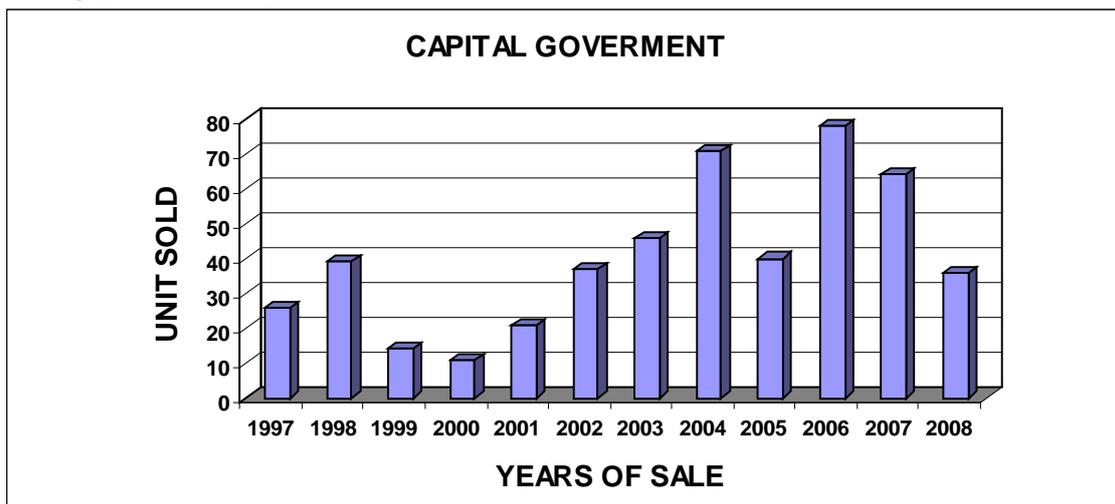


Figure 3.4b: Overview about the Total Investment Unit in *Hawally Governance* during (1997 – 2008)

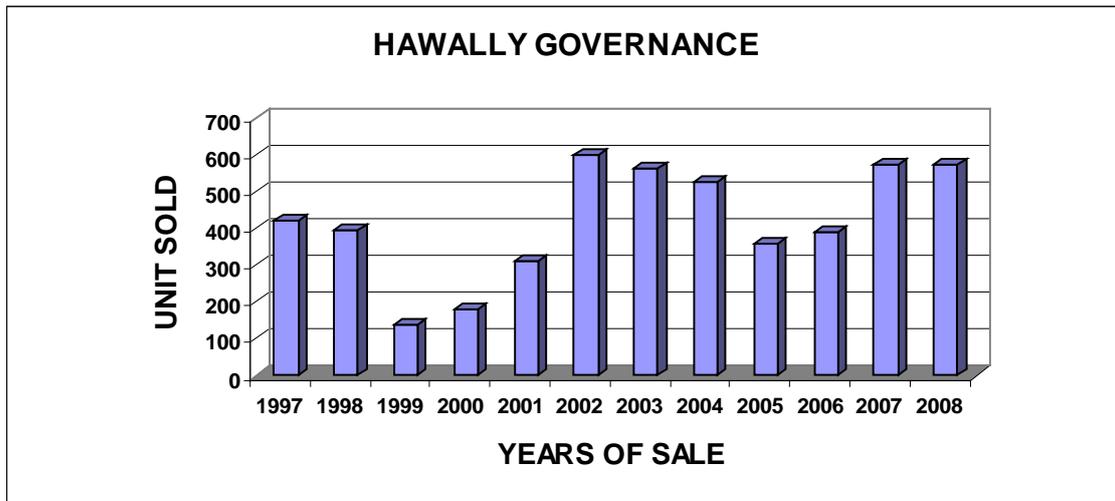


Figure 3.4c: Overview about the Total Investment Unit in *Farwanaya Governance* during (1997 – 2008)

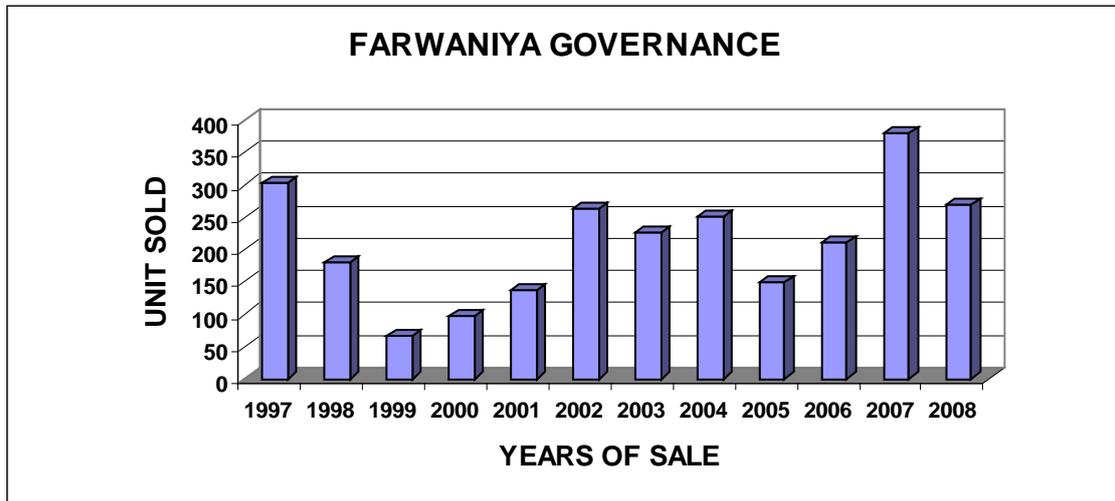


Figure 3.4d: Overview about the Total Investment Unit in *Mubarak Al- Kabeer Governance* during (1997 – 2008)



Figure 3.4e: Overview about the Total Investment Unit in *Ahmadi* Governance during (1997 – 2008)

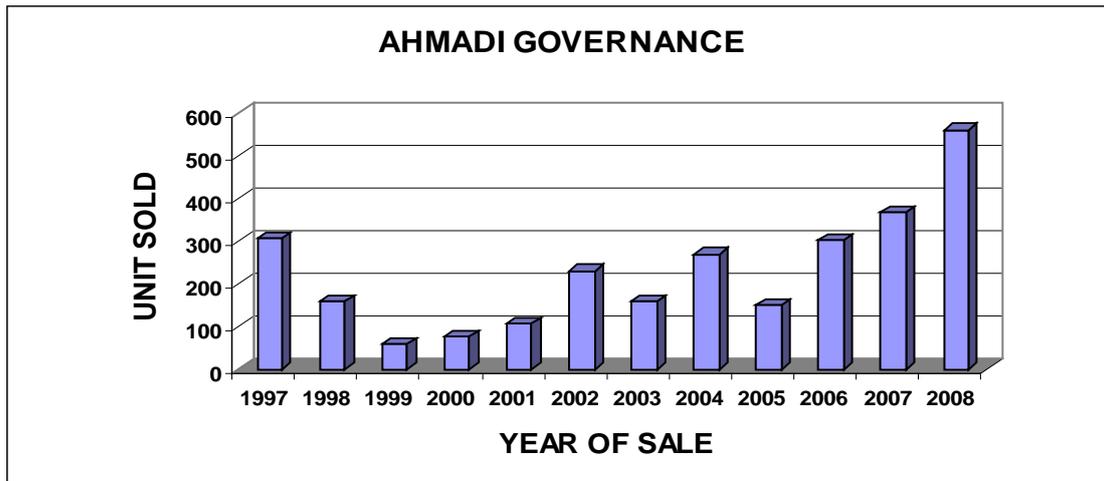


Figure 3.4f: Overview about the Total Investment Unit in *Jahra* Governance during (1997 – 2008)

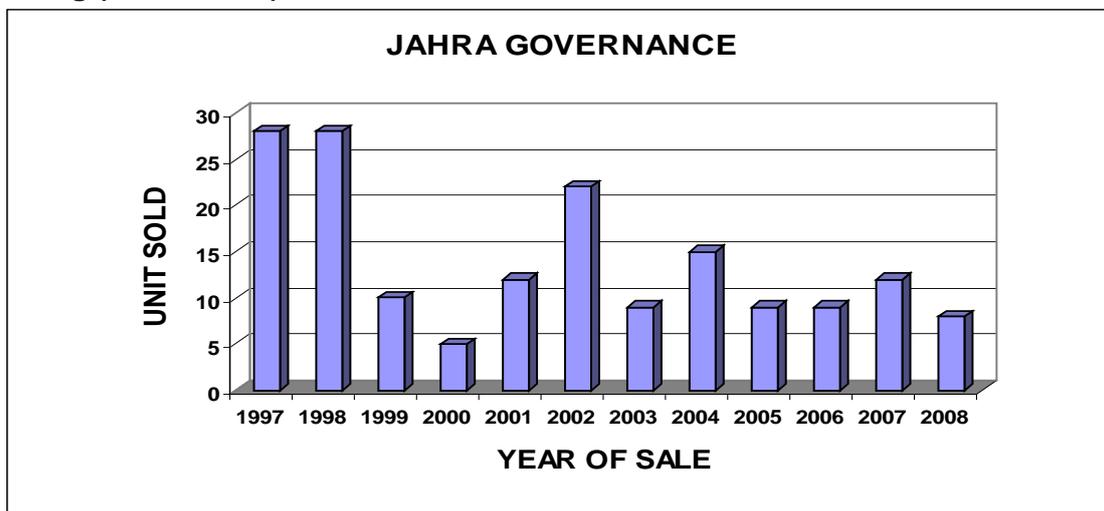


Table 3.2 and the charts (3.4, 3.4a, 3.4b, 3.4c, 3.4d, 3.4e and 3.4f) above; contain information about purchases made in the investment sector during 1997-2008. The figures were received from the Real Estate Registration and Authentication Department governed by Ministry of Justice. However, the data was taken for 1997–2008; we described in the table the purchases of all the years separately according to the areas we denoted as Capital government and the five sub governances, i.e. *Capital, Hawaly, Farwanya, Mubarak Al Kabeer, Ahmedi* and *Jahra* respectively. As described above in the ‘Private sector’, at the end of 2000 Mubarak Al Kabeer governance did not exist as it had only been announced by the Capital government and came into operation in 2001. So, before 2001 any property belonging to this area was part of *Hawally* and *Ahmadi* governance.

The investments made in the Capital government area, the figures for selling and purchasing, remained almost the same. The reason behind this is that, since 1997, very few developments were made in this area. The Capital government area is the oldest and most famous area in Kuwait and is considered to be the governmental, commercial and business area. Physically, it consists of very tall commercial buildings. More opportunities exist there for investors.

In *Hawally* governance, there has always been development; new areas were included as the part of this government, so we can see a growth in figures. However, it does not only include new development, as the government has commercialized much of the area in *Hawally* governance. Therefore, investors are purchasing those older houses that now have become part of the commercial area and, after demolishing them, are building commercial buildings and shopping complexes.

Farwaniya government remains the biggest populated area of all time. This is the main area, where not only nationals but also foreigners reside. Therefore, this area holds a big attraction for investors. It contains many commercial places for business. A little development is always there involving converting residential areas into commercial areas. As it is a more populated and crowded area, small business investors therefore find it attractive.

Mubarak Al Kabeer, as mentioned above, came into operation in 2001. In this governance, areas included from the *Hawally* and *Ahmedi* governances were amalgamated and formed the area as a new governance. In 2006, this area was fully functioning with respect to all facilities. Although a very small area, it is considered to be an attraction for investors.

In *Ahmadi* governance, there are many opportunities for all types of investors. It has a big commercial area and is experiencing continuous development. New commercial buildings and shopping complexes are the main attraction for investors. It enjoys a mixed population, as foreigners and nationals alike live

in this governance. This governance can be considered as the third largest investment area for investors.

Jahra governance has remained unchanged. It is a small area and has not experienced any new development so far. This governance can be defined as a downtown area where there is nothing for investors.

As described above, in 2008 the selling and purchasing in the Kuwait real estate market went down. The decline was due to the inflation rate, which went up by 5.6% in 2008, affecting the real estate market as it was in 2007 5.5 and raised by double in 2008, i.e. 10.5.

3.3.3b. Price of the Investment Sector (In KD)

Table 3.2a below shows the prices of houses been sold in each governance and in the capital government. The first column shows the years from 1997-2008, the second column shows the capital government, while the next five columns represent all the five governances. In the last column, a total is made showing each year's entire sale price. Therefore, in the 'Total' column, each year's sale price for the whole of Kuwait can be seen.

Table 3.2a: Overview of the Total Price (In Million KD) For Investment Sector for the whole of Kuwait (1997–2008)

Years	CAPITAL	HAWALLY	FARWANIYA	MUBARAK AL KABEER	AHMADI	JAHRA	TOTAL	AVG
1997	9.857	65.837	46.086	0	39.502	3.292	164.592	27.43
1998	11.853	74.505	40.639	0	37.252	5.080	169.329	28.22
1999	5.493	41.195	22.886	0	19.224	2.746	91.544	15.26
2000	4.677	39.775	16.378	0	15.598	1.560	77.990	13.00
2001	9.875	80.650	36.210	1.646	32.918	3.292	164.591	27.43
2002	18.952	185.733	83.390	3.790	79.600	7.581	379.047	63.17
2003	27.937	203.544	87.803	7.982	64.848	3.991	396.106	66.02
2004	38.546	240.914	106.002	9.637	81.911	4.818	481.829	80.30
2005	32.537	203.358	89.477	8.134	69.142	4.067	406.715	67.79
2006	67.539	238.986	114.298	5.195	88.321	5.195	519.534	86.59
2007	130.398	461.407	220.673	10.031	170.520	10.031	100.306	167.18
2008	88.412	312.843	149.620	6.801	117.656	4.761	680.092	113.35

Source: Real estate registration and authentication Department (1997 – 2008)

Figure 3.5: Overview about the Total Price (In Million KD) For Investment Sector for Capital Government during (1997 – 2008)

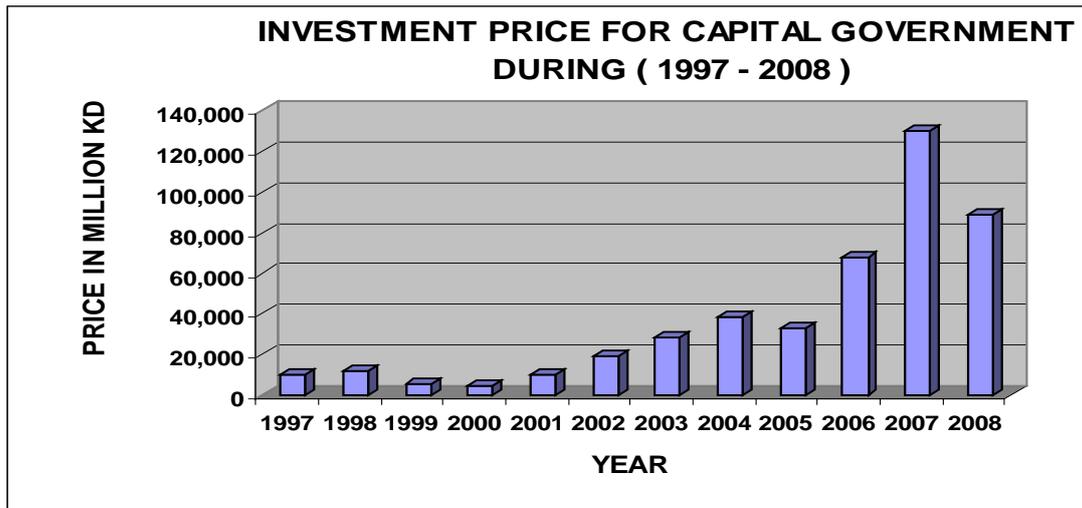


Figure 3.5a: Overview of the Total Price (In Million KD) For Investment Sector for Hawally Governance during (1997 – 2008)

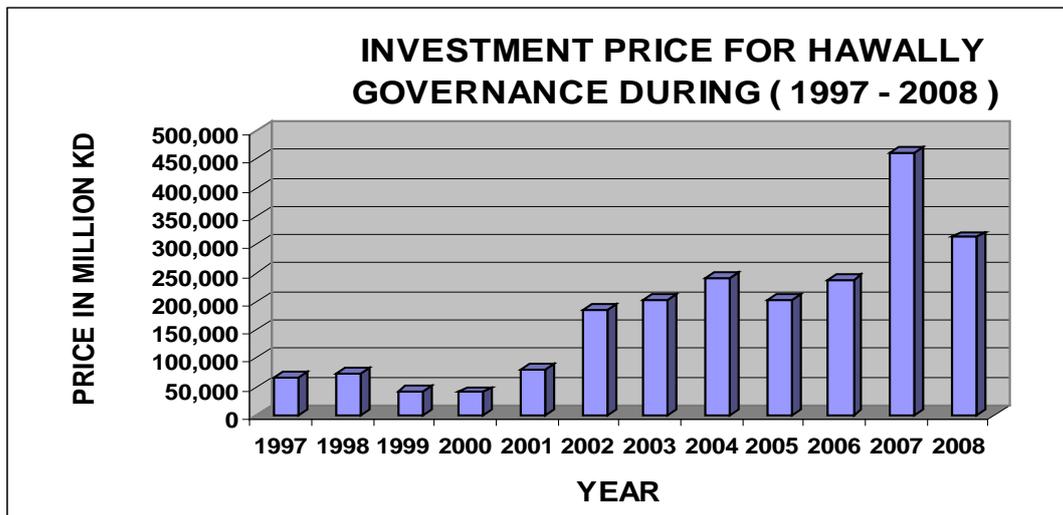


Figure 3.5b: Overview of the Total Price (In Million KD) For Investment Sector for Farwanya Governance during (1997 – 2008)

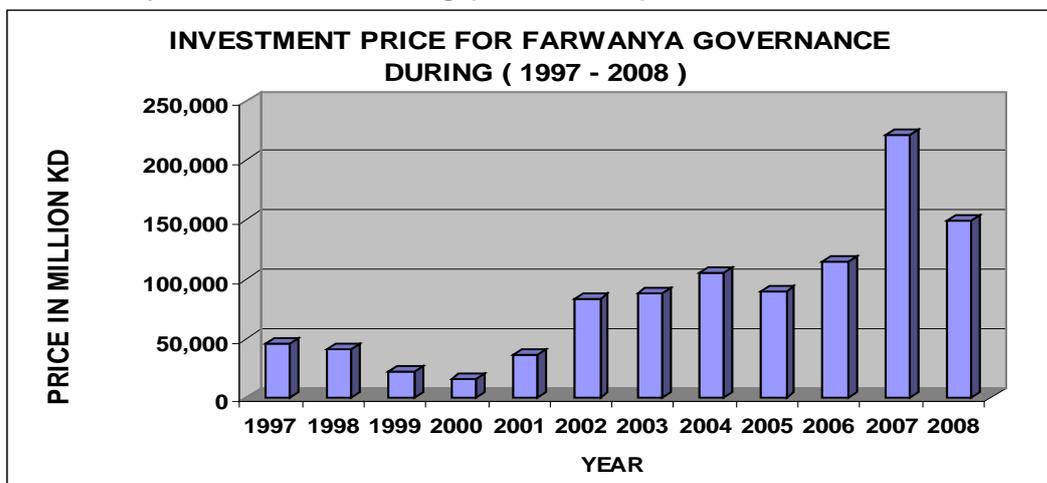


Figure 3.5c: Overview of the Total Price (In Million KD) For Investment Sector for *Mubarak Al- Kabeer* Governance during (1997 – 2008)

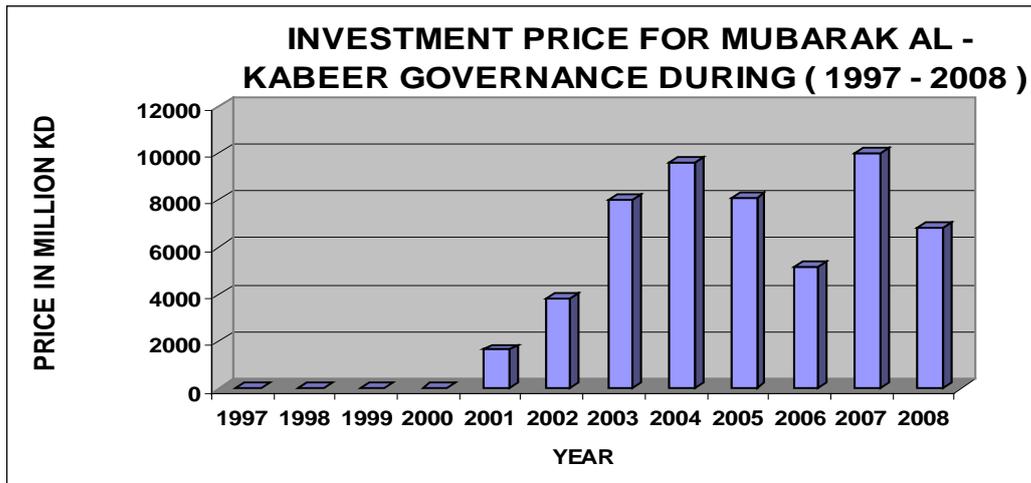


Figure 3.5d: Overview of the Total Price (In Million KD) For Investment Sector for *Ahmadi* Governance during (1997 – 2008)

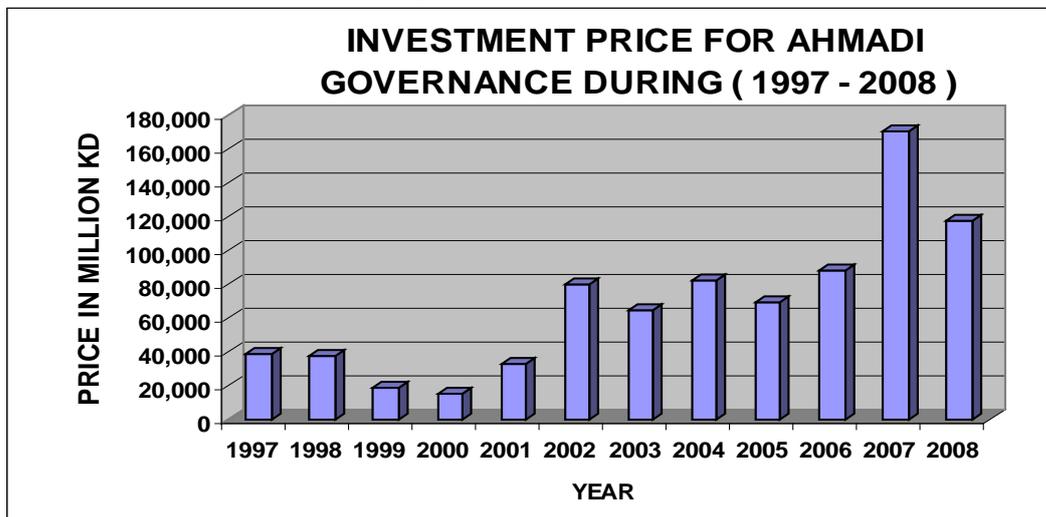
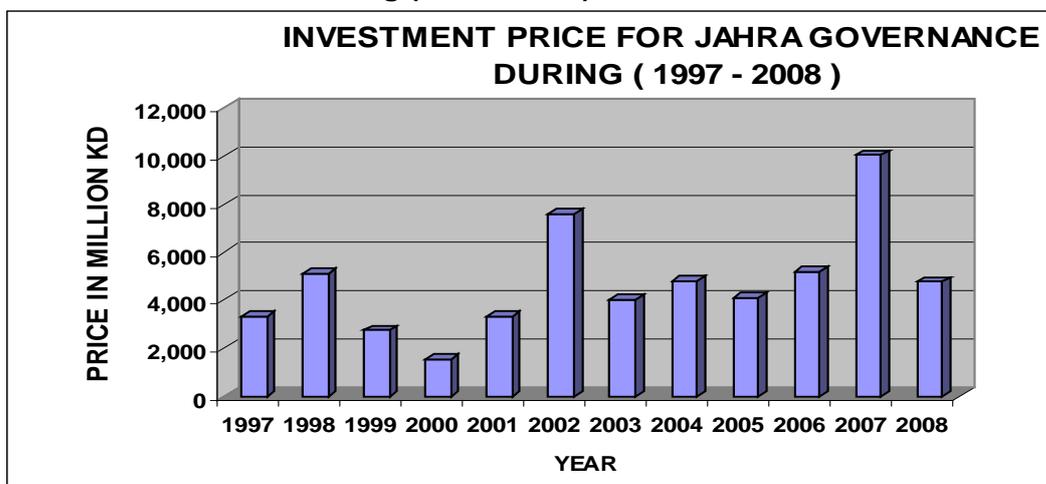


Figure 3.5e: Overview of the Total Price (In Million KD) For Investment Sector for *Jahra* Governance during (1997 – 2008)



It has been observed that these two tables are co-linked with each other; they are related to the Investor Sector where one table signifies the unit sale per year and per government, whereas the other table signifies the total amount for per unit sale for the respective government, as shown in the example below.

Unit sale for the *Farwaniya* governance in the year 1997 was 303. This is the total number of apartments and residential complex sold.

The total price for the 303 sold apartments and residential complex is 46,086 million KD. Similarly, tables 3.2 and 3.2a denote the other governance as per above example.

3.3.3c. Investment Average Price

Table 3.3b below gives a clear idea about the average house price market transactions made in governances separately. It covers the period 1997 to 2008 only. Each column in the table denotes a separate governances of average housing price according to the booklet records Ministry of Justice ('Real Estate Registration and Authentication Department') starting from 1997 and ending with the year 2008.

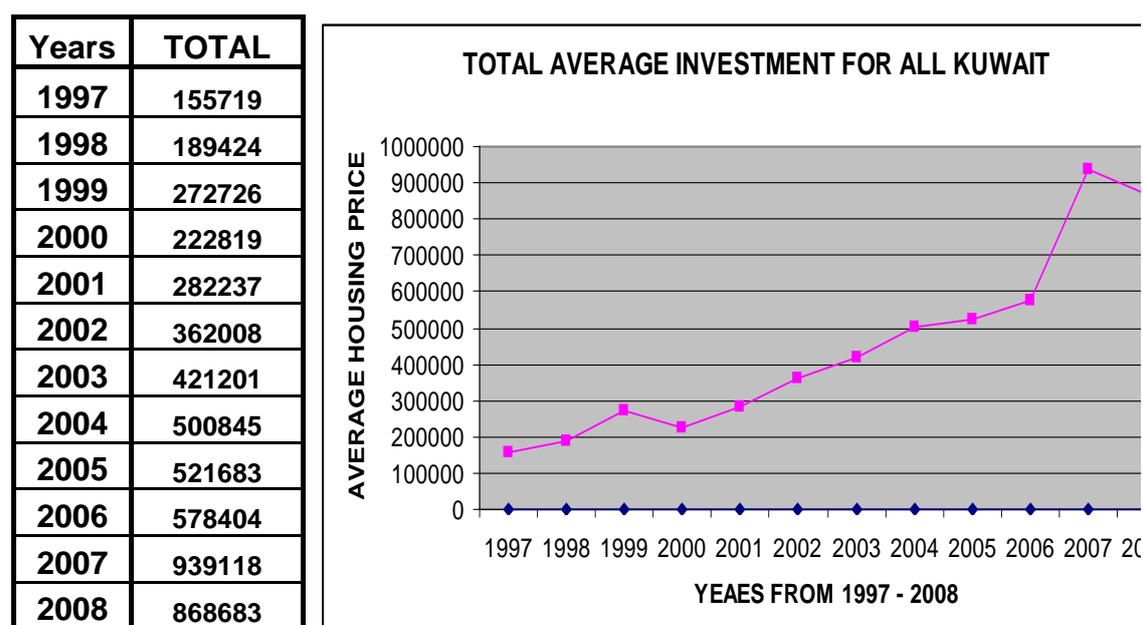
From Table 3.3b we obtain an outcome that the total average housing price is always continuing to increase for capital government and the rest of the governance during 1997–2008.

Table 3.3b: Overview about the Average Price for Each Investment Sold (In Thousand KD) For Kuwait Government (1997-2008)

Years	CAPITAL	HAWALLY	FARWA NIYA	MUBARAK AL KABEER	AHMADI	JAHRA	TOTAL	AVG
1997	379,115	156,012	152,099	0	129,515	117,571	934,312	155719
1998	303,923	188,144	225,772	0	237,274	181,429	1,136,542	189424
1999	392,357	296,367	341,582	0	331,448	274,600	1,636,354	272726
2000	425,364	220,972	170,604	0	207,973	312,000	1,336,913	222819
2001	470,238	259,325	264,307	117,571	307,645	274,333	1,693,419	282237
2002	512,216	309,040	315,571	344,545	346,087	344,591	2,172,050	362008
2003	607,326	359,926	386,797	319,280	410,430	443,444	2,527,203	421201
2004	542,901	458,884	424,008	963,700	303,374	312,200	3,005,067	500845
2005	813,475	568,039	596,513	239,235	460,947	451,889	3,130,098	521683
2006	865,885	615,943	541,697	577,222	292,454	577,222	3,470,423	578404
2007	2,037,688	803,845	580,718	911,909	464,632	835,917	5,634,709	939118
2008	2,455,889	545,023	556,208	850,125	209,725	595,125	5,212,095	868683

Figure 3.6 shows the average investment market price for the whole of Kuwait during 1997–2008. The ‘Years’ and ‘Total’ columns extracted for Figure 3.6 show the average total price for each year in Kuwait.

Figure 3.6: Overview about the Total Average Investment Price in Kuwait during (1997-2008)



The figures (3.6, 3.6a, 3.6b, 3.6c, 3.6d, 3.6e, and 3.6f) are derived from the six charts, which support the discussion above. The charts below cover all governments individually and how their pricing performance.

Figure 3.6a: Average Investment Price *Capital* Government during (1997 – 2008)

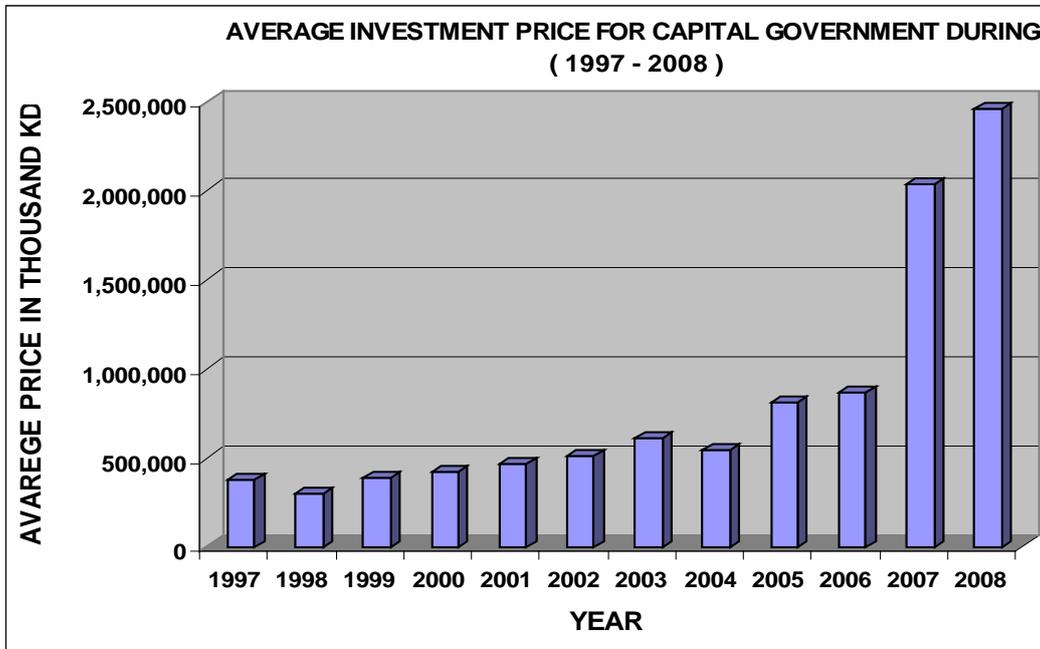


Figure 3.6b: Average Investment Price for *Hawally* Governance during (1997 – 2008)

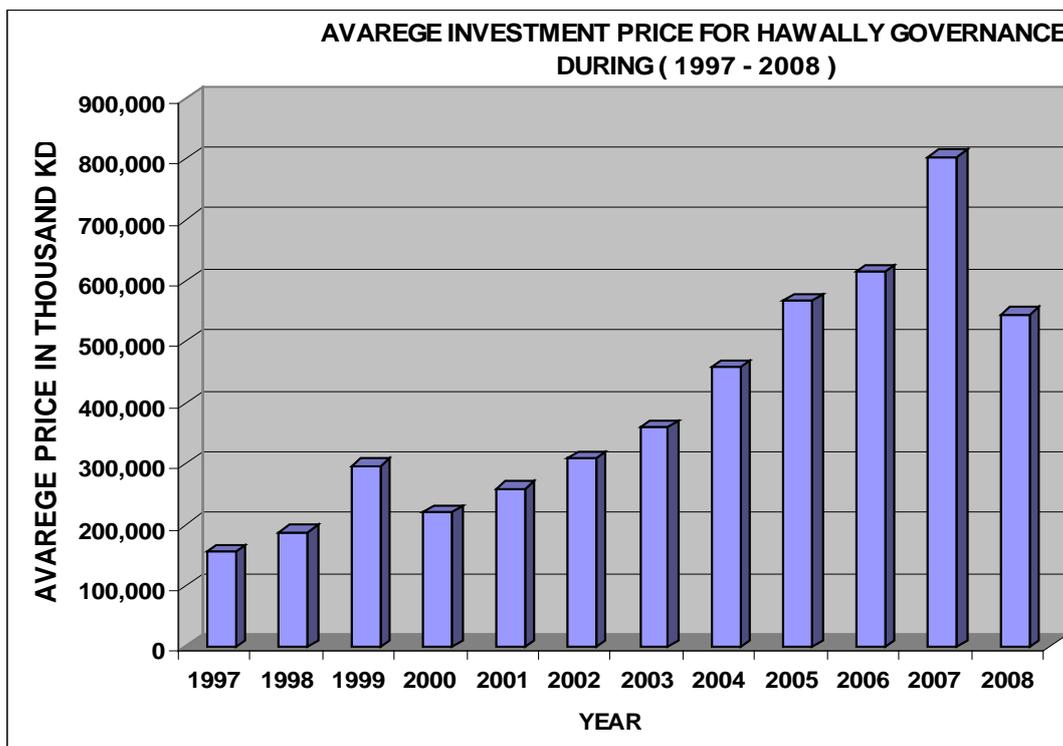


Figure 3.6c: Average Investment Price for *Farwaniya* Governance during (1997 – 2008)

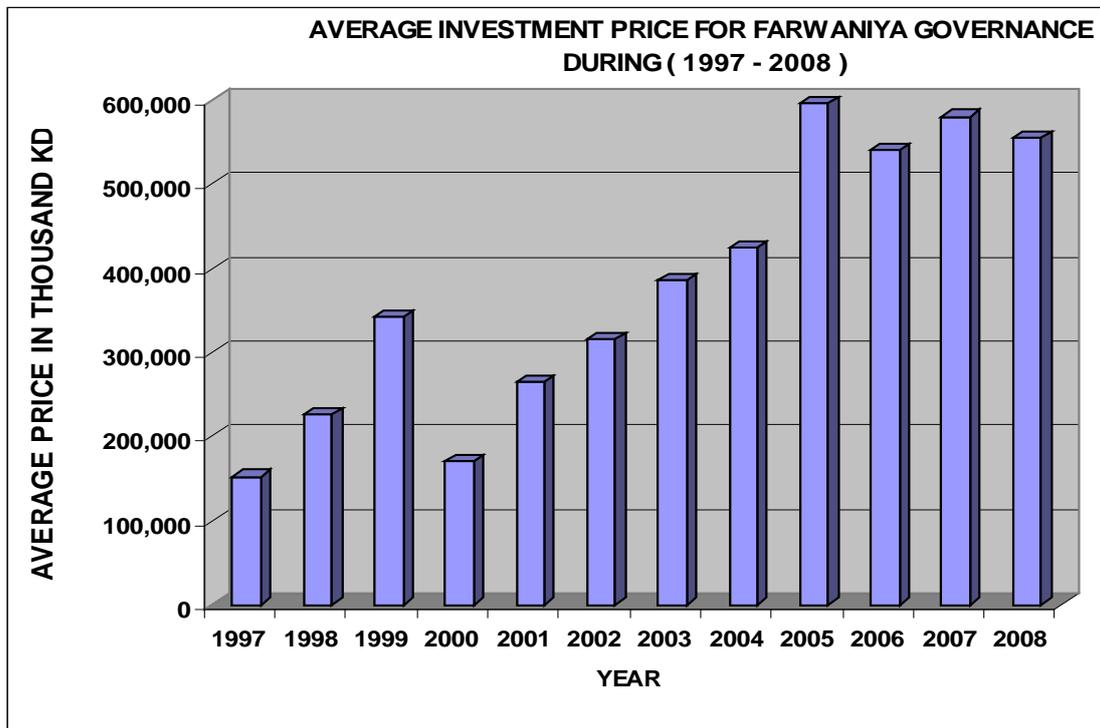


Figure 3.6d: Average Investment Price for *Mubarak Al-Kabeer* Governance during (1997 – 2008)

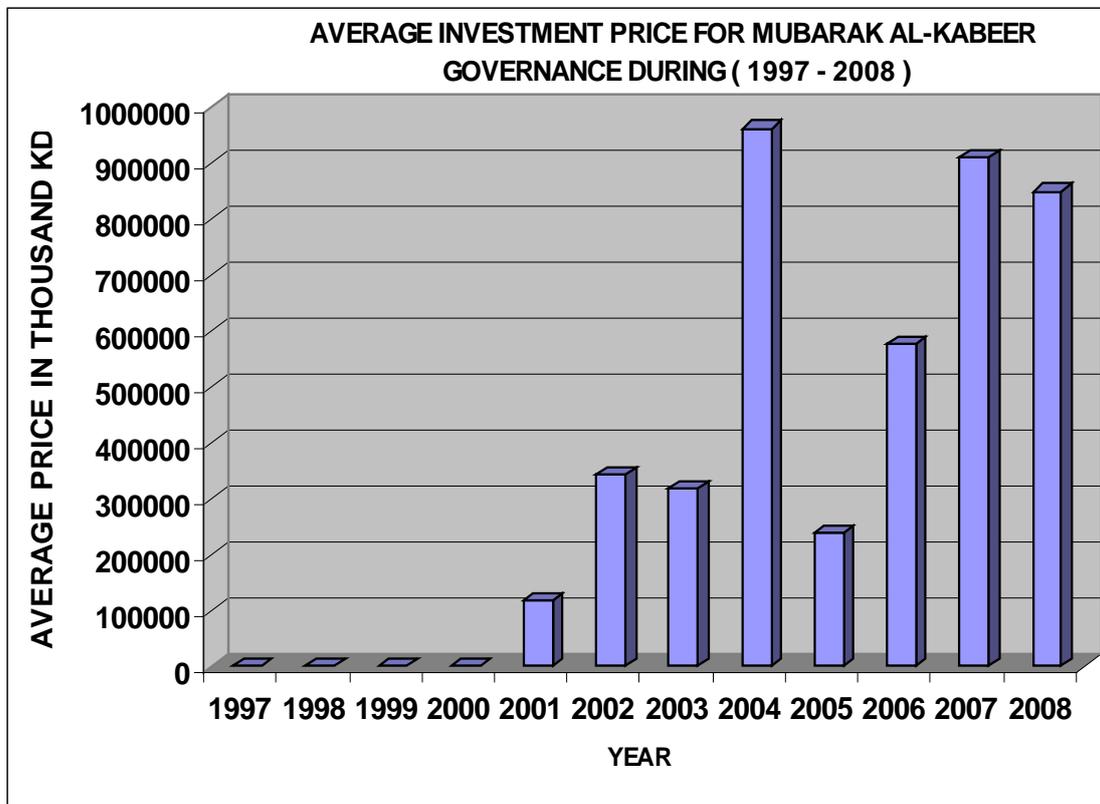


Figure 3.6e: Average Investment Price for *Ahmadi* Governance during (1997 – 2008)

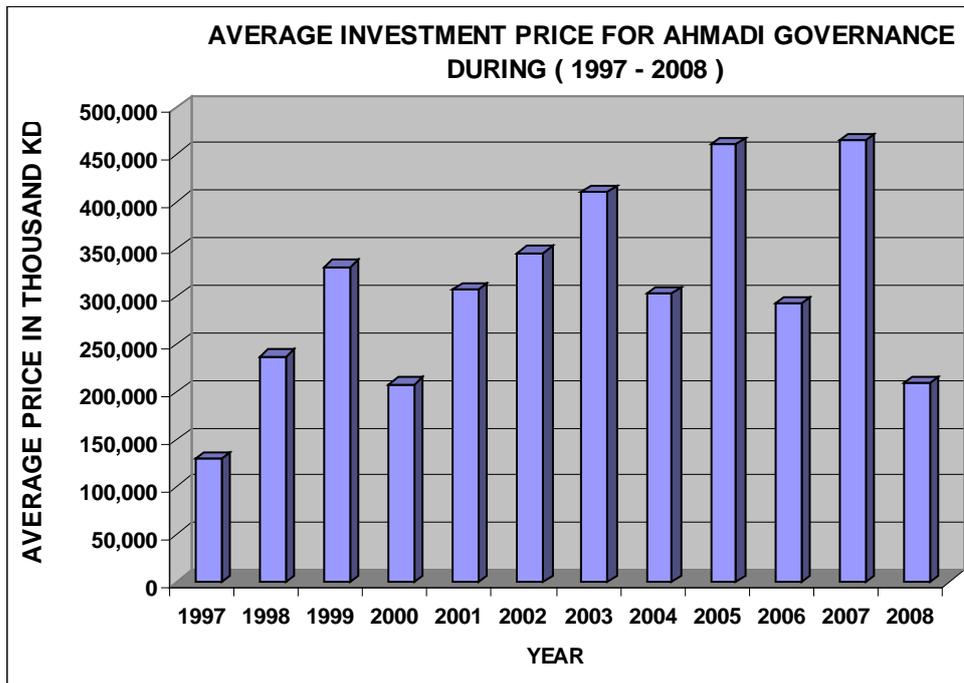
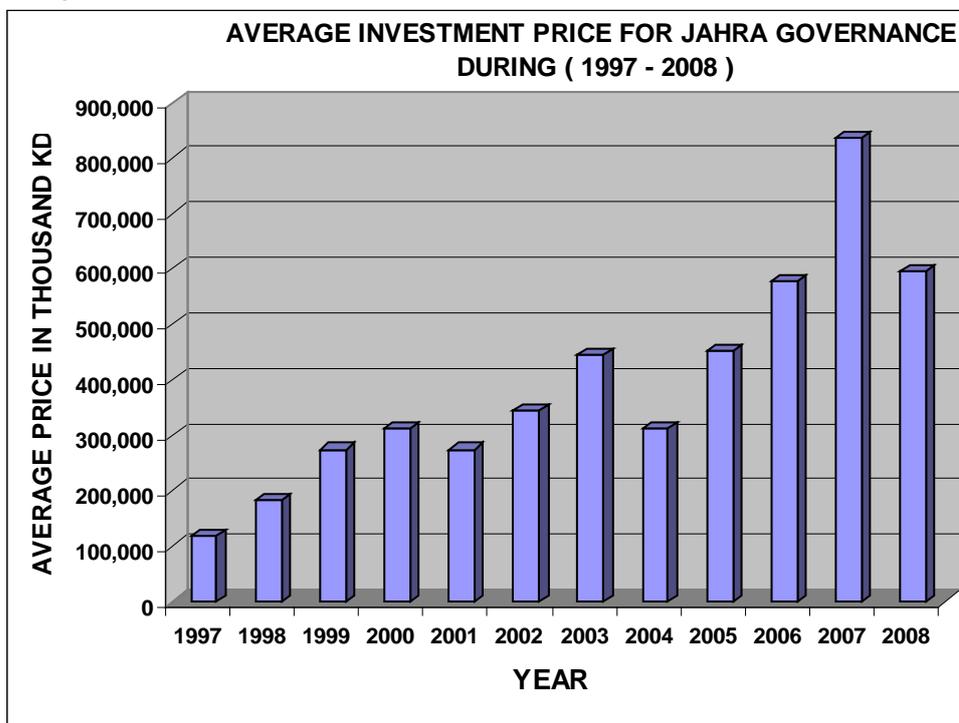


Figure 3.6f: Average Investment Price for *Jahra* Governance during (1997 – 2008)



It is observed from Table 3.3b that the unit sale price for the investment sector was 152,099 KD for *Farwaniya* governance in the year 1997. Further, as with the link with Table 3.3b, investment Average Housing Price is associated to

Table 3.1b, which defines the average sale price for buildings for Commercial and Residential, Shopping Complexes and malls. In 1997, the *Farwaniya* governance average sale price per commercial unit was 556,208 KD, the same as within the other governances.

3.4. SUMMARY OF INVESTOR AND RESIDENTIAL HOUSING MARKET

Finally we extracted data from our tables that describes the actual number of houses sold and their average prices in capital government and each governance separately during the period of 1997 – 2008. This data enabled us to calculate the increase and decrease in average prices in percentage for each year from 1997 – 2008. We calculated the percentages for private housing and as well as residential housing. The increase or decrease can be seen as below:

3.4.1. Residential Housing Market in Kuwait from 1997 – 2008

In the years 1998 there was increase of 17.01% from previous year in the residential housing market with the amount of 74.25 million Kuwaiti dinars.

In the years 1999 there was decrease of 16.03% with the amount of 240.58 million as compare to 1998.

In 2000 market again showed the downward trend of 4.94% amounting KD 25.1 million.

The year 2001 took the residential housing market towards stability and the market increased by 6.7% showing the increase in average price in the region and comparing to previous year, the increase in market become at 57.4 million KD.

In 2002 residential housing market of Kuwait remained at upward trend with 3.06% and the increase in the market was 170 million KD. Nearly about 1000 more residential houses were sold in 2002 as compare to 2001.

The year 2003 shows good buying power among the region. In 2003 there was the noticeable change in the market as compare to last 4 years. The average prices of the houses increased by 26.93% in 2003. As far as number of houses are concerned there were only 88 more houses sold as compare to 2002. The entire number was 6,169 houses in 2002. The total difference or increase in 2003 was 194.2 million KD as compare to 2002.

In 2004 the market remained stable and there was a little increase only with 2.1% in average housing prices amounting 0.73 million KD.

In 2005 the residential housing market increased by 6.32% as compare to 2004. The difference between two years in average house price was 10,000 KD approximately resulting 44.22million KD difference on total residential housing market.

In 2006 there was a little downward trend in the average residential housing price that is 0.11%. The number of houses sold in 2006 was more than 2005. The increase in the total residential housing amount was 72.42 million in 2006 as compare to previous year.

In 2007 there was good increase in the residential housing market with 14.6% with the difference of 460.2 million as compare to 2006. The difference in average house was almost 25,000 KD. It was because the government allowed their nationals to sell their houses in different areas that were prohibited earlier.

In 2008 average prices of houses went down to 0.71% as compare to 2007. The number of houses sold this year was quite less than 2007. In 2007 the total houses sold in residential market were 7,809 houses and in 2008 the total number of houses sold was only 4,577 houses. The difference in the number of houses is 3,232 houses, resulting the difference in total residential houses sold at 645.3 million KD.

3.4.2. Commercial sector Market in Kuwait from 1997 – 2008

In the year 1998 there was increase of 40%. Comparing with the year 1997 in commercial sector the increase that was equals to around 4.8 million Kuwait Dinar in commercial housing sector.

In year 1999 there was increase of 50.2% with amount of 78 million compare to previous year. Due to very high average price rate the selling and buying went down in the year of 1999.

In 2000 the Activity of transaction of commercial sector market showed upward trend as more houses were sold as compare to 1999. It was because of the average prices decreased by 33% with amount 13.5 million KD. The average prices in commercial housing market again went to the same position as it was 2 years back.

In 2001 the market started to become stable and kept showing upward trend in transactions (602) and average housing prices that were increased by 29% comparing to 2000 and the change was noticed as 87 million KD within the year.

In the year 2002 the average prices increased by 19% with the transaction of 1165 and the increased noticed in KDs was 215 million in the commercial market.

In year 2003 commercial market remain stable. A small increase in average prices at 18.2% was noticed. Even the transactions remain almost same. The increase in KDs was only 17 million that is not noticeable.

In year 2004 the average prices went up by 10% compare with 2003 but the transactions remain almost same as previous year with the increase of 86 Million KD because of the 10% increase in average prices.

In year 2005 it is downward trend in transactions in commercial market and the average prices went up showing the increasing amount in commercial market by 75 Million KD.

In 2006 the average price decreased by 5% and also the transactions went down by 75.2 million KD as compare to last year (2005).

In 2007 the average commercial housing market went down dramatically by 86.3% with amount of 419.2 Million KD. Impacting increased in transactions.

In 2008 the average price for commercial sector went up by 556% with amount of 579.7 Million comparing to previous year.

According to the report published in *Kuwait Times*, Kuwait's Minister of Commerce and Industry, *Falah Fahad Al-Hajri*, discussed with his ministry that it was his mission to accumulate a revision on the cause after increasing rates of land and real estate and ways to resolve this difficulty. The revision will be referred to the cabinet, *Al-Hajri* told reporters after opening an exhibition entitled 'Real Estate World' here. "To control the increasing rates of real estate require rigorous hard work by both the legislative and executive authorities."⁴⁹

The main cause of the rise in real estate prices across the Arab Gulf countries, including Kuwait, is seen. The main cause of the rise prices to real estate in Kuwait and other GCC are the rising prices of oil and shortage of land.

The planned studies envision a method for controlling the rising rates of real estates through making changes to some present legislation and introducing new ones.

⁴⁹ Real estate prices increasing fast, Kuwait Times Retrieved on October 22,2007 from http://www.kuwaittimes.net/read_news.php?newsid=MTA4NzUzMjQ0MQ==

As in the *Real Estate World*, Al-Hajri further stated that his ministry was eager to hold and contribute to a presentation, particularly regarding real estate. Such proceedings can help incorporate local and regional knowledge and inform the man on the street of the most proper position regarding business or residence purposes.

3.5. CONCLUSION

The essential organization and institutional features of Kuwait's financial system have not changed much over the past 20 years. These two decades were, however, both exciting and demanding, mainly because of the *Souk Al Manakh* disaster in the early 1980s and the regional crisis of Gulf War II during 1990-91. The years subsequent to the *Souk Al Manakh* crisis were noticeable by hard work on the part of the Kuwaiti authorities, both to overcome the financial penalty of the huge amount left overdue by this incident and, concurrently, to broaden and deepen the instruments of monetary policy employed by the Central Bank.

As to the near future, policies continue to be reviewed and further changes for strengthening the supervisory and regulatory regime are under consideration. In addition to actions imposed by the Central Bank, local banks planned and then established an 'inter bank centre of risk assessment ' in the end of 1996 to assist in evaluating the financial positions of persons applying for credit. Indeed, considering the progress made in the last two decades in both the exercise of monetary policy instruments by authorities and the restoration of reasonable health to the financial infrastructure, current indications are this progress will continue in the future.

Chapter 4: INTRODUCTION TO THE CASE STUDY: THE NATIONAL BANK OF KUWAIT AND KUWAIT FINANCE HOUSE

4.1. INTRODUCTION

Case studies can either be based on the study of a single case or multiple cases. Single cases are used to corroborate or test a theory, or to symbolize an exclusive or extreme case. Single-case studies are also ideal for revelatory cases, where a viewer may have access to an occurrence that was formerly unreachable. Single-case designs require careful investigation to avoid misrepresentation and to maximize the investigator's access to the confirmation.

This chapter deals with the single-case study, as it discusses the single case of two types of banks: the Islamic and the conventional.

Economic markets and financial organizations are an important part of any contemporary economy. Kuwait made a momentous development in financial intensification and in building a contemporary financial infrastructure. Surplus oil revenues resulted in the amassment of considerable overseas resources and private wealth, part of which were intermediated by the banking division. Kuwait, along with other GCC countries, was a net provider of investments to the rest of the world until 1990. In 1990-91, the Iraqi invasion deeply stressed the Kuwaiti financial system and its financial sector. Subsequent to the liberation, and the return of confidence, banks strengthened their deposit base and improved productivity by acquiring advanced technologies.

Currently, there are many challenges facing commercial banks in Kuwait that are likely to impact on their function in a more robust environment.

The economy of Kuwait continues to depend on oil as its main source. Oil still makes up more than 90 per cent of Kuwait's goods sold abroad, with its earnings accounting for 80 per cent of the country's financial income. In addition, the public sector dominates the economy in the provision of

possessions and administration. The presentation of the private sector and the non-oil sector activities are associated with different government expense plans involving credit and loan financial support, and input prices. As a result of this important reliance on oil and the public sector, it has been difficult to expand the various money-making profitable asset opportunities outside the limited range of real estate, trade business and stock market performance. This has translated into a concentration of bank loans on consumer loans, real estate, and trade finance at the cost of the extension of loans to the industrial sector. Loan opportunities are still much more limited due to the presence of a large number of expatriates in the population, whose right of entry to bank credit is limited. As a result of the lack of economic diversity, coupled with surplus liquidity resulting from considerable oil exports revenues, many tentative crises have come into existence.

The first and perhaps most serious crises came in 1982 when the stock market collapsed. It left the banking sector with a collection of non-performing financial credit. This was a period where Kuwait commercial banks went through major restructuring and reorganization to broaden their range of activities beyond conventional banking services and to expand into such new activities, such as speculation and indemnity. Furthermore, Kuwaiti commercial banks not only required a correction to the rigid structure in order to compete with banks worldwide, but they too had to face stiff competition from well-established local domestic investment and insurance companies. Kuwaiti commercial banks are also expected to face additional spirited pressure when Kuwait opens up its local domestic market to foreign banks in fulfillment of its obligations towards the World Trade Organization. The ability of Kuwaiti commercial banks to face these challenges depends on how professionally the proposed changes are executed.

The following section briefly discusses the differences between Islamic and conventional banks in Kuwait. In addition to pointing out the major differences between the two banks that are the subject of the case study at hand, i.e. the National Bank of Kuwait (NBK) and the Kuwait Finance House KFH, the analysis will also discuss the balance sheets, total assets and total liabilities of both banks.

4.2. FINANCIAL SYSTEM OF KUWAIT

The financial sector regularly refers to institutions or a big organization in relation to the development of transfer funds from savers to investors. It seem to be a give-and-take business where its deals with finance.

These financial possessions come in unusual and diverse forms such as deposits, currencies, stocks, bonds, shares, as well as other forms of assets by financial institutions beside other parties or client, and vice versa. These financial markets are responsible for the formation and interaction of these possessions. The expansion and multiplicity of this sector reflects the measure level of expansion and multiplicity in the economic sector; as a result, countries vary in their opinion as to their dimension, the multiplicity of their financial segments, and the volume of mobilized finances through this financial institution.

The Kuwait financial system comes up with firm significant changes in its dimension and organization, with new technology and new groups, causing it to become an advanced economy. Kuwait has a comparative branch of financial system as referred to the banking and financial system.

Banks' lending to the private sector has grown rapidly, at an average of 22% annually during 2004-2008⁵⁰, funded mostly by robust growth in bank deposits. Important changes occurred in the structure of banks' credit portfolios, including a shift toward financing real estate activities and the purchasing of securities by individuals and Investment Companies (ICs).

The Kuwaiti authorities responded forcefully to adverse developments, which helped maintain financial stability. The response came in several forms:

⁵⁰ International Monetary Fund, Washington, D.C., retrieved date Nov 06, 2010, from <http://www.imf.org>

- (a) The extension of blanket guarantees⁵¹ on all bank deposits
- (b) Liquidity injections through central bank repo operations, swaps, direct collateralized placements and government deposits at commercial banks
- (c) A reduction in repo and discount rates
- (d) The enactment of the financial stability law (FSL) allowing for substantial financial sector guarantees
- (e) An easing of the prudential loan-to-deposit ratio to facilitate credit growth
- (f) Support to the Kuwaiti stock market through the establishment of a stabilization fund

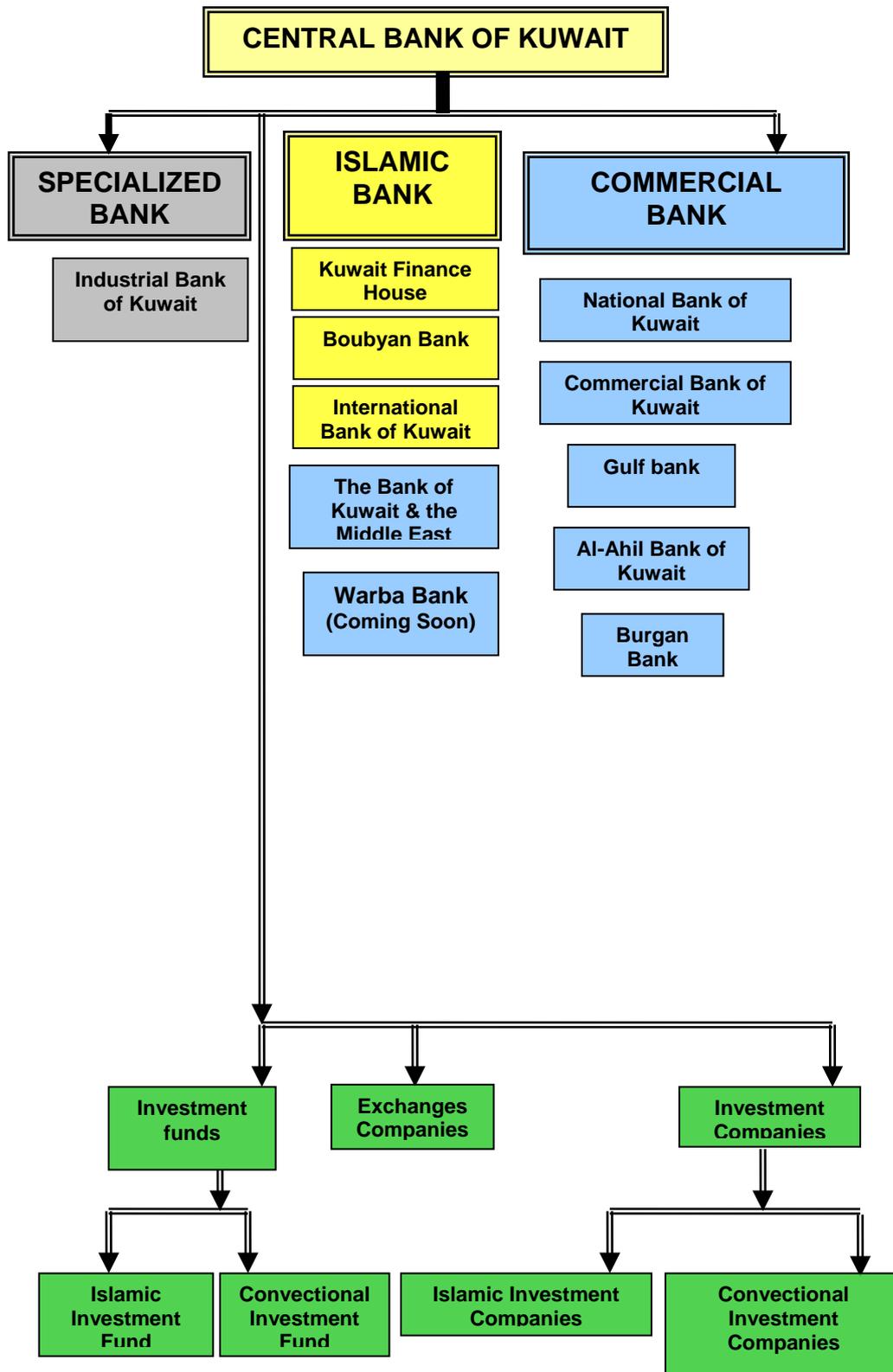
⁵¹ In theory, blanket guarantees can prevent bank runs if they are credible. However, guarantees can add substantial fiscal costs to bank restructuring programs and may increase moral hazard going forward

Table 4.1: Financial Systems in Kuwait

Name Of Banks	Year Of Incorporation	No Of Operating Local Banks Branches In The State Of Kuwait	No Of Operating Companies Registered At The Central Bank Of Kuwait.	No Of Bank Branches In Abroad	No Of Representative Offices In Abroad
CENTRAL BANK OF KUWAIT	1968				
SPECIALIZED BANKS					
Industrial Bank Of Kuwait	1974	1			
ISLAMIC BANKS					
Kuwait Finance House	1977	47			
Bubyan Bank	2004	14			
International Bank Of Kuwait	1973	9			
COMMERCIAL BANKS					
National Bank Of Kuwait	1952	67		8	2
Commercial Bank Of Kuwait	1960	53			
Gulf Bank	1960	64			
Al-Ahli Bank Of Kuwait	1967	22		1	
The Bank Of Kuwait And The Middle East.	1971	23			
Burgan Bank	1976	21			
Bank Of BNP Paribas	2005				
National Bank Of Abu Dhabi	2005				
Bank Of Bahrain & Kuwait	1977				
Doha Bank	2008				
Qatar National Bank	2007				
HSBC Bank Middle East	2005				
Citibank N.A. New York	2006				
INVESTMENTS FUNDS			111		
Islamic Investments Funds			54		
Conventional Investment Funds			57		
EXCHANGES COMPANIES			39		
INVESTMENT COMPANIES			100		
Islamic Investment Companies			54		
Conventional Investment Companies.			46		

Source: CBK (CENTRAL BANK OF KUWAIT), Economic Report, 2006

Figure 4.1: Financial Systems in Kuwait



Source: CBK (CENTRAL BANK OF KUWAIT), Economic Report, 2006

Figure 4.1 shows the structure indicated The Central Bank of Kuwait is at the head. Those are the Specialized Bank, Islamic Bank and Commercial Bank. There are also investment funds, exchange companies and investment companies. Specialized Bank deals with Industries, i.e. Industrial Bank of Kuwait established in the year 1974 with one branch in Kuwait. Islamic banks are merely based on the Islamic *Shari'ah*, Kuwait Finance House (KFH) established in 1977 with 47 branches across Kuwait, Boubyan Bank established in 2004 with 14 branches in Kuwait and International bank of Kuwait established in 1973 with nine branches across Kuwait.

The Commercial Bank has thirteen banks which are available in Kuwait. National Bank of Kuwait established in 1952 with 67 branches, Commercial Bank of Kuwait established in 1960 with 53 branches, Gulf Bank established in 1960 with 46 branches, Al-Ahli Bank of Kuwait established in 1967 with 22 branches, the Bank of Kuwait and the Middle East established in 1971 with 23 branches, Burgan Bank established in 1976 with 21 branches. Further, there are the Bank of BNP Paribas, National Bank of Abu Dhabi, Qatar National Bank, Bank of Bahrain & Kuwait, HSBC Bank Middle East, Citibank and Doha Bank.

There are other operating companies registered at the Central Bank of Kuwait. With Investment funds, the total is 111, Islamic Investment Funds registered no 54, and Convectional Investment Funds registered No 57. Exchange Companies total registered 39, Investment Companies total registered 100. Beneath the investment companies there are two companies, which are Islamic Investment Companies. The total registered are 54 and Conventional Investment Companies registered at Central Bank of Kuwait total 46.

4.2.1. Central Bank of Kuwait

The Central Bank of Kuwait was well-known in 1969 with a mission to lay down the details and protect a flexible and solid monetary financial system in the State of Kuwait, the Central Bank of Kuwait and the group of Banking Business. It replaced the Kuwaiti Currency Board, which had been familiar by virtue of the Amiri Decree No. 41 of 1960.⁵²

The role of the Kuwaiti Currency Board, unlike central banks, which carry out broad functions ranging from the drawing/getting and execution of financial policies to the management of banks, was limited to the issuance of bank notes and coins. Therefore, the organization of CBK was in reaction to the need for keeping side by side with both domestic and international economic developments, especially as the role of the financial policy gained further importance in the case of social and economic development in the country.

CBK started operating on 1st of April 1969 as specified in Article 15 of Law No. 32 of 1968. Its objectives are:

1. To exercise the privilege of the issue of currency on behalf of the state.
2. To endeavor to secure the stability of the Kuwaiti currency and its free convertibility into foreign currencies.
3. To direct the credit policy to assist social and economic progress and increase national income.
4. To supervise the banking system in the state of Kuwait.
5. To serve as banker to the government.
6. To provide financial advice to the government.

The Central Bank of Kuwait was established in 1969 with a mission to lay down the foundations and maintain a flexible and stable monetary financial system in the State of Kuwait.

CBK's objectives include:

⁵²Central Bank of Kuwait Retrieved on 21 April 2006. from <http://www.cbk.gov.kw/www/index.html>

- Issue the Kuwaiti Dinar on behalf of the State of Kuwait
- Direct credit policy to assist social and economic progress
- Assist the growth of the national income
- Control the banking system in the country.

CBK's strategy also aims to protect comparative constancy of Kuwaiti Dinar (KD) exchange rate against other currency, particularly the US Dollar, and defend the domestic economy from the effects of increase in import. This replicates the significance of the exchange rate policy in the Kuwaiti economy where there are no limitations on the movement of funds. From 18 March 1975 to the end of 2002,⁵³ the CBK followed an exchange rate strategy of pegging the KD to a weighted currency basket. That policy based the purpose of the KD exchange rate on an especially weighted basket of currencies of the countries that have important trade and financial relations with the State of Kuwait. It had verified its success in accomplishing a high degree of comparative constancy in the KD exchange rate against main world currencies. From the beginning of 2003, the KD has been pegged to the US Dollar, in agreement with the Decree No. 266/2002 that lays down pegging the KD exchange rate to the US Dollar within limits around an equivalent rate as of the commencement of 2003.

Sheikh Salem Abdul Aziz Al-Sabah, the Governor, has proclaimed the parity rate of the KD exchange rate against the US Dollar for the first day of trading in January 2003 parallel to Sunday 5 January 2003. This rate is set at 299.63 fils per dollar with limits of more or less of 3.5%. Therefore, the KD exchange rate against the US Dollar after 5 January 2003 shall not go beyond 310.11 fils/dollar and shall not fall lower 289.14 fils/dollar. This equality rate was resolute by the same ideology and thought used in times gone by. CBK settled on the KD exchange rate under the earlier system of the currency basket to ensure a smooth change from the currency basket peg to the dollar peg in margins. As a result, the margins that were set around the equality rate were to ensure sufficient relative suppleness for the KD exchange rate that

⁵³ www.cbk.gov.kw/www/index.html. Retrieved on 21 April 2006

would make possible its overall constancy against world currencies, while taking into account the individuality of the Kuwaiti economy and its trade and financial relations with the outside world. It would also help take up the sharp variation in the exchange rates of major currencies in world markets.

4.2.1a. Specialized Bank

Specialized banks were established in Kuwait as a positive step to offer long-term and medium-term loans. In the early 1970s, three banks were established and great prospect was held for the financial support and encouraging of the investment in different projects and in different sectors.

Until 1993, there were three specialized banks in Kuwait, namely 'The Industrial Bank of Kuwait', 'The Real Estate Bank' and 'The Savings and Credit Bank' (SCB). In the 1994 the SCB went under the control of the Public Authority for Housing Care and 'The Real Estate Bank' (which was incorporated in 1973) renamed same as "Kuwait International Bank" to exercise its business but converted into Islamic bank on 1st July 2007 and stopped functioning as industrial bank.

At present there is only one left for industrial loans in Kuwait which is 'Specialized Bank' that grants medium-term finance for industry. The Industrial Bank of Kuwait (IBK) was established in 1974. The Banks are allowed to accept time and savings deposits from the public but they cannot accept demand deposits. They provide technical assistance and play an important advisory role in their respective fields of operation. Normally, detailed feasibility studies on projects submitted for finance are required and they apply rigorous techniques of project evaluation. This bank is also active in the domestic and international loans market.

4.2.1b. Islamic Banks

Based on several well-established concepts and Islamic principles;

First and foremost, Islamic banking has to function within the structure of the religion, based on *Qura'n* and *Sunna*. Therefore, merely *Halal* behaviors are permissible. This holds principles supreme and, as a result, those activities forbidden to Muslims, i.e. gambling, liquor, hoarding and usury based lending, are severely restricted. The Bank does not, for instance, finance liquor industrialization, transportation, storage or sharing companies. The researcher was trained in Islamic law (Islamic Jurisprudence) and screened the appropriateness of investments on an ongoing basis and provides guidance on products to the Bank's management.⁵⁴

Interest, known as *Riba* in Islam, is not allowed. Therefore, all banking activities must avoid interest. Instead of interest, the Bank earns profit (mark-up) and fees on financing amenities are given to customers. Also, depositors earn a share of the Bank's profit as different to interest.

Joint venture and the allocation of risks are another principle of Islamic finance which is based on a profit-sharing partnership among the parties concerned in a business.

The return on savings and investment financial records are changeable and dependent on the Bank's presentation and the profits from *Halal* business transactions only. While these profits are not essentially guaranteed and are subject to a degree of threat, these are managed resourcefully to ensure better returns than from many other conventional banks.

Current accounts do not make profits as they are used as *loan*, from depositors to the bank. They do not bear any risk of loss moreover since they are kept as safekeeping (security) or *Amanat*.

Banking under the management of *Shari'ah* is part of today's financial markets in Islamic countries. In 1977, the first Islamic bank was established in Kuwait.

⁵⁴Islamic Banking Retrieved on 21 April 2006 from <http://www.projectdubai.com/faqs.php?part=2>.

This is the largest Islamic commercial bank in the world serving Kuwait's economy. This bank adopted an innovative approach in Islamic banking and developed many modern instruments to serve its customers.⁵⁵

4.2.1c. Commercial Banks

The function and operating models of commercial banks are based on manmade principles. The investor is assured of the predetermined rate of interest. It aims at maximizing profit without any restriction. It does not deal with *Zakat*. Directing money and getting it back with compounding interest is the fundamental function of commercial bank.

Kuwait's first commercial bank, The National Bank of Kuwait, was established in 1952. In 1960, two other banks were established, the Commercial Bank of Kuwait and the Gulf Bank. In 1967, the Al-Ahli Bank of Kuwait came into existence. The establishment of the Bank of Kuwait and the Middle East in 1971 replaced the British Bank of the Middle East. Finally, in 1976 the Burgan Bank was established. Kuwait now has a total of thirteen commercial banks, the same can be seen in Table [4.1] above under 'Kuwait Financial System' topic.

⁵⁵ *Presley, J.R. and Wilson R.(1992), Banking in the Arab Gulf, Ch.3 pp 46-66, London: Macmillan, London*

4.3. CONVENTIONAL HOUSING FINANCE IN KUWAIT

There is a great deal of literature on housing finance which lists different mechanisms of housing finance, to help finance a prospective home consumer. It is fair to say that there are somewhat complementary differences as well as similarities in the home finance instruments and their mechanisms among countries like the United Kingdom and the United States. This segment, thus, attempts to offer a reconsideration of the conventional housing finance, in particular in the United Kingdom and the United States. The reason for including these two countries is that they both have an urbanized and superior financial sector. On the other hand, a section is dedicated to discussing housing finance in developing countries. This is because, as Kuwait is considered to be in this group, it should be interesting to look at the financial banks of Kuwait. Conventional housing in Kuwait has its encoded rate of interest. There are various banks available in Kuwait which as conventional bank. These banks are represented as commercial banks of Kuwait. There are thirteen banks under the Commercial Bank of Kuwait. The majority of the world's population prefers to opt for financing to buy their house instead of an all-cash option. Most people do not have enough money to buy their property outright. A person who has financial capacity still opts for financing for the sake of liquidity and better investment options. Thus, with the growth of population increasing, house needs and preference for home financing, more and more financial institutions and banks are finding their place in the modern day finance era.

4.4. ISLAMIC HOUSING FINANCE IN KUWAIT

As a substitute structure of Islamic housing finance, the Islamic financial system may be illustrated as a 'fair' and 'free' financing. Islam, as a religion, recommends convinced principles which preside over economic and financial life. Islam offers the freedom to make dealings and enter into an agreement. On the other hand, there is a level of restraint to ensure that certain objectives are accomplished. These objectives consist of conducting transactions based on religious values; safeguarding of faith, wealth and economic prosperity; encourage, as well as managing, Islamic financial activities according to Islamic principles; to have fair sharing of wealth and prospect. These objectives are intended at satisfying through positive restraint, such as the prohibition of *Riba* and *Gharar*.⁵⁶

An understanding of the financing procedure of owning a home, all the way through Islamic modes, has only come into being recently after the arrival of the Islamic banking system during the 1970s, at which time it was the cause of many premature anxieties. It is seen as substitute financing for those who seek as much as are likely to desist themselves from being concerned in *Riba*. Islamic housing finance products stick to the principles of Shari'ah. In a very unsophisticated sense, Islamic mortgages engage in the purchase of the house by the investor, who would moreover sell or lease the product to the individual or customer who primarily comes up to the investor for financial support. It is the financier who has to take the forthright risk.⁵⁷

⁵⁶ *Obaidullah, M.* (2005). Islamic Financial Services (Islamic Economics Research Centre), King Abdul Aziz University.

⁵⁷ *Qaiser, W.* (2006), Introduction to Islamic Banking. (*Islamic Finance Summer School 2006*). Durham University, UK.

4.5. DIFFERENCES BETWEEN ISLAMIC AND CONVENTIONAL BANKS

In Western societies, the whole banking system is founded on the use of interest. Customers' deposits are a conduit to a diversity of small and continuing mortgages, and their rates of interest are dependent upon the period of time. The interest rates are pre-determined and are certain. The borrower must pay the interest on the mortgage, and the lenders will be given the interest assurance in addition to the return of their primary deposit. The bank's productivity depends wholly upon the individual who has the mortgage and the lending rates. The definite procedure of a conventional bank is a multifaceted one and, fundamentally, this is the centre of the banking standard and principle.

In contrast to conventional banking, Islamic banking functions on a profit-sharing basis. The banks provide financing to depositors for a wide range of businesses. A part of profit received is paid to depositors in a pre-determined profit-and-loss ratio. The profit is not and should not be determined in advance.

In the case of conventional banking, the rate of interest is determined in advance, irrelevant of the outcome. Islam does not reject the notion that capital should be justly returned; however, investors have no right to claim a fixed rate of return.

4.6. SOURCES OF FUNDS IN ISLAMIC BANKS

In addition to their own capital and equity, Islamic banks rely on two main sources of funds⁵⁸

Transaction deposits, which are risk free but yield no return

Investment deposits, which carry the risks of capital loss for the promise of variable profit rates.

⁵⁸ Corporate governance in Islamic banks, By Nasser M. Suleiman, retrieved date: 11 May 2010, From <http://www.al-bab.com/arab/econ/nsbanks.htm>

There are four main types of accounts:

- Current accounts
- Savings accounts
- Investment accounts
- Special investment accounts

Current accounts are based on the principle of *al-wadiah*, whereby the depositors are guaranteed repayment of their funds. At the same time, the depositor does not receive remuneration for depositing funds in a current account, because the guaranteed funds will not be used for PLS ventures. Rather, the funds accumulating in these accounts can only be used to balance the liquidity needs of the bank and for short-term transactions on the bank's responsibility.

Savings accounts also operate under the *al-wadiah* principle. Savings accounts differ from current deposits in that they earn the depositors income: depending upon financial results, the Islamic bank may decide to pay a premium, *hiba*, at its discretion, to the holders of savings accounts.

An investment account operates under the *Mudaraba al-mutlaqa* principle, in which the *Mudarib* (active partner) must have absolute freedom in the management of the investment of the subscribed capital. The conditions of this account differ from those of the savings accounts by virtue of: a) a higher fixed minimum amount, b) a longer duration of deposits, and c) most importantly, the depositor may lose some of or all his funds in the event of the bank making losses.

Special investment accounts also operate under the *Mudaraba* principle, and usually are directed towards larger investors and institutions. The difference between these accounts and the investment account is that the special investment account is related to a specified project, and the investor has the choice to invest directly in a preferred project carried out by the bank.

4.6.1. Uses of funds in Islamic Banks

The *Mudaraba* and *Musharaka* modes, referred to earlier, are supposedly the main conduits for the outflow of funds from banks. In practice, however, other important methods applied by Islamic banks include:

Murabaha (mark up). The most commonly used mode of financing seems to be the 'mark-up' device. In *Murabaha* transactions, the bank finances the purchase of a good or assets by buying it on behalf of its client and adding a mark-up before reselling it to the client on a 'cost-plus' basis profit contract.

Bai' muajjal (deferred payment). Islamic banks have also been resorting to purchase and resale of properties on a deferred payment basis. It is considered lawful in *fiqh* (jurisprudence) to charge a higher price for a good if payments are to be made at a later date. According to *fiqh* this does not amount to charging interest, since it is not a lending transaction but a trading one.

Bai'salam (prepaid purchase). This method is really the opposite of the *murabaha*. There the bank gives the commodity first, and receives the money later. Here the bank pays the money first and receives the commodity later, and is normally used to finance agricultural products.

Istissanaa (manufacturing). This is a contract to acquire goods on behalf of a third party where the price is paid to the manufacturer in advance and the goods produced and delivered at a later date.

Ijara and *ijara wa iqtina* (leasing). Under this mode, the banks buy the equipment or machinery and lease it out to their clients who may opt to buy the items eventually, in which case the monthly payments will consist of two components, i.e. rental for the use of the equipment and installment towards the purchases price.

Qard hasan (beneficence loans). This is the zero return type of loan that the Holy *Qura'n* urges Muslims to make available to those who need them. The borrower is obliged to repay only the principal amount of the loan, but is permitted to add a margin at his own discretion.

Islamic securities and financial institutions often maintain an international Islamic equity portfolio where the underlying assets comprise ordinary shares in well run businesses, the productive activities of which exclude those on the prohibited list (alcohol, pork, armaments) and financial service based on interest income.

4.7. ACCESSING THE FINANCIAL PERFORMANCE OF THE BANK

As indicated earlier, this case study examines an example of an Islamic bank and another conventional bank operating in Kuwait, in an attempt to highlight the main points of differences and/or similarities in the housing lending practices of these two types of bank. As noted earlier, the National Bank of Kuwait (NBK) represents an example of a conventional bank, while the Kuwait Finance House (KFH) provides an example of an Islamic bank, both of which operate in Kuwait.

Under the regulation and influence of the Central Bank of Kuwait (CBK), the Kuwait financial sector comprises of thirteen commercial banks that follow international banking standards. These banks make available different banking facilities to customers, such as conventional banking services such as savings accounts, traveler's checks, credit cards, money market accounts, allowances, etc. Kuwaiti banks also provide American companies and individuals with financial assistance and support. The Kuwait Finance House is the only Islamic bank in Kuwait providing services and products equivalent to those of a Western-style commercial bank.

There are three Islamic banks available in Kuwait. These are the International Bank of Kuwait, formerly the Kuwait Real State Bank, which was re-structured as a specialized bank. Another Islamic bank is the Boubyan Bank, established more recently in 2004. There is one specialized bank governed and owned by

State of Kuwait that provides medium and long-term financing only for Industrial purposes (The Industrial Bank of Kuwait), which normally finances industrial and agricultural projects. The role of the Credit and Savings Bank is to financially help individual Kuwaitis with meeting their housing needs and personal residential development. There are also the Investment funds, Exchange companies and Investment Companies, which are regulated by the Central Bank of Kuwait (CBK). The Investment fund comprises the Islamic Investment Fund and Conventional Investment Fund. The above banks have various branches which can be seen in detail in the approaching section.

Numerous Kuwaiti banks have full correspondent relationships with major US banks, with which they have various transactions. These banks are Citibank, Bankers Trust and Chemical Bank. There are, however, several other American banks that provide specific services, such as investment advice, credit card processing, traveler's check processing and foreign exchange trading services. In addition, many non-US banks with operations in the United States also have firm correspondent relationships with Kuwaiti banks. These comprise Credit Lyonnais, Deutsche Bank, Dresdner Bank and Standard Chartered Bank.

Due to the broad and complicated nature of operations at Kuwaiti banks, there are opportunities that allow foreign correspondent banks to act in response to a full range of banking requirements. Kuwaiti banks have a global perspective and anticipate their foreign correspondents to work with them at that level.

4.8. GENERAL FINANCING AVAILABILITY

Kuwait recommends to American companies numerous resources for trade and project financing, which consist of world-class commercial banks, complicated savings companies and Islamic financial institutions. Kuwaiti banks are able to offer financial services directly to a US company based on its financial statements, or supported by a guarantee from a trustworthy bank in the US. Subject to the nature of the consignment; financing by Kuwaiti banks can be accessible on a variety of terms. These include direct payment, cash in advance, documentary collection, letters of credit, and letters of guarantee. The following section will specifically address the case of the Kuwait Finance House and the National Bank of Kuwait, which are the focus of this study.

4.9. OVERVIEW ON KUWAIT FINANCE HOUSE

As an Islamic bank, the Kuwait Finance House (KFH) is well-known in the State of Kuwait. It was founded in 1977 as the primary bank operating in agreement with the Islamic *Shari'ah*. KFH is listed on the Kuwait Stock Exchange (KSE), with a market capitalization of KD 3.133 billion as of 31 December 2006.⁵⁹ Its holdings total KD 6.314 billion and deposits are equal to KD 3.730 billion, accounting for 25% of the total deposits in the Kuwaiti market, as per the balance sheet of 2006. KFH offers a wide variety of Islamic *Shari'ah* - compliant products and services, which cover banking, real estate, trade and finance, investment portfolios, and other products and services.

Since the 1980s, KFH has witnessed enormous growth on an international level. It has opened well-known independent banks in different countries like Turkey, Bahrain, and Malaysia. Furthermore, it has pledged to open additional Islamic banks. Its investment behaviour in the US, Europe, South East Asia and the Middle East greatly contribute to accomplishing the ever-growing profit of KFH, in association with the world's most important companies and

⁵⁹ Overview On Kuwait Finance House Retrieved on 21 April 2006. from <http://www.kfh.com>

banks, such as Citibank, Deutsche Bank, JP Morgan, Chase, BNP Parisbas, ABN Amro, HSBC, and the Islamic Development Bank (IDB). KFH has constantly endeavored to enlarge its network of 47 local branches, in introducing branches that service women only. The bank has upheld its status as a ground-breaking entity in developing recent technology to meet the needs of the different areas in which it functions by means of an online service, SMS, as well as phone service, and has received an outstanding customer satisfaction and service levels.

4.9.1. REAL ESTATE SERVICE BY 'KUWAIT FINANCE HOUSE' (KFH)

The Local Real Estate Department of KFH has an entrenched record that spans approximately twenty years of experience, and has been facilitating real estate services to its customers for much of that time. The Department endeavors to offer the most distinguished services to its customers. It supports the local infrastructure and real estate investments, contributes to the expansion of the construction expansion in the State of Kuwait, assisting in the realization of young people's aspirations for finding suitable residences at reasonable prices. In so doing, it utilizes a flexible and profitable technique to satisfy customers, thus contributing to making a better future for everyone.

The Department presents a host of real estate services and products, as it deals with all types of realties, including land, residential, investment and commercial real estate properties, and public utilities such industrial and agricultural plots, villas and cottages.

4.9.2. EXTERNAL REAL ESTATE PROPERTIES

The Kuwait Finance House (KFH) places paramount importance on fulfilling its customers' needs for fresh services and products, whether through banking, marketable commercial or investment products equally inside and outside Kuwait. The innovative products and services obtainable from KFH contain the international real estate *Murabahah* service in Holy Mecca, Medina, Bahrain, Sultanate of Oman, Emirates, Lebanon, Egypt and London.

Kuwait Finance House (KFH) emphasized the continuance of the geographical expansion plan efforts targeting further growth and spreading out by launching new branches in different regions, based on the effective role of "KFH" in the economic development and meeting the growing needs of its clients' for distinctive banking services, relying on economic, technological, and modern standards as well as specialist banking team offering its Islamic banking services to individuals and companies in all areas.

Noteworthy to mention in this regard that, "KFH" maintains 52 branches in the local market covering the major active areas in addition to an excellent geographical spread in the foreign markets. The most important among its foreign branches is strategically positioned in the Turkish market through the "KFH Turkey". KFH has plans in place and aims at increasing the total number of its branches from 132 branches currently to 145 by the end of 2010. "KFH" also operates in Bahrain and Malaysia.⁶⁰

4.9.3. PRODUCT ADVANTAGES

KFH designs its products in such a way that they will provide benefit and advantage to its customers. It fulfills the customer's wish to possess a real estate property overseas at suitable conditions for both the citizens of Kuwait and the expatriates of GCC. It has also utilized an easy mode of installments suitable to the customer's circumstances and income.

For the benefit of customers, KFH has also arranged a suitable grace period to pay the initial installment. KFH has a specialized team that offers essential and practical services. To practise safe borrowing, the *Murabahah* operation takes place by means of a specialist in the real estate field with the follow-up and agreement of KFH.

KFH also has plans for the combined legal liability insurance on debt in case of death, or lasting total disability.

⁶⁰ Kuwait Finance House launches five new branches in 2010
Retrieved date Kuwait: Monday, July 26 - 2010 from <http://www.ameinfo.com/238710.html>

4.9.4. CONDITIONS FOR ACQUIRING THE FINANCING PRODUCTS

According to KFH, there are certain conditions that need to be adhered to before acquiring the financing products as well as the sale by installments, *Murabahah*, lease or external realties. The following conditions shall be fulfilled:

- It is dependent on the monthly income of the customer, i.e. that of the husband and wife's monthly income, even though it is more likely in a traditional society such as Kuwait that the husband would be the sole earner.
- The customer acquiring the finance has to transfer his or her salary to KFH.
- The customer shall pay a processing fee or an advance payment of the real estate property to be purchased or rented.

4.9.5. Papers required in order obtaining the Product

- Certificate of validity of the salary of the customer and the associate, if any, as well as that of the sponsor, if any.
- A copy of the civil status identity card and nationality of the customer, sponsor and partner, if any.
- Any additional documents in case there is an income other than the salary.
- The existence of a sponsor who meets the conditions (according to the controls).
- The marriage agreement in case of the addition of the wife's salary.
- A photocopy of the passport.

4.9.6. Real Estate Owner's Particulars

- Photocopy of the civil status identity card, nationality, and document.
- Sketch or the plan of area.

4.10. OVERVIEW OF NATIONAL BANK OF KUWAIT (NBK)

The National Bank of Kuwait (NBK) is one of the most prominent conventional banks operating in Kuwait. Since NBK's establishment in 1952, first as a national bank and then as the first combined joint stock company in the Gulf region, it has been steadily increasing its proceeds, which stood at \$1 billion in 2007, and an ROE⁶¹ of 29.9%. Amongst Arab companies, NBL has the highest market capitalization of \$18.5 billion as at the end of 2007.

NBK bank is the leading financial institution in Kuwait. It has also earned the uppermost credit ranking in the Middle East. Along with Arab banks, NBK has widespread local and international networks, which comprise branches, auxiliaries and envoy offices in many other countries, such as New York, London, Paris, Geneva, Lebanon, Jordan, Bahrain, Qatar, Dubai, Egypt,

⁶¹ Return On Equity

Singapore, China, Iraq, Turkey and Saudi Arabia. Additionally, it has a determined strategy for development in the near future to cover Syria and other country states.

NBK's operating income topped \$1.6 billion in 2007. The bank's cost to income ratio stood at 26.7% in 2007. The ratio for non-performing loans to total loans was 1.96%, among the lowest internationally, with subsequent stipulation to such loans equivalent to 166.4% of its value. These corroborate the bank's status of having the benefit of long-standing experience.

As the economic growth was solid in 2007, the confidence level was high, customer expenditure and asset were strong, and there was good credit demand to fuel further growth. Capital markets were optimistic, which created a good growth opportunity in investment banking and services.

Its basic strength permitted NBK to reap the benefits of a positive business environment and expand the client support in all aspect, thus creating balanced growth along its overall business lines and regions. The National Bank of Kuwait achievement has been propelled by a clear vision of assigning importance to customers and upholding strong relationships built on trust.

Planned programs have meant the expansion of the National Bank of Kuwait's market management and the increase of local presence. The bank has had a very strong performance as a result of its entry into new markets in Qatar and Jordan. The bank's international operations have played a very important role in generating additional wealth for National Bank of Kuwait, and these operations have focused on a wide range of industries, finance deals, as well as corporate and private banking.

The National Bank of Kuwait has maintained very close ties with the Egyptian market, the largest in the Arab world. In 2007, the National Bank of Kuwait obtained 98.1% ownership in the Egyptian National Bank.⁶² Also in 2007, the bank increased its ownership share in the International Bank of Qatar from a

⁶²National Bank of Kuwait Retrieved on 21 April 2006. from <http://www.nbk.com>

20% to 30% bet. This year, the NBK operated 67 branches in the State of Kuwait, and eight branches for its representative offices abroad. With its strong standing, the bank is poised to achieve further growth in the future. The following section examines the real estate operations offered by the NBK, with a particulate focus on housing loans.

4.10.1. Real Estate Services Provided by National Bank of Kuwait (NBK)

For a number of years, we have urbanized a wide range of business and individual associates inside the real estate markets in the UK, USA, France and Lebanon, collectively for residential and commercial belongings properties. As a result, NBK is able to present its customers with responsive, specialized recommendation and support across a wide range of necessities - as well as with purchasing, selling and renting property all throughout the United Kingdom, France and elsewhere in Europe.

The services, which are customized to the client's exacting needs and situation, include: providing the Trade, selling residential or commercial properties on behalf of customer. For the benefit of the customer, NBK deals for the private or business foreword to specialist qualified advisors, such as lawyers, assessors. The Requirements of offshore companies to grasp property in the USA, UK and France in the most tax-efficient manner is to provide general support with the successful conclusion of real estate dealings and recommendation on financing of property dealings.

4.10.1a. Customer Loans Conditions

- Minimum Loan KD 1,000 and Maximum Loan is KD 15,000
- The minimum tenor is 12 Months, while the maximum is 5 years
- The applicant should be younger than 60 years old at the maturity of the loan
- Minimum salary KD 400
- Salary must be transferred to NBK.

4.10.1b. Documents Required

- Copy of Your Civil ID
- Military ID is required for MOI, MOD, National Guards
- Salary Certificate
- Salary Transfer Continuation Certificate.

4.11. STRENGTH AND WEAKNESS

According to the strength and weakness, there are different criteria to consider on the basis of the banks, namely National Bank of Kuwait NBK and Kuwait Finance House KFH.

4.11.1. NATIONAL BANK OF KUWAIT (NBK)

NBK has consistently received the highest all-round credit ratings among banks in the Middle East and emerging markets by the major rating agencies including Moody's, Standard & Poor's, Fitch Ratings, and Capital Intelligence. This reflects its relatively stable management and conservative strategy. It was the only Kuwaiti bank to remain solvent during Kuwait's 1982 Manakh crisis thanks to prudent management lead by CEO Ibrahim Dabdoub. Furthermore, the bank has the following strength and weakness:

4.11.1a. STRENGTH

- Concrete financial position, ranking well above peer group average.
- Highly specialized and long portion senior management team.
- Leading share in the domestic market and considerable abroad assets.
- Well expanded assets in order to diminish threat exposure.
- Very traditional foremost policy as can be seen from the bank stipulation to total loans.

4.11.1b. WEAKNESSES:

- Dependence on short-term inter-bank deposits which may become unstable in stress acknowledgment.
- The total holding of lower-yielding and illiquid government paper required to be reduced further.
- High expansion rate of operational expenses with some efforts to cut costs, operational expenses.

NBK has emerged to be a very firm organization to additional local domestic banks. It has, for all time, held a most important position and has demonstrated its ability to survive in extraordinary circumstances. It was the only Kuwait bank to stay in business during the Gulf crisis. This reflects both its financial potency and good management. NBK has a number of concrete franchises and its standard and reputation overseas has always been excellent. Given the bank share in the sector, good management and strong financial position, we consider that current levels of productivity are sustainable in the medium term. In relation to other banks within the region, the bank's confidence on inter-bank financial support emerges high.

4.11.2. KUWAIT FINANCE HOUSE (KFH)

KFH, the only Islamic bank that provides a financial service in Kuwait, has lead the way in endorsing the Islamic banking movement. It has strong government possession and is well sponsored. This is also reflected in its solid deposit base which remains, on the other hand, frequently short-term in nature. Furthermore, liquidity is very tight, even for an Islamic bank. Given the revelation concerning uncertain amounts outstanding, we believe that the bank's possessions quality is not acceptable due to the high level of bad debts on the balance sheets, while provision for these debts emerges as insufficient.

The bank has the following strengths and weakness:

4.11.2a. STRENGTHS

- Concrete interior customer base
- The first and strongest Islamic bank in the domestic local market.

4.11.2b. WEAKNESSES

- According to the KFH bank, uncertain debts are the highest in the market, while supplies next to these doubtful debts emerge to be inadequate.
- Liquid possessions account for a very low portion of the balance sheet.
- Even though improved, disclosure in the account remains poor when compared to other local banks.

KFH has a desirable position in that it is the major Islamic operator in the domestic market. It has built a significant franchise and is well observed in the Gulf region. With the organization of a new regulatory structure for Islamic banks in the country, KFH might face new opposition over the medium term which will act as an additional catalyst for the bank to strengthen its already strong position. The new law would also bring the bank under the shade of the central bank. Certainly, by not having a prescribed treatment link to the central bank, KFH may be at an inconvenience for the reason of its hybrid status in the banking sector. This is possibly most reproduced in the lack of restriction for its risk categorization and provisioning necessities.

Economic markets and financial organization are an important part of any contemporary economy. Kuwait made momentous developments in financial intensify and in building a contemporary financial infrastructure. Surplus oil revenues direct to the gathering of considerable overseas resources and private wealth, part of which were intermediated by the banking division. Kuwait, along with other GCC countries, was a net provider of investments to the rest of the world until 1990. During 1990-91, the Iraqi invasion deeply affected the Kuwaiti financial system and its financial sector. Subsequent to the release, and the return of confidence, banks strengthened their deposit base and improved productivity by acquiring advanced technologies.

At present state, there are many challenges facing the commercial banks of Kuwait that will probably affect their skill to raise and function inside more spirited surroundings. The economy of Kuwait remains to be dependent on oil as its main source. Oil still makes up more than 90 per cent of Kuwait's goods sold abroad earnings and 80 per cent of financial plan income. In addition, the public sectors dominate the economy in provisions of possession and administration of most behavior. Still, the presentation of the private sector and the non-oil sector activities are associated to different government expenses plans throughout the support of financial credit and loans, and input prices, evenhandedness booster, bailouts, and favorite in government bond. As a result of this important reliance on oil and the public sector, it has been difficult to expand various money-making profitable asset chances outside the limited range of real estate, trade businesses and stock market performance. This has interpreted into the attentiveness of bank loan into consumer loans, real estate, and trade finance at the cost of loans to the industrial sector. Loan opportunities are still limited by the great allocation of expatriates in the population, whose right of entry to bank credit is hindered by assets of numerous systems as well as those connected to real estate and corporate possession. Due to this, the lack of economic assortment, coupled with surplus liquidity resulting from considerable oil exports revenues, has produced many tentative bubbles.

In 1982, the stock market breakdown resulted in the bursting of one of the majority of tentative bubbles in the history of Kuwait. It left the banking sector with a non-functioning collection of non-performing financial credit. It was a period in which Kuwaiti commercial banks went through a period of reorganization, made a great effort to make bigger the range of their services than conventional banking services and into activities such as speculation and indemnity. Furthermore, Kuwaiti commercial banks not only required the correct authoritarian structure to play the role of worldwide banks, but they too had to face rigid competition from well-established local domestic investment and insurance companies. It is also predicted that Kuwait commercial banks will face additional spirited pressure when Kuwait opens up its local domestic market to foreign banks in accomplishment of its promises to the World Trade

Organization. The capability of Kuwaiti commercial banks to get together as a result of the challenges depends on how professionally they are executed.

4.12. NATIONAL BANK OF KUWAIT AND KUWAIT FINANCE HOUSE: COMPARATIVE ANALYSIS

This describes the methods of home finance offered by the two banks.

The government provided 70,000 KD to the citizens of Kuwait as housing finance. This amount is not in kind, nor is it a gift for the citizen; it is a simple loan at the rate of 10% of a person's monthly salary with no rate of interest. This 70,000KD is not sufficient for the purchase of a house, but it enables the client to take out a private loan either from the Islamic bank or the conventional bank of Kuwait, that is the Kuwait Finance House (KFH) or National bank of Kuwait (NBK). Conventional banks have a fixed rate of interest according to the Central Bank of Kuwait (CBK); for example, if the rate of interest at today's date is 6% and, after a period of time there is a change of rate of interest by the central bank of Kuwait, the client and the bank has to accept the particular rate of interest accordingly (**variable rate**).⁶³ In terms of Islamic banks, as Kuwait Finance House (KFH) is a *sharia*-based bank, the contract signed between the client and the bank is called a *Murabahah*, which is fixed and will remain unchanged during the lifetime of the loan (**fixed Rate**).⁶⁴

Further detail is mentioned below as an example.

Example below shows a financial housing transaction sample based on Islamic and conventional bank. We took National Bank of Kuwait as conventional bank and Kuwait Finance House as Islamic mortgage provider to the customers.

⁶³ A variable rate or adjustable rate refers to any type debt instrument, such as a loan, bond, mortgage, or credit that does not have a fixed rate of interest over the life of the instrument. (Routledge German Dictionary of Business commerce and finance.)

⁶⁴ A fixed rate mortgage (FRM) is a mortgage loan where the interest rate on the note remains the same through the term of the loan (Routledge German Dictionary of Business commerce and finance.)

The first example will talk about the conventional, followed by the Islamic home finance by *Murabahah*. Both clients take loans in order to purchase a home with a market value of 112,000 KD.

Example: Conventional Bank (National Bank of Kuwait) Approach.

The market value is 112,000 KD and the government gives the client 70,000 KD as of this point.

$112,000 \text{ KD} - 70,000 \text{ KD} = 42,000 \text{ KD}$ The balance amount of money the client should receive from the bank in order to purchase the home.

$42,000 \times 0.06057 = 2625 \text{ KD}$ This is the annual interest on the balance amount.

Presume the amount tenure fixed and accepted by client is for 10 years.
 $2625 \times (10 \text{ year which is equal } 120 \text{ months}) = 26250 \text{ KD}$

Total loan = $(42000 \text{ KD} + 26250 \text{ KD}) = 68250 \text{ KD}$.

To find the monthly installment for the desire loan = $(68250 \text{ KD} \div 10 \text{ year } (120 \text{ months})) = 568 \text{ KD}$.

Example: Islamic Bank home finances (Kuwait Finance House)

In a similar case, the client will acquire funds from Kuwait Finance House, financing through *Murabaha*. The market value is 112,000 KD and the government provides the client with 70,000 KD through the Kuwait savings bank, as mentioned in Kuwait Housing Market and Financial Systems.

The customer approaches the Kuwait Finance House for a housing loan; on behalf of the customer, the Kuwait Finance House evaluates the transaction and purchases the property which the customer is supposed to purchase. After approval by the bank, the customer signs the agreement (*Promise To Buy Contract*), the tenure for 10 years. The bank is the proprietor of the property until the assigned amount is cleared by the client.

Total *Murabahah* = (42,000 KD X 0, 60) = 25,200 KD.

Total Resolvable = (25,200 KD + 42,000 KD) = 67200 KD.

To find out the monthly payment installment

= 67200 KD ÷ 10 year (120 months)) = 560 KD.

From the above two examples of the conventional bank and Islamic bank, we discover that the example output amount is very similar but, as we discussed above, the conventional bank (National Bank of Kuwait) is an interest-based bank (*Riba*), where the rate of interest is altered by the Central Bank of Kuwait, which also affects the client at the time of payment to the bank. It has been observed that the rate of interest is not permanently fixed. It has also been found that there is a fluctuation in the rate of interest with the conventional bank.

On the other hand, the Islamic bank (Kuwait Finance House) is *sharia*-based, and thus deals with *Murabahah*, which is fixed and will never change during the lifetime of the tenure assigned between the banks and the customers. This is the profit and loss share (PLS) between the bank and the client.

Table 4.2 below represents the amount of funding given by the Kuwait Finance House for house purchases during the period 1996–2008. It also shows the growth rate of home financing made by the Kuwait Finance House (Islamic Bank), as well as the percentage of change in home finance to total receivables.

Table 4.2.: The Home Finance and Growth Rate for *Kuwait Finance House* during (1996–2008)

Years	HOME FINANCE IN KFH		TOTAL RECEIVABLES		HOME FINANCING TO TOTAL RECEIVABLES
	MD (KD)	Growth Rate %	MD (KD)	Growth Rate %	
1996	136,110	-	880,376	-	1.55%
1997	117,240	-13.86%	952,238	8.16 %	1.23 %
1998	137,250	17.07%	950,535	-0.18 %	1.44 %
1999	115,270	-16.01 %	1,009,54	6.21 %	11.42 %
2000	81,559	-29.25 %	1,070,52	6.04 %	7.62 %
2001	80,141	-1.74 %	1,179,85	10.21 %	6.79 %
2002	80,930	0.98 %	1,285,36	8.94 %	6.30 %
2003	74,227	-8.28 %	1,457,49	13.39 %	5.09 %
2004	450,609	507.07 %	1,484,97	1.89 %	30.34 %
2005	501,474	11.29 %	2,104,35	41.71 %	23.83 %
2006	515,482	2.79 %	2,778,17	32.02 %	18.55 %
2007	2,346,675	355.24%	3,988,11	43.55%	58.84%
2008	1,140,312	-51.41	4,779, 78	19.85%	23.86%
Total	3,423,951		1,5153,386		15.11 %

Source: Kuwait Finance House, Consolidated Balance sheet (1997–2008). Finance Department and Local Real Estate Department.

In this section we will be discussing the finance and the growth rate from the period 1996 to 2008 under the Kuwait Finance House (KFH). Private housing transactions were recorded as the highest in the year 2007, with a total of 2,346,675 KD, while 2003 was the lowest total with 74,227 KD. In the year 2007, the government had made it more easier for the citizens of Kuwait to obtain facilities to purchase real estate. This is in comparison with the year 2003 and the unstable political situation between Kuwait and Iraq. This period had brought about distrust and people didn't have the confidence to invest in real estate. The real estate private housing transactions for the period 1996-2008 amounted to KD 3,432,951 million.

Calculation:

1. To find the % of growth rate of home finance receivable, for example year 1997.

$$= \text{home finance year (1997)} - \text{home finance year (1996)} \div \text{home finance year (1996)} \times 100.$$

For example:

$$= 117,240 - 136,110 \div 136,110 \times 100 = - 13.86\%$$

2. To find the % of Growth rate to total receivable for year (1997).

$$= \text{Receivable year 1997} - \text{Receivable year 1996} / \text{Receivable year 1996} \times 100.$$

For example:

$$= 952.238 - 880.376 \div 880.376 \times 100 = 8.16 \%$$

3. To find the Home Financing to total receivable Rate % for year (1996).

$$= \text{home financing for year (1996)} \div \text{total receivable for year (1996)} \times 100.$$

For example:

$$= (136,110) \div (880,376) \times 100 = 15.46\%$$

Table 4.3 below represents the amount of funding given by the National Bank of Kuwait for house purchases during 1996–2008.

Table: 4.3.: Home Financing And Growth Rate for the *National Bank of Kuwait* during (1996-2008)

Years	HOME FINANCE IN NBK		TOTAL RECEIVABLES		HOME FINANCING TO TOTAL RECEIVABLES
	MD (KD)	Growth Rate %	MD (KD)	Growth Rate %	
1996	156,049	-	1,529,278	-	10.20 %
1997	148,770	-4.66 %	1,609,441	5.24 %	9.24 %
1998	153,083	2.90 %	1,344,516	-16.46 %	11.39 %
1999	180,703	18.04 %	1,291,465	-3.95 %	11.99 %
2000	329,918	82.57 %	1,398,915	8.32 %	23.58 %
2001	431,053	30.65 %	1,563,256	11.75 %	27.57 %
2002	467,795	8.52 %	2,142,578	37.06 %	21.83 %
2003	110,901	-76.29 %	2,478,389	15.67 %	4.47 %
2004	159,165	43.52 %	2,744,722	10.75 %	5.80 %
2005	440,771	176.93 %	3,363,654	22.55 %	13.10 %
2006	549,974	24.78 %	4,309,836	28.13 %	12.76 %
2007	750,538	36.47 %	5,920,308	37.37 %	12.68 %
2008	1,290,313	71.92 %	6,955,405	17.48 %	18.55 %
Total	5,169,033	-	36,651,763		14.88 %

Source: National Bank of Kuwait, Consolidated Balance sheet (1997–2008). Finance Department.

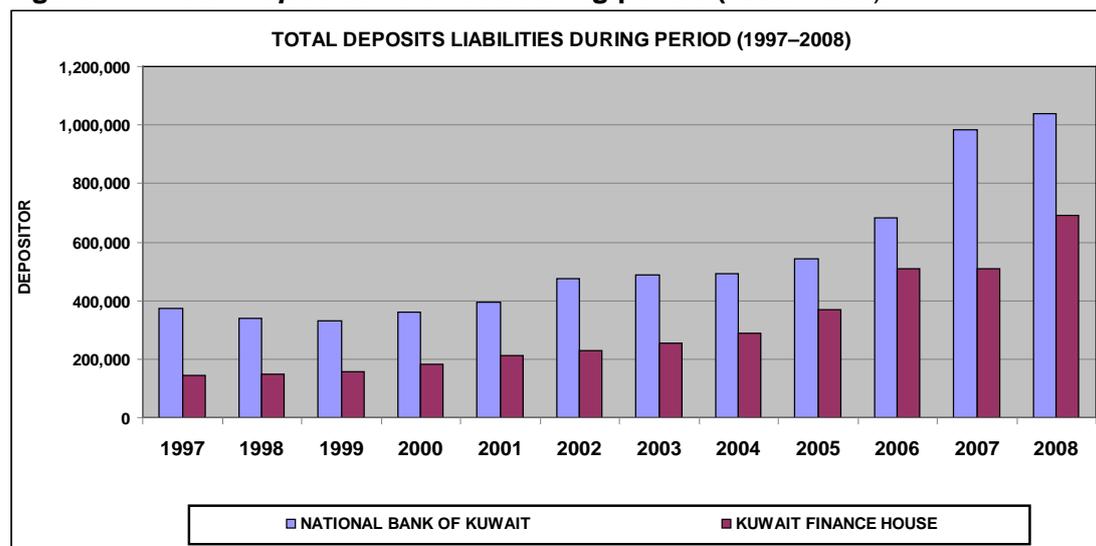
We can see from the table 4.3 Home finance during 1996-2008 by National Bank of Kuwait (NBK) This part we will be discussing the finance and the growth rate from the period of 1996 to 2008 under the National Bank of Kuwait NBK. For private housing transaction has recorded the highest in the year 2007, total 750,538 Million *KD* and the lowest to the year total 2003, the total amount 110,901 Million *KD*. In year 2007 government had made more easier and facility in term of real estate for the citizen of Kuwait. As compare to the year 2003 because of the political situation was not stable between Kuwait and Iraq, due to that it had brought less of trust and confidence in country people to invest in real estate sector. The real estate private housing transactions during 1996-2008 have accounted the total 5,169,033 *KD* Million.

Table 4.4: Total Deposits Liabilities during Period (1993 – 2008)

Deposits liabilities (Million KD)		
YEAR	National Bank of Kuwait	Kuwait Finance House
1997	3,749,47	1,452,36
1998	3,387,33	1,500,36
1999	3,322,86	1,577,29
2000	3,595,62	1,808,38
2001	3,947,27	2,135,68
2002	4,739,93	2,292,41
2003	4,861,07	2,533,70
2004	4,917,09	2,889,81
2005	5,425,38	3,691,76
2006	6,832,33	5,099,26
2007	9,844,51	5,099,21
2008	10,404,76	6,928,40

Source: The Financial Operating Reports, Consolidated Balance sheet (1997–2008), by the Research Unit Institute of Banking Studies, Kuwait

Figure 4.2: Total Deposits Liabilities during period (1993–2008)



From Table 4.4 and the chart figure 4.2, which is the total deposits liabilities for the National Bank of Kuwait and Kuwait Finance House, the performance in total deposits liabilities of National Bank of Kuwait is higher than the Kuwait Finance House during 1997–2008. However, it can be seen that, for the Kuwait Finance House during the period 2005 to 2008, the total deposits liabilities continued to increase rapidly. It is forecasted that in the coming five years or so the National Bank of Kuwait will reach almost the same level of performance.

The Table 4.5 and figure 4.3 below gives details about the total assets of National Bank of Kuwait (NBK) and Kuwait Finance House (KFH) for the years 1993-2008. According to the table and figure, it is clear that the NBK assets are higher than the KFH, the reason being that NBK was the first bank in Kuwait to be established in 1952, whereas KFH was the first Islamic bank in Kuwait to be established in 1977. As a result, the NBK has more clients than the KFH, thus the asset total differs.

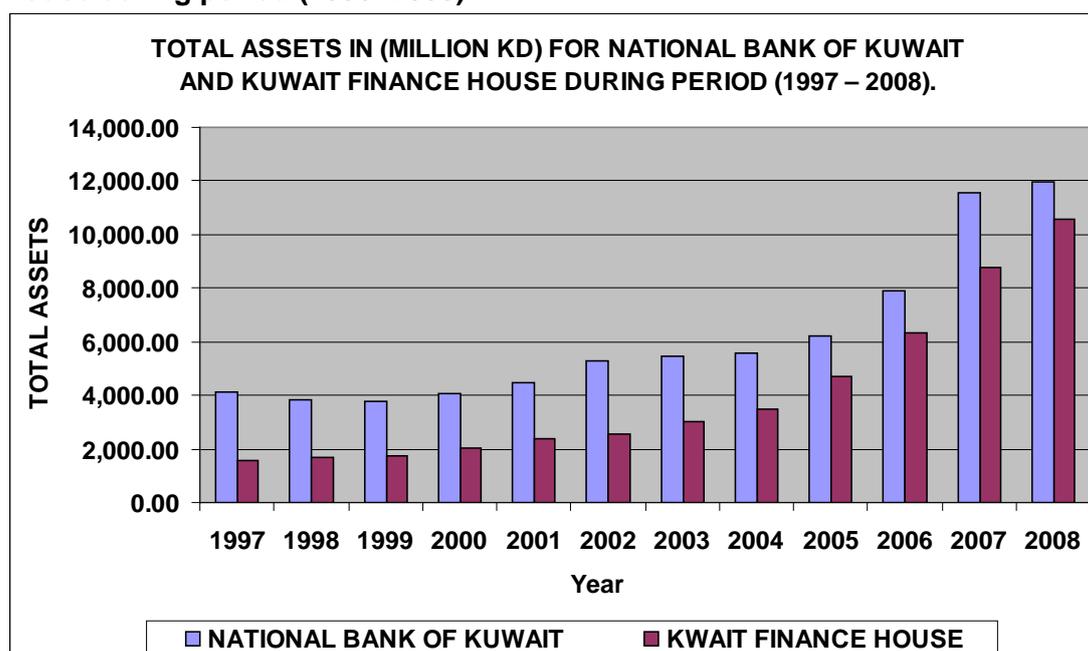
Table 4.5 figure 4.3 shows an overview of the total assets for both banks in order to see the total assets performance during the same period of 1997–2008.

Table 4.5: Total Assets (in million KD) during the period (1993–2008)

TOTAL ASSETS (Million KD)		
YEAR	National Bank of Kuwait	Kuwait Finance House
1997	4,118,05	1,580,80
1998	3,835,00	1,669,31
1999	3,796,90	1,769,50
2000	4,093,17	2,025,61
2001	4,470,16	2,375,49
2002	5,274,45	2,554,38
2003	5,439,11	3,041,11
2004	5,572,89	3,458,07
2005	6,200,32	4,681,12
2006	7,898,25	6,313,79
2007	11,539,42	8,797,92
2008	11,973,32	10,544,14

Source: The Financial Operating Reports, Consolidated Balance Sheet (1997–2008), by the Research Unit Institute of Banking Studies, Kuwait

Figure 4.3.: Total Assets for National Bank of Kuwait and Kuwait Finance House during period (1993–2008)



From Table 4.3 and figure 4.3, the chart can tell us the total assets growth for Kuwait Finance House (Islamic bank, and National Bank of Kuwait (conventional bank). This has been collected from the annual reports for both banks. In chart above the volume of total assets is increasing and they are semi leveled in Kuwait Finance House. The size of total assets of the National Bank of Kuwait do not increase during the period 1997–2000, but then began to increase until 2008.

However, it can be seen that the total assets were almost equal in 2008, which shows the performance in total assets for the Kuwait Finance House was better than the National Bank of Kuwait. As was noted, although the National Bank of Kuwait has been operating over a longer period of time (since 1952) than the Kuwait Finance House (since 1997), the performance for both banks is very good.

4.13. KUWAIT FINANCE HOUSE AND NATIONAL BANK OF KUWAIT: COST INCOME RATIO

The Cost Income Ratio or cost-to-income ratio shows the efficiency of a firm in minimizing costs while increasing profits. The lower the cost-to-income ratio, the more efficient the firm is running. The higher the ratio, the less efficient management is at reducing costs.

Cost-to-income ratio equals a company's operating costs divided by its operating income.

For Example:

Operating expenses ÷ Operating income = Cost of Income Ratio

Operating expenses each month = **KD 500,000**

Operating income each month = **KD 900,000**

KD 500,000 ÷ KD 900,000 = 0.555 (Cost of Income ratio)

The operating expense and Operating Income for the period of 1997 – 2009 is collected from Kuwait Finance House (KFH) and National Bank of Kuwait (NBK) annual reports published for the stock holders and formed in the shape of table 4.6 for Kuwait Finance House and 4.7 for National Bank of Kuwait.⁶⁵

⁶⁵Cost income ratio, Retrieved 15 November 2010, from http://www.ehow.com/how_6398870_calculate-cost_to_income-ratio.html

Table 4.6 KFH Cost Income Ratio Statement (1997–2009)

Calculation of Cost of Income Ratio for KFH			
Year	Operation income	Operation Expenses	Cost income Ratio
1997	122,206	36,544	0.299036054
1998	131,986	42,595	0.322723622
1999	134,054	28,590	0.213272263
2000	145,989	48,155	0.329853619
2001	143,180	30,180	0.210783629
2002	146,524	31,728	0.216537905
2003	163,357	40,887	0.250292305
2004	230,475	57,802	0.250795097
2005	383,328	127,976	0.33385508
2006	578,987	204,107	0.352524323
2007	831,148	253,747	0.305297011
2008	884,853	487,808	0.55128705
2009	776,703	497,109	0.640024565

Source: Annual Report for NBK and KFH (1997 – 2009)

Table 4.7 NBK Cost Income Ratio Statement (1997–2009)

Calculation of Cost of Income Ratio for NBK			
Year	Operation income	Operation Expenses	Cost income Ratio
1997	132,976	46,275	0.347995127
1998	131,552	50,957	0.38735253
1999	148,578	50,725	0.341403169
2000	154,483	51,321	0.332211311
2001	161,099	48,265	0.299598384
2002	160,647	47,983	0.298685939
2003	186,526	50,957	0.273189797
2004	235,475	57,802	0.245469795
2005	311,463	72,976	0.234300703
2006	395,156	98,862	0.250184737
2007	424,369	113,099	0.266510985
2008	508,474	159,501	0.313685656
2009	518,451	179,906	0.347006757

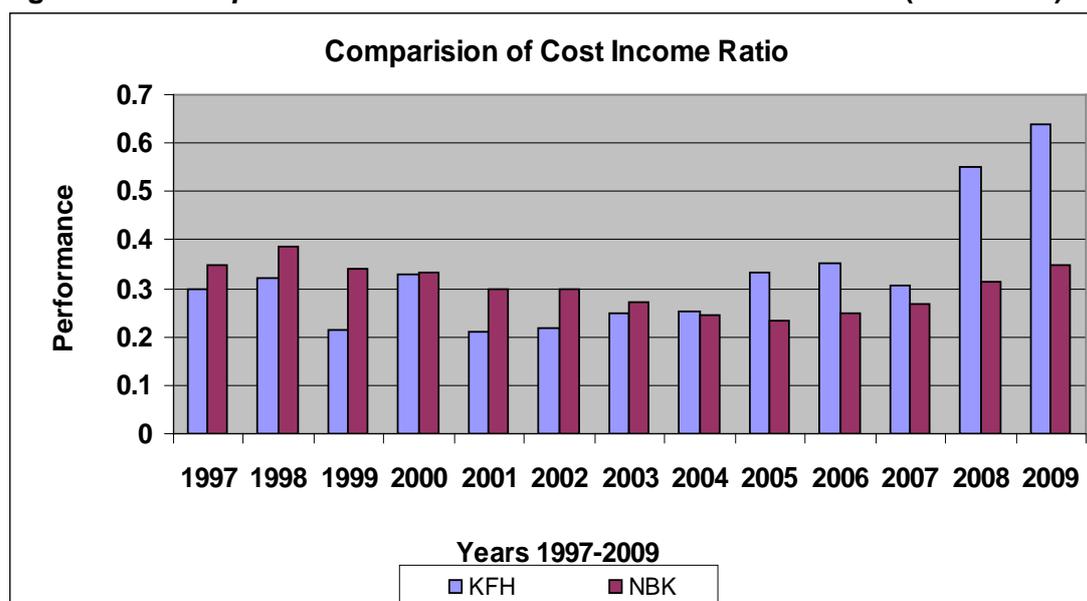
Source: Annual Report for NBK and KFH (1997 – 2009)

In the table 4.8 Cost Income Ratio of both of the banks are shown for the comparison against each year (1997-2009) further presenting the data in Chart 4.4.

Table 4.8 Shows the Cost Income Ratio for Kuwait Finance House and National Bank of Kuwait for the years 1997-2009

Comparison of Cost Income Ratio		
Year	KFH Cost Income Ratio	NBK Cost Income Ratio
1997	0.299036054	0.347995127
1998	0.322723622	0.38735253
1999	0.213272263	0.341403169
2000	0.329853619	0.332211311
2001	0.210783629	0.299598384
2002	0.216537905	0.298685939
2003	0.250292305	0.273189797
2004	0.250795097	0.245469795
2005	0.072981885	0.234300703
2006	0.352524323	0.250184737
2007	0.305297011	0.266510985
2008	0.55128705	0.313685656
2009	0.640024565	0.347006757

Figure 4.4.: Comparison of Cost of Income Ratio for KFH & NBK (1997-2009)



It is sought through Cost Income Ratio comparison for both of the banks that KFH is always remain successful in curtailing their expenses resulting maximizing their profit. Especially at the time of global crises seen by all financial entities KFH remain stable and kept growing more faster than ever.

4.14. CONCLUSION

The research findings clearly suggest that the drive towards the Kuwait Finance House (KFH) is favoured by the customer. As an Islamic country, citizen of this state look towards the Islamic product and the Kuwait Finance house can offer a wide variety of Islamic *Shari'ah*-acquiescent products and services, as there are ample numbers of Muslims who approach the bank on religious grounds. In the real estate sector, the Kuwait Finance House is confident in providing smooth transactions to its customers. There are many Muslims who prefer to deal with the conventional banks and have no worries about changing their deposit between NBK and KFH banks, depending on the bank which offers a better return. Islamic banks like KFH deal with *Murabahah*, which fulfills every customer with its best services.

Chapter 5: RESEARCH METHODOLOGY

5.1. INTRODUCTION

Islamic banks have gained a substantial momentum and worldwide growth in the recent past. Though the growth rate has been fast-paced, banks are facing increasing competition among themselves and from their conventional counterparts. The banks are facing tremendous challenges to come up with products that cater to the various financial needs of the customers.

One such attempt is in the field of home financing. The Kuwait home financing market is dominated by conventional products. All the major players in home financing in Kuwait offer conventional home financing products, with the exception of Kuwait Finance House, the only player in its field.⁶⁶ This restricts the choice of potential users in terms of the variety and choices of the product and lowers competitiveness among the suppliers. Thus, KFH has the competitive advantage of being the dominating player in its segment. However, it also has a disadvantage in that it is the only one to compete with the strength of the number of conventional players.

The growing demand for Islamic modes of financing in Kuwait and the competition that it is offering to its conventional counterparts makes it worthwhile to study and to analyze the bank's current potential and future prospects. With this motive in mind, the present research work entitled "A comparison of Islamic and conventional home financing in Kuwait: Client perceptions of the facilities offered by the National Bank of Kuwait and Kuwait Finance House" has been conceptualized.

⁶⁶ Islamic Financing in Kuwait is dominated by Kuwait Finance House and until recently it was the only player in its segment. Now, the *Boubyan* Bank and more recently the Kuwait Real Estate Bank are also providing Islamic home financing with different options for the customers in Kuwait.

The present chapter elaborates on the research aims, the various hypotheses used for evaluating the merits of the research findings, the research approach, methodology and the data collection process, statistical analysis and conclusion.

5.2. RESEARCH AIMS AND OBJECTIVES

The present study aims to investigate whether Islamic home finance has any restrictions over the conventional home financing options in the case of the State of Kuwait. With this aim in mind, the present study makes a comparison between the concepts of Islamic and conventional home financing systems with respect to the following issues:

- Structure
- Pricing
- Term
- Availability
- Customer satisfaction
- Customer knowledge and product awareness
- Supplier's knowledge of these products.

Further, as the objective of the research is to identify the demand for Islamic home financing in Kuwait, it involves the collection of primary data through survey techniques, using a questionnaire to elicit a response from potential users of home financing products. Some general questions were also asked to interviewees to help familiarize them with the subject and to help the interviewer gather what is deemed to be subjective information.

5.3. RESEARCH QUESTIONS

The following questions were considered in order to analyze the benefits of Islamic Home finance compared to conventional home finance in Kuwait.

1. Does religious belief have any impact on the choice of mortgage products?
2. Is there a significant difference between the Islamic and conventional banks with respect to the pricing of home finance?
3. Is the structure of home finance different between Islamic and conventional banks?
4. Are there differences between Islamic and conventional banks in terms of the availability of home finance to the customer?
5. Do the terms of home finance differ between Islamic and conventional banks?
6. What is the perceived level of customer satisfaction between Islamic and conventional home financing?

5.4. SETTING UP OF HYPOTHESIS

A *hypothesis* refers to a provisional idea whose merit needs evaluation. For evaluation, the specifications of the hypothesis need to be defined in operational terms. Any useful hypothesis will enable predictions by reasoning, including deductive reasoning. It might predict the outcome of an experiment in a laboratory setting or the observation of a phenomenon in nature.

Testing and setting up a hypothesis is an essential part of statistical inference. In order to formulate such a test, usually some theory has to be put forward, either because it is believed to be true, or because it is to be used as a basis for argument, but has not been proved; for example, the claim that a new drug is better than the current drug for treatment of the same symptoms.

5.4.1. Null Hypothesis

The null hypothesis (H0) represents a theory that has been put forward, either because it is believed to be true, or because it is to be used as a basis for argument, but has not been proved.⁶⁷

5.4.2. Alternative Hypothesis

The alternative hypothesis (H1) is a statement of what a statistical hypothesis test is set up to establish.⁶⁸

Null and alternative hypotheses were set up to conduct the actual research. A number of null hypotheses were developed to determine various aspects of Islamic home financing and its nature as compared to the conventional methods of home financing.

5.5. STUDY HYPOTHESES

The following hypotheses and their corresponding alternative hypotheses were proposed:

H1: Islamic home finance is more expensive than conventional home financing.

H1A: Islamic home finance is not more expensive than conventional home financing.

H2: There are differences between the Islamic and conventional banks in terms of the factors considered in pricing home finance.

H2 A: There are no differences between Islamic and conventional banks in terms of the factors considered in pricing the home finance.

⁶⁷ For example, in a clinical trial of a new drug, the null hypothesis might be that the new drug is no better, on average, than the current drug. We would write H0: there is no difference between the two drugs on average.

⁶⁸ For example, in a clinical trial of a new drug, the alternative hypothesis might be that the new drug has a different effect, on average, compared to that of the current drug. We would write H1: the two drugs have different effects, on average. The alternative hypothesis might also be that the new drug is better, on average, than the current drug. In this case we would write H1: the new drug is better than the current drug, on average.

H3: Islamic home financing is in demand due to the religiosity of the people.

H3 A: Islamic home financing is not necessarily in demand due to religiosity.

H4: There are different structures for Islamic home finance, while there is only one structure for conventional home finance.

H4 A: Islamic home finance has a single structure similar to a conventional home finance facility.

H5: The *Ijara* and *Iqtena* (lease and possession) contract is likely to be the most common contract used in Islamic home finance in Kuwait.

H5 A: The *Ijara* and *Iqtena* contract is not the most widely used contract in Islamic home finance in Kuwait.

H6: There are no differences between Islamic and conventional banks in terms of the duration of the home finance facility.

H6 A: Islamic banks and conventional banks have a considerable difference in terms of the duration of the home finance facility.

H7: The home finance customers of a conventional bank are more satisfied than the customers of an Islamic bank.

H7 A: The home finance customers of Islamic banks and conventional banks show a similar level of customer satisfaction.

H8: Islamic home finance might be available for customers with high income compared to the conventional.

H8 A: Islamic home finance is available to all income groups with the same ease as the conventional home finance.

To test the hypotheses, data was collected, analyzed, evaluated and statistically interpreted. For data collection, a survey technique was used and a number of questions were asked to the interviewees to arrive at a

conclusion. Additionally, past balance sheets of the bank and other historical data were also collected using the observation technique. All the data collected was arranged quantitatively, and statistical analysis was conducted in order to arrive at the results.

5.6. RESEARCH APPROACH

Research is an organized and systematic way of finding answers to questions.⁶⁹ It is also a process for collecting, analyzing and interpreting information to answer questions. The research question is central to the research, as it gives a purpose to the research, and thus must be focused on useful and important questions.⁷⁰ Researchers normally use two types of research approaches, namely the quantitative and qualitative approach. The data collection and analysis process in a research are based on either approach, or a combination of the two approaches. The two approaches are not mutually exclusive. This is obvious, since social researchers rarely rely on one approach. Secondly, both approaches are frequently shared and overlapped.⁷¹ Certain findings from one research strategy can be reinforced with a method drawn from the other research strategy. Secondly, combining research strategy enables researchers to explore an area in both ways. This study, for example, collects qualitative data which gains access to the perspectives of the people under examination, whilst the quantitative data allows specific issues to be explored further. Thus, a combination of both approaches is used in the desired proportion in the present research.

⁶⁹ Henrichsen, L., M. T. Smith, et al. *Research Methods in TESL and Language Acquisition*. Retrieved 10 October 2006, from http://linguistics.byu.edu/faculty/henrichsen/ResearchMethods/RM_2_03.html.

⁷⁰ *ibid*

⁷¹ Two of the three reasons suggested by Martyn Denscombe (1998) state that in the real world researches cannot be clearly distinguished into Qualitative and Quantitative Approaches as there is a thin line dividing the two.

5.7. RESEARCH METHOD

A researcher has to use a set of procedures or specific techniques in collecting and analyzing the data used in answering the questions that were initially posed.⁷² The research method is simply a set of instruments to be used for data collection and analysis.⁷³ The research strategy and the techniques employed must be appropriate for the questions to be answered, or to the research questions.⁷⁴ That entails the selection of a method or methods to be employed, which must be based on what kind of information is wanted, from whom and under what circumstances.⁷⁵ While framing the research methods, usually the qualitative and quantitative approaches are used by social science researchers.

5.7.1. Qualitative Method

Generally, qualitative research focuses on the subjective experience and perception of the research subjects. The qualitative method is most often used when the motive is exploration. Data that is treated as qualitative are mainly those which are written or spoken words or observations which do not have a direct numerical interpretation.⁷⁶ The main research methods associated with qualitative research are participant observation, qualitative interviewing, focus groups, language-based approaches to the collection of data such as conversation analysis, and the collection and qualitative analysis of texts and documents.⁷⁷

In qualitative research, the researcher is the key instrument of data collection. Tools used in qualitative research include open-ended interviews, field notes, and 'conversations' with participants or journal diaries. The focus of qualitative

⁷² Robson, C. (2002). *Real World Research*, Blackwell Publishing.

⁷³ Cohen, L., L. Manion, et al. (2005). *Research Methods in Education*, London, Routledge Falmer.

⁷⁴ Robson, C. (2002). *Real World Research*, Blackwell Publishing.

⁷⁵ *ibid*

⁷⁶ Schutt, R. K. (2001). *Investigating the Social World*, Pine Forge Press.

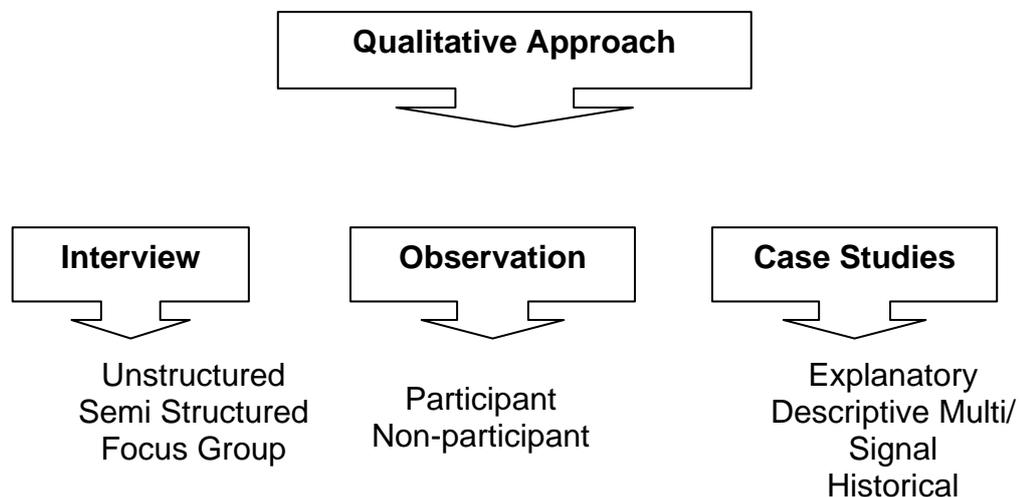
⁷⁷ Bryman, Alain. (2004). *Quantity and Quality Social Research Methods*, Oxford Press

research is not only to describe, but also to analyze: it seeks to look at the *why* of events, not just the *what* (Tuckman, 1988).

5.7.1.1. Nature of qualitative research

Qualitative research is an array of interpretive techniques which seek to describe, decode, translate and otherwise come to terms with meaning, not with the frequency, of certain more or less naturally occurring phenomena in the social world.⁷⁸ Qualitative research is perceived to be any type of research that generates output which is not derived by statistical procedures or means of quantification.⁷⁹ It is a research strategy which usually gives an emphasis on words, rather than quantification in the collection and analysis of data.⁸⁰ It explores experiences, meanings, perceptions and feelings.⁸¹ In essence, the qualitative method attempts to capture and understand individual definitions, description and meanings of events.

5.7.1.2. Types of the qualitative method



⁷⁸ Van Maanen, J. (1983), *Qualitative Methodology*. London: Sage

⁷⁹ Strauss and Corbin. (1998). *Basics of qualitative research, techniques and procedures for developing grounded theory*. London: Sage Publication.

⁸⁰ Bryman, Alan. (2004). *Social Research Methods*, New York: Routledge.

⁸¹ Kumar, R. (2005). *Research Methodology A Step by Step Guide For Beginners*. London, Sage Publication

5.8. INTERVIEWS

The interview is a form of questioning characterized by the fact that it employs verbal questioning as its principle technique of data collection.⁸² The interview constitutes generating conversations with people on a specific topic, or a range of topics and interpretations from the resultant data. It gives insights into people's experiences, opinions, values, attitudes and feelings.⁸³

5.8.1. *Type of Interviews*

There are four types of interviews in qualitative analysis. These are: 1) the structured interview; 2) the semi structured interview; 3) the unstructured interview; and 4) group interview.

1. Structured interview.

This involves the use of a questionnaire instrument so that the same question is asked in the same way to each person and the interviewee has very little freedom to express his/her own opinions in his/her own way.

2. Semi-structured interview.

Allows the interviewer the freedom to probe beyond the answers and expand on issues raised whilst the interviewee is allowed to answer more on their own terms

3. Unstructured interviews

This type of interview has an open-ended character in that, even though the interviewer has the aim in mind, the interviewee nevertheless is given more freedom to talk about the topics being discussed.

4. Group interview.

⁸² Sarantakos, Sortirios. (1994). *Social Research*. London: The Macmillan Press Ltd.

⁸³ May, T. (2001). *Social Research, Issues, Methods and Process*, Buckingham, Open University Press.

This involves the participation of eight to twelve individuals to discuss a particular topic.⁸⁴

5.8.2. Advantages of interviews⁸⁵

Like the questionnaire method, there are various advantages and disadvantages to using the interview method. These will be discussed below.

1. The interview makes it easier for the interviewer to accomplish his/her goals through getting to know a specific subject matter, and then setting out to gather quality data for the research.
2. The interview creates favourable circumstances for both the Interviewee and the Interviewer to explore the subject in detail and share their views and visions freely and extensively.
3. The interview can be conducted with limited facilities. The conversation skill is the main basis for the interview. Equipments such as pen, pencil, notebook and, if necessary, tape recorder are sufficient to conduct interviews, provided the interviewee is the real representative of the research subject.
4. As the interviewer can have direct contact to the interviewee, doubts could be clarified in a legible manner which will ensure accuracy and validity in data collection.
5. Both the interviewer and interviewee can set a time and location at their convenience and it is their responsibility to conduct the interview in a constructive manner.

⁸⁴ May, T.(2001). *Social Research, Issues, Methods and Process*, Buckingham, Open University Press.

⁸⁵Denscombe, M. (1998). *The Good Research Guide for a Small Scale Social Research Projects*,_Open University Press.

5.8.3. Disadvantages of interviews

1. Most of the time, the interviewer may gather the information from the interviewee in a transcribing and coded form. While analyzing the data, it would be difficult for the interviewer to decode such information. Indeed, it would be a hectic task and a time consuming process.
2. The information gathered from the interviewee may not be reliable in some occasions whereby the interview subject is unique and focuses on specific individual for the interviewee. In this situation, the interviewer cannot expect consistency in his/her research data and analysis.
3. The identity of the interviewer in terms of his/her job, his/her authoritative nature of talk may sometimes impact the statements that the interviewee makes. This 'interview effect' could create wide variation between the interviewee's statement and his/her actual work.
4. The interviewee may lose his original conversation capabilities sometimes, if his/her statement is recorded by tape recorder. These unnatural circumstances may deter the flow of facts in the interviewee's statement.
5. The interviewer may face difficulties in conducting the interview, if the interviewees are located in different places. Gathering information from them at different times and locations and travelling to meet them would be a hectic task for the interviewer.

5.9. OBSERVATION METHOD

Observation is a method that employs the sense of vision as its main source. It is normally used in combination with other techniques. Observation is conducted depending on the need of the research participant or non participant⁸⁶. There are many positive aspects of the observation research approach; namely, observations are usually flexible and do not necessarily need to be structured around a hypothesis. For instance, before undertaking more structured research, a researcher may conduct observations in order to form a research question. This is called descriptive research. Observation research findings are considered strong in validity, because the researcher is able to collect a depth of information about a particular behaviour. However, just like the other methods of conducting research, there are negative aspects to observation. In observational research, findings may only reflect a unique population and, therefore, cannot be generalized to others. There are also problems with the researcher's bias. Often, it is assumed that researchers may 'see what they want to see'. Bias, however, can often be overcome with training or through the electronic recording of observations. Hence, overall, observation is a valuable tool for researchers.

5.10. CASE STUDY

A case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between the phenomena and context are not clearly evident, and in which multiple sources of evidence are used. While using qualitative research, the reliability and validity of the data should be determined. Case study research excels at bringing us to an understanding of a complex issue or object, and can extend experience, or add strength to what is already known through previous research. Case studies emphasize detailed contextual analysis of a limited number of events or conditions and their relationships. Researchers have used the case study research method for many years across a variety of

⁸⁶ While in participant observation, the researcher becomes a member of the research group without disclosing his identity; in non-participant research, the researcher is not a part of the subject and his position is clearly defined.

disciplines. Social scientists, in particular, have made wide use of this qualitative research method to examine contemporary real-life situations and provide the basis for the application of ideas and extension of methods.

5.11. NATURE OF QUANTITATIVE RESEARCH

The focus of quantitative research is on objective measures, rather than subjective experience. It is a research strategy which is usually designed to produce conclusions in the form of numerical data, and typically uses 'closed' questions.⁸⁷ The analysis of data subjects variables to frequency distributions, cross-tabulations or other statistical procedures.⁸⁸ Data is collected in some objective and replicable manner; this methodology provides greater distance between the data and researcher than in qualitative studies. In addition, data is usually analyzed statistically in this type of research. The tools of quantitative research include testing performance scores, physiological readings, survey responses and spectrometer readings.

The quantitative methodology is based on a positivist philosophy. The quantitative method is most often used when the motives for research are explanation, description, or evaluation. Data that are treated as quantitative can either be in numbers or attributes, which can be ordered in terms of magnitude, for example people's attitude and behavior.⁸⁹ The main research method associated with quantitative research is surveys.⁹⁰ Surveys gather data at a particular point in time and vary in their levels of complexity, from providing simple frequency counts to that which present a relational analysis.⁹¹

⁸⁷ Arksey, H. and P. Knight (1999). *Interviewing for Social Scientists*, London, Sage Publications.

⁸⁸ Kumar, R. (2005). *Research Methodology A Step by Step Guide For Beginners*. London, Sage

⁸⁹ Schutt, R. K. (2001). *Investigating the Social World*, Pine Forge Press.

⁹⁰ Arksey, H. and P. Knight (1999). *Interviewing for Social Scientists*, London, Sage Publications.

⁹¹ Cohen, L., L. Manion, et al. (2005). *Research Methods in Education*, London, Routledge Falmer.

5.12. SURVEY TECHNIQUE

The survey technique is used to gather relevant data. The choice of survey method depends on several factors. These include:

Table 5.1: The Survey Technique

Speed	Email and Web page surveys are the fastest methods, followed by direct and telephone interviewing. Mail surveys are the slowest.
Cost	Personal interviews and telephone interviews are more expensive, followed by mail. Email and web page surveys are the least expensive for large samples.
Internet Usage	Web page and email surveys offer significant advantages, but it may not be possible to generalize their results to the population as a whole.
Literacy Levels	Illiterate and less-educated people rarely respond to mail surveys.
Sensitive Questions	People are more likely to answer sensitive questions when interviewed directly in one form or another.

5.13. QUESTIONNAIRE

The questionnaire is the main apparatus of the case study and a means for information collection. It provides the task of quantity⁹² and an examination device that contains questions in a self-administered survey.⁹³ There are three ways in which a questionnaire can be managed: (i) clear-cut, self-managed questionnaires, (ii) face-to-face or personnel-level interview, (iii) or a hotline interview or interview received by email.⁹⁴ Self-managed questionnaires can have various structures, such as the postal questionnaire or telex questionnaire.

In this study a survey on 240 respondents were conducted, out of which 117 of them obtained home mortgages from Kuwait Finance house (KFH) which adopts the Islamic Banking System and 123 from National Bank of Kuwait (NBK) which is following the conventional banking system. Among the sample we omitted 40 responses due to reasons like vagueness, incompleteness etc. Finally, 100 responses from Kuwait Finance House customers' and 100 from NBK customers' been selected in this study. The result of the survey shows that most people prefer Islamic banking system because it is in conformity with their Islamic beliefs. This is a comparative study as it compares two different banking systems. It also throws light on some of the shortcomings of the Islamic Banking services as well as its advantages. In this study we adopted several statistical methods including descriptive analysis, chi-square test, cross tabulation, ANOVA test and factor analysis in order to analyze the preferences of respondents.

5.13.1. Types of Questionnaire Items

Questions are of two types, namely open-ended and closed-ended questions. Open-ended questions do not have definite answers, while close-ended questions have a finite set of answers from which the respondents can choose

⁹² Oppenheim, A. N. (1992). *Questionnaire Design, Interviewing and Attitude Measurement*, Pinter Pub Ltd., p. 100.

⁹³ Schutt, R. K. (2001). *Investigating the Social World*, Pine Forge Press, p.222.

⁹⁴ Robson, C. (2002). *Real World Research*, Blackwell Publishing, p. 236

the correct answer. In the present survey, most of the questions are designed as close-ended questions.

Close-ended questions consist of five main styles. One style uses the Likert-scale, which is useful for learning the respondents' feelings or attitudes about the subject as they are asked to indicate how closely their feelings match the question or statement on a rating scale. Multiple choice questions as the respondent only chooses the best answer from the possible options. Ordinal questions are useful for ranking the possible answers in order. Categorical questions are considered when the possible answers for a question are in categories for which a response must belong in either one of them. Lastly, numerical questions are asked whenever the answer is in real numbers.⁹⁵

A combination of the qualitative and the quantitative techniques was used in the present study, in which the qualitative aspect of this research was carried out through interviewing the candidates in person. In addition to the interviews, survey questionnaires were also used to gather the statistical data for analysis by adopting an appropriate sample design.

5.13.1.1. Advantages of questions

There are various disadvantages in using a questionnaire. However, the advantages seem to outweigh the disadvantages, thus the reason for the insistence on carrying out the survey method of questionnaire for the purpose of the present study. Below is a list of advantages and disadvantages of using a questionnaire:

1. The questionnaire is an easy method of approaching the research study for analysing its objectives, characteristics and facts.
2. As research questions are similar in terms of wordings and meanings, the respondent's replies could be converted as standard data with great consistency.

⁹⁵ Encyclopedia of Educational Technology. "*Types of Survey Questions*." Retrieved 16 October 2006, from <http://coe.sdsu.edu/eet/Articles/surveyquest/index.htm>

3. Distributing questions to a large number of respondents by posting or e-mail is an easiest and speedy way to get the requisite information about the research subject.
4. Gathering the relevant information from respondents through a questionnaire may save the administrator time and cost.
5. The questionnaire allows respondents to maintain their privacy and guilelessness while replying to some sensitive questions.
6. It would be an easy task for respondents to reply to the questions in a convenient place and time and in a relaxed manner.

5.13.1.2. Disadvantages of questionnaires

The disadvantages of using the questionnaire method include the following:

1. Respondent's unfavourable attitudes, such as inexperience, lack of awareness and insincerity may be responsible for the uncertainty and unreliability of the research data.
2. Respondents' responses may not necessarily reflect their actual beliefs and faiths towards the research subject.
3. Respondents may face difficulty in fully understanding the questions in order to offer their responses. This misunderstanding factor is also an unavoidable demerit of the questionnaires.
4. Respondents may sometimes not be interested in the subject matter of the questionnaire. This attitude may result in the respondent offering an irresponsible and unreliable response to the questions.

5.14. SAMPLING

Two kinds of sampling procedures were utilized in the current study, namely probability and non-probability samples. Probability samples ensure that the samples taken are representatives of the population, as each person in the population has an equivalent opportunity of being incorporated in the sample. Non-probability samples are used when it is complicated or inappropriate to make certain that each person in a growing population has an equivalent possibility of being included in the sample. Probability samples are of many types, and these include straightforward random samples, methodical samples, stratified random sampling and multi-stage group sampling. Non-probability sampling types consist of purposive or convenience sampling, snowball sampling and quota sampling.⁹⁶

The clientele of the Islamic bank and the conventional bank in Kuwait are the main target group of this research. As the property ownership in Kuwait is

⁹⁶ Bryman, A. (2004). *Social Research Methods*, Oxford Press.

limited and restricted just to Kuwaiti citizens, the current study does not include the expatriate population for the survey. Thus, the current study is focused only on Kuwaitis, who engage in bank transactions, either with a conventional or an Islamic bank in terms of owning a bank account and securing a home financing loan.

In the analysis of the study's population, overcoming time and expenditure limitations⁹⁷ depends on the sampling method. In order to ensure the equal representation of the target group, a questionnaire was provided to 200 individuals. Personal interviews were conducted with them on the subject matter. To have an even distribution of the population and to avoid biased responses, an equal number of persons, drawn each from NBK (conventional Bank) and KFH (Islamic Bank), were contacted.

Since the banks have a large network but an unequal number of branches, the samples were drawn from branches throughout Kuwait. This ensured that the questionnaire was evenly distributed throughout the country with a maximum participation of target group on a rational basis.

In order to distribute the questionnaires to the correct proportion of different age groups of male customers, the statistical reports of the Ministry of Planning in the State of Kuwait were used. The following outlines the characteristics of the sample:

⁹⁷ Sekaran, Uma, *Research methods for business: A skill-building approach*, Second Edition, John Wiley & Sons, Canada, 1992, p. 227.

TABLE 5.2: DISTRIBUTION OF SAMPLING PER LOCATION.

STATE OF KUWAIT	NUMBERS OF RESPONDENTS IN SAMPLE	
	NBK	KFH
Hawally	15	15
Mubarak Al-Kabeer	20	20
Farwaniya	15	15
Ahmadi	15	15
Jahra	15	15
Kuwait City	20	20
Total	100	100

5.15. SURVEY DETAILS

- Survey Type: Direct Interview and Questionnaire
- Sample Selection: Random Sample
- Sample Control: Sample controlled by the account number for the various customers who have or wish to avail home finance facility from a conventional bank and an Islamic bank
- Satisfaction Index:
 - Dissatisfied
 - Neutral
 - Somewhat satisfied
 - Very much satisfied.

5.16. INTERVIEW QUESTIONS

Separate questions were asked to participating NBK and KFH officials, while the survey questionnaire was kept unchanged for both. The interview questions can be found in Appendix (B).

The questionnaire was designed based on the model developed by Parasuraman *et al.* (2008). To render a summary of the research process, Table 5.3 outlines the research questions and the related hypotheses and the corresponding statements.

Table 5.3: Summary of the Research Process

Research Questions	Research Hypotheses	Questionnaire Statements	Interview Questions
Is the pricing of home finance different between Islamic and conventional banks?	H1&2	Q -16	NBK – Q 4, 11 KFH – Q 6,
Is the structure of home finance different between Islamic and conventional banks?	H4	Q – 17, 19	NBK – Q 1 KFH – Q 1
The <i>Ijara</i> and <i>Iqtana</i> (lease and possession) contract is likely to be the most common contract used in Islamic home finance in Kuwait?	H5	Q - 15	Q - 1
Are there differences between Islamic and conventional banks in terms of the availability of home finance to the customer?	H8	Q - 7	
Do the terms of home finance differ between Islamic and conventional banks?	H6	Q - 20	NBK – Q6 KFH – Q8
Does customer satisfaction with regards to home finance differ between Islamic and conventional bank?	H7	Q -28,29	
Does religiosity have any impact on the choice of mortgage products?	H3	Q – 9,4,29	KFH – Q 3,

This research utilizes the outcome of the quantitative method, and describes the nature of the questionnaire (open-ended and close-ended questions) and aims of the section.

Open-ended question: An open-ended question is designed to encourage a full, meaningful answer using the subject's own knowledge and/or feelings. Open-ended questions typically begin with words such as "Why" and "How", or phrases such as "Tell me about..." Often they are not technically a question, but a statement which implicitly asks for a response.

Closed-ended questions: Closed-ended questions encourage a short or single-word answer and limit respondents' answers to the survey. Participants are allowed to choose from either a pre-existing set of dichotomous answers, such as yes/no, true/false, or multiple choice with an option for "other" to be filled in, or ranking scale response options.

5.17. DATA ANALYSIS

SPSS was used for quantitative data analysis (frequencies, descriptive and analytical methods) and interpretation method used for interviews.

5.17.1. Limitations and Difficulties

Although competent efforts were made in the data collection process, the possibility of some unavoidable limitations cannot be ruled out. To mention a few:

- Random sampling was used to select different age groups of home loan users. This type of selection of respondents can be expected to produce samples that are reasonably representative of the population for these different sub-groups. However, there were some refusals by selected individuals among these sub-groups, and this may serve to bias the sample in ways that are not readily evident.
- The information collected in the study was of a self-report nature which, depending on the subject areas being queried, may be prone to some

inaccuracy as a result of less than accurate recall, lack of information, or discomfort with self-disclosure.

- The research design was a one-time survey that produced a profile of the characteristics of persons who either do not own a home or want to own another one. This type of cross-sectional design precludes the drawing of any conclusions about the cause-and-effect relationships between these characteristics.

5.17.1.1. Data analysis

Questionnaire Data Analysis

The respondents' statements and views gathered during the interviews and the written replies received for the questions were the major source of information for the present research. The replies obtained for the questionnaires were thoroughly verified to ascertain whether these replies are relevant for the specific questions or not. The irrelevant answers were eliminated in order to maintain the accuracy of the information. The re-checked and refined information was then converted into research data, so as to enable it to fit for statistical analysis using SPSS package. The purpose of using the SPSS software is it helps you in case study for Descriptive statistics: Cross tabulation, Frequencies, Descriptive, Explore, Descriptive Ratio Statistics, t-test, ANOVA, Correlation, Nonparametric tests and prediction for numerical outcomes: Linear regression. Furthermore, prediction for identifying groups: Factor analysis, cluster analysis (two-step, K-means, hierarchical) and discriminate.

5.17.1.2. Interview data analysis

The answers of each interviewee were recorded using a tape recorder and then the recorded answers were carefully transcribed. By re-hearing the recorded information and re-reading the transcribed texts, the refined answers were focused for specific questions with due consideration to their suitability.

Apart from this, some of the answers were considered as groups. Both individual as well as group answers are used for data analysis.

In the present study, the answers to the questions and the information obtained from the interviews are arranged as data with due consideration of the themes of individual questions put forth in the questionnaire and for the interviews. Thus, the information gathered through these questionnaires and interviews was focused as valid data and it forms the basis for preparing the report of data analysis.

5.18. LIMITATION AND DIFFICULTIES

There are limitations and difficulties encountered in the present survey and they are summarized below:

1. The number of home mortgage users was restricted to 100 from the conventional Bank Sector (NBK) and another 100 from the Islamic Home Finance Sector (KFH). It could perhaps have been more useful for enriching the research findings if more respondents were surveyed. This could not be achieved due to the lack of time and the delayed responses from the respondents.
2. Insufficient literacy among the respondents was also one of the frustrating factors that had the potential to delay the survey process. The researcher spent a lot of time explaining each question and its objectives to such respondents in order to elicit their views and statements in the form of questionnaire and interviews.
3. Respondents who owned more than one property by way of a mortgage may have become confused and, as a result, may have given an unsuitable reply or opted not to complete the questionnaire.

5.19. CONCLUSION

The present chapter outlines the research methodology and methods used for gathering the relevant information through the semi-structured interviews and the pre-determined questionnaires. It justifies the combined usage of qualitative and quantitative data collection methods. It elaborates on the data analysis process and points to the limitations and difficulties that were encountered during the survey process.

Chapter 6: PERCEPTION ANALYSIS: QUESTIONNAIRE

6.1. INTRODUCTION

In this study a survey on 240 respondents were conducted, out of which 117 of them obtained home mortgages from Kuwait Finance house (KFH) which adopts the Islamic Banking System and 123 from National Bank of Kuwait (NBK) which is following the conventional banking system. Among the sample we omitted 40 responses due to reasons like vagueness, incompleteness etc. Finally, 100 responses from Kuwait Finance House customers' and 100 from NBK customers' been selected in this study. The result of the survey shows that most people prefer Islamic banking system because it is in conformity with their Islamic beliefs. This is a comparative study as it compares two different banking systems. It also throws light on some of the shortcomings of the Islamic Banking services as well as its advantages. In this study we adopted several statistical methods including descriptive analysis, chi-square test, cross tabulation, ANOVA test and factor analysis in order to analyze the preferences of respondents.

The purpose is to identify the factors that directly affect the respondents' decision to choose their present banking system. It also probes in to the reasons for their non preference of other banking system. We also made a comparative study of the services and features of both banking system and realized the importance of religious beliefs in the preferences of respondents. Through this study we probe whether the functioning and services of Islamic bank is outdated or not and it is revealed that the services and functioning especially the mode of publicity of Islamic bank is somewhat not up to date, at the same time people who are more religious adopted it with out any hesitation to abide with their strict religious practices.

The reason for non preference of a particular bank may be due to the improved quality of service of other banks or it may be due to unawareness of services of other banks. Therefore in this study we put forward some important factors which include religious, social and technical factors in order to assess the perception level with regard to their preferences and non preferences.

With the application of modern statistical theories we established the crux or the determinant factor of decision of the customers. The respondents expressed their perception level as first option, second option, third option, fourth option and fifth option. Thus we can identify whether a particular feature or service of a banking system is considered as the first preference or we can identify the degree of importance of each features or each services according to the perception of the respondents. With regard to the conventional bank customers instead of probing the features of it we tried to conceive the perception level of the respondents with regard to the disadvantages of Islamic banking that made them to choose the conventional banking system.

6.2. FINDINGS AND SUGGESTIONS

The results of the survey suggest that customers who are religious enough and care to avoid *Haram* products accept and acquire the products which completely follow the rules and regulations stated by the *Shari'ah*. Such customers don't bother to negotiate or acquire those products that are not according to their religion's rules and regulations.

Also, loans taken from Islamic banks have a fixed installment period to the end of tenure, as agreed with both of the parties (Bank and Customer), while conventional banks do not have that system. They increase and decrease (variable rate) the amount of installment to be submitted upon the new interest rate provided or issued by the Central bank, according to their policies and depending upon global influences. This results in a variable interest rate, which is not fixed at all.

Customers who have a fixed income every month budget according to their needs. This is also one of the reasons that customers approach the Islamic products, as they offer fixed rates for the entire tenure of the payment.

The Islamic financing system is always a bit cheaper according to figures and payments structures, while the conventional financing system always has a higher rate of return to the provider. Thus, the Islamic financing system has its own attraction for customers, who are able to choose from either system. It is also worth to notice that this feature of Islamic banking is quite unaware among the customers of conventional bank and they still believes that Islamic banking is expensive.⁹⁸

There are some customers who always consider recommendations of others in their decision making. They usually consult with their family and friends before acquiring any financial products. Therefore, they acquire Islamic products because of their family and friends' recommendations or experiences.

Some users acquire Islamic financial products because they are asked to do so by their employer's policies. For example, in Kuwait the KFH (Kuwait Finance House) offer their customers from 3 months to 12 months in which to start paying their first installment, which is quite attractive compared to the conventional system.

6.3. METHODOLOGY

6.3.1. Questionnaire design

All the customers were provided with a comprehensive questionnaire consisting of 29 questions. The questions have sub-sections with five sub-questions each (Appendix-A). Questions 1-3 (under Section One) describe the personal information of the respondents. Section Two consists of questions 4-

⁹⁸ Refer to chapter 4 (2 case studies: NBK and KFH, the evidence stating that the Islamic Finance is Cheaper than the Conventional one (Page 129).

6, and basically deals with the awareness concerning Islamic finance products. Questions 7-9 in Section Three focus on client preferences with respect to mortgages they obtained from banks. Questions 10-13 under Section Four shed light on the Islamic home mortgage and its conditions. Questions 14-29 under Section Five address clients' dealings with finance providers with respect to their home mortgages.

6.3.2. Statistical methods

Statistical methods like factor analysis, descriptive analysis, cross tabulation, chi-square test, ANOVA test etc are adopted for the analysis of this study.

The third part of the questionnaire is subjected to factor analysis. Factor analysis is a data reduction technique used to reduce a large number of variables into a smaller set of underlying factors that summarize the essential information contained in the variables.⁹⁹

By applying the rule of factor analysis we are able to find out the factors which seem to be more important by the respondents. It was our task to find out the demographic and technical information about the customers. But we can say that the crux of the subject matter lies in assessing the respondent's reason for choosing their bank because the strength of a banking system depends on its customers' preferences and satisfaction. Here comes the significance of the application of the rule of factor analysis as we are trying to find the answer of an important question that is the strength of the banking system in an indirect way by asking the preferences of the existing customers.

For the factor analysis of the study we adopted the method of principal component analysis. Principal component analysis is the most common form of factor analysis which is used to extract the most important factors. By applying the method of Principal Component Analysis we could remove

⁹⁹ Coakes, S. J. and L. G. Steed (31 Jan 2003). *SPSS Analysis Without Anguish (Version 11)*, John Wiley & Sons Inc

variances from a linear combination of variables and eventually it explains the maximum proportion of the remaining variance which finally results in uncorrelated factors (orthogonal factors).

The application of principal component analysis results in the determination of Eigen value in order to represent the amount of variance explained (extracted). The ratio of Eigen value is the ratio of explanatory importance of the factors with respect to the variables. If a factor has a low Eigen value, then it is contributing little to the explanation of variances in the variables and may be ignored.¹⁰⁰

Screen Plot is the method adopted to plot the successive Eigen values. Screen tests help us to give an idea about how many factors that we need to retain. On plotting the eigen value on a screen plot if it indicates a smooth decrease of Eigen value to level off to the right of the plot that is to be considered as a determinant factor. We consider only the number of factors at the elbow point in the diagram to be the effective factors that will be retained.

Analysis of variance or ANOVA test helps to compare the differences or mean values of both banking system and in this study this technique is highly regarded to compare the two types of banking system.

Chi-Square Test is used to test whether the observed distribution supports the theoretical concepts. In specific it will determine if two categorical variables are independent against an alternative hypothesis that they are dependent. If H_0 is a null hypothesis that the variables are independent and H_1 is the hypothesis that the variables are dependent. If the p-value is less than .05 it means that the null hypothesis is rejected. That is the variables are dependent. We want to reject the null hypothesis and to establish our hypothesis that the variables are dependent. Here the value is less than .So in the chi square test we can test our theoretical concepts.

¹⁰⁰ Field, A. (2005). *Discovering Statistics Using SPSS, (Introducing Statistical Methods Series)*. London, Sage Publications.

6.4. DEMOGRAPHIC INFORMATION

6.4.1. This Section consists of 1-3 questions which solicit information about the respondent's personal information, including gender, age-group and average annual income. This question dealt with the gender of those taking part in the questionnaire in order to find who prefers Islamic finance over conventional finance.

Table 6.1: Distributions among Customers of Home Finance

Bank	Gender		Total Frequency of Customers
	Male	Female	
KFH (Islamic)	Male	100	100
	Female	0	
NBK (Conventional)	Male	91	100
	Female	9	

Table 6.1 shows that, with respect to the clients of the Islamic bank, all 100 respondents are male whereas, in the case of the National Bank of Kuwait, among the 100 customers, 91 are male and 9 are female. This implies that the majority of the customers are males. This is due to the traditional patrimonial family structure of Kuwaiti society, which is 'patriarchal' in nature, as men are the main providers for the family. Although the results divulge that all the customers of Kuwait Finance House (Islamic finance) are male, it is presumed that the Kuwait Finance House may also have female customers. The reason for misrepresentation of female customers may be attributed to the limited number of sampling in the present study. Further, as the customers of the National Bank of Kuwait (conventional banking and finance) are also dominated by males to the level of 91 out of 100. It is realised that the women in Kuwait have very limited exposure to home mortgages due to their traditional family background, as women have minimal involvement in financial dealings in Kuwait.

This question deals with the age group of the customers who obtained home finance, either through Islamic financing or conventional financing.

Table 6.2: Age Group Distributions among Customers of Home Finance

banks * age Cross tabulation							
BANKS		age					Total
		21-30	31-40	41-50	51-60	60+	
KFH	Count	13	49	32	5	1	100
	% within banks	13%	49%	32%	5.0%	1%	100%
	% within age	29.5%	51.0%	62.7%	71.4%	50%	50%
	% of Total	6.5%	24.5%	16%	2.5%	.5%	50%
NBK	Count	31	47	19	2	1	100
	% within banks	31%	47%	19%	2%	1%	100%
	% within age	70.5%	49%	37.3%	28.6%	50%	50%
	% of Total	15.5%	23.5%	9.5%	1%	.5%	50%
Total	Count	44	96	51	7	2	200
	% within banks	22%	48%	25.5%	3.5%	1%	100%
	% within age	100%	100%	100%	100%	100%	100%
	% of Total	22%	48%	25.5%	3.5%	1%	100%

Table 6.2.1 Chi – square / Likelihood / Linear-by Linear Association test significant

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	12.005 ^a	4	.017
Likelihood Ratio	12.305	4	.015
Linear-by-Linear Association	9.917	1	.002
N of Valid Cases	200		

Figure 6.1: Age Group Distributions among Customers of Home Finance

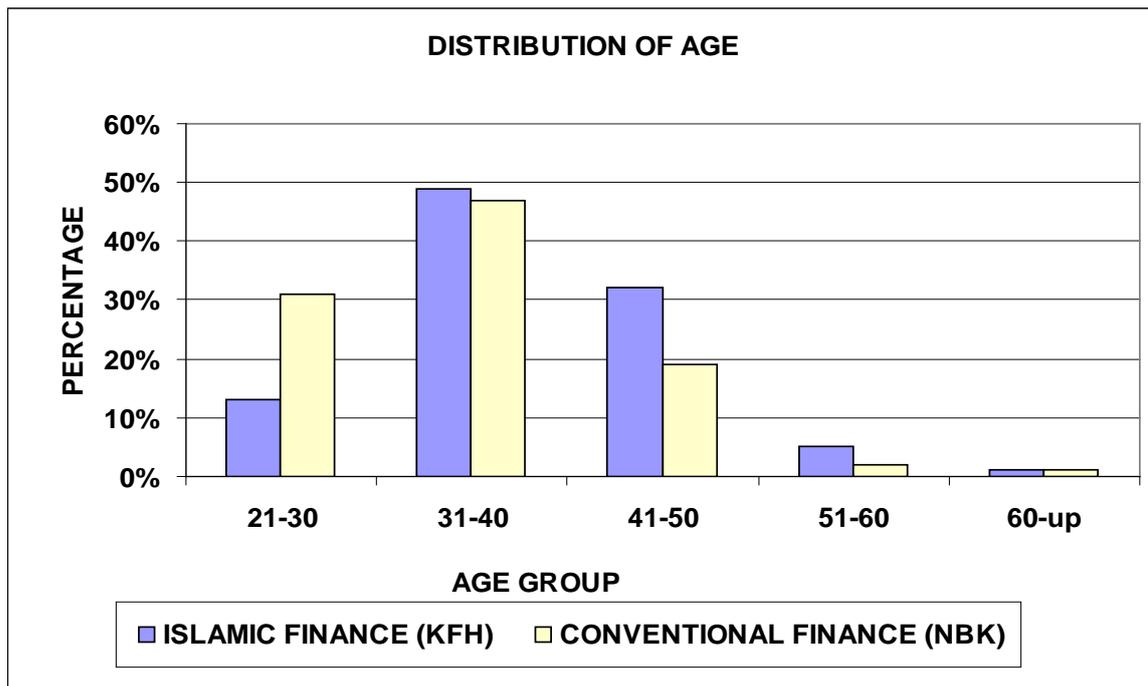


Table 6.2 and Figure 6.1 represent "Home loans taken by users under different age groups". It is shown in the Table 6.2.1 that the p-value through Pearson Chi-Square, Likelihood Ratio and Linear-by-Linear Association is 0.017, 0.015 and 0.002 respectively which indicates that age has significant impact on the preferences of the respondents. Likelihood Ratio always gives a bit more powerful results among contingency data than the Pearson Chi-Square. Whereas Linear-by-Linear Association gives the association between the data. In our case it's a very strong positive correlation stating that upon plotting the values in the graph it gives a smooth upward slope from left to right means that there is positive association.

It is revealed that, out of all the respondents who obtained home financing from KFH (Islamic bank) and NBK (conventional bank), 49% and 47% of the respondents belong to the age group between 31-40 years old respectively, which is a high ratio among all age groups.

The main reason for the high rate within this age group to acquire loans from KFH (Islamic bank) is the awareness of Islamic financing among this age

group of 31-40 years. It is almost 50% of the entire sample. It is also worth to notice that both the banks have 25 years of time difference of establishment in the region, as NBK was established in 1952 while KFH was established in 1977.

A wide differentiation prevails among home loan users in the age category of 21-30 in which only 13% of the customers have dealings with the KFH whereas, in the case of the NBK, 31% of the customers have obtained home mortgages.

It is also evident that the age category of 21–30 mostly prefers to use the conventional banking system for home mortgages over the Islamic banking system. Apart from religious and *Shari'ah* aspects, the youth, being beginners, are not interested in considering in-depth and long term benefits provided by the Islamic banking, which is always profitable and secure (according to our comparisons) when compared to conventional banking. It means that they are least concerned about the banking calculations of loans and long-term or short-term profit and loss.

However, if this group (31–40) is compared in percentage with the previous age group (21–30), it may be noticed that the Islamic banking group increased from 13 to 49 (36% increase), while the conventional banking group increased from 31 to 47 (16% increase). The reason for the increase in the number of customers towards Islamic banking may be attributed to rising religious awareness in this age category as well as the difference in banking calculation aspects for their fixed installments and cheaper rates offered by Islamic banking.

With respect to home financing, the 41-50 age group is considered to be the luckiest because they were the ones who faced the hardship of the Iraq invasion in Kuwait in 1990. After the liberation of Kuwait, all customers (Kuwaiti nationals) of home financing were written off by the government.

According to the facts and figures, this age group (41-50) took new home loans afterwards. The ratio for those home loans was 32% in KFH (Islamic banking) and 19% for NBK (conventional banking). There was a 13% high towards Islamic banking. This again is as a result of awareness and benefits provided by the Islamic banking.

6.4.2. This Question Deals with Monthly Income of Clients

Home mortgage preference in relation to client's salary slab

Table 6.3: Monthly Salaries of Customers

Banks * Salary Cross tabulation						
Banks		Salary				Total
		600-1200	1201-1750	1751-3000	more than 3000	
KFH	Count	62	32	5	1	100
	% within Banks	62%	32%	5%	1%	100%
	% within Salary	44.3%	62.7%	71.4%	50.%	50%
	% of Total	31%	16%	2.5%	.5%	50%
NBK	Count	78	19	2	1	100
	% within Banks	78%	19%	2%	1%	100%
	% within Salary	55.7%	37.3%	28.6%	50%	50%
	% of Total	39%	9.5%	1%	.5%	50%
Total	Count	140	51	7	2	200
	% within Banks	70%	25.5%	3.5%	1%	100%
	% within Salary	100%	100.%	100.%	100%	100%
	% of Total	70%	25.5%	3.5%	1%	100%

Table 6.3.1 Table 6.2.1 Chi – squire test significant

Chi-Square Tests			
	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	6.428 ^a	3	.093
Likelihood Ratio	6.511	3	.089
Linear-by-Linear Association	5.003	1	.025
N of Valid Cases	200		

Figure 6.2: Home Mortgage Preference Based On Client's Salary

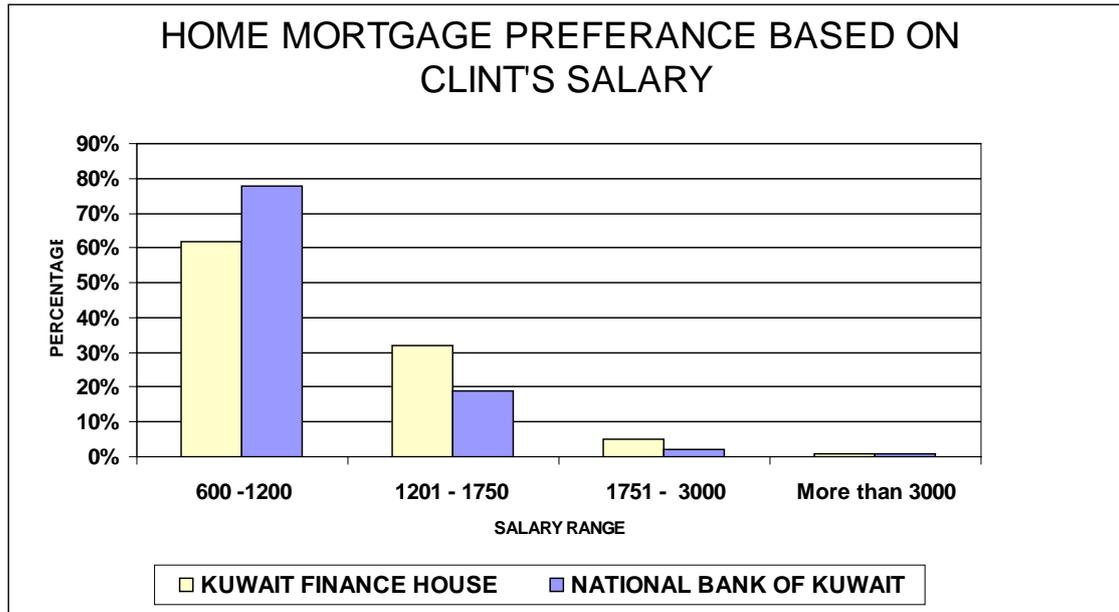


Table 6.3 and Figure 6.2 indicate the "salary-based income" of the clients who obtained home finance from *KUWAIT FINANCE HOUSE* (KFH) and *NATIONAL BANK OF KUWAIT* (NBK). The p-value is .093 which indicates that salary has significant impact on the preferences of home mortgages.

The salaries are categorised into four groups, i.e. 600-1200 KD, 1201-1750 KD, 1751-3000 KD and 3000 KD and above within the NBK (conventional bank) and KFH (Islamic bank). The data is collected from both the banks' existing customers who are using the home finance products.

The salary group from 600-1200 KD constitutes 78% in NBK and 62% for KFH. The salary group from 1201-1750 KD constitutes 19% in NBK and 32% for KFH. The salary group from 1751-3000 KD constitutes 2% and 5% within NBK and KFH respectively.

For both of the banks, the salary group that states 3000 KD and above is 1% each only. This reveals that both the KFH and NBK provide home finance to clients categorised in different salary groups.

6.5. AWARENESS AMONG CLIENTS

6.5.1. With Awareness among Clients of Islamic Finance Products (Question Nos. 4–6)

The purpose of the question is to find the "*level of awareness*" among the home loan users with respect to Islamic jurisprudence against '*Riba*' and also to learn the exact reasons behind their desires for opting for Islamic financing or the conventional financing.

The data collected through questionnaires and the figures states that all the respondents have sound awareness of Islamic rulings against '*Riba*'. Within the 30 years since the establishment of KFH (Islamic bank), customers switched from conventional banks to KFH. This was not only because of KFH fixed installments and cheaper return rates; the main factor for the switch was the Islamic bounding and prohibition of '*Riba*'

This study reveals how the KFH (Islamic) and NBK (conventional) banks operate in a Muslim society that is largely religiously conscious. The customers of the two banks have a fairly good awareness and understanding of *Shari'ah* rules, culture and integrity. Moreover, faith is a very important factor for those using Islamic banking, which prohibits them from resorting to usury. As for those who deal with conventional banking, it may be assumed that their faith is not as strong as that of the clients of Islamic banking.

Although religious beliefs constitute an important factor in the Islamic way of life, their impact becomes weak if the clients obtain a home loan from a conventional bank. This attitude indicates that if awareness of the *Shari'ah* is the main factor, then no one would have opted for conventional financing. It is apparent that all home loan seekers from the age of 31 onwards have high religious awareness of the *Shari'ah* and desire to own their own house. In the case of the lower age group, i.e. below 30 years, these constitute 31% out of the 100 clients of NBK and 13% of KFH. The reason is that they may be least bothered with *Shari'ah-compliant* home mortgages and their religious awareness may not be as high as the other age groups.

6.5.2. Awareness Regarding the Existence of Islamic Banking Services

This question deals with the awareness of the availability of Islamic banking products with proper advertising strategies to home loan seekers in Kuwait. The purpose of this question is to ascertain whether all users of home mortgages are aware of the availability of Islamic finance products in Kuwait. It is found that all clients are aware of the existence of Islamic finance products in Kuwait. Since all clients are *Muslims*, they know the difference between Islamic banking and conventional banking systems and also Islamic rulings. Although all the clients of both the banks are well aware of the availability of the various Islamic products, they opted to choose their products as per their desire with consideration to their financial benefits without much consideration for their religious faith.

6.5.3. Awareness of the Availability of Islamic Home Finance Products, Whether to the Users of Islamic Banks or Conventional Banks

This question deals with the awareness of the availability of Islamic home finance products, whether to the users of Islamic banks or conventional banks.

Table 6.3.2: Awareness of the Availability of Islamic Home Finance Products

BANK	VALID	FREQUENCY	PERCENT
NBK (Conventional)	Yes	76	76%
	No	24	24%
	Total	100	100%

It is obvious that all customers of the Islamic banks know that there is an Islamic banking service for housing finance. On the other hand, Table 6.3 reveals, only 76% of conventional bank customers are aware of Islamic

housing finance services, whereas 24% of customers do not know about the existence of Islamic banking services for housing financing in Kuwait. This denotes that the Islamic housing finance system is quite well-known in Kuwait, and customers are well aware of its existence and its services, including the mortgage finance under the Islamic *Shari'ah*. There is also a significant indication that 24% of the customers of conventional banks do not know about the Islamic services and products provided by the Islamic banks. This may be negligence on the part of the Islamic banks, which are unable to deliver their messages and advertise their services and products to attract a greater number of potential customers as possible from conventional banks. As far as conventional banks are concerned, their financial options are more limited than Islamic banks; however, they afford freedom to their customers to choose whatever banking system they desire.

6.6. CLIENT'S PREFERENCE ON HOME MORTGAGE

6.6.1: Clients' Preferences With Respect To Home Mortgages

This question deals with the preference of the clients, while purchasing their properties, either from Islamic banking or conventional banking in terms of their age groups.

Table 6.4: Cross Tabulation Age and Mortgage Preference

BANK	AGE					Total
	from 21 -30	from 31-40	from 41- 50	from 51- 50	60 and up	
(KFH) Islamic Bank	13 (13%)	49 (49%)	32 (32%)	5 (5%)	1 (1%)	100
(NBK) Conventional Bank	31 (31%)	47 (4)	19 (19%)	2 (2%)	1 (1%)	100
total						200

Figure 6.3: Distribution Cross Tabulation Age and Mortgage Preference.

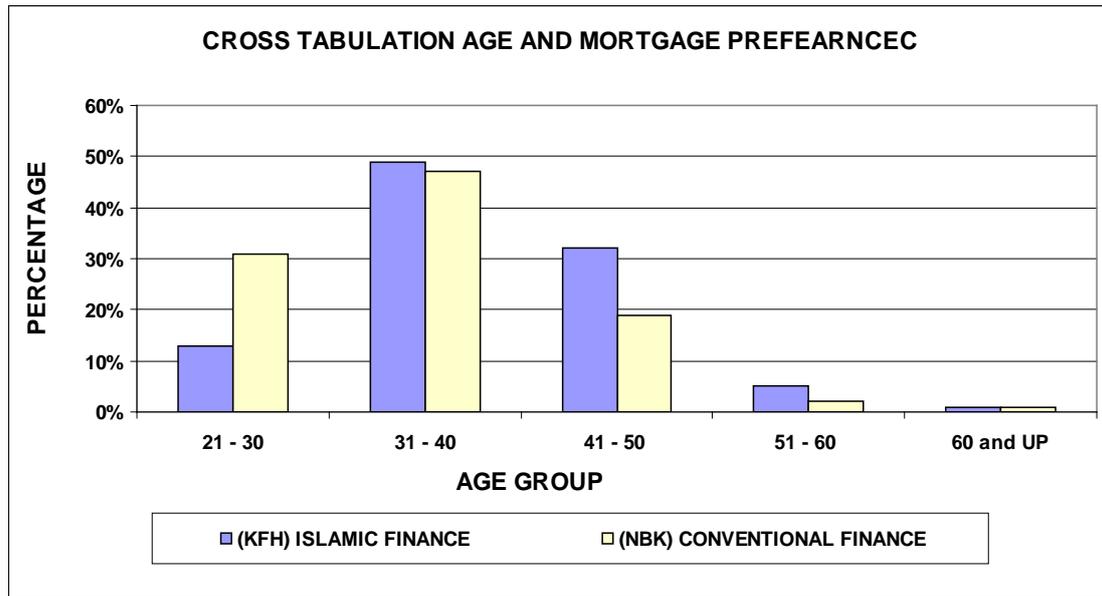


Table 6.4a: Distribution of Mortgage Option Preferences

Bank	Frequency	Percent	Valid Percent	Cumulative Percent
Islamic finance	100	50 %	50 %	50%
Conventional finance	100	50 %	50 %	100 %
Total	200	100 %	100 %	

Tables 6.4 and 6.4a and Figure 6.3 indicate that "the age group is one of the significant" factors for choosing a banking system. The age group under 30 uses the Islamic finance system the least and its representation is only 13% out of 100 respondents from KFH. The next age group (31-40) is the dominant, as it represents 49% of the overall users, followed by the subsequent age group (41-50) who constitute 32% of customers obtaining Islamic finance system. Home loan users of the remaining two age groups represent 5% and 1% respectively.

In the case of conventional finance systems, the home loan users' preference is different. Even the younger group (below 30 years old) shows great interest in obtaining a home loan and it constitutes 31% out of 100 respondents. The next age group (31-40) is the major group of users, representing 47%, followed by the next age group (41-50) which represents 19%. The remaining two age groups constitute only 2% and 1% respectively.

The observation reveals that age plays an important role in deciding the desired kind of finance. Among the younger age group, whose age is under 30, religious belief is not an important consideration in obtaining a loan, as 31% of this group obtained loans from a conventional banking. Though conventional banking provides interest-based loan facilities, which are against Shari'ah, young customers do not refrain from using and dealing with them. Lack of religious faith among the younger customers may be the reason for their lowest representation among customers obtaining Islamic home finance. This question deals with the clients who "preferred Islamic mortgage" over conventional mortgage. The purpose of this question is to ascertain the real reasons for a client's preference for Islamic finance over conventional finance.

Table 6.5: Ranking of the Reasons within Islamic Home Financing

Reasons	Percent
Because it is <i>Shari'ah</i> Compliant	93%
Better cash flow management because of the fixed installment obligation	4%
Islamic mortgage was cheaper	3%
Tempted by the growing popularity	0%
Others	0%
Total	100%

The Tables below (6.5 to 6.5a, 6.5b, 6.5c, 6.5d and 6.5e) show the frequency of options given by respondents upon answering the question number 8. In this question, respondents were given the 5 options to rate their preferences. The question was asked to 100 customers who are already using the Islamic home finance instead of the conventional one.

Table 6.5a: (Related to *Shari'ah* Compliant)

Preferences			
	Observed N	Expected N	Residual
1	93	25.0	68.0
2	4	25.0	-21.0
3	1	25.0	-24.0
4	2	25.0	-23.0
Total	100		

Table 6.5a.1 Chi – squire test significant

Test Statistics	
	preferences
Chi-Square	246.800 ^a
df	3
Asymp. Sig.	.000

Table 6.5 “*Related to Shari’ah Compliant*” tell us that 93% of the customers chose the first option as the most attractive while having an Islamic home finance product, i.e. *Shari'ah* compliant. Four respondents out of 100 chose the *Shari'ah* compliant as their second preference. One respondent out of 100 chose *Shari'ah* compliant as their third preference. Two respondents out of 100 chose *Shari'ah* compliant as their fourth preference. Chi-square test reveals that “*Shari'ah compliant*’ has significant impact on the preferences of the respondents.

It shows that a large number of respondents out of 100 chose Shari'ah compliant as their first preference for using Islamic Home Finance product.

Table 6.5b: (Related to Fix Installment payback)

preferences			
	Observed N	Expected N	Residual
1	4	20.0	-16.0
2	23	20.0	3.0
3	48	20.0	28.0
4	24	20.0	4.0
5	1	20.0	-19.0
Total	100		

Table 6.5b.1 Chi – square test significant

Test Statistics	
	preferences
Chi-Square	71.300 ^a
df	4
Asymp. Sig.	.000

Table 6.5b relates to "*Fix Installment payback*". Four respondents out of 100 chose the Fix Installment as their first preference. The frequency of 23 respondents out of 100 choose Fix Installment as their second preference; 48 respondents out of 100 chose Fix Installment as their third preference; 24 respondents out of 100 chose Fix Installment as their fourth preference; and 1 respondent out of 100 chose it as a fifth preference. Chi-square test reveals that "fix installment pay back" has significant impact on the preferences of the respondents.

Table 6.5c: (Related to Cheaper Home Finance Installment)

Preferences			
	Observed N	Expected N	Residual
1	3	20.0	-17.0
2	21	20.0	1.0
3	21	20.0	1.0
4	24	20.0	4.0
5	31	20.0	11.0
Total	100		

Table 6.5c.1 Chi – square test
Significant

Test Statistics	
	preferences
Chi-Square	21.400 ^a
df	4
Asymp. Sig.	.000

Table 6.5c shows the "*Cheaper Home Finance Installment*" preferences. Three respondents out of 100 chose the Cheaper Home Finance as their first preference. The frequency of 21 respondents out of 100 chose Cheaper Home Finance as their second preference; 21 respondents out of 100 chose Cheaper Home Finance as their third preference; 24 respondents out of 100 chose Cheaper Home Finance as their fourth preference; and 31 respondents out of 100 chose it as a fifth preference. Chi-square test reveals that "cheaper home finance" has significant impact on the preferences of the respondents.

Table 6.5d: (Related To Popularity of Islamic Finance)

Preferences			
	Observed N	Expected N	Residual
2	17	25.0	-8.0
3	27	25.0	2.0
4	51	25.0	26.0
5	5	25.0	-20.0
Total	100		

Table 6.5d.1 Chi – squire test significant

Test Statistics	
	preferences
Chi-Square	45.760 ^a
df	3
Asymp. Sig.	.000

Table 6.5d relates to the fourth option "*Popularity of Islamic finance*". There are no respondents who chose Popularity as their first preference for choosing Islamic product. Seventeen respondents out of 100 chose the Popularity of Islamic Finance as their second preference. The frequency of 27 respondents out of 100 chose Popularity of Islamic Finance as their third preference; 51 respondents out of 100 chose Popularity of Islamic Finance as their fourth preference; 5 respondents out of 100 chose Popularity of Islamic Finance as their fifth preference. Chi-square test reveals that "popularity of Islamic Finance' has significant impact on the preferences of the respondents.

Table 6.5e: (Other Reasons, If any)

Preferences			
	Observed N	Expected N	Residual
2	34	25.0	9.0
3	4	25.0	-21.0
4	2	25.0	-23.0
5	60	25.0	35.0
Total	100		

Table 6.5e.1 Chi – squire test significant

Test Statistics	
	preferences
Chi-Square	91.040 ^a
df	3
Asymp. Sig.	.000

Table 6.5e shows there are no respondents who chose "Other Reasons" as their first preference for choosing an Islamic product; 34 respondents out of 100 chose the Other Reasons of Islamic Finance as their Second preference. The frequency of 4 respondents out of 100 chose Other Reasons of Islamic Finance as their third preference; 2 respondents out of 100 chose Other Reasons of Islamic Finance as their fourth preference; 60 respondents out of 100 chose Other Reasons of Islamic Finance as their fifth preference. Chi-square test reveals that "other reasons" has significant impact on the preferences of the respondents.

The reason for majority of the respondents to choose KFH is that it is *Shari'ah* compliant. As we already discussed this subject let us deal with the other preferences of the respondents. The Chi-Square test established that all these options have significant impact on the respondents in the ranking of their preferences. The fixed installment system of KFH is obviously an attractive feature and a majority of the respondents consider this as their third option for choosing KFH. The perception level that KFH has the cheaper home finance installment is evenly distributed among the respondents as their second, third, fourth and fifth option. The popularity of Islamic Bank is the fourth attractive feature of it while there are other reasons for a considerable majority to choose KFH as their home mortgagor. The awareness of the respondents about *Riba* may be a reason for respondents to choose KFH as their home mortgagors.

Factor Analysis

Table 6.5f: The Variance Explained of Islamic Housing Finance

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative%	Total	% of Variance	Cumulative%
1	1.999	39.989	39.989	1.999	39.989	39.989
2	1.230	24.593	64.582	1.230	24.593	64.582
3	1.072	21.435	86.017	1.072	21.435	86.017
4	.650	12.992	99.010			
5	.00	.990	100.000			

Extraction Method: Principal Component Analysis

Table 6.5f shows the variance explained of Islamic housing finance. A factor analysis was carried out on five (5) items in question number 8 from the questionnaire by subjecting them to Principle Component Analysis (PCS) using *SPSS* version 11. Prior to performing PCA, the suitability of data for Factor Analysis was assessed.

In Table 6.5f, there are three factors with Eigen values greater than 1 (1.999, 1.230 and 1.072). This initial analysis, therefore, resulted in a three-factor solution. That is, those five items can be reduced to three factors. Each factor describes a specific variance in those five items.

In this case, factor 1, 2 and 3 explains 39.989%, 24.593% and 21.435% of the variance respectively. Together, these three factors explain a total of 86.017% of the variance. The more the variance that is explained by the factors, the better the factor solution is in reducing the initial five items to three factors.

The screen plot in figure 6.5 below shows that the plot slopes downwards and from this it is decided to retain two factors for more findings. To aid interpretation of these two factors, Varimax orthogonal was used.

Figure 6.4: Screen Plot Showing Islamic Housing Finance

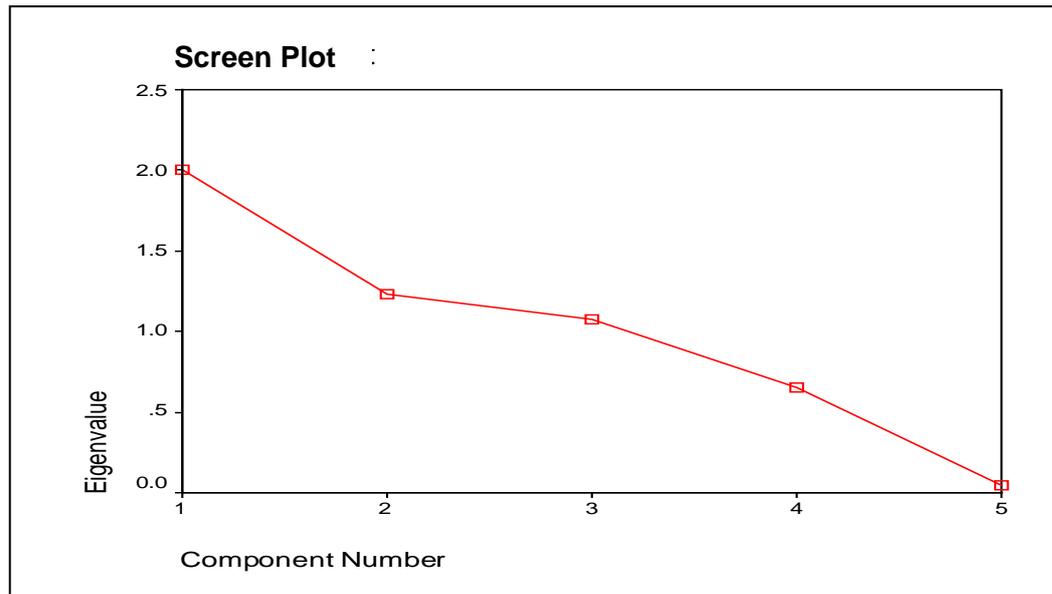


Table 6.5g: For Component Matrix of Islamic Housing Finance

	Component		
	1	2	3
Item 1 <i>Shari'ah</i> Compliant	-0.558	0.32	0.562
Item 2 Fix installment	0.279	-0.901	0.004
Item 3 Cheaper Home Finance	0.789	0.219	0.486
Item 4 Popularity of Islamic Finance	0.413	0.515	-0.675
Item 5 Other Reasons, If any	-0.904	-4.90E-02	-0.247

Extraction Method: Principle Component Analysis.

a. 3 components extracted.

From Table 6.5g, it can be seen that since factor 1 (Eigenvalue 1.999 and variance 39.989) and factor 3 (Eigenvalue 1.072 and variance 21.435) has the higher Eigenvalue and variance, it becomes as a total for both at the higher side (Eigenvalue 3.071 and variance 61.424). This result implies that users of Islamic Housing Finance generally state the deciding factor is faith and secondly cheaper home finance. However, the strongest and most important reason for them is still faith as it is compliant to *Shari'ah*. This finding is very much in resonance with the earlier findings of the survey results, in that faith was the most important reason and cheaper home finance was the second most important

6.6.2: Participants' Preference for Conventional Mortgage over Islamic Mortgage

This question deals with participants' preference for a conventional mortgage over an Islamic mortgage. It also determines the actual reasons for choosing conventional banking over Islamic mortgages.

Table 6.6: Reasons for Choosing Conventional Mortgage

Reasons	Percent
UNAWARE OF THE AVAILABILITY OF THE ISLAMIC MORTGAGE AS AN OPTION	55%
CONVENTIONAL MORTGAGES ARE LESS EXPENSIVE	15%
LACK OF VARIETY AND FLEXIBILITY UNDER ISLAMIC FINANCE	17%
OTHERS, IF ANY	12%
TOTAL	100%

Table 6.6 represents the "*reasons for opting for a conventional mortgage*". We have learned that 55% of the customers chose the first option as their most preferable option, i.e. unaware of availability of the Islamic mortgage as an option. 15% respondents out of 100 chose the conventional mortgages are less expensive as their second preference. 17% respondents out of 100 chose lack of variety and flexibility under Islamic finance as their third preference. 12% respondents out of 100 chose others as their fourth preference.

This shows that a large proportion of respondents chose the first option (unaware of the availability of the Islamic mortgage) as their first preference for using conventional mortgage products.

Tables 6.6, 6.6a, 6.6b, 6.6c, 6.6d and 6.6e show the frequency of choosing number 9 by the respondents. In this question, respondents were given the four options to rate their preferences. The question was asked to 100 customers who are already using the conventional home finance instead of the Islamic one.

Table 6.6a: Show the Unawareness of the Availability of the Islamic Mortgage as an Option

PREFERENCE			
	Observed N	Expected N	Residual
First	55	25.0	30.0
Second	10	25.0	-15.0
Third	19	25.0	-6.0
Fourth	16	25.0	-9.0
Total	100		

Table 6.6a.1 Chi – squire test significant

Test Statistics	
	preferences
Chi-Square	49.680 ^a
df	3
Asymp. Sig.	.000

Table 6.6a shows the *"unawareness of the availability of the Islamic mortgage as an option"*. It shows that 55% of the customers chose the first option as their most preferred choice because they did not have a clear idea about the Islamic Home Finance. Ten respondents out of 100 chose it as their second preference; 19 respondents out of 100 chose 'unawareness' as their third preference; 16 respondents out of 100 chose 'unawareness' as their fourth preference.

Table 6.6b: Conventional Mortgages Are Less Expensive

PREFERENCE			
	Observed N	Expected N	Residual
First	15	25.0	-10.0
Second	41	25.0	16.0
Third	32	25.0	7.0
Fourth	12	25.0	-13.0
Total	100		

Table 6.6b.1 Chi – squire test significant

Test Statistics	
	preferences
Chi-Square	22.960 ^a
df	3
Asymp. Sig.	.000

Table 6.6b shows the *"Conventional Mortgages are less expensive"*. We learned that 15 respondents from the 100 chose the first option as their preference while having conventional home finance product because they are

cheaper than the Islamic one; 41 respondents out of 100 chose it their second preference; 32 respondents out of 100 chose *conventional home finance* as their third preference; 12 respondents out of 100 chose *conventional home finance* as their fourth preference. Chi-square test reveals that “less expensive mortgage’ has significant impact on the preferences of the respondents.

Table 6.6c: The Lack of Variety and Flexibility under Islamic Finance

PREFERENCE			
	Observed N	Expected N	Residual
First	17	25.0	-8.0
Second	33	25.0	8.0
Third	32	25.0	7.0
Fourth	18	25.0	-7.0
Total	100		

Table 6.6c.1 Chi – square test significant

Test Statistics	
	preferences
Chi-Square	9.040 ^a
df	3
Asymp. Sig.	.029

Table 6.6c shows "*lack of variety and flexibility under Islamic finance*". It shows that 17 respondents out of 100 chose the first option as their preference as a conventional home finance product because there is lack of variety and less flexibility in the Islamic one when compared to the conventional one; 33 respondents out of 100 chose it their second preference; 32 respondents out of 100 chose it as their third preference; 18 respondents out of 100 chose it as their fourth preference. Chi-square test reveals that “*lack of variety and flexibility under Islamic finance*’ has significant impact on the preferences of the respondents.

Table 6.6d: (Other Reasons, If any)

PREFERENCE			
	Observed N	Expected N	Residual
First	12	25.0	-13.0
Second	18	25.0	-7.0
Third	17	25.0	-8.0
Fourth	53	25.0	28.0
Total	100		

Table 6.6d.1 Chi – squire test significant

Test Statistics	
	preferences
Chi-Square	42.640 ^a
df	3
Asymp. Sig.	.000

Table 6.6d shows the fourth option which is "other reasons". It shows that 12 customers chose it as their preference when they had conventional home finance product; 18 respondents out of 100 chose it as their second preference; 17 respondents out of 100 chose it as their third preference; 53 respondents out of 100 chose it as their fourth preference. Chi-square test reveals that "other reasons" has significant impact on the preferences of the respondents

The Chi-square tests establish that all reasons have significant impact on the preferences of the respondents. Majority of the respondents choose NBK because of their unawareness of the availability of KFH. The second reason for the majority of the respondents is that they believe that NBK is less expensive. It is to be noted that the third reason for the respondents to choose NBK is due to the lack of flexibility and variety of KFH. AT the same time other reasons constitute a significant reason for the respondents. It may be due to the innovative publicity method adopted by conventional banking system and their attractive canvassing system. The fascination of the young generation to become trendy or to walk in a different path may be a reason that can be considered as other reasons.

Table 6.6e: The Variance Explained in Conventional Mortgage

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative%	Total	% of Variance	Cumulative%
1	2.095	52.385	52.385	2.095	52.385	52.385
2	1.107	27.683	80.068	1.107	27.683	80.068
3	0.786	19.652	99.721			
4	1.118	0.279	100			

Extraction Method: Principal Component Analysis

Table 6.6e shows "*variance explained in conventional mortgage analysis*". It shows that analysis carried out on four (4) items (4 items means 4 choices of answers) in question number Nine (9) from the questionnaire by subjecting them to Principle Component Analysis (PCS) using SPSS version 11. Prior to performing PCA, the suitability of data for Factor Analysis was assessed.

From Table 6.6e, it can be seen that factor 1 (Eigenvalue 2.095 and variance 52.385) and factor 4 (Eigenvalue 1.118 and variance .279) have the higher eigenvalues and variance and become a total for both at higher side (Eigenvalue 3.213 and variance 52.664). This result implies that customers of conventional housing finance generally give as a reason for choosing conventional home financing is 'unawareness of availability of Islamic home financing'; secondly, they did not have any good reason for applying for Islamic financing products.

The screen plot in figure 6.6 below shows that the plot slopes downwards at two factors, that is factor 1 and factor 4 and applying the principles of screen plot which considers steep downward plot as a determinative factor we can conclude that factor 1 that is unawareness of availability of Islamic mortgage and factor 4 that is "other reasons" which implies that they have no other good reasons for not preferring Islamic finance as most important factors for choosing conventional banking. To aid interpretation of these two factors, Varimax orthogonal was used.

Figure 6.5: Screen Plot of Conventional Mortgage

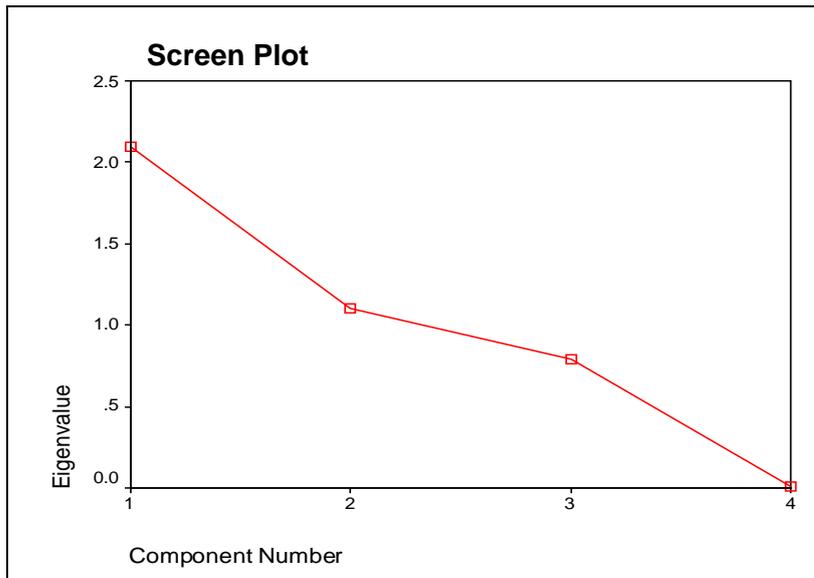


Table 6.6f: For Component Matrix of Conventional Mortgage

	Component	
	1	2
Item 1 UNAWARE OF THE AVAILABILITY OF THE ISLAMIC MORTGAGE AS AN OPTION	-.775	-.585
Item 2 CONVENTIONAL MORTGAGES ARE LESS EXPENSIVE	.703	-.369
Item 3 LACK OF VARIETY AND FLEXIBILITY UNDER ISLAMIC FINANCE	-.592	.735
Item 4 OTHERS, IF ANY	.806	.298

Extraction Method: Principle Component Analysis.
a. 2 components extracted.

6.7. ISLAMIC HOME MORTGAGE

This question deals with clients' preferences with respect to home mortgages based on a comparison between Islamic and conventional home mortgages.

Table 6.7: Ranking Of Preferences by Client Based On a Comparison between Islamic and Conventional Home Mortgages

Variable	KFH (ISLAMIC)	NBK (CONVENTIONAL)
INTEREST FEATURE	16%	21%
REPAYMENT PERIOD	17%	20%
MONTHLY INSTALLMENT AMOUNT	18%	21%
FLEXIBILITY IN THE REPAYMENT INSTALLMENTS	21%	17%
OTHER REASON	28%	21%
TOTAL	100%	100%

Figure 6.6: Distribution of Basis for Comparison between Islamic and Conventional Home Mortgages

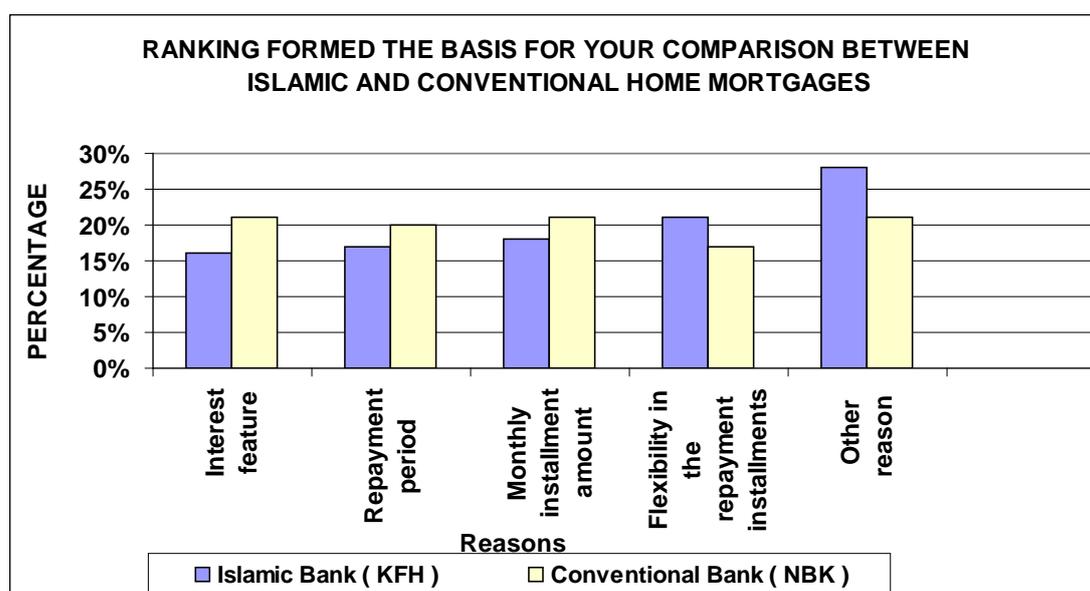


Table 6.7 and figure 6.6 represents “Ranking of Preferences by Client based on a Comparison between Islamic and Conventional Home Mortgages”

In order to assess a client’s preference with respect to home mortgage, a comparative analysis was conducted between the Islamic banking (KFH) and conventional banking (NBK) in terms of the following five parameters.

1. Interest feature
2. Repayment period
3. Monthly installment amount
4. Flexibility in the repayment installments
5. Other reason.

The client’s perceptions on the five parameters were given percentage values, as demonstrated in Table 6.7 and Figure 5.6.

Among the five preferred parameters, interest features facilitate 16% of KFH clients and 21% of NBK clients for their house loan preference. The repayment period does not show much difference, as the percentage of clients whose preference for obtaining a home loan is influenced by this factor is only 20% of NBK customers and 17% of KFH customers. Customers’ preference is considerably varied in terms of monthly installment, and it affects 21% of NBK customers and 18% of KFH customers.

Flexibility in repayment installments is one of the main criteria that affect a customer’s preference for a home loan, affecting 17% of NBK customers and 21% of KFH customers. Clients are significantly varied due to ‘*other reasons*’ also on their selection for financial providers and the percentage values constitutes 28% for KFH customers and 21% for NBK customers.

In general, clients’ preferences based on this parameter do not have a large impact on their decision to obtain a home loan from an Islamic bank (KFH), or from a conventional bank (NBK).

Table 6.8: OPINIONS ABOUT VARIETY MORTGAGE PRODUCTS

BANK	Variable	Percent
KFH (Islamic Bank)	Do not know	18%
	Less variety	53%
	Moderate variety	6%
	Wide variety	23%
	Total	100%
NBK (conventional Bank)	Do not know	0
	Less variety	34%
	Moderate variety	28%
	Wide variety	38%
	Total	100%

FIGURE 6.7: DISTRIBUTION OF VARIETY MORTGAGE PRODUCTS

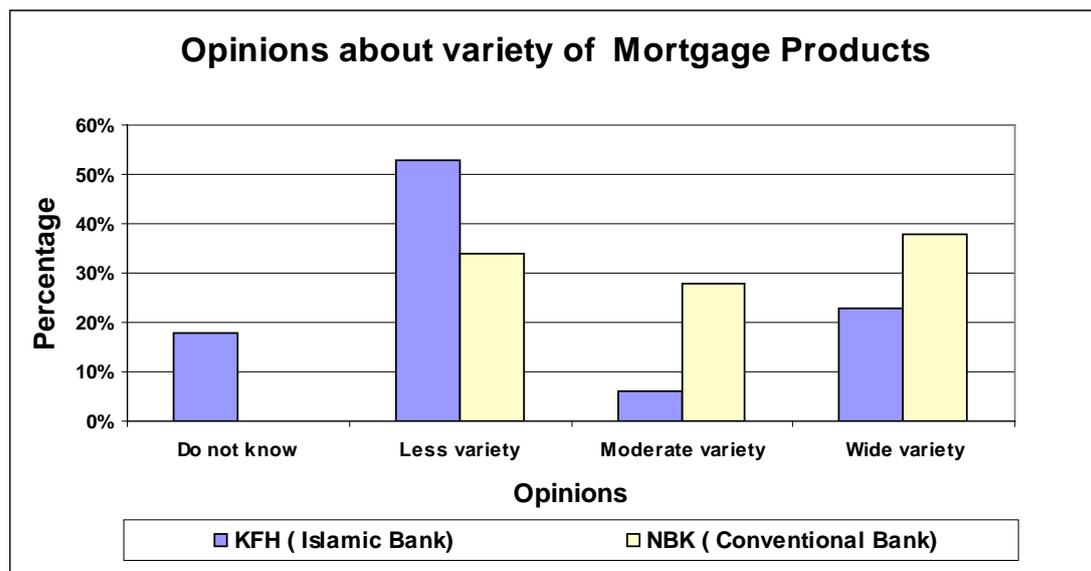


Table 6.8 and Figure 6.7 reveal that there are great differences of opinion among the respondents regarding the variety of Mortgage Products. It is surprising that the majority of the clients (53%) of KFH (Islamic bank) opinions that the variety of Islamic Mortgage Products is less than that offered by conventional banking. But a majority of conventional banking clients (38%) mentioned that Islamic banks offer a wider variety than the conventional Mortgage Products. This may raise a question of why those who think that the variety of Islamic Mortgage Products are of less interest to them and why

those who think that the variety of Islamic Mortgage Products are of wide do not interest them. The respondents who stated that Islamic Mortgage Products were of moderate variety were (6%) and (28%) for Islamic banking and conventional banking respectively.

Though 53% of the KFH customers feel that their financial provider has less variety with respect of their products, they are still more inclined to obtain a home loan from KFH. The reasons may be attributed to their strong religious faith and interest in engaging in *Shari'ah*-compliant financial dealings. However, the preference of NBK customers may not be influenced by religious faith, but it depends on the variety of products offered by the bank.

6.7.1. Source of Information for the Clients of Islamic Home Mortgages

This question deals with the information on Islamic home mortgages which the clients received from various sources.

Table 6.9: Distribution of Information Sources about Islamic and Conventional Mortgages

BANK	VARIABLE	FREQUENCY	PERCENT
KFH (Islamic Bank)	News papers	22	22%
	Internet	1	1%
	Bank call Services	7	7%
	Recommended by friend	7	7%
	Other	63	63%
	TOTAL	100	100%
NBK(Conventional Bank)	Newspapers	45	45%
	Internet	1	1%
	Bank call service	19	19%
	Recommended by friend	30	30%
	Other	5	5%
	TOTAL	100	100%

Figure 6.8: Distribution of Sources of Information for Customers of Home Finance

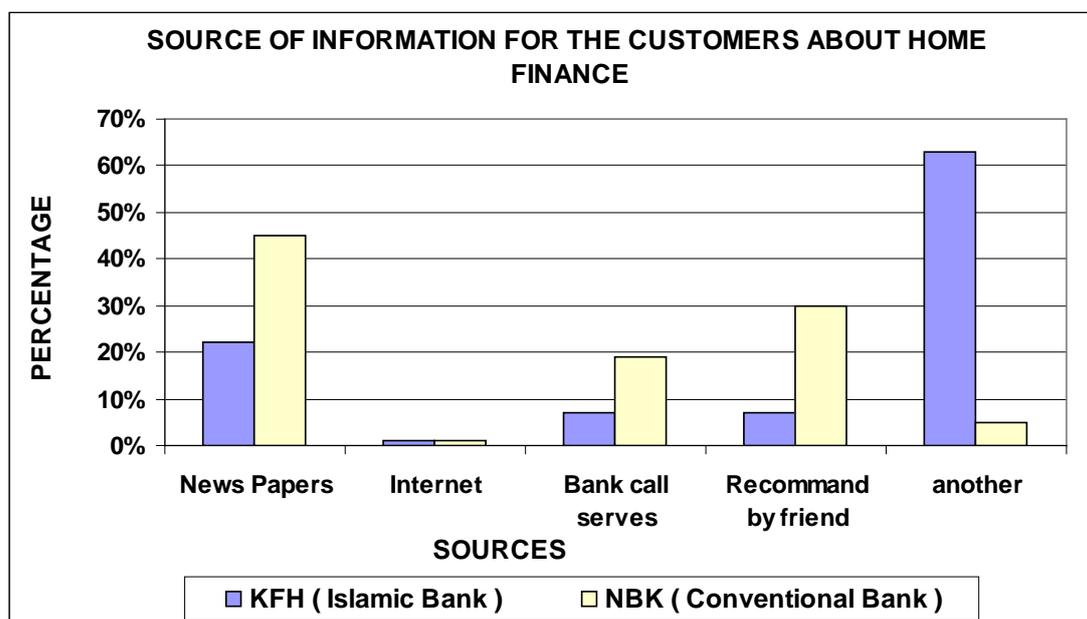


Table 6.9 and Figure 6.8 demonstrate the different sources of information available to customers of the Islamic and conventional mortgage providers. The most important source of information regarding Islamic Home Finance is identified as 'If Other, specify' option, which is the fifth option.

When we looked into the details of that "If Other, specify" option, we discovered that the main reason for most of the customers is 'Faith'. The customers of the Islamic bank perceived that they have "other" sources than that mentioned in the survey. Popular sources of information are mentioned in the questionnaire but "religious source" is omitted. They do not bother about what kind of other benefits they are receiving besides having Islamic Home Financing products i.e. *Ijara, Murabaha and Musharaka*.

There are five sources of information, with the first being newspapers. The clients in Islamic banking (22%) and conventional banking (45%) identified newspapers as their primary source of information. The second source regarding Islamic and conventional mortgage is the Internet, which was 1% and 1% for the Islamic banking and conventional banking respectively.

The third source says that "*Bank call Services*" are identified as 7% for the (KFH) which is Islamic financing and 19% for conventional (NBK).

The fourth source is "*Recommended by friend*" which become the KFH 7% and the NBK 30%. As for KFH, the main reason again is faith, because customers that have already engaged with KFH are recommending their friends to acquire a financing product from KFH. The fifth source is for "*Other Reasons*" that becomes the KFH 63% and the NBK 5%. Here, "*Other Reasons*" for KFH (Islamic financing) is the higher percentage among all other sources of information to acquire home financing. Popular sources of information are mentioned in the questionnaire but "religious source" is omitted. The reason behind this is co-related with our question number 8. If we look back at our options for question number 8, which are *Shari'ah*-compliant, better cash flow management and cheaper financing (as compared to the conventional), it shows that the customers who were seeking a solution related to their religion (*Shari'ah*) immediately switched or acquired the Islamic financing. The strong religious faith of the customers of Islamic bank is revealed in the study and hence we can presume that religious source is the source of information of the Islamic bank customers about the home finance.

6.7.2: Contract Type Made Between the Clients and Islamic Home Mortgages Provider

This question deals with the type of contract participants signed to obtain an Islamic mortgage.

Table 6.10: Distribution of Islamic Mortgages Contract

BANK		Percent
KFH (Islamic Bank)	<i>Murabaha</i>	90%
	<i>Ijarah</i>	9%
	<i>Musharka</i>	1%
	Total	100%

Figure 6.9: Distribution of Islamic Mortgages Contract

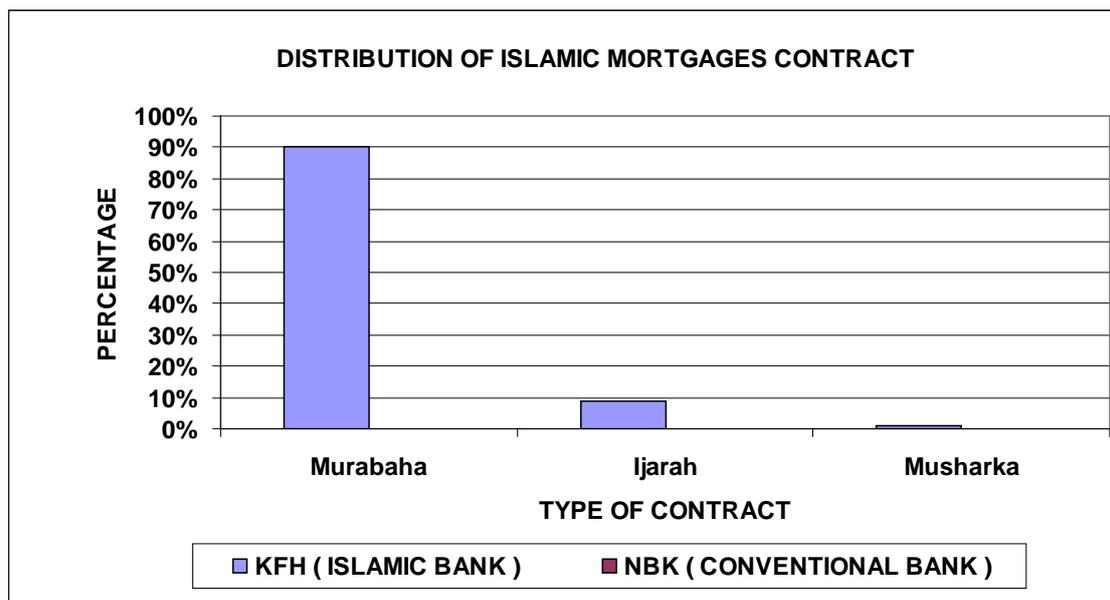


Table 6.10 and Figure 6.9 demonstrate the contract type entered between the Islamic finance provider and the clients. Islamic mortgage contracts provided by Islamic banking differ considerably in their services. Most respondents (90%) use the *Murabaha* deals with Islamic banking. A large number of clients use this service as it is the oldest service available to clients. It came into existence in 1977 by KFH. As for *Ijara*, KHF started it around 1992. And as far as *Musharika* is concerned, it is a very new product which has been available to clients since 2004. Only a very few number of Clients are using that *Musharika* service; the reason behind this fact is that clients are used to using the other two services/products provided by KHF, i.e. *Murabaha* and *Ijara*.

As far as *Ijarah* is concerned, only 9% of clients use this type of contract. A *Musharaka*-type contract is used only by 1% of the clients. It seems that the financial options of *Murabaha* contract are more well-known by customers, as they seem to show a particular preference for it.

This question deals with the purchase price from the financial providers.

Table 6.11: Distribution of Entire Purchase Price Financed by the Mortgage Provider

BANK	Valid	Frequency	Percent
KFH (Islamic Bank)	yes	62	62%
	No	38	38%
	Total	100	100%
NBK (Conventional Bank)	yes	66	66%
	No	34	34%
	Total	100	100%

Figure 6.10: Distribution of Entire Purchase Price Financed by the Mortgage Provider

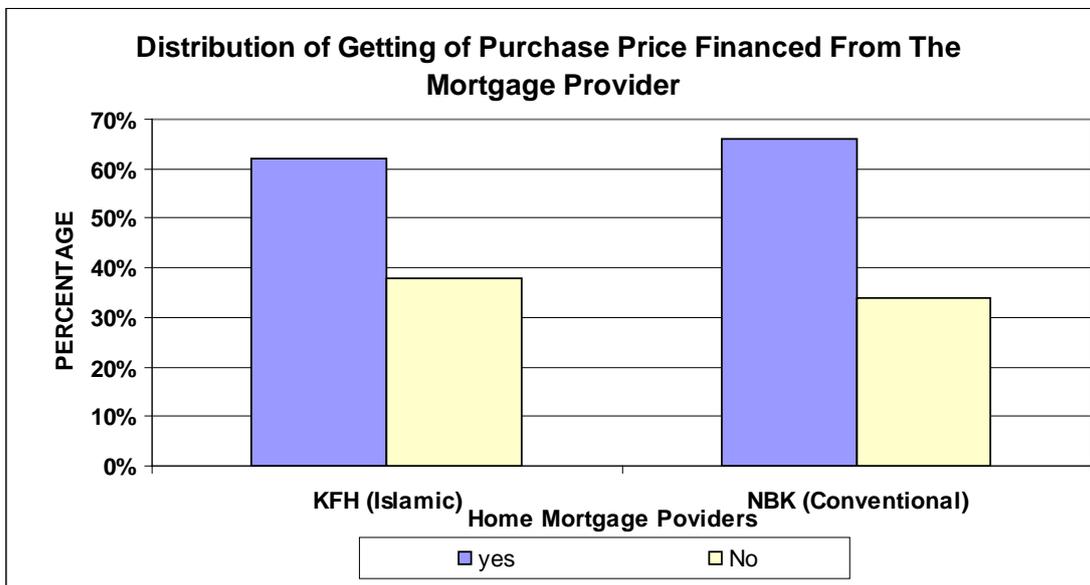


Table 6.11 and Figure 6.10 reveal the percentage of purchase price acquired by clients from the Islamic bank and conventional bank. Some 62% of the respondents from the Islamic banking claimed that they received the full

purchase price from the Islamic banks, while 38% mentioned that they did not get entire purchase price.¹⁰¹

As far as conventional banking is concerned, 66% of clients stated that they have received the full purchase price, while 34% mentioned that they did not get the entire purchase price.

The customers' statement about the purchase price indicates that both financial providers (KFH and NBK) do not provide full purchase amounts to clients and it become the mandatory requirement for clients to keep at least 30 to 40% of the capital amount in their saving account at the concerned bank for home mortgages.

¹⁰¹ Entire Purchase price means the amount customer asked for Home mortgage from the provider. In Kuwait, as it is stated earlier in Chapter 04 (Page 130 - 132), after marriage of 10 years government provide 70,000 KD loan (payable back to the government in 20 years, without charging any profit) to every citizen of Kuwait to purchase a house which is not enough to purchase a house, now a days. So citizens choose a house to purchase and go to bank and ask for home mortgage to complete the difference of the price of house (which is again limited to 42,000 KD, they can not ask for more than that). This can be done only once in their life.

The second situation can be before beginning or after completion of the above case. The customer goes to bank and ask for loan to purchase a house. In this case he will have to pay 30% of price of the house to the bank, rest (70% cost) will be completed by the bank and bank will hold the title until the last installment. After fully completed of payback to the bank the title will be transferred to the customer as owner.

6.8. HOME MORTGAGE DEAL WITH CUSTOMERS

6.8.1. Time it takes to process and finalise a home loan application from the time that an application is submitted.

This question deals with the period of the finalisation and the required formalities for a particular mortgage after a client's submission of a loan application.

Table 6.12: Period for Finalisation of all required formalities for the Extension of a Given Mortgage

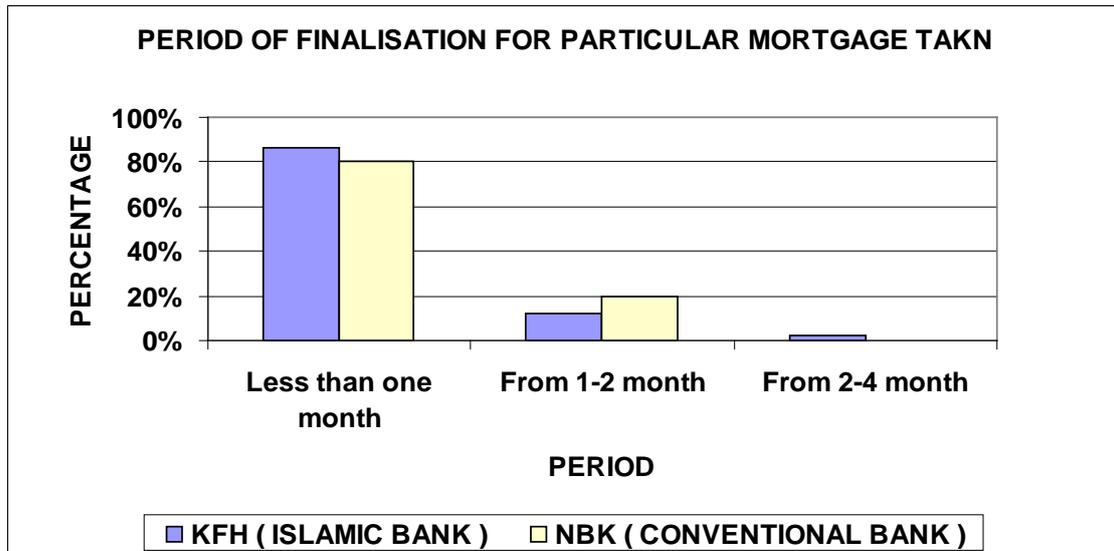
BANK	Variable	Frequency	Percent
KFH (Islamic)	Less than one month	86	86%
	From 1-2 month	12	12%
	From 2-4 month	2	2%
	Total	100	100%
NBK (Conventional)	Less than one month	80	80%
	From 1-2 month	20	20%
	From 2-4 month	0	0%
	Total	100	100%

ANOVA

Table 6.12a: Finalisation Duration

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	.080	1	.080	.474	.492
Within Groups	33.440	198	.169		
Total	33.520	199			

Figure 6.11: Distribution of Finalisation Duration for a Particular Mortgage



Tables 6.12, 6.12a and Figure 6.11 demonstrate the period of time required to finalise all formalities for a particular mortgage. The majority of respondents from the Islamic banking (86%) and the conventional banking (80%) indicated that it takes less than one month to finalise the required formalities for a particular mortgage. As far as the second variable is concerned, the loan formalities require one to two months for 12% of the Islamic bank customers and 20% of KFH customers. Some 2% of KFH customers said it takes 2-4 months, but for a conventional mortgage no one said that the mortgage takes 4 months. Therefore, it is indicated in Table 6.12 as 0%.

This is a clear indication that the banking standards, policies and procedures of both Islamic banking and conventional banking are almost the same.

Differentiation analysis has been applied to find out whether there are differences with statistical indication between both banks. The results of individual differentiation analysis reveal that there are no differences with statistical significance in the length of time it takes to process a home mortgage transaction.

This signifies that both banks are similar in their transaction processing periods. The (R^2) value has been calculated so as to explain the difference.

$R^2 = 0.80 / 33.520 = 0.023$, and it indicates a very small fraction of difference between the two banks' processes. Therefore, it can be ignored. The F-test in ANOVA also indicates insignificant differences.

The observation reveals that both banks (Kuwait Finance House and Kuwait National Bank) process the home mortgage purchase deal as quickly as possible so as to promote their products among home loan seekers.

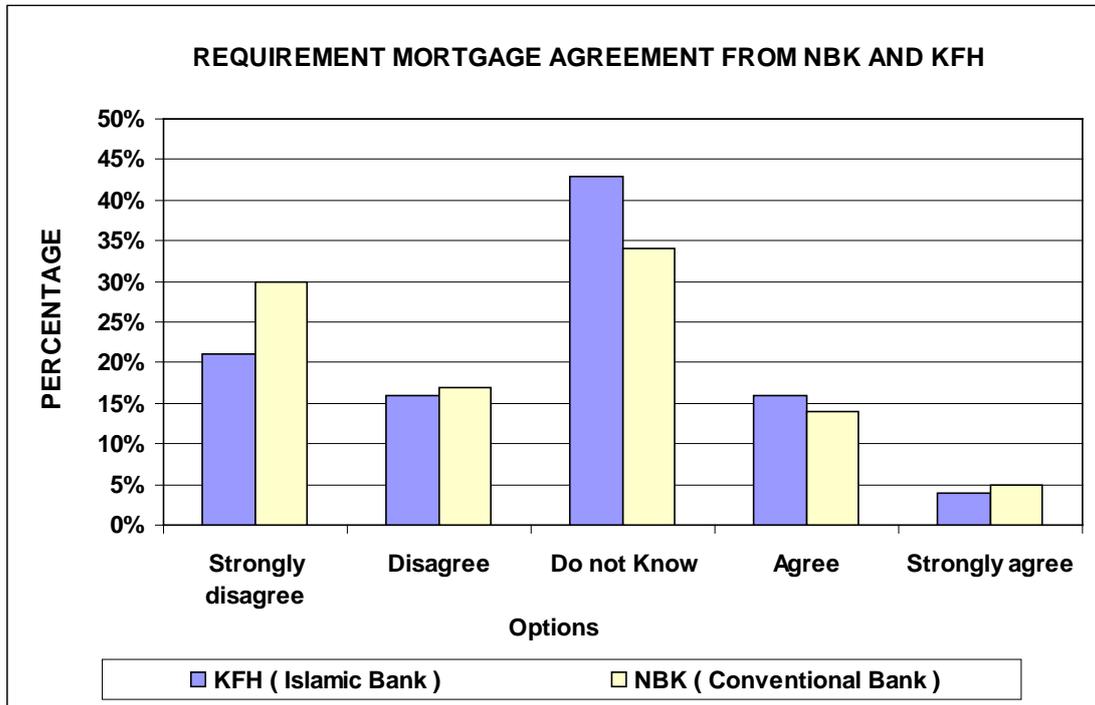
6.8.2. Possibility That the Islamic Bank May Have More Requirements In The Process Of Mortgage Agreement than the Conventional Bank

This question deals with the client's perception of whether or not the home mortgage formalities and procedures required by Islamic Banks are more than those required by conventional banks.

Table 6.13: Clients' perception of mortgage formalities required by NBK and KFH

BANK	VARIABLE	FREQUENCY	PERCENT
KFH (Islamic Bank)	Strongly disagree	21	21%
	Disagree	16	16%
	Do not know	43	43%
	Agree	16	16%
	Strongly agree	4	4%
	Total	100	100%
NBK (conventional Bank)	Strongly disagree	30	30%
	Disagree	17	17%
	Do not know	34	34%
	Agree	14	14%
	Strongly agree	5	5%
	Total	100	100%

Figure 6.12: Requirements of the Islamic and Conventional Providers



Descriptive Analysis

Table 6.13a: KFH Has Greater Requirements than NBK In The Process of Mortgage Agreement

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Islamic	100	2.6600	1.10298	.11030	2.4411	2.8789	1.00	5.00
conventional	100	2.4700	1.20147	.12015	2.2316	2.7084	1.00	5.00
Total	200	2.5650	1.15431	.08162	2.4040	2.7260	1.00	5.00

In a 5 likert scale where 1 represent strongly disagree and 5 represents strongly agree most of the results are about option 2, this implies that the most preferred answer ranges between 'disagree' and 'do not know' .

ANOVA

Table 6.13b: KFH Has Greater Requirements than NBK In The Process of Mortgage Agreement

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	1.805	1	1.805	1.357	.245
Within Groups	263.350	198	1.330		
Total	265.155	199			

Tables 6.13, 6.13a, and 6.13b and Figure 6.12 ascertain whether the requirements of KFH are more than NBK in the process of mortgage agreement. Surprisingly, the majority of respondents from both the Islamic banking (43%) and the conventional banking (34%) indicated that they do not know whether the requirements for the process of a mortgage agreement with KFH are more than those required by the NBK. On the other hand, 21% of the Islamic bank's clients and 30% of the conventional bank clients strongly disagreed that the requirements for the process of mortgage agreement in KFH is more than NBK.

As far as the variable "agree" is concerned, 16% of the respondents from the Islamic banking group said that they agree that the requirements for mortgage operations in KFH are more than NBK; whereas 14% of the respondents from the conventional banking claimed that they agree that the requirements for mortgage operations in KFH are more than NBK.

The distribution and ANOVA test was conducted on the customers' opinions to determine whether there are differences between the Islamic and conventional banks in terms of requirements needed for approval of a financial transaction.

While applying the differentiation analysis, the result revealed that there are no differences with statistical indication in terms of the requirements for home financing in the Islamic or conventional banks. This indicates that the requirements for approval are flexible and relatively easy for all customers. The R^2 value ($R^2 = 1.805 / 265.155 = 0.0068$) also indicates that only a fraction of the difference can be explained among the differences between the banks and, therefore, this could be ignored. This has been indicated by the insignificance of the F-test in ANOVA.

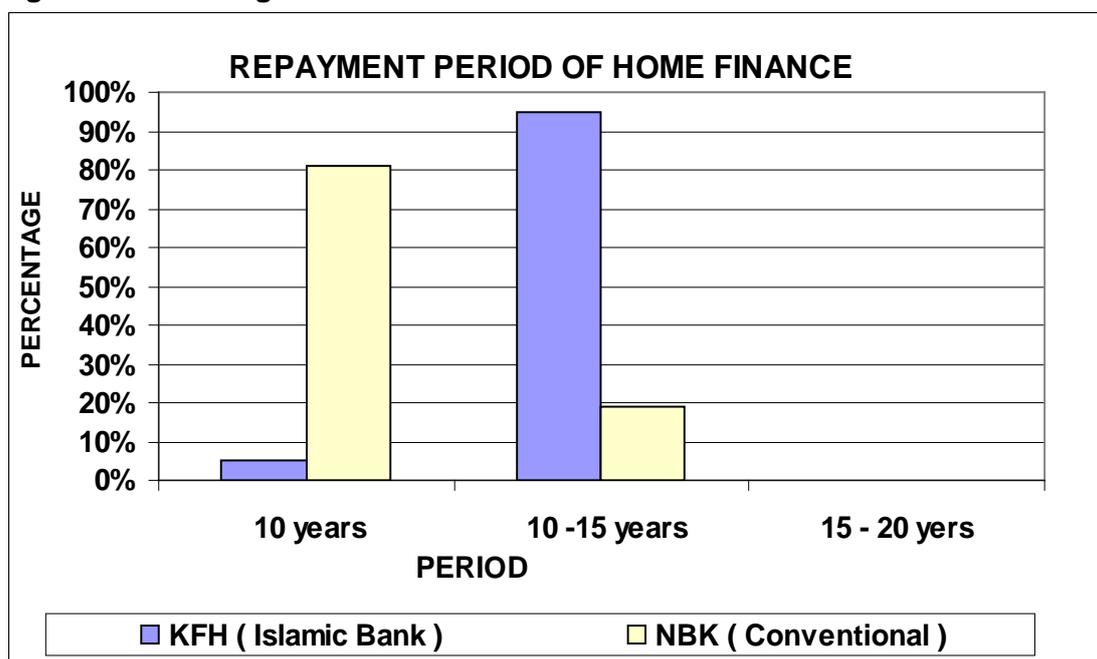
6.9. REPAYMENT PERIOD REQUIRED BY BOTH KFH & NBK

This question deals with the repayment period of the loan amount owed to the Islamic bank and the conventional bank.

Table 6.14: Repayment Period of Home Financing

BANK	VARIABLE	PERCENT
KFH (Islamic Bank)	Less than 10 years	5%
	From 10 -15 years	95%
	Total	100%
NBK (Conventional Bank)	Less than 10 years	81%
	From 10 -15 years	19%
	Total	100%

Figure 6.13: Average Duration of a Home Loan



Descriptive

Table 6.14a: Repayment Period of Home Financing

	N	Mean	Std. Deviation
KFH (Islamic Bank)	100	1.9500	.21904
NBK (Conventional Bank)	100	1.1900	.39428
Total	200	1.5700	.49632

ANOVA

Table 6.14b: Repayment Period of Home Financing

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	28.880	1	28.880	283.925	.000
Within Groups	20.140	198	.102		
Total	49.020	199			

Tables 6.14, 6.14a and 6.14b and Figure 6.13 show the repayment period of home financing for both Islamic banking and conventional banking.

Repayment in installments in “less than ten years” is preferred only by 5% of Islamic banking customers whereas, in the case of conventional banking, 81% of respondents prefer a shorter period for their repayment. As far as the longer period (10–15 years) is concerned, 95% of the clients of Islamic banking showed their preference for this option, while in conventional banking only 19% of the customers preferred such a lengthy repayment period. This denotes that Islamic banking offers longer periods for their customers for the repayment of home loans, while conventional banking offers a shorter repayment period.

The result indicates that the majority of clients (95%) from KFH chose the repayment period ranging from 10–15 years, which is the maximum period prescribed under the Central Bank regulations of Kuwait, and only 5% prefer the minimum period of 10 years for paying their dues. In the case of the NBK, 81% of clients prefer less than 10 years and only 19% prefer 10–15 years. The preference for a longer payment period among KFH customers may reflect customers’ convenience, standard income and long-term budget management. Preference of minimum repayment period by the conventional banking customers may be attributed to the customers’ sound financial position.

The ANOVA differentiation analysis was applied to determine whether there is a difference between both banks for the repayment period. Table 6.14b reveals that the results of individual differentiation analysis show slight differences with statistical indications between both banks.

R^2 value ($R^2 = 28.880 / 49.020 = 0.589$) also reveals that the F-test result is significant and the goodness of fitting R^2 values shows that about 58% of the difference in the repayment period of home financing could be explained by the difference of the banking.

Islamic banks could attract more clients for home mortgages by offering longer repayment periods which would help clients to pay their dues easily and comfortably, unlike other conventional banks.

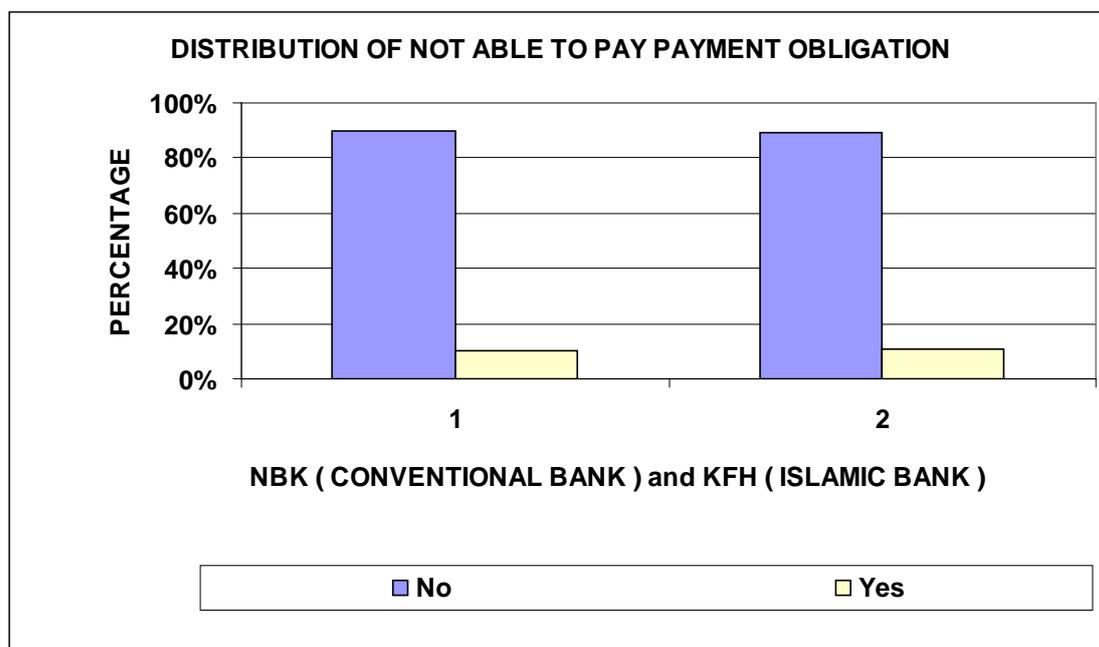
6.9.1. The ability to make a payment to NBK & KFH banks

This question deals with the client's ability to pay their monthly installment. Here we asked a very simple question to our customers: Are you sometimes unable to pay your monthly installment within an agreed period of time or on an agreed date? In Table 6.15 the percentage is defined according to customers' answers:

Table 6.15: Distribution of Ability to Meet Payment Obligations

BANK	Valid	Frequency	Percent
KFH (Islamic Bank)	No	90	90%
	Yes	10	10%
	Total	100	100%
NBK (Conventional Bank)	No	89	89%
	Yes	11	11%
	Total	100	100%

Figure 6.14: Percentages of Clients Involved in Monthly Installments



ANOVA

Table 6.15a: Distribution of Clients Unable To Make Payment

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.005	1	.005	.053	.819
Within Groups	18.790	198	.095		
Total	18.795	199			

Tables 6.15, 6.15a and Figure 6.14 reveal that those clients who are able to pay their monthly installment on time in Islamic bank are 90%, while those who are unable to pay the monthly installment on time are 10%.

Similarly, in conventional banks, 89% are able to meet their monthly installments and only 11% are unable to do so. This denotes that the issue of payment dues has nothing to do with the banks they choose - it all depends upon the ability of the client according to his hardship in life that he may be facing. It may be related to the mentality of the people or the cultural background or even to the financial standing of the concerned clients.

The ANOVA test ($R^2 = .005 / 18.795 = .000266$) also indicates a very small fraction of difference and, therefore, this could be ignored. This was also indicated by the insignificance of the F-test in the ANOVA test.

6.9.2. Problem and Reason for Non-Payment

This question deals with the reason for non-payment of monthly installments by clients.

Table 6.16: Reasons for Nonpayment of Monthly Installments

BANK	Variable	Frequency	Percent
KFH (Islamic Bank)	Sudden loss of job	4	40%
	Installment amount is increasing	N/A	N/A
	Permanent disability leading to a loss of job	2	20%
	Other (Specify)	4	40%
	Total	10	100%
NBK (conventional Bank)	Sudden loss of job	1	9.09%
	Installment amount is increasing	5	45.45%
	Permanent disability leading to a loss of job	4	36.36%
	Other (Specify)	1	9.09%
	Total	11	100%

In the above Table 6.16, for NBK bank, the total percentage is 100% whereas the frequency total count is 11. To give the actual total for NBK with the help of SSPS, a certain formula has been implemented. In this kind of implementation, we divided each number of frequency (1, 5, 4, 1 as they appear in order from up to down) by the total number of frequency which is 11 (11 respondents out of 100) and multiply by 100. By doing so, an actual percentage can be calculated for the respondents who chose from the

different reasons, while failing to make the monthly installment in time. So the formula for calculating the percentage will look like:

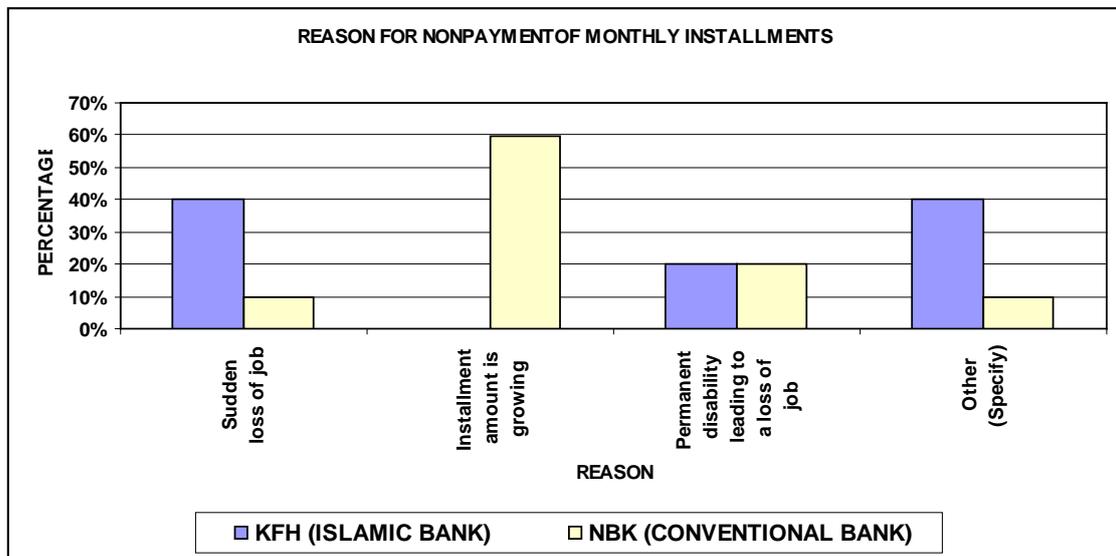
$$4 \div 11 \times 100 = 36.36\% \text{ (the answer)}$$

Where 4 is the frequency out of 100 respondents

11 is the total number of respondents who failed to make installments in time

100 is the total number of respondents who participated in the survey.

Figure 6.15: Reason for Nonpayment of Monthly Installments



ANOVA

Table: 6.16a Reason for Nonpayment of Monthly Installments

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.997	1	.997	.785	.387
Within Groups	24.145	19	1.271		
Total	25.143	20			

Out of the 100 respondents, only 10 customers of Islamic bank and 11 customers out of 100 respondents in the NBK defaulted in their timely payments.

Tables 6.16, 6.16a and figure 6.15 demonstrate the reasons for non-payment of monthly dues of housing mortgage among the clients of Islamic banking and conventional banking.

As far as the Islamic banking is concerned, job loss is the main reason for non-payment of monthly installments, according to 40% of respondents. 40% of the clients have specified other reasons for the non-payment of their monthly dues, such as car accident, purchases of emergency household items, hospital expenses etc. 20% can be defined as permanent disability leading to job loss, e.g. premature retirement due to disability etc. In Islamic banking, there is no possibility of failure due to, for example, a change in the rate of monthly installment because Islamic banking has a fixed installment rate.

As far as conventional banking is concerned, the majority of respondents (45.45%) stated that the value of repayment installments increases, eventually becoming higher than their income. 9.09% of the customers mentioned that their permanent disability is the main factor behind their job loss. Customers (36.36%) chose permanent disability as a factor. Other reasons for conventional bank customers can be defined as 9.09%.

The 'Other reasons' for failing in make monthly installments are the same as stated above for Islamic bank customers.

The ANOVA test $R^2 =, 997/ 25.143 =, 039653$ value shows that there is no significant difference, except for very small fraction which could be ignored.

6.9.3. NON-PAYMENT TO ISLAMIC (KFH) AND CONVENTIONAL BANKS (NBK)

This question deals with the period of non-payment to Islamic banking and conventional banking.

Table 6.17: Period of Non-Payment

BANK	VARIABLE	FREQUENCY	PERCENT
KFH (Islamic Bank)	Month	2	20%
	Two month	3	30%
	Three month	4	40%
	Permanent non payment	1	10%
	Total	10	100%
NBK (Conventional Bank)	Month	2	18.2%
	Two Month	4	36.4%
	Three Month	3	27.3%
	More than three Month	2	18.2%
	Total	11	100%

Figure 6.16: Period of Non-Payment

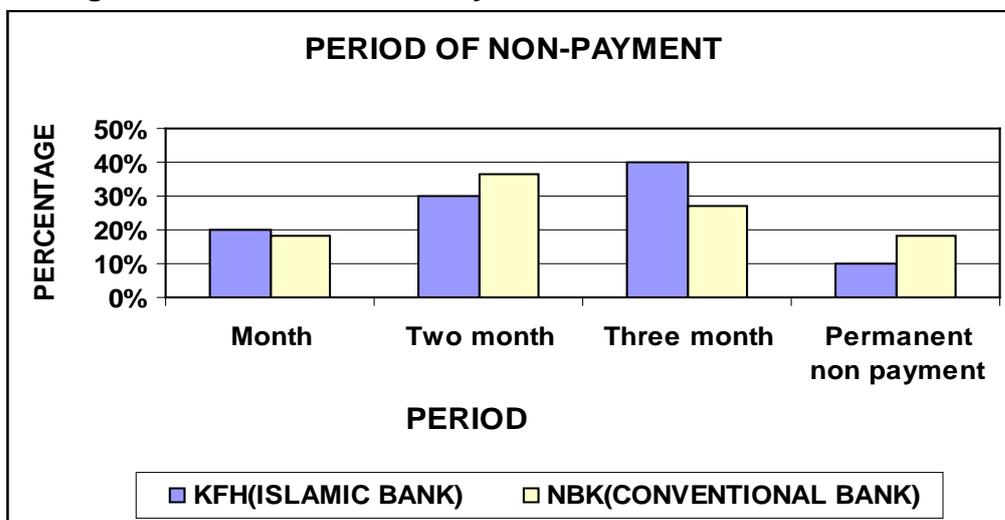


Table 6.17 and figure 6.16 reveal the length of the non-payment of monthly installments for both the Islamic bank and the conventional bank. There were four variables for each type of banking. The first variable is “non -payment for one month” and the percentage of clients who are unable to pay their installments for this period is 20% and 18.2% respectively for the Islamic bank and the conventional bank. The second variable is “non- payment for two months” and the percentage of clients is 30% and 36.4% for the Islamic bank and conventional bank respectively. The third variable is “non- payment for three months” and the percentage of clients for the Islamic bank is 40% and 27.3% for the conventional bank. The fourth variable is the “permanent non-payers” which is 18.2% for the conventional bank and 10% for Islamic bank.

This indicates that there are a great number of clients of both the Islamic and the conventional bank who refrain from paying their installments. This is an increasing nuisance in Kuwait, and many debates and arguments have been raised in order to find viable solutions to overcome this problem.

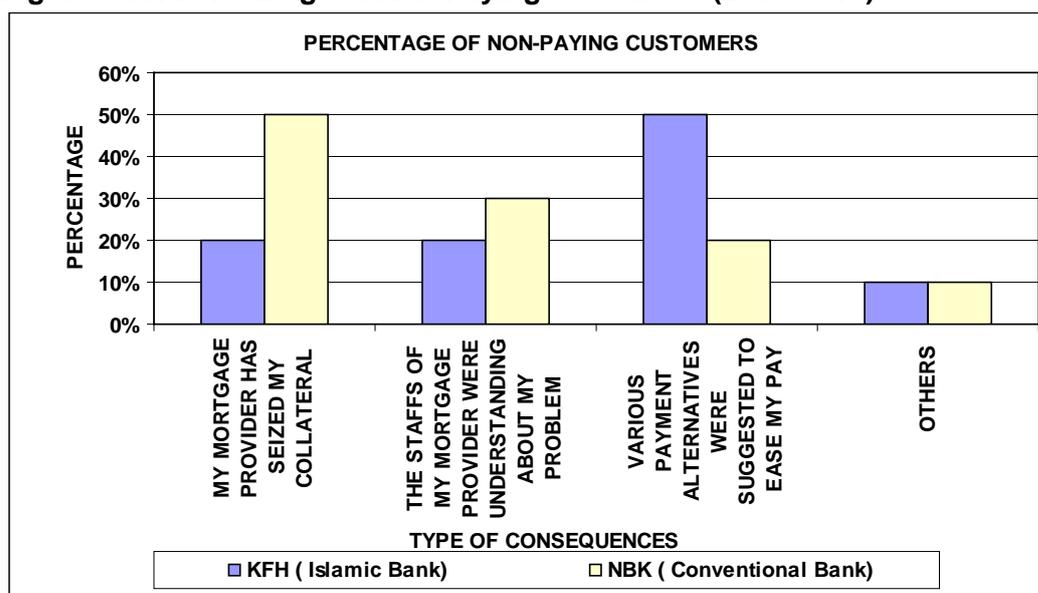
6.9.4. REASON FOR CUSTOMERS’ NON-PAYMENT AND BANK ACTIONS AGAINST THEM (NBK & KFH)

This question deals with the consequences taken against the customer by the provider when they fail to make their monthly installments in time. In the survey, first we identified in our previous questions how many respondents failed to make their monthly installments on time. As a result, we got 10 customers out of 100 from Islamic financing and 11 customers out of 100 from conventional financing. Only 21 customers out of 200 customers participated in our survey. In this question, those 21 customers were given five (5) options to choose from as their answer about consequences taken against them.

Table 6.18: Consequences of Non-Payment

BANK	Variable	Frequency	Percent
KFH (Islamic)	My mortgage provider has seized my collateral	2	20%
	The provider of my mortgage was understanding about my problem	2	20%
	The provider was not very understanding about my problems	0	0%
	Various payment alternatives were suggested to ease my payment	5	50%
	Others (Please state)	1	10%
	Total	10	100%
NBK (conventional)	My mortgage provider has seized my collateral	5	45.45%
	The provider of my mortgage was understanding about my problem	3	27.27%
	The provider was not very understanding about my problems	0	0%
	Various payment alternatives were suggested to ease my pay	2	18.18%
	Others (Please state)	1	9.09%
	Total	11	100%

Figure 6.17: Percentage of Non-Paying Customers (Defaulters)



Tables 6.18, 6.18a descriptive analysis and figure 6.17 represent those customers who failed to make installments on time to their providers. The results indicate that only 10 customers of the Islamic bank and 11 customers of the conventional bank were unable to pay their monthly dues in time.

As for the option "My mortgage provider has seized my collateral", the percentage of respondents from the Islamic bank customers who chose this variable was 20%, while the percentage of respondents in the conventional bank was 45.45%.

The second variable is "*The provider of my mortgage understood about my problem*". 20% 'defaulted customers' from Islamic bank and 27.27% from conventional bank selected this variable as their choice.

The third variable can be identified as 0% for both of the banks which is '*The provider was not very understanding about my problems*'.

The fourth variable is '*Various payment alternatives were suggested to ease my payment burden*'. Some 50% of these customers were from the Islamic bank, while those from conventional bank were 18.18%. This difference in numbers reveals that the provider of the Islamic bank does provide various options once any of their customers fails to payback their due installments.

The last variable which is 'Others' in the question can be elaborated as 10% and 9.09% for Islamic and conventional bank respectively.

In general, the delayed payment of monthly installments from the clients is acceptable to a certain level by both banks, which tend to favour the provision of various opportunities to clients to fulfill their financial obligations toward the bank.

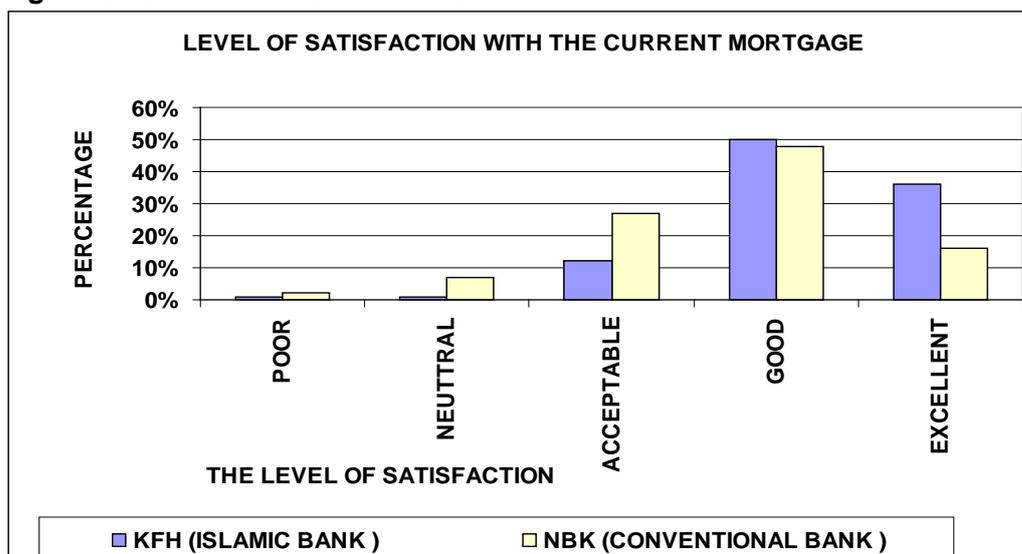
6.10. LEVEL OF CUSTOMER SATISFACTION WITH THE SERVICE PROVIDER

This question deals with the level of satisfaction among customers of both banks in respect of paying their installments for home finance.

Table: 6.19 Level of Satisfaction with the Current Mortgage

BANK	VARIABLE	FREQUENCY	PERCENT
KFH (Islamic)	Poor	1	1%
	Neutral	1	1%
	Acceptable	12	12%
	Good	50	50%
	Excellent	36	36%
	Total	100	100%
NBK (Conventional)	Poor	2	2%
	Neutral	7	7%
	Acceptable	27	27%
	Good	48	48%
	Excellent	16	16%
	Total	100	100%

Figure 6.18: Level of Customer Satisfaction with the NBK &KFH



Tables 6.19, 6.19a, 6.19b and Figure 6.18 show the level of customer satisfaction with the current mortgage operations. It is worth noting that the level of satisfaction was higher for the Islamic bank than the conventional bank. The majority of the respondents from the Islamic bank (50%) mentioned that the current mortgage operations are good, whereas in the case of the conventional bank, 48% agreed with the same variable.

A considerable number of the clients of the Islamic bank (36%) stated that the current mortgage operations are excellent, while only 16% of the conventional bank customers indicated that the current mortgage operations are excellent. A good number of respondents from the Islamic bank (12%) and conventional bank (27%) agreed that the current mortgage operations are acceptable. This indicates that clients of the Islamic bank (KFH) are more satisfied with the current mortgage operations than the clients of the conventional bank (NBK).

Descriptive Analysis

Table 6.19a: Level of Satisfaction with Current Mortgage

	N	Mean	Std.Deviation	Std.Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
KFH	100	4.19	0.76138	0.07614	4.0389	4.3411	1	5
NBK	100	3.69	0.8955	0.08955	3.5123	3.8677	1	5
Total	200	3.94	0.86611	0.06124	3.8192	4.0608	1	5

From Table 6.19, we can see the descriptive analysis test which shows that the level of satisfaction with the current mortgage of the clients of the KFH (Islamic bank) is closer to excellent while, in the case of the NBK, it is closer to good. It also indicates that the satisfaction is higher for the KFH than it is for the NBK (conventional bank) according to the derived test results.

ANOVA

Table 6.19b: Level of Satisfaction with the Current Mortgage

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	12.500	1	12.500	18.095	.000
Within Groups	136.780	198	.691		
Total	149.280	199			

A significant difference (8%) is observed among the client satisfaction which was proved through the ANOVA $R^2 = 12.500 / 149.280 = 0.0837$.

The overall observation indicates that clients from both banks are satisfied with their current home mortgage dealings as their responses are 'good' in the present study. If we look more closely at the level of satisfaction among Islamic and conventional banking and put aside the first two variables (Poor and Neutral), which do not reveal a strong level of satisfaction, we can conclude the satisfaction level among Islamic banks is 98%, while for the conventional banks it is 91%.

6.10.1. Client’s Attitude Towards Their Shifting From Conventional Bank To Islamic Bank Or Vice Versa Based On Their Satisfaction And Convenience

This question deals with switching from a conventional mortgage to an Islamic mortgage or vice versa for Islamic banking and conventional banking. In this question, customers were asked about their current preference, if they are given the option to switch from their current mortgage provider to the other, i.e. from Islamic to conventional.

Table 6.20: Distribution of a Choice to Switch from Current Mortgage Provider to Other

BANK	VALID	FREQUENCY	PERCENT
KFH (Islamic Bank)	Yes	5	5%
	No	95	95%
	Total	100	100%
NBK(Conventional Bank)	Yes	70	70%
	No	30	30%
	Total	100	100%

Figure 6.19: Customers' Willingness to Move from One Bank Provider to Another, if Given the Chance

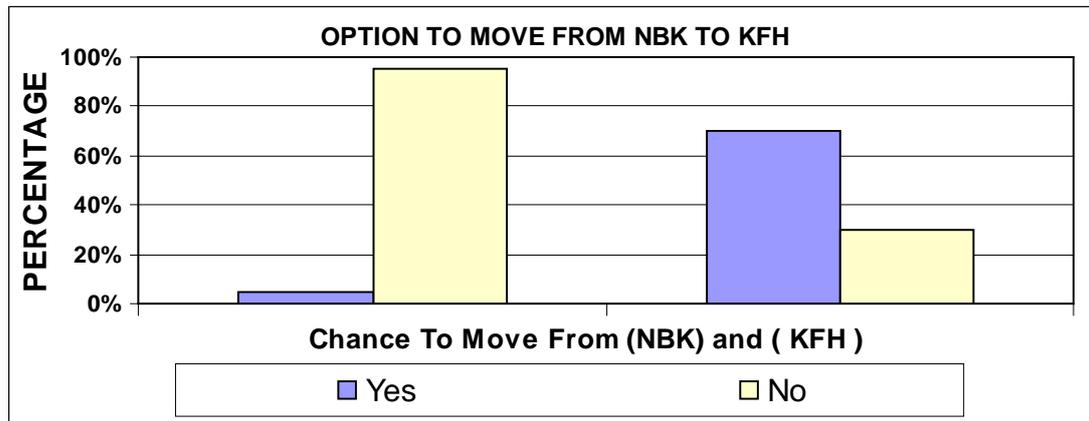


Table 6.20 and Figure 6.19 reveal the tendency of clients of both Islamic bank and conventional bank to move from NBK (conventional bank) to KFH (Islamic bank), or vice versa. The majority of clients from the Islamic bank (95%) mentioned that they do not want to switch from the Islamic bank to the conventional bank, stating '*Shari'ah-compliant*' as a reason and they don't want to switch at all. Furthermore, they said that they know very well the importance of faith in their daily lives and they can not deny or put behind the facts which impact on their lives. Only 5% indicated that they want to move from the Islamic bank to the conventional bank, giving as a reason that they acquired the Islamic product because of the their employer's policies or recommendations from family or friends, and for them it does not make any difference whether they take a mortgage either from an Islamic or conventional provider.

The attitude is completely different with the clients of the conventional bank, as the majority of them (70%) claimed that they would want to move to the Islamic banking, while only 30% did not want to move to Islamic banking.

This denotes that most of the clients of the Islamic bank are satisfied with their bank and they do not want to move to other conventional banks, while the majority of clients in the conventional banks expressed that they wish to change their home mortgage dealings from a conventional bank to the Islamic bank if they had the choice.

6.11. CONCLUSION

In order to highlight the differences between the conventional and Islamic financing, a survey was carried out. In this survey, we adopted several approaches to summarize the answers of the survey questionnaires. There were many findings seen as a result.

In this study a survey on 240 respondents were conducted, out of which 117 of them obtained home mortgages from Kuwait Finance house (KFH) which adopts the Islamic Banking System and 123 from National Bank of Kuwait (NBK) which is following the conventional banking system. Among the sample we omitted 40 responses due to reasons like vagueness, incompleteness etc. Finally 100 responses from both Kuwait Finance House customers' and from NBK customers' were selected in this study. The result of the survey shows that most people prefer Islamic banking system because it is in conformity with their Islamic beliefs. This is a comparative study as it compares two different banking systems. It also throws light on some of the shortcomings of the Islamic Banking services as well as its advantages. In this study we adopted several statistical methods including descriptive analysis, chi-square test, cross tabulation, ANOVA test and factor analysis in order to analyze the preferences of respondents.

We visited 240 customers randomly, who already had a mortgage. Out of 240 responses some were omitted due to incompleteness and ambiguous data. Finally 100 responses belonged to KHF (Islamic) customers and 100 belonged to NBK (Conventional) customers were selected for the study. We presented them with the survey questionnaire and collected their thoughts, perspectives, concerns, procedures and paperwork, and time duration they faced.

The main concern when conducting the survey was to get an idea of the main differences among the Islamic and conventional banking operations in the region and how and why people acquire their financial products (especially

home mortgage) from both of the systems. From the outcome we can compare the satisfaction level among the customers.

About 70% of home mortgages have been taken by the 31-50 age group. One of the main reasons for this age group in particular is again because of the government policies designed for their citizens. Those policies make the citizens eligible to have a direct loan from the government after 10 years of their marriage. A fixed amount, e.g. 70,000 KD, is deductible as a monthly installment, an amount equal to 10% of their current salary with no stipulated repayment period. Therefore, the entire home mortgage is taken (either from Islamic or conventional banks) after receipt of that government loan. If we look carefully at the aspect of completion of education and then marriage and 10 years after, every citizen lies in the above age group. Besides that, the Central Bank of Kuwait has a strict policy for their citizens that state that no citizen can have any kind of loan that has a monthly installment repayment amount of more than 50% of their monthly salary. A very good thing about the policies of the Central Bank of Kuwait towards providers (either Islamic or conventional banks) is that, once a mortgage is issued to a customer, the installment amount is automatically transferred to the provider from the customer's salary. The customer receives his or her salary in their account after deduction of their installment amount. Such a home mortgage has 20 years (maximum) repayment duration, which would have been 15 years. It is not like a loan, which depends on only the 10% (fixed) of your salary. Obviously, this is already agreed between the provider and customer in the contract of repayment. So the chances of non-payments and delayed payments are minimised.

If we only talk about the awareness of Islamic ruling, we can say that awareness is almost 100% among the citizens of the region. But still there are people who care and implement the Islamic ruling and make that ruling as a part of their life, while some don't care. The people who adopted Islamic home finance said that they acquired their mortgage from Islamic banks because they want to strictly follow the religious aspects while making any decisions in their life.

In this chapter, we also analysed the awareness of home mortgage products provided by the Islamic and conventional banks, the channels being used by the providers to address citizens and the variety of products of home mortgage available from the providers (banks). We also looked at the actions taken by the providers against those customers failing to repay their installments.

At the same time the unawareness of services of the Kuwait Finance House is discovered as an important factor for seeking mortgages from other banks. This implies the necessity of publicity of the services rendered by KFH. In this modern era advertisement plays an important role in the publicity of all types of services and products and it is true that we cannot yield better fruits without proper utilisation of advertising techniques adopted and accepted by people as source of information in the society.

Chapter 7: INTERVIEWS OF ISLAMIC AND CONVENTIONAL MORTGAGE PROVIDERS

7.1. INTRODUCTION

This chapter discusses and provides the results of the semi-structured interviews that have been carried out. In our study, which was to compare an Islamic mortgage with a conventional Mortgage, firstly we targeted two of the biggest and well-known banks, as well as other conventional and Islamic banks and companies. To widen our findings, we also interviewed two scholars who are working in Islamic banks in their *Shari'ah*-compliant department. We took the Kuwait Finance House, which is operating in the region, as an Islamic bank and the National Bank of Kuwait, which is operating as a conventional bank, here in Kuwait. In chapter 4 we discussed in some details both of the banks, such as their receivables, growth rate and the time they have been in operation in the region. In our study, we only addressed the home mortgage product.

According to Mohammed Al Omar, who is CEO of Kuwait Finance House, with a well-established history in the Islamic financial services sector, Kuwait is at the forefront of the rapidly growing industry. The GCC as a whole makes up more than 40% of the estimated \$750bn to \$1trn in global *Shari'ah*-compliant assets, and Kuwait's Islamic financial institutions (IFIs) have established a strong reputation and are competing aggressively with their domestic conventional counterparts. Indeed, *Shari'ah*-compliant companies made up 57% of the total market capitalization in the country as of July 2008, suggesting there is significant scope for investment and growth. While it was previously thought the more conservative conception of risk would insulate *Shari'ah*-compliant operators from the worst of the financial crisis, the sector did not escape unscathed. Kuwaiti IFIs avoided several impaired asset classes but were hit by their exposure to asset bubbles in the local and

regional stock and real estate market. Although Kuwait's IFIs have been affected by the financial downturn, the potential in the market is clear and conventional banks are looking to enter the sector. As Islamic windows have not been permitted, the trend is towards conventional banks buying stakes in Islamic banks – as NBK did this July, buying up 13% of Boubyan Bank – or full conversion to *Shari'ah*-compliance, the path chosen by the Kuwait Real Estate Bank in 2007. The three established Islamic banks (a fourth, the Bank of Kuwait and the Middle East is in the process of conversion) are looking to build on their strengths, moving forward by bolstering their core businesses and expanding both their retail and corporate operations – with a further roll-out of branches expected. The sector needs new and innovative products – including a drive towards the *sukuk* (Islamic bond) market – to move to the next stage of development. For this to happen, the government may have to take a more active role in introducing regulations and issuing its own *sukuks* to provide a sovereign benchmark.

In 1977, Kuwait Finance House began its *Shari'ah*-compliant product to serve Kuwaiti citizens. The reason behind this was that a majority of citizens was looking for an alternative solution to fulfill their financial needs. Since then, there has been a continuous diversification in the area of Islamic financing products supported and appreciated by the citizens.

Nowadays, in Kuwait the banks or companies that provide financial services are only involved in one method of financing. They are conventional systems that are *Shari'ah*-compliant and which follow strictly the Islamic principles. In some other developing countries, however, banks and institutions are providing financial services to their customers by both the conventional-based system and the Islamic-based system. Malaysian banks and companies are one such example.

In this chapter, interviews were conducted within Islamic and conventional banks, companies and with *Shari'ah*-compliant scholars.

For details of Islamic home financing we interviewed Mr. Imad A. Al-Thaqeb Assistant General Manager (Finance Sector, Real Estate Department), in Kuwait Finance House, Mr. Yousef Thunayan Al-Ghanim, Credit Analyst (Corporate Finance Department) at Boubyan Bank of Kuwait, and Dr. Sadeq J. Abul, Manager (Economic Research Department) at 'Kuwait International Bank. The Islamic financing company is Rasameel Structured Finance Company and the interview was taken by Mr. Issam Z. Al- Tawari, Chairman & Managing Director of the company. Furthermore, to get in-depth detail of Islamic home financing products and their progress and popularity in the region, we also interviewed some famous Islamic *Shari'ah* scholars. It was not only the questionnaire but also a detailed interview that helped to conclude our third set of interviews. Those Shari'ah scholars are Shaikh Adnan Almulla (Committee member at Kuwait Finance House) and Dr Shaikh Abdulazeez Al-Qasar, the Committee Consultant of *Shari'ah* compliant at Boubyan Bank and International Bank.

For the details of conventional home financing we interviewed Mr. Ghazi K.Abdul – Raheem, Senior Manager (Economic Research) at National Bank of Kuwait, Mr. Dhari S. Aljutaili, Associate Portfolio Manager (Corporate Banking Group) at Gulf Bank of Kuwait and Mr. Abdulrahman Al Khubaizi, Senior Credit Office (Corporate Finance Department) at Al Ahly Bank of Kuwait. The conventional financing company is Iskan Financing Co. and the interview was taken by Mr. Khaled A. Al-Attar, Assistant Manager Marketing Department.

In our interview, our emphasis was on the different kinds of home financing products that both banks (conventional and Islamic) were offering to their customers, the demand of the financing in the region, pricing issues consulted by the customers, available and possible periods of mortgages to be offered by the banks, development in Kuwait with respect to housing thus resulting in increased purchases and mortgages for housing, competition among each other, etc.

In total, three (3) sets of interviews were taken by bank personnel, *Shari'ah* scholars and government offices within conventional and Islamic banks, real estate personnel and financial companies.

The interview question comprised of a total of twelve questions. The three (3) different sets of questions are as follows:

7.1. a The Questions asked in Conventional Banks and companies

(First set):

1. Please kindly state the types or structures of home financing you provide in the Kuwaiti market.
2. Are you happy with the demand for your home financing products?
3. What is the strength of your home financing products?
4. Would you think that pricing is the most important strength of your product?
5. Would you please comment on the profitability and competitiveness of your home financing products?
6. What is the term-period of your products?
7. Please comment on the developments in the Kuwaiti housing market and housing financing market.
8. What is the ratio of approved application to mortgage application in the bank?
9. Do you consider the other Islamic banks as strong competitors in the housing finance market?
10. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (i.e. the cheapest, in the middle, etc.).
11. Do you know if the Islamic home finance products are substantially different than the conventional mortgages? Or is only the structuring different?
12. Do you think that you might open an Islamic home financing window?

7.1. b. - The Questions asked in Islamic Banks and *Shari'ah* compliant companies (Second Set):

1. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?
2. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?
3. Are you happy with the demand for your home financing products, in particular due to its Islamic nature?
4. If the demand has not been as good as you expected, what could be the reasons?
5. What is the strength of your home financing products?
6. Would you think that pricing is the most important strength of your product?
7. Would you please comment on the profitability and competitiveness of your home financing products?
8. What is the term-period of your products (e.g. 10 years, 20 years)?
9. Please comment on the developments in the Kuwaiti housing market and housing financing market.
10. What is the ratio of approved mortgage applications in the KFH?
11. Do you consider the NBK as a strong competitor in the housing finance market? Do you expect other Islamic financial institutions to come onto the market?
12. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle etc.)

7.1. c. - The Questions asked to *Shari'ah* Scholars (Third Set):

1. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?
2. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?
3. Why do people prefer conventional financing while Kuwait is an Islamic country and there are opportunities to obtain Islamic financing? What are your views in this regard?
4. Do you think that Islamic home finance is in good demand? If the answer is (No), what are the reasons in your point of view?
5. What are the strengths that characterise Islamic home finance in comparison with its traditional counterpart in view of *Shari'ah*?
6. Would you think that pricing is the most important strength of your product?
7. What are your comments on competition in Islamic home finance in view of the appearance of new Islamic banks?
8. Do you think that Islamic home finance has reasonable costs for the client in comparison to conventional mortgage finance?
9. Are there clients who bought a house through Islamic home finance and find it difficult to make payment for any reason, regardless product through *Murabaha* or *Ijara* or *Musharaka*? What legal procedures apply in such a case?
10. In case of the death of the client who bought a house from Islamic home finance, what are the legal procedures of the Bank in this regard?
11. We have noticed recently that the gap between citizens who take Islamic real estate finance and citizens who have traditional real estate finance has been reduced. Does this have anything to do with simplifying the procedures of having traditional real estate finance?
12. The last three decades witnessed an increase in the number of Islamic banks. Is there competition affecting *Murabaha* products? What is the percent of this competition with traditional banks?

7.2. ABOUT NATIONAL BANK OF KUWAIT (NBK)

The National Bank of Kuwait was founded in 1952 when a prominent Kuwaiti merchant went to the British Bank of the ME to open a Letter of Guarantee for the amount of 10,000 Indian Rupees (which is equivalent today to 750 KD). Much to his surprise, his request was rejected, on the condition he provides a guarantor. This well-known merchant was shocked and appalled by the treatment that he had received, and news of this went all over town.

7.2.1. NATIONAL BANK OF KUWAIT (NBK) INTERVIEW

Interview in NBK (the conventional housing finance provider in Kuwait) *Mr. Ghazi K.Abdul – Raheem, Senior Manager, (Economic Research)*

Q 01. Please kindly state the types or structures of home financing you provide in the Kuwaiti market.

Answer 01. One of the financial components of National Bank of Kuwait is property finance, as the bank extends loans in a traditional way to finance land, autos, furniture, and other types of similar loans to its customers. For example, the required amount for home finance usually depends on the applicant's salary and his/her number of years in service. A longer period of service and higher salary make it easier for the customer to secure a bigger loan, and the period for installment settlement extends up to 15 years. Customers can apply for a housing loan and the formalities are processed within a shorter period of time that can be 2-3 weeks maximum. When the transaction is approved, the customer receives the financing amount and proceeds with preparations to purchase his/her house. No collateral guarantees are required. However, the salary certificate, declaration form and the place of employment are needed to make regular monthly transfers from the client's salary to the bank in a continuous manner.

Q 02. Are you happy with the demand for your home financing products?

Answer 02. The demand on housing loans has been increasing during the past 10 years, and the bank takes into account this increase in all its local and international branches. Obviously demand has been increased as the population of the region has been increased with sound numbers. Besides existing customers, a lot more new applicants are there in the market and they have to choose from the available providers of the home mortgage.

Q 03. What is the strength of your home financing products?

Answer 03. Actually the strength again depends on the demand in the market. In Kuwait, market prices have been increased for the lands and for the houses. Therefore, almost 95% of the Kuwaiti people, when they have a sound job, start planning to buy a land or a house. To make that dream come true, they have to go to any of the banks operating in the market. The customers have to choose from the available products on offer by the banks regarding home finance. According to their needs and the products for home finance they fit for, they choose and carry on. Customers appreciate expeditious and flexible systems that the bank offers with respect to the home loan process. We are very proud of our quality service and easy processing of transactions, which forms a strong base for attracting more customers in the bank's system.

Q 04. Would you think that pricing is the most important strength of your product?

Answer 04. Not only NBK, but all the banks have provided crystal clear policies by the Central Bank of Kuwait while entertaining their customers with respects to loans. So there is not a huge difference between the pricing issues. So this pricing can not be considered as a strength for our product. Among other incentives

and interests, the rates offered by NBK are crucial for their customers. Customers are well aware about a bank's convenient financial options with the variable interests applicable to housing loans. In many events, the rate plays a vital role in the loans, and when all financial institutions propose the same conditions, customers always prefer the lower rates.

Q 05. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 05. The banks are targeting the average customers, for which all circumstances and factors are taken into consideration when the finance schemes are developed. The bank has prepared the most efficient procedures and the simplest methods for customers to avail their loans on time for the interest, which will be so competitive and appropriate and will never affect his/her income potentiality. Our normal practice in this regard is to entertain each and every customer. Definitely we take into account one's ability to pay back the installment amount. Furthermore, the policies made by the Central bank of Kuwait are to entertain not only the customers, but the banks as well.

Q 06. What is the term-period of your products?

Answer 06. NBK always provide home loans with the best interest rates to the customer. It facilitates the repayment installment period by making it as comfortable as possible for customers. It offers 10 years for those who have higher salaries and 20 years for customers who may suffer due to higher installments if repaid during 10 years. In general, the periods are arranged according to the benefit of the bank and the situation of customer. But the maximum available period to pay back is 20 years.

Q 07. Please comment on the developments in the Kuwaiti housing market and housing financing market.

Answer 07. The Kuwaiti housing market has been witnessing a great boom over the last 10 years. For many factors, such as the welfare of population and oil price increase, customers are keen to own their own houses. Moreover, demand on plots and the existing houses are increasing always for family purposes. People approach the financial institutions because funds from their savings and Credit Bank are insufficient for their housing needs, despite the fact that the governmental-owned entity known as the Credit Bank extends interest-free loans. In the first half of 2000, the Credit Bank faced a shortage in funds to finance any housing mortgages. As the trend of housing market is now flourishing, the housing loan applications will continue to increase, after having reached a high of 65,000 by the end of 2006.

Q 08. What is the ratio of approved application to mortgage applications in the bank?

Answer 08. The NBK lending policy depends on the applicant's salary potential. Acceptance of a loan application is probable when the applicant fulfils the requirements of the bank, and has no significant obstacles hindering the process. So normally the approval rate for the applications is almost 100%

Q 09. Do you consider the other Islamic banks as strong competitors in the housing finance market?

Answer 09. The NBK performs its role, regardless other financial institutions, but it believes that the KFH is the strongest competitor in the region, as it has captured a big part of the finance market since its operating and offers the same product but in an Islamic way.

Q 10. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle, etc.).

Answer 10. The NBK has established a good relationship with all of its customers; hence the increased number of customers of NBK customers makes the cost so effective. Most of the financial providers face higher costs due to a limited number of transactions and customers. NBK offers large amounts for funding housing transactions on the basis of least cost with the lesser time of transaction performance. Since the NBK has been operating for a long time in the region and can facilitate more customers, it represents a large section of the finance market. Depending upon its strong capital and ability to entertain smoothly, NBK has a line of products to entertain their customers.

Q 11. Do you know if Islamic home finance products are substantially different than conventional mortgages? Or is only the structuring different?

Answer 11. Actually, the products provided by the Islamic financing are not different in operation. Like us, they provide loans for home finance and other reasons. The same system of monthly installments is used, i.e. deductible directly from customers' salaries, and the period of time provided to repay is almost the same. The only difference is that they are *Shari'ah* compliant and follow the ruling of *Shari'ah* and depend on Fatwa (Legal Islamic Approval) for a financial transaction, and they feel that such a system conforms to their beliefs and thinking.

Q 12. Do you think that you might open an Islamic home financing window?

Answer 12. The NBK plans to launch an Islamic finance system in the future.

Nothing prevents the NBK from introducing Islamic products to provide a quality service to our customers. It believes such development and changes in the future would benefit the bank and our valuable customers.

7.3. ABOUT GULF BANK

Gulf Bank was established in 1960 and has since progressed to becoming an industry-leading financial services provider complemented by a large network of 50 branches strategically positioned in key locations throughout Kuwait. The main groups of the Bank are Retail, Corporate and International Banking.

The quality and commitment of the Gulf Bank team has received international recognition, winning a number of awards from leading international financial magazines including 'Best Retail Bank' from the Banker Middle East for four consecutive years.

7.3.1. GULF BANK OF KUWAIT INTERVIEW

Below are the answers given by Mr. *Dhari S. Aljutaili*, Associate Portfolio Manager (Corporate Banking Group), at Gulf Bank of Kuwait:

Q 01. Please kindly state the types or structures of home financing you provide in the Kuwaiti market.

Answer 01. The bank offers two types of consumer loans that can be used to finance the purchase of a house. The first one is lent against cash collateral, and can be up to 90% of the collateral amount. The maximum repayment period is 10 years. The second one is lent against the customer's salary, and can be up to 70,000 KD. The customer may be given a 6-month grace period, and the maximum repayment period is 15 years. Another way some customers obtain financing for housing is through a corporate loan. This is normally given to high net worth customers who can pledge adequate collateral to secure the loan.

Q 02. Are you happy with the demand for your home financing products?

Answer 02. There is certainly adequate demand in the market for housing, but it does not translate accurately into demand on financing products because real estate prices are higher than the maximum loan amount (70,000 KD) the customer can obtain from the bank. Therefore, an increase in market supply will reduce real estate prices, which will likely increase demand on financing products.

Q 03. What is the strength of your home financing products?

Answer 03. One of the strengths is that it provides extended periods of repayment ranging from 2 to 15 years. Also, a grace period of 6 months may be given to customers. In the second type of loan, no collateral is needed as long as the salary is adequate to cover monthly payments of principal and interest.

Q 04. Would you think that pricing is the most important strength of your product?

Answer 04. It could be. However, pricing is determined based on several factors such as the customer's salary, the loan amount, the repayment period, and the maximum pricing cap set by laws and central bank regulations.

Q 05. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 05. Profitability depends on the pricing given, which in turn depends on several factors. The competitiveness is achieved through the strengths of the products as answered for question #3.

Q 06. What is the term-period of your products?

Answer 06. It's ranging from 2 to 15 years.

Q 07. Please comment on the developments in the Kuwaiti housing market and housing financing market.

Answer 07. The housing market is stagnant due to the shortage in supply in terms of real estate land or development projects. This has resulted in an increase in real estate prices over the past few years. Also, in 2008 parliament passed two laws placing a ban on corporations and business entities owning, mortgaging, and trading residential properties. Although these laws theoretically helped stabilise prices from increasing due to trading, it also carried the negative effect of taking away one of the financing avenues available for potential homeowners. Currently, banks cannot own or mortgage residential houses as collateral for housing loans (with the exception of Islamic banks who won a court ruling exempting them from these laws).

If the recently passed economic development plan goes into execution effectively, this should move forward the long-awaited housing projects promised by the government and the private sector. As of today, there are 80k families waiting in line for housing. This huge demand poses a potential business opportunity for banks and financing companies if development projects are carried out. Of course, that would require changing some existing laws like those passed in 2008.

Q 08. What is the ratio of approved applications to mortgage application in the bank?

Answer 08. I don't know (and this might be classified information).

Q 09. Do you consider the other Islamic banks as a strong competitor in the housing finance market?

Answer 09. Yes. As per a recent court ruling, only Islamic banks are exempt from the 2008 laws, which give them an absolute competitive advantage over other conventional mortgage provider companies. Though this Feb. 2008 law article number 230¹⁰² does not affect conventional bank directly but it does effect the market positional of conventional banks indirectly.

Q 10. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g.. the cheapest, in the middle, etc.).

Answer 10. I don't have enough information to answer the question.

Q 11. Do you know if the Islamic home finance products are substantially different than the conventional mortgages? Or is only the structuring different?

Answer 11. In the end, both products achieve the same goal, which is financing the purchase of a house. However, there are slight differences in the way they are structured. The Islamic model is based on the purchase and reselling of the house (*Murabaha*), while the conventional model is based on the typical mortgage finance. Also, the Islamic model may offer a fixed interest (profit) rate, while the conventional model's rate floats with the discount rate set by central bank.

¹⁰² Sabah Al-Ahmad Al-Jaber Al-Sabah, Issued in Alsief Palace: 7 Safar 1429 AH. February 14, 2008 AD

Article 230: "It is prohibited to all companies and individual firms to deal in buying, selling, mortgaging or transferring the right to others or issuing procuration to act for another, or to accept the procuration to act on behalf of another in lots or homes intended for the purposes of private accommodation in any location and in any project, whether it is in a direct or indirect way, and is absolutely null and void, such like deal like and every action that would transfer ownership of lots and houses allocated for the purposes of private housing being in violation of the provisions of this law."

Q 12. Do you think that you might open an Islamic home financing window?

Answer 12. That will be up to the bank's Board and senior management to examine its business viability and its legal framework. However, generally, the Kuwaiti market is becoming saturated with Islamic banking. Currently, three local banks (KFH, KIB, and Boubyan) are Islamic, with the expected addition of BKME and Warba Bank this year. Therefore, if there's still an opportunity in the market, it is diminishing.

7.4. ABOUT AL AHLY BANK

The creation of ABK in 1967 brought together diverse departments which are extraordinary in their individual capabilities as well as in the ways they enhance and complement each other. They are serving the needs of the retail market through deposit products, the provision of Visa or 'MasterCard', credit services and a comprehensive consumer loan program.

ABK has a retail network of 23 branches and two overseas branches in Dubai and Abu-Dhabi, UAE. The full-service branch in Dubai and Abu-Dhabi has been servicing both Kuwaiti and UAE-based clients, clearly demonstrating their commitment to the commercial business between Kuwaiti and Gulf-based Arab producers and exporters.

7.4.1. AL AHLY BANK OF KUWAIT INTERVIEW

Below are the answers given by Mr. *Abdulrahman Al Khubaizi*, Senior Credit Office (Corporate Finance Department) at Al Ahly Bank of Kuwait:

Q 01. Please kindly state the types or structures of home financing you provide in the Kuwaiti market?

Answer 01. Housing finance is divided into two sections:

- (I). Short-term Real Estate Financing: It is a short-term period of financing which consists of 12 months or less and the interest prices are less than others.
- (II). Long term Financing: A long-term period (14 months or more) and the interest is high due to the high risk of this kind. As long as the period increases, the change in market is increased.

Q 02. Are you happy with the demand for your home financing products?

Answer 02. The demand on the real estate product is very good but it is less than previous years.

Q 03. What is the strength of your home financing products?

Answer 03. The products seem to be similar at all conventional banks and, as far as the strength is concerned, it depends on the differences between pricing and currencies.

Q 04. Would you think that pricing is the most important strength of your product?

Answer 04. Yes

Q 05. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 05. The competition is close and the primary factor is the customer's loyalty to the bank, as the competition for financing products is close and the only difference is the pricing and period.

Q 06. What is the term-period of your products (e.g. 10 years, 20 years)?

Answer 06. The maximum loan period is 15 years.

Q 07. Please comment on the developments in the Kuwaiti housing market and housing financing market?

Answer 07. Each bank has a maximum limit for real estate funding and this limit is determined by the Central Bank of Kuwait based on the Bank's Capital and financial position.

Q 08. What is the ratio of approved applications to mortgage applications in the bank?

Answer 08. The following should be made available with the lowest effort in order to accept the application:

- (I). Availability of Mortgages
- (II). Bank statement of good cash flow to cover interests and asset
- (III). Salary Certificate
- (IV). A copy of Nationality Certificate of the client
- (V). A copy of the civil ID
- (VI). A copy of passport of the client
- (VII). A copy of the marriage contract (if any)
- (VIII). A copy of the document property (property title)
- (IX). Guarantees apply the conditions in the case of a request
- (X). The document from 'Ci-Net' company that shows the financial position of the client.

Q 09. Do you consider the other Islamic banks as strong competitors in the housing finance market?

Answer 09. Yes

Q 10. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle etc)

Answer 10. Medium

Q 11. Do you know if the Islamic home finance products are substantially different from the conventional mortgages? Or is only the structuring different?

Answer 11. The difference may be in with respect to operating / price / period but the target is the same that is financing.

Q 12. Do you think that you might open an Islamic home financing window?

Answer 12. No, we don't think so.

7.5. ABOUT ISKAN FINANCING CO.

Iskan Financing Co. (ISKAN) established in February 2002 with paid-up capital of KWD 29.8 million and is engaged in providing real estate and industrial loans as well as other kinds of loans, providing leasing services to its customers, trading and developing real estates and lands, in addition to setting up investment funds and investing the company's surplus funds in different investment portfolios.

7.5.1. Interview of conventional home finance company

ISKAN Finance Co. (ISKAN): interview from Mr. Khaled A. Al-Attar, Assistant Manager Marketing Dept.

Q 01. Please kindly state the types or structures of home financing you provide in the Kuwaiti market?

Answer 01. Leasing and Commercial

Q 02. Are you happy with the demand for your home financing products?

Answer 02. No, because it is not like before.

Q 03. Is the strength of your home financing products in your company?

Answer 03. Yes, we provide competitive prices

Q 04. Would you think that pricing is the most important strength of your products in the company?

Answer 04. The most important factors.

Q 05. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 05. It is strong and growing.

Q 06. What is the term-period of your products (e.g. 10 years, 20 years)?

Answer 06. 15 years at max.

Q 07. Please comment on the developments in the Kuwaiti housing market and housing financing market?

Answer 07. Housing market is not enough. It needs more attention from authorities and the housing financing market is good.

Q 08. What is the ratio of approved application to mortgage application?

Answer 08. It is high.

Q 09. Do you consider Islamic bank and other Islamic financial companies as strong competitors in the housing financing market?

Answer 09. Yes, of course.

Q 10. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle etc.)

Answer 10. High.

Q 11. Do you know if the Islamic home finance products are substantially different than the conventional mortgages? Or is only the structuring different?

Answer 11. Yes, at some extent they are different as far as attraction aspect is concerned.

Q 12. Do you think that you might open an Islamic home financing window?

Answer 12. No. In our existing system of financing it does not fit.

7.6. ABOUT KUWAIT FINANCE HOUSE (KFH)

Kuwait Finance House (KFH) is a pioneer of the Islamic banking phenomenon known as Islamic Finance, or *Shari'ah* compliant banking. KFH is the first Islamic bank established in the State of Kuwait and it is one of the foremost Islamic Financial Institutions in the world.

From its inception in 1977, KFH has grown into a robust banking and financial institution, as well as a leader in the Islamic financial industry. KFH is now a market leader not only in the Islamic banking industry, but also in the banking sector as a whole, providing a wide range of *Shari'ah* compliant products and services covering banking, real estate, trade finance, investment portfolios and corporate, commercial and retail financial markets.

7.6.1. KUWAIT FINANCE HOUSE (KFH) INTERVIEW.

The interview was conducted with Mr. Imad A. Al-Thaqeb, Assistant General Manager (Finance Sector, Real Estate Department), 'Kuwait Finance House'.

Q 01. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?

Answer 01. In KFH they provide three kinds of products to facilitate their home finance customers i.e. *Murabaha*, *Musharaka* and *Ijara*.

The settlement program is rescheduled without any extra interest, because the KFH is concerned about the welfare of its customers and endeavors to facilitate smooth repayment capability without default. The *Murabaha* or *Ijara* mechanism triggers no other increments because in this *Murabaha* finance process, the bank acquires the property for itself on behalf of the customer. For instance, KFH purchases any property for itself. It therefore

confirms the market value of property and acts as consultant for the customer.

Q 02. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?

Answer 02. In the *Ijara* Contract, KFH purchased the property and leased the same to the customer with promise to own. The property will be in the possession of the KFH and it will be leased to the customer for a period on rental basis. The property shall remain in the name of KFH with promise from the customer to own, and is transferred when the complete payment has been made.

An *Ijara* contract states that the customer shall own the property under lease when he/she has settled the entire required amount, regardless of further profit. For instance, if a customer leases the property for 12 months and settled the whole amount after four months, further profit for the remaining eight months will not be charged to the customer. Therefore, early settlement guarantees the customer the option of limited profit for the period of rent payment. If the customer defaults, he/she would be sued and the property will be sold. The proceeds are applied for the settlement of the bank's rights and the remaining amount in favour of the customer. *Ijara* contracts are suitable for customers, who are very familiar with the transaction process.

KFH will not finance any property, unless it ensures the promising market and receives advance payment that realizes the financing aspect and appropriate surety. In addition, there are investment contracts wherein the bank makes customary contracting agreement for construction of the property and finances the building under agreement with the contractor. The required procedures or points are arranged in the contracting agreement, which is prepared by the bank. The building will be sold then to

the customer for a given period of time according to a pre-agreed payment method.

In *Musharika*, spouses may join in the contract and can be considered as one of the parties to own the property. In all types of such contracts, the bank permits such partnership between the husband and wife to make the contract. This type of contract is called semi-partnership, which sometimes is entered between the wife and husband or either spouse with another person who shall be committed to pay the respective share. This type of contracts is rare and in general the bank doesn't encourage it. There is also another type of finance relating to Kuwaitis outside the State of Kuwait, who apply for financing from foreign countries such as the UK, Lebanon and Dubai, and the bank authorizes such finance.

The most common contracts are *Murabaha* and *Ijara*, which have been used on a broad scale. The KFH has been extensively involved in *Murabaha* while *Ijara* contracts relate to investors. Exceptions are made for customers who wish to construct their own homes: the first is for that who demands integrated contracting contract and the second for that who requires materials for construction. The customer who demands complete building has to obtain consent.

It is obvious from the Islamic law perspectives that the KFH takes no profit for settlement delay. The contract is clear from the beginning and is not amenable to amendments. Sometimes, the KFH gives rewards for the customers who settle completely. The bank charges no profit or interest for the delay, as it adopts the Islamic law and considers "The contract is the law of the signatory parties". Other banks increase the interest rate for any period of delay.

Q 03. Are you happy with the demand for your home financing products, in particular due to its Islamic nature?

Answer 03. KFH is fully functional according to the Islamic ruling that is *Shari'ah* compliant. KFH always endeavors to provide the best service and tracks the customers' needs, and implements the best system of home financing, e.g. the Ijara system which was adopted 4-5 years ago for the convenience of the customers. KFH has a distinguished panel of scholars for all Islamic matters, and it focuses on various aspects for the benefit of the customers. Customers who are and were looking for the products for home financing compliant with *Shari'ah* and strictly following the Islamic ruling, services and products provided by the KFH is the answer for them.

Q 04. If the demand has not been as good as you expected, what could be the reasons?

Answer 04. The demand is not only good but it's excellent in the region. For a long time a large number of people were looking for a solution to acquire their financial products (not only home finance) in a way that was completely compliant to *Shari'ah*. Therefore, when KFH came into operation and offered the market with the solution which is completely *Shari'ah* compliant and following the ruling of Islam, a big part of the market started acquiring their financial products from the KHF.

Q 05. What is the strength of your home financing products?

Answer 05. The very first and basic strength of our products is they are *Shari'ah* compliant. This is the very basic attraction for the customers who want to live their lives according to the Islamic ruling. Furthermore, the repayment systems are a bit different as compared to the conventional one. In our products, we don't have

variable installment rates to pay back. We follow the fixed installments equally divided upon the entire tenure of the financing period. For longer periods of time, like 15-20 years of finance, the amount of the repayment monthly installment is a bit cheaper than the conventional one, which means we have less up-front charges as compared to conventional systems in the long term.

Q 06. Would you think that pricing is the most important strength of your product?

Answer 06. Actually it's not the pricing that is our most important strength; it's the attraction of the system we are offering in the region, i.e. *Shari'ah* compliant. Apart from that, people are well aware of KFH, which intends to be the strongest competitor through its pricing as well, work mechanisms and full satisfaction of customer.

Q 07. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 07. KFH as an Islamic bank has already captured a great part of the market and has become the biggest competitor of all conventional banks. A lot more customers are obtaining their financial products from KHF. The KFH is keen to be the main source and, therefore, it reviews the market prices of the properties on a case by case basis. The KFH endeavors to be ahead always and periodically communicating and meeting customers, providing them with updated information, and soliciting their opinions and sympathetically considering their inquiries to keep them close to us.

Q 08. What is the term-period of your products (e.g. 10 years, 20 years)?

Answer 08. In the State of Kuwait, the settlement period is 20 years under the Central Bank Act, which regulates all financing authorities in Kuwait, including traditional banks. The 20-year property finance is a maximum of K.D 70,000. It is available for 20 years under securities subjected to the conditions for building materials and investment.

Q 09. Please comment on the developments in the Kuwaiti housing market and housing financing market?

Answer 09. In the light of the recent development, there is no doubt that property cycles in Kuwait have an average of 7-8 years of rise and drop. These economic cycles are normal; nevertheless, there have been abnormal events such as the Kuwait Stock Market failure, or what is known as the “Al-Manakh Market Crises”, and the Iraqi invasion of Kuwait. The investment property market trend fluctuates many times with the rise and drop of the interest rates. In these events, the customers of the investors’ class abstain from building construction or investment options, because of their low profit and hence they prefer to deposit their savings in the banks.

Q 10. What is the ratio of approved mortgage applications in the KFH?

Answer 10. As the bank’s services are interesting and attractive to most of our customers, the bank intended to do new developments with quality service that considers customer expectations to own his house in the newly allocated areas in Kuwait. Therefore, the approval rate for the applications is almost 99.5%.

Q 11. Do you consider the Conventional banks (NBK, Gulf, Ahly etc.) as a strong competitor in the housing finance market? Do you expect other Islamic financial institutions to come into the market?

Answer 11. The NBK and others undoubtedly are our competitors, and we consider all financing entities to be our competitors. We therefore experience this challenge and do our best to present better services to benefit the customer and other Islamic banks. This will promote the Islamic financial market whenever any other Islamic financing corporation appears. It is our strong position to finance these entities, and it will be their turn to finance their customers. We admit that financing these bodies will take some share, but KFH has trust in its customers who maintain close financial connection with the bank.

Q 12. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle etc.)

Answer 12. Customers appreciate the bank's performance, internal mechanisms, speedy service and good interest rates. The KFH has a keen interest in acquiring customer cooperation in investment fields. The bank grants them a quality service with higher revenues and promising opportunities that the bank endeavors to be realised for them.

Periodically, the bank reviews the rates and offers the best service to its customers. It always maintains close relations with its customers and offers special prices, although some of them do not consider the prices to be the ultimate standard for appreciation. The bank, nevertheless, is committed to providing the best.

7.7. ABOUT BOUBYAN BANK

Boubyan Bank foresees an integral role for Islamic Banking in the mainstream industry internationally. It was established in 2004, with a capital of KD100 million (\$350 million) and carries out its activities in accordance with *Shari'ah* principles with a vision a global standardization phenomenon which will establish universally understood and accepted standards, systems, procedures and modes for Islamic Banking operations. Boubyan Bank is working towards establishing co-operation channels for Islamic Banks across the globe.

Boubyan Bank's endeavor is to establish clear differentiators to classify the operational standards of *Shari'ah* principles and practices, the effective distribution of profits between shareholders and depositors, establishing guidelines for the development of *Shari'ah* compliant investment instruments and capital mobilization vehicles, and promote awareness of credit rating requirements and standards.

The policies are derived from strong value-based ideology of Islamic banking & finance, which predates the recent importance attributed to good corporate citizenship and its indispensable link to positive business performance. The business objectives, while promoting profitable performance, are closely linked to *Shari'ah* principles and practices.

7.7.1. BOUBYAN BANK INTERVIEW

Below are the answers to our questions given by Mr. Yousef Thunayan Al-Ghanim, Credit Analyst (Corporate Finance Department) at Boubyan Bank of Kuwait:

Q 01. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?

Answer 01. Lease to own (*Ijara*), the bank purchases the real estate and write the deed under the bank's name. Then it is leased to the client. Since we are the corporate finance department, the central bank had placed a regulation to stop banks taking residential real estate as collateral. The client has to pay 50% of the value and the bank pays 50% of the value.

Murabaha Tawarruq. The client is given cash loan (in an Islamic manner) to purchase the home and the client gives us another form of collated.

Q 02. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?

Answer 02. *Ijara* loan is different than the conventional products, because the bank purchases the real estate and puts it under the bank's name. The real estate acts as a collateral while conventional banks give the client the cash to do as he please.

Murabaha Tawarruq is a cash loan with two contracts. The first contract the client signs, tells the bank to purchase goods for the client and then the second contract, the client tells the bank to sell the goods. Once the goods are sold the money goes into the client's account to purchase the home.

Q 03. Are you happy with the demand for your home financing products in particular due to its Islamic nature?

Answer 03. Yes, since the real estate itself is its own collateral, the client is comfortable with the *Ijara* financing the most. Due to the fact that clients have a hard time to find collateral to give to banks, they choose *Ijara* financing and provide the purchase. Currently there is a high demand on *Ijara* (lease to own) financing. However since the central bank regulation on residential real estate cannot be held as collateral, the financing has been stopped pending the central bank's decision.

Q 04. If the demand has not been as good as you expected, what could be the reasons?

Answer 04. The reason would be that the advance payment was too high for clients the previous year. Before the current economic situation, the advance payment was 40% for the client and the bank paid 60% of the real estate. However, the percentage has currently changed to 50% each.

Q 05. What is the strength of your home financing products?

Answer 05. The first strength is that the real estate is the client's collateral and, since the real estate is in the banks name, it can cover the financing if the client defaults.

The second strength is that the bank shares the risk with the client since both parties pay a certain percentage.

The third strength is the pricing, sine Islamic financing has fixed pricing, Ijara is not fixed because payment acts as rent which could be changed every quarter depending on the discount rate.

Q 06. Would you think that pricing is the most important strength of your product?

Answer 06. No, to me the most important thing is that the real estate is under the bank's name and is used as collateral since, in credit analyst, the important thing is repayment of the financing. Other corporate employees focus on pricing, but in my view if the client can't pay what would happen then?

Q 07. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 07. Well, since there are a lot of banks in Kuwait, providing finance to their customers, the competition is high, which reduces the profitability of the product. Banks (Islamic) would reduce the pricing just to obtain a customer. Another way to obtain customer in the high competitive market is the percentage of advance payment - the client prefers to pay less and thus turns to the bank that pays more.

Q 08. What is the term-period of your products (e.g. 10 years, 20 years)?

Answer 08. Since I work in the corporate finance department the term periods are short, 1 – 5 years.

Q 09. Please comment on the developments in the Kuwaiti housing market and housing financing market?

Answer 09. Well, there is a high demand in the Kuwaiti housing market. However due to Central Bank of Kuwait's laws; those banks can't have residential real estate as collateral, the financing market decreased significantly. It is due to decrease sharply right now since people can't afford to pay the expensive price.

Q 10. What is the ratio of approved mortgage application?

Answer 10. Currently the ratio of approved mortgage application is decreasing due to the central bank regulations.

Q 11. Do you consider the Conventional banks (NBK, Gulf, Ahly etc.) as a strong competitor in the housing finance market? Do you expect other Islamic financial institutions to come into the market?

Answer 11. Before the global recession I would have said yes. However, due to central bank regulations the housing finance market has decreased and currently approval is only given if the client is cash rich or has other collateral to give.

Q 12. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle etc.)

Answer 12. The cost is currently the same compared to Islamic bank. However, the Islamic bank's costs are higher than conventional banks. Islamic banks have the same if not identical cost, while it is cheaper for the conventional since they just deposit the need loan in the account. Islamic banks evaluate the real estate and use the lowest evolution as a benchmark for the amount given to purchase the house.

7.8. About Kuwait International Bank

On 1st July 2007, the Kuwait Real Estate Bank (incorporated in 1973) was renamed the “Kuwait International Bank” to exercise its business as an Islamic bank. The Bank carries out all banking and investment transactions in compliance with the provisions of the Islamic *Shari’ah* and pursuant to the instructions and regulations issued by the Central Bank of Kuwait.

7.8.1. KUWAIT INTERNATIONAL BANK INTERVIEW

Below are the answers of our questions given by Dr. Sadeq J. Abul (Economic Research Department), at ‘Kuwait International Bank:

Q 01. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?

Answer 01. The Bank offers several types and different forms of funding to fulfill the needs of the real estate market and customers, including *Ijara* (Contract) where the bank acquires the asset on the behalf of the client for a fixed term contract with the promise of returning property if he pays the full rental value of the possessory. This is one of the products that is very popular in the real estate market, because of its characteristic flexibility. The bank also provides other financing products that are *Murabaha* and *Istisna* and *Wikala* for Investment.

Q 02. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?

Answer 02. Islamic products are contracts that are clear and detailed and the agreed profit margins are already set with the customers. This contract contributes effectively and secures the market balance

through investments in Islamic banks directly or through financing the customers to buy the assets of all kinds, and construct it and sell it on current price.

Q 03. Are you happy with the demand for your home financing products in particular due to its Islamic nature?

Answer 03. Yes, as the Islamic finance market is sharing and growing very well in the region, it will direct many other traditional banks and institutions to turn to or become the Islamic system. Like Kuwait Real Estate, the bank was conventional and converted into Islamic with Kuwait International Bank. Also 'The Bank of Kuwait and the Middle East' did the same.

Q 04. If the demand has not been as good as you expected, what could be the reasons?

Answer 04. Actually Islamic financing was not started based on growth or initiated to offer a new kind of a business. It is what people were looking forward to have according to *Shari'ah* compliant since long. And the facts are evident that, since its commencement, it has been increasing. Again, there are no set targets for the growth that have to be achieved.

Q 05. What is the strength of your home financing products?

Answer 05. As I have already mentioned, the contracts for Islamic finance are clear in terms of buying, selling and leasing, but also flexible and abreast of the developments and according to the nature of real estate market.

Q 06. Would you think that pricing is the most important strength of your product?

Answer 06. The price of the product is the most important factor, while determining the strength of the product and also how popular it is. Clients are always looking for the cheapest way of funding.

Q 07. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 07. The profit for the financing bank is an important factor in determining whether we provide a continuous service to the customers or not. On the other hand, we have to make sure that the profit must not be increased to the extent where we forfeit the ability to compete with other institutions and banks that offer the same product.

Q 08. What is the term-period of your products (e.g. 10 years, 20 years)?

Answer 08. In certain financing contracts such as *Murabaha*, we would prefer not to invest long term in those contracts and only prefer medium or short (one to three years) to avoid the interest rate fluctuations. This is because the rate of profit in these contracts is fixed on the day of the signing of a financing contract until the date of maturity.

In *Ijara* contract (leasing) it overcomes the problem of interest rate fluctuations. The signed contract is renewed annually on the due date. Then the remaining balance of the debt is taken into account and the discount rate is applied again at the renewal date of the contract. Thus, it can reach the debt repayment period to fifteen years.

Q 09. Please comment on the developments in the Kuwaiti housing market and housing financing market?

Answer 09. Kuwaiti banks are characterised by their large capacity to absorb and cope with any development occurring in the market in terms of technical capabilities and provide the necessary liquidity.

Q 10. What is the ratio of approved mortgage applications?

Answer 10. Sometimes there are delays in the approval because of lack of required supporting documents. Otherwise, it is almost 98% approvals.

Q 11. Do you consider the Conventional banks (NBK, Gulf, Ahly etc.) as a strong competitor in the housing finance market? Do you expect other Islamic financial institutions to come into the market?

Answer 11. There is very strong competition in the mortgage market, particularly from Islamic banks, and certainly will increase the number of institutions that deal with Islamic system.

Q 12. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (e.g. the cheapest, in the middle etc.)

Answer 12. The cost of real estate finance is medium.

7.9. ABOUT RASAMEEL STRUCTURED FINANCE COMPANY

Rasameel Structured Finance Company (*Rasameel*) was established in January 2006 as a Kuwaiti Shareholding Company K.S.C. (closed) with an authorised and paid up capital of 30,000,000 KD. The key objective is to provide a diversified portfolio of *Shari'ah* compliant predictable cash flow generating assets and securities to both private and institutional investors looking for structured Islamic investment products that consistently outperform relative to the benchmark and within predetermined risk parameters.

Rasameel is the result of a successful partnership between groups of independent, well-established companies, these companies being: Aayan Leasing and Investment Co., Al-Madar Financing & Investment Company, Gulf Investment Corporation, Commercial Bank of Kuwait, Awqaf Foundation, *Abdul-Latif Al-Essa* Group, Kuwait Investment Company and a number of other prominent institutional and private shareholders. The combined expertise and longstanding experience of these successful companies sets *Rasameel* ahead of the competition and places it in a unique and providential position within the local and regional markets concerned with securitisation. The mission of *Rasameel* is to provide reliable alternative funding source and rated investment securities.

7.10. INTERVIEW OF ISLAMIC HOME FINANCE COMPANY

RASAMEEL Structured Finance Co. *Mr. Issam Z. Al- Tawari*, Chairman & Managing Director

Q 01. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?

Answer 01. Islamic finance in the State of Kuwait is divided into financing through *Ijara* (leasing) and *Murabaha* financing. They are more common in Kuwait for financing because they give the flexibility and duration of the funding needed.

The bank or leasing company owns the property on its name and then leases the house to lessee for the financing period of the contract against the rent and lessee pay the nominal amount for the transfer of the asset to the financing bank or the company at the completion of the financing period and the property is transferred to the lessee making him / her the owner of the property.

Murabaha: A purchase and sale of an asset or property of origin and, of course, is often used in cases of short-term period of 5-6 years. 'Diminishing *Musharaka*' is not being used on large scale in banks, institutions and real estate companies who have large volume of customers.

Q 02. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?

Answer 02. Islamic Finance is:

- (i). Asset Risk.
- (ii). The Lessor (bank/institution) should bear asset maintenance and insurance charges.
- (iii). They do not have 'Pre Payment Clause' especially in *Murabaha*.
- (iv). Delaying in *Murabaha* does not result in increase profits.

While in Conventional:

- (i). More flexibility, restructuring and renovation.
- (ii). The legal system applied on the basis of the conventional system in case of filing a case against customer and there are more precedents.
- (iii). Former conventional contracts.

Q 03. Are you happy with the demand for your home financing products in particular due to its Islamic nature?

Answer 03. Nowadays, the Islamic Finance constitutes between 30-50% of the total finance in Kuwait. That means there is direct competition from conventional banks and, if the competition is there, then all prices and services must be almost equal.

Q 04. If the demand has not been as good as you expected, what could be the reasons?

Answer 04. There are customers who deal with Islamic banks and companies and this percentage represents Captive Market Customer, while there are customers who prefer Islamic banks and Islamic financing companies as they think that the prices and services are equal offered by all finance providers.

The reasons for demand in Islamic Finance are that Islamic banks and companies are providing finance on supported assets. The factors and reasons for Islamic financing are the representation of guarantee, assets and captive customer market. Those reasons are clear for demand for Islamic financing, both from companies and banks.

Q 05. What is the strength of your home financing products?

Answer 05.

- This is the alternative of banking finances especially the real estate finance.
- Through '*Tawarruq*' a company gives an opportunity to have cash in the shape of a loan to overcome their financial needs.

Q 06. Would you think that pricing is the most important strength of your product?

Answer 06. The price is not the only important factor in the strength of a financing product, but it also depends on flexibility, services, financing cost and quality staff.

Q 07. Would you please comment on the profitability and competitiveness of your home financing products?

Answer 07. The profitability depends on criteria that are very high in our company and we have a good market segment.

Q 08. What is the term-period of your products (e.g. 10 years, 20 years)?

Answer 08. Normally we finance for 7 years but others are financing for 15 - 20 years too. It all depends on the ability of the bank in terms of how much it is to get sources for funding.

Q 09. Please comment on the developments in the Kuwaiti housing market and housing financing market?

Answer 09. Kuwait has a developed and innovative real estate market because of its strong and straightforward laws. But the new amendments in laws are not suitable, which states that private financing companies can only finance the houses for a maximum of 3 years and the customers must complete their housing mortgage within this period of time. This short period (3 years) is not flexible for individuals seeking home finance.

Q 10. What is the ratio of approved mortgage application?

Answer 10. Depends on the availability of required initial documents by the customers

Q 11. Do you consider the Conventional banks (NBK, Gulf, Ahly etc.) as a strong competitor in the housing finance market? Do you expect other Islamic financial institutions to come into the market?

Answer 11. Yes, there is competition within Islamic banks and conventional banks that are Kuwait Finance House, Bubiyan Bank, National Bank of Kuwait, all the banks etc. Some of the financing companies are out of the market because of a shortage in liquidity and sources.

Q 12. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (i.e. the cheapest, in the middle etc.)

Answer 12. As far as similar products in the market are concerned it's a bit on cheaper side. The reason behind is relaxation in down payment and lengthy durations of installment pay back. So the profit margins are high. Moreover, the new conditions for financing set by the Central Bank of Kuwait are less flexible and some of them are as under:

- (I). High rate of down payment
- (II). Salary / Income should be high
- (III). No financing can be made above the 40% of the salary amount

7.11. *Shari'ah* compliant Scholars:

The answers from *Shari'ah* compliant Scholars:

7.11.1. SHARI'AH COMPLIANT SCHOLAR AT KUWAIT FINANCE HOUSE

Shaikh Adnan Almulla, *shari'ah* compliant scholar at KUWAIT FINANCE HOUSE. *The answers of Sheikh Adnan Almulla are as follows:*

Q 01. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?

Answer 01.

- (i) - *Ijara* (leasing): the Islamic bank buys any item based on the promise of the client leasing is. After owning it, the bank concludes lease (*Ijara*) agreement with the client and promises the client to have the item (whether by selling or granting) at the end of *Ijara* (leasing) agreement. This is called *Ijara* ending with ownership. There is another type called operational *Ijara* in which the leased item is returned to the owner (lessor) at the end of the leasing agreement.
- (ii) - *Murabaha*: The Islamic bank buys the required item upon request from the client. After owning this item, the bank concludes the selling agreement with the client.
- (iii) – *Musharaka*: In a *Musharaka* agreement, the Islamic bank becomes a partner with the client in owning the assets of the project or in the financed activity. The partnership might be permanent as the bank might continue owning the assets of the project in partnership with the client till whole liquidation. *Musharaka* might be contradictory as the client could regularly buy bank shares in the project till he owns it outright.

Q 02. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?

Answer 02.The differences of Islamic real estate bank and traditional bank are as follows:

(i) The traditional real estate finance bank is an absolute hypothetical process as the bank provides loans for the client with a profit (one way of financing).

(ii) Islamic Real Estate Finance Bank is characterised by multiple finance methods as it enables the client to have the real estate through *Murabaha* or bargaining.

(iii) Indebtedness ceiling in traditional real estate bank might increase when the rate of profit increases or decreases. However, indebtedness ceiling is constant in Islamic Real estate finance because, after concluding *Murabaha* or bargaining agreement, certain fixed debt is set for the client.

Q 03. What do people find attractive in conventional financing, while Kuwait is an Islamic country and opportunities are there to obtain Islamic financing? What are your views in this regard?

Answer 03.The most important reasons are as follows:

(i) The lack of religious motives.

(ii) The campaigns are launched in such an attractive manner by conventional banks and companies.

Q 04. Do you think that Islamic home finance is good in demand? If the answer is No, what are the reasons from your point of view?

Answer 04.Yes, I think so. The demand is very good.

Q 05. What are the strengths that characterise Islamic home finance in comparison with its traditional counterpart in view of *Shari'ah*?

Answer 05. Basically the strength depends on:

(i)- It prohibits *Riba* (usury).

(ii) - It is committed to the conventions of Islamic *Shari'ah*.

Q 06. Would you think that pricing is the most important strength of your product?

Answer 06. I don't think so.

Q 07. What is your comment on competition in Islamic home finance in view of the appearance new Islamic banks?

Answer 07. As a matter of fact the competition is a positive, as Islamic banks develop themselves and come up with the Islamic real estate products that meet the expectations and needs of clients.

Q 08. Do you think that Islamic home finance has reasonable costs for the client in comparison to conventional mortgage finance?

Answer 08. Yes, I think so.

Q 09. What if a client who bought a house through Islamic home finance finds it difficult to make payment for any reason regardless of what ever product through *Murabaha* or *Ijara* or *Musharaka*? What are the legal procedures that apply in such a case?

Answer 09.

(i)- The bank should wait for the customer and help him/her to pay the debt.

(ii) In case of non-payment due to procrastination, legal procedures which ensure the rights of the bank might be taken.

Q 10. In case of the death of the client who bought a house from Islamic home finance, what are the legal procedures of the Bank in this regard?

Answer 10. If real estate is done through *Murabaha* or Musawama (Negotiation), and there are outstanding debts, then the inheritors are contacted and they may acquire the same conditions of payment until the completion of debts.

Q 11. We have noticed recently that the gap between citizens who take Islamic real estate finance and citizens who have traditional real estate finance has been reduced. Does this have anything to do with simplifying the procedures of having traditional real estate finance?

Answer 11. Actually the procedures to obtain the home finance are almost the same regardless of conventional and Islamic because the set of documents required are the same from both type of banks. The differences are within the products. There is no capacity to simplify the procedures because the rules are set by Central Bank of Kuwait.

Q 12. The last three decades witnessed an increase in the number of Islamic banks. Is there a competition affecting *Murabaha* product? What is the percentage of this competition with traditional banks?

Answer 12. I think that competition with traditional banks in *Murabaha* product doesn't have a great effect as there is a difference between the style of Islamic finance and traditional finance.

7.11.2. Sheikh (Scholar) *Dr Abdulazeez Al-Qasar* is the Committee Consultant of *Shari' ah* compliant at Boubyan Bank and International.

Q 01. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara*, diminishing of *Musharka Murabaha* etc.)?

Answer 01.

- (i) - *Ijara* (Product Leasing): The bank buys the property on the behalf of the client then leases it to the client with a deed which says 'Promise to Buy', which means that the client will buy at the end of contract and will become owner of the property.
- (ii) - Through *Murabaha* (Markup on sale): The bank purchases the property upon the request of the client and immediately sells it to the client at a higher price on installment.
- (iii) - Through product of *Musharika* (Partnership): Bank enters into a deal of purchasing the property as a partner with its client on current market value and the bank withdraws its part of the property for its partner, who is actually its client. It's all based on the price that both (bank and customer) agreed on at the time of purchasing. There are no other conditions to pay any extra amount at the time of withdrawal. The client only pays the amount which is in their partnership deed, regardless of the market value at the time of withdrawal. This process is to avoid the *Riba*.

Q 02. Would you please briefly mention the distinguishing characteristics of your Islamic home financing products in comparison to conventional products?

Answer 02.

- (i) - If the Islamic finance under the *Ijara* contract lease (contract ended with ownership): ensuring the property and its maintenance during the lease period will be on landlord, in this case the bank is landlord.
- (ii) - If funding under the *Murabaha* contract: the *Murabaha* contract, since it was held stable (there are no changes, once contract is signed by both of the parties) so that at the time of contract initiating the contract value is the total value of the property + profit and the contract will remain stable in terms of the contract amount for *Murabaha*. This contract does not allow a fine of delays caused by the delay in the payment of installments.
- (iii) - If funding under the *Musharikah* (Partnership): It is permissible to sell his share to his partner (client); that there is no requirement for obligation to pay the extra amount, but leaves the selling price according to market price or to negotiate at the time of sale

In the case of a traditional bank

There is no relationship between bank and client in terms of sales or purchase. It is interest based fixed or variable loan. In case of delay in payment, a compound interest on the principal amount and fine for delayed payment will be charged additionally.

Q 03. We are an Islamic country and there is a great section of people who go to traditional real estate finance banks. What are the reasons from your point of view?

Answer 03.

(i) - Because the cost of Islamic finance through leasing is more expensive than traditional financing there is no delay, while there are delay penalties in conventional financing.

(ii) – In case of *Murabaha* the bank has the right to take back the property if the client is unable to pay the installments, as this condition is part of the contract and states clearly at the time of signing. In conventional financing, bank can not do this immediately but it has to contact the solicitors to do so.

(iii) – In case of *Musharika* the contract of participation is based on market price or mutual negotiation on both the parties (bank and client) for which some of the clients do not feel comfortable.

Q 04. Do you think that Islamic home finance has a good demand as you think? If the answer is No, what are the reasons from your point of view?

Answer 04. Demand for Islamic finance is well motivated by faith. A wide range of committed Muslims (Practical Muslim) are there who avoid *haram* (completely forbidden by *Shari'ah*) and strongly wish to be away from *Riba*. It also held that law does not allow a fixed compound interest (penalties for delay).

Q 05. What are the strengths that characterise Islamic home finance in comparison with its traditional counterpart in view of *Shari'ah*?

Answer 05. The strongest point of Islamic mortgage finance is that it is based on buying and selling but not on the basis of the loan interest called (*Riba*). God Almighty says (*Allah* has permitted trading and forbidden *Riba*).

Q 06. Would you think that pricing is the most important strength of your product?

Answer 06. The total value of the *Murabaha* contract is held stable if the property purchased, for example for one hundred thousand in installments for a period of ten years. The principal amount of the contract will remain stable and will not change in case of delayed payments, nor will compound interest be charged on delayed installments.

Q 07. What is your comment on competition in Islamic home finance in view of the appearance new Islamic banks?

Answer 07. Competition in Islamic financing banks will bring positive results in terms that it will lead to reduce profit gains from customers at the time of contract. There are negative effects too. More facilities provided by the banks will lead to increased prices in real estate market.

08. Do you think that Islamic home finance has reasonable costs for the client in comparison to Conventional Mortgage finance?

Answer 08. In Islamic home financing:

- (i) In *Ijara* contract (Leasing) the cost is more than traditional banks because the Islamic bank is responsible for making any kind of maintenance required during the end of the contract and also for the insurance for the property, and this is all calculated before initiating the contract.
- (ii) In *Murabaha* contract the cost is almost the same as conventional banks.

Q 09. What if there is a client who bought a house through Islamic home finance and finds difficulties in making payment for any reason what so ever through *Murabaha* or *Ijara* or *Musharaka*? What is the legal condition in this?

Answer 09. In *Murabaha* contract the client is given two months free to pay his installments and after two month the case is submitted to the authorities (court) to take back the property from the client.

In *Ijara* contract the delay in installments (rent) leads the client to a new contract. This new contract includes the earlier rent, which is not paid, resulting in a new contract which will have the increased rent amount.

Q 10. In case of the death of the client who bought a house from Islamic home finance, what are the legal procedures of the Bank in this regard?

Answer 10. In *Murabaha*, if the client dies and there are unpaid installments to settle, the bank takes the rest of the amount from the insurance company (*Takaful; an Islamic insurance*), or the bank will deduct the remaining amount from his inherited (left over).

In the case of *Ijara* contract (leasing), the contract is terminated by itself. And the heirs (maybe his sons) will sign a new *Ijara* contract with the same conditions for the remaining amount.

Q 11. We have noticed recently that the gap between citizens who take Islamic real estate finance and citizens who have traditional real estate finance has been reduced. Does this have anything to do with simplifying the procedures of having traditional real estate finance?

Answer 11. The competition depends on the expenses of the finance and the clients compare those expenses.

Q 12. The last three decades witnessed an increase in the number of Islamic banks. Is there a competition affecting *Murabaha* product? What is the percent of this competition with traditional banks?

Answer 12. *Murabaha* represents 80% of Islamic bank transactions. Recently, traditional banks obtained '*Tawarruq*' contracts from Islamic banks to obtain liquidity and profit through international goods market.

There is also competition in the provision of cash funding from Islamic banks on the basis of a '*Tawarruq*' product. It shows the cash funding to the traditional bank.

Both the banks, conventional and Islamic, provide cash but Islamic banks provide on the base of *Murabaha* and *Tawarruq* contracts, while conventional banks provide on the basis of interest contracts.

The outcome of the interviews shows a very clear picture of availability, procedures, duration and competition among them in house mortgage financing in Kuwait, either conventional or Islamic. In the region, banks and financial companies extend loans for lands, autos, furniture, jewelry, education, traveling tickets and complete travelling packages besides house mortgage.

7.12. THE BASIS OF ISLAMIC FINANCE

The Islamic finance is based on the principles already clearly defined by the *Shari'ah* as well as other Islamic rulings, known as '*Fatwa*'¹⁰³, issued by qualified Muslim scholars. Admittedly, some of the issues covered by these rulings can be quite complex, forcing the institutions involved to often seek the assistance of experts in interpreting them.

As a result, it has become a common practice for Islamic banks to appoint their own board of scholars. Nevertheless, since expertise in these matters is still relatively scarce in some countries, different Islamic banks often share the same scholars. This phenomenon has the beneficial side-effect that it promotes consistency across the services and products offered by these institutions. Therefore, the first measure that an institution wishing to offer Islamic products must undertake, is to appoint a Shari'ah board or, at a very minimum, a Shari'ah counselor.

An additional important aspect for the regulator is that its rulings and decisions are consistent with those of the *Shari'ah* boards of foreign supervisory agencies. An important effort towards achieving international consistency was

¹⁰³ A *fatwā* in the Islamic faith is a religious opinion concerning Islamic law issued by an Islamic scholar. The person who issues a *fatwā* is called, in that respect, a Mufti, i.e. an issuer of *fatwa*.

A *fatwā* is not automatically part of Islamic teachings. While the person issuing it may intend it to accurately to represent the teachings of Islam, this does not mean that that person's interpretation will gain universal acceptance. There are many divergent schools within the religion, and even people within the same current of thought will sometimes rule differently on a difficult issue. This means that there are numerous contradictory *fatwā*, prescribing or proscribing a certain behavior.

From: <http://en.wikipedia.org/wiki/Fatwā> retrieved on May 8, 2010

the creation of two multilateral institutions: (i) the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which issues internationally, recognised Shariah standards on accounting, auditing, and governance issues; and (ii) the Islamic Financial Services Board (IFSB), which issues standards for the effective supervision and regulation of Islamic financial institutions. The roles of the two institutions are discussed in more detail below.

Finally, the Islamic Fiqha Academy, inaugurated in 1988 in Jeddah under the auspices of the Organization of the Islamic Conference, has earned the respect of Muslim scholars around the world. Although not officially binding, its rulings and opinions on economic and financial matters are certainly taken into consideration by Islamic finance practitioners and policy-makers.

7.12.1. *Shari'ah* Committee

The *Shari'ah* Committee of Kuwait Finance House (Malaysia) Berhad reviews and ensures that all transactions, contracts, products and applications relating to KFHMB comply to *Shari'ah* rules and principles with the specific fatwa, rulings and guidelines that have been issued.

Sheikh Adnan Ali has been the Senior *Shari'ah* Advisor of Kuwait Finance House, Kuwait since 2001 and serves as a member of the Fatwa and *Shari'ah* Supervisory Board of *Ijarah* House Holding Company in Kuwait. In 1989, he was appointed as an Imam and *Khatib* by the Ministry of *Awqaf* and Islamic Affairs in Kuwait. Sheikh Adnan is also a trainer in the field of Islamic Commercial Law (Muamalat) at Kuwait Finance House and Human Investment Company. He holds a Bachelor of *Shari'ah* from the Kuwait University.

The nature of the business of the Islamic financial institutions mainly refers to the Islamic law of transaction classified under *fiqha*. Hence, the SC frameworks on *Shari'ah* matters will be confined within the matter under *fiqha*. They may give advice to the banks on any matter related with *fiqha* and their decision will determine the Islamic and permissibility of certain products. That

is why the selection of the SC members will be based on the expertise in Islamic law of transaction and *fiqha*. The expertise in these two areas is very important so as to ensure the smoothness of making decisions or '*Ijtihad*' (Arabic Word). This is a technical term of Islamic law that describes the process of making a legal decision by independent interpretation of the legal sources, the *Qur'an* and the *Sunnah*.

Generally, a Mujtahid (the one who does *Ijtihad*) is an educated Muslim who makes up his own ruling on the permissibility of an Islamic law, but only for himself, to any complex issues involved in Islamic banking and finance.

7.12.2. Main Product of Islamic Finance

Islamic banks and companies offer three main products to their customers to home financing, which are *Murabaha* (Markup on sale) the closest to the conventional system of home financing but the style is different, *Musharaka* (Partnership) and *Ijara* (Lease to own). This *Ijara* is the most recent system offered by the Islamic banks and companies to its customers. It was started within the last 4-5 years. All the systems related to Islamic financing have a fixed rate of monthly installments. *Murabaha* represents 80% of Islamic financing. Furthermore, those systems provide flexible options in case customers fail to pay their monthly installments.

7.12.3. Available durations for Islamic Finance

The maximum period for home mortgage varies from bank to bank, but 20 years is the maximum and minimum is two years only. The National Bank of Kuwait provides its customers with 20 years to repay their liabilities while Gulf Bank provide only 15 years as the maximum time to its customers. Other banks, like Al Ahly, also provide short-term loans such as for one year and so on. Islamic banks like Kuwait Finance House offer the maximum of 20 years and Boubiyah Bank, being a new bank in the region, provides its customers with four years maximum only. Obviously, refinancing and transfer of financing is possible. For example, a person takes a loan for 15 years and he finishes his ten years of installments. He realises that he needs another mortgage from any bank or company. So he reschedules his installments to be

completed within the next 10 years; as a result, his monthly installment amount will decrease because of the addition of more than 5 years and he is then able to have another mortgage. In some other countries, like Malaysia, the maximum available duration for housing mortgage is 35 years from one Islamic bank (Affin Bank), which is a very long duration for house financing. To avail a 35-year house loan in Malaysia, a person must be 30 years or under in order to sign the contract because one has to complete all of his installments before the age of 65 years. However, in Malaysia there are two other banks which are offering 25 years in the sector of house financing to their clients. HSBC¹⁰⁴ is one of them.

7.13. Applications approval ratio

The normal approval time, for long-term loans, does not differ from banks to banks and companies to companies. In the case that all required documents are ready, the maximum time is 2-3 weeks. Actually, in Kuwait everything is centralised by the Central Bank of Kuwait. Every bank can easily get the information upon request about the client who submits an application for house financing. The only aspect banks make sure of is the capability of the client to repay the monthly installment on time and, to do so, the Central Bank of Kuwait has given the banks authority to deduct the monthly payment from a client's salary directly. To make the process easier, the Central Bank of Kuwait has authorised a company with the right to maintain all the client's liabilities and information on whether he/she took any kind of loan from any bank or companies. This company is working under the name of 'Ci-net' (Credit Information Network)¹⁰⁵ in Kuwait which is directly linked with the

¹⁰⁴ HSBC's presence in Malaysia dates back to 1884 when the Hongkong and Shanghai Banking Corporation Limited established its first office in the country. It opened branches in Ipoh in 1909 followed by branches in Malacca, Johore Bahru and Kuala Lumpur in 1910. The Kota Bharu branch was opened in 1912.

Retrieved Date April 30, 2010 from <http://www.hsbc.com.my/1/2/about-hsbc/corporate-information>

¹⁰⁵ Ci-Net, which began operations in October 2002, is an independent commercial institution that collects and maintains data for the mutual benefit of the financial institutions of Kuwait. These institutions are under the supervision of the Central Bank and the Ministry of Commerce and Industry. The company is owned by sixteen Banks and Finance Companies who oversee agreed policies and practices of the bureau. Ci-Net is not a credit granter or a collections company and is subject to Kuwait's law and particularly to data privacy and consumer protection. It acts as a 'trustee' of the credit and personal data from the lending

Central Bank of Kuwait; they have the complete credit history of every client involved in loan transactions. Banks and companies may request to 'Ci-net' to have such information to secure their interest from those clients who do not qualify for a new or another loan for any of their financial needs. The clients are also asked to sign the form provided by the 'Ci-Net' to banks in order to have complete financial records of the clients. Then this form is submitted to the 'Ci-Net' by the bank.

community and exists entirely upon the contribution of data from the lenders for sharing purposes.
Retried Date April 30, 2010 from <http://www.cinet.com.kw/background.htm>

7.14. Monthly repayment of Islamic housing finance

The tiered rates of Islamic housing finance differ from bank to bank, and those tiered rates for monthly repayment depend on the tenure of an available financing period. The clients can choose from those available housing finance periods.

Financial companies have their own rates which are sometimes more flexible than the banks. The reason behind that is that the Central Bank of Kuwait has limited the financial companies to offering house financing tenure to three years. After three years those companies must transfer the property papers to the client's name. For example, Kuwait finance house, being an Islamic bank in the region, offers 4.8% for 5 years against their '*Murabaha*' product of financing, whereas National Bank of Kuwait, being a conventional bank, offers 5.5% for five years. In case anyone takes a house financing loan for 15 years from Kuwait Finance House, the rate of the monthly payment will be decided at the time the contract is signed and this rate will remain the same for the next 15 years. However, if someone takes the same house financing loan from National Bank of Kuwait, the rate will remain fixed only for the first 5 years and then the bank will apply a new repayment rate for the next remaining 10 years. In such a situation, the rate of the monthly repayment, i.e. variable, can disturb one's monthly budget because it all depends on the new rate applied by the Central Bank of Kuwait.

Any Islamic banks operating in Kuwait are not forced to apply these new rates to their old customers who signed the contract before this new rate of repayment. If earlier, the contract states that they will pay 5.5%, meaning they will continue to pay 5.5% until the completion of their contract, regardless of whether it was signed for 5 years or for 15 years.

7.15. Re-mortgaging and transfer of liabilities in housing finance

Conventional and Islamic banks in Kuwait provide the facility of re-mortgaging housing finance to their customers in order to save some money for other needs. The procedure includes signing another contract with the difference of the amount that is desired plus the balance amount of the remaining installments of the earlier contract. Therefore, the bank deducts all the liabilities of the old contract and the customer starts paying their new installments to finish their new contract installments.

In Kuwait (like we discussed in Chapter 3), the government gives a fixed 70,000 K.D. loan to every citizen (male) after 10 years of their marriage returnable at the rate of 10% of their salary, which is deducted from their salary. There is no time limit for it to be repaid. The only aspect is 10% of the current salary until completion of 70,000 KD. Another facility is provided to the citizens after 15 years of this 70,000 K.D. loan. For example, this facility is again 10,000 KD loan through Credit Saving Bank to enable a customer to renovate his house. The important factor to notice in both of the loans (70,000 & 10,000) is that both are profit free.

Almost all the banks allow their customers to transfer their mortgage to any other bank they desire. They can transfer from conventional to Islamic and vice versa; they can even transfer from one conventional bank to another conventional bank. Some of the banks have rules for the customers to complete a minimum of five years' worth of installment payments regularly before transfer of their mortgage to other banks.

Another point to notice here is banks and all financial companies provide their own employees with home mortgages at more flexible rates than their clients. Some of the banks offer attractive rates to government employees that are not available for their general customers.

No penalties are imposed to the customers who wish to pay their balance payments at lump sum. Even some of the banks and companies provide their customers a rebate while paying their balance installments in a lump sum. So it can be said that early settlement of the mortgage is possible and normally those customers who receive their employee provident fund try to make early settlement in order to gain peace of mind.

7.16. Muslims in Kuwait using conventional banks

From the conducted interviews with the *Shari'ah* scholar, according to the answers received the reasons why Muslims use conventional banks for their house financing needs are as follows:

- Lack of awareness of the Islamic products
- Lack of guidance through family members
- Recommendations from their employers / companies
- Excellent marketing by conventional banks
- Attractive offers by conventional banks
- Easy approach to conventional banks
- Large numbers availability of conventional banks branches
- Engagement of conventional financing for a long time.

7.17. DUTIES AND RESPONSIBILITIES OF SHARI'AH COMMITTEE

All *Shari'ah* Committee members are expected to participate and engage themselves actively in deliberating *Shari'ah* issues put before them. The main duties and responsibilities of the *Shari'ah* Committee are as follows:

- (a) To advise the Board on *Shari'ah* matters in its business operation The *Shari'ah* Committee shall advise the Board on *Shari'ah* matters in order to ensure that the business operations of the Islamic financial institution comply with *Shari'ah* principles at all times.
- (b) To endorse *Shari'ah* Compliance Manuals. The Islamic financial institution shall have a *Shari'ah* Compliance Manual. The Manual must specify the manner in which a submission or request for advice be made to the *Shari'ah* Committee, the conduct of the *Shari'ah* Committee's meeting and the manner of compliance with any *Shari'ah* decision. The Manual shall be endorsed by the *Shari'ah* Committee.
- (c) To endorse and validate relevant documentations. To ensure that the products of the Islamic financial institutions comply with *Shari'ah* principles in all aspects, the *Shari'ah* Committee must endorse the following:
First the terms and conditions contained in the proposal form, contract, agreement or other legal documentation used in executing the transactions; second the product manual, marketing advertisements, sales illustrations and brochures used to describe the product.
- (d) To assist related parties on *Shari'ah* matters for advice upon request the related parties of the Islamic financial institution such as its legal counsel, auditor or consultant may seek advice on *Shari'ah* matters from the *Shari'ah* Committee. The *Shari'ah* Committee is expected to provide assistance to them so that compliance with *Shari'ah* principles can be assured completely.

(e) To advise on matters to be referred to the SAC the *Shari'ah* Committee must advise the Islamic financial institution to consult the SAC on any *Shari'ah* matters which have not been resolved or endorsed by the SAC.¹⁰⁶

7.18. A brief of Kuwait Real Estate Market

According Dr. Rodney Wilson, to Durham University the Kuwait Finance House, which has built up a stake in the local deposit market of around 20%, stresses that it is an interest-free financial institution that has competed successfully with its rivals which offer interest on their deposits.

The report published in the second quarter of 2010 about Kuwait Real Estate; said that Kuwait's economy was showing signs of recovery at the beginning of 2010 and the state should be able to ramp up oil production and exports as global demand increases. We expect domestic demand generally to recover slowly, hampered by unemployment levels and unfriendly business environment.

The Real Estate Registration and Authentication Department of the Ministry of Justice says that, in the third quarter of 2009, real estate investment transactions increased 1.18%, while commercial real estate transactions declined by 83.46%, warehousing transactions by 85.8% and private housing by 4.47%. The last few months of 2009 saw a noticeable boom in the residential rentals and property investment with the prices on an upward trend.

Residential real estate has been hit particularly hard by the global economic crisis. Islamic banks like Kuwait Finance House (KFH) valued third quarter of 2009 private housing transactions at KWD172, 397 (in million), down by 4.47% compared to their second quarter of 2009 figures. Kuwait faces a severe housing shortage. According to Global Investment House, the

¹⁰⁶ BANK NEGARA MALAYSIA, CENTRAL BANK OF MALAYSIA, *GUIDELINES ON THE GOVERNANCE OF SHARIAH COMMITTEE FOR THE ISLAMIC FINANCIAL INSTITUTIONS*, December 2004

residential segment is expected to pick up as it continues to witness supply shortages. Kuwait Finance House (KFH) put the total real estate investment at a 1.18% increase compared to their second quarter of 2009.

7.19. CONCLUSION

In most Islamic countries, Islamic Banking & Finance will potentially grow both in terms of size and sophistication, so as to progressively dominate the domestic banking landscape. This, however, may only materialise through a unique combination of focusing on its true spirit of ethics and dynamics, cultivating a far-sighted belief in an ideal scenario of banking and business partnerships and a broad perspective of business adaptation and application that transforms challenges into opportunities.

The demand of housing loans been increased considerably in Kuwait during the last 10 years. The reason is an increase in population. The cost of land is high due to shortage in supply, as existing development projects are not enough. Almost 95% of the citizens who plan to purchase a house contact the banks and financial companies. The National Bank of Kuwait was the first bank to provide home financing in Kuwait; however, the Kuwait Finance House, which began in 1977 and is an Islamic finance provider, is one of the biggest competitors of the National Bank of Kuwait. All financing banks and companies strictly follow the rules set by the Central Bank of Kuwait to entertain their customers in their house mortgage needs. To initiate financial schemes for the customers, the Central Bank of Kuwait already takes into account all the circumstances, factors and targets of average customers. In order to purchase their first house the procedures are very flexible.

To secure their investment, all banks and companies providing financial loans abide by the set rule that states that all customers will be deducted their monthly payments immediately after receiving their salaries. The system deducts the customers' monthly liabilities directly from their salaries. This is one of the main reasons why the home financing system functions so smoothly.

For quite some time, the private companies providing home finance have not been happy with the new policies of the Central Bank of Kuwait, which states that private companies must finance their customers for more than three years (Article 8 &9 appeared in April 2008). We also realise that some of the private conventional companies and banks are planning to open a window or department to provide home mortgages to their customers in the Islamic way, and some of the banks and companies are planning to completely convert into Islamic banks and companies. Some of the famous banks are Kuwait Middle East Bank and Kuwait International Bank. Both of these banks were conventional but now they have changed into Islamic banks completely.

As far as facts are concerned, the Islamic banks have captured a 50% segment of the financial market in Kuwait since 1977 and they are very satisfied with their growth, performance and demand, as a large number of people have been waiting and looking for Islamic finance products that are *Shari'ah* compliant for a long time. The very basic motive and attraction that drives customers to acquire products from Islamic banks is that they are *Shari'ah* compliant.

The above ten interviews from conventional and Islamic banks and companies provide a complete picture of home financing in Kuwait.

The compilation of results derived from interviews reveals that all of the banks do not use only the Base Lending Rate (BLR) to determine their rate of profits. The factors included in the determination of the profits are the current cost of funds, administration costs, profit margin and the market situation and the offerings from the market by their competitors. If we look at a glance, the rates and overall expenses for house mortgages look similar. The reason for that is that the basic ideology is the same in providing the finance to the customer. The profit margins of the Islamic financing companies are nearly the same as conventional banks because they aim to be seen as competitive as the conventional banks. The only main difference we discovered is the mechanism of profit rate; that is, in conventional financing it remains variable, and while in Islamic financing it remains fixed.

Islamic banks and companies have their own advantages, as they attract customers for home mortgages due to the customers' religious beliefs and faith in Islam. Islamic banks are mostly financing *Murahbaha* and *Ijara* types of housing finance on a fixed contract basis in terms of settlement period and lump sum amounts. But the conventional banks provide finance in a traditional way on an interest basis with a variety of products. Though both conventional and Islamic financial providers are satisfied with their performance and transactions with the customers, the Islamic banks attract more customers and have substantial growth prospects. It seems Islamic financing will always flourish in Kuwait and they will render their services in home finance in a welcoming and hospitable manner.

The primary challenge of Islamic banking today, therefore, is to reconcile its dual roles as a business facilitator and as a financial institution. Although growing remarkably fast in terms of size and regional expansion, the slow evolutionary process of Islamic banking worldwide is exemplified in the prevalence of diluted alternative applications of *Shari'ah* principles instead of the ideal balance between the application of PLS (Profit & Loss Sharing) mode of financing in measured combination with other fixed return modes.

Chapter 8: DISCUSSION AND CONCLUSIONS

8.1. INTRODUCTION

The expansion of Islamic financial institutions since the early seventies has invigorated interest in non-interest (profit sharing) financial institutions and in Islamic financial institutions in particular. A great deal of work has been written on this subject, particularly on banks, at both the theoretical and empirical levels. The limitations of the research conducted are discussed in this chapter, and suggestions are made for potential future work.

On the other hand, most of the text has concentrated on the theoretical part of this issue, ranging from the development of an appropriate structure for these institutions that fulfills Islamic principles, to examining the macroeconomic consequences of the advent of such institutions. The discussion of these issues is still on-going, with supporters and opponents equally concerned about the feasibility of Islamic financial institutions evolving into secure and thorough institutions. The main concern in this discussion is how these institutions can operate in the current interest-based economy and what other policy measures are needed to deal with this type of financial institution, particularly in the area of administration and regulation. The ability of such institutions to organise money supply requires closer examination. These issues are very significant, due to the nature of the process of Islamic banks that are considerably different from that of conventional banks. This is mainly because Islamic banks are in actuality a combination of banks, investment companies, and finance companies. The unique features of Islamic banks necessitate a special set of regulations to suit the special nature of these institutions which, in turn, raises the issue of how to place these banks in the interest-based economy without negatively affecting the ability of the Central Bank to administer and control the financial sector.

This thesis is an effort to provide an empirical assessment of the financial concert of Islamic banks with conventional banks. To accomplish this goal, the study is based on Kuwait where two banks have been playing a major role in home financing. The National Bank of Kuwait (NBK) was selected as a representative of a conventional bank, while the Kuwait Finance House (KFH) was selected as a representative of Islamic banks. The choice of these two banks was based on the fact that NBK is the foremost conventional bank in the country, while the KFH is one of the Islamic banks operating in Kuwait. In addition, the alternative of two banks from one country was determined in order to counterbalance the impact of inter-country divergence in social, economic and political factors on the behavior of these institutions and therefore the focal point detailed the banks themselves and their behavior. Such factors can be separated into two groups: group one consists of the organizational structure and conclusion-making process, while group two includes rules and regulations governing the activities of every institution.

The most important purpose of this is to appreciate whether the variant rules and principles governing the activities of Islamic banks have any unfavorable consequence on the ability of these institutions to compete and continue to exist in the current interest-based surroundings.

Additionally, a revision is proposed to be aware of how Islamic banks have urbanised their sources of funds and the channels developed for these funds, and how successful they have been in doing so. These two issues lie at the centre of the present debate on Islamic financial institutions. Experiential testing of these issues will elucidate many contentious views concerning the potential of these institutions to compete.

8.2. RESEARCH SUMMARY

The results of the review were analysed using *SPSS* and the interviews were transcribed and textually investigated. The survey was analysed based on a list of questions that had been set out earlier according to the aims and objectives of this research. The partially semi-structured interviews were analysed according to the questions; and the subject matter that seemed to be extremely significant and important was discussed in the interview analysis and findings chapter. Assessments of the perception were made to a certain level between Islamic and conventional housing finance. There are numerous characteristics relating to the customers' behaviour and awareness that can be learnt from the results of the analysis of the survey and partially structured interviews; also from the opinions of those in charge of housing finance as well as the *Shari'ah* scholars

8.3. THE STUDY HYPOTHESIS

As discussed earlier, this thesis is a proportional experiential study of Islamic and conventional banks, intended to test the ability of Islamic banks to struggle and continue to exist through the following hypotheses:

- Islamic financial banks are similar to conventional banks in protected funds.
- Islamic financial banks are similar to conventional banks in presentation and good organisation.
- Clients' religious approaches are not the most important consideration behind the accomplishment of these institutions.
- Limitations forced on these institutions do not comprise an obstruction to their ability to compete.

The above hypotheses sum up the main subject related to the activities of Islamic banking, particularly when it comes to its ability to compete with conventional banking institutions. For that reason, a financial examination was

conducted covering the period from 1997 to 2008. The analysis was predicated on four main issues: asset quality, capital adequacy, liquidity and profitability. The results for the banks have been evaluated with the supplementary and with the whole industry average, and with regards to the customer examination.

Face-to-face meetings and interviews were conducted with Senior Management of conventional banks and financial companies and Islamic banks and financial companies as well as some of the Islamic scholars working for *Shari'ah* board as advisors. The issues covered in interviews are the type of structure of home financing offered by conventional and Islamic banks and companies, competition among them and how they are different from each other, the demand, strength and competitiveness of home financing in the region, the periods available and offered to customers for home financing in both type of banks and companies.

The analytical tools symbolize a complete package that examines the main issues of concern in this study i.e. Survey analysis (outcome from 200 questionnaire distributed to customers who took home finance from both conventional and Islamic banks), interviews from the home finance providers as well as the customers, case study data and secondary data.

8.4. SUMMARY, FINDINGS AND RECOMMENDATIONS

The financial analysis indicates that the Islamic banks in Kuwait established the ability to conquer a variety of obstructions facing financial institution, among which is the development of substitute investment channels that observe Islamic principles. This symbolises a significant sentence that supports the hypothesis of this study. Furthermore, the Islamic banks financial concept has surpassed that of most of its competitors in the domestic and familiar banking sector and put it on a par with the conventional banks working in the region. The financial examination reveals that the Islamic banks and finance companies have been successful in attracting funds and making use of these funds in money-spinning outlets. This undermines the argument that Islamic banks are not as good as conventional banks, in spite of the difference

between the two types in terms of rules and regulations governing their activities, thus supporting the first and the third hypotheses of this study.

The client survey reveals a great deal of resemblance and a small number of dissimilarities between the Islamic banks and the conventional banks. With consideration to client fulfillment, the result findings from the questionnaire point towards the fact that the clientele of both the Islamic and conventional banks are satisfied with their services. There are several inconsequential differences that do not pose any serious problems to the Islamic banks, particularly in view of the fact that it is comparatively new in the region compared to conventional banks.

Normally, respondents who choose Islamic Home Finance as compared to the conventional bank state they chose it because it is according to their religion and belief. They do not want to compare the two to see how different or similar to each other they are. Such respondents not only choose only the home finance products, but also they acquire every other kind of financial products only from the Islamic banks, like car renting, car leasing, household stuff and every kind of insurances including car, life, traveling etc.

When we compared the pricing issues in both nature of banks, it is discovered that they are both almost the same at some extent. In Islamic financing, they use their own terminologies which have been extracted from Islamic ruling to give a particular name to their provided products for financing. Those products are named with the words that are all being used in conventional Arabic language, i.e. *Murabaha, Ijara, Musharika*.

When we talk about the structures of both of the providers of home mortgage, from the customer's point of view they both look the same, in that the customer has to pay his monthly installments by the end of the mortgage period. The only two main differences that customer can see is the variable installment rate in the conventional bank and a fixed rate of monthly installment. Other than that, in Islamic home financing, the customer has to pay a little less in monthly installments as compared to the conventional one.

The overall observation indicates that clients from both banks are satisfied with their home mortgage providers. But when we looked carefully (according to the questionnaire conducted in Chapter 6) at the level of satisfaction among Islamic and conventional banking, we can conclude the satisfaction level among Islamic banks is 98%, while for the conventional bank it is 91%.

Even the Islamic financial system is attractive to non-Muslims because of its fixed and cheaper monthly installment rates. They find it easier to meet their monthly budget instead of paying a variable monthly rate. The fact that it is religion-compliant is not an issue for non-Muslims.

The observations articulated in the semi-structured interviews with Senior Management of both natures of banks are very comparable. This emphasises an important factor: specifically, that, being an Islamic banking institution does not basically mean that a dissimilar set of problems relating to apprehension and obstacles face its operations. This in turn supports the arguments that Islamic banks are able to adapt and overcome the obstacles facing their operations.

On the other hand, the semi-structured interviews with senior management generally supported the hypothesis of this study. The consequences of these interviews pointed to the fact that rules and regulations controlling the activities of the Islamic banks do not appear to hinder its ability to complete for funds and to make use of these funds in sound profitable channels. These results symbolise a significant finding in this study and, in turn, contrast with the skeptic argument concerning Islamic banks.

To sum up, it can be argued that an examination of Islamic banking has revealed that this type of financial institution has been booming and successful in establishing itself as a practical substitute to conventional banking, in spite of what has been measured as authoritarian and nonflexible rules and regulations governing the activities of this type of financial institution. Islamic banks have been successful in developing substitute methods for attracting and utilising funds in money-making outlets, regardless of being a comparative beginner in the field. Future prospects for the bank are

even more promising, as experience is likely to improve the capability of these institutions to compete and to improve their performance.

8.5. Hypotheses and Empirical Results

Islamic home mortgage is not more expensive than the conventional home mortgage. Both banks does not provide the whole amount instead and the client need to keep at least 30-40% of the capital amount in their savings account of the concerned bank. Throughout the study it is revealed that the concept that the Islamic home mortgage is much expensive is absolutely wrong. Case studies and interviews also support the alternative hypothesis that the Islamic banking is not more expensive.

The alternative hypothesis that Islamic home mortgage is not necessarily in demand due to religiously is rejected in this study. This study reveals the eagerness of Islamic banking customers to become strictly religious in their life. 93%of the respondents choose Islamic bank because it is Shari'ah complaint. It is also interesting to note that more than half of the respondents of the conventional banking is not aware of the Islamic banking mortgage facility. At the same time 70% of the customers of conventional bank want to switch to Islamic banking. So it is evident that regarding the conventional banking customers their unawareness of existence of Islamic banking was the reason for their decision to choose conventional bank. The satisfaction level of customers of conventional bank is also not bad. Still if they want to shift to Islamic banking it is due to their inclination towards their religion.

Majority of respondents have no idea about the difference regarding formalities in conventional banking and in Islamic banking. So we can presume that the customers before choosing their bank for home mortgage were not making any comparative analysis of both banking system. In this scenario, advantage lies with the bank which adopts more advertising programs for their products. But here also the alternative hypothesis is supported by the perception of the majority of respondents of Islamic banking

that the period of finalization of all required formalities for Islamic banking takes only less than 1 month.

The alternative hypothesis that *Ijara* is not the widely used contract is evidently supported by the figure that only 1 among the 100 respondents claimed that *Ijara* system is following.

Regarding duration of home finance the alternative hypotheses is accepted that there is a considerable difference in terms of duration of home finance. 95% of Islamic banks choose 10-15 years while 81% of conventional bank customers prefers 10 years. This confirms that policy of profit of Islamic banking is comfortable to its customers and that is why they are selecting long term policies from their banker.

The study reveals that the customer satisfaction level of the Islamic banking is more than that of conventional banking which supports the alternative hypotheses. The alternative hypotheses states that the customer satisfaction level is same, the study reveals that the customer satisfaction level of Islamic banking is much above than that of conventional banking customers. The satisfaction level of Islamic banking is 98 % while that of conventional banking is 91%. At the same time the perception of the Islamic customers to stay with their present banking system and the attitude of the conventional banking system to switch to Islamic banking is a major finding in this study. In this regard it is also remarkable that the most recurring answer for consequence of non payment of mortgage amount is handled by the Islamic bank is by giving its customers.

8.6. RECOMMENDATIONS / PROPOSAL

Even though the results are acceptable and satisfactory, when it moved on to examining the financial presentation of Islamic banks, several significance issues came to the fore that warrant special mention and that may form a solid basis for future performance improvement.

- The management should be more cautious in its lending policy in order to diminish the bank's uncertain debts.

- The management has to work on increasing the liquidity of the bank by improving the possessions/liabilities maturity arrangement.
- The management has to improve the bank's accounting revelations.
- The need of professionals is required in the model of Islamic banking that is not only skilled in the financial world, but fully aware of Shari'ah.
- Islamic banks need an Islamic-compliant tool that can serve as an alternative to the loan that is used in conventional banking and that is prohibited in Islamic *Shari'ah*. The *Murabaha* is considered too costly in this case
- Particularly in the GCC countries, Islamic banks are real-estate oriented. Focusing only on real-estate can be dangerous in the future. The same strategy is being followed by the Islamic banks globally.
- Usually Islamic banks are being governed by national authorities. All the Islamic banks do not have a center location or authority to govern all Islamic banks globally. The level and nature of the supervision varies across markets globally, reflecting the Islamic finance industry's infancy and fragmented regulatory framework. Resulting, still there is no availability of complete range of Islamic investment products in Kuwait like other Islamic banks functioning globally.
- The most of the products in Islamic banks are based on goods and commodities while prices and currency rates go up and down frequently, creating a big risk for them being traders in reality especially in the case of *Salam* and *Istisna'a*. To hedge the risk, they are in need of derivative products and consequently of Future Exchanges.

8.7. *Suggestions for Further Research*

This study intensively focuses on one characteristic of Islamic banks, namely their financial performance. On the other hand, other important issues must be examined, including the following:

- Expansion of an authorised framework to incorporate Islamic financial instruments into the domestic financial sector under the supervision of the Central Bank.
- Growth of the supervisory system for Islamic Banks similar to those functional to conventional banks with alteration to suit the different nature of the operations of Islamic banks.
- The impact of the introduction of Islamic banks on the financial sector and monetary policy.

Future studies of Islamic housing finance might do well by focussing, for example, on the subject of securitisation; or perhaps the suitability of Islamic housing finance from an Islamic viewpoint.

APPENDICES (A)



School of Government and International Affairs
Institute of Middle East and Islamic Studies
Al-Qasimi Building
Elvet Hill Road, DURHAM DH1 3TU, UK
<http://www.durham.ac.uk/sgia>

Dear Participant,

Re: Questionnaire in Home Financing

Islamic Finance has been growing in an unprecedented sense in recent years and more Muslims are looking for *Shari'ah* compliant modes of financing. As part of this growth and expansion in the Islamic financial services, Islamic home financing is now a possibility and is being offered by a number of Islamic financial institutions.

This study aims to locate the demand for Islamic finance and evaluate the existing Islamic home financing in comparison to conventional financing, which is a part of a research leading to Ph.D at the School of Government and International Affairs, Durham University, UK.

I, therefore, kindly request you to spare a few minutes to fill this questionnaire. Your responses will be strictly kept confidential and will only be used to assist the completion of the research aim of this study.

Please kindly tick the most appropriate option among the given choices and insert numbers (1 to 5) in case of rating, where 1 would correspond to the most preferred.

Thank you very much in advance for your support by responding to this survey. If you have any queries you may forward them through email to me at: humoud almutairi <humoud.almutairi@durham.ac.uk>

Humoud Almutairi

Personal Information

1. What is your gender? **D**

Male

Female

2. Which age group do you belong to? **D**

21-30 Years

31-40 Years

41-50 Years

51-60 Years

Above 60

3. What is the average annual income of your household? **D**

KD__ 600__ - KD ____ 850 _____

KD__ 900__ - KD ____ 1150 _____

KD__ 1200__ - KD ____ 1450 _____

KD __ 1500 __ - KD ____ 1750 _____

Islamic Finance

4. Are you aware of the Islamic ruling against Riba? **D + (CROSS TABULATION WITH 2)**

Yes

No

5. Are you aware of the availability of Islamic finance products? **D**

Yes (Proceed to question)

No

6 - Have you ever used Islamic Financial Product? **D**

Yes

No

7 - Are you aware of the availability of Islamic house financing products in Kuwait? **D**

Yes

No

Financing Options

8 - When purchasing your property, what mortgage options did you prefer? **D + CROSS TABULATION WITH Q 2**

- Islamic (Proceed to question 9)
- Conventional (Proceed to question 10)
- Did not opt for a mortgage (proceed to question 11)

9 – On what grounds do you prefer Islamic mortgage over conventional mortgage? Please rate the options (1 – most preferred option, 4 – the least preferred option). **D + FACTOR ANALYSIS +ANOVA**

- Because it is Shariah Compliant
- Better cash flow management because of fixed instalment obligation
- Islamic mortgage was cheaper than the conventional counterparts
- Tempted by the growing popularity of Islamic Finance
- Others (mention) _____

10 - Kindly rate the reasons for which you opted for conventional mortgage

(1 – most preferred option, 4 – the least preferred option). **D+ FACTOR ANALYSIS**

- Unaware of the availability of the Islamic mortgage as an option
- Conventional mortgages are less expensive
- Lack of variety and flexibility under Islamic Finance
- Others (state)_____

11 - The reason for which neither Conventional nor Islamic Mortgage was used? **D + FACTOR ANALYSIS**

- Unaware of the different modes of Financing
- Both the Islamic and conventional modes perceived to be very costly
- Others (mention)_____

Islamic Home Mortgage

12 - When searching for an ideal home mortgage what formed the basis for your comparison between Islamic and

Conventional Home Mortgage? Kindly rate. **D + FACTOR ANALYSIS**

- Interest feature
- Repayment period
- Monthly instalment amount
- Flexibility in the repayment instalments

- Client relationship management
- Other reason (state) _____

13 - Do the Islamic House Mortgage products provide enough variety? **D**

- Wide variety
- Moderate variety
- Less variety
- Do not know

14 - Where did you get the information for Islamic Home Mortgage from? **D**

- Newspaper/ TV
- Internet
- Calls from the mortgage providers
- Recommended by friends
- Others (specify) _____

15 - If you had Islamic mortgages, do you know the contract type ? **D**

- Murabaha
- Ijara
- Musharaka

Your Home Mortgage Details

16 - Did you get the whole of purchase price financed from the mortgage provider? **D**

- Yes
- No

If No, what percentage did you get financed and where did you arrange the difference amount.

17- How long did the finalization of all the required formalities of the mortgage after you made the decision to opt for a

particular mortgage take? **D +ANOVA**

- Less than a month
- 1-2 months
- 2-4 months
- More than 4 months

18 - What was your mortgage amount?

19- Do you think the requirement of Islamic Bank more than conventional bank in the process of mortgage agreement? **D +ANOVA**

- Strongly disagree
- Disagree
- Do not know
- Agree
- Strongly Disagree

20 - What is the repayment period? **D +ANOVA**

- 10 Years or Less
- 10-15 Years
- 15-20 Years
- 20-25 Years
- More than 25 Years

21 - Do you have a fixed monthly instalment?

- Yes (Proceed to question 22)
- No (Proceed to question 23)

22 – What is your current instalment and how has it varied and will vary in future over the year?

23 - What is your monthly instalment?

24 - Were you at some time not able to pay your payment obligation? **D +ANOVA**

- No, I have always fulfilled my obligation to pay on time (Proceed to question 28)
- Yes, I have experienced non fulfilment of obligation (Proceed to question 25)

25 - Reason for the non payment of the monthly instalments? **D +ANOVA**

- Sudden loss of job
- The repayment instalment growing as compared to my fixed income
- Permanent disability leading to a loss of job
- Others (Specify)

26 - Period of non payment? **D +ANOVA**

- 1 Month
- 2 Months
- 3 Months
- More than three months
- Permanent non payment

27 - What were the consequences of your non-payment? Choose whichever that applies: **D + FACTOR ANALYSIS**

- My mortgage provider has seized my collateral
- The staffs of my mortgage provider were understanding about my problem
- The staffs were not very understanding about my problems.
- Various payment alternatives were suggested to ease my payment burden.
- Others (please state) _____

28 -Your level of satisfaction with the current mortgage **D + ANOVA**

- Excellent
- Good
- Acceptable
- Neutral
- Poor

29- If given a chance would you like to move from conventional to Islamic mortgage or vice versa? **D**

- Yes
- No

Thank you.
Homoud Almutairi

APPENDICES (B)

Interview:

1. Please kindly state the types or structures of home financing you provide in the Kuwaiti market?
2. Are you happy with the demand for your home financing products?
3. What is the strength of your home financing products?
4. Would you think that pricing is the most important strength of your product?
5. Would you please comment on the profitability and competitiveness of your home financing products?
6. What is the term-period of your products (e.g. 10 years, 20 years)?
7. Please comment on the developments in the Kuwaiti housing market and housing financing market?
8. What is the ratio of approved application to mortgage application in the NBK?
9. Do you consider the KFH as a strong competitor in the housing finance market?
10. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? ? (i.e. the most cheapest, in the middle etc.)
11. Do you know if the Islamic home finance products are substantially different than the conventional mortgages? Or is only the structuring different?
12. Do you think the NBK might open an Islamic home financing window?

QUESTIONS TO KFH

1. Please kindly state the types or structures of Islamic home financing you provide in the Kuwaiti market (*Ijara wa Iqtina*, diminishing *murabaha* etc.)?
2. Would you please briefly mention the distinguishing characters of your Islamic home financing products in comparison to conventional products?
3. Are you happy with the demand for your home financing products in particular due to its Islamic nature?
4. If the demand has not been as good as you expected, what could be the reasons?
5. What is the strength of your home financing products?
6. Would you think that pricing is the most important strength of your product?
7. Would you please comment on the profitability and competitiveness of your home financing products?
8. What is the term-period of your products (e.g. 10 years, 20 years)?
9. Please comment on the developments in the Kuwaiti housing market and housing financing market?
10. What is the ratio of approved applications to mortgage application in the KFH?
11. Do you consider the NBK as a strong competitor in the housing finance market? Do you expect other Islamic financial institutions to come into the market?
12. In evaluating the cost of your average home financing product, what would be the ranking in the market with similar products? (i.e. the most cheapest, in the middle etc.)

APPENDICES (C)

University Supervisor's Letter to NBK



School of Government
and International Affairs

Shaped by the past, creating the future

9th December 2005

To whom it may concern in National Bank of Kuwait

Humoud Al-Mutari

This is to confirm that Humoud Al-Mutari is registered a full time PhD student at Durham University in the United Kingdom under my supervision. He has been registered here since 1st April 2005.

His research topic is "Islamic home finance in Kuwait"

I should be grateful for any assistance you could provide to facilitate his research.

If you require any further information please do not hesitate to get in contact

Yours sincerely

A handwritten signature in purple ink that reads 'R. S. A. Wilson'.

Professor Rodney Wilson

Director of Postgraduate Studies

The Al-Qasimi Building Elvet Hill Road Durham DH1 3TU UK
Telephone +44 (0)191 334 5660 Fax +44 (0)191 334 5661
www.durham.ac.uk/sgia

APPENDICES (D)

University Supervisor's Letter to KFH



Durham
University

School of Government
and International Affairs

Shaped by the past, creating the future

9th December 2005

To whom it may concern in Kuwait Finance House

Humoud Al-Mutari

This is to confirm that Humoud Al-Mutari is registered a full time PhD student at Durham University in the United Kingdom under my supervision. He has been registered here since 1st April 2005.

His research topic is "Islamic home finance in Kuwait"

I should be grateful for any assistance you could provide to facilitate his research.

If you require any further information please do not hesitate to get in contact

Yours sincerely

A handwritten signature in blue ink, appearing to read 'R. Wilson'.

Professor Rodney Wilson

Director of Postgraduate Studies

The Al-Qasimi Building Elvet Hill Road Durham DH1 3TU UK
Telephone +44 (0)191 334 5660 Fax +44 (0)191 334 5661
www.durham.ac.uk/sgia

APPENDICES (E)

Installment Deferral Form

10101 7101

FROM : LOCAL REAL ESTATE DEPT KFH FAX NO. : 005652441075 Jun. 23 2003 09:07PM F1

التاريخ : ٢٠٠٣ / ٦ / ٢٤ م

السيد / مدير إدارة العقار المحلي
المحترم
السلام عليكم ورحمة الله وبركاته ،،

الموضوع : تأجيل أقساط

يرجى التكرم بالموافقة على تأجيل قسط شهر لعام ٢٠٠٣ م
إلى نهاية المدة وذلك للظروف التالية : -

بيانات العقار : -
(المنطقة :) (القطعة :) (القسيمة :)

* وفي حالة الموافقة على طلبى إدارة العقار المدلى بخصم الرسوم المقررة على التأجيل وقدردنا ثلاثة اشهر خصمياً
من حسابي .

مقدم الطلب :

الإسم :
رقم الهاتف :
التوقيع :

10101 7101

اسبب التأجيل اذا كان القسط باع

APPENDICES (F)

Installment Deferral Form

٢٠٠٥ / / التاريخ :

المحترم السيد/ مدير إدارة العقار المحلي
السلام عليكم ورحمة الله وبركاته ..

الموضوع : تأجيل أقساط
(السنة بعشرة)

يرجى التكرم بالموافقة على تأجيل قسط شهر لعام ٢٠٠٥م حسب الآتي:

م	الشهر	البيان
٧	يوليو	
٨	أغسطس	
٩	سبتمبر	
١٠	أكتوبر	
١١	نوفمبر	
١٢	ديسمبر	

م	الشهر	البيان
١	يناير	
٢	فبراير	
٣	مارس	
٤	إبريل	
٥	مايو	
٦	يونيو	

بيانات العقار :-
المنطقة : () القطعة : () القسيمة : ()
(السنة بعشرة)
مقدم الطلب :
الإسم :
رقم الهاتف :
التوقيع :

ANSA

٢٠٠٥ / / التاريخ :

APPENDICES (G)

KFH Letter to Kuwait Saving Bank

بيت التمويل الكويتي
KUWAIT FINANCE HOUSE



التاريخ :
رقم الإشارة: 1/15

السيد / مدير عام بنك التسليف والادخار المحترم

السلام عليكم ورحمة الله وبركاته،،،

نفيدكم بأن السيد /
قد تقدم إلينا برغبته في شراء العقار الكائن في منطقة () قطعة
رقم () و الموصوف بالقسيمة رقم () ، على أن يتضمن شروط
البيع تحويل قيمة القرض المزمع منحه له من قبلكم لبيت التمويل الكويتي .

لذلك

يرجى التكرم بموافقتنا بتعهد بقيمة القرض العقاري المستحق للعميل مشروط
بأي التزامات على العقار .

شاكرين لكم حسن تعاونكم معنا،،،

و تفضلوا بقبول فائق الاحترام و التقدير ،،،

إدارة العقار المحلي

عالية الربط ببنك التسليف والادخار
سيد شهر سيلم، لشؤون العقار المحلي

APPENDICES (H)

Salary Form

بيت التمويل الكويتي
Kuwait Finance House



نموذج إدخال حقل الراتب والدخول الأخرى
(فقط لعقود التمويل المقسط)

العقار: المنطقة: القطعة: القسيمة:

اسم العميل:

الراتب: الدخول الأخرى:

اسم الشريك / الكفيل:

نبر الصفة الكفيل

الراتب: الدخول الأخرى:

اسم الشريك / الكفيل:

الراتب: الدخول الأخرى:

اسم الشريك / الكفيل:

الراتب: الدخول الأخرى:

.....

توقيع المسوق

APPENDICES (I)

Client's Acknowledgement of Lease Obligation



بيت التمويل الكويتي
Kuwait Finance House

وعد ملزم باستئجار عقار بموجب عقد إيجار ينتهي بالتملك وإقرار بتحمل أي أعباء مالية ناتجة عن الإخلال بالوعد

بيانات الواعد بالشراء

	الاسم		المدني		الشريك

بيانات العقار

	المنطقة		القطعة		الحصة
					القيمة
					الأوصاف
					المساحة
					المخطط

بيانات الشراء

	مدة العقد		إجمالي القيمة الإيجارية		الإيجار السنوي
					دفعة التملك
					رقم الحساب
					الإيجار المقدم
					الإيجار المؤجل
					بداية العقد
					نهاية العقد

إقرار العميل بالوعد

أقر أنا الموقع أدناه بالتزامي باستئجار العقار المبين أعلاه، وبالقيمة الإيجارية والقيمة التملكية المحددة أعلاه، وأقر بأنني اطّعت على شروط عقد الإيجار المنتهي بالتملك المعدة من قبلكم، وأقبل التعاقد وفقاً لها، وأتعهد بالتوقيع على عقد الإيجار المنتهي بالتملك متى استكملتم إجراءات شراء العقار من مالكه، وفي حالة تخلفي لمدة أقصاها أسبوع واحد من تاريخ شرائكم للعقار عن التوقيع على عقد الإيجار المنتهي بالتملك المعد من قبلكم، يحق لكم اعتبار هذا الوعد مفسوخاً من تلقاء نفسه دون حاجة لأي إجراءات قضائية ودون حاجة إلى إداري أو إنذاري، وأصرح لكم بتأجير العقار مجدداً لمن تشاؤون بالأجرة التي ترونها مناسبة، مع تحملي لأي خسارة تلحق بكم نتيجة فارق القيمة الإيجارية المدونة في هذا الوعد، وبين القيمة الإيجارية التي تأجرون بها العقار، والتزام بسداد قيمة هذه الخسارة لكم باعتبارها ديناً حالاً وواجب الأداء، كما أصرح لكم بخضمتها من أي من حساباتي الشخصية لديكم حتى ولو كانت جارية وترتب على ذلك كشف أي منها، كل ذلك دون حاجة لأي إجراءات قضائية، ودون حاجة للحصول على حكم بالزامي بقيمة هذه الخسارة، باعتبارها ديناً مقر بصحته دون منازعة ومحسّد من قبلكم وفقاً لتفويض مني غير قابل للنقض أو العدول.

وهذا وعد مني وإقرار بمدبونيته بما يترتب عليه، للعمل بموجبه.

وتفضلوا بقبول فائق الاحترام،،،

الواعد المقر بما فيه

إعداد / رئيس القسم المفوض بالتوقيع

٢٠٠٧/٠١/١٤

APPENDICES (J)

Customer Consent Form



شركة شبكة المعلومات الائتمانية (ش.م.ك.م.)
Credit Information Network Company [K.S.C.C]

تفويض العميل

CUSTOMER CONSENT

Declaration Date : تاريخ التفويض :
Customer Name : إسم العميل :
Civil ID Number : رقم البطاقة المدنية :

Acknowledgement

إقرار

I the undersigned holding Civil ID number shown above acknowledge and approve that Credit Information Network Company KSCC allows the banks, investment companies supervised by Kuwait central bank, Kuwait Finance House and the commercial establishments supervised by Ministry of Commerce and Industry, all such institutions of which are entitled to grant credit facilities through the sales by installment for goods and services, and which are object to the Law No. (2) for the year 2001, all such institutions to exchange all the information relating to the consumer loans and the credit facilities corresponding to sales by installments granted by the said institutions.

أنا الموقع أدناه وحامل البطاقة المدنية الموضحة أعلاه، أوافق وأسمح لشركة شبكة المعلومات الائتمانية (ش.م.ك.م.) بتبادل المعلومات الخاصة بالقروض الإستهلاكية والتسهيلات الائتمانية المرتبطة بعمليات البيع بالتقسيط وذلك فيما بين البنوك وشركات الاستثمار الخاضعة لرقابة بنك الكويت المركزي وبيت التمويل الكويتي والشركات والمؤسسات التجارية الخاضعة لرقابة وزارة التجارة والصناعة التي تقوم بمنح تسهيلات إئتمانية عن طريق البيع بأي شكل من أشكال نقل الملكية بالتقسيط للسلع والخدمات وفقا للقانون رقم (2) لسنة 2001

Furthermore I accept that Credit Information Network shall have the right to obtain all my personal information recorded with the Public Authority for Civil Information and the provision of such information to the banks and other financial and commercial institutions subject to Law No. (2) for the year 2001 without any liabilities or responsibilities on the part of the Public Authority of Civil Information or Credit Information Network.

كما أوافق وأسمح لشركة شبكة المعلومات الائتمانية (ش.م.ك.م.) بالحصول على البيانات والمعلومات الخاصة بي والمسجلة لدى الهيئة العامة للمعلومات المدنية وتزويد البنوك والشركات الخاضعة للقانون رقم (2) لسنة 2001 بهذه البيانات والمعلومات دون أدنى مسؤولية على الهيئة العامة أو شركة شبكة المعلومات الائتمانية (ش.م.ك.م.).

Customer Signature

توقيع العميل

X

Signature Verification

إعتماد التوقيع

.....

For Official Use Only

للإستعمال الرسمي

Subscriber code : 01010 : رمز المشترك
Subscriber Name : Kuwait Finance House : إسم المشترك
User ID : : رمز الموظف
Ployeer Name : : اسم الموظف
User Signature : : توقيع الموظف

APPENDICES (K)

Property Installments Calculation System Form

نظام احساب الأقساط العنقارية

Datu passe.

بيت التمويل الكويتي
Kuwait Finance House



*	طريقة السداد		نوع العقار
	عدد الأقساط		مدة السداد
	فترة السداد		سعر الشراء
	المقدم		دفعة التسليف
	تاريخه		القسط الأول
	تاريخه		القسط الأخير
	المرابحة		المتبقي
	المديونية		الموكل
	رسوم التسجيل		الإجمالي
	مبلغ التأمين		فترة التأمين
	قسط الدفعة		الدفعة الأخيرة

* حسب الشروط والضوابط الائتمانية لبيت التمويل الكويتي

المستندات المطلوبة من صاحب العقار (البائع)	المستندات المطلوبة عند تقديم الطلب
<ol style="list-style-type: none"> 1- صورة البطاقة المدنية. 2- صورة الجنسية. 3- صورة وثيقة العقار. 4- مخطط العقار (الكروكي). 	<ol style="list-style-type: none"> 1- شهادة راتب للعميل والشركاء والكفيل. 2- صورة الجنسية للعميل والشركاء والكفيل. 3- صورة البطاقة المدنية للعميل والشركاء والكفيل. 4- صورة جواز سفر للعميل والشركاء والكفيل. 5- أي مستندات أخرى خاصة بالدخل الآخر. 6- كفيل تطبق عليه الشروط في حالة الطلب. 7- صورة من عقد الزواج. 8- صورة كرت بنك التسليف في حالة شراء البيت.
ملاحظات	
<ol style="list-style-type: none"> 1- يستحق أول قسط بعد ثلاثة شهور من تاريخ توقيع العقد بالنسبة للسكن الخاص. 2- يستحق أول قسط في بداية الشهر الجديد بالنسبة للسكن الاستثماري. 3- سعي الدلالة ورسوم التسجيل على المشتري. 	

فروعنا العنقارية : الفعالة المصرفية (2445050/2122/2159) المدنية (2413720) الفجاء (2561979)
فيطن (4756491) الألاس (4866037) لرفة (3967953)

21/03/2007

APPENDICES (M)

Property Assessment Request Form

KUWAIT FINANCE HOUSE



طـاع التمويـل

إدارة العقار المحلي

التاريخ: / / 2003 م

نموذج طلب تقييم

المحترم

رئيس قسم التقييم

السلام عليكم ورحمة الله وبركاته ،

التكرم بموافقتنا بتقييم العقار الواقع لي :

المخطط	المساحة	القيمة	القطعة	المنطقة
شاليه <input type="checkbox"/>	مزرعة <input type="checkbox"/>	تجاري <input type="checkbox"/>	استثماري <input type="checkbox"/>	سكني <input type="checkbox"/>
..... <input type="checkbox"/>	أخرى <input type="checkbox"/>	أرض فضاء <input type="checkbox"/>	جاخور <input type="checkbox"/>	صناعية <input type="checkbox"/>

ب من التقييم: إجارة مراخمة رهن لـ (.....) أخرى (.....)

تليفون:	تليفون:	تليفون:

حظرات:	الحد:	السوم:	السعر المطلوب:
تاريخ: / / 2003 م	تليفون:	التوقيع:	

التاريخ: / / 2003 م

المحترم يرجى التكرم بعمل اللازم نحو التقييم

حظة:

الاسم: التوقيع:

حظرات المقيم:

التوقيع:

مرفقات طلبات التقييم

أرض فضاء:	صورة الوثيقة / المخطط / الرأي التنظيمي / الموقع / مخطط بناء أن وجد
بيت سكني:	صورة الوثيقة / رخصة البناء / الرأي التنظيمي / الموقع / كشف الإيجار
تجاري/ استثماري:	صورة الوثيقة / رخصة البناء / الرأي التنظيمي / الموقع / كشف الإيجار
عقود المنفعة:	عقد المنفعة من وزارة المالية / رخصة البناء أو المخطط / الرأي التنظيمي / الموقع / أخرى

evaluation

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