

Waqf Instruments for Construction Contract: An Analysis of Structure

Abdullaah Jalil
Asharaf Mohd Ramli
Universiti Sains Islam Malaysia

ABSTRACT

The *waqf* instruments for construction and development of property are still underutilized in this country. Taking into consideration the increasing cost of construction and limited sources of funds, the potential of *waqf* instruments to attract more public funds should not be ignored. *Waqf* instruments could be developed for financing the development of several institutions such as universities, research centres and et cetera. The paper aims to study and analyze the structure of *waqf* instruments that could be further developed for construction of potential assets. This includes the risks, parties involved, advantages as well as disadvantages. It is a conceptual paper and the authors apply the inductive and deductive methods as well as analysis of the relevant literatures to reach at the findings. The findings suggest several methods and structures of *waqf* instruments for future development. It could be significant for those institutions that have planned to apply this concept in the nearest future.

Keywords: *Waqf*, endowments, *waqf* property, construction, Islamic financial instruments

Introduction

The *waqf* instruments for construction and development of property (e.g. buildings) are still underutilized in Malaysia. Taking into consideration the increasing cost of construction and limited sources of funds, the potential of *waqf* instruments to attract more public funds should not be ignored. *Waqf* instruments could be developed for financing the development of several institutions that could generate their own incomes such as universities, hostels, research centres and et cetera where the incomes will finally be distributed for charitable purposes.

For the purpose of the discussion, the construction contract is defined as “*formal agreement for construction, alteration, or repair of buildings or structures (bridges, dams, facilities, roads, tanks, etc.)*.”¹ The discussion of the paper is on the possible framework that could be adopted in the construction contract for *waqf* buildings. It could provide a preliminary or general framework that could be discussed in details later.

Problem Statement

Some institutions may have limited fund to develop their buildings that are necessary to the operation of their tasks/roles. At the same time, the institutions may have significant contribution and roles in the development of the Muslim community. This advantage may provide opportunity for the institutions to consider the concept of *waqf* to attract fund from the potential donors such as public community, corporate institutions, wealthy individuals and et cetera. Hence, there are several questions needed to be answered for the purpose of this study. The questions are:

1. What is the framework of *waqf* concept for the construction of buildings?
2. What are the instruments that could be used to raise fund from the potential donors?
3. What are the advantages and disadvantages of this scheme?

¹Source:<http://www.businessdictionary.com/definition/construction-contract.html>. Retrieved on July 7, 2008.

Objectives of the Paper

This paper aims:

- to study and analyze the structure of *waqf* instruments that could be developed for construction project
- to suggest the framework of *waqf* instruments that suitable for construction project
- to analyze and illustrate the advantages and disadvantages of this scheme based on a possible implementation at public universities

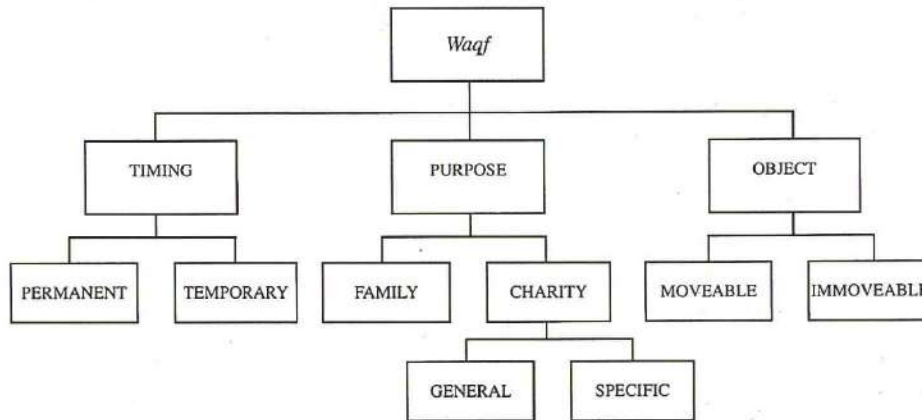
It is a conceptual and theoretical paper and the authors apply the inductive and deductive methods as well as analysis of the relevant literatures to reach at the findings. The findings shall suggest the structure of *waqf* instruments for future development. It could be significant for those institutions that have planned to apply this concept in the nearest future.

Literature Review

Waqf or Islamic endowment is a well-known topic in the area of Islamic economics, Islamic finance and Islamic jurisprudence. The topic has been discussed in great details in the literatures of Islamic jurisprudence especially and Islamic studies generally by the Islamic jurists and scholars for hundreds years. In general, *waqf* could be categorized into several categories from three different aspects i.e. timing of *waqf*, purpose of *waqf* (the beneficiaries) and the *waqf* object.

In principle, the timing of *waqf* must be permanent. However, it could be temporary in accordance to the Malikiyyah (al-Zuhayli, 2000). From the authors' point of view, the temporary nature of *waqf* may pose several risks (e.g. managerial risk, unfeasibility of long-term development) that are contradict to the purpose of *waqf* itself. In term of the purpose of the *waqf*, the *waqf* could be made to the family of al-waqif (donor) or to the public for the charitable purposes. The charitable purposes could be general or specific (e.g. for the purpose of education only). However, from the managerial perspective, general *waqf* is better than the specific *waqf* as it gives more flexibility to the manager to develop the *waqf* property in order to optimize the benefit of the *waqf*. In term of the object of *waqf*, generally it could be moveable or immovable. (See Figure 1 for illustration).

Figure 1: The Categories of *Waqf* in Islamic Jurisprudence



Nowadays, the main issues related to *Waqf* properties or assets are the management and development aspects. Most of the current literatures focus on the development of *Waqf* property rather than the establishment of new *Waqf* property. Sources for the financing and development of *Waqf* property could be obtained from (al-Misri, 2005):

- i. The property of al-waqif (donor)
- ii. The property of al-mawquf calayh (beneficiaries)
- iii. The revenue of the *waqf* property
- iv. The revenue of other *waqf* property
- v. Baitumal for maslahah (public interest)
- vi. Reserves from the revenue of the *waqf* property
- vii. The sale of a portion of *waqf* property to develop the remaining portion of *waqf* property
- viii. The lease of the *waqf* property with advanced rentals
- ix. Charities
- x. Loan or debts (without interest)

Developing *Waqf* properties according to Abu Zahrah (2007) is essential to make sure that these assets are continuously provided benefits or usufruct to the beneficiaries as stipulated by the founder. Cizaksa (1998) states that *Waqf* institutions during Ottoman Empire are responsible in providing public facilities such as mosques, public halls and schools which enable the Government to reduce the expenditure on establishing such services. The income generated by *Waqf* properties according to Kahf (www.kahf.net) are used by the *Waqf*

managements to build public hall, religious schools or madrasah, universities and to make payment for Imams, and preachers. In Malaysia as stated by Ahmad Zaki et.al (2006), most of the traditional religious schools are built on *Waqf* lands.

Waqf properties can be developed through various ways. Kahf (www.kahf.net) has categorized three modes of financing that can be applied in developing *waqf* assets, namely; traditional modes, modern schemes modes and self finance modes. The traditional concepts of hukr, istibdal and ijaratain have been widely used by *Waqf* institutions in the Muslim countries. Hukr or indefinite lease right according to Anas Zarqa (1994) requires the lessee of *waqf* assets to pay large lump sum of rent and it is used by the Nazir to develop *waqf* assets. The concept of istibdal and ibdal require the exchanging of *waqf* assets to other properties. Modern schemes of developing *waqf* assets as suggested by Md. Nurdin Ngadimon (2006), Muhamad Kholid et. al (2007), Kahf (www.kahf.net) and Tahir Sabit (2003) is the securitization of *waqf* through sukuk. The difficulty of getting enough funds to develop *waqf* assets required *waqf* institutions to finance the development projects by themselves through cash *waqf* and share *waqf*. Cizaksa (1998) elaborated on the experience of cash *waqf* during Ottomon Empire and its possible implementation in the contemporary Muslim countries.

It could be observed that the focus of the contemporary writings is on the development of existing *Waqf* property (land). However, the focus of this study is the construction of *Waqf* building on public (government) land.

Methods of Analysis

Since this study is conceptual and theoretical in nature. The sources are secondary data available in the literature related to the management and development of *waqf* property. The literature comprises books, seminar proceedings, periodicals and internet resources, in either English or Arabic. The authors apply the inductive, analytical and critical methods through deep and intense readings and understanding of the previous texts and literatures related to the topics in order to achieve the previously stated objectives. For the purpose of illustration of the *waqf* framework, the authors discuss the potential implementation of the concept at Islamic Science University of Malaysia (USIM).

Findings: The General Framework of *Waqf* Concept for Construction Project: An Analysis

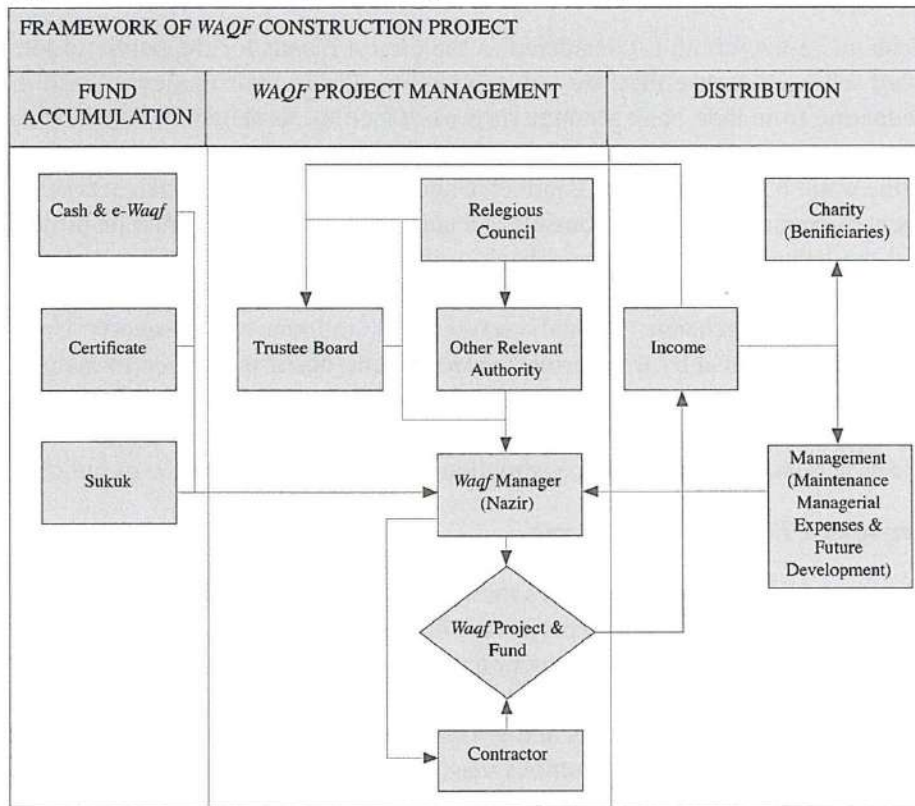
In this section, the authors propose the general framework of *waqf* concept for construction project and highlight the main issues that should be reviewed and discussed further. Based on the analysis, it is observed that there are three main stages that take place in the general framework of *waqf* concept for construction project namely (See Figure 2 for illustration);

- Fund Accumulation;
- *Waqf* Project Management; and
- Distribution of Income or Yields.

This framework could be a useful reference for *waqf* administrators for developing a *waqf* construction project. These stages should only commence after having the complete and finalized design of the building. This is important to ensure that potential contributors have enough information on the project to avoid the element of *al-jahalah* (lack of information). It is due to the fact that the building does not exist yet at the time of contribution.

Each stage involves specific Shariah contracts and carries several issues. It begins from the process of raising fund from the public through several instruments. After the amount of fund has achieved its target (i.e. the total cost of the construction project), the management of the *waqf* construction project takes place. This stage involves a lot of legal issues and perhaps, it is the most critical stage out of the three stages. The issues of authority and ownership, the status of the parties involved and the selection of contractor should be vigilantly addressed. Then, the distribution of the income or yields generated from the *waqf* property takes place.

Figure 2: The Three Main Stages of the *Waqf* Construction Project



Instrument for Fund Accumulation of the Waqf Construction Project

The accumulation fund for the construction of *waqf* project could be realized through the setting up of the three instruments, namely; cash and e-*waqf* fund, per-square feet value certificate and the issuance of sukuk². These instrumentst provide an opportunity for the donors to dedicate their wealth for *waqf* purposes according to their preference as stated below:

²Asset-backed financial certificates/instruments.

Cash and e-Waqf Fund

Cash and e-waqf fund is considered as the easiest means for the public to join *waqf* scheme because they are only obliged to donate their money in cash or deducting from their bank account via e-waqf facility. As shown in Figure 2 the accumulated fund will be managed by *Nazir*³ who is acted as an agent on behalf of the waqif based on wakalah contract. Under wakalah contract, *Nazir* acts as the agent of donors and he is responsible to channel the fund for construction project and the balance will be returned back to the fund for future project. Wakalah contract is deemed more practical due to the difficulty of getting the permission of the waqif to exchange (istibdal) cash money into immovable property. Upon getting the approval by *waqf* project management, *Nazir* is allowed to manage the fund and appoints contractor for the construction of *waqf* project. The *Nazir* should be a competent institution (and not an individual) that has knowledge and experiences in managing construction project and maintenance of building

Per-square Feet Value Certificate

The per-square feet value certificates for *waqf* project will be offered to the public once the details of the intended project are finalized. The essential elements of the project such as the type of construction project, the cost, description and design of the project, the price of each certificate and the duration of the project must be disclosed in details. While cash and e-waqf fund do not required any minimum amount, any individual or institutions must pay certain amount in order to get the certificate e.g RM 30.00 per square feet. The pool of money accumulated will be directed to construct buildings such as research centers and labs.

The Issuance of Sukuk

Developing wakaf assets through the issuance of sukuk is another potential instrument to be applied by *waqf* administrations. This instrument is still underdeveloped in Malaysia although the country is well known for pioneering the issuance of various sukuk at the domestic and global stages. Two countries i.e. Saudi Arabia and Singapore have so far developed their *waqf* lands through the issuance of sukuk al-muntafa'ah and sukuk musharakah respectively. The sukuk of al-muntafa'ah and musharakah could provide financial returns to the holders as well as channel a portion of the profit back the management of *waqf* for distribution. These two structures are suitable for "profit-seeking donors" or "charitable investors" and could be tradeable in the Islamic capital market.

³ The supervisor and manager of the *waqf* property.

However, the focus of the paper is on the pure endowment project where no financial returns are expected by the donors. Hence, sukuk based on wakalah and *waqf* concept seems more appropriate. In this framework, the Nazir acts as agent for the waqif (donors) in channelling their donation for construction of *waqf* building. At the same time, the Nazir acts as the agent of relevant authorities in managing and monitoring the *waqf* project. In such structure, Nazir is responsible to issue the sukuk and channel the fund accumulated for *waqf* project construction. It is worth to note that this instrument is developed mainly for large scale project that requires a large amount of money, for example to build a university and hospital. In addition, the nominal value of each sukuk certificate is higher than the previous two instruments. For that reason, Nazir should use appropriate marketing strategies to attract the wealthy, organizations as well institution to participate in this charitable activity. This sukuk is not tradeable in the secondary market and it is not an instrument in the Islamic capital market. However, it may prove the endowment made by the holders and if possible, may entitle the holders for tax deduction or exemption.

From the authors' point of view these three instruments could be further divided into three categories according to the types of construction projects whether small, medium or large scales. While cash and e-*waqf* fund is suitably designed for small scale projects, per-square feet value certificate and sukuk could be more viable for the construction of medium and large scale projects respectively.

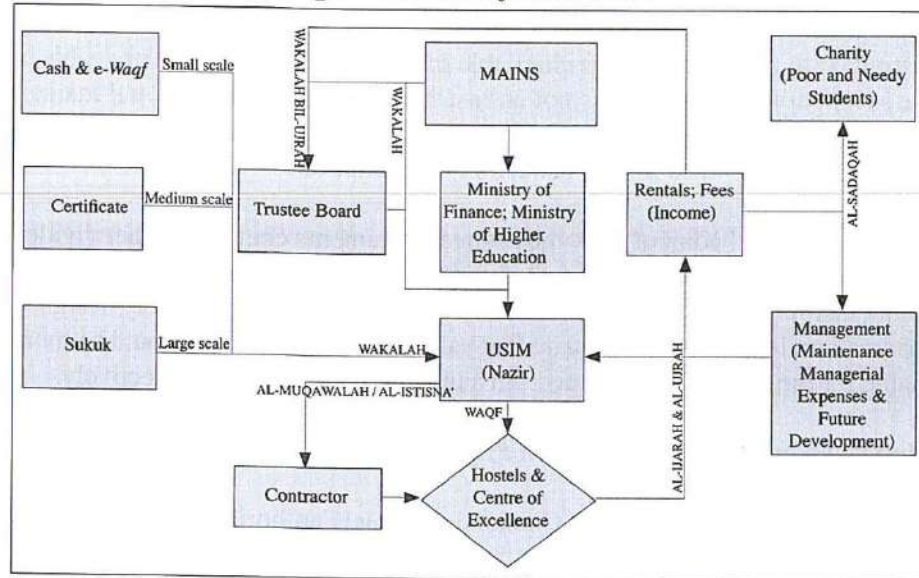
Management of Waqf Construction Project

In Malaysia, the State Religious Council is the solely authorized party to manage the *waqf* property in accordance to the Article 74(1) (2) Federal Constitution of Malaysia within its area (Siti Mashitoh Mahamood, 2001). Hence, the involvement of the State Religious Council in the *waqf* construction project is inevitable. However, the State Religious Council could engage into al-Wakalah contract to appoint the relevant institutions (e.g. USIM) to be the manager of the project as the project directly involves with their interest.

In another way, the documents of *waqf* could establish USIM as the Nazir appointed by the donors and the State Religious Council. With the authorization of the donors and the State Religious Council, the Nazir (e.g. USIM) would be competent legally to act as manager of the scheme in managing the feasibility of the project, safeguarding the capital of *waqf* project in the event of insolvency as well as be liable for damages in the event of violation and ignorance.

The State Religious Council could also establish a Trustee Board that is responsible in monitoring the Nazir (in this case i.e. USIM) and would continuously ensure that the objectives of *waqf* are achieved. The Trustee Board also acts as agent (with fee) of the State Religious Council in decision making related with the *waqf* project. The concept of trustee in managing the *waqf* project is highly important to provide transparency and confidence to the potential donors on the *waqf* project. The members of the Trustee Board could be representatives from the State Religious Council, Shariah scholars, USIM, Ministry of Higher Education, Ministry of Finance, donors and other parties deemed necessary.

Figure 3: An Illustration of *Waqf* Construction Project Framework



The Contributions: Cash Waqf or Wakalah?

In the proposed framework of *Waqf* construction project, the donors or contributors contribute in the form of cash. Hence, it might be seen as “cash *waqf*” at the first glance. However, in details, “cash *waqf*” is not suitable for the *waqf* construction project as it may have several issues. The issues are:

- “Cash *Waqf*” is a type of *waqf* al-manqul (endowment of movable properties) which is considered as invalid according to al-Hanafiyyah (Al-Zuhayli, 2000). Additionally, a movable property is easily subject to total physical loss.

- “Cash *Waqf*” has no benefit unless it is consumed (exchanged) with another. Hence, the cash has no eternal attribute which should be available in the *waqf* property.
- The value of “Cash *Waqf*” is subject to volatility. One of the disadvantage of cash *waqf* is that the value of cash is very much subject to depreciation and inflation which may affect the purchasing power of the cash *waqf* (al-Misri, 2005)
- The application of *istibdal* is inevitable in the “Cash *Waqf*” and the practice of *istibdal* has several strict conditions.

Hence, the proposed Shariah contract should be based on the *wakalah* (agency) contract. The potential “Nazir” acts as the donors’ agent to manage the *waqf* fund and develop the prescribed building at the prescribed area. Hence, the potential project should be prescribed in details to avoid the factor of *al-jahalah* (lack of information) that may invalidate the *wakalah* contract.

Project Construction

The construction of the building (e.g. hostels or excellence centre) could be based on the contract of *al-muqawalah*⁴ (manufacturing and/or maintenance contract) or *al-istisna*’ (manufacturing sale)⁵. In this particular framework, the Nazir (acting as agent) deals with the contractor to build the building as prescribed in the *wakalah* and *waqf* contract. No third party financing is needed if the *waqf* fund is sufficient. In the case of non-sufficiency of the fund, a more complex structure is needed⁶.

However, there are several Shariah and legal issues that should be addressed before embarking on the project construction. The main issues are:

⁴*Al-Muqawalah* is a contract where one party manufactures the subject matter of the contract or performs services and tasks described in the contract for payment(s) made by the customer. It could be a combination of *al-istisna*’ (manufacturing sale) and *al-ijarah ‘ala al-‘amal* (service charge) (Za’tari, 2008).

⁵*Al-istisna*’ is a type of sale contracts for non existing object. It refers to the sale with order to the manufacturer (in this case – the contractor) to manufacture (build) a specified object/asset.

⁶For example, the Nazir (e.g the university) could put his own money upfront and engage in a diminishing partnership (*musharakah mutaqisah*) contract with the State Religious Council. In a specified period, a portion of the income generated from the *Waqf* property could be used to acquire/buy the Nazir’s shares of the *waqf* property. At the end, MAINS will finally own the building. This practice could be done from the Shariah point of view. However, the legal issues in such practice are massive.

The Separation of Ownership between the Land and the Waqf Building.

For example, if USIM constructs the *waqf* building on its own land, the land should remain as its property and not being transferred to the State Religious Council as *waqf* property. The *waqf* property is only the building and not the land where the building is built on. Could this separation be practiced according to Shariah and Malaysian Law?

The Exit Mechanism (Istibdal)

The *waqf* building is legally owned by the State Religious Council and USIM only acts as the Nazir of the *waqf* property appointed by the waqif or agent of the State Religious Council in managing and monitoring the *waqf* project. If the State Religious Council deems that the *waqf* building is no longer fit for charitable purposes, could the building be sold to USIM? Could istibdal be practiced if deemed necessary by the State Religious Council? If so, what is the pricing mechanism?

These two issues need further discussions and researches. However, the discussions are not within the scope of this study.

Income and Distribution

The building e.g. hostels, could be leased to the university or students or any users at a reasonable rate. Exemption or rebate on the rentals could be given to any qualified and deserving parties (e.g. poor and needy students). The rentals acquired could be used for two main purposes. The two main purposes are:

- The maintenance of the (*waqf*) building. This involves the cost of managing (manager's salaries, security, etc.), upgrading, renovating, fixing, repairing, cleaning of the assets or et cetera.
- The charity purposes. This is based on the contributors' intention whether to make a general or specific endowment. It is better to make a general endowment so that the Nazir could channel the fund to any types of charity purposes. The description of the beneficiaries could be done on the basis of their attributes e.g. poor and needy students.
- The payment for the members of Trustee Board. This payment could be based on fee (*ujrah*).

The portion of each category could be stated in the contract. In order to avoid lack of information (*jahalah*) on behalf of the donors, the stipulations and conditions of distribution should be enlightened up-front of the *waqf* contract where necessary information should be provided to them. The *waqf* scheme could be more attractive if the donors could select their own beneficiaries. However, it is more accommodating if the contract gives flexibility to the Nazir to manage the income and distribution according to his own diligence.

The Advantages and Disadvantages of the *Waqf* Concept for Construction Project

The advantages of the *waqf* concept for construction project are:

- The access to the public fund at the lowest cost
- No third party financing is needed
- The *wakalah* concept provides flexibility to the managing party
- The willing donors and contributors could be local or global
- The building that could generate income is suitable for this project

However, the *Waqf* concept for construction project may have several disadvantages. They are:

- There are legal issues that should be discussed and addressed
- The risk of under-subscription of *Waqf* instruments. Hence, the *Waqf* fund is not enough to meet the cost of the construction
- Default of contractor may lead to loss of public fund and confidence

Conclusions

The *Waqf* concept offers the access to raise fund from the public for relevant institutions in the development of their institutions. The concept should not be underestimated as it has played undebatable vital roles in the development of several critical institutions, particularly in the area of education, worship and medication, throughout the Islamic history. The management of the *waqf* construction project is the most critical part of the whole process. Hence, the religious authorities in Malaysia should not involve in this project except with highly capable and reputable institutions in order to ensure and maintain the public confidence. The authors believe that there is an enormous amount of ready money and willing donors from inside and outside of this country to participate in this scheme if it can be well managed in transparency and integrity. The authors also suggest that more researches, particularly from the legal and marketing perspectives, should be conducted on the topic. The potential of this concept is vast and it should be developed in the nearest future.

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