



## Company Background

American Finance House LARIBA (“AFHL”) was established in 1987 by a group of low-key and dedicated community members. They are business men and women who believe in the LARIBA System as a True Expression of “Islamic Banking and Financing.”

The Company is one the oldest companies in the USA offering both consumer and commercial financing. The company offers socially responsible asset-based financing and investing opportunities that comply with the Islamic Shariaa (jurisprudence.)

Based in Pasadena, Ca, AFHL is currently registered to operate in 21 states throughout the USA including Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Iowa, Maryland, Massachusetts, Michigan, Minnesota, Ohio, Oregon, Pennsylvania, New Jersey, North Carolina, Texas, Virginia and Washington.

## Mission/Services

**Our mission is to provide products and services that will help remove Riba from people’s lives. CHANGING THE LAWS OF THE UNITED STATES IS CERTAINLY NOT PART OF OUR MISSION.**

American Finance House LARIBA endeavors to meet the financing and investing needs of those members of the community who are particular about conducting their financial affairs in a “La-Riba” environment regardless of their faith, ethnicity, gender, skin color or national origin. AFHL facilitates the basic financing needs of the community for items such as homes, automobiles, and household equipment. AFHL also caters to the needs of businesses including financing of equipment, materials/trade, and business acquisition/expansion. It is important to note that LARIBA is not a Venture Capital company. We are extremely conservative.

The company is committed to providing a “La-Riba” financing alternative to the conventional “Riba- based” system. The “La-RIBA” financing offered is designed to comply with both the Islamic Shariaa and the strict Laws and Regulations of

the United States. Again, CHANGING THE LAWS OF THE UNITED STATES IS CERTAINLY NOT PART OF OUR MISSION.

AFHL also strives to offer the community the opportunity to invest a portion of their resources to help fund the various community financing transactions. It is a way to earn a reasonable rate of return (without Riba) and contribute to the development of the community.

## **LARIBA CONCEPTS**

American Finance House LARIBA ascribes to the following concepts:

1. Money is not a commodity. It is a measuring tool. It only grows when used in an economic activity.
2. Wealth should be circulated within the community to help develop the economic growth and prosperity of the community.
3. The LARIBA system of economics, finance and monetary theory is based on three important pillars:
  - a) Wealth and property (Assets) are God's properties. Man (male/female) is appointed as its trustee and custodian.
  - b) The system of "Zakah" or "alms" giving.
  - c) The system of "Miraath" or inheritance.
4. LARIBA financing is not simply "no-interest" or "interest free" financing. LARIBA financing is not money lending, it is actual financing of a tangible asset or service. It requires the exchange of assets/properties. Also the rate of return generated is based on the economic value of the assets being financed, which is measured using the concept of "marking the property or service to its real market value." By this we mean that rent of a house or an automobile on the market as contrasted to the rent of money expressed in terms of interest. This way money can be used to generate economic activities in the community.

## HOME FINANCING

Islamic (LaRiba) financing was first offered to the community in the United States in 1986/1987 by two companies in California. These are Muslim Savings and Investments (MSI, now headquartered in Houston) and American Finance House LARIBA (LARIBA.com). Since that time demand for Islamic financing has grown. In response to this growth, new companies came to the scene. Most significant of these was Al-Baraka Bancorp (a wholly owned subsidiary of the Jeddah, Saudi Arabia based Dallah Al-Baraka), which started in California (now headquartered in Chicago, Illinois). Al-Baraka's entry brought additional liquidity to the poorly capitalized private Islamic finance companies. Most recently (mid-1998) the United Bank of Kuwait, UBK, started financing mortgages using the lease-to-purchase model in a program called Al-Manzil. The United Bank of Kuwait decided earlier this year (2000) to terminate its operations in the United States and focus on operations in the United Kingdom and Bahrain. MSI and LARIBA.com are the only two significant companies that now serve the US market for Islamic (LaRiba) financing products.

We believe that the greatest challenge facing these companies in the coming years will be raising sufficient capital to meet the growing demand. Traditional means of raising capital in a conventional setting may be tapped, but many of them do not meet the strict standards of Shari`aa (Islamic Law). The global challenge for Islamic (LaRiba) finance thus takes the form of raising capital in a manner that both abides by the regulatory standards of various countries, as well as the rules of Shari`aa. We estimate that – to meet the Islamic financing demands in America – the Islamic financial industry needs to raise roughly \$2 billion, \$1 billion for mortgage financing, and another \$1 billion for financing automobile, equipment, and other business purchases.

In this paper, we review conventional capitalization methods, with a view to developing Islamic (LaRiba) alternatives. To motivate this review, we begin by highlighting the large volume of unmet demand for Islamic financial service. We then proceed to discuss various capitalization strategies for generating sufficient liquidity to satisfy that demand.

### ***I. A Conservative Estimate of American Demand for Islamic Financial Services***

The primary market segment for Islamic finance companies in the United States is a small segment of American Muslims who refuse to participate in Riba under any circumstance. Many of those households have sufficient cash savings to purchase an automobile or durable household appliance in cash. However, their cash savings are typically insufficient to buy a home without resorting to mortgage financing. Consequently, such households are typically debt free. It is

estimated that this segment represents approximately 2% to 5% of the observant Muslim community, and consists of mostly professionals. It is the moral responsibility of the Islamic (LaRiba) bankers and investment/mortgage bankers to cater to the needs of this “Puritan” segment of the community. Note that we use the term Puritan intentionally. This term conveys the core principles of American democratic participatory freedom and virtue through industriousness and property ownership.

### ***A. The Number of Households***

A very conservative estimate of the Muslim population in the USA is 6 million Muslims, or 1.5 million Muslim households. We further assume that 50% of those households can afford buying and maintaining a home. This gives us an estimate of 750,000 Muslim households that either own or may wish to own a home. If we assume that 20% of those households wish to live according to Islamic laws; i.e., praying regularly, attending Friday (Jum’aa) prayers and Eid prayers, paying Zakah and performing Hajj, then we have 150,000 households that may potentially use Islamic alternatives to conventional mortgage financing. Finally, we assume 5% to 10% of this number is “Puritans”, as the term was defined above. This gives us a final estimate of 7,500 to 15,000 households who need such an Islamic alternative. We thus feel that 10,000 households is a very conservative estimate of the minimum market size for Islamic (LaRiba) mortgage financing.

The profile of this market segment is unique. Such individuals are extremely pious. They run cash only households. They use banks only for safekeeping of deposited funds and refuse to accept money market interest. They carry no debt and fulfill their obligations on time. They are honorable and extremely successful and reputable. They do not boast their success and accumulated savings because of their training to be humble. They are extremely particular about details of Halal and Haram (permissible, and forbidden actions, respectively). Their trust is not earned easily. However, once their trust is earned, it is earned fully. They are indeed the most credit worthy members of the community. However, such individuals can only be identified by Islamic bankers through extensive knowledge of the community at the grassroots level.

### ***B. Market size***

The median prices of homes in the US vary widely from one state to another. A conservative estimate of the median house price in California is \$250,000 compared to \$ 150,000 in Texas. For purposes of this analysis we use a conservative benchmark price of \$150,000 per house. If one assumes that 70% of the value of the home to be financed, then the average Islamic (LaRiba) financed amount would be \$105,000. Therefore, a market of 10,000 households represents a demand of about \$1,050 million. As the Islamic (LaRiba) mortgage concept gains credibility and develops a proven track record, we expect the

market to grow further by attracting younger Muslims, and encouraging older Middle Class Muslims to re-finance their homes in an Islamic manner.

If we further assume that each household buys one car (usually each household in the US owns at least 2 cars) at a median price of \$20,000, then the potential market for car leases in the US is approximately US\$200 million.

**It is also important to note that the population of American Muslims is expected to reach around 20 million by 2025 mainly due to the growth in the number of children born to the first generation Muslim immigrants. This new generation will assume better and more affluent positions in the American infrastructure than their parents, which will increase the percentage of prospects among them for this financing. We believe that the market potential for Islamic home mortgages could reach at least \$3,000 million. This does not include other community Islamic financing needs that include automobile financing, small business financing and construction financing.**

## **American Finance House LARIBA Home Financing Model**

### **Background:**

It is no secret that laws and regulations of the United States concerning consumer financing are very strict and clear about legal transactions, documentations and disclosures. We embrace the benefits of this environment and endeavor to comply with its requirements. As mentioned earlier, changing the laws of the United States is certainly not our mission.

### **Concept:**

AFHL provides a purchase-financing model based on the Lease-to-Purchase concept, which assumes that AFHL would purchase the property jointly with the client and the client agreeing to purchase the share of AFHL over a period of time. Conceptually, until the purchase is complete, the client would agree to lease AFHL's share in the property.

Given the client's agreement (at the beginning of the transaction) to re-purchase AFHL's share of the property, AFHL does not register its name as a co-owner. Instead, AFHL authorizes the client to undertake the purchase of the property from the seller and register it directly into his/her name.

The monthly re-purchase of AFHL's share is called REPAYMENT OF CAPITAL ("RofC" – pronounced rofsee) and can be made over a period of time up to 30 years, at cost without adding any time-value. During such period, AFHL's share diminishes while the client's share increases gradually to reach 100% at the end of the financing period.

During the re-purchase period, the client will compensate AFHL for its share of the property. Such compensation is based on the lease/rental value of the property on the open market, as mutually determined and agreed upon between the client and AFHL and certainly NOT the prevailing mortgage interest rates. The amount paid monthly by the client is based on the share of AFHL during that month which will be reduced as the client re-purchases AFHL's share. This monthly payment is called RETURN ON CAPITAL ("RonC" – pronounced Ronsee.)

The model allows the client to finance a home and pay a rate of return that is based on marking the property to the fair rental value in the market place, as sanctioned by Islamic Jurisprudence. (See Fatawa Albaraka 1997-1998 assembled by Dr. Abdul-Sattar Abu-Ghuddah and Mr. Ezzudin Khoja page 81 to 87 in Arabic.)

## **Payment Calculation:**

The monthly payment is a function of the fair rental value of the property, amount contributed by AFHL of the total home value, and the financing period. Our process requires that the client checks with at least three real estate agencies in the market about the fair rental/lease value for a similar property in the same neighborhood. AFHL does the same checking process independently. The client and AFHL would then agree on a mutually acceptable rental/lease value. The client's total monthly payment consists of the sum of "RofC" and "RonC."

American Finance House LARIBA uses a proprietary computer program; third generation software developed by LARIBA originally in 1995 for a client after he consulted with a reputable Muslim scholar in Islamabad, Pakistan. The model incorporates the principles described above and generates a level/equal monthly payment (including both the "RofC" and "RonC") over the Financing Period for the convenience of the homebuyers.

In order to comply with US laws and regulations concerning disclosure and transparency in financing and "Truth in Lending", AFHL inputs the monthly payments obtained from the Lease-To-Purchase model above into a traditional mortgage program to obtain the "Implied Interest Rate". This allows AFHL to disclose such a rate, complete the standard mortgage financing documentation, as well as, issue the required forms for the tax deductibility of the "RonC" portion of the monthly payments.

## **Home Financing Numerical Example**

### **Assumptions**

1. Cost of Home \$300,000.
2. Down Payment available from client - \$60,000 (20% of purchase price).
3. Financing Period – 10 years. Please note that we are using 10 years pay back in this example for simplicity. Repayment periods can be as long as 30 years, as mutually agreed upon by client and AFHL.

### **Determination of Return on Capital, "RonC"**

The first step is to determine the fair rental value to be able to determine the Return on Capital ("RonC"). If we assume the client surveys the market and obtains estimates for similar properties in the same neighborhood for \$900, \$1,000 and \$1,100 per month; and AFHL does the same process independently and discovers rents of \$1,000, \$1,100, and \$1,200 per month. Then the two parties will negotiate together, out of their own free will, and reach an agreed

upon rent that will be fixed for the entire period of financing. For this example we will assume \$1,000 per month is the value agreed upon.

Given a rental value of \$1,000, the client is assumed to pay to AFHL rent in the first month of \$800 based on its share of 80%. This is the first payment of "RonC" or the return on AFHL's capital. Conceptually, the amount of "RonC" will decline each month from \$800 to eventually zero as the client buys back the shares of AFHL.

### **Determination of Repayment of Capital, "RofC"**

Given that the client contributes 20% (\$60,000) of the \$300,000 home value with the remaining 80% (\$240,000) contributed by AFHL. Then conceptually, the client owns 20% and AFHL owns 80%. Given a mutually agreed upon Financing Period of 10 years (120 months), then the client is assumed to make monthly Repayment of Capital ("RofC") of \$2,000 per month (\$240,000 divided by 120 months). Conceptually, this way the client buys back the share AFHL gradually over time.

### **Total Monthly Payment:**

Based on the above, the first monthly payment would be \$2,800, representing the sum of "RofC" of \$2,000 and "RonC" of \$800 "RonC". Total monthly payments would decline each month as the rental amounts paid decline to reach \$2,000 per month at the last payment. **Note, in order to make it more convenient for the client's budgeting and to lower the higher payments in the early months, AFHL's payment calculation program provides a level payment for the entire 120 months which in this example would be \$ per month for the 120 months.**

**MIKE please add the piece on the implied interest rate in this example & the value of "The Marking to the Market Approach."**

## **THE LARIBA AUTOMOBILE FINANCING MODEL**

American Finance House LARIBA's automobile financing model works in an identical manner to the Home Financing described above. The Lease-to-Purchase concept is applied. The fair rental value of automobile is independently determined from the lease /rental values offered by auto dealers and rental agencies in the area of the client and mutually negotiated exactly as described in Home Financing above.

The repayment period for automobiles can be negotiated up to five years. Down payment requirements are 20% for new cars and 30% for used.

### **CONCLUSION**

American Finance House LARIBA is a community-owned finance company. AFHL is honored to serve the financing and investing needs of the community, particularly those members who choose not to participate in the Riba-based services offered by other banking and finance organizations. The Company offers a wide range of socially responsible asset-based financing and investing products that are structured to comply with both the Islamic Shariaa and the rules and regulations of the United States of America. For a complete listing of our services please visit [www.lariba.com](http://www.lariba.com).