



Raqaba
Shari'a Audit & Islamic Financial Consultations
912 Maynard Creek
Cary, NC 27513
NC, USA

Tel: +1 919 917 6595
+1 919 300 0012
Website: www.raqaba.co.uk
E-mail: info@raqaba.co.uk

Independent Shari'a Auditor's Report

LARIBA Residential Property Financing Model "Declining Participation in the Usufruct (DPU)"

All praise is due to Allah alone, prayers and peace be upon the last Prophet, his Relatives and Companions.

To Messrs. / Shareholders

American Finance House -LARIBA
California, USA

Report on the product's Shari'a compliance

1. We have audited the design of LARIBA Residential Property Financing Model "Declining Participation in the Usufruct (DPU)" (the product) to express an opinion whether the design of product's procedures and documentations, initially approved on December 31, 2014, remains in compliance with Shari'a rules as they are in the "Shari'a References" paragraph in this report.

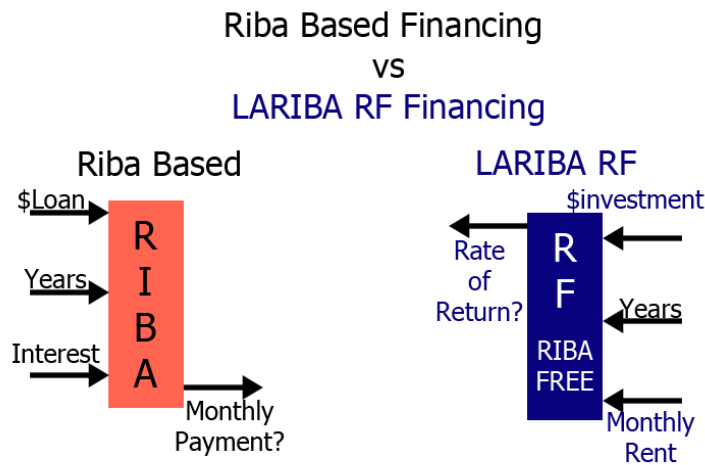
Product's structure & procedures

2. LARIBA Residential Property Financing Model "Declining Participation in the Usufruct (DPU)" is a financing model based on purchasing the property jointly with the client, then sale of the financier's share in Milkul Raqabah (ownership of property title) to the client without Haqul Manfaa (usufruct), and renting out the financier's share in the usufruct to the client throughout the financing period as described on the following steps:
 - a) The client applies for residential property financing.
 - b) LARIBA obtains the approval of GSEs (fannie mae and freddie mac) to participate in the transaction as a Wakeel on behalf of the GSE.
 - c) LARIBA presents the client a prequalification letter, which is a letter to prove that the client is capable and qualified to get the financing.



- d) LARIBA provides the client with an "RF Preliminary Term Sheet" to inform the client and describe the financing procedures. This preliminary term sheet has no legal or Shari'a effect.
- e) Both parties, LARIBA & the client, sign a "Wakala Agreement".
- f) The client (Wakeel & Partner) signs the "Purchasing Agreement" with the original owner on behalf of both LARIBA and Client.
- g) LARIBA evaluates the prudence of buying a house based on the rate of return on investment realized if the property were to be leased in the open market. LARIBA finance officer and the customer research the market rent of a similar property in the same neighborhood. Each of the finance officer and the customer come up with three market estimates of the rent. LARIBA finance officer and customer agree on a fair rent to be the average of the six rent estimates.

LARIBA then applies its unique and patented computer algorithm to evaluate the economic rate of return on investment by using its proprietary computer model based on the LARIBA RF Finance model called "ISLAMABAD". In the computer model, LARIBA inputs the invested amount, the number of years of financing and the average rental value based on the live market. The unknown is the Rate of Return on investment. This is in contrast to what other banks do as shown below:



Please note that LARIBA does not start with an interest rate (interest is the rate of rental of money which is Riba) but relies on actual rental value of a similar property in the same neighborhood as described earlier:

- I. If the rate of return is higher or equal to the charged by the competition LARIBA issues a "Commitment Letter". If it is higher, then LARIBA voluntarily reduces the agreed upon market rent such that the monthly



payment is competitive with rates offered by other banks and finance institutions.

- II. If the rate of return is very low indicating that it is imprudent to invest in this property, LARIBA declines financing and advises customer that the property is overpriced even though the appraised value may indicate otherwise. This is what saved many of LARIBA customers from participating in the US economic price bubble of 2008
- h) Both parties sign disclosure documents that meet Federal and Shari'a legal requirements.
 - i) Both parties sign "RF Final Term Sheet" in which LARIBA sell its share of Milkul Raqabah (ownership of property title) to the client without Haqul Manfaa (usufruct) which is rented throughout the financing period.
 - j) Property title is to be registered in the name of the client.
 - k) A mortgage lien is perfected in the name of LARIBA, the client signs a deed of trust which is a conventional document where some terminologies such as loan, interest and late payment fees are shown in this document to protect both parties' interest as per legal requirements.
 - l) Property is to be handed over to the client.
 - m) When the period of financing ends, or the client pre-pays the entire principal amount, the exception of Haqul Manfaa (usufruct) ends and the client becomes the sole owner of Haqul Manfaa (usufruct), and the transaction would be closed.

Product's documents

3. The Product's document contains two types of documents:
 - a) Shari'a documents.
 - b) Conventional documents, Disclosures and Deed of Trust or Mortgage which constitutes evidence of "Lien", these documents confirm the liability initiated by the Shari'a compliant documents.

Product's Shari'a principles

4. "Declining Participation in Usufruct" is a financing tool which is structured based on a well-known legislative case that is selling the title (Al-Raqabah) and keeping the usufruct (Al-Manfaa). This model differ from the well-known following models: Murabaha with a promise to buy, lease-purchase (rent-to-own), and diminishing Musharaka. The Shari'a rulings of these products are describe below:



Al-Kafi fi Al-Fiqh - Ibn Qudamah al-Maqdissi – (Sale Chapter – exemption section):

5. Ibn Qudamah Maqdisi mentioned in his book Al-Kafi, Hanbali book, the terms and conditions of this tool, he said:

The sale is legal for whoever sold an asset and excluded the usufruct for a definite period of time such as: a camel with a condition to ride to a specific destination, a property with a condition to stay in for a month, and slave with condition to stay serving him/her for a year, as it was narrated that Jabir bin 'Abdullah sold to the Prophet (ppuh) a camel with condition to ride it to Madina. (Al-Bukhari and Muslim). And because the exemption is explicit, it complies with Abu Hurairah's hadith. (Al-Kafi)

This is considered as an authorizing of the case foundation in reference to Jabir's Hadith and the Abu Hurairah's, narrated by Al-Termithy, in which the Prophet (ppuh) forbade the exemptions unless it is defined such as it is for whoever sold an orchard and exempted a particular tree or sold a herd and exempted a specific sheep.

6. Ibn Qudamah discusses further the tool and says:

"If the purchaser offered to pay the seller in exchange to it (i.e. the usufruct), the seller is not obligated to accept because it is his/her right, as if he/she has rented it, and even if he intended to rent it out for that period. Ibn Aqeel said that: This case is acceptable in Hanbali's Qiyas because he/she owned the usufruct so he/she has the right to rent it out as a tenant". (Al-Kafi)

These are the foundations of the LARIBA's utilization of the exempt usufruct. LARIBA is the owner of the usufruct as if LARIBA rented it and has the right to utilize the usufruct for LARIBA directly or indirectly by renting it out even to the client who purchased the title. LARIBA is not obligated to rent the usufruct to the client, but the relation can be conducted on the basis of a binding promise from either one of the two parties as the binding promise from one party is accepted by the International Islamic Fiqh Academy No.[40-41 (2/5,3/5)] and the paragraph (2/3/1) from the Shari'a standard No.8 (Murabaha). Worth noting, renting the exempt usufruct to the clients is not forbidden in Shari'a and it cannot be described as Einah because LARIBA has possessed the usufruct from a third party that is the first owner of the title and its usufruct. Thus, the LAIRBA's profits come from renting the exempt usufruct and the rental value represents the return on investment.

7. Concerning the title damage consequence of losing the exempt usufruct, Ibn Qudamah says:

If the purchaser damaged the title, he/she must pay its value... because he/she damages another person's right of ownership. If the damages happened unintentionally without any carelessness, Ahmad's saying



implies holding the purchaser responsible but he/she could not be so because the seller did not possess the usufruct from the purchaser, therefore; the purchaser should not compensate for the damage. Such as, if a sold fertilized palm tree was damaged or an orchard from which a tree was exempted. Thus, Ahmad's saying shall be interpreted to hold those who happened to careless". (Al-Kafi)

This quote explain that the client shall not be held responsible to LARIBA for the usufruct in the exemption period in case there was no carelessness from his/her side (the purchaser). Ahmad's opinion would be more appropriate to consider when the damage happened intentionally or because of carelessness from the purchaser side (the owner of the title).

8. Ibn Qudamah states that the purchaser has the right to sell the title to others. He said: "If the purchaser sold the title, the deal is accepted and the usufruct is exempted". This transaction is conditioned with the second purchaser's awareness of the exemption of the usufruct and conditioned with the acceptance of the bank that has a lien over the property, which it the usufruct that was exempted, as it is the practice of LARIBA Model.

Fatawa of Al-Baraka Seminar No. 6/2,6/4 and 9/4:

9. Fatwa of Al-Baraka Seminar No. (6/4) held on Algeria dated March 2-6, 1990 C.E concerning Home Financing product for Al-Baraka Bank London which states:

Registering the house's title in the partner's name, based on trust, from the inception of the contract is permissible under Shari'a. Registering the property's title in this manner does not contradict the agreed-upon partnership, especially since the partner's ability to sell the home is restricted until his full ownership of the property is established. In this regard, we took into consideration the fact that this registration of title is a form of documentation insured by the officially established lien on the property, according to the conditions agreed upon with the partner. (Al-Baraka)

Making the partner alone responsible for all [closing costs like] registration, survey, and other documentation costs associated with the jointly owned property from the inception of the contract, and absolving the bank from responsibility for such costs, is permissible if the partners agreed accordingly. This is particularly appropriate, since the partner will ultimately become the sole owner of the property at the end of the financing contract. (Al-Baraka)

10. According to the mentioned fatwa of Al-Barak, the process is arranged as follows:
 - a) "The bank and the client jointly purchase the home according to the agreed-upon proportions.



- b) The bank sells its share in the physical property ownership (milk Al-Raqabah) to its partner, while retaining its share of ownership of the right to use it (haqul-manfa'h) until its partner pays the remaining portion of the price.
 - c) The bank collects an annual rent in proportion with the actually paid portion of the property's price".
11. The approved procedures of the product in LARIBA comply with process arrangement in Albaraka's fatwa motioned above. According to the approved procedures of the product in LARIBA, the client signs a "Purchasing Agreement" as a Wakeel, then LARIBA sells its share of Milkul Raqabah (ownership of property title) to the client, and finally the property title is registered in the name of client. And the client pays for the applicable fees.
12. Fatwa Al-Baraka Seminar No. (6/2) held on Algeria dated 2-6 March 1990 C.E concerning using the term "interest" as an alternative to the term "profit" or "rate of return" which states:

Despite the fact that interest, as conventionally used in banking transactions, coincides precisely with the Riba that is forbidden in the Law (Shari'a) to pay or receive, and regardless of whether the underlying transaction is a consumption or production loan, we have found that there is no objection to the use of the term (interest) in the cases related to those dealing with Al-Baraka Bank, London, aiming to benefit from the financial advantages given to interests in various cases of deposits and financing. (Al-Baraka)

In this regard, it is imperative to ensure that the term (interest) in the sense described above is used only in the forms required by entities other than the bank, e.g. tax declaration forms for depositors, or special forms used in various financing cases. However, if the intent is to change the nature of the transaction to make it an interest-bearing loan, then such transaction will be fundamentally impermissible. (Al-Baraka)

13. Fatwa of Al-Baraka Seminar No. (9/4) held on Jeddah dated February 15-17, 1994 C.E concerning establishment of pro forma ligatures or contracts, or formation of sister or branch special purpose entities to benefit from tax advantages given to Ribawi interest which states:

Islamic banks should be wary of writing pro forma Ribawi contracts or ligatures with pro forma Ribawi interest to benefit from tax or other advantages legally offered to Ribawi interest. (Al-Baraka)

There is nothing wrong if Islamic banks use language in their financial statements to explain the nature of permissible profit. For instance, the Bank may say that [such profit] is (the Islamic alternative for interest in the Ribawi system) or that (it is the return on investment) if such language will allow them to benefit from the tax advantages offered by Ribawi



systems. However, the terminologies (Riba) or (interest) must never be used in any financial statement issued by the Islamic bank. (Al-Baraka)

14. The approved procedures of the product in LARIBA comply with the terms and conditions of Albaraka's fatwas motioned above, the Shari'a procedures have included what is related to the partnership (Musharaka), agency (Wakala), buying, owning, sale and leasing of the product. Also, the documents that are documenting these procedures comply as well inclusive of the commitment to pay late payment fees to a special charitable fund.
15. The use of terminologies such as; loan, interest and late payment fees in mortgage lien document which is not issued by LARIBA does not contradict the actual financing process as shown in the Shari'a compliant documentation. These terminologies refer to the value of Milkul Raqabah (financing principal) and the value of Haqul Manfaa (financing return) and the late payment fees as a commitment of donation to a third party.

Shari'a standard No. 3 (Default in payment by a debtor):

16. Paragraph (2/1/8) on Shari'a standard No.3 "Default in payment by a debtor" mentioned that:

It's permitted to prescribe in contracts involving indebtedness... an obligation on the debtor, in the case of default in payment, to donate an amount or a percentage of the payment due on condition that this be donated to charitable courses under the supervision of the bank's Shari'a supervisory board. (Shari'a Standard No. 3)

The approved procedures of the product in LARIBA comply with the contents of Shari'a standard mentioned above since the procedures and documents include the obligation of late payment fees as a commitment of donation to a special charitable fund.

International Islamic Fiqh Academy resolution No. 64 (7/2):

17. International Islamic Fiqh Academy resolution no. 64 (7/2) concerning early settlement mentioned that:

To reduce a deferred debt with the aim of accelerating its repayment, whether at the request of the creditor or of the debtor (pay less but ahead of time), is permissible in Shari'a and does not fall within the province of Riba (which is forbidden) as long as it is not based on an advance agreement and as long as the relationship between the creditor and the debtor are bilateral. If there is a third party among them, the reduction is not permissible as it will then be subject to the ruling on discount of commercial papers. (Resolution No. 64)



Shari'a standard No. 8 (Murabaha)

18. Paragraph (5/9) of Shari'a standard No.8 (Murabaha) concerning early settlement mentioned that: "It is permissible for the institution to give up part of the selling price if the customer pays early, provided this was not part of the contractual agreement".
19. In case the client who owns Al-Raqaba (the title) pays the remaining value of the Raqaba (financing principal) early, then the usufruct owner has two choices. First, to claim the value of the excluded usufruct for the remaining period after recalculating as if it was paid in advance, that means a discount to be given to the client. Second, the seller "usufruct owner" forgoes the usufruct at any time when the client settles all the remaining financing amount. The second choice is the one that is applied in LARIBA's model as mentioned previously in product's procedures and documentations.

Discussion of the resolution by the fatwa Committee of the Muslims Jurists of America (AMJA) concerning the product

20. The AMJA Fatwa Committee issued a resolution concerning Islamic Home Financing in the United States in the meeting held in Houston on Dhul-Qadah 20-22, 1435 A.H. (September 15-17, 2014 C.E.). The resolution contains Shari'a rulings on whether dealing with certain companies in U.S market is permissible or not, the resolution contains an important paragraph stated as follow:

"The Committee would like to emphasize that this ruling on this issue is directed towards those who wish to deal with these companies to purchase real estate via their financing and contracts and the ruling holds as long as the contracts are as they are in the present state and the modes of purchase are as they are now. Any change in their contracts or manner of execution would therefore require a change in the ruling.

As for the companies themselves, this ruling is actually in need of more clarification from them concerning their relationship with the Public government-sponsored enterprises federal financing institutions [such as Freddie Mac], a matter concerning which the RFC Committee was not able to receive a detailed clarification". (AMJA)

21. The committee resolution mentioned a number of home financing companies in U.S market and clarified the opinion of the committee on whether dealing with these companies is permissible in Shari'a or not including the opinion in regard to LARIBA as follow:

"The contract of this company does not differ from a traditional mortgage that interest-based banks provide. This is the overriding contract between this company and the purchaser and what they present as an Islamic form to it actually has no existence in reality and has no legal authority in case of dispute.



The ruling of the Committee is that it is not allowed to deal with this company as their model contains clear and explicit interest. We advise those in charge of this company to review and correct their model and to fulfill the trust that has been put in them by those who wish to avoid interest in their financial dealings". (AMJA)

22. It's clear that the implication of AMJA fatwa is limited to the applicable contracts and procedures at the time of issuing the resolution. In case of any modification in the contracts or the procedures or existence of contracts and procedures that the committee has not seen, the fatwa does not apply. Accordingly, we clarify that the contracts and procedures that we base this report on shows the following:
- a) Shari'a procedures for partnership (Musharaka), agency (Wakala), buying, owning, sale and leasing of the product, and the documents that documented this procedures.
 - b) According to previous procedures, the full ownership of the title (Al-Raqabah) ends with the client, while the Haqul Manfaa (usufruct) is rented to the client during financing period.
 - c) A mortgage lien is perfected in the name of LARIBA on the title (Al-Raqabah) aiming to guarantee the payment of LARIBA share in the title (Al-Raqabah) and usufruct (Haqul Manfaa). For documenting the mortgage, Federal and State legal documents are being used.
 - d) In the event of legal dispute, the mentioned legal documents will be sufficient from the Shari'a point of view to protect both parties' rights.
 - e) The use of terminologies such as loan, interest and late payment fees in mortgage lien document doesn't reflect the actual financing process as shown in product's procedures and documentations.
23. It's clear that the committee was not able to survey the relationship between Islamic finance companies in the US market and the federal institutions such as "Freddie Mac" and "Fannie Mae". In this regard, LARIBA had found an acceptable way from the Shari'a point of view to deal with the federal institutions. This was is described by the federal institutions engaging with the available financing transactions for Islamic finance companies as an investor, either through paying the full amount of funding or though participating with LARIBA in funding. In all cases, follow-up of debt service and debt collection will be with LARIBA that has executed the contract with the client according to Shari'a procedures and documentations which was included in this report.

Discussion Outcome:

24. Shari'a procedures and documents which is the basis of this report represents the applicable and actual model, not a virtual one.



25. The conventional mortgage documentation is not the base documentation for the model. It is a documentation for indebtedness initiated by the Shari'a compliant procedures and documents.
26. The arbitration in the case of dispute based on the traditional mortgage lien does not lead to any Shari'a violations, because what was mentioned in it as a loan and interests represent the title (Al-Raqabah) and usufruct (Haqul Manfaa) according to Shari'a documents. Also, what is mentioned in it as late payment fees represents a permissible penalty as a commitment of obligated donation to a third party which mentioned in the documents.
27. The relationship with "Freddie Mac" and "Fannie Mae" does not include sale of debt.
28. Based on the above, the committee resolution does not apply concerning LARIBA Residential Financing product.

Shari'a References

29. Al-Kafi fi Al-Fiqh, Ibn Qudamah al-Maqdissi – Sale Chapter, Exemption Section.
30. Decisions of Islamic Jurisprudence academies in relation.
31. Shari'a Standards for Islamic Financial Institutions (SSIFIs) issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAIOFI).
32. Al-Baraka Shari'a opinions (Fatwa)

Management's responsibility for Shari'a compliance

33. The Management is responsible for the design and implementation of LARIBA Residential Property Financing Model in compliance with Shari'a rules, and it is responsible as well for the design and implementation of the system of Internal Shari'a control as it deems necessary to ensure that the design and implementation of LARIBA Residential Property Financing Model are in compliance with Shari'a rules.

Shari'a auditor's responsibility

34. Our responsibility is to express an opinion whether the procedures and documentations of the Product originally approved on December 31, 2014 are in compliance with Shari'a rules, as described above in the Shari'a references paragraph, based on our audit.

We conducted our audit in accordance with Governance Standards for Islamic Financial Institutions (GSIFIs) issued by Accounting and Auditing Organization for Islamic Financial institutions (AAOIFI) and in accordance with International Standards on Assurance Engagements No. 3000 (ISAE 3000) issued by International Auditing and Assurance Standards Board (IAASB) concerning



“assurance engagements other than audits or reviews of historical financial information”. Those standards require that we comply with ethical requirements of profession and plan and perform the audit to obtain reasonable assurance whether the approved product's procedures and documents are in compliance with Shari'a rules.

35. Auditing involves performing procedures to obtain audit evidence about the continued compliance of the product's procedures and documentations, originally approved on December 31, 2014, with Shari'a rules. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

36. In our opinion, the design of product's procedures and documentations, originally approved on December 31, 2014, is in compliance with Shari'a rules in accordance with Shari'a standards for Islamic financial Institutions (SSIFIs) that is issued by Shari'a Board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the decisions of Islamic academies and the relevant jurisprudence seminars and other details in the Shari'a references paragraph of this report.

Other

37. The opinion concerning LARIBA's product for Residential Property Financing was issued on December 31, 2014. We are reissuing the opinion in this report for additional Shari'a and technical clarifications of the product and there is no amendment on our opinion issued on December 31, 2014.

May the peace, mercy and blessings of Allah be with you all.

North Carolina March 15, 2016



Dr. Abdulbari Mashal
Chairman, Raqaba Group