

SAN FRANCISCO

Daily Journal

Serving the Bay Area
Legal Community
Since 1893

Wednesday, October 29, 2003

CLEAN INVESTING



S. TODD ROGERS/Daily Journal

JOAN STORY — “I’m translating the way we do business in the U.S. and the way these Shariah structures are done.”

By Erik Cummins
Daily Journal Staff Writer

Muslims invest billions of dollars around the world, some of it in the West.

Some of them do so with at least one major caveat: they cannot pay or receive interest on their investments.

In the U.S., where interest-based financing is the foundation of the real estate and business worlds, that religious prohibition prevents some Muslims from participating in such common transactions as borrowing money from a bank to buy a house or a car.

“You can lose a large degree of financial flexibility,” said Cyrus Sanai, a

Pious Muslims Find Creative Ways to Avoid Paying or Receiving Interest as Part of Their Business Deals

lawyer with Jeffer, Mangels, Butler & Mamaro in Los Angeles.

Not all Muslims believe borrowing or lending money is a sin; as many as half of all Muslim investments in the U.S. are done with interest-based financing, according to Joan Story, a partner with Sheppard, Mullin, Richter & Hampton in San Francisco.

Story caters to the other half, helping Muslims invest within the limits of strict interpretations of Shariah, the Islamic code of conduct that regulates the daily lives of millions. Those interpretations prohibit almost all forms of interest, with some minor and pragmatic exceptions such as borrowing money to feed one’s family.

“Until the mid-1990s, there was almost no Shariah-compliant investing

■ INVEST: Sharing Risk Is More Acceptable

in the U.S.," Story said.

In recent years, Muslims have looked for investment opportunities outside the Middle East and other Muslim regions.

"There's also an increased interest in religion and religious compliance, and a development of much more sophisticated investments," she said.

Muslims invest an estimated \$100 billion in Shariah-compliant deals worldwide, Story said. U.S. investment advisers are eager to tap into that wealth.

Story began crafting Shariah-compliant real-estate deals for Muslim institutional investors in the early 1980s.

Although it remains a small portion of her practice, Story has developed a sub-specialty helping Muslims invest in U.S. real estate. She often acts as an intermediary between her Muslim clients and U.S. investment advisers.

"I'm translating the way we do business in the U.S. and the way these Shariah structures are done," she said. "A lot of it is an education process for the U.S. parties involved in the transaction."

Story cautions that she is not herself an expert in Islamic theology, which has many interpretations.

"I certainly don't hold myself out as an Islamic scholar — I'm not," she said. "I've just dealt with Arab clients for much of my career."

Shariah, which is based on the Quran, encourages commerce and free enterprise but prohibits the earning of illegitimate profits in the form of *riba*, according to "Introduction to Islam," by DePaul University College of Law professor M. Cherif Bassiouni.

Some Muslims interpret *riba* as usury. Those Muslims can borrow and lend money legitimately, as long as the interest is not excessive.

One verse in the Quran notes, "O believers, take not doubled or redoubled interest, and fear God so that you may prosper."

Others believe the prohibition of *riba* means they cannot make money from money itself. In other words, they can't borrow or lend money in the traditional Western way.

"Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil ...," the Quran says.

Story said the Quran generally encourages Muslims to share risk with other investors for the benefit of the community at large.

"There's a perception in a loan situation that a lender is not sharing that risk, that there's not an equal relationship," she said.

"Cheating in that sense is between you and your god," she said. "You're dealing with whether there will be salvation or not."

"By collecting a predetermined, fixed interest, the Muslim neither earns a profit from his work nor shares in risk of his capital. Speculation is prohibited, as is undue profiting from the need or misery of others," Bassiouni wrote.

The rules do not prohibit investments in mutual funds or special trusts, where the investor "bears the burden of potential loss," he continued.

"In fact, there exists in Islamic law a form of contract called *muqaradah*. Here a person entrusts capital to another person for commercial investment. The risk-taking element justifies the profits, which are neither fixed nor predetermined."

It helps to hire a lawyer who is familiar with doing Muslim deals in the U.S., said Sanai, "just so you don't do anything stupid such as characterizing any part of a lease payment as an interest component."

Story has helped Shariah-compliant Muslims take part in at least two types of real estate transactions common in the West.

The first involves a master lease, in which an investor takes a lease on a building and then subleases it to other tenants. Money can be made over the life of the lease as rents rise and costs are kept down.

In the second, investors pool their money with banks or other like-minded investors in limited partnerships, again hoping to profit from rising lease rates and real estate values in the buildings they buy and develop. These deals frequently involve investments in apartment buildings, subdivisions, assisted-living facilities and manufacturing plants.

In the late 1980s and early 1990s, banks regularly invested money in deals with Muslim and non-Muslim investors to buy and develop real estate.

"It comes in cycles," said Barry Lee, managing partner of Steefel, Levitt & Weiss in San Francisco. "A lot of banks got in financial distress because of that. They were owners of empty buildings in Houston."

In addition, Muslims have to be careful their partnerships don't venture into activities prohibited by some interpretations of the Quran, according to Story. A shopping center can't lease space to a grocery store that sells pork or alcohol, for instance. Gambling and pornography are definite no-nos. Many Christians have similar views.

Shariah-compliant deals have long been common in the Middle East, Story said.

"Now they're exporting them to the rest of the world. But we're still speaking about a tiny piece of the market," she said.

Muslim investing is more common in the United Kingdom than the U.S., said Brian Donnelly, a partner at Farella, Braun & Martel in San Francisco. Likewise, the Japanese often are willing to structure no-interest deals, according to Sanai, who dealt with Shariah-compliant investments in Japanese trading houses.

It isn't that Shariah-compliant commercial transactions are more complicated than other U.S. deals. It's just harder to sell them to wary U.S. investors and bankers than in the U.K. or Japan.

"You have to educate the potential buyer or additional investors," Lee said. "I'm sure there are investors who would rather put their money in vehicles they're more familiar with."

That said, Muslims who lease office buildings and other structures can make money here, Donnelly said.

"People lease property all around town and are successful at it," he said.

Unlike commercial investors, Shariah-compliant consumers can have a much more difficult time investing in the U.S., which favors interest-based lending. That's because homebuyers who adhere to the more traditional views of *riba* can't borrow money or take interest deductions on their taxes as other homebuyers do.

"As you have more observant Muslims moving in to the U.S., buying houses becomes an issue," Story said.

Some U.S. banks accommodate Muslim consumers by buying their homes and then leasing them back to them, with an option to buy them at the end of the lease.

"You have to have someone else go out and buy the property. You're paying rent instead of interest," Donnelly said.

For that and other reasons, Sanai hasn't seen the same kind of demand for Islamic finance among Muslims in the U.S. as he finds elsewhere.

"It's unclear to me how many American Muslims hold that interest is bad," he said. "There isn't a consensus within Islam. ... There isn't a dictionary from the prophet's time defining what *riba* meant."

Or perhaps Shariah-compliant deals happen all the time in the U.S. Some transactions, such as joint ventures, are so common that their religious connotations are opaque, Sanai said. Those investors simply tell their lawyers they want to do certain kinds of deals, without mentioning they want to do those deals because they are Shariah-compliant.

"A sophisticated Muslim businessman might say, 'I don't want to disclose this,'" Sanai said. "In many ways, it might be disrespectful to ask."