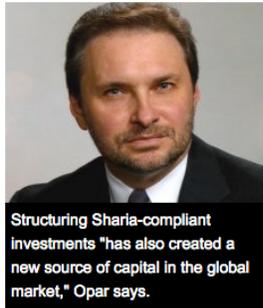


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## Sharia and Real Estate: Investing on Principles



Structuring Sharia-compliant investments "has also created a new source of capital in the global market," Opar says.

**NEW YORK CITY**—CBRE recently reported that Middle Eastern investors are expected to spend an estimated \$15 billion per year on commercial real estate globally in the near term, with an increasing share of that outflow coming to the US. It's reasonable to assume that a good number of investors from the region, although not necessarily all, will be Muslim, and that a good number of Muslim investors will abide by the principles of Sharia.

In years past, adherence to Sharia and investing in real estate might have been incompatible, but over the past 15 years it has become more common. The ability to structure investments in accordance with the Sharia "has opened up the global market to a new group of investors," **John Opar**, a partner at **Shearman & Sterling LLP** and a specialist in Sharia-compliant transactions, tells GlobeSt.com.

"These are investors who have the wherewithal to invest across the globe and want to be able to do so in accordance with their religious principles," he continues. "Being able to facilitate the structuring of these investments has opened up the market for individuals and compliant companies (such as takaful companies, providing compliant insurance products) as well. It has also created a new source of capital in the global market that people are able to access."

**Opar** says that the earliest Sharia-compliant forays into US CRE, dating back about two decades, took the form of investment in parking garages. At the time this was considered the most straightforward and uncomplicated asset class, in that the garages' intended use—to park cars—did not conflict with Sharia in the way that investing in a hotel, which likely would have a bar or a restaurant with a liquor license on the premises, probably would.

The turning point for such investments, he says, was the 1998 issuance of a fatwa for Dow Jones Islamic Market Indexes, which spelled out how equity securities could or could not be considered Sharia-compliant. "That fatwa, which was really focused on creating an index for the stock market for compliant investment, opened up Islamic investment generally by essentially recognizing principles that were probably implicit before but not explicit," **Opar** says.

One of those principles was "the recognition that there is some permissible degree of impurity, that there are very few investments, if any, that would comply 100% with Sharia. You probably can't think of a company that has no interest rate receivables, or interest-bearing bank accounts, or some other non-compliant activity. So the Dow Jones fatwa recognized that a degree of impurity was

permissible, and established ranges for what was permissible. It also established the concept of cleansing or purifying, such that by appropriate treatment of tainted income—through charitable donations, for instance—one could cleanse an investment."

Accordingly, the DJIMI fatwa, "while strictly applicable to the stock market, opened up investment generally, including US real estate," **Opar** says. "Since then, there has just been steady growth."

Islamic investors' initial emphasis on parking garages soon gave way to "the recognition that multifamily housing was a more attractive, and probably better earning, target class," says **Opar**. "There are investors who have made office and industrial investments, principally single-tenant assets where they can control the activity onsite and the degree of impurity within the onsite activity."

Some asset classes give compliant investors more pause than others. "There are investors who won't do retail," **Opar** says. "Hospitality is probably the furthest point along that spectrum of comfortable investment, and one where investors tend to shy away if they're compliant." There are also, he says, "differences of opinion" among individual compliant investors on matters such as how much leverage is permissible.

With 1.6 billion practicing Muslims around the globe, Sharia-compliant investment can and does occur outside the Gulf region. Aside from Malaysia, which pioneered the sukuk, or Islamic bond, "there are large populations of compliant investors to Pakistan, India, Indonesia and Singapore," says **Opar**. "Not all of those countries are looking outward to the same extent. In Pakistan we do a great deal of compliant investment work in infrastructure, but that is inbound to Pakistan. You don't see the government or private wealth flowing out of Pakistan that you do with some of the Gulf countries. But there is certainly the potential for additional compliant investment from South Asia."

Even within the US, he says, there are differences. "A number of compliant products, especially consumer products, really originated in the Michigan area, where there's a large Muslim population. The first compliant home mortgage loans, which were done as musharakahs, were developed by finance companies in the Detroit area."

**Opar**, who has advised on a number of large-scale Sharia-compliant transactions across most of the major property sectors, finds the US real estate community "receptive, generally, to this type of investment activity. We've gone up the learning curve significantly from where we were 15 years ago."

He adds, however, that "you still see pockets of not confusion, but lack of familiarity. I did a deal a few years ago with a local bank which wanted me to issue an opinion that its interest-based loan was Sharia-compliant. I just scratched my head; obviously, I didn't do the job of educating them perhaps as well as I thought. They didn't fully grasp the principles, but I believe they're more the exception rather than the norm these days."