Soliev Jasurbek Abdujabbor ugli
The student of Namangan State University

DIMINISHING MUSHARAKAH: AN ALTERNATIVE WAY OF HOME FINANCING TO MORTGAGE LOANS IN ISLAMIC FINANCE

DOI: https://doi.org/10.5281/zenodo.10807619

Annotation. Buying a house on the basis of diminishing musharakah is a concept commonly used in Islamic finance. Diminishing musharakah is a form of partnership where a bank and an individual purchase a property together based on joint ownership. The individual gradually buys out the bank's share in the property while also paying rent on the portion owned by the bank. This method allows individuals to purchase a property without taking an interest-based loan, which is prohibited in Islamic finance. Instead, the bank and the individual share the risks and rewards of property ownership until the individual becomes the sole owner.

Keywords: Islamic finance, Musharakah, Mortgage, Credit, Capitalistic economy, Diminishing Musharakah, Real estate, Lease, Shirkat-ul-Milk, Investor, Interest.

Introduction: It is pertinent at the outset to understand the true nature and meaning of the Musharakah before moving to the diminishing form. The term "Musharakah" comes from Arabic and means to partner or collaborate, indicating joint ownership derived from the term "*shirkah*". [2] If we look at it from a trade standpoint, musharakah is also described as shared ownership between two or more parties. This financial method is widely used today and is considered the best alternative in Islamic finance compared to interest-based financing. Although interest-based loans are commonly used in our current capitalistic economy, they are not allowed in Islam due to the prohibition of riba (usury). That's why this method cannot be used as a means of investment in Islam. Because of these reasons, musharakah, which is based on Islamic principles, plays a significant role in the Islamic economic system.

Nowadays, buying a home or similar essential properties with cash has become quite challenging for many people. Therefore, currently, the trend in purchasing homes and similar necessary assets is not with cash but involves paying for them in installments, which has gained widespread popularity. In Islamic finance, to meet this need of individuals, there exists a developed type of partnership called "Diminishing Musharakah," which has evolved in recent times.

Methods: This article delves into Musharakah that has been one of the financial instruments of Islamic finance, considering it as an alternative to conventional mortgage loans, with a focus on Sharia principles and without exceeding its limits.

Results and discussion: Diminishing Musharakah involves an Islamic bank, acting as a financing party, gradually transferring ownership of a specific asset (such as real estate or an investment project) to the ultimate owner (customer). [1] While focusing on the essence of Diminishing Musharakah, it includes a financial institution and its customer jointly owning a particular property or engaging in a joint ownership in a specific trade. In this arrangement, the property is divided into several portions, and the customer gradually purchases these portions individually over a specified period. After some time, the customer becomes the sole owner of all portions, making complete payment to acquire full ownership. Diminishing Musharakah is applied in various financial relationships based on this model. Now, Let us consider this form of Musharakah in the context of buying a house for financing:

Diminishing Musharakah consists of the following contractual transactions:

1. To create joint ownership in the property (Shirkat-ul-Milk).
2. Giving the share of the financier to the client on rent.
3. Promise from the client to purchase the units of share of the financier.
4. Actual purchase of the units at different stages.
5. Adjustment of the rental according to the remaining share of the financier in the property. [3]

Let's delve into the contractual transactions mentioned above:

a) The first of the mentioned contractual transactions is the formation of joint ownership. Establishing ownership together is possible through various means, particularly through jointly purchasing the property. All major schools of law in Islam find this form of partnership permissible. In this type of ownership, there is nothing wrong.

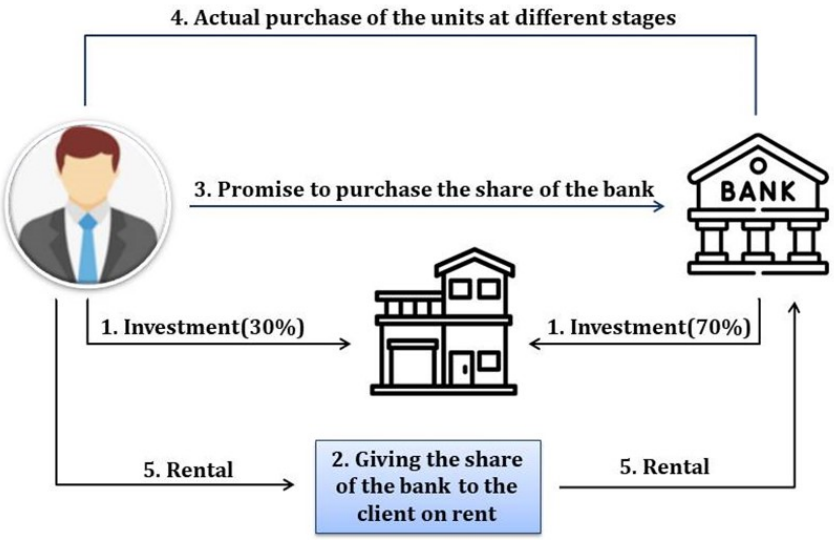
b) The second part of the arrangement is that the financier leases his share in the house to his client and charges rent from him.This arrangement is also above board because there is no difference of opinion among the Muslim jurists in the permissibility of leasing one's undivided share in a property to his partner. If the undivided share is leased out to a third party its permissibility is a point of difference between the Muslim jurists. Imam Abu Hanifah and Imam Zufar are of the view that the undivided share cannot be leased out to a third party, while Imam Malik and Imam Shafi'i, Abu Yusuf and Muhammad Ibn Hasan hold that the undivided share can be leased out to any person. But so far as the property is leased to the partner himself, all of them are unanimous on the validity of 'ijarah'. [3]

c) In the third step of the contractual transactions, the customer purchases the shares of the financial institution in the jointly acquired property in several parts during agreed-upon intervals, and this type of transaction is permissible without any disagreement. Disagreement, however, arises when it comes to selling these indivisible shares to a third party.

d) When a customer purchases the shares of the financial institution in the jointly acquired property, undoubtedly, their share in the property also increases accordingly. Consequently, the portion for which they receive rental payments also decreases proportionally. It is preferable for the customer to buy the shares at a price based on the market value in that specific trade area. However, indicating the price agreed upon during the purchase is also acceptable.

Indeed, all the mentioned relationships

DIMINISHING MUSHARAKAH



are lawful, and according to a specific rule in Islamic shariah, if all these transactions have been combined by making each one of them a condition to the other, then this is not allowed in Shariah, because it is a well settled rule in the Islamic legal system. [3] Therefore, to avoid this, the customer, in the first instance, engages in leasing the indivisible property and pays rent accordingly. In the second instance, the customer enters into a separate agreement to purchase the shares of the financial institution in portions. This ensures that the conditions of each relationship are clearly defined without being contingent on one another.

Now, if we illustrate the previously emphasized relationships with a practical example: someone desires to buy a house but lacks sufficient funds, so they approach an investor ready to finance. The house's price is divided into 30% for the customer and 70% for the investor, establishing a partnership basis. Consequently, the customer owns 30% of the house, and the remaining 70% is under the investor's ownership. After acquiring the indivisible property through this joint ownership, the investor leases their share to the customer. When the customer moves in, they utilize the home for residential purposes and pay rent. Simultaneously, the investor's share in the indivisible property is divided into seven parts, each representing 10%. Both parties agree to sell each part every three months. At the end of the first three months, the customer purchases 10% of the investor's share. Subsequently, the investor's share decreases from 70% to 60%, and the rent payable by the customer also decreases proportionally. In the second round, after three more months, the customer buys another 10%, bringing their ownership to 50%, while the investor's share drops to 50%, and they continue to receive rent for that portion. This process continues in the same order until the customer acquires all of the investor's shares.

Conclusion: This agreement allows the investor to generate income through rent and, in addition, enables them to reclaim their investment by gradually selling portions of their shares to the customer. Diminishing Musharakah emerges as a compelling alternative to traditional mortgage loans within the framework of Islamic finance. This financial arrangement embodies principles of shared ownership and gradual acquisition, allowing individuals to purchase a property without resorting to interest-based loans. The unique feature of Diminishing Musharakah lies in the diminishing co-ownership, where the customer gradually buys out the financial institution's shares until full ownership is achieved. This not only aligns with Islamic principles but also provides a practical and ethical avenue for individuals to realize their homeownership aspirations while avoiding the pitfalls of conventional interest-based financing.

References

1. E.A. Baydaulet Fundamentals of Islamic Finance" translation by Botyrhoja Joraev,Uzbekistan 2019

2. https://islommoliyasi.uz/uz/kamayib-boruvchi-mushoraka-uy-joy/

3. Usmani, M. M. T. (2021). An introduction to Islamic finance (Vol. 20). Brill.