

CIFE08, 09: UNDERSTANDING IJARAH – ISLAMIC LEASING

What is an Islamic lease? This module helps you find out. We introduce Ijarah, the Islamic lease, and look at the prerequisites for their execution, legal title, possession, maintenance, earnest money, default, and insurance. We begin answering the question "How does an Ijarah work?" with step-by-step practical explanations. You learn the rights and obligations of the lessor and the lessee and focus on defective assets, sub-leases, extensions and renewals, transfer of ownership, and termination.



Ijarah is the lease of a specific asset or service to a client for an agreed period of time in exchange for rent which at the end of the lease period may result in transferring the subject matter's ownership to the lessee.

Types of Ijarah

- Ijarah tul Aamaal
- Ijarah tul Manafaay

Ijarah tul Aamaal:

A lease contract providing services in exchange for agreed rent. For instance, the services of a lawyer purchased by a client in return for a fee.

Ijarah tul Manafaay:

A lease contract executed to transfer the benefits of an asset in exchange for an agreed price. For instance, an apartment leased for a year in exchange for a monthly rent. A part of the year's rent may

be paid in advance and the remainder be paid as monthly installments, mutually agreed upon between the lessor and lessee.

Usufruct lease categorized as:

- *Specific Asset Lease:* A particular asset. For instance, a car identified by the lessee, a red fully loaded, automatic sedan.
- *Lease of asset based on specifications:* An asset not specifically identified by the lessee but one required to meet certain conditions. For instance any sedan.

Ijarah classification based on transfer of ownership to lessee

Standard Ijarah

A lease contract where the lessee benefits from the asset for a specific time period but it does not result in the eventual transfer of ownership of the asset to the lessee.

Ijarah wa Iqtina

A lease contract conducted solely to transfer ownership of the leased asset to the lessee at the end of the lease period.

Ijarah prerequisites

The client and lessor enter into a promise to execute an Ijarah for the usufruct of a particular asset or service. The institution undertakes to provide the asset or service and the client undertakes to enter into a lease contract for it. The asset or service must be owned by the lessor and made available to the lessee before the Ijarah commences. The lease period commences once the subject matter of the lease is made available to the lessee.

Ijarah - Key Elements

Subject Matter

All Shariah-compliant assets or services may be used as Ijarah subject matter.

Legal Title

Generally the lessor owns the leased asset and it should be in his name however for regulatory reasons the asset may be registered in the lessee's name.

Possession

Ijarah may only be executed for subject matter the lessor owns and possesses.

Maintenance

Periodic Maintenance: The lessee is responsible for regular maintenance of the leased asset.

Major Maintenance: The lessor is responsible to meet all requirements to ensure the leased asset continues to provide intended use.

Earnest Money

A sum of money the lessee deposits with the lessor. The lessor maintains it as compensation for actual loss in case the client goes back on his word about executing an Ijarah. If the client fulfills his undertaking to lease and enters into an Ijarah contract, the lessor returns him the earnest money.

Insurance

The Ijarah asset can be insured by means of Shariah-compliant Takaful insurance.

Ijarah Rent and Remuneration

Rent

1. Rent must be clearly defined, it may in the form of cash or kind or an asset's usufruct.
2. Different rentals may be established for different periods.
3. Rent for the initial Ijarah period must be established and received in advance from the lessee and rent for the remaining period may be linked to a well known benchmark.
4. Rent begins to accrue as soon as the subject matter of the lease is made available to the lessee.

Remuneration

Remuneration for a service is established in relation to time.

Default in Ijarah

Default in an Ijarah is a failure on the lessee's part to make a rental payment.

If the lessee defaults on lease payments, the lessor may reclaim the asset or grant him respite until his financial condition improves.

Lessor's Rights and Obligations

Lessor's Obligations

1. Lessor bears all the risks associated with the leased asset during the lease term.
2. Lessor takes care of major maintenance expenses and insurance costs. The lessor may include insurance costs at the time rentals are determined however once rentals are established, they

may not be adjusted to accommodate a change in expenses. Lessor may appoint client as agent to deal with the insurance company.

3. The lessor is obliged to deliver the asset and all associated leased items necessary to transfer usufruct to the lessee. The lessor must rectify any problem that prevents the lessee from utilizing the usufruct.

Lessor's Rights

1. In case the lessee defaults on lease payments, the lessor is within his rights to reclaim the leased asset or grant respite for a time. He may also charge a late payment fee which includes administrative charges that belong to the lessor and a late payment penalty that is given to a designated charity.
2. In case of excessive damage to the leased asset, the lessor may rescind the Ijarah.
3. The lessor may contract an Ijarah with more than one lessee for the same asset for different time periods.
4. The lessor may rescind the contract if he becomes aware of the lessee's intent to use the Ijarah asset for unlawful purposes.

Lessee's Rights and Obligations

Lessee's Obligations

1. Lessee must utilize the Ijarah asset according to customary practice by which similar assets are used. He must take necessary measures to preserve it from damage or defect and benefit from the usufruct as provided in the contract and not in any way beyond its scope.
2. The lessee is obliged to pay rentals once the Ijarah's subject matter is made accessible to him. If the Ijarah asset is available to the lessee only for a part of the contract's duration, the lessee is not obliged to pay rentals for the period the usufruct is not at his disposal.

Lessee's Rights

1. The lessee is within his rights to rescind the Ijarah contract if the lessor refuses to repair the Ijarah asset's defects that occur after the contract date or exist on the contract date unbeknownst to the lessee.

Sublease

The lessee may sublease the Ijarah asset to a third party with the lessor's consent.

Ijarah Renewal

The Ijarah may be extended when it reaches maturity if the lessee still wants to continue benefiting from it. A new Ijarah is not required.

Transfer of Ijarah Asset Ownership

In order to transfer the Ijarah asset's ownership to the lessee at the end of the lease term, a separate document independent of the original Ijarah contract is prepared. In this document the lessee undertakes to purchase the Ijarah asset at the end of the Ijarah period for a mutually agreed amount at the time of Ijarah contract execution.

The price may be the actual cost of the leased asset or any other nominal value. Alternatively the lessor may gift the leased asset to the lessee at the end of the Ijarah period.

In some cases, with the lessor's consent, the lessee may even purchase the asset during the lease period by making complete payment of rentals due or paying for the market value of the asset at the time. The asset is sold to the client at the end of the lease period based on a separate sale contract that represents the transfer of ownership.

Negligence in Ijarah

Negligence is the loss that results from the violation of contract conditions.

If the Ijarah asset is damaged as a result of the lessee's negligence, he must bear repair expenses. However the lessee is not liable for rent for the period the asset remains out of use.

Ijarah Termination

The Ijarah is terminated:

- Based on contractual terms
- One of the party's rescission
- Due to the theft or destruction of the Ijarah asset's usufruct.

As a general rule, contracts cannot be terminated unilaterally but only by mutual consent, however there are some conditions as a result of which contracts are automatically terminated:

1. If the lessee fails to meet lease terms
2. If the lessee loses his sanity during the lease period
3. In case of the lessee's death

Lessee can terminate the Ijarah:

If the Ijarah asset contains or develops defects. He may return the asset to the lessor and demand compensation for the period of defect. The lessee may not rescind the contract if the defect does not hinder usufruct utilization or the lessor ensures its immediate replacement.

Remember that the lessee can exercise rights of rescission in an Ijarah of a specific asset only.