Islamic Finance news Supplements
April 2013

Europe and the US: A little less conversation...

Features

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The offshore centers of America and Europe

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Greener Pastures

Although the economic situation in Europe and America seem to be abating, it is still teetering on precariousness. As policies are being revamped and discussion after discussion mulled over; other methods such as investments into alternative asset classes and attracting cold hard cash from Asia and the Middle East are becoming increasingly popular.

In America, S&P, one of the largest index providers in the world, are still heavily promoting their Islamic indices, while wealthy Muslims; particularly in North America, are becoming more aware of the alternative investment tools and products available to them via Islamic finance and increasingly more academic institutions are beginning to recognize and absorb Islamic finance into their curriculum as the subject gains popularity. South America, a seemingly unassuming market, is also at the top of the list in terms of capitalizing on Islamic finance opportunities; with Brazil being the world's largest exporter of Halal food products to the GCC.

Europe, with its longstanding trade ties with the Middle East, has become a hotspot for real estate investments; particularly in the UK. Qatar, one of the wealthiest nations per capita, has become increasingly active in terms of property acquisitions and investments in the UK, while the two governments seek bilateral investment opportunities. The growing number of Muslims in Europe; especially in France and the UK also signal opportunities for the growth of Islamic finance retail and investment products.

In this issue of Islamic Finance *news* Supplements, we explore the available opportunities in Europe and the Americas and speak to industry players on the potential of Islamic finance being a mainstay in the vast and complex markets of the west.

Nazneen Halim,
Editor

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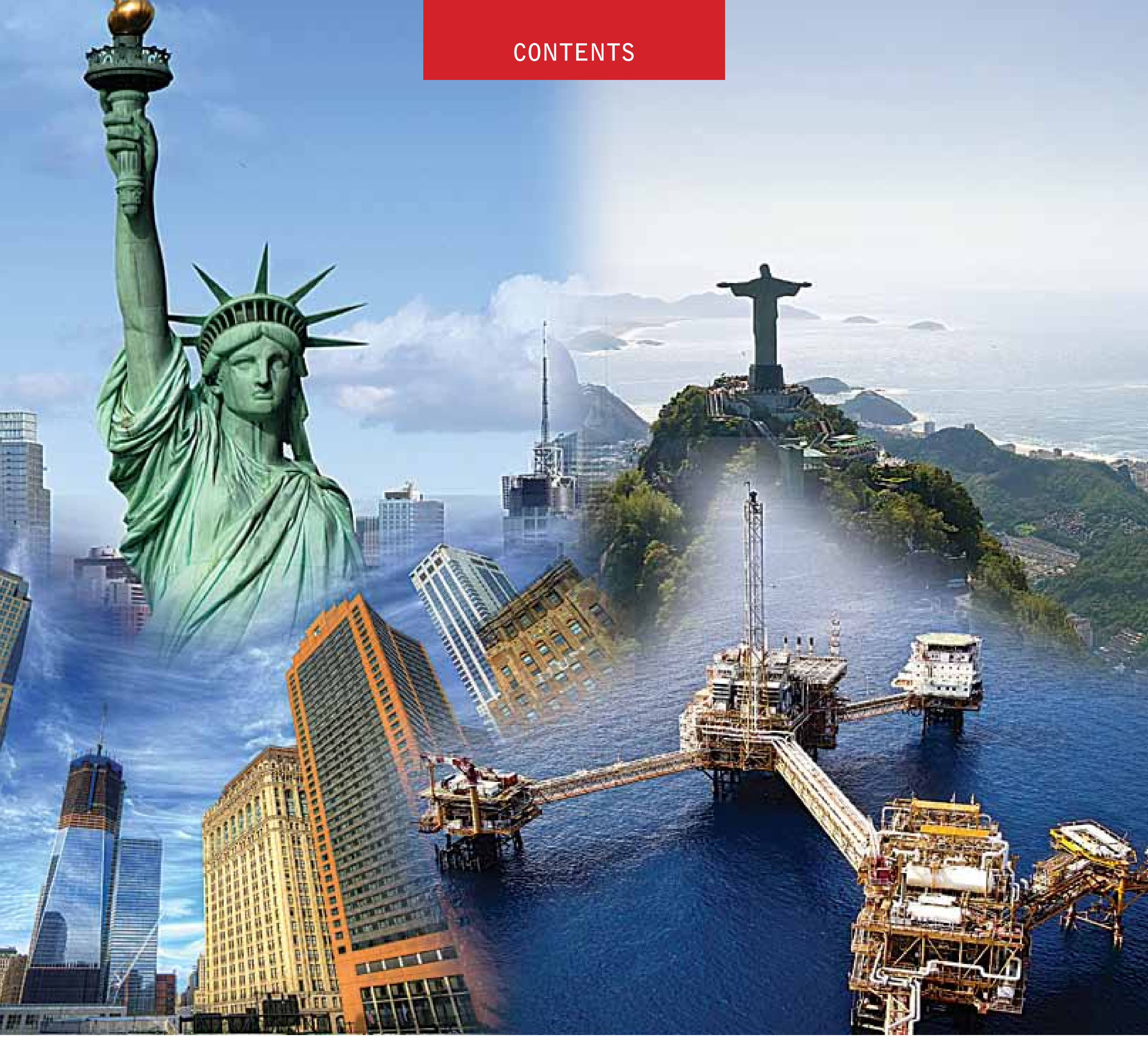


PIONEERING ISLAMIC ARBITRATION

There is now a set of arbitration rules that cater to both conventional and Shariah-compliant commercial transactions and agreements. The Islamic commerce and financing industry players may want to consider arbitration under the Kuala Lumpur Regional Centre for Arbitration (KLRCA) i-Arbitration Rules as an alternative route to their dispute resolution.

INTRODUCING KLRCA

KLRCA is a regional arbitration centre set up in 1978 by the Asian African Legal Consultative Organisation (AALCO) under a host country agreement with the Malaysian Government. Its primary role is to promote and facilitate international commercial arbitration and alternative dispute resolution in the Asia-Pacific region. It is a non-government, non-profit centre set up with as a mission with immunities and privileges under the International Organisations (Privileges and Immunities) Act, 1992. KLRCA provides administrative assistance to arbitration tribunals and parties to arbitral proceedings.

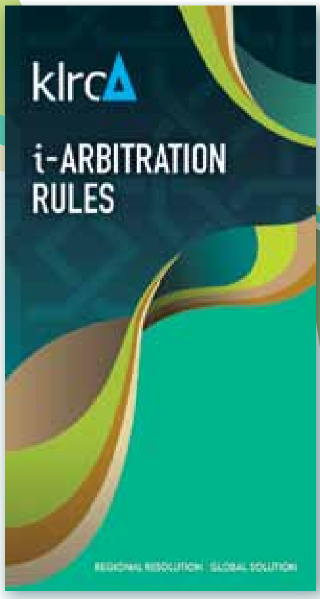
THE KLRCA i-ARBITRATION RULES: A GLOBAL SOLUTION

The sophistication and innovation of Islamic finance products and services have made the international business community more aware and receptive towards transactions and contracts that are based on Shariah principles. Their wide acceptance around the world has seen an increase in cross-border Shariah-based deals and agreements.

Arbitration is fast gaining popularity in the world as a way to settle business disputes, especially cross-border commercial disputes, outside the traditional court system. The attraction of arbitration lies in the privacy and confidentiality of the hearings as well as the international enforceability of the arbitral awards (similar to a court judgment or ruling), and the disputing parties' right to select an expert in the relevant field as an arbitrator.

With these factors in mind, KLRCA envisaged a need for an effective and an internationally enforceable set of arbitration rules suitable for Islamic commercial transactions.

The KLRCA i-Arbitration Rules ("The Rules") is a set of procedural rules that covers all aspects of the arbitration process that allows for the resolution of disputes arising from any commercial transactions that may contain Shariah components.



It is the first of its kind in the world to adopt the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, which ensures international recognition, while taking into account the need for reference to Shariah experts to define and determine the principles. This makes it the first set of arbitration rules that cater to both conventional and Shariah-compliant commercial transactions.

In addition, Malaysia is a signatory to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (often referred to as the New York Convention) which is the operating mechanism for enforcing international arbitration awards around the world. This means that the arbitral awards under the KLRCA i-Arbitration Rules would be enforceable in 148 countries that are also signatories to the Convention.

BACKGROUND TO THE KLRCA i-ARBITRATION RULES

Previously, KLRCA had introduced the 2007 KLRCA Rules for Islamic Banking and Financial Services Arbitration, which was restricted to domestic application in Malaysia and was specifically for transactions and business arrangements involving financial instruments and commodities.

With the globalisation and growth of Islamic financing and commercial transactions, the application of the Rules has been expanded for international commercial transactions in other sectors and industries. The Rules now allows parties to refer to a Shariah Advisory Council or Islamic experts of their choice to clarify on the Shariah principles involved.

WINNER OF
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The KLRCA i-Arbitration Rules recently won the prestigious Global Arbitration Review "Award for Innovation 2012"

For more information on KLRCA and the KLRCA i-Arbitration Rules, please visit
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klrca
REGIONAL RESOLUTION GLOBAL SOLUTION

A little less conversation…

As the world's most influential economies struggle to make sense of their current fiscal states, Islamic finance has been suggested as a viable alternative to encourage Asian and Middle Eastern liquidity into the system. NAZNEEN HALIM addresses the current state of play in Europe and the US.

In recent weeks, the UK government has announced the setting up of an 'Islamic Finance Task Force', a special group assigned to study the viability of introducing Islamic finance into the UK financial landscape and to work on mobilizing the country's much-anticipated sovereign Sukuk issuance. The task force, which on some levels is not dissimilar to the Malaysia International Islamic Financial Center, has also been created to attract more Islamic investments into the country, via the myriad of Middle Eastern investors who have become increasingly interested in investing in the UK.

The Qatar Investment Authority has already gained a solid foothold in the country, pumping in big bucks for the development of western Europe's tallest building, The Shard, as well as the acquisition of the Chelsea Barracks, Harrods and the London Olympic Village. Prime minister David Cameron is also actively pursuing Middle East investments into the country's energy sector. In March, the Department of Energy and Climate Change, a branch of the UK government, initiated a collaboration with The Green Deal Finance Company to come up with Islamic financing options to allow British Muslims to take advantage of the government's Green Deal initiative.

Catch-22

However, the recent set up of the UK Islamic Finance Task Force — co-chaired by financial secretary to the Treasury, Greg Clark; and senior minister of state at the Foreign & Commonwealth Office, Baroness Warsi, who is also the minister for faith and communities at the Department for Communities and Local

Government — could remain futile if liquidity issues are not addressed promptly. According to UK-based Islamic finance practitioners, Shariah compliant banks are at a “disadvantage” with regards to current liquidity rules and a lack of availability of liquid assets. However, the country’s lenders are facing a catch-22 situation as it is currently more cost effective for the government and Treasury to issue conventional bonds over Sukuk; further fueling their liquidity woes.

“The cost of funding via conventional sovereign bonds is still more advantageous than the cost of funding via Sukuk,” said Haissam Saleh, head of MENA treasury structuring and sales at Qatar Islamic Bank (UK) to Bloomberg. Speaking to the newswire, Liam Parker, a representative from the Bank of England said: “An allowance is made for Shariah compliant firms with regard to the instruments they are required to hold to meet their liquidity requirements, but not to the quantity of liquidity.”

Although it has been suggested that a highly-rated international organization such as the IDB issue a Sukuk in sterling pounds in order to create movement in the UK Islamic capital markets, there have been no official comments from the multilateral lender. At present, there are five UK-based Islamic banks: Gatehouse Bank, the Bank of London and the Middle East, European Islamic Investment Bank, Qatar Islamic Bank (UK) and the Islamic Bank of Britain (IBB). IBB recently reported a loss of GBP6.99 million (US$10.82 million) at the end of 2012; a GBP2.01 million (US$3.11 million) improvement on 2011 loss, while its total customer financing grew by 86% to GBP129 million, with home financing and retail deposits seeing a 92% and 22% surge respectively.

> “The cost of funding via conventional sovereign bonds is still more advantageous than the cost of funding via Sukuk”

Property prospects

Despite the current Eurozone crisis, the UK is also touted to be a strong market for real estate and property investments. There are several factors currently working in favor of the Shariah compliant real estate market in the UK including the search by investors for safe havens to park their money, a growing demand from the affluent Middle East market looking to explore opportunities outside the Middle East and an underdeveloped real estate and mortgage market with a myriad of untapped opportunities.

Naomi Heaton, the CEO of London Commercial Property, which launched the UK’s first Shariah compliant residential fund, elucidated: “As a whole, the UK property market has experienced little growth of late. Over the last year, property prices have slightly fallen in England and Wales by 0.68%. The UK property market is affected by domestic concerns: the level of employment, earnings and mortgage availability which are all under pressure in the current economic environment. However, our company, London Central Portfolio (LCP), and our residential property funds focus solely on the prime London central property market which is not correlated to the UK housing market or even Greater London as a whole. It benefits from international buyers who have little or no reliance on credit, making the market far more robust than the UK in general. London Central’s property prices were up 10% over the last year.”

Testament to growing interest in the UK property market; particularly in central London, was Takaful Malaysia’s recent foray into the London property market – the group’s first overseas investment. According to its group managing director, Mohamed Hassan Kamil: the depreciation of the sterling pound and a devalued market is what piqued the firm’s interest in the London property market.

Despite the ongoing Eurozone crisis, Heaton maintains that it has done little to deter international investments in London Central. She said: “From a short term perspective, it has probably done the opposite. In times of political and economic crisis and stock market volatility, investors retrench to blue-chip tangible assets – with London Central residential property being a favorite. Hence Eurozone investors have been turning to London to take advantage of its position as a safe haven asset class. This trend has been seen many times before, in recent times during the Arab Spring and the Russia Diaspora. It is interesting to see the very close correlation between the performance of prime London Central and gold in times of market volatility.”

According to Heaton, there have been fears that the UK Shariah compliant real estate has been over-weighted in the areas of student housing and the commercial property sectors; which has spurred the desire to explore the residential market primarily as a means of diversifying their investment portfolios. “It provides a way of re-balancing portfolios and providing investors access to one of the best performing asset classes in the UK. Our current investment profile, by value, shows that almost ¼ of our investment is from Muslims at 23.4%, with over ⅓ (34.6%) coming from outside the UK,” she said.

In terms of Islamic real estate investment trusts (REITs), the UK market is said to still be underdeveloped compared to the rest of the world, but industry players believe that the future is bright for this sector. Heaton said: “With 450,000 Muslim millionaires in the Middle East alone, Islamic investment options are becoming increasingly important on the world stage. It is also a sector in its infancy with only 765 Islamic mutual funds available globally, compared with some 60,000 in the conventional finance sector. We have definitely seen a growing demand for Shariah compliant funds amongst Muslim consumers both in the UK and abroad. We expect to see a growing demand for these forms of investment due to the benefits they can provide.”

America: The land of promise?

There is a growing affinity amongst Middle East and Asia-based issuers to issue RegS/144A paper in the market and it seems that this is currently the single greatest export from the US to the Islamic finance industry at present. Issuing 144A paper means that a Sukuk is on par with a bond in terms of disclosure and transparency. However, don't hold your breath in terms of waiting for a US government Sukuk, industry players say.

Circa 2005-06, the US treasury department had hired an Islamic finance expert, Professor Mahmoud Amin El Gamal from Rice University in Texas to provide the department with an overview on Islamic finance and also to familiarize themselves with Sukuk. However, all went quiet on the Islamic finance front and no other efforts have been made from a government standpoint, except in some pockets throughout the vast state. With US municipal finances under strain and local government budgets tightening, there was a call in 2011 made to introduce legislations that will facilitate Islamic product introduction. Kevin Parker, a senator whose Brooklyn constituency includes a large Pakistani community, hoped that by structuring US municipal bonds to be Shariah compliant, it would encourage Muslim investors into local government projects such as schools, hospitals and community centers.

However, industry-wide standards has yet to exist across US regulatory bodies and while the regulatory environment continues to remain relatively hostile, US federal banking regulators have little incentive to issue formal guidelines pertaining to Islamic products and services. The complex layering of federal and state laws further exacerbates the introduction of Shariah production into the conventional system. This uneven regulatory environment and limited knowledge of Islamic financial principles continue to hinder the further implementation, development and growth of the industry.

William Rutledge, the executive vice-president in charge of the Bank Supervision Group at the Federal Reserve Bank of New York, stated: "US regulators are open to Islamic financial products. Our mindset is to try and accommodate a variety of approaches to finance."

Formal guidance pertaining to Islamic products and services has been issued by US federal banking regulators in the past, in particular the Office of the Comptroller of the Currency, with regards to basic Ijarah and Murabahah products. However, several conditions were placed on the loans in relation to risk and legal entitlement, whereby they must conform to conventional banking standards in order to obtain approval.

Current US laws and regulations are not considered flexible enough to accommodate most aspects of commercially viable Islamic financial products without significant legislative changes. As a result, American domestic banking windows and mortgage brokers offering Shariah compliant products and services remain localized institutions catering to small concentrated Muslim communities.

Beyond funds

The Islamic finance sector in the US remains concentrated primarily in the mutual fund industry. With an estimated US$4 billion of assets under management, it represents the fastest-growing and most prominent Islamic financial product. Part of this success is its marketability to non-Muslim investors, attracted to the solid fund performance during the recent downturn and with increasing interest in socially responsible investments.

However, Tariq Al Rifai (*caricature*), executive director at Failaka Advisors, believes that there is a gap that exists on the financing side to encourage consumers to enter into the Islamic retail market. "Simply put, it is easier to give people money than to take their money — it is an easier sell. And there is huge demand for the financing of businesses, such as SMEs."

"The investment products that exist now, provided by Saturna Capital, Azzad, etc, are all equity funds and there is demand for that because people understand the product, but there is also demand for fixed-income and income-generating funds. In Malaysia for instance, you have Balanced Funds, Sukuk Funds, Islamic REITs; and REITs are very popular in America, and the market could do with an experienced REIT fund manager to come up with an Islamic REIT," he added.

When asked if Islamic REITs would be a wise choice in today's US property market, Tariq believes that the property market has stabilized: "The US is not having the same kind of trouble Europe is having. The US real estate bubble has popped; unlike China, Canada and Europe."

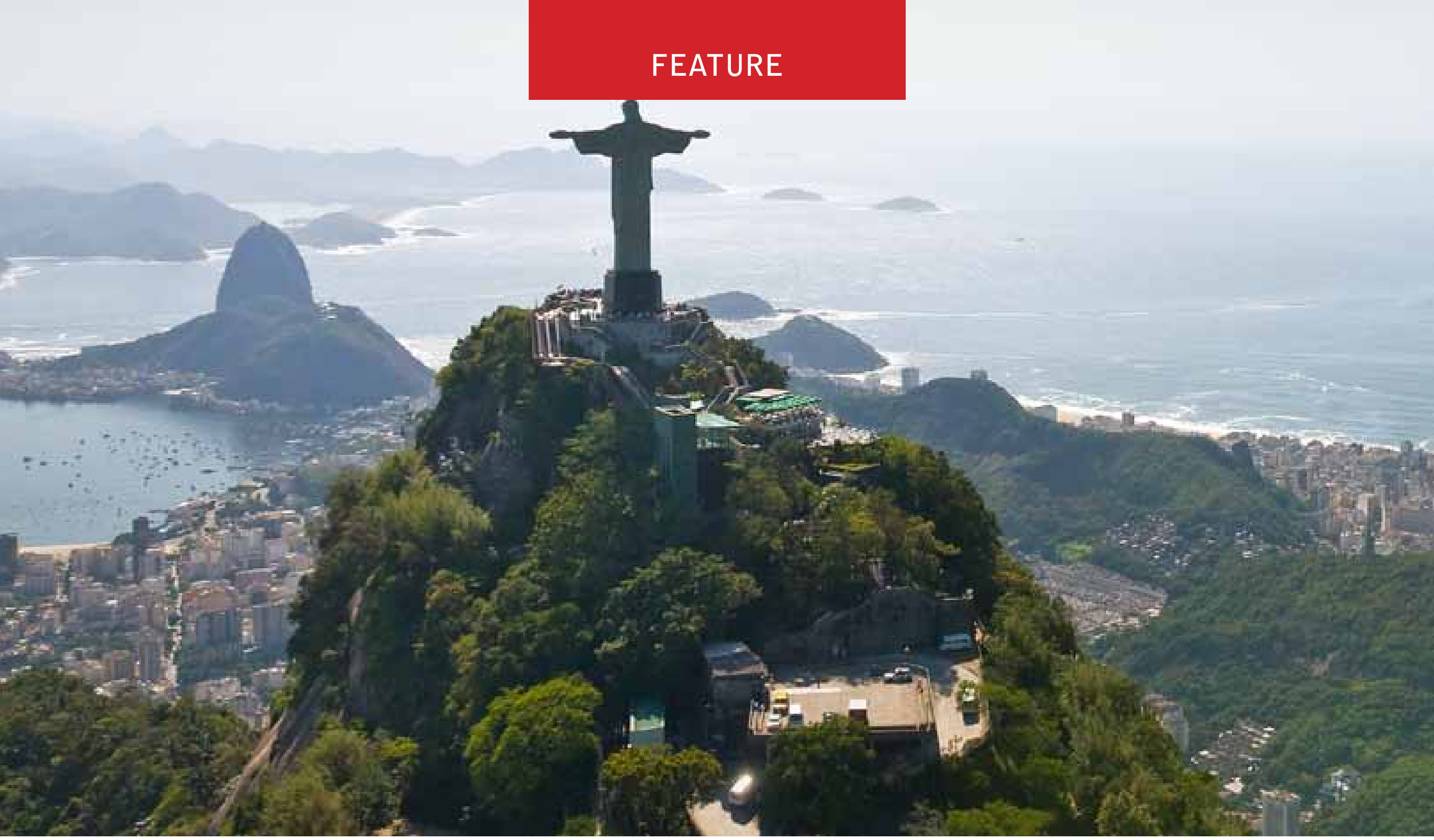
Tariq, who helped to set up the Amanah outfit for HSBC in New York in 2004, says there is much potential for the Takaful market to flourish in the US: "America is one of the largest markets for insurance in the world. There will be demand for investment products such as Auto Takaful and Life Takaful. If this sector were to grow in tandem with the US insurance market, there is no doubt that Takaful in America will be bigger than in the GCC."

Long way to go

Although the UK has made significant traction in its bid to become Europe's center for Islamic finance outdoing its other European counterparts such as Ireland, France and Luxembourg; there are still gaping holes in the country's financial and regulatory systems that need to be addressed — such as the issue of liquidity and the creation of an Islamic interbank money market.

Despite several discussions and attempts at creating an Islamic financial system; the US is still far from fulfilling its potential. Mortgage lenders such as LARIBA and Devon Bank, which have demonstrated impressive staying power in the market are still few and far between.

Perhaps it is time for a little less conversation and a little more action; please.



Brazil: The next bastion of Islamic finance?

As one of the four BRIC emerging markets and its position as one of the world's largest exporters of Halal food to the GCC; Brazil seems a likely candidate to succeed in the global bid to create a sustainable Islamic finance market. As Shariah compliant deals begin to emerge from one of Latin America's most populous and prosperous countries in recent years, NAZNEEN HALIM considers the vast potential of Islamic finance in the Brazilian economy.

With a population of 200 million people, most of whom are non-Muslim, Brazil is a paradox of extravagance and poverty; modernity and the backwaters. However, in recent years, following political and demographic shifts and new policies, the Brazilian economy has seen an unprecedented boom; particularly in the areas of energy and infrastructure, consumer business and retail, healthcare and exports.

Already regarded as the top supplier of Halal food – including sugar, meat and corn – to the GCC, with exports totalling at an estimated US$4.1 billion at the end of 2011 and constituting at least 62% of key GCC food imports (i.e. sugar, chicken, soy, corn and beef), Brazil is not to be overlooked in terms of new opportunities for Islamic investors and issuers alike. Its established trade ties with the GCC also doubles as a key nation in terms of providing food security, while the country relies on the Middle East for its natural resources and energy-intensive product imports. This has placed the Brazilian market in a unique position with the economies of the GCC — one which is most definitely symbiotic.

Case study

Capitalizing on this seemingly indelible relationship between Brazil and the GCC; Abu Dhabi Equity Partners (ADEP), a Cayman-registered Shariah compliant boutique investment firm, closed Brazil's first Shariah compliant agricultural inventory finance transaction. The deal, which was structured with Wakalah and Murabahah agreements, had capital and

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Greenergy: £20 million to finance the acquisition of strategic assets

Asset Based Lending

Regency Factors: £8 million receivables financing facility to fund trading activities

Forbes Rentals: £3 million receivables financing facility to fund acquisition of rental assets

Property

Acorn: £3.52 million facility to finance the development of nine town houses in Cornwall

Curzon Asset Management: £12 million facility for the development of 9 luxury apartments in Kensington

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Blue Sky Intermodal: $5 million finance lease facility for marine containers

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profit protection features offered by a global 'A'-rated bank, as well as physical assets to finance a leading sugar and ethanol producer in the state of Mato Grosso do Sul; an agricultural state with land area equivalent to the size of Germany.

By financing an ethanol fuel plant, the transaction's arrangers were able to fund anhydrous ethanol used as an environmentally friendly biofuel additive to gasoline (not for human consumption), to be sold to prominent oil companies. Muneef Tarmoom, founder and managing partner at ADEP commented: "The use of ethanol, made of raw sugar cane, in ADEP's transaction is consistent with Shariah affinity to socially responsible investing in "green" renewable energy. Brazil is a world leader in renewables, with over 90% of new cars sold running on flexi-engines that utilize ethanol or gasoline or a combination thereof, depending on global price of sugar versus gasoline. The genuine use of physical commodities as part of ADEP's product offerings has been getting enthusiastic reviews by scholars. This theme is now being expanded to Halal cattle and Salam crop production financing products."

In terms of executing and structuring a deal consistent with the needs of the issuer, its investors and creditors, especially in an environment where Islamic finance is an incredibly new concept; Juan Fernando Valdivieso, also founder and managing partner at ADEP said: "Originating, structuring and placing Shariah compliant products is not easy, and to adapt them to Brazil was very challenging; it took persistent effort from our Abu Dhabi and Miami offices and origination team on the ground in Brazil to coordinate and execute processes with trading companies, prospective growers, as well as our network of advisors.

But it is now beginning to pay ample dividend with deals being closed and over US$100 million-worth of identified physical cattle and sugarcane-based transactions in the pipeline for the second half of this year. ADEP's strength has been in combining emerging markets, agri-business, Islamic finance and business management discipline to arrive at new investment solutions."

According to ADEP, the deal's investors comprised mainly from the Americas and the Middle East, who were mainly interested in Brazil's status as an emerging market, as well as the deal's structure of being backed by soft-commodity physical assets. The process, which was said to take a painstaking two years, included a need to understand the agricultural sector value chain in Brazil, the Islamic structuring options available to the deal's issuers and arrangers; consistency with Brazil's tax laws and regulations, and an understanding of the Brazilian macro and micro environment, as well as the establishment of a relationship with the deal's growers, suppliers, trading companies, banks and logistics companies.

Muneef added: "By solving said challenges and completing multiple successful full investment cycles, ADEP is now able to offer investors various short-term Shariah agri-product backed liquidity management instruments over a three to 12 month tenure span, in a leading global agricultural production source."

In terms of why the Cayman-based company led by an experienced sovereign wealth fund executive and a global management consultant chose the Brazilian agriculture business as one of its projects, Muneef elaborated: "From a macro perspective, it is clear that the Gulf region is rich in capital and energy products and short on food, while Brazil is short on capital and energy products but rich in food. A platform of mutual interests therefore exists for what ADEP terms "E4F" [Energy for Food] initiatives that swap energy for food security along the growing 'South-South' trade corridor. Respectively, the primary candidates for such trade are urea, LNG, propane, jet fuel for sugar, poultry, cattle and corn, with multiple "winning" stakeholders along the way ranging from investors, financial institutions, chemical groups, corporates, logistics providers, growers, trading companies, beef producers and governments. Put simply, it's a win-win-win opportunity to the GCC, Brazil and ADEP. "

Alexandre Lopes, a Sao Paolo-based partner at the American international law firm, Maalouf Ashford & Talbot commented on the prospects of the Brazilian Halal sector fueling the proliferation of Islamic finance in the country: "The international demand for agricultural commodities has been a key driver for economic growth in Brazil, given its position as the world´s largest exporter of soybean; at 41% of the world´s exports and making up 35% of global exports of raw cane and refined sugar; a product that has already attracted attention from Arab investors. Moreover, it is worth noting that Brazil is also a large exporter of Halal meat, which proves its ability to competitively adapt to the Islamic-based market requirements and, thus, its readiness to attract the Halal dollar. In addition, Brazilian trade with Arab countries reached US$26 billion in 2012, with exports that included sugar worth US$4.24 billion and meat worth US$3.93 billion."

"The international demand for agricultural commodities has been a key driver for economic growth in Brazil"

Exciting frontiers

Not only famous for its potential as a huge market for food exports and global food security, Brazil is also known for its numerous startup success stories and potential in private equity and venture capital–two extremely interesting sectors in Islamic finance, although incredibly unpopular at present.

Most would agree that private equity, despite its massive potential, is an incredibly underserved market in Islamic finance. This is perhaps due to the lack of transparency amongst major but family-owned companies in the GCC, and an almost unnatural unwillingness amongst Islamic investors to bear risk.

However, despite this, private equity is seen as a major sector in the Brazilian economy, with recent statistics pointing to its increasing contribution to the nation's economic growth. As at the end of 2011, Brazil's private equity industry contributed US$7.1 billion, or 18% of new capital committed to emerging

markets. Out of this, more than half the deals were focused on the energy, infrastructure, healthcare and retail sectors. The country's sheer large population has placed it amongst the most consumer-centric countries, with its retail sector said to be the largest in Latin America.

According to an analyst covering the Brazilian market, the country's private equity sector has seen incredible growth over the past decade, deploying over US$22 billion of capital. He said: "Brazilian PE (private equity) funds have played an important role in the economy, helping to professionalize family-owned businesses, improve corporate governance and provide needed growth capital. According to a 2011 report, nearly ⅓ of the companies listed on the country's largest exchange (BM&FBOVESPA) between 2004 and 2008 were PE-backed, helping to promote the development of the country's capital markets."

A Dubai-based lawyer highlighted the immense potential for Islamic finance investors and funds alike in capitalizing on the strength of the Brazilian private equity sector saying: "I have believed this for years now, and I think it is a good time to act on the growing strength of the country's PE sector, the nation's growing infrastructure and energy demands, as well as its growing focus on research and development in the sciences and agricultural sectors."

"The country is also ranked in the top 100 in terms of investor protection, as well as ease of starting up a new company in the World Bank Doing Business index, and it is already a trusted market for private equity funds," he added.

Brazil-based Lopes highlighted the prospects of raising money in a Shariah compliant manner to cater to the country's growing infrastructure needs. He said: "Another program with great potential is the "Public and Private Partnership" (PPP) program, which is based on joint efforts of government and private business, that works as a financing tool to boost expanding infrastructure needs. According to its rule, in such a partnership, parties agree on the aimed object for five to 35 years. Under its concessions programs, the government plans to transfer to the private sector 7,500km of highways, 10,000km of railways and 159 ports, to be built and operated.

This type of partnership, being mainly used for infrastructure projects, may well fit the Islamic finance asset-backed funding system. With an inflow that reached US$65.3 billion in 2012, Brazil is certainly hunting for investors. As Brazil gets ready to host the 2014 World Cup and 2016 Olympic Games, it seems that the best is yet to come, given the perspective of a rising tide of investments."

Although the prospect of doing business in a Shariah compliant manner in a seemingly obscure and non-Muslim majority market such as Brazil might raise a few eyebrows now, with some regulation and proper research in identifying the core sectors for Islamic finance in the country, the future might hold ample returns for the Islamic investor.

Go west! Real estate investment in the UK and the US

Despite the challenging economic conditions, property investment into the UK and the US is booming especially from Gulf investors, as high levels of cash seek safe havens. With a number of significant deals occurring in the UK in recent years combined with renewed interest in the US market, LAUREN MCAUGHTRY looks at how the Islamic dollar appears once again to be turning westward.

With the global financial crisis perceived to be all but over, Islamic investors are venturing back into their former stomping grounds and funds are once more funnelling into the west as renewed confidence sparks increased interest. Market experts also note that due to the increased uncertainty brought about by the Eurozone crisis, there has been a greater movement towards the safe haven of the US as economic recovery highlights the rich pickings available.

The UK continues its strong performance

However, investment in the UK property market shows few signs of flagging. Gulf interest in the UK has been well-documented over the last few years, with several major deals including the purchase by Qatar Holding (a subsidiary of the country's US$60 billion sovereign wealth fund; the Qatar Investment Authority) of the Credit Suisse London headquarters in February 2012 and a US$300 million deal to redevelop the iconic Shell Center; while the recent completion of the notorious 72-storey Shard skyscraper, the tallest building in the EU, only completed with the assistance of a consortium of Qatari investors including Qatar National Bank, QInvest, Qatar Islamic Bank and Barwa Real Estate, who purchased an 80% stake in 2008 for US$150 million after the project ran into funding difficulties. In fact, Qatar's investment in the UK market has been so exceptional that other countries have attempted to lure the country into their own property markets. In 2012, the French government announced that it would offer significant tax exemptions for Qatari investment into the country, which to date have resulted in acquisitions topping US$4 billion.

However, the UK continues to be one of the most popular locations for Shariah compliant investment due to its favorable laws and tax structures and demand for property in the UK is both only high but rising. "We are seeing a strong influx of funds into UK real estate, especially into central London, because it is an attractive, diversified and protected investment strategy," says Omar Shaikh, a board member of the UK Islamic Finance Council (UKIFC) and a member of the UK Treasury Advisory Sub-Committee advising the UK Government on fiscal policies for Islamic products.

"Institutional money and high net worth entities from the Middle East really just want real estate at the moment," confirms Keith Leach, the head of real estate for the Islamic financial services division of ABC International Bank in the UK. "We arranged about GBP800 million (US$1.25 billion) last year so it's good business for us."

An evolving market

Leach also points out that: "There has been a lot of work done over the last decade in terms of the UK government coming to terms with Islamic finance and trying to break down the barriers that would prevent Islamic finance from growing, particularly in terms of what they can control, such as legal and regulatory regimes, and that has been quite successful. As a place for Islamic finance to compete, London is still well-positioned."

Philip Churchill, a founder partner of UK-based Shariah compliant real estate firm 90 North Real Estate Partners agrees. "The rate of preference for Shariah compliance over the past two years has noticeably accelerated." In addition, investors are becoming more adventurous and the profile of property investment is evolving as they become more sophisticated and willing to take greater risks. "The demand for UK real estate has grown but investors themselves are also more confident with different asset classes. Last year we did a large student accommodation project, a gas turbine maintenance facility, a warehouse transaction in Nottingham and a central London residential development. Four completely different sectors in four different parts of the country. Investors are increasingly looking outside London to get the strong cash deals they want to achieve. They are looking to add value rather than create income," said Churchill.

A central hub

As well as investment in the UK itself, London is also developing as a hub from which investors and institutions can access the wider European market. Despite the impact of the Eurozone crisis, investment continues to flow in as funds look to snap up cheap bargains and basement-level prices. And as the capital continues its quest to cement its position as an Islamic finance hub, its favorable regulatory framework and robust financial industry are increasingly encouraging players to base their business in the UK. Farmida Bi, a partner at law firm Norton Rose, observes that : "The international banks are using London to execute deals which are originated in the Middle East or Africa. There is a significant focus on emerging markets for growth and new deals."

Mansur, an executive director at private equity firm Dar Capital, confirms this: "Although we are based in London, most of the work that we do is not in the UK and we do not actively market to clients in the UK. We work mostly in Europe and further afield - London is just a base whereby the group can grow in Europe and the US. What we have been doing over the last few years is to be a bridge between European corporate institutions looking for Islamic structured products, and Middle East institutions looking for good assets. So we have not concentrated much on the UK, although we see a lot of opportunity in Europe – there are some very good assets where we believe Islamic institutions can benefit."

Mansur also highlights the benefits of a UK base: "One of the great advantages of the UK in the past has been that the government has been very accommodating towards Islamic finance both in terms of the regulatory and the taxation framework. Many of the countries, even some of the Islamic countries, do not have such a robust regime as the UK government has provided."

The US picks up pace

This is certainly true of the US, which has struggled in the past with its federal fragmented system which has inhibited the evolution of a standardized framework for Shariah compliant transactions. However, this has not stopped wealthy Islamic investors from looking to the country as a lucrative safe haven for bricks and mortar as economic conditions improve. Wadih Boueiz, the co-head of corporate and investment banking for the MENA region for Bank of America Merrill Lynch, noted in a 2012 interview that: "Interest in the US has always been there but it went through a major slowdown. The US is now starting to show signs of improvement in its fundamentals, banks are doing better and corporates are sitting on excess cash."

Isam Salah, a senior finance partner at King & Spalding's New York and Dubai offices and the head of its Middle East and Islamic finance practice group, confirms that: "With the ongoing tensions in the region, the US is viewed as a safe haven. People should be taking advantage of that. And as we have seen a resurgence in real estate as the economy improves, I think we will see more transactions from the US."

A missed opportunity

At the moment, however, despite the increasing funds looking to park in US property, US-based institutions are failing to take advantage of this opportunity. "US banks are not currently focused on this market yet," explains Ibrahim Mardam Bey, the group president of independent investment banking firm Taylor-DeJongh. "They are too busy addressing their own new market realities, and as such Islamic capital tends to come on and off their radars."

"We do see a lot of property investment coming into the US from the Gulf, but we don't see the Wall Street institutions involved in the role of raising equity capital," agrees Salah. "The banks are tapped to provide financing, but they are not involved in an advisory way, they don't have the mandates or the advisory agreements. It is really the traditional real estate firms that have asset management and advisory arrangements with these sources of capital. So you will have Gulf financial institutions and investment firms and family offices, either using their own capital (in the case of family offices) or raising capital from their high net worth clients and small investment firms, for real estate investment in the US. And those Gulf financial institutions are either going into joint ventures with US property operating companies, or they are putting in 100% of the capital and entering into advisory or asset management arrangements with traditional real estate investment and investment advisory firms as well as smaller boutique shops that are real estate-focused.

"So although real estate is the major flow, it is not the banks but the real estate companies that have the market there and have the relationship with the Gulf."

> **"The government has been very accommodating towards Islamic finance both in terms of the regulatory and the taxation framework"**

Little and often

In addition, the type of investments coming into the US have also changed, with smaller sums purchasing greater volumes compared to the giant deals seen prior to the financial crisis. Shariah compliant capital in the US is predominantly real estate investment. Before the financial crisis, there was a fair amount of private equity, led by Arcapita, but now you see a lot less big ticket stuff – the funds are not big enough.

Their goal is to raise money for their client base, and they are much more comfortable with real estate, which means you are seeing a much bigger flow of real estate investment into the US. There is definitely a renewed interest in real estate coming out of the Gulf this year."

Going strong

A November 2012 survey from Colliers International conducted across a cross-section of major international institutional and private property investors concluded that: the most desirable region for increased global real estate investment in 2013 is the US, followed by Asia and western Europe; in particular London, Paris and major cities in Germany.

In another survey from the Association of Foreign Investors in Real Estate, respondents ranked the US as the most stable and secure property market with the best opportunity for capital appreciation, with 81% expecting to increase their portfolio size over the coming year.

With interest picking up, prices will inevitably follow. It looks like 2013 may be the year for a renewal of the property markets – and westward is the way to go.

The offshore centers of America and Europe: A conduit between the east and west?

The increasing desire to raise money in a Shariah compliant manner has sparked interest in offshore centers as a jurisdiction to circumvent onshore regulatory and tax hurdles, as well as establish a neutral link between the Middle East and the west; NAZNEEN HALIM discovers.

Luxembourg has become more or less as iconic in the Islamic finance sphere as Dubai. The offshore jurisdiction, which has been tireless in its efforts to showcase itself as a global name in Shariah compliant funds especially, has created momentum for other offshore jurisdictions worldwide. The Luxembourg Stock Exchange was the first European stock exchange to list Islamic securities and had a total of US$5.5 billion in Sukuk listed.

A report by KPMG on Luxembourg as a hub for Islamic finance investments read: "The Luxembourg financial center boasts key strengths, including the flexibility of policymakers, proactive attitude of industry leaders, banking confidentiality and the possibility to obtain certainty and security in advance from the Luxembourg tax authorities on a case-by-case basis. Government support and a favorable regulatory environment together encourage Islamic companies and financial institutions to set up operations in Luxembourg."

The jurisdiction's position as a founding member of the EU also ensures its credibility and transparency, as well as the incorporation of EU Tax Directives; including the elimination of withholding tax and the possible elimination of double taxation on profits. Its tax neutrality, coupled with tax treaties with a vast network of Middle Eastern and Asian countries; including Kuwait, Azerbaijan and Krygyzstan, has made Luxembourg one of the most talked about jurisdictions to incorporate Shariah compliant products and instruments.

Bermuda, with its proximity to the North and Latin American countries, places it in a unique position in terms of preferred destinations for Islamic finance transactions. The offshore jurisdiction, with its advanced tax and regulatory stance towards Islamic finance, including the issuance of Guidance Notes on Islamic finance, as well as its disposition as one of the world's preferred destinations for insurance underwriters; makes Bermuda fans even more optimistic of the jurisdiction's ability to attract Takaful and re-Takaful firms. In 2012, Bermuda-based reinsurers wrote an excess of US$65 billion in global premiums.

> **"Offshore centers are becoming more popular amongst GCC-based issuers and fund managers looking to access western markets"**

The Cayman Islands is fast making its mark in the world of Islamic structuring, as more Gulf-led transactions are being structured via the Cayman Islands. The government of Abu Dhabi's TDIC Sukuk, as well as the AED7.5 billion (US$2.04 billion) JAFZ Sukuk are amongst the landmark transactions structured out of the jurisdiction. According to lawyers familiar with Cayman laws, many Gulf-based issuers, fund managers and investors are comfortable doing business in the Cayman Islands due to its Arabic language facility, which allows companies to receive their incorporation documents in dual language, as well as a sense of familiarity amongst high-net worth Gulf individuals and families who have been part of its business environment for many years now.

According to a UK-based consultant, offshore centers are becoming more popular amongst GCC-based issuers and fund managers looking to access western markets while receiving tax neutrality benefits and finding a safe haven to park their funds. He said: "The instability in the GCC region during and after the Arab Spring created opportunities for offshore centers to attract assets and liquidity with its proven history of stability, transparency and compliance. There are currently an estimated US$1 trillion in Shariah compliant assets, or more. Vast oil revenues pouring into small countries have given the GCC region a huge pool of excess liquidity, estimated at around US$5 trillion, in the hands of high net-worth individuals, sovereign wealth funds and financial institutions."

Ireland has also recently opened up its gates to becoming a Shariah-friendly offshore jurisdiction, eliciting an almost instantaneous response from one of the world's most active Islamic finance players. In 2012, CIMB Principal Islamic Asset Management launched CIMB Principal Islamic Asset Management (Ireland), with three products readily available. Its three UCITS-compliant equity funds; the Islamic Global Emerging Markets Fund, the Islamic Asia-Pacific ex-Japan Fund and the Islamic ASEAN Equity Fund, were registered in Ireland with a view to gain access to the US, Switzerland, Germany, Saudi Arabia, Bahrain, the UAE and Singapore.

Perhaps it is unwise to overlook the role of offshore centers as a link between Asia, the Middle East and the west; while also keeping a prudent eye on transparency, enforcement and regulatory oversight.


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