

Beyond Compliance: Making Islamic Housing Finance Work for Affordability

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The views expressed here are the author's own. They reflect a housing policy and planning perspective, not a religious ruling, and any structure discussed should be reviewed by qualified Shariah scholars and the relevant Shariah supervisory authority before use.

Introduction

Across many Muslim-majority countries, most families still build houses without going to banks. In [Pakistan](#), an estimated 80 to 85 percent of housing finance comes from informal sources. Even on the broadest measure, housing finance accounts for only about 7 percent of private-sector credit. The national shortfall is about 10 million units and grows by about 350,000 every year.

Islamic finance could play a significant role in changing that. This piece explores how Islamic commercial and social finance can be structured to expand access to adequate and affordable housing, especially for those excluded from conventional housing finance. The test is not only whether a product passes a Shariah compliance check, but also whether it actually advances the objectives of Shariah (Maqasid al-Shariah): protecting vulnerable households, allocating risk fairly and justly, and supporting lasting housing stability without compromising legal or financial discipline.

Islamic finance is governed by principles that prohibit Riba (commonly known as interest), excessive Gharar (uncertainty), and Maysir (gambling). It requires lawful subject matter and the linkage of financial returns to ownership, asset use, trade, services, investment, or the assumption of legitimate commercial risk. In mainstream Islamic finance, money functions primarily as a medium of exchange and a measure of value, rather than a commodity or asset, and a loan is not meant to generate a return merely through the passage of time.

The Islamic finance industry has achieved a notable global impact on financial development. According to the Islamic Financial Services Board, global Islamic financial assets reached [US\\$4.4 trillion](#) in 2025, a 13.4 percent year-on-year increase. Islamic banking makes up about 70 percent of this total, and outstanding Sukuk crossed [US\\$1 trillion](#) for the first time. Despite this growth, Islamic finance has not translated into proportionately more affordable housing. I believe the main constraint is the lack of sufficiently integrated design, subsidy, governance, and delivery capacity.

Pakistan is about to test this at a national scale. The federal government has [finalized a strategy](#) that requires all new financing to be Shariah-compliant starting January 1, 2028, in line with the Federal Shariat Court's 2022 ruling and the 26th Constitutional Amendment. Islamic banking institutions already hold [23 percent of banking assets, 28 percent of deposits, and 38 percent of financing](#). This means new housing finance across most of the banking system will be built on Islamic contracts, but it remains to be seen whether these contracts will actually reach households otherwise excluded.



How Islamic Finance Works

In an Islamic housing transaction, a financier's entitlement to profit or rent arises from a valid sale, lease, partnership, agency, or construction arrangement, and not from an interest-bearing loan. Islamic housing finance uses asset linkage, clear contractual rights, and transparent pricing to strengthen payment discipline and reduce customer ambiguity. These features do not automatically make a product affordable or socially inclusive, but they do uphold and strengthen consumer protection.

Institutions must disclose at signing, where applicable, acquisition costs, profit or rental methodology, ownership expenses, the takaful (insurance) arrangements, late-payment treatment, early-settlement policy, default remedies, and how changes in benchmark rates may affect payments. This level of transparency matters for households who cannot absorb financial shocks. In sale-based contracts such as Murabahah, a deferred sale price may exceed the cash price, provided the sale is valid under Shariah, but once agreed, it cannot be increased even if payment is delayed. While Islamic products can still carry variable rents, fees, and default costs, households gain price certainty on the core debt and, through contract transparency, are better protected from 'hidden' charges. Still, a pre-agreed sale price does not eliminate financial risk, and benchmark pricing is not automatically impermissible. The decisive point is the contract's legal substance, including its Shariah validity and fairness.

Islamic finance should also not be described as universally based on profit-and-loss sharing. Murabahah, Ijarah, Salam, and Istisna are exchange-based contracts, while Musharakah and Mudarabah are partnership-based. Each allocates ownership, market, performance, and credit risks differently. In a well-structured contract, each party bears the risk that legally accompanies their ownership or contractual role, rather than transferring every material risk onto the vulnerable household itself. Tying profit to services, assets, or invested capital creates stronger incentives for asset protection, safekeeping, and long-term value growth, shifting finance from extraction and exploitation to participation. A Shariah-compliant product may resemble a conventional product in economic terms, especially where both use market benchmarks and credit-risk controls. Beyond risk and reward, Islamic products should be distinguished by genuine ownership, or usufruct, valid sequencing, enforceable documentation, and outcomes consistent with justice, transparency, and harm avoidance, ensuring financial incentives align with asset preservation and value.

Yet in practice, Islamic finance often replicates conventional structures with only minor contractual modifications for compliance. Some may call this form over substance: the contract changes, but the economics do not. If the goal is structural inclusion, simply mirroring conventional financing weakens its promise to social welfare. The challenge, then, is not just compliance but intentionally designing these structures to address exclusion.

The Core Instruments and Their Role in Housing

The partnership and exchange-based contracts described above, together with Wakala, an agency contract used for management and servicing, each play a distinct role in housing finance.



Musharakah and Diminishing Musharakah	In Musharakah, partners contribute capital and share profit according to an agreed ratio, while loss is borne in proportion to capital contribution. In Diminishing Musharakah, the institution and customer jointly own the property; the customer may lease the institution's share and gradually purchase ownership units. The partnership, lease of the institution's share, and unit purchases are separate legal relationships, each with its own rights and obligations. The rent must have a valid basis, and units must be purchased through the agreed Shariah-approved mechanism. Ownership-related risks and responsibilities follow ownership shares, subject to the governing Shariah standard and local law.
Mudarabah	Mudarabah is an investment partnership in which one party provides capital and the other provides management or enterprise. It may support a housing-development fund or specialist delivery platform, but it is generally less suited to a standard retail home-purchase facility because capital loss is borne by the capital provider unless caused by misconduct, negligence, or breach by the manager.
Murabahah	Under Murabahah, the institution acquires an identified property or relevant goods and sells them to the customer at disclosed cost plus an agreed profit, commonly on deferred-payment terms. The institution must acquire ownership and bear the asset risk required by Shariah before resale. Murabahah provides price certainty, but affordability depends on tenor, subsidy, fees, and responsible underwriting.
Ijarah	Ijarah transfers the usufruct of an identified asset for agreed rent while ownership remains with the lessor. The lessor bears ownership-related liabilities and major structural maintenance, whereas use-related expenses may be allocated to the lessee. Ijarah may support social rental housing, lease-to-own structures, or long-term affordable occupancy, provided the documentation does not improperly shift the lessor's essential ownership obligations to the tenant.
Istisna and Salam	Istisna is well suited to construction or manufacture according to agreed specifications, price, and delivery terms. A bank may use a parallel Istisna with a developer, provided the two contracts remain legally independent. Salam, by contrast, concerns the advance purchase of specified fungible goods for future delivery and is ordinarily more relevant to agricultural or commodity finance than to the direct purchase of completed housing.
Wakala	Wakala is an agency contract under which an agent performs defined tasks within an agreed mandate, with or without a fee. It may be used for investment management, collection, servicing, procurement, or project administration. It is not a safekeeping contract or a deposit-guarantee mechanism. Current accounts are commonly structured as Qard, so the legal basis for any deposits or program funds should be specified separately from the agency role.



Each instrument has standalone utility and solves a different problem. None, however, can solve housing affordability on their own. For example, Murabahah gives price certainty without lowering housing costs, and Diminishing Musharakah changes the ownership pathway without removing the initial equity requirement. Their real social welfare potential, however, lies in mobilizing them collectively alongside faith-based redistributive mechanisms such as Zakat and Waqf, which have no parallel in conventional finance.

Designing for Inclusion

A. Redistributing wealth toward housing need

i. Zakat as targeted housing assistance

Zakat may support eligible beneficiaries within the eight Quranic recipient categories, particularly the poor and the needy, subject to the rules of the competent Zakat authority and the Shariah position adopted in the relevant jurisdiction. It may fund rent, essential repairs, basic shelter, a qualifying beneficiary's equity contribution, or other housing needs where the required transfer of ownership or benefit (tamlik), eligibility, and disbursement conditions are satisfied. In many Muslim-majority countries, Zakat is collected annually and flows consistently through both formal and informal channels. It is one of the most powerful redistribution mechanisms in the Muslim world, yet its distribution is often fragmented: in Pakistan, fewer than [2 percent](#) of Zakat givers use the state Zakat fund. As a result, Zakat remains underutilized as an effective anti-poverty instrument.

The scale is significant, and also largely invisible. A 2025 [factsheet](#) by the Institute of Development Studies and Lahore University of Management Sciences, drawing on a nationally representative 2024 survey of 7,500 Sunni Pakistanis, estimated that Pakistanis pay over [619 billion rupees in Zakat every year](#), which is more than the budget of the country's largest state cash transfer program, the Benazir Income Support Program. Formalized institutional collection could look very different: [Zakat Selangor](#) in Malaysia collected 1.31 billion ringgit in 2025 and distributed 1.33 billion ringgit to more than 426,000 recipients.

An institutional implementing arm could aggregate Zakat funds and channel them into structured housing support. In doing so, however, Zakat must not be treated interchangeably with Waqf. Zakat is an obligatory transfer only for eligible recipients; Waqf is an endowed asset or fund whose corpus is preserved, with benefits distributed as per the founder's lawful specifications. Accordingly, Zakat should not be converted into a perpetual Waqf-style corpus without a clear Shariah basis and approval. Used strategically, Zakat could serve not just as annual episodic charity but also as institutional, structured housing protection. An obligation unique to Islamic economic life can then support long-term financial inclusion beyond just short-term relief.

ii. Integrated Zakat, Waqf, and Qard Hasan

Integrated institutions may operate within one program while remaining legally and operationally segregated. Zakat can address eligible beneficiaries' immediate needs; cash Waqf or income-producing Waqf can provide durable program capital; and a separately governed financing vehicle can offer interest-free loans (Qard Hasan), Diminishing Musharakah, or other approved facilities. Separate



ledgers, bank accounts, eligibility rules, contracts, and reporting are essential to prevent commingling and preserve each fund's Shariah character. Aligned in this way, these institutions can create a funding source that provides ongoing liquidity and long-term capital for housing finance. Qard Hasan can support repairs, deposits, incremental construction, or small housing-linked enterprises, with repayment required only on the principal amount (the lender may recover actual administrative costs, but not a margin, so cost recovery does not become a disguised return). For low-income households, access to small, zero-interest loans can reduce reliance on exploitative, interest-based, informal lending.

Some early evidence in Pakistan suggests that interest-free housing finance can work at scale. According to Punjab's Chief Minister, the [Apni Chhat Apna Ghar program](#) has given loans to more than 200,000 people to build homes in 18 months, disbursing 260 billion rupees in interest-free loans, with more than 125,000 families already moved in and a recovery rate above 99 percent. These are early government-reported figures for a young program with long-tenor loans, so the actual test of repayment is still ahead. The program is a publicly funded, interest-free loan scheme, not a formal Islamic product; its principal-only repayment resembles Qard Hasan. Critics have questioned the effectiveness of cash-based housing loans for self-build housing in dense cities, where vertical housing may work better. These results so far are encouraging, but scaling up such programs through Islamic financial institutions depends on the cost of capital, administrative costs, recovery over the full tenor, and ongoing subsidy.

iii. **Waqf land and endowments for housing**

Waqf can support affordable housing through endowed land, cash Waqf, subsidized usufruct, or investment returns applied to eligible housing purposes. A Waqf asset cannot be pledged as collateral casually: its corpus is generally inalienable, and enforcement could defeat the founding purpose. A safe, potentially more socially beneficial structure may place development on Waqf land under an approved long-term lease or development arrangement, while using non-Waqf guarantees, reserve accounts, first-loss philanthropic capital, or public support as credit enhancement, which can reduce lender risk and lower financing costs for homebuyers. Any mortgage, substitution, long lease, development right, or encumbrance requires careful review under the Waqf deed, applicable law, competent Waqf authority, and relevant Shariah opinion.

B. **Protecting households from shocks**

iv. **Takaful for climate and disaster risk**

Low-income households in disaster-prone areas are often excluded from formal insurance systems. After the 2022 floods, Sindh province alone saw [more than two million homes](#) either fully or partially damaged, equivalent to over 60 percent of the nation's housing losses. Without a domestic risk pool of sufficient capacity, reconstruction largely relied on development finance institutions such as the World Bank, Asian Development Bank, and the Islamic Development Bank, with total funding exceeding [US\\$1 billion](#).



A disaster-based Takaful model can pool contributions from domestic participants into a fund to compensate covered losses under cooperative risk-sharing principles, which aligns with the Islamic principle of shared social responsibility: sharing risk across a community rather than transferring it for profit. The operator manages the fund under an approved Wakala, Mudarabah, or hybrid model and should not guarantee the participant fund except as required under an approved Qard mechanism or applicable regulation. The participant fund, the operator, and any Qard facility each carry distinct obligations. Takaful may protect the property, construction works, and, where available, payment capacity following defined events. Coverage, exclusions, contribution subsidies, surplus policy, and claims governance should be transparent, and climate adaptation, resilient construction, and disaster reserves should complement financial coverage.

C. Mobilizing long-term capital

v. Social Sukuk for affordable housing

Social Sukuk may mobilize institutional capital for affordable housing when investors hold Shariah-compliant ownership or beneficial interests in eligible assets, usufructs, services, projects, or investment activities. In practice, structures may be genuinely asset-backed or only asset-based; the distinction affects investor recourse, insolvency treatment, and risk allocation, and must be disclosed accurately. An asset link alone does not make Sukuk asset-backed. What is important is what investors actually own and who bears what risk. Returns must arise from the underlying Shariah contract, such as rental income streams under Sukuk al-Ijarah or project proceeds under an approved structure, not from a debt obligation dressed as an asset. Structured properly, Sukuk can give impact investors steady, predictable returns while financing large-scale development.

According to Zafar Masud, Chairman of Pakistan's Banks Association, Pakistan's pool of long-term investable capital is only [3 to 4 percent](#) of gross domestic product, far below Bangladesh (13 percent) and India (25 percent), and most of it is held in government securities. With the first hybrid Ijarah-cum-Murabahah Sukuk of [109 billion rupees](#) issued in April 2026 and the government planning an Asset Registry Company to maintain a register of federal assets to support regular Sukuk issuance, the infrastructure is taking shape. If social housing assets could be brought into a similar framework, housing could become one of the clearest pipelines of eligible assets.

Sukuk alone will not make housing affordable. That comes from combining Sukuk proceeds with public land, viability-gap grants, Waqf usufruct, concessional first-loss capital, or targeted subsidies. The issuer must establish measurable social objectives, beneficiary criteria, allocation reporting, and impact reporting, alongside Shariah, legal, credit, and asset-management controls.

D. Delivering affordable homes

vi. Social rental housing through Ijarah

In economically challenging markets such as [Pakistan](#), where ownership finance is unaffordable for most low-income households, a long-term social rental model is also worth considering. The asset-owning vehicle acquires or develops the housing and leases units at an agreed rent. Public land, capital grants, Waqf support, or cross-subsidy may reduce the economic rent to an affordable level through



operational leasing. The lease should clearly allocate responsibility for major and minor maintenance, utilities, and damage, as well as renewal and termination rights. NGO land trusts or public-private partnerships may absorb part of the capital costs, and the lessor may retain asset ownership and maintenance responsibility. Structurally, the asset-owning vehicle should keep debt-to-equity ratios conservative, limit excessive value extraction, uphold tenant protection, and build in renewal flexibility.

Fixed or periodically reviewed rent may be used if the rental amount or adjustment mechanisms are sufficiently determined for each rental period. The structure may also include affordability protections such as rent caps, hardship protocols, cure periods, relocation support, and independent complaint handling. Late payment clauses should deter willful delay without generating income for the financier; any late-payment amounts should go to charity, and any penalty mechanism must follow the institution's approved Shariah policy and applicable law.

This mechanism is Ijarah structured intentionally to support social housing. Because Ijarah earns income from asset use, rent can be set at what households can afford, with a subsidy covering the gap. This opens the possibility of Shariah-compliant affordability engineering.

vii. Istisna-Ijarah for social housing

An Istisna contract can finance the construction phase of social housing, defining specifications, milestones, and delivery terms. After completion, when the asset can deliver usufruct, a separate Ijarah contract can govern occupancy. Rent should not, however, accrue before the leased usufruct is available to the tenant, and where forward leasing is used, advance rental and non-delivery treatment must comply with the applicable Shariah standard. The Istisna component allows affordable, transparent payment terms during construction, while the Ijarah provides a stable, rental-based model for residents.

This long-term approach, which separates development risk from occupancy risk, can be structurally significant. It allows capital to be deployed for construction without binding potential tenants into debt-based ownership before construction is completed. Where a bank commissions the developer under a parallel Istisna, it bears construction risk, owns the completed property, and then enters the Ijarah as lessor. The contracts must not be legally conditional in a way that reduces the bank's obligations or removes construction and ownership risk it must bear. Completion guarantees, performance security, takaful, and independent certification can mitigate risk without changing the contracts' Shariah substance. For large-scale housing programs in particular, this hybrid structure balances developers' construction needs with tenants' post-construction affordability, showing how transparent contract structures can align project finance with social protection.



Governance Safeguards for Scale

A scalable program requires more than product documentation. At minimum, the sponsoring institution should establish:

- Shariah governance: ex-ante product approval, legal-document review, implementation testing, periodic Shariah audit, and a process to rectify and purify non-compliant income.
- Fund segregation: distinct governance, accounts, and reporting for Zakat, Waqf, participant risk funds, shareholder funds, and commercial financing vehicles.
- Consumer protection: affordability assessment, plain-language disclosure, fair treatment in arrears, responsible restructuring, and proportionate enforcement.
- Asset and project controls: verified title, valuation, construction monitoring, procurement integrity, takaful, maintenance planning, and lifecycle reserves.
- Impact discipline: objective beneficiary criteria and measurable indicators covering affordability, housing quality, security of tenure, inclusion, and beneficiary outcomes.
- Legal and regulatory alignment: enforceability, licensing, capital treatment, insolvency remoteness, tax neutrality, data protection, and compliance with local Waqf and Zakat rules.

Conclusion

Islamic finance offers more than just ethical alternatives to conventional financing. Its distinctive value lies in its structural features. Zakat and Waqf provide targeted relief and long-term social infrastructure, commercial contracts mobilize and deploy capital, and Takaful pools defined risks. The value grows when intentional structuring and long-term thinking assign each instrument a lawful, economically coherent, complementary, and sustainable role. The strongest model will preserve genuine ownership and contractual substance, respect each instrument's distinct rules, allocate risk fairly, protect customers in hardship, and demonstrate measurable affordability outcomes. If Islamic financing simply mirrors conventional financing without its own ownership discipline and social safeguards, its developmental reach will remain limited. If designed with Shariah integrity, prudent governance, and intentional subsidy, it can become a credible platform for secure and affordable housing, aligning religious obligations with meaningful social welfare and long-term community stability at scale.

The question one must ask when structuring such a product is simple. Does a family that could not borrow before now hold a secure path to tenancy or a growing share of a home? If the answer is no, the contract may be compliant, but it has not yet served the Shariah purposes it was meant to serve.



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