The Role of Community Economic Development Organizations in Providing Islamic Financing: A Twin Cities Case Study

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Over the past century, access to capital has directly impacted the sustained economic health of U.S. communities. The availability of Islamic financing products for America's growing Muslim population is a new facet of community finance challenges. While several mainstream banks and other financing institutions are developing products to serve this population, there remains a segment of the American population that requires the additional technical assistance services that community economic development organization provide. After reviewing American Muslim demographics, the basic principles of Islamic financing and current products available through mainstream financial institutions; this paper provides a case study of how three community economic development organizations are meeting the capital needs of the Muslim immigrant population in the Twin Cities, Minneapolis.

Structural Overview

The economic success of communities within the United States correlates directly with their access to capital and financing tools. Many examples throughout the twentieth century, from redlined neighborhoods to Federal Housing Authority restrictions on mortgage insurance for African American families, prove the important role that financing plays in a community's ability to achieve sustainable economic health. Recently, the topic of Islamic Financing has emerged as a new issue in community finance. As Community Development Corporations (CDCs) and Community Development Financial Institutions (CDFIs) exist to address the issues of community access to capital, they may be the best equipped vehicles for addressing the Muslim American community's need for financial resources. Much of this community is comprised of new immigrants to the U.S. Beyond their need for Islamically acceptable forms of financing, they also require more technical assistance and financial education than mainstream borrowers. This paper explores *how community development organizations can meet the financing needs of the Muslim small business community?*

In order to answer this question, this paper is divided into two parts. The first portion begins with an exploration of Muslim demographic data in the U.S. followed by a discussion of the fundamental tenets of Islamic Finance. Detailed in the latter section is a description of Islamic financing mechanisms based on an interpretation of Islamic law, which views interest-

based loans as unfair and prohibited.[1] The paper then provides a survey of some of the current mainstream financial institutions' efforts to provide Islamic financing to the American Muslim population, and when possible, an evaluation of how these tools have performed financially. Generally, efforts towards providing financing options to the American Muslim community are new and their performance levels are difficult to assess. However, the increasing number of Islamic financing products available points towards a profitable market.

The second part of the paper introduces Community Development Corporations and Community Development Financial Institutions and, using a case-study analysis of three of these organizations in Minneapolis, illustrates how such organizations can potentially provide much-needed patient Islamic financing. Barriers these institutions and their clients face, as well as their successes, are then highlighted. The paper concludes with lessons extracted from the experiences of the Minneapolis organizations that may help guide future endeavors to provide patient Islamic financing.

Muslims in America

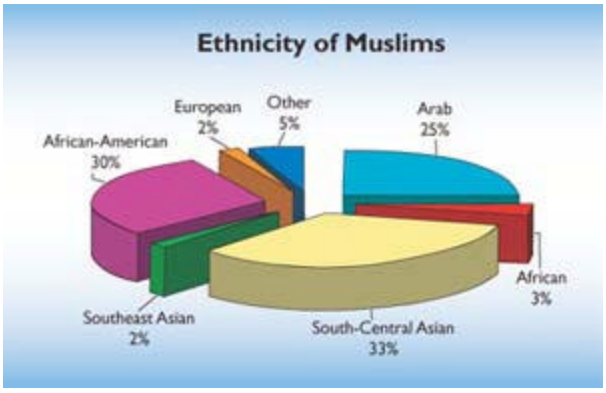
Estimates of the U.S. Muslim population vary widely, from between two and seven million people.[2] In order to ensure the separation of church and state, the estimation of religious group sizes is not one of the functions of the U.S. Census. Therefore, only two viable options exist for researchers investigating the Muslim population. The first involves independent studies, such as the 2001 American Religious Identification Survey (ARIS) conducted by the Graduate Center at the City University of New York. This survey estimated the Muslim population at 1.1 million adults. Considering a +/- 0.5 sampling error, the maximum estimate of

[1] Timur Kuran, "Islam and Mammon," *The Milken Institute Review*, third quarter 2004: 61-81.
[2] Jane I. Smith, "Patterns of Muslim Immigration" (US Department of State, 2001) available from http://usinfo.state.gov/products/pubs/muslimlife/immigrat.htm; accessed 20 February 2005.

this survey is 2.2 million Muslim adults or slightly less than 3 million if children are included.[3] The other estimating option involves collecting membership data from mosques. ARIS found that 62 percent of Muslims surveyed belonged to a mosque. However, these data may not be reliable given that only 219 Muslims were interviewed in the ARIS survey.[4] In addition, Mosques often do not have stringent membership requirements and the religious leaders surveyed may have motivation for over-counting members.

It is important to understand the demographic composition of American Muslims. Often, Muslims are associated with people of Arab decent.[5] As illustrated in Figure 1 below, this assumption is highly erroneous. For one, between 17 and 30 percent of the American Muslim population are converts to the faith. Increasingly, African Americans are identifying with Muslim ideology. ARIS results found the African American share of the total US Muslim population to be 27 percent.[6]

Figure 1: Composition of American Muslim Population



Source: Smith, Jane I. US Department of State. 2001.

[3] Barry A. Kosmin and Egon Mayer, "Profile of the Muslim Population" in *American Religious Identification Survey Report No. 2* (New York: The Graduate Center of the City University of New York, October 2001) available from http://www.gc.cuny.edu/studies/aris_part_two.htm; accessed on 20 February 2005.
[4] Ibid.
[5] Ibid.
[6] Ibid.

While previous waves of Muslim immigrants sought to blend into mainstream American culture by changing their names and dress, current immigrants are searching for a balance between their Muslim and American identities.[7] There has been a 25 percent increase in the number of mosques between 1994 and 2001. Moreover, thirty percent of mosque participants are converts.[8]

The complicated matter of estimating the number of Muslims in the U.S., coupled with the uncertainties surrounding the issue of how strictly they adhere to the faith creates a difficult environment to assess the demand for Islamic financing. Geographically, however, the Muslim population tends to be concentrated. Using the distribution of Mosques across the United States as a proxy for Muslim residents (see Figure 1 in Appendix A), the population appears concentrated in California, New York, New Jersey, Michigan, Pennsylvania and Texas.[9] Within those states, Muslims are further concentrated around certain cities, such as Los Angeles and San Francisco in California.[10] The use of Mosques as a proxy is useful in this context since the greatest concentrations of Muslims needing Islamic financing are likely to be members of a Mosque. The issue of the geographic concentration of Muslims in the U.S. will be revisited later in this paper during the discussion of the role Community Development Financial Institutions can play in the provision of Islamic Financing.

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[7] Smith; 2001.
[8] "Demographic Facts" in *Muslim Life in America* (US Department of State, October 2002) available from http://usinfo.state.gov/products/pubs/muslimlife/demograp.htm; accessed on 20 February 2005.
[9] "Number of Mosques in the United States by State" in *Muslim Life in America* (US Department of State, October 2002) available from http://usinfo.state.gov/products/pubs/muslimlife/musmap.htm; accessed on 20 February 2005.
[10] Smith; 2001.

Islamic Finance, The Basic Tenets

The prohibition of *riba*, or usury, guides the field of Islamic finance. As one scholar notes, "Riba is said to have been considered by the Qur'an to be the most heinous of the major sins."[11] This section details the Islamic definition of usury and explores the various financial tools developed by modern financial institutions to adhere to *Sharia'a*, Islamic law. As will be discussed in detail below, some Islamic financing contracts have been met with varying degrees of acceptance from Muslim religious scholars.

The Arabic word *riba* literally translates to 'increase,' 'addition' or 'growth.' However, it is generally used as the equivalent of usury.[12] There are two primary forms of *riba* prohibited in Islam. The first, *riba al-nasia*, also referred to as *riba al-nasa*, is "the usury of waiting, [which] involves the non-simultaneous exchange of equal qualities and quantities of the same commodity and does not therefore involve a surplus but only a difference in the timing of exchange."[13] The second *riba al-fadl* "involves an exchange of unequal qualities or quantities of the same commodity simultaneously, and could therefore be described as the usury of surplus."[14] In terms of a financing, *riba al-fadl* occurs with the lending of money with the intention of a larger return than what was borrowed. *Riba al-nasia* occurs when the loan period is extended and, in return, the lender charges more than the principal value.[15] Modern loans incorporate both types of *riba* and are termed *riba al-qarud*. They involve a surplus charged on an original value

[11] Shahrukh Rafi Khan, *Profit and Loss Sharing* (Karachi, Pakistan: Oxford University Press, 1987), 45.
[12] Tariq El Diwany, "What is Usury," available from http://www.islamic-finance.com/item5_f.htm; accessed on 21 February 2005.
[13] Ibid.
[14] Ibid.
[15] "Why is Interest/Reba Prohibited in Islam?," available from http://muslim-investor.com/principles/why-no-interest.html; accessed on 21 February 2005.

in return for a delay in payments.[16] The following quote provides one moral justification for the prohibition of *riba*:

> Apart from the clear Quranic injunction on the prohibition of riba, there are other issues with *riba* which cause it to be prohibited. It is considered a form of injustice, and exploitation. Moreover, conventional economy today is debt-based, and only does risk transfer. Islamic economy in contrast is asset-based, and does risk sharing. It is all about fairness to all parties.[17]

Moreover, it is important to understand the Islamic law condemns the lender, borrower, contract writer and witnesses for a loan marred by usury.[18]

The argument presented in this paper, however, does not relate to any moral or religious justification for Islamic financing. The underlying fact that financing is a basic need for any community's ability to achieve sustainable economic health suffices as a reason for the provision of *riba*-free financial options. While Islamic law prohibits usurious contracts, profit from risk-sharing activities is perfectly acceptable. Therefore, it is important to differentiate between the concepts of "interest rate" and "return rate," as the former is prohibited and the latter is encouraged in Islamic law.[19] The following section presents the various types of Islamic financing as well as a discussion of their level of acceptability among the Muslim community. There are five basic forms of Islamic contracts, three mark-up and two profit and loss sharing.

Mark-Up Contracts

Murabaha

Murabaha transactions are also known as "cost-plus" financing. These contracts involve a buyer purchasing an asset at an agreed upon mark-up from a seller. The profit margin may be a fixed amount or a percentage of sales as long as both parties agree to the terms in advance of the

[16] El Diwany.
[17] "Why is Interest/Reba Prohibited in Islam?"
[18] El Diwany.
[19] Mervyn K. Lewis and Latifa M. Algaoud, *Islamic Banking* (Cheltenham, UK: Edward Elgar, 2001), 39.

transaction. Today, the majority of Islamic financing activities are based on *Murabaha*.[20] In these financial deals, the bank adopts the role of seller and the mark-up is often based on credit risk, interest rate indices such as the short T-bills rate, the goods being financed and the transaction size.[21] Essentially, the bank acts as a middleman. The buyer may make one balloon payment or installments, known as *Bay Bithamin Ajil* (BBA). Either way, the payment must occur after the goods have been delivered to the buyer at an agreed upon time in the contract.[22]

Much debate surrounds the issue of whether *Murabaha* conforms to the rules of Islamic finance. The mark-up certainly resembles a fixed-interest charge and there is a question of whether the financier enters into any risk at all. Having the buyer inspect the product prior to the financier's purchase skirts even the possibility that a buyer may reject the quality of goods acquired by the financing institution.[23] Further, some institutions require the buyers to sign a contract binding them to purchase the goods before the financier engages in any transactions. This element, which eliminates all risk for the financier, is one aspect of the *Murabaha* contract that Islamic scholars find troubling.

Many Islamic scholars consider *Murabaha* to be a questionable tool at best. They fear that this tool may be used as a "back door for dealing on a fixed interest basis."[24] However, the practitioners of Islamic financing believe it to be a flexible option that allows them to operate in a variety of markets and compete with traditional financial institutions. One suggested litmus test is to compare the difference in the pricing of a spot payment and the total BBA payments. If

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[20] "Murabaha," available from http://www.islamic-finance.com/item_murabaha_f.htm; accessed on 21 February 2005.
[21] Tarek S. Zaher and M. Kabir Hassan, "A Comparative Literature Survey of Islamic Finance and Banking," *Financial Markets, Institutions and Instruments*, vol. 10 no 4 (2001): 160.
[22] "Murabaha."
[23] Zaher, 160.
[24] Ahmed Abdel-Fattah El-Ashker, *The Islamic Business Enterprise* (London: Croom Helm, 1987), 95.

no difference exists, the loan is considered to be *riba*-free.[25] Other scholars argue that if the financier bears the risk of the transaction until the borrower takes possession of the asset financed, the deal is in accordance with Islamic law.[26] This debate will continue. In the context of the argument presented here, as long as *Murabaha* satisfies the American Muslim community's need for Islamic financing, it should be made available to them.

Ijara

Ijara is a leasing contract. The ownership of a tangible item remains with the lessor while the lesee pays to utilize the asset.[27] *Ijara wa-Iqtina* translates as lease and ownership.[28] Here, the lessee is given the option of owning the asset at the end of the lease period and a portion of payments made is directed towards the purchase of the asset. In both types of contracts the lease payments and period must be agreed upon in advance to avoid any speculation.[29] Islamic leasing is "becoming the most popular form of Islamic finance."[30] It deals with tangible assets, which provides a form of financial guarantee and the profit margin is generally larger than in *murabaha*. Some Islamic scholars, however, argue that this form of financing is not very different than traditional banking products.[31] Moreover, some Islamic jurists prohibit *ijara wa-Iqtin*a since it guarantees profit for the lessor without any associated risk.[32] One scholar, while admitting this is a complicated financing structure, suggests tying the lease or rental payments to a percentage of business profits attributed to the leased asset.[33]

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[25] "Murabaha."
[26] M. Umer Chapra, *Towards a Just Monetary System* (Leicester, UK: The Islamic Foundation, 1985), 170.
[27] Zaher, 160.
[28] "Ijara," available from http://www.islamic-finance.com/item_ijara_f.htm; accessed on 21 February 2005.
[29] Zaher, 160.
[30] Ibid., 164.
[31] Ibid., 163.
[32] "Ijara."
[33] Ahmed Abdel-Fattah El-Ashker; 94-95.

Istinsa

Istinsa is another "mark-up" contract, similar to *murabaha* and *ijara*.[34] This type of contract is used in a deferred delivery situation and applies to customized orders.[35] It is most often used in the long-term financing of large projects. Under *istinsa*, the lender can either retain ownership of the plant and charge the operating company fees based on their profits; or the lender can package the contract in a similar way to *murabaha*, except in an *istinsa* contract various fees can be packaged into the deal.[36] Regarding *riba*-free financing, Islamic scholars express the same hesitations towards *istinsa* as with *murabaha* and *ijara* contracts.

Table 1: Overview of Islamic Financing Tools

Product Type	Financing Tool	Description	Level of Islamic Acceptability
Mark-Up Contracts	*Murabaha*	"Cost-Plus" Financing: financier purchases an asset and sells it to the borrower for an agreed upon profit margin. Payments may be in installments or a balloon payment.	Highly debated, depends on financing terms.
	Ijara and Ijara wa-Iqtina	Lease and Lease to Own: lessor maintains ownership of the asset as well as responsibility for insurance and maintenance. Payments and lease period must be established in advance.	Highly debated, depends on financing terms.
	Istinsa	Deferred Delivery Financing: used for customized orders and large, long-term finance deals. Can resemble *murabaha* or profit-sharing financing.	Highly debated, depends on financing terms.
Profit and Loss Sharing	*Mudaraba*	Limited Partnership: investor makes no management decisions and investor losses are limited to the amount invested.	Widely accepted
	Musharaka	Joint Venture: investors are involved in management decisions. Profits and losses are shared based on agreed upon proportions so that potential financial losses are not limited to the amount of money invested.	Widely accepted

[34] Zaher, 165.
[35] "Ijara."
[36] Zaher, 165.

Profit and Loss Sharing

There are two methods of profit and loss sharing financing, *mudaraba* and *musharaka.* Both types are equity investments that involve the investor sharing in the risk of an entrepreneurial venture. Hence, both contracts are accepted throughout the Muslim community.

Mudaraba is a limited partnership in which the entrepreneur and investor agree to a profit-sharing ratio in advance. In such deals, an investor is not involved in management decisions and losses are limited to the amount of capital invested. Also, the entrepreneur may not receive any set wages from the project, all compensation must come from their share of profits earned.

Musharaka is a joint venture in which investment partners have the right to make decisions regarding the project operations. In this type of contract, potential losses incurred by the investors are not limited to the amount invested. Rather, profits and losses are shared in the proportions agreed upon at the outset of the project. Partners are also permitted to establish salaries as part of contract agreements.

Current Islamic Financing Products Offered in the U.S.

In order to best understand the financing needs of the American Muslim community, the tools currently available must first be studied. The following section surveys the products available in the U.S. for Islamic banking, home mortgages, business finance, insurance and mutual funds. The appendix contains more detailed descriptions of the companies discussed in this portion of the paper as well as the products they offer. While unable to capture all activities in the Islamic financing sector, this analysis explores the major trends and products available to the American Muslim community.

Islamic Banking Services

In its February 14, 2005 issue, *BusinessWeek* named three U.S. banks in an article on "Islamic Friendly Lenders." The three banks were HSBC, University Bank and Devon Bank.[37] HSBC Amanah is headquarterd in the United Arab Emirates with regional offices in the United States, as well as several other countries. HSBC offers an interest-free banking product with a MasterCard debit card. Devon Bank, a sixty-year-old Chicago community bank, offers similar consumer products. More unique, the University Bank, based in Ann Arbor, Michigan is the first bank to offer an FDIC insured deposit instrument that is also *Sharia'a* compliant, the SHAPE Profit Sharing Deposit. For this product, University Bank invests deposits in a portfolio of *Sharia'a* compliant investments. Returns on the deposits are based on gross profits from the portfolio companies. Since the yields are not pre-set, depositors may retain all profits. Moreover, the depositors are not at risk of loosing any money since deposits are FDIC insured. Returns have consistently been over 1 percent the last twelve months (further detail available in Appendix B).

Islamic Mortgages

The Islamic home mortgage finance market is a fast growing resource available to American Muslims. American Finance House LARIBA is the largest financier in the U.S. of *Sharia'a* compliant mortgages.[38] LARIBA, meaning "no interest," stands for Los Angeles Reliable Investment Bankers Associates. It was established in Pasadena, California in 1987 and can now provide financing vehicles throughout the United States, with the exception of New

[37] "University Bank's Islamic Banking Division Is an "Islamic Friendly Lender" According to This Week's Business Week Magazine; One of Just Three in the United States," *University Bank Press Release*, 8 February 2005; available from http://biz.yahoo.com/iw/050208/080586.html; accessed on 20 February 2005.
[38] Alex Frangos, "For Devout Muslims, Interest is Forbidden," *The Wall Street Journal, Real Estate Journal*. 20 March 2003; available from http://homes.wsj.com/buysell/mortgages/20030320-frangos.html; accessed on 20 Februrary 2005.

York State, due to a strategic partnership with the Bank of Whittier. LARIBA structures home mortgages using an *ijara wa iqtina* contract blended with "diminishing" *musharaka* characteristics. LARIBA and the borrower enter a joint purchase agreement and over time, the borrower purchases LARIBA's share of the property. In addition, the borrower pays market-rate rent on their property. The rent paid to LARIBA corresponds to their share of ownership, which diminishes over time. However, to reduce confusion resulting from variable monthly payments, LARIBA structures this deal into fixed monthly payments. *Ijara wa iqtina* products are also available through Guidance Financial Group, based in Reston, Virginia; University Bank's MALT Home Mortgage Program; and Devon Bank. However, only LARIBA reduces the rent paid by the borrower as their share of equity in the property increases. Devon Bank and HSBC also offer *murabaha* home mortgage financing options. In these contracts the bank purchases the property and sells it to the borrower at a profit. Payments are made in monthly installments and rates are competitive with traditional mortgages.

Figure 2: An Example of Borrower Ownership Acquisition

Source: "A Program Tailored To Meet Your Needs," Guidance Financial Group; available from: http://www.guidancefinancialgroup.com/products/OurProgram.aspx; accessed on 1 March 2005.

In March 2001, Freddie Mac approved American Finance LARIBA as the first Islamic mortgage seller/servicer. That year, Freddie Mac purchased $20 million in Islamic home

financing.[39] In 2002, Freddie Mac and Fannie Mae committed $110 million to fund Islamic mortgages.[40] According to Yahia Abdul-Rahman, who founded LARIBA, Freddie Mac investments increased the volume of LARIBA home loans from about two per month to 10 per week, reduced down payments and tripled repayment periods to 30 years.[41] Freddie Mac has also benefited from the arrangement, "Freddie Mac's Islamic mortgage products are doing 'gangbusters business,' says company spokesman Brad German. 'We're doing about $20 million a month.'"[42] The company has continued to contract to purchase Islamic mortgages. A January, 2005 agreement with Devon Bank underscores Freddie Mac's commitment to this market.[43]

Business Finance

Both LARIBA and Devon Bank offer business financing. LARIBA targets small and medium businesses with a preference towards entrepreneurs with previous experience and national franchise businesses, such as gas and service stations and franchise restaurants.[44] LARIBA offers *musharaka* contracts as well as *ijara wa iqtina* financing. For trade finance, LARIBA uses a *murabaha*, cost-plus, tool. Devon Bank also provides *murabaha* financing to businesses in either a one-time transaction contract or a Murabaha Guidance Line, which is similar to a line of credit. For business real estate financing, an *ijara wa iqtina* tool is available that resembles the home mortgage contract structuring.

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[39] James F. Carey, "Freddie Mac's Role in the U.S. Housing Finance System," *Presentation to the Ninth Annual LARIBA Symposium*, 16 June 2001: 12; available from http://www.lariba.com/knowledge-center/articles/pdf/LARIBA%202002%20-%209th%20Annual%20LARIBA%20Symposium.pdf; accessed on 2 March 2005.
[40] Frangos; 2003.
[41] "Freddie Mac To Invest In Islamic Mortgages," *Islam Online* News, 4 April 2001; available from http://www.islam-online.net/English/News/2001-04/04/article5.shtml; accessed on 2 March 2005.
[42] Jeff Sanford, "Muslim Profit," *Canadian Business*, 27 September 2004; available from http://www.canadianbusiness.com/article.jsp?content=20040927_62214_62214; accessed on 2 March 2005.
[43] "Devon Bank, Freddie Mac Announce Expanded Financing Opportunities for Muslim Homebuyers," *Freddie Mac Press Release*, 10 January 2005; available from http://www.freddiemac.com/news/archives/afford_housing/2005/20050110_devonbank.html; accessed on 2 March 2005.
[44] "Business Financing" LARIBA American Finance House; available from http://www.americanfinance.com/business-financing.htm; accessed on 2 March 2005.

Significantly, pure venture capital is not an available financing mechanism through these institutions. Globally, Islamic financial institutions only invest around $1 billion annually in *musharaka* contracts, the equivalent of venture capital deals.[45] In 2002, there were around 100 Islamic Investment funds with over $3 billion in assets.[46] However, "Islamic funds do not invest in Islamic companies, they invest in companies listed on major stock markets screened according to *Sharia'a* guidelines."[47] The funds attempt to achieve high returns and are, generally, geographically diversified. The appendix contains profit measures of some U.S. equity funds for 2001, the most recent data available from Failaka International, Inc., the industry leader in Islamic fund information. Only one fund realized positive yields in 2001. The Islamic funds favored technology companies since their activities are considered Sharia'a compliant and were hit hard when that bubble burst.[48]

Islamic Mutual Funds

Mutual funds offer an Islamic investment alternative that mitigates much of the risk of investing while increasing capacity for wealth accumulation compared to tools like the SHAPE Profit Sharing Deposit. Failaka International, Inc. identifies three companies, Amana, Azzad, and the Dow Jones Islamic Fund, offering five different Islamic mutual funds in which US residents can invest. Both Amana and the Dow Jones Islamic Fund use advisory boards of Islamic scholars to guide investment decisions. All five funds experienced negative gains in the first few years of this decade, corresponding to the economic recession. Since Azzad and the

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[45] Muhammad Saleem, "Venture Capital: Where Muslims Fear to Tread," *Alt.muslim*, 9 February 2005; available from http://www.altmuslim.com/perm.php?id=1392_0_24_0_M; accessed on 2 March 2005.
[46] "Islamic Equity Funds: Analysis and Observations on the Current State of the Industry," *Failaka International, Inc.*, 5 March 2002: 2; available from http://www.failaka.com/Library/Articles/Islamic Fund Analysis 2002.pdf; accessed on 2 March 2005.
[47] Ibid., 3.
[48] Ibid., 1.

Dow Jones Islamic Fund were established in 2000, they are just starting to establish a record of positive yields. Further fund information may be found in Appendix B.

Amana Mutual Funds Trust offers two investment funds that avoid interest and investments in businesses not in-line with Islamic principles, such as the bank and the liquor industries. The Income Fund first began operating in 1986. The Income Fund "seeks current income and preservation of capital." The Growth Fund was started in 1994 for investors wanting long-term capital growth.[49] Saturna Capital Corporation administers both funds. The two mutual funds have over 6,600 shareowner accounts and more than $78 million invested.[50] In the first half of the 2004-2005 fiscal year, the Growth Fund gained 16 percent and the Income Fund grew 19.7 percent. These figures compare to 5.7 percent for the S&P 500 Index and 5.8 percent for the NASDAQ Composite Index over the same period.[51]

Azzad Asset Management, Inc. offers two ethical mutual fund products. The Azzad Ethical Mid-cap Fund (ADJEX) began operating in November of 2000. Before December of 2003, the fund was known as the Azzad/Dow Jones Ethical Market Fund and invested in large cap U.S. stocks. Now, most of the fund assets are invested in mid cap stocks, that is, companies with between $500 million and $10 billion at the time of investment. The fund tries to match or better the performance of the Standard & Poor's Midcap 400 Index. 2003 was the first year the fund experienced positive returns. The October 7, 2004 year-to-date performance was 1.12 percent growth.[52] The Azzad Income Fund (AEIFX) primarily invests in equity securities with the objective of providing current income consistent with ethical values. The majority of

[49] "Amana Mutual Funds Trust," available from http://www.amanafunds.com/; accessed on 2 March 2005.
[50] "Amana Semi-Annual Report," 30 November 2004: 1; available from http://www.amanafunds.com/; accessed on 2 March 2005.
[51] Ibid.
[52] "Prospectus: The Azzad Funds Ethical Investing," 5 November 2004: 6; available from http://www.azzadfund.com/pdf/PNov2004.pdf; accessed on 2 March, 2005.

investments are in large-cap dividend-paying companies. This fund also only experienced gains in 2003. The year-to-date yields on October 7, 2004 were 1.8 percent. Both funds are managed by Wright Investors' Service, which manages over $2.5 billion in assets.[53]

The Dow Jones Islamic Fund (IMANX), offered by Allied Assets Advisors, a subsidiary of the North American Islamic Trust, is a fifth fund option available to Muslim investors. Established in June of 2000, the fund attempts to provide capital growth in accordance with Islamic principles. At least 80 percent of the fund assets are invested in foreign and domestic securities listed on the Dow Jones Islamic Market Indexes.[54] This fund also only began realizing positive returns in 2003.[55]

Summary

A variety of banking and financing tools are being developed to cater to the American Muslim population. Much of the emphasis has been on wealth creation and accumulation, whether in the form of home equity or long-term investments in mutual funds. The demand for these products is driving their availability and their profitability. Freddie Mac anticipates that the first 5 years of activity in the Islamic home mortgage market will yield around $5 billion in loans.[56]

Many of the products are far too new to allow for an assessment of their financial returns. While, the hope is that these tools are allowing Muslim families to access the same opportunities for wealth building as the rest of the American population, the demand for financing remains high. Current financing structures, relying highly on mark-up contracts, may not satisfy the most puritan of Muslim populations. Innovation and invention must be encouraged so that the entire

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[53] Ibid.,12.
[54] "The Dow Jones Islamic Fund," available from http://www.investaaa.com/; accessed on 2 March 2005.
[55] "Dow Jones Islamic Fund Prospectus," 1 October 2004: 3; available from http://www.investaaa.com/; accessed on 2 March 2005.
[56] "Freddie Mac to Invest in Islamic Mortgages."

community may be served. Moreover, a greater variety of business financing products need to be made available. This market is profitable and far from saturated.

Community Development Organizations

Community Development Corporations (CDCs) and Community Development Financial Institutions (CDFIs) both attempt to redress the problem of financial disinvestment in minority and low-income communities and the resulting neighborhood physical distress caused by this gap in capital access.[57] They generally hold a non-profit tax-exempt status, have a volunteer board of directors and a volunteer loan committee if they provide financing services. The vast majority of CDCs and CDFIs focus on housing development, though between 30 to 50 percent of CDCs provide business development services.[58] The following section briefly describes the origins and histories of these two types of community development organizations, as well as the policies that have influenced their developmental trajectories. The potential role of CDCs and CDFIs in the provision of Islamic financing tools is then discussed. That leads us into the next portion of the paper, a case study of Minneapolis community development organizations providing patient Islamic-based financing.

Origins and Histories

The first generation of CDCs originated from the Special Impact Amendment to the Economic Opportunity Act, legislation initiated by Senators Robert Kennedy and Jacob Javits after a visit to the Bedford-Stuyvesant neighborhood in Brooklyn. This first wave of about 100 CDCs, including the Bedford-Stuyvesant Redevelopment Corporation (BSRC), concentrated on

[57] Randy Stoecker. "The CDC Model of Urban Redevelopment: A Critique and an Alternative." *Journal of Urban Affairs*, vol. 19 no. 1 (1997): 1-22.
And Kristin Moy and Alan Okagaki. "Changing Capital Markets and Their Implications for Community Development Finance." *Capital Xchange Journal*, July 2001.
[58] Stoecker; 2.

job creation. The second movement of CDCs occurred during the 1970s in response to displacement caused by urban renewal and financial redlining activities. This generation consisted of between 500 and 1000 organizations with missions targeting housing development. As local government funding targeting urban poverty issues decreased, private and federal funds stepped in. New funding sources included "private philanthropy such as the Ford Foundation's Grey Areas Program, support groups, intermediaries, and funding from Title VII of the Community Services Act."[59] Between 1966 and 1980, federal funding levels for CDCs increased to over $500 million, resulting in a surge of new CDCs that brought the total number of these organizations to around 2,000.

The first community development financing activities, such as loan and venture capital funds, were offered by the first generation of CDCs. BSRC developed a small business lending program as part of its initial redevelopment activities.[60] Today, they continue to manage a "Restoration Capital Fund."[61] However, less than 50 CDCs received Special Impact Program funding from the Office of Economic Opportunity, not of all which provided financing services. In the 1970s, the first community development banks and credit unions were established, such as South Shore Bank of Chicago in 1973. While many newly established CDFIs turned to federal sources of funding, including funds from Housing and Urban Development, Department of Agriculture and The Economic Development Administration, others raised philanthropic capital from local and religious institutions and individuals. These organizations created loan and

[59] Ibid; 2.
[60] Moy and Okagaki; 3.
[61] "Restoration Capital Fund," available from http://www.restorationplaza.org/bd/rcf.html; accessed on 11 April 2005.

revolving loan funds to finance home mortgages, community land trusts and low-income co-operatives.[62]

Throughout the 1980s, federal funding for affordable housing was reduced by over 70 percent. As a result, many CDFIs and CDCs focused their efforts on affordable housing. Two federal policies, the Community Reinvestment Act (CRA) and Low-Income Housing Tax Credits (LIHTC) created by the Tax Reform Act of 1986, contributed to increased bank and corporate investment in affordable housing. State and local governments turned to CDCs and for-profit housing developers to answer their local affordable housing needs. Finally, national community development organizations, such as the Enterprise Foundation and the Local Initiatives Support Corporation (LISC), mobilized large amounts of corporate investment in affordable housing through the syndication of LIHTC in order to support a vision of "community-based non profits as developer, managers and financers of affordable housing."[63]

In the 1990s, CDFIs received a major boost from the Clinton administration's support of stronger CRA requirements. The legislative changes, passed in 1995, caused an increase in bank investments and lending activities in low-income communities. Clinton also endorsed the 1994 Riegle Community Development and Regulatory Improvement Act, establishing the CDFI Fund. The CDFI Fund operates a variety of programs aimed at certifying organizations as CDFIs, improving CDFI lending capacities and encouraging banks to invest in low-income communities and CDFIs. The CDFI Fund was also given the administration portfolio for the New Markets Tax Credit Program (NMTC), a program designed to encourage private investment in economically distressed neighborhoods in exchange for tax credits.[64]

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[62] Moy and Okagaki; 3-4.
[63] Ibid; 6-7.
[64] Benjamin Lehn, Julia Sass Rubin, and Sean Zielenbach, "Community Development Financial Institutions: Current Issues and Future Prospects," March 2003. Paper presented at Chicago Federal Reserve Bank Conference: *Seeds of*

Today CDFIs are responding to three types of community development needs: "basic financial services; affordable credit for home purchase, rehabilitation, and maintenance; and loan and equity capital for business development."[65] By 2001, the number of certified CDFIs had increased to about 650 organizations with assets ranging between $5,000 and $730 million. Moreover, beyond community development banks and credit unions, CDFI activities now include community development venture capital; micro-enterprise funding; and housing, business and facility loan funds.[66]

The Role of CDCs and CDFIs in Islamic Financing

A 2001 article by Kristin Moy and Alan Okagaki highlights that CDFI market niches are with clients requiring a great deal of technical assistance, products with high transaction costs, and high-risk investments.[67] Thus, CDFIs and CDCs, experienced in providing capital and technical assistance to populations traditional financial institutions cannot and will not serve, are well positioned to provide Islamic financing options to growing segments of the American Muslim population. Specifically, community development organizations possess the services and grass-roots orientation required to reach America's Muslim immigrant population.

These communities lack the skills and understanding to navigate and succeed in mainstream financial circles. Moreover, immigrants have not built the necessary credit histories and business track records that banks generally require. Merging the patient lending products developed by CDCs and CDFIs with Islamically acceptable financing products can address this capital gap.

Growth; Sustainable Community development: What Works, What Doesn't and Why, Washington, DC, March 2003. pp. 5-8.

[65] Ibid. p. 3.

[66] Ibid. p. 2.

[67] Moy and Okagaki; 10.

Finally, interpretations may vary among different communities regarding how strictly financing products must adhere to the tenets of Islamic law. Community development organizations, with their focus on local needs, are able to develop financing products to address the specific requirements of the communities they serve; whereas banks are looking at products that must satisfy broad sectors of Muslims across the U.S.

The following section of the paper will demonstrate how Minneapolis-based community development organizations are providing such tools and meeting local demands. Thus far, these three organizations are the only identified CDCs and CDFIs providing Islamic-based financing products in the United States. They have combined years of patient financing experience with Islamic financing products that meet their Muslim immigrant community's needs.

The Provision of Patient Islamic Financing in the Twin Cities, A Case Study

The African Community in the Minneapolis-St. Paul MSA

The 2000 U.S. Census estimated that 30,388 African immigrants called the Twin Cities home. Almost 80 percent of that community immigrated to the U.S. between 1990 and 2000 and nearly all of them do not have citizenship status (see Appendix C, Figures 1 and 2). Twenty-three percent, or 8,933 of those claiming African ancestry in the Minneapolis-St. Paul MSA were of Somali origin.[68] This reflects the highest metropolitan concentration of Somalis in the U.S.[69] Public school enrollments in Minnesota reveal a doubling of Somali students between the 1999-2000 school year and the 2001-2002 school year, concentrated in metropolitan areas (see Appendix C, Figure 3). During the same period of time, nearly 5,000 refugees from Somalia

[68] 2000 U.S. Census, Summary File 3, QT P13 Ancestry 2000; available from www.census.gov; accessed 8 April 2005.
[69] Art Hughes, "Census: poverty still a problem for some minorities." Minnesota Public Radio. Aired September 25, 2002 available from http://news.minnesota.publicradio.org/features/200209/25_hughesa_census/; accessed on 8 April 2005.

settled in Minnesota (see Appendix C, Figure 4). Nearly all Somalis subscribe to the Muslim faith.

High levels of poverty characterize the immigrant population of the Twin Cities. Of the total foreign-born population in the MSA, 19 percent fell below the poverty line in 2000. The vast majority of the foreign-born population living in poverty are not U.S. citizens. While the Census does not report poverty statistics based on place of birth or ancestry, it does report poverty levels categorized by year of entry. Around one-quarter of the total foreign-born Twin Cities population that immigrated to the United States between 1990 and 2000 are living in poverty. Again, most of them do not hold U.S. citizenship. Though it is difficult to infer from these data what the income status is of African and Somali immigrants in the Minneapolis-St. Paul MSA, it does provide anecdotal evidence suggesting that poverty and lack of economic opportunities are amongst the major challenges these communities face.

Financing Muslim Small-Businesses

Three community development organizations have stepped in to serve the Twin City Muslim small-business community: the Neighborhood Development Center (NDC), the African Development Center (ADC), and the Minneapolis Consortium of Community Developers (MCCD). These three organizations operate in a cooperative fashion to provide the needed financing and supportive services to assist the Muslim population in addressing their community economic needs. The following section describes these three lenders, their organizational missions and intertwined organizational histories. The next part of the case study depicts the process of Islamic Financing in Minneapolis and how it evolved there. Following that, an explanation of the Islamic lending products available through these institutions is provided. The next section details the other services made available to clients to assist in their business and

financial success. Finally, an analysis of the impacts of these organizations' Islamic lending activities concludes this segment of the case study.

Research Methodology

The case study analysis builds upon three research methods. Key informant interviews constitute the primary source of information. Interviews are supported with information from organizational websites. The second method of examination utilized direct observation of organizational activities at ADC's office in the Cedar Riverside Neighborhood of Minneapolis, Minnesota. Finally, NDC internal documentation provided impact data for the organization's Islamic financing transactions and archival records at the client level were used for an assessment of ADC and NDC's services.

Nine individuals from all three community development organizations were interviewed for this study, with a focus on those involved in the Islamic finance activities. At ADC, all four staff members were interviewed in person. Also, Tim Mungavan, Chairman of ADC's Board of Directors, provided an in-person interview; and Alison Halley, Loan Committee Chair, was interviewed over the phone. From NDC, Mara O'Neil, the Chief Operating Officer, was interviewed over the phone. MCCD Executive Director, Jim Roth, and Loan Pool Manager, Dave Chapman, also gave face-to-face interviews. One other interview with a representative from a non-lending ADC partner, Tavyer Buechler of Common Bond Communities, helped establish the necessary context regarding the status of Somali immigrants in Minneapolis. Wafiq Fannoun, Executive Director of Reba Free, LLC, declined an interview. Clients also informed the case study research, generally through informal visits to their place of business. For example, a visit to one of the Somali Malls—a concentration of Somali owned stores in a converted warehouse—provided insight to the types of businesses that have been financed by

NDC. [70] One client, identified by ADC staff as comfortable enough with English and willing to be interviewed, answered questions in a more formal meeting during a visit to their store. For the purpose of protecting borrower privacy, no entrepreneur or business names are included in this report or the bibliography. Furthermore, any specific information relayed during these experiences is combined with data or information from other sources, thus contributing to the overall analysis.

A site visit at ADC from March 14th through the 16th, 2005, established an understanding of the cultural and organizational functions of ADC. Interactions with walk-in clients and visitors were observed, as were staff activities and cooperation. Moreover, the geographical context of the Cedar Riverside neighborhood and Minneapolis Somali business community were clarified through this visit.

Important information was also acquired from organizational documents. An NDC internal document supplied detailed historical background on the organization's involvement with Islamic Financing as well as data regarding their loan volumes. From ADC, a spreadsheet with detailed client, loan and business information, compiled by Hussein Farah, was used to ascertain the impacts of ADC's activities. Together, these sources of information provided the necessary foundation for an analysis of the Islamic lending activities in the Twin Cities.

Organizational Information

Neighborhood Development Center (NDC)

Inspired by South Shore Bank of Chicago, Western Bank in St. Paul established Western Initiatives for Neighborhood Development (WIND) in 1990. WIND, a Community Development Corporation set up as a subsidiary of Western Bank, "support[s] local economic

[70] Mara O'Neil, phone interview with author, March 23, 2005.

revitalization initiatives in core areas of poverty in St. Paul and Minneapolis."[71] In response to identified neighborhood needs, WIND leadership and Western Bank supported the creation of the Neighborhood Development Center as an independent, community-based, not-for-profit, 501(c)3 entity. Since NDC's establishment in 1993, Western bank has continued to support NDC through the provision of technical assistance, resources and guidance.[72]

NDC's mission is to "help emerging entrepreneurs develop successful businesses that serve their community, and to help community groups build a stronger neighborhood economy."[73] NDC employs a three-pronged approach to community development aimed at the revitalization of low-income, inner city and ethnic neighborhoods. Their three branches focus on neighborhood development, enterprise development-- the creation and support of small businesses operated by low-income persons-- and community empowerment through community organizing and social capital development.[74]

Services offered by NDC include business training, traditional and Islamic financing, technical assistance, business incubation, and they recently added real estate development services in 2002. The organization also provides client services in four languages, Hmong, Somali, Oromo and Spanish. NDC approaches their mission as a partner with communities, allowing the local community to control the revitalization process. By providing training, financing and support for community entrepreneurs, NDC advances their goals of generating community income and wealth, creating jobs, strengthening the local economy, establishing businesses that act as community gathering places and encouraging business owners to fill the

[71] "About NDC," available from http://www.windndc.org/1about_ndc/1about.html; accessed 30 March 2005.
[72] Ibid.
[73] Ibid.
[74] Ibid.

roles of community leaders.[75] NDC partners with 18 neighborhood and community organizations in order to deliver their business training, financing, ongoing business technical assistance and real estate services in designated low-income areas of the Twin Cities and to the ethnic communities of African Americans, Native Africans, Hmong, American Indians and Latinos.[76] ADC is one of these organizations and Mulki Hussein, program coordinator at ADC, sits on NDC's board of directors.[77]

Minneapolis Consortium of Community Developers (MCCD)

The Minneapolis Consortium of Community Developers officially incorporated as a 501(c)3 in 1989 after nine years of informal inter-institution cooperation among non-profit developers working in Minneapolis. At the time of incorporation, MCCD consisted of 11 member organizations.[78] Currently, there are 27 member institutions working on affordable housing and economic development initiatives in Minneapolis, seven of which were original members. MCCD promotes cooperation between these organizations to "increase opportunities for development of quality, community-based projects through collaborative action on public policy issues, loan fund development, public education efforts, and long-term strategic planning."[79] Both NDC and ADC are members of MCCD and Mike Temali, Executive Director of NDC, currently sits on MCCD's board of directors.[80]

MCCD, a certified Community Development Financial Institution,[81] established a micro-loan fund soon after the organization's incorporation. These loans are targeted as seed capital for new and early-stage small businesses in the Minneapolis area. MCCD loans range from $2,000

[75] Ibid.
[76] "Who We Serve," available from http://www.windndc.org/2who_we_serve/2whoweserve.html; accessed 30 March 2005.
[77] Mulki Hussein, interview by author, digital sound recording, Minneapolis, MN, March 15, 2005
[78] "Our History," available from http://www.mccdmn.org; accessed 30 March 2005.
[79] "Home," available from http://www.mccdmn.org/; accessed 30 March 2005.
[80] Jim Roth, interview by author, digital sound recording, Minneapolis, MN, March 16, 2005.
[81] Ibid.

to $15,000. If the loan is done in partnership with a bank, the maximum amount financed can reach $50,000.[82] MCCD also provides technical assistance to businesses through their member organizations, seven of which also provide clients with financing opportunities.

The original MCCD model parsed the city into districts serviced by member institutions. Using this map, MCCD clients were referred to an organization based on the client's geographic location. However, this model required adjustment with the recent additions of the African Development Center and the Latino Economic Development Center, both of which support ethnic communities, wherever locate, rather than geographically-defined neighborhoods.[83]

African Development Center (ADC)

Established in 2002 as a 501(c)3 non-profit organization, the African Development Center's mission is "to work within the African communities in Minnesota to start and sustain successful businesses, build assets, and promote community reinvestment."[84] ADC is an ethnically based organization, focused on serving pan-African immigrant and refugee communities across Minnesota. However, this new organization is still building capacity. Currently most of their clients are members of the Somali community in Minneapolis and St. Paul.[85]

ADC offers courses on financial literacy, business training courses in conjunction with NDC, ongoing business technical assistance, traditional and Islamic business financing, and home ownership training courses.[86] Three of the four ADC staff members are Somali natives; their language skills and cultural knowledge enhance the courses and training offered to this

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[82] "Terms and Conditions," available from http://www.mccd.nonprofitoffice.com/index.asp?Type=B_BASIC&SEC={C4368EB1-B31E-4205-8733-5A9AA4E23F1C}; accessed 30 March 2005.
[83] Jim Roth.
[84] "Home," available from http://www.adcminnesota.org/; accessed 30 March 2005.
[85] Hussein Samatar, interview by author, digital sound recording, Minneapolis, MN, March 14, 2005.
[86] Mulki Hussein.

community. As the organization builds momentum, they plan to increase outreach programs to other Native African communities as well as build their geographic reach.[87]

ADC operates through many inter-institutional partnerships. In the area of business development, ADC works in conjunction with NDC and MCCD. The Home Ownership Center and the Project for Pride in Living are two key partners in ADC's homeownership training initiative. Finally, ADC works with Wells Fargo Bank, Freddie Mac and US Bank on financial literacy services.[88]

The Development of Islamic Financing and Providers in Minneapolis

The Leadership Of The Neighborhood Development Center

The development of Islamic financing in Minneapolis originated with a simple realization that Somali graduates of the Neighborhood Development Corporation's business training program were not applying for micro-financing from the organization. With the help of board member Wafiq Fannoun, NDC developed a *murabaha* lending product that addresses the Muslim community's aversion to interest-based loans. In April of 2001, NDC began providing Islamic financing to the underserved Muslim community of Minneapolis.[89]

With approximately $20,000 of NDC loan funds, the organization piloted the Profit-Based/Reba Free Financing Program. The first deal financed a five-thousand dollar used van for an entrepreneur providing food delivery service from a local Somali restaurant to taxi drivers working at the airport and other locations across town. The second entrepreneur received financing to purchase a bus that he uses to transport children to a Muslim private school.

With the success of their pilot program, NDC launched their Islamic financing program using $100,000 from The Minneapolis Foundation. The *murabaha* financing met such great

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[87] Hussein Samatar, March 14.
[88] "Partners and Sponsors," available from http://www.adcminnesota.org/partners.html; accessed 30 March 2005.
[89] Mara O'Neil.

demand that NDC was quickly forced to seek out more funding for the program. The State of Minnesota provided support for the new lending program by changing language in their Urban Initiatives Program (UIP) to allow those funds to be used for Islamic financing. NDC designated $150,000 of these allocations towards the *murabaha* product. The City of Minneapolis Enterprise Zone also allocated $150,000 to NDC for *riba* free financing. Finally, NDC received a distribution of $47,000 from the Office of Refugee Resettlement to provide financing to women refugees and asylees. Beginning in March of 2003, NDC began expanding their program to service the Twin Cities suburbs using an additional $100,000 in UIP funds for program eligible neighborhoods, and $100,000 if internal NDC funds for non-UIP eligible areas.

NDC has received national recognition since their launch of the *murabaha* product. In June 2003, the Association for Enterprise Opportunity (AEO), the national association for microenterprise developers, presented its 2nd Annual AEO Innovation Award to NDC's Profit-Based/Reba Free Financing Program. The following month, NDC's Islamic financing was featured on PBS's nation-wide program *Right on the Money*, hosted by economist Chris Farrell. The program explored how immigrants cope with American financial customs and what programs are available to them.[90]

The Role of Reba Free, LLC

Fannoun created the *murabaha* loan product working closely with Muslim scholars. During this process in 2000, he established Reba Free, LLC, a limited liability corporation that provides Islamic financial, investment and consulting and owns the proprietary rights to the *murabaha* product and lending documents. NDC contracts with Reba Free to conduct the underwriting for *murabaha* financing and provide guidance regarding their Islamic-based

[90] "Profit-Based/Reba Free Financing Program, Background Information," NDC internal document, provided by Mara O'Neil March 23, 2005.

financing. As Mara O'Neil, Chief Operating Officer for NDC, explains, there are always questions as to what one can and cannot do. In those cases she turns to Fannoun for answers.

Working in the sphere of patient micro lending, NDC does not operate with absolute loan terms. As loan parameters are being worked out, NDC turns to Reba Free to ensure that the final loan product still meets Islamic financing standards.[91] Reba Free now also contracts with MCCD to provide the organization with the *murabaha* documentation and training for their loan officers. Fannoun is also looking to expand Reba Free's services to other parts of the United States. Currently, he is working with a New York CDC to establish an Islamic financing product.[92]

The Origination of the African Development Center

The African Development Center emerged from within NDC and Reba Free's activities and as a result of the increasing needs of the African immigrant community. Hussein Samatar, Executive Director of ADC, previously served as NDC's Islamic loan portfolio manager between 2001 and 2004. During this time, he also participated in a Somali radio show with Mulki Hussein on KFAI, Fresh Air Radio. Hussein had been working at a credit counseling organization, helping individuals with credit problems and providing debt consolidation services. The idea for a community development organization focused on the specific economic needs of the Somali immigrant community materialized as these two Somali community advocates exchanged thoughts and concerns regarding the financial situation of their community.[93]

While still employed at NDC, Samatar began working on ADC in 2003. With the blessings of NDC Executive Director Mike Temali, Samatar spent one day a week establishing the new organization. During this year, Mulki Hussein received a Local Initiative Support

[91] Mara O'Neil.
[92] Jim Roth.
[93] Hussein Samatar, March 14.

Corporation (LISC) internship grant that allowed her to take a community development course and paid her a small stipend to work part-time at ADC. The West Bank CDC (WB) provided ADC with office space. A relationship with WB existed early on, as WB owned the building in which both the KFAI radio station and WB offices are located. Samatar and Hussein looked to Tim Mungavan, Executive Director of WB and current president of ADC's board of directors, for guidance in establishing their CDC.[94]

Eventually, Samatar's time commitments shifted towards ADC, and by March of 2004 he was working full-time as ADC's executive director.[95] Throughout the process of establishing ADC, Samatar began assembling potential staff members. He met with Kris Maritz in December of 2003. Maritz first joined the staff as a consultant to ADC, applying her MBA in Finance and background in small business consulting.[96] Hussein Farah, who holds a degree in Islamic Finance from a Malaysian university, originally worked for Reba Free as a consultant to NDC, where he and Samatar first worked together. Samatar approached Farah and invited him to join the ADC team. Farah first began working as a consultant to both ADC and Reba Free. However, this arrangement became complicated as issues of conflicts of interest and client ownership emerged. Forced to choose, Farah came to work as a full-time consultant for ADC in mid-2004.[97] As funding has become available, the staff have been given full-time positions, starting with Hussein in early 2004. Farah came on as full-time staff in January of 2005, and Maritz became a full-time employee on April 1, 2005.[98]

Using Smatar's and Farah's knowledge of the *murabaha* lending product developed by Reba Free, ADC was able to structure their Islamic financing to mirror NDC's. However, loans

[94] Hussein Samatar, March 14 and Mulki Hussein.
[95] Hussein Samatar, March 14.
[96] Kris Maritz, interview by author, digital sound recording, Minneapolis, MN, March 15, 2005.
[97] Hussein Farah, interview by author, digital sound recording, Minneapolis, MN, March 15, 2005.
[98] Hussein Samatar, March 14.

from ADC only became available in the beginning of 2005, coinciding with an allocation of interest-free funds from the Minnesota Urban Investment Program (UIP) to form their first loan pool. Prior to that, ADC arranged financing for their clients through other organizations. The tasks performed by ADC staff included a wide array of functions, such as securing financing options, loan origination, due diligence, entrepreneur consultations and assistance with payment collection.[99]

All of the Islamic financing deals were done through NDC's *murabaha* product. As ADC increases its own lending activities, both traditional micro-finance loans and Islamic micro-financing, they continue to collaborate with NDC, with the added potential role of taking part in the actual lending. As Samatar expressed, "we have no intention of going alone in any loan."[100] Moreover, ADC has worked to bring a third partner into the fold, the Minneapolis Consortium of Community Developers.[101]

The Minneapolis Consortium of Community Developers

The Minneapolis Consortium of Community Developers gained interest in Islamic micro-financing during the process of ADC's initiation into their organization.[102] MCCD has operated a micro-loan pool for over a decade.[103] With the dramatic increase in demand for Islamic financing, they realized the importance of providing Minneapolis' new immigrant population with access to capital. Contracting with Reba Free and NDC for the *murabaha* loan documentation as well as loan-officer training to be conducted by Reba Free, MCCD entered the

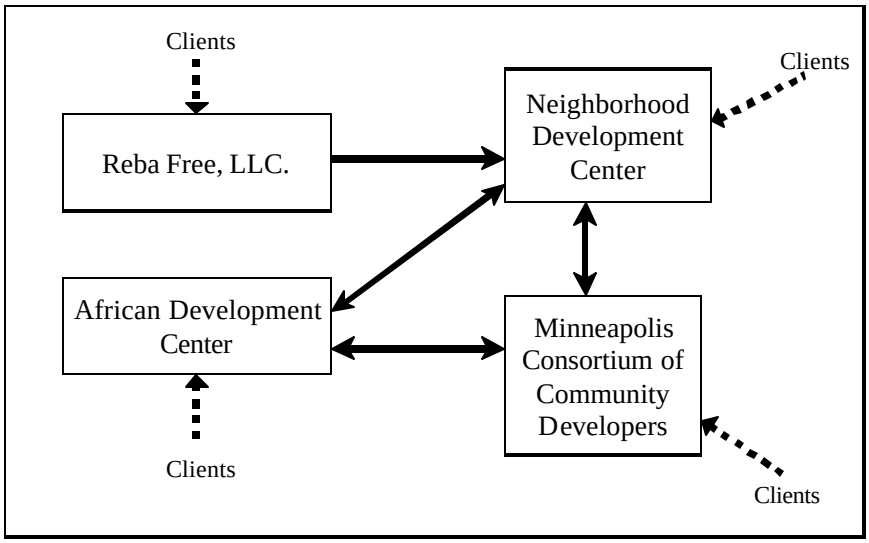
[99] Hussein Farah, interview, and Mara O'Neil.
[100] Hussein Samatar, March 14.
[101] Hussein Samatar, March 14
[102] Dave Chapman, interview by author, digital sound recording, Minneapolis, MN, March 16, 2005. and Jim Roth.
[103] "Our History," available from http://www.mccdmn.org; accessed 30 March 2005.

Minneapolis-St. Paul Islamic Financing arena in late 2004. The contract covers all of MCCD's member organizations, including ADC.[104]

Thus far, MCCD has purchased 50 percent of two Islamic financing deals from NDC. In order to do so, they tap into their own UIP allocation. ADC worked to coordinate NDC and MCCD roles in these two loans. With their own loan pool, ADC has recently approved their first Islamic loan, to be executed in conjunction with MCCD, each organization participating 50 percent in the total amount borrowed. MCCD has also recently closed their first *murabaha* loan in which no other organization participated. However, MCCD does not plan to conduct much of their Islamic financing without ADC. While suggesting that the volume of their Islamic financing deals will be dependent on ADC's participation, MCCD representatives also indicated that they hope to close 20 to 30 Islamic loans in 2005 of up to $25,000 per deal. MCCD also administers ADC's new loan pool in order to capitalize on their experience and reduce redundant overhead costs between the two organizations. On the other side of the partnership, ADC will perform much of the required tasks in the loan process, such as purchasing the product financed and transferring it to the business owner, as well as loan collections.[105]

[104] Jim Roth and Dave Chapman.
[105] Ibid.

Figure 3: Organizational Interaction



Financing Structure

The *murabaha* financing offered to borrowers in the Twin Cities adheres to the basic tenets described in the first part of this paper. In the process developed by Reba Free, the lending institution purchases an asset on behalf of the business owner and resells the item at a mark-up price. The mark-up is around 10 percent,[106] and is calculated using the amount of interest a regular NDC borrower would have paid on a similar loan with similar repayment terms.[107] The entrepreneur is not required to sign a purchase contract prior to the lending institution's acquisition of the item to be financed.[108] In this way, NDC, ADC and MCCD participate in the risk of the transaction, as required by Islamic finance law. While the profit earned on the mark-up does reflect some of the same issues of risk and time that traditional loans capture in fees and interest, in these loans the mark-up is fixed and loan pre-payments do not reduce the overall amount of financing. However, according to O'Neil at NDC, if a borrower

[106] Chris Farrell, "Coming to America: Challenges immigrants face when building a financial identity in America." Right on the Money, episode 525. Produced by Maggie Tacheny and Erin Halden. Twin Cities Public Television, Inc. Original air data July 5, 2003. Transcript available from http://www.rightonthemoney.org/shows/525_immigrant/show_525.html; accessed on 6 April 2005.
[107] "Profit-Based/Reba Free Financing Program, Background Information."
[108] Mara O'Neil.

does pay off their debt well under the agreed upon terms, NDC does forgive part of the price mark-up. NDC has also piloted a Royalty Agreement product, where NDC will jointly purchase inventory with an entrepreneur. As the inventory is sold, the entrepreneur pays NDC their portion of the initial investment plus a negotiated return.[109]

There are several factors that limit the maximum loan amount available to borrowers. The primary reason loans sizes are restricted relates to the funding source for the loan pool. In order for a loan to satisfy Islamic financing requirements, the source of funds used by the lender may not charge the lender interest. NDC, ADC and MCCD found such "clean" allocations from the Urban Investment Program. This state fund was established to provide community organizations that provide micro-credit with an interest-free source of funding. The recipients of these funds are required to repay the state. They may, however, retain any interest or profit earned from lending the money.[110] NDC worked early on to remove any reference of interest from their program documentation.[111] Thus the UIP funds became flexible enough to satisfy the need for interest-free loan-pools. Though, all three organizations use their UIP allocations for both Islamic and traditional micro-loans.[112]

One of the stipulations regulating the use of UIP funds restricts the lending organization to maximum loan amounts of $25,000. The state wanted to ensure that the UIP funds reached as many entrepreneurs as possible with the added benefit of limiting the amount of risk incurred by the state. Early on, sharing in larger loans so that no single organization used more than the UIP permissible amount circumvented this limitation. Thus, the total amount financed for a single entrepreneur could exceed $25,000. While the organizations continue to partner on loans, this

[109] "Profit-Based/Reba Free Financing Program, Background Information."
[110] Hussein Samatar, March 14.
[111] Mara O'Neil.
[112] Hussein Samatar, March 14, Kris Maritz, Mara O'Neil, Jim Roth and Dave Chapman.

practice of loaning more than the maximum UIP limit has been halted. Now the organizations restrict each financing deal to the total maximum allowable.[113]

NDC is also the recipient of an Enterprise Zone loan pool allocation, allowing them to provide loans over $25,000. This program also required working with officials to change the wording in the program documentation in order to eliminate references to interest.[114] However, some interviewees suggested that due to the current political climate, this source of funds is not likely to continue providing allocations.

The second element of the *murabaha* product restricting size relates to the asset-based financing in itself. The lenders must be able to finance, mark-up, and transfer ownership over a tangible asset. This greatly restricts the availability of financing to Muslim entrepreneurs. Start-ups must look elsewhere for funds to cover rent, permit acquisition and other costs related to opening a new business. Most often entrepreneurs use personal savings to cover these costs. It is also common for new businesses to experience cash flow difficulties, and *murabaha* financing cannot be used to bridge a business through those difficult times.[115] One borrower mentioned tapping into household finances to cover business losses for the first few months of operation.

Other Client Services Provided

As with any patient lending, the business owners seeking Islamic financing from NDC, ADC, and MCCD require a significant amount of technical assistance. Alison Halley, head of ADC's newly formed loan committee, anticipates that the vast majority of applicants for Islamic financing are going to be new business start-ups. Moreover, the entrepreneurs, though they may

[113] Hussein Samatar, March 14.
[114] Mara O'Neil.
[115] Kris Maritz.

have industry work experience, will very likely be first-time business owners with no track record. This increases the risk level of these loans.[116]

In order to mitigate against these increased risk levels, all three organizations couple their financing activities with entrepreneurial training. All three lenders generally require that all borrowers either complete a business training course, have a strong business plan or have at least one year of strong business financial performance. NDC, MCCD and ADC partner on providing a business training course which is taught in Somali and walks aspiring entrepreneurs through the process of developing and writing a business plan. Students have eight class sessions as well as eight one-on-one meetings. Throughout the course they are taught to utilize information technology to conduct research on their proposed business industry and prepare the appropriate financial projections. The classroom used for the course is located in the Lake Street Small Business Center and is equipped with a computer at each desk. Students are also able to access a computer laboratory in the Center.[117] In addition, NDC offers course scholarships to members of targeted ethnic communities, including native Africans.[118]

Once a business opens, NDC contracts with ACD to provide the technical assistance and ongoing consulting to designated clients, capitalizing on the newer organization's culture and linguistic expertise. Business assistance services provided include "marketing, merchandising, financial record-keeping, credit repair, retail management, restaurant layout, design & management, legal assistance, business operations, as well as food production and sales."[119] NDC clients may also be able to locate in one of NDC's five business incubators.[120]

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[116] Alison Halley, phone interview by author, March 29, 2005.
[117] Hussein Farah, interview, and Mulki Hussein.
[118] "Who We Serve."
[119] "Ongoing Support," available from http://www.windndc.org/3small_business_services/3c.services_support.html; accessed 6 April 2005.
[120] "Business Incubation," available from http://www.windndc.org/3small_business_services/3d.services_bisincubation.html; accessed 6 April 2005.

ADC also provides walk-in consultations to interested community members. These consultations are intended to assist potential entrepreneurs with identifying focused business goals. While some individuals continue pursuing their business aspirations, either on their own or with the assistance of ADC, many come to realize that they are not prepared for the requirements of small business ownership or financing. Some individuals do not have a clear vision of their business goals and choose to wait until they are more prepared. Some members of immigrant communities are unwilling to produce the necessary loan documentation, such as tax returns, in order to receive financing. ADC staff members still consider this latter circumstance a success for the organization, as they have helped prevent these individuals from entering into deals that may result in greater financial burdens and have generated a better understanding of the requirements of US financial markets.[121]

Moreover, ADC has several programs geared towards maintaining community wealth gains. Their financial literacy course addresses the common problems immigrants face when trying to integrate into the financial mainstream. Credit, for example, is often a new and misunderstood concept and many immigrants are hesitant to become involved with banks and other financial institutions. ADC's home ownership class is a newer service offered by ADC in conjunction with the Home Ownership Center. This course provides individuals with the resources and knowledge to become homebuyers, allowing members of the African community to build their equity and sustained wealth.[122] One ADC small business client interviewed has taken the financial literacy course and the business course, received an Islamic loan from NDC, been given ongoing marketing and technical assistance through ADC and is currently enrolled in the ADC homeownership course.

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[121] Kris Maritz and Hussein Farah, interview.
[122] Mulki Hussein.

Murabaha Program Evaluation

Measuring the impacts of Islamic financing activities in the Twin Cities presents a major challenge towards an evaluation of programmatic success. Howell Baum's comments regarding the assessment of community initiatives are appropriate here as well:

> At the least, evaluation depends on identifying specific, fixed standards for success and being able to track the outcomes of an intervention with full information and without ambiguity…the goals of these initiatives—affecting significant changes in institutions and everyday lives—make them inherently complex and difficult to define.[123]

ADC, NDC, and MCCD are all attempting to promote their broader organizational goals of creating community wealth and increasing financial capacity. However, it is impossible to ascertain what the impacts are on the greater Muslim immigrant population in Minneapolis and St. Paul and whether these larger community economic development objectives are being met.

While measuring the larger social impacts of the financing programs remains problematic, the following section demonstrates that the *murabaha* product is determinedly popular and is reaching entrepreneurs that would otherwise be without small business financing. Individual client accounts testify to wealth creation and business expansion. Moreover, client demand for the loans continues to exceed supply and default rates are lower than other microfinance portfolios.[124] Finally, the organizations are continuing to develop training and services that will hopefully ensure the retention of community wealth.

Between April 30th 2001 and February 28th, 2005, NDC provided Islamic financing to 46 entrepreneurs, totaling $741,214. According to an internal NDC document "nearly half of the entrepreneurs we have assisted through this program are women. Many are refugees or

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[123] Howell S. Baum, "How Should We Evaluate Community Initiatives?," *Journal of the American Planning Association* 67:2 (Spring 2001): 148.
[124] Mara O'Neil

asylees."[125] NDC has financed specialty retail stores selling clothing and household items such as rugs and blankets; trucking, busing, delivery and auto repair businesses; and other service-based businesses including a restaurant, a barber shop, and small grocery and halal meat markets. These businesses are, generally, the main income source for to the entrepreneur's family and a needed community service.[126] For example, one business owner opened a boutique to provide sophisticated Islamic clothing options for women. Other Islamic borrowers have found a profitable niche in the trucking industry.[127]

In its first year of operation, ADC has assisted 13 businesses with Islamic financing, totaling $250,500. All but two deals, worth $35,000, were done through NDC's loan program and overlap with their reported numbers. Seven entrepreneurs received *murabaha* financing for the purchase of trucks, two others financed a tow-truck and a delivery van. ADC's Islamic financing clients have translated their loans into 31 additional full-time jobs and 4 part-time positions for their communities, exclusive of the employment of the entrepreneurs in these ventures.[128]

Beyond the needed jobs and services these entrepreneurs provide their communities, there are personal stories of accomplishment and advancement. One woman was able to use her new business to leverage her family out of welfare. Another young gentleman earned enough money in one year of running an owner-operated trucking business to pay off his financing in full, and after selling his truck had enough money to return to college. Several of these businesses first opened several years ago with NDC financing and are already expanding their businesses. One grocery store owner has now transformed into a successful wholesale/retail

[125] "Profit-Based/Reba Free Financing Program, Background Information."
[126] Ibid.
[127] Hussein Farah, interview.
[128] Hussein Farah, Client Information, Excel document, provided March 30, 2005.

operation. Two innovative entrepreneurs that began as truck drivers, sharing the same vehicle, now manage their own trucking and dispatch company. They have a crew of drivers and also contract with other self-employed truck drivers that get paid on commission. In measuring the success of NDC, MCCD and ADC, it is important to keep these individual stories in mind, as all three organizations aim at creating positive entrepreneurial role models within the African community.[129]

Other impacts are more difficult to measure. For example, based on the ADC sign-in sheet, 550 individuals have come to ADC seeking advice and guidance. This is an undercount, as many visitors chose not to sign the roster.[130] Maritz estimates that she has spoken to between 30 and 50 walk-ins, providing them financial and business advice. The assistance given in these cases can range from lease agreement assistance to discussing a vision for a new business. While these efforts cannot be reported in dollars or number of jobs, they are extremely important in raising the level of financial and business literacy as well as protecting gains in community wealth. This is one of the main motives behind ADC's home ownership course, to protect their community against predatory lenders and ensure that people are educated to choose the best mortgage tool for their family. Using a Fannie Mae database system, ADC is keeping track of home ownership course graduates, though it is far too early to gauge any such results from the program.[131]

Challenges and Successes

While it is still early to capture the complete impacts of Islamic financing in the Twin Cities, the experiences of the lending institutions in this early stage of developing and providing this new financing product illuminate some key challenges and mechanisms for success. All

[129] Hussein Farah, Excel document.
[130] Hussein Samatar, March 14.
[131] Mulki Hussein.

three community development organizations faced a variety of hurdles in establishing their lending product, which fall into two major classes. The first is difficulties relating to the Islamic financing. The second class of hurdles includes the adjustment needed in the community development arena to accommodate a new, ethnic focused CDC. The following section of the paper explores these two subjects and how to potentially address difficulties associated with them.

Islamic Financing Challenges

According to an NDC internal document, the *murabaha* product is a simply structured financing tool that is not complicated to understand.[132] While this is true conceptually, there are several elements that complicate the ability to provide sufficient quantities of Islamic-based financing in the Twin Cities to meet the community's demand. These financing issues fall into three classifications: those relating to the clients, the lending community and the elements of Islamic financing themselves.

Client Issues

The borrowers seeking Islamic financing in Minneapolis and St. Paul inherently present higher risk than those seeking conventional financing or even regular interest-based micro-financing. Many clients are new arrivals to this country, often lacking much of the required documentation for mainstream financial institutions and a credit history. Those that do have a credit history often have poor credit. Many of the African immigrants arrive in the U.S. through church-sponsored programs that loan them the cost of the plane ticket. Unfortunately, many of those newcomers fail to understand that the ticket was a loan and not a gift until they attempt to rent an apartment and discover they owe upwards of $10,000.[133]

[132] "Profit-Based/Reba Free Financing Program, Background Information."
[133] Mulki Hussein

Muslim borrowers are also at a disadvantage with respect to collateral. Banks prefer collateral that is fixed in place, such as a home. Many small businesses attain start-up capital through second mortgages on their homes. For Muslim borrowers, this is often not an option since their interest aversion prevents them from securing a mortgage and owning a home. Furthermore, the rent they pay is not taken into account in establishing credit histories. ADC, NDC and MCCD provide some flexibility in the areas of credit and collateral. Though they do stand firm on requiring one year of tax returns, they also accept letters from landlords certifying that the borrowers pays rent on time every month and are more lenient in regards to the collateral they accept.[134] When NDC originally launched the murabaha client, they relaxed some of their requirements, including having clients participate in the business training course. They were just so eager to get the loans out the door. This turned out to be problematic, and they have since tightened the requirements to meet consistent organizational loan evaluation standards.[135]

It is important to realize that even by CDC standards, the Islamic financing product is considered very time-intensive. Just adding the purchasing and reselling process to the transaction increases the time required to complete the financing by an estimated 2 to 5 hours. The collection of supplemental documentation required for the *riba*-free product further adds to the time burden.[136] Moreover, the payment collection process can also consume time. According to O'Neil at NDC, their portfolio of Islamic financing since 2001 has a loan default rate of 3 percent, which is much lower than the 9 percent default rate over the past 7 years for their conventional micro-financing portfolio. However, 25 percent of *murabaha*-financed deals are labeled "problem balances," indicating that those borrowers may be difficult to contact or may not be paying on time.

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[134] Kris Maritz.
[135] Mara O'Neil.
[136] Dave Chapman.

The citizenship status of applicants can also become an issue for some financial institutions. Asylees are not eligible for any U.S. sponsored loan programs, including insurance. As a result, traditional lenders often shy away from deals with clients in this category. For a conventional financing deal, Maritz at ADC had to call ten different banks before finding willing partners. Some of the banks cited the Patriot Act as a reason for declining the deal, highlighting the challenges immigrant clients often face.

Lending Community Issues

This leads into the second set of issues complicating the provision of Islamic financing in the Twin Cities, the lending community. This community includes the community economic development organization as well as traditional financial institutions. One major obstacle to increasing Islamic financing is the lack of knowledge and understanding of Islamic financing. Within NDC, ADC and MCCD this technical expertise is institutionally compartmentalized. The development of new products remains in the domain of Wafiq Fannoun, Hussein Samatar and Hussein Farah. By providing Islamic finance training to others with greater experience in the micro-lending field, more innovation in products may be stimulated. None of the interviewees indicated the availability of any other financing product other than *murabaha*. However, an NDC document refers to the "piloting of a Royalty Agreement."[137] Reba Free's website suggests one other form of financing available through NDC in addition to the *murabaha* and Royalty Agreement, a Lease Purchase product, or *ijara wa-iqtina*, that allows the borrower to lease equipment or goods from NDC for a specified duration and costs at the end of which the entrepreneur purchases the product at the agreed upon contract price.[138] It does not appear, however, that these other financing options are being rigorously promoted.

[137] "Profit-Based/Reba Free Financing Program, Background Information."
[138] "Our Services," available from http://www.rebafree.com/ourservices.html; accessed 7 April 2005.

Moreover, loan committees do not receive much training regarding the tenets of Islamic financing nor do the members of the three organizations' committees network with each other.[139] This is a missed opportunity. ADC's and MCCD's committee members could learn from the past experiences of those serving on NDC's committee. As described by ADC loan committee chair, Alison Halley, the loan committee's job is to analyze proposed financing deals and suggest changes to loan structures that do not meet committee approval. With a deeper understanding of Islamic finance law, the loan committee process could be improved.

Beyond the technical knowledge of Islamic finance law lie the cultural and linguistic skills that are necessary for community outreach. The primary clients for Islamic financing in the Twin Cities are Somali immigrants. As such, NDC and Reba Free employed Samatar and Farah, two native Somalis, to manage the Islamic loan pool and those borrowers. With the establishment of ADC and the move of these two staff members to ADC, NDC and MCCD can now both access the Somali community through this new community organization. ADC's outreach activities have increased the economic development community's reach into to this growing population in the Twin Cities.

Finally, it is important to understand that, ultimately, traditional funding institutions must also provide Islamic financing products for the Muslim community to sustain economic growth. CDCs and CDFIs function as vehicles to transition their clients into the mainstream financial system. As the Muslim immigrant population becomes more settled, their financial needs are going to grow and these three microfinance institutions, already inundated with potential clients requiring Islamic financing, will be even harder pressed to meet the community's needs.

[139] Alison Halley.

Informal ties are currently being established between ADC and one community bank in Minneapolis.[140] As this process continues it will become important to educate the larger financing community regarding Muslim clients. As one interviewee noted, many people consider immigrants to be uneducated, which simply is not the case. Moreover, ADC has learned to use the term "Islamic-based financing," rather than "interest-free," to avoid the common misperception that these loans are "free money."[141] As banks and other financial institutions develop Islamic financing products, they will be ale to provide the necessary access to capital for those clients that require less guidance and technical assistance, allowing the CDCs and CDFIs to focus on their core missions.

Islamic Finance Issues

The expansion of Islamic financing opportunities raises a third set of issues stemming directly from the tenets of Islamic financing. As lending institutions seek to serve the Muslim community, they must identify "clean sources" of funding for their Islamic finance pools. NDC, MCCD and ADC all use UIP allocations for their financing deals. MCCD and ADC completely depend on this source of interest-free funds. UIP is nearing the end of its allocation from the State. In order to meet demand, community economic development organizations are not just hoping for a reallocation of funds to UIP, but an increase in the amount of state dollars invested in the program.[142]

The financing experience of NDC also raises the issue of eliminating the time-value of money in the *murabaha* product. As mentioned in the description of the NDC Islamic Financing Product, O'Neil forgives some of the price mark-up if a borrower repays their financing in full ahead of the negotiated payment schedule. As she explained it, it is unfair to penalize

[140] Hussein Samatar, March 14.
[141] Kris Maritz.
[142] Dave Chapman.

individuals financially because of their religious convictions. However, this opens the *murabaha* deals to questioning regarding the time-value of the financing. In order to avoid negating the *murabaha* product's circumvention of the time-valuation of money, a structure must be established in which borrowers may receive pre-payment incentives that mirror the Islamically permitted late-payment penalties.

The fact that the *murabaha* mark-up is based on comparable interest-bearing loans compounds the problem of placing a time-value on money. By eliminating the absoluteness of the mark-up price with debt forgiveness for early repayment, the *murabaha* product may be criticized by some as a matter of semantics. In truth, this is a matter open to interpretation and the real test is the client acceptance of the product. While the product developed by Reba Free seems to work for the Muslim community in the Twin Cities, specifically for the Somali community, it is possible that it might not transfer well to other American Muslim communities. The current product might require some adjustments and local Imams should be consulted regarding their community's needs.

The Muslim community also requires greater innovation in the types of Islamic financing provided. Currently there is no way to provide working capital for Muslim businesses. So that entrepreneurs need not use household income to cover business losses or shortages, NDC, Reba Free, ADC and MCCD need to explore ways to address this issue. By combining the micro-lending experiences of NDC and MCCD with Reba Free and ADC's cultural and religious knowledge these organizations are capable of arriving at new, unexplored Islamic financing options. One potential micro-lending tool that might be altered into an Islamically acceptable financing mechanism is the revolving loan fund. A similar, informal arrangement already exists in Somali culture, called a *hagba*, whereby participants contribute a specific amount to the fund

each month and each month a different participant may use the funds for their needs. Somali women in the Twin Cities establish this type of fund to assist with major household purchases, such as furniture.[143] Another potential tool worth exploring is the establishment of a venture capital fund to invest in micro-enterprises.

Islamic mortgages presents another area requiring innovative financing tools. ADC is currently working on developing such a product. Guidance Financial Group is the only organization actively promoting their Islamic mortgage in the Twin Cities. ADC presents students in their homeownership course with this mortgage option since "Muslims would not bother signing up if we did not at least inform them about it."[144] However, all the staff members at ADC feel that this mortgage is far too expensive and is too demanding in regards to the down-payment requirement. Samatar is in the process of developing a better Islamic mortgage tool. Through consultations with local Imams, Islamic scholars, and other Islamic mortgage providers such as American Finance House, Samatar hopes to create a Freddie Mac-approved mortgage tool that will better serve ADC's clients. Franklin Bank, a local Minneapolis bank, has agreed to supply these mortgages. A pilot launch of this product is tentatively schedule for early 2006.[145] Progress on Islamic mortgages is also needed in regards to state and federal tax codes. Muslim homebuyers using a non-interest mortgage cannot receive any tax deductions for payments made on their mortgage.[146]

Inter-Institutional Relationship Challenges

Minneapolis has had only two new community development organizations emerge in the last 20 years, the Latino Economic Development Center (LEDC) and the African Development

[143] Hussein Samatar, interview by author, Minneapolis, MN, March 16, 2005.
[144] Mulki Hussein.
[145] Mulki Hussein, Hussein Farah and Hussein Samatar, March 14.
[146] Kris Maritz.

Center.[147] Both CDCs were established in the past few years to respond to the growing needs of their respective ethnic and cultural communities. These new institutions are changing the face of economic development in the Twin Cities while expanding the level of services available to their target populations.

LEDC and ADC both experienced some level of negative receptivity from existing CDCs. This conflict played out during both organizations' applications to join MCCD. A few MCCD members argued that CDCs should have a geographic focus; therefore, LEDC and ADC did not meet the technical criteria for MCCD membership. While those organizations were outvoted and both ethnic-focused CDCs joined MCCD, changes were needed to accommodate the new people-based CDC model. For one, MCCD had an established system of client referrals based on geography. They divided the city into districts, and each member of MCCD held responsibility for one of these districts. Now, referrals take into account the ethnicity of client as well as their place of residence, giving these individuals more options.[148]

There is some speculation that the CDCs opposing the initiation of LEDC and ADC into fabric of community economic developers stemmed from the fear of competing for sources of funding. While competition does exist for limited sources of funding, some organizations addressed this threat by establishing partnerships with the new organizations. For example, the collaboration of the Home Ownership Center with ADC on the homeownership course has allowed each organization to successfully use the other's name in their fundraising efforts.[149]

The partnerships between ADC and NDC and MCCD highlight how an ethnically-focused CDC can improve the capacity of existing organizations. Without needing to employ staff with the necessary language and cultural skills, NDC and MCCD have gained access to the

[147] Hussein Samatar, March 16.
[148] Jim Roth, Dave Chapman and Hussein Samatar, March 16.
[149] Mulki Hussein and Hussein Samatar, March 14.

African immigrant community in the Twin Cities. MCCD has also been able to expand its reach to the suburbs of Minneapolis. Prior to the admission of LEDC and ADC into the coalition they were confined to activities within the city-limits.[150]

The benefits of these partnerships extend the other way as well. MCCD manages ADC's loan pool, capitalizing on their years of loan management experience and reducing ADC's overhead costs.[151] ADC's collaboration with NDC on the business course allows the new organization and their clients to access the new facilities at the Lake Street Business Center. Furthermore, by sharing in their lending activities, all three organizations are spreading risk and diversifying their portfolios.

Most importantly, the inter-institutional cooperation benefits the clients. ADC has increased the provision of all three organizations' services to the African community. ADC is adding a consultant to conduct the organization's outreach to the African Liberian community in Minneapolis.[152] These activities, in effect, will bring the aid of all three organization to this community. Moreover, as one organization needs to cut back on lending services, as NDC recently did, the other two organizations can step in together to maintain the supply of financing.[153]

Conclusion

The Twin Cities case study illustrates how community economic development organizations can offer the American Muslim community, particularly the immigrant population, much needed Islamic and flexible financing. While hurdles were encountered in the provision of

[150] Dave Chapman.
[151] Jim Roth.
[152] Hussein Samatar, March 14.
[153] Hussein Farah, interview.

murabaha microfinancing, the mechanisms used for overcoming these obstacles highlight critical success factors towards the expansion of such programs across the Unites States:

- The grass-roots, community-level orientation of community development organizations positions them to identify and recognize the need for Islamic-based financing products to serve their clients.

- Clients benefit from the technical assistance and services CDCs and CDFIs provide in addition to the small business financing, especially new immigrant communities.

- Increasing the level of education regarding Islamic finance amongst community development practitioners may encourage greater collaboration on Islamic-based products that incorporate their experiences and advance product innovation.

- Conventional financial institutions must also become partners in the provision of Islamic financing. They can relieve some of the demand burden by providing Islamic financing to less-risky clients with fewer technical assistance needs. As current ADC, NDC and MCCD clients establish themselves and their businesses financially, they will need to graduate into mainstream financial culture. This will also allow the community economic development organizations to focus on those clients that most require their assistance.

The experiences of the economic development community in Minneapolis also highlight the trend towards ethnic community-focused CDCs, without geographical restrictions, as compared to the traditional CDC model centered on servicing a particular neighborhood. These organizations are changing the community development landscape and have met opposition from some existing CDCs that fear loosing funding, or "turf." Other organizations, however, have recognized the opportunity for collaboration, which has already proven to be fruitful in several ways:

- NDC and MCCD have been able to capitalize on the cultural and language expertise of the ethnically-focused CDCs in order to deepen and improve their provision of services to these communities without having to add staff to their payroll.

- The Home Ownership Center and ADC have found that their collaboration has improved funding opportunities for both organizations.

- ADC, NDC and MCCD share in financing deals, thus spreading the level of risk exposure from each loan and increasing the number of clients each organization assists.

- Clients benefit from better services that incorporate the language and cultural knowledge of the ethnic CDC with the experience and facilities of the more established institutions.

The topic of Islamic financing is just beginning to attract the attention of traditional financial institutions and community development organizations in America. However, if the 25 percent increase in the number of mosques in the U.S. is any indication of the demand trends for Islamic financing; this issue is only going to grow in importance. In order to adequately finance the American Muslim community, immigrant and native-born, progress must be made towards three key steps.

First, conventional financial institutions and community-based organizations will have to cooperate on product development and innovation. Community development organizations are better structured to identify and investigate community financial needs compared to mainstream financial institutions. On the other hand, banks and mainstream financial institutions generally have greater lending capacity. Collaboration between the community development organizations and traditional financial institutions during the process of product development will increase the probability of creating a financing mechanism acceptable to the target community and increasing the banks ability to participate in financing. For example, as ADC works towards being able to provide an Islamic mortgage product to the Twin Cities' Muslim population, they have established a relationship with a local bank to ensure the greatest number of clients have access to the new financing product.

Second, it is vital to combine knowledge of Islamic finance law with the experiences of established CDCs and CDFIs. Community development organizations have over two decades of

experience marrying lending activities with technical assistance to improve the success rates of client businesses and increase the level of community wealth. By increasing community development practitioners' levels of Islamic finance knowledge and understanding, better products can be developed. New Islamic financing tools should build on years of program achievements and failures rather than reinvent the wheel.

Finally, one of the hurdles facing CDFIs, as identified by Moy and Okagaki, is that CDFIs "remain largely vertically-integrated, self-contained retail institutions at a time when mainstream institutions have moved away from this model...this model results in higher transaction costs, less specialization and less efficiency."[154] Conversely, vertical integration "can help CDFIs maintain closer relationships with clients, and offer them more flexibility and customized products and services."[155] The three community development organizations in this case study demonstrate how CDCs and CDFIs can become horizontally integrated by forming an inter-organizational network. Thus, they are accessing the benefits of horizontal integration while mainting those of vertical integration.

[154] Moy; 11.
[155] Ibid.

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Appendices

Appendix A: US Muslim Population Data

Figure 1: Distribution of Mosques in the U.S.

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Appendix B: U.S. Islamic Financial Products Available

Exhibit 1: Islamic Financial Products Offered in the U.S. through Mainstream Financial Institutions

American Finance House Lariba (AFHL) (www.americanfinance.com)

- Home Mortgage Financing
  - Ijara wa Iqtina, lease to purchase contract with "Diminishing" musharaka characteristics.
    - A joint purchase between AFHL and the client is assumed to occur with a covenant that AFHL will sell its portion to the client. Technically, however, AFHL authorizes the purchaser to own the title to the property while repurchasing AFHL's share at purchase cost in monthly payments over the agreed upon financing period. AFHL holds a lien on the property.
    - The second part of the financing involves a lease agreement between the borrower and AFHL. A monthly fair value rent is determined using comparable properties in the same neighborhood. AFHL requires that the borrower consult three real estate agents while AFHL conducts its own research. The two parties then agree on a fair monthly lease price. The rent is split between the two parties based on their share of ownership. As the borrower increases their share of property ownership, the share of rent payment to AFHL decreases.
    - The borrower's monthly payment is a combination of property repurchase and rent payments to AFHL.
    - Using a proprietary program, ISLAMABAD III, AFHL calculates level monthly payments over the financing period.
    - In order to comply with federal and state laws and tax and financial regulations, AFHL translates this monthly payment into a traditional mortgage program to calculate the required documentation of the "Implied Interest Rate."
    - Maximum finance term: up to 30 years.
    - Minimum down payment: 5 percent.

- Business Financing
  - Two business loan structures:
    - Musharaka, joint venture: The entrepreneur agrees to manage the business for a fee. Profit is distributed between the partners based on a negotiated ratio. The agreement may include an option for the entrepreneur to purchase the business after a certain period.
    - Joint Venture Lease-To-Purchase: See Lariba mortgage structure above.
    - An entrepreneur should have at least 3 years of prior business experience and Lariba prefers to finance nationally recognized name brand service facilities.
  - Murabaha for trade finance:
    - LARIBA finance company buys goods on behalf of the customer and sells it to them at a pre-arranged mark-up.
    - Profit is independent of interest rates and based on negotiations between Lariba and the customer.
    - It can be used in import/export, purchase of raw materials and financing inventory
  - Financing is available in all U.S. states except the state of New York.

HSBC Amanah (www.amanahfinance.hsbc.com)

- Banking Services
  - Interest free checking
  - MasterMoney Debit MasterCard Card

  - HSBC Mortgage Corporation (USA)
    - HSBC Murabaha Home Finance
      - No interest; stated profit amount is paid in installments.
      - Only available in the state of New York.
      - Eligible properties:
        - one to four family primary residences,
        - one family second homes,
        - one to four family investment properties,
        - and one family condominium.
      - Maximum financing available to borrower: up to $1.5 million.
      - Minimum down payment: 5 percent.
      - Rates are competitive with traditional mortgages.

University Bank, Islamic Banking Division (http://www.university-bank.com/IslamicBanking/IBDmain.htm)

- Money Market Accounts
  - SHAPE Profit Sharing Deposits
  - University Bank invests in Sharia'a compliant portfolio
  - Gross operating profits of a business line determine deposit yields, meaning returns are not set.
  - Deposits are FDIC insured, protecting the depositor from any risk of losses.
  - Available nationally.

Profit Paid* on SHAPE Money Market Accounts:

3-Nov	0.00%
3-Dec	0.54%
4-Jan	0.83%
4-Feb	1.19%
4-Mar	1.19%
4-Apr	1.23%
4-May	1.15%
4-Jun	1.15%
4-Jul	1.15%
4-Aug	1.20%
4-Sep	2.20%
4-Oct	1.51%
4-Nov	1.42%
4-Dec	1.66%
5-Jan	1.48%

*as a percentage of deposited funds

*source: http://www.university-bank.com/IslamicBanking/IBDdeposit.htm

- Home Mortgage Financing
  - MALT Home Acquisition Program
    - Ijara wa Iqtina, lease to own structure
    - The borrower's monthly payment includes monthly rent and a "payment on-account" portion.
    - If the property is sold and gains are realized, the borrower receives all the profits. If the property is sold at a loss, the loss comes out of the borrower's portion of property equity and the bank absorbs any remaining losses.
    - Adjustable and fixed rental options are available.
    - Maximum mortgage: $650,000.
    - Minimum down payment: 5 percent.

<u>Devon Bank (www.devonbank.com/Islamic/index.html)</u>

- Banking Services
  - Non-interest bearing checking accounts.
  - Debit card.

- Home Mortgage Financing
  - Murabaha, cost-plus contract.
    - Devon Bank purchases the property for the borrower and sells it to him/her at a mark-up.
    - The borrower pays a down payment and fixed monthly payments.
    - Financing periods of 15, 20 or 30 years.
  - Ijara wa Iqtina, rent to own financing.
    - More flexible and more expensive than the murabaha instrument.
    - The rent calculation is linked to an "objectively measurable index."
    - Ijara contracts are not available in all areas served by the bank.

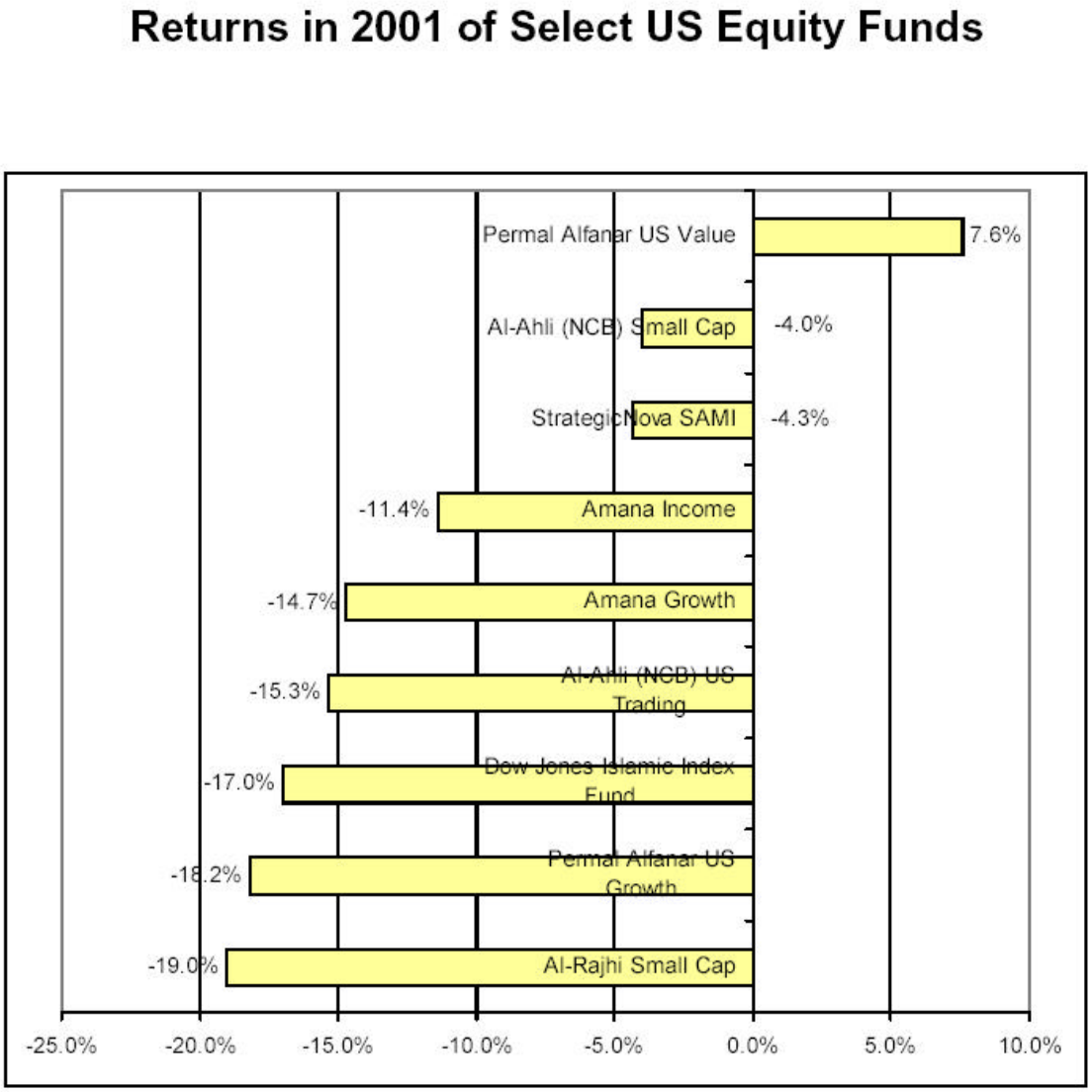
- Business Financing
  - Available for business real estate, business and trade good financing.
  - Murabaha
    - Single transaction financing,
    - or a Murabaha Guidance Line, similar to a line of credit, for equipment and trade good purchases.
    - Maximum seven-year financing period.
  - Ijara wa Iqtina
    - Available for real estate only.
    - Financing terms for businesses are the same as Devon Bank's home Ijara wa Iqtina mortgages.
  - Maximum 20-year financing period.

- Available in: Alaska, Arkansas, California, Georgia, Idaho, Illinois, Indiana, Kentucky, Michigan, Missouri, New Hampshire, North Carolina, South Dakota, Tennessee, Texas and Wisconsin

Guidance Financial Group/ Guidance Residential, LLC (www.guidancefinancialgroup.com)

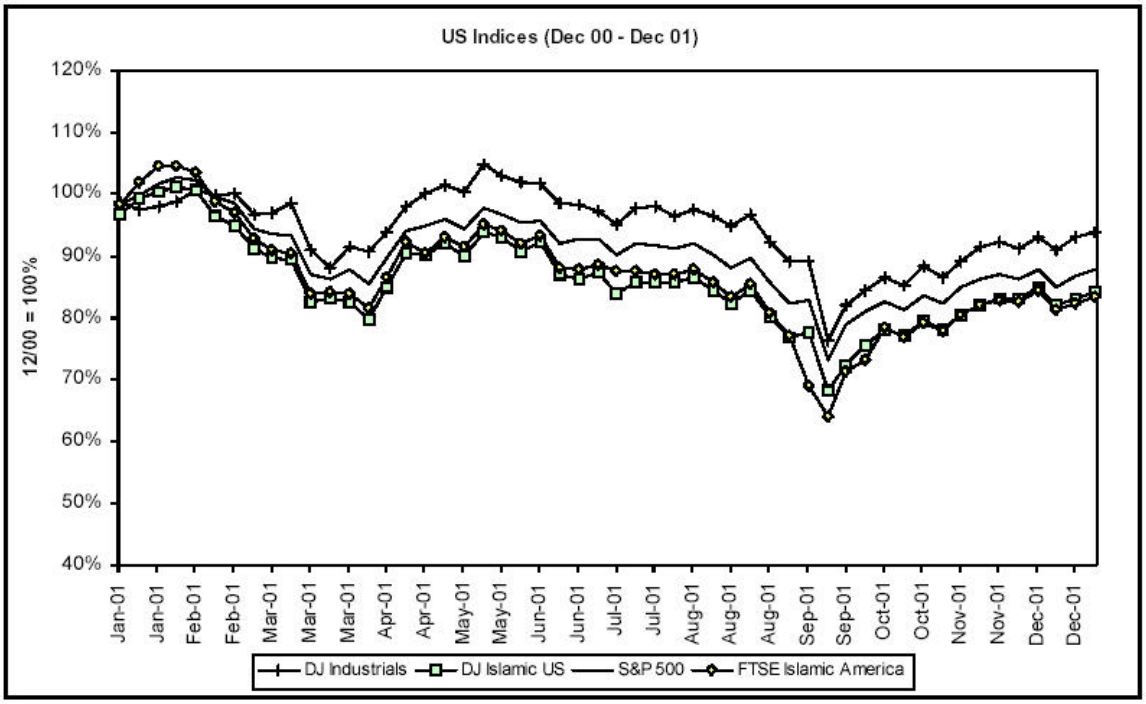
- Home Mortgage Financing
  - Declining balance co-ownership program
    - For use in new home purchase or refinancing.
    - Guidance and borrower enter in joint ownership agreement based on initial equity shares.
    - Borrower acquires Guidance ownership share incrementally.
    - A monthly charge for use of the property is built into the monthly payments.
    - Payments are fixed and competitive with conventional mortgages.
    - Finance period is for 15, 20 or 30 years.
    - Minimum down payment: 5 percent.
    - Refinancing can be for up to 95 percent of home value, including an equity cash-out option.
    - No prepayment penalties.
    - Non-recourse commitment that, in case of borrower default, limits Guidance's claims to the borrower's share of equity in the property.
    - Available in: California, Florida, Georgia, Illinois, Maryland, Michigan, Minnesota, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Virginia and Washington, D.C.

Figure 1:



Source: Failaka International, Inc. "Failaka Islamic Fund Review: Year End 2001." www.failaka.com.

Figure 2: Performance of Select Islamic Indices



Source: Failaka International, Inc. "Failaka Islamic Fund Review: Year End 2001." www.failaka.com.

Figure 3: Amana Funds Portfolios by Industry

Amana Income Fund	
Utilies	16.8%
Energy	16.6%
Mining & Metals	11.4%
Telecommunications	10.7%
Medical	7.0%
Transportation	6.5%
Building Materials	5.9%
Cash	5.0%
Real Estate	4.4%
Publishing	3.7%
Steel	3.7%
Automotive	3.1%
Other (under 2% each)	5.2%

Amana Growth Fund	
Medical	20.9%
Electronics	14.2%
Computer Hardware	13.4%
Energy	7.5%
Computer Software	6.8%
Cash	4.8%
Transportation	4.6%
Food Production	3.8%
Building Materials	3.3%
Paper & Publishing	3.2%
Telecommunications	3.2%
Automotive	3.1%
Retail	3.1%
Mining & Metals	2.9%
Machinery	2.2%
Other (under 2%)	3.0%

Source: Amana. Semi-Annual Report, November 2004. Available online: http://www.amanafunds.com/

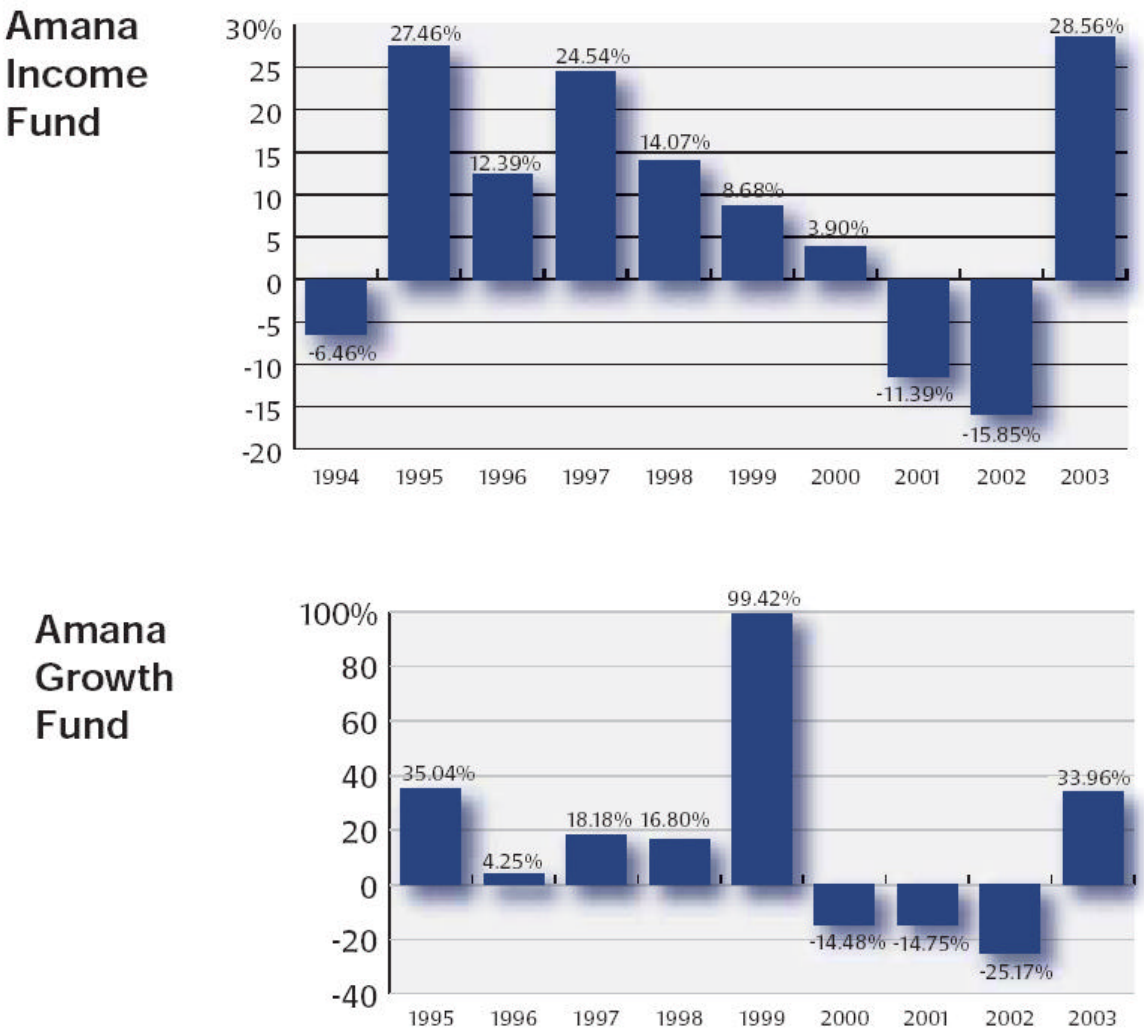
Figure 4: Amana Funds Average Annual Returns

Average Annual Returns*	1 year	5 years	10 years
Amana Income Fund	20.76%	3.76%	10.28%
Amana Growth Fund	23.04%	-2.10%	13.30%

* for years ended 12/31/2004

Source: Amana. Semi-Annual Report, November 2004. Available online: http://www.amanafunds.com/

Figure 5: Amana Funds Returns



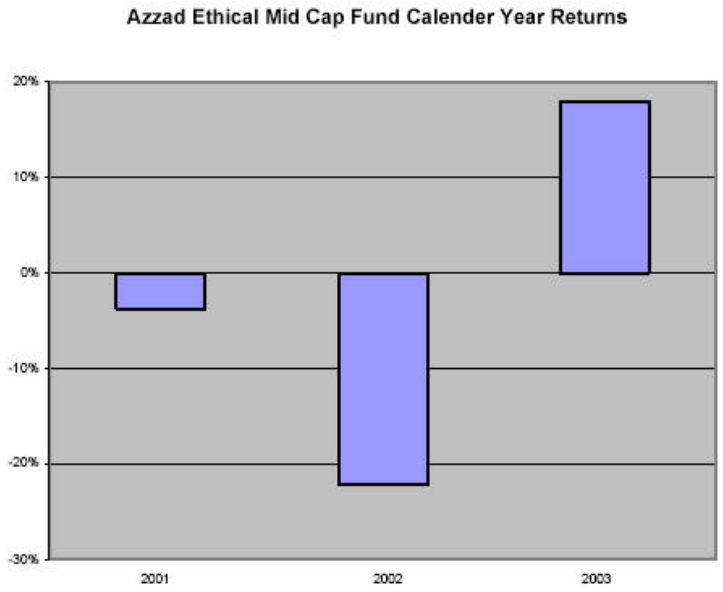
Source: Amana. Prospectus. Available online: http://www.saturna.com/pdfs/amanapro.pdf

Figure 6: Azzad Ethical Mid-cap Fund Ten Largest Holdings (10/26/2004)

Name	%
Mohawk Inds Inc.	5.23
Equitable Resources Inc.	4.97
XTO Energy Inc.	4.64
Murphy Oil Corp	3.8
Lincare Holdings Inc.	3.73
Claire's Stores Inc.	3.6
Cytec Ind. Inc.	3.35
Pogo Producing Co.	3.09
Abercombie & Fitch Co CL	3.06
Copart Inc.	2.73

Source: Azzad Fund. http://www.azzadfund.com/default.cfm?page=E1_1&menu=group_funds.

Figure 7: Azzad Ethical Mid-cap Fund Annual Returns



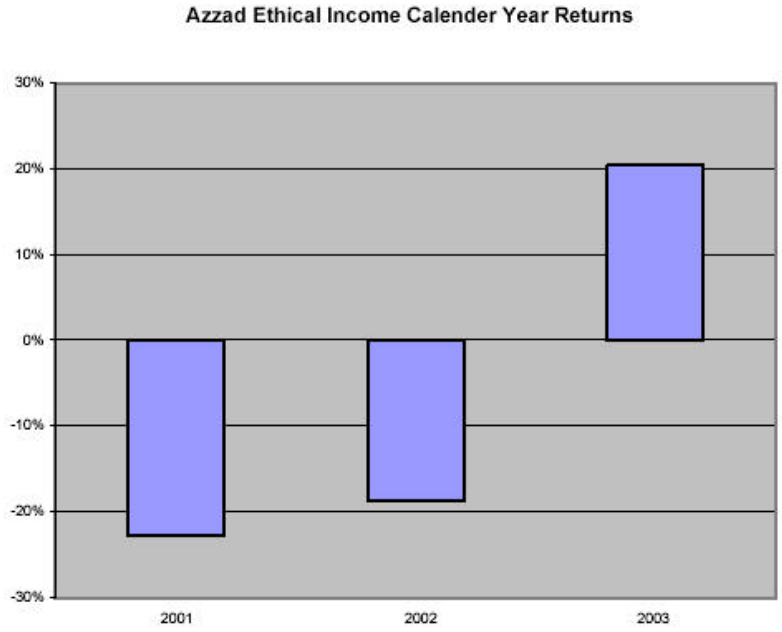
Source: The Azzad Funds Ethical Investing. "Prospectus: November 05, 2004." Available online: http://www.azzadfund.com/pdf/PNov2004.pdf.

Figure 8: Azzad Ethical Income Fund Ten Largest Holdings (9/2003)

Name	%
Cisco Systems Inc.	5.41
Microsoft Corp.	5.19
Exxon Mobil	4.6
Pfizer Inc.	4.57
Intl Business Machines	4.38
Merck & Co. Inc.	4.04
Intel Corp.	3.81
Johnson & Johnson	3.75
Honeywell Inc.	3.64
Procter & Gamble Co.	3.26

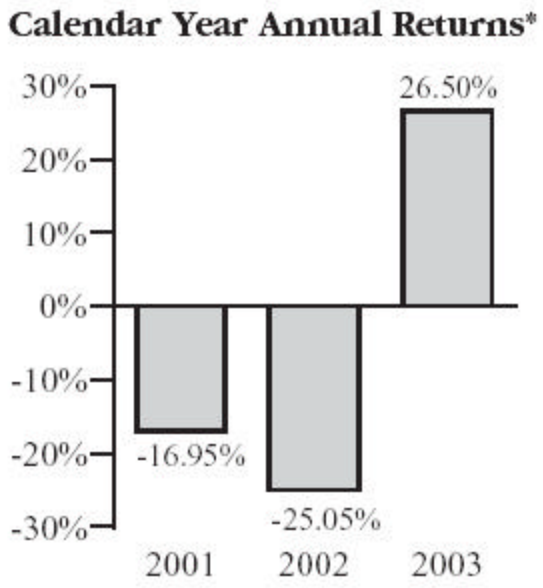
Source: Azzad Fund. http://www.azzadfund.com/default.cfm?page=incomefund&menu=group_funds.

Figure 9: Azzad Ethical Income Fund Annual Returns



Source: The Azzad Funds Ethical Investing. "Prospectus: November 05, 2004." Available online: http://www.azzadfund.com/pdf/PNov2004.pdf.

Figure 10: Dow Jones Islamic Fund



Source: Dow Jones Islamic Fund. Prospectus, October 1, 2004. Available online: http://www.investaaa.com/

Figure 11: Dow Jones Islamic Fund October 1, 2004 Prospectus

Average Annual Total Returns for the Periods ended December 31, 2003

	1 Year	3 Year	Since 06/30/00 Fund Inception
Dow Jones Islamic Fund			
Return Before Taxes	26.50%	-7.66%	-11.40%
Return After Taxes on Distributions(1)	26.47%	-7.70%	-11.44%
Return After Taxes on Distributions and Sale of Fund Shares(1)(2)	17.27%	-6.45%	-9.47%
Dow Jones Islamic Market USA Index (reflects no deduction for fees, expenses or taxes)(3)	26.85%	-7.85%	-11.22%
Russell 3000 Growth Index (reflects no deduction for fees, expenses or taxes)(4)	29.56%	-9.61%	-15.74%

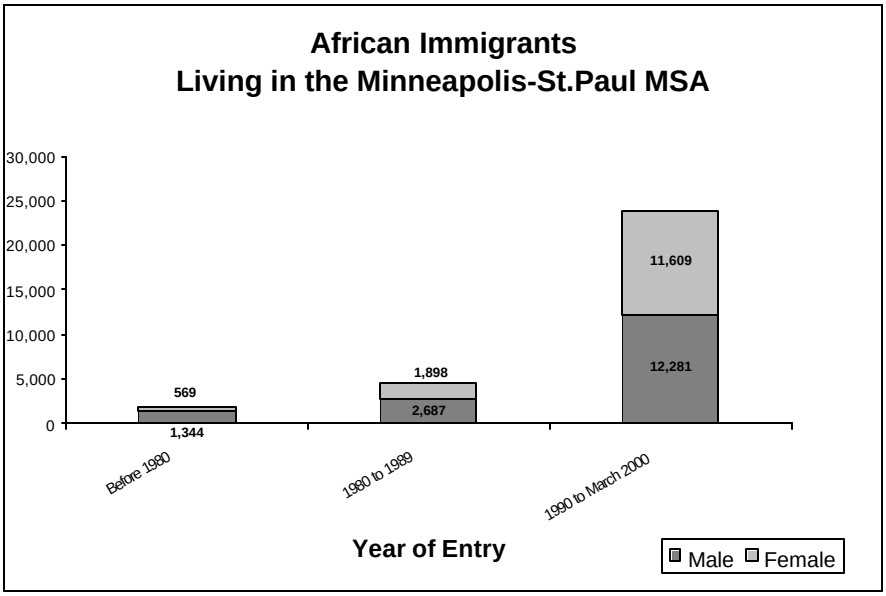
(1) After-tax returns are calculated using the historical highest individual federal margin income tax rates and do not reflect the impact of state and local taxes. Actual after-tax returns depend on your tax situation and may differ from those shown. Furthermore, the after-tax returns shown are not relevant to those who hold their shares through tax-deferred arrangements such as 401(k) plans or IRAs.

(2) The "Return After Taxes on Distributions and Sale of Fund Shares" may be higher than certain return figures because when a capital loss occurs upon the redemption of Fund shares, a tax deduction is provided that benefits the investor.

Source: Dow Jones Islamic Fund. Prospectus, October 1, 2004. Available online: http://www.investaaa.com/

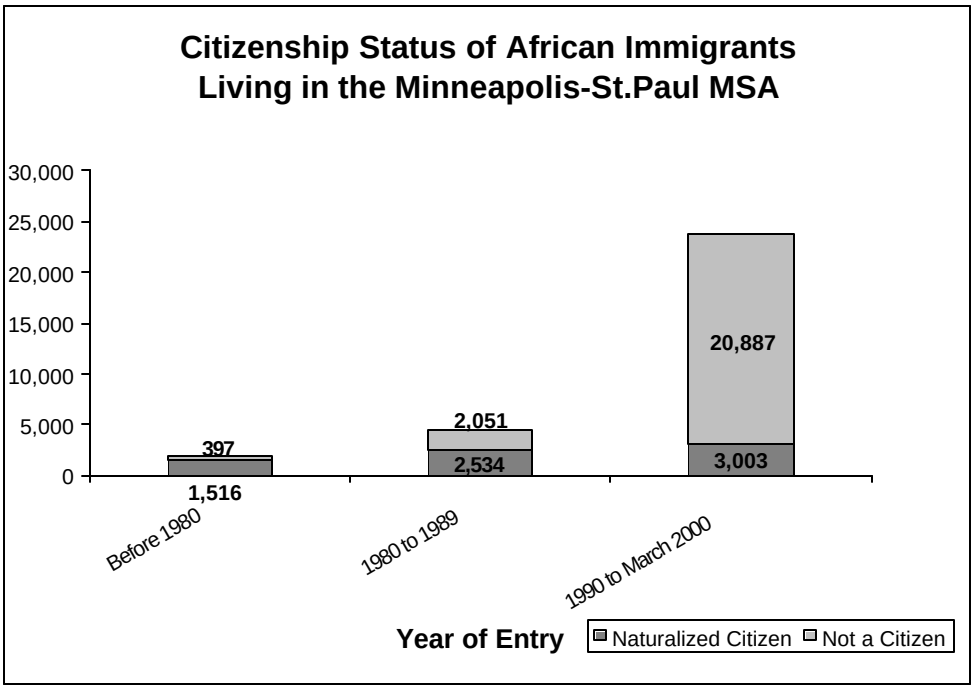
Appendix C: Twin Cities Case Study Information

Figure 1: African Immigrants in the Twin Cities



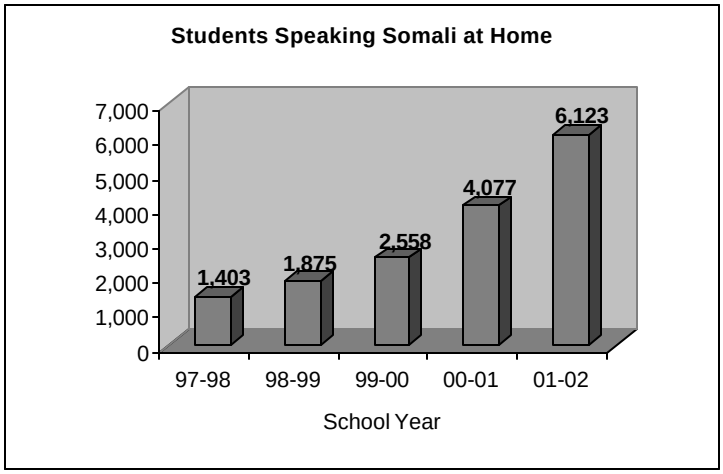
Source: US Census 2000, Summary File 4. www.census.gov.

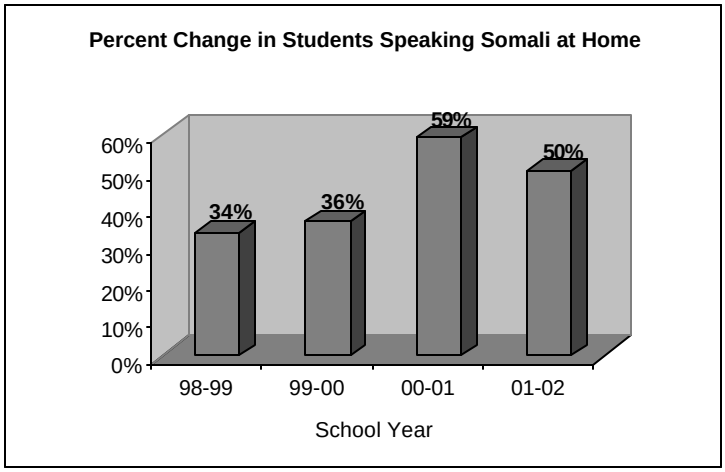
Figure 2: Citizenship Status of Immigrants in the Twin Cities



Source: US Census 2000, Summary File 4. www.census.gov.

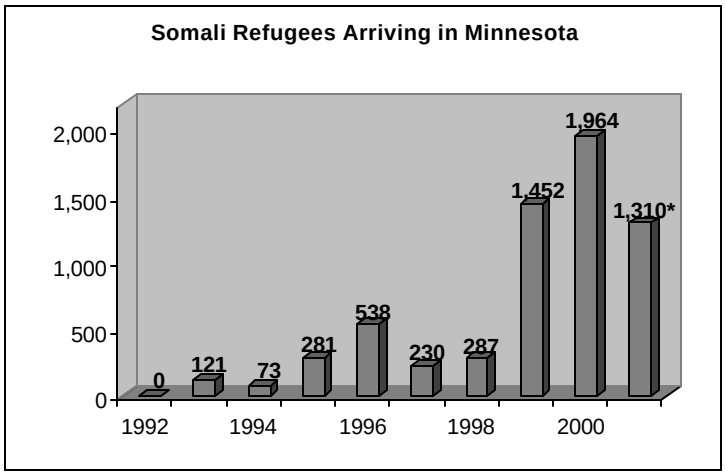
Figure 3: Somali Student Data

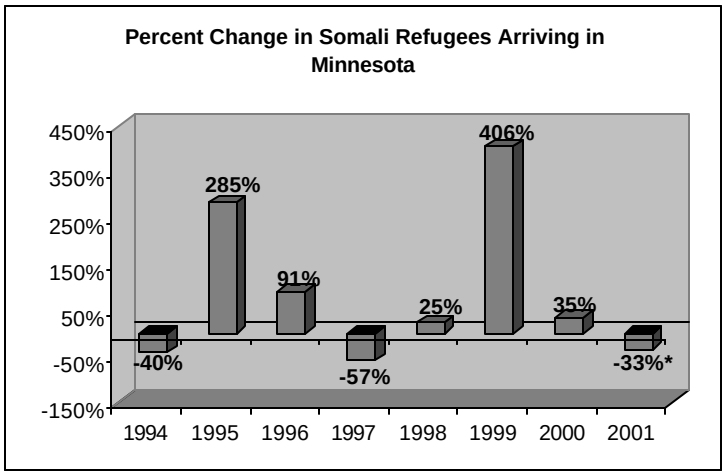




Source: Grumney, Ray. "Somali populations favor metro areas." Map and graph. Minneapolis Star Tribune (Mar. 16, 2002). And author's calculations.

Figure 4: Somali Refugee Data





Source: Grumney, Ray. "Somali populations favor metro areas." Map and graph. Minneapolis Star Tribune (Mar. 16, 2002). And author's calculations.

** Represents the first nine months of the year. No refugees were admitted in October, November or December because of the September 11th attacks.*

Table 1: List of Organizational Interviewees for the Case Study

Name	Organizational Affiliation	Role
Samatar, Hussein	African Development Center	Executive Director
Hussein, Mulki	African Development Center	Program Coordinator
Maritz, Kris	African Development Center	Senior Business Analyst
Farah, Hussein	African Development Center	Business & Information Systems Specialist
Mungavan, Tim	African Development Center	Chairman of the Board of Directors
Halley, Alison	African Development Center	Chairman of the Loan Committee/ member of the Board of Directors
Roth, Jim	Minneapolis Consortium of Community Developers	Executive Director
Chapman, Dave	Minneapolis Consortium of Community Developers	Loan Program Manager
O'Neil, Mara	Neighborhood Development Center	Chief Operating Officer
Buechler, Tavyer	Common Bond Communities	Advantage Program Coordinator