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Counsel Briefing

Sharia-Compliant Capital in U.S. Commercial Real Estate

Five common structures for deals led by a Sharia-compliant investor — how they work, how they sit alongside conventional debt, and what changes when a deal goes sideways.

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What this briefing covers

Sharia-compliant capital is an established — if still specialized — source of equity and financing for U.S. commercial real estate. This briefing maps the structures most often seen in practice and walks through how they behave across the full life of a deal, from closing through workout.

01 **The fundamentals**
What "Sharia-compliant" actually requires

02 **The five structures**
Murabaha · Ijara · Musharaka · Mudaraba · Istisna'a

03 **Pros, cons & pitfalls**
Why sponsors use it — and where it breaks

04 **Meeting conventional debt**
Construction, stabilization, permanent

05 **Stress, workouts & remedies**
What changes when the deal turns

THE ARC OF THE BRIEFING

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The Sharia ground rules

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The toolkit in U.S. CRE

03 **Trade-offs**
Pros, cons & pitfalls

04 **Capital stack**
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THE FUNDAMENTALS

What "Sharia-compliant" actually requires

THE CORE IDEA

Sharia-compliant investing replaces interest-based lending with ownership, leasing, and shared-risk arrangements. The financier earns a return by taking real participation in an asset or venture — not by charging interest on money. A Sharia board (fatwa committee) typically reviews and approves the structure.

THE GROUND RULES

No riba (interest). Money cannot rent money; return must tie to a real asset or enterprise.

No gharar (excessive uncertainty). Terms, price, and the subject of the deal must be clear and defined.

No haram assets. No alcohol, gambling, or other prohibited uses in the underlying property.

Risk-sharing. The financier shares genuine ownership risk, not just a fixed coupon.

FOUR FILTERS EVERY DEAL MUST PASS

Riba
No interest on money

Gharar
No excessive uncertainty

Haram use
No prohibited assets

Risk-sharing
Real ownership exposure

Source: DLA Piper · Covington

The five structures most used in U.S. CRE

These are the structures counsel most often encounters when the lead outside investor is Sharia-compliant. This is illustrative, not exhaustive — wakala, sukuk, and hybrid variants also appear, and most real deals combine elements.

Murabaha 01

Cost-plus sale

Financier buys the asset, resells to the sponsor at a disclosed markup paid over time. Closest to a conventional secured loan.

Ijara 02

Lease / lease-to-own

Financier owns the asset and leases it to the sponsor; rent plus a purchase undertaking transfers title at the end.

Musharaka 03

Co-ownership partnership

Financier and sponsor jointly own the property; sponsor buys out the financier's share over time (diminishing musharaka).

Mudaraba 04

Profit-sharing venture

Financier supplies capital, sponsor supplies expertise; profits shared by agreement, capital losses borne by the financier.

Istisna'a 05

Construction-to-completion

Financier funds construction in stages, then sells or leases the finished asset — typically rolling into an ijara.

Source: Covington · Hutfin

STRUCTURES 1 & 2 · DEBT-LIKE

Murabaha and Ijara — the loan-like pair

Murabaha *cost-plus sale*

HOW IT WORKS

The financier purchases the property and immediately resells it to the sponsor at cost plus a disclosed, fixed profit margin, payable over time. Title passes to the sponsor at closing.

IN U.S. CRE

The structure closest to a conventional secured loan. The OCC has treated it as "functionally equivalent" to a mortgage; on default, the financier can sell the property to recover, much like a foreclosure.

Ijara *lease / lease-to-own*

HOW IT WORKS

The financier buys and holds title to the property, then leases it to the sponsor for rent. A purchase or sale undertaking transfers ownership at lease end or earlier default.

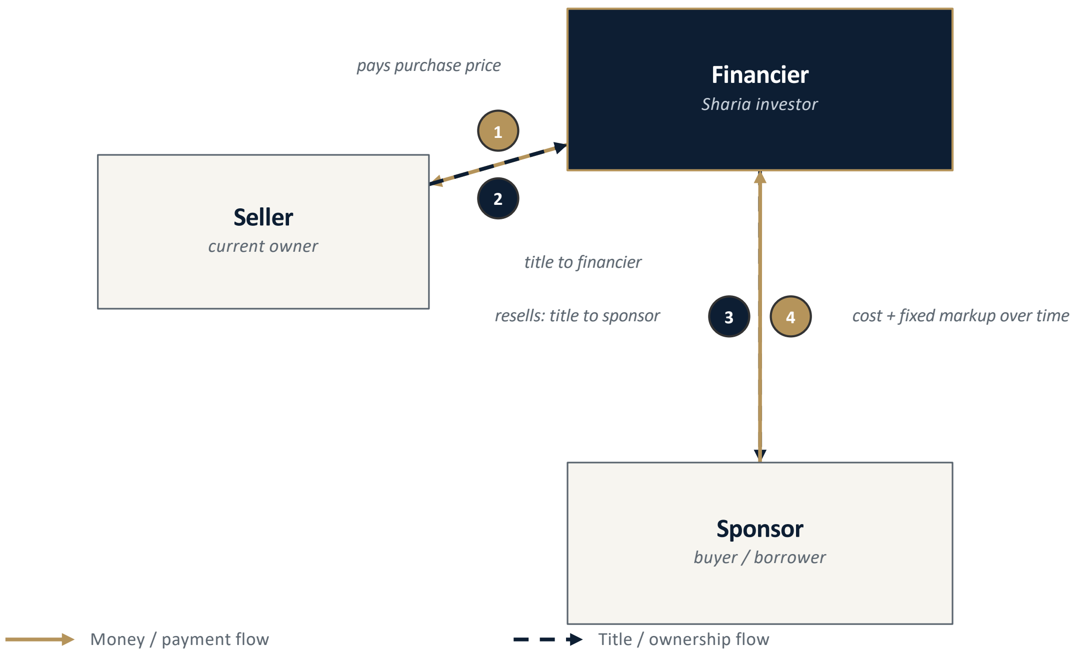
IN U.S. CRE

Common for income property because it needs a tangible asset. The financier carries owner duties (insurance, major maintenance), often passed through to the sponsor as lessee.

Source: Pillsbury · Covington

STRUCTURE 1 · DIAGRAM

Murabaha — cost-plus sale



HOW MURABAHA WORKS

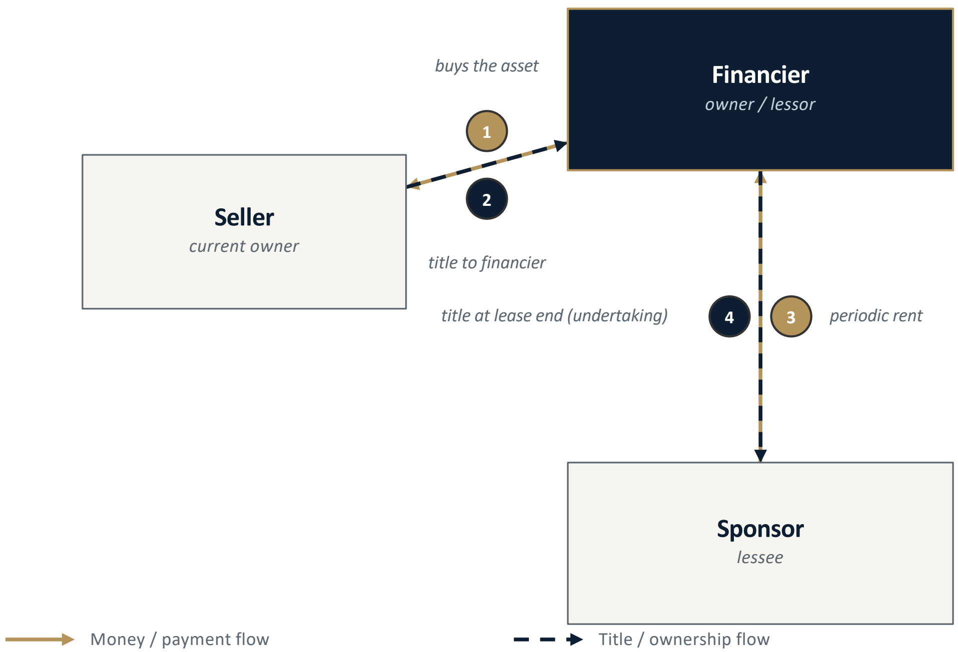
1. Financier buys the property from the seller at cost (a brief, real ownership step).
2. Title passes to the financier — it must genuinely own the asset, even momentarily.
3. Financier immediately resells to the sponsor; title transfers to the sponsor at closing.
4. Sponsor repays the cost plus a disclosed, fixed profit margin in installments over time.

Key point: *The most loan-like structure. The markup is fixed and disclosed up front — not interest that accrues. The OCC has treated it as functionally equivalent to a mortgage.*

Source: Covington · Pillsbury

STRUCTURE 2 · DIAGRAM

Ijara — lease / lease-to-own



HOW IJARA WORKS

1. Financier purchases the asset and pays the seller.
2. Financier takes and holds title throughout the lease — it remains the legal owner.
3. Sponsor leases the asset and pays periodic rent (the financier’s return on ownership).
4. A purchase / sale undertaking transfers title to the sponsor at lease end (or on early default).

Key point: *The financier truly owns the asset and carries owner duties (insurance, major maintenance), usually passed back to the sponsor. On total loss, rent ceases. Istisna’a commonly converts into ijara at completion.*

Source: Covington · Pillsbury

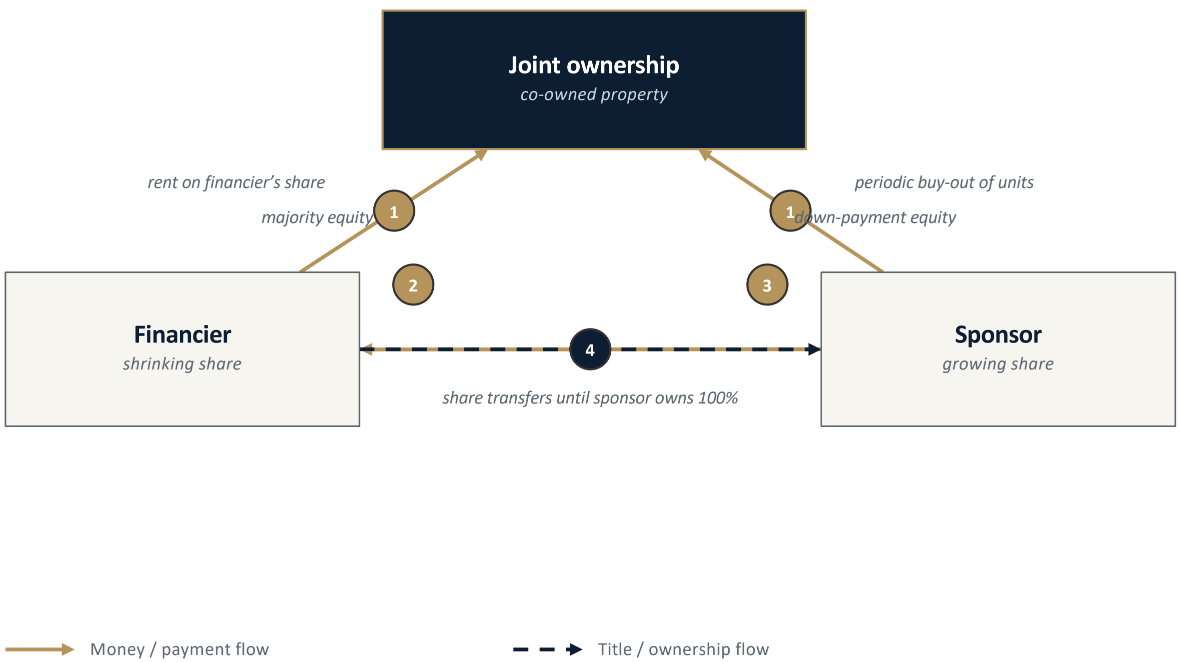
Musharaka, Mudaraba and Istisna’a

Musharaka *co-ownership*	Financier and sponsor jointly own the property and share profit and loss by ownership percentage. In diminishing musharaka — the common CRE variant — the sponsor pays rent on the financier’s share and buys that share down over time until it owns 100%.
Mudaraba *profit-sharing*	The financier provides capital (rab-al-mal) and the sponsor provides expertise and management (mudarib). Profits are split by a pre-agreed ratio; a loss of capital is borne by the financier, while the sponsor loses its time and effort. More common as a fund or JV layer than as direct property finance.
Istisna’a *construction*	A construction-to-completion contract: the financier funds the build in stages against specifications, then sells or leases the finished asset to the sponsor — typically converting into an ijara once construction completes. The natural fit for ground-up development.

Source: Covington · Pillsbury · HalalWallet

STRUCTURE 3 · DIAGRAM

Diminishing Musharaka — co-ownership buy-down



HOW IT WORKS

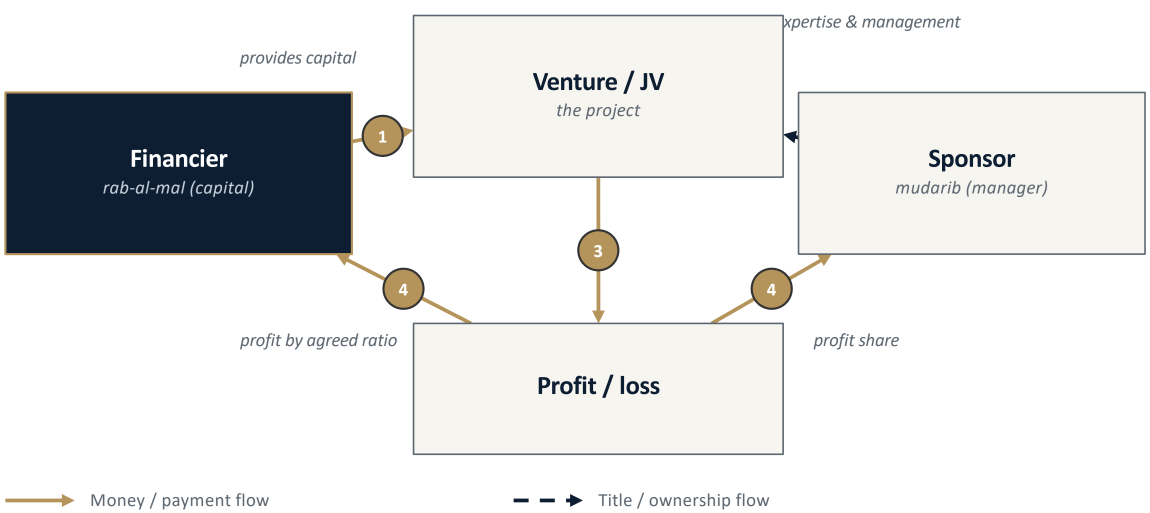
1. Financier and sponsor jointly buy the property, each contributing equity and co-owning it.
2. Sponsor pays rent on the portion the financier still owns — the financier's return.
3. Sponsor periodically buys out units of the financier's share with separate payments.
4. The financier's ownership diminishes over time until the sponsor owns 100%.

Key point: *The workhorse CRE variant and the most equity-like. Profit AND loss are shared by ownership percentage — the financier is genuinely a partner, not just a lender.*

Source: HalalWallet · Hutfin

STRUCTURE 4 · DIAGRAM

Mudaraba — capital meets expertise



HOW MUDARABA WORKS

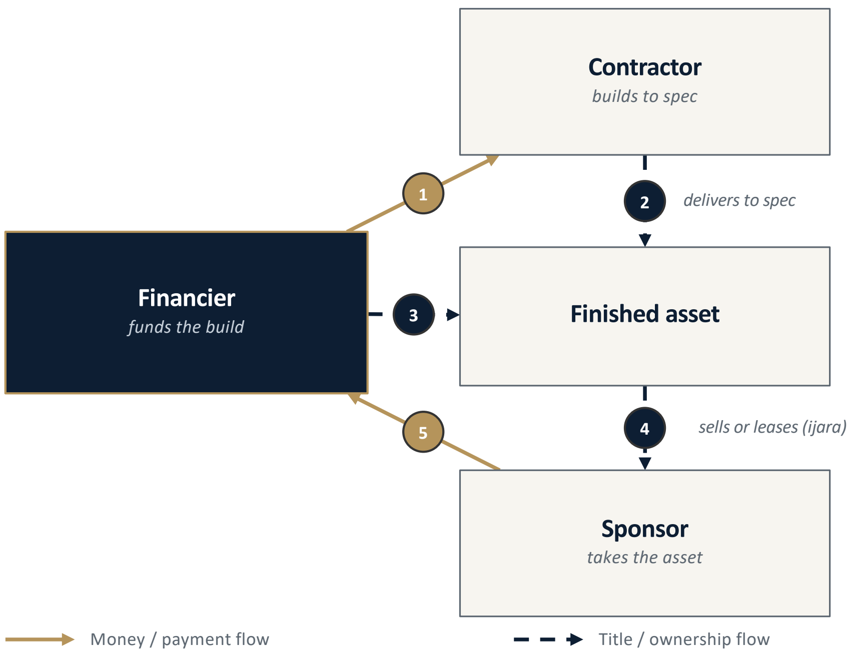
1. The financier (rab-al-mal) supplies all the investment capital for the venture.
2. The sponsor (mudarib) contributes expertise and day-to-day management — not cash.
3. The venture generates profit (or loss) from its operations.
4. Profits are split by a pre-agreed ratio. A loss of capital falls on the financier; the sponsor loses only its time and effort.

Key point: *Asymmetric risk: the financier bears capital losses, the manager bears effort risk. Seen more often as a fund or JV layer than as direct, mortgage-style property finance.*

Source: Covington · DLA Piper

STRUCTURE 5 · DIAGRAM

Istisna’a — construction, then ijara



HOW ISTISNA’A WORKS

1. Financier funds construction in stages against agreed specifications.
2. Contractor builds and delivers the asset to specification.
3. Financier owns the work-in-progress and the completed asset.
4. On completion the financier sells or, more commonly, leases the asset to the sponsor — converting into an ijara.
5. Sponsor pays the deferred price or ongoing ijara rent over the hold.

Key point: *The natural fit for ground-up development — and the bridge to the capital stack: istisna’a funds construction, then rolls into an ijara at stabilization, mirroring construction-to-permanent takeout.*

Source: Covington · Pillsbury

Accessing this capital: pros and cons

Why sponsors reach for it	What you give up
+ Access to a deep, patient, relationship-driven pool of equity and financing capital.	— A thinner U.S. provider market — fewer lenders, less price competition.
+ A genuine risk-sharing partner — the financier has real skin in the asset.	— More documentation and a Sharia-board approval step that adds time and cost.
+ Often comparable all-in economics to conventional debt once profit is priced.	— Extra property transfers can trigger transfer taxes and recording fees.
+ Strong fit for asset-heavy, income-producing CRE that Sharia rules favor.	— Asset-use and structural constraints can limit flexibility mid-deal.

Source: Hutfin · Pillsbury

EXECUTION RISK

Common pitfalls with these structures

1. **Form over substance** — If a U.S. court sees the deal as a disguised interest loan, the Sharia overlay may not survive recharacterization.
2. **Double transfer costs** — Buying then reselling the property can trigger transfer taxes and recording fees — though NY relieves some ijara/mudaraba transfers.
3. **Regulatory limits** — The National Bank Act limits a bank holding real estate to secure debt beyond five years; partnership/equity rules constrain musharaka and mudaraba.
4. **Sharia-board mismatch** — Counsel drafts for enforceability; the board approves for compliance. Misalignment late in the deal forces costly redrafting.
5. **Tax uncertainty** — Murabaha profit is treated as interest, but the IRS has not fully addressed ijara and mudaraba payments.

Source: Pillsbury · Wisconsin ILJ

THE CAPITAL STACK

Sitting alongside conventional debt

THE LIFE-OF-DEAL VIEW

A Sharia-compliant investor rarely funds a project alone. Its capital usually sits alongside conventional construction, bridge, and permanent debt — so the structures must map onto familiar financing phases without breaking either side's rules.

Istisna'a → Ijara is the classic bridge: istisna'a funds the build, then converts to an ijara lease once the asset stabilizes — mirroring construction-to-permanent takeout.

Intercreditor terms, collateral sharing, and lien priority must be negotiated up front — the Sharia investor's ownership interest has to coexist with the conventional lender's security.

MAPPING ONTO FINANCING PHASES

Construction
Istisna'a funds staged build
pairs with conventional construction loan

Stabilization
Convert istisna'a → ijara
lease-up; rent begins on completed asset

Permanent
Ijara or diminishing musharaka
long-term hold; sponsor buys down share

Source: Covington · Pillsbury

WHEN THE DEAL TURNS

Modifications and workouts under stress

THE CORE TENSION

Conventional workouts lean on default interest and late fees to compensate the lender. Sharia rules limit exactly that — so restructurings have to find a compliant path to the same commercial result.

WHAT CHANGES IN A RESTRUCTURING

No compounding default interest. Late charges must be tied to actual loss (ta’widh); pure penalties (gharamah) generally must go to charity, not the financier.

Re-price through the asset. Extensions are often re-papered as a new sale or lease, not a rate bump.

Undertakings drive the exit. Purchase / sale undertakings give a contractual route to unwind or transfer on default.

Board sign-off again. Material modifications may need fresh Sharia-board approval.

HOW LATE CHARGES ARE TREATED

Ta’widh

Compensation for the financier’s actual, provable loss

Kept by the financier

Gharamah

A penalty beyond actual loss, to deter delay

Paid to charity — not income

Source: Islamic Finance SG · Covington

THE LENDER'S PERSPECTIVE

How structure shapes the exercise of remedies

Structure	Lender's position on default	Remedy character
Murabaha	Holds a secured claim for the deferred price	Sell the property to recover — effectively a foreclosure
Ijara	Owns the asset; enforces purchase undertaking	Re-take / re-let the asset; recover via undertaking
Musharaka	Co-owner; shares loss by ownership %	Partition / forced buy-out; loss-sharing, not pure debt
Mudaraba	Capital provider; bears capital loss	Limited clawback — weakest downside protection
Istisna'a	Owns work-in-progress; controls completion	Step-in / complete-and-sell; pre-completion exposure

Bottom line: the more equity-like the structure, the more the financier shares downside and the less it looks like a creditor with a clean foreclosure path. Document undertakings, lien priority, and intercreditor terms before stress arrives.

Source: Pillsbury · Covington

Questions?

We help sponsors and lenders structure Sharia-compliant real estate capital that holds up — at closing and through workout.

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