

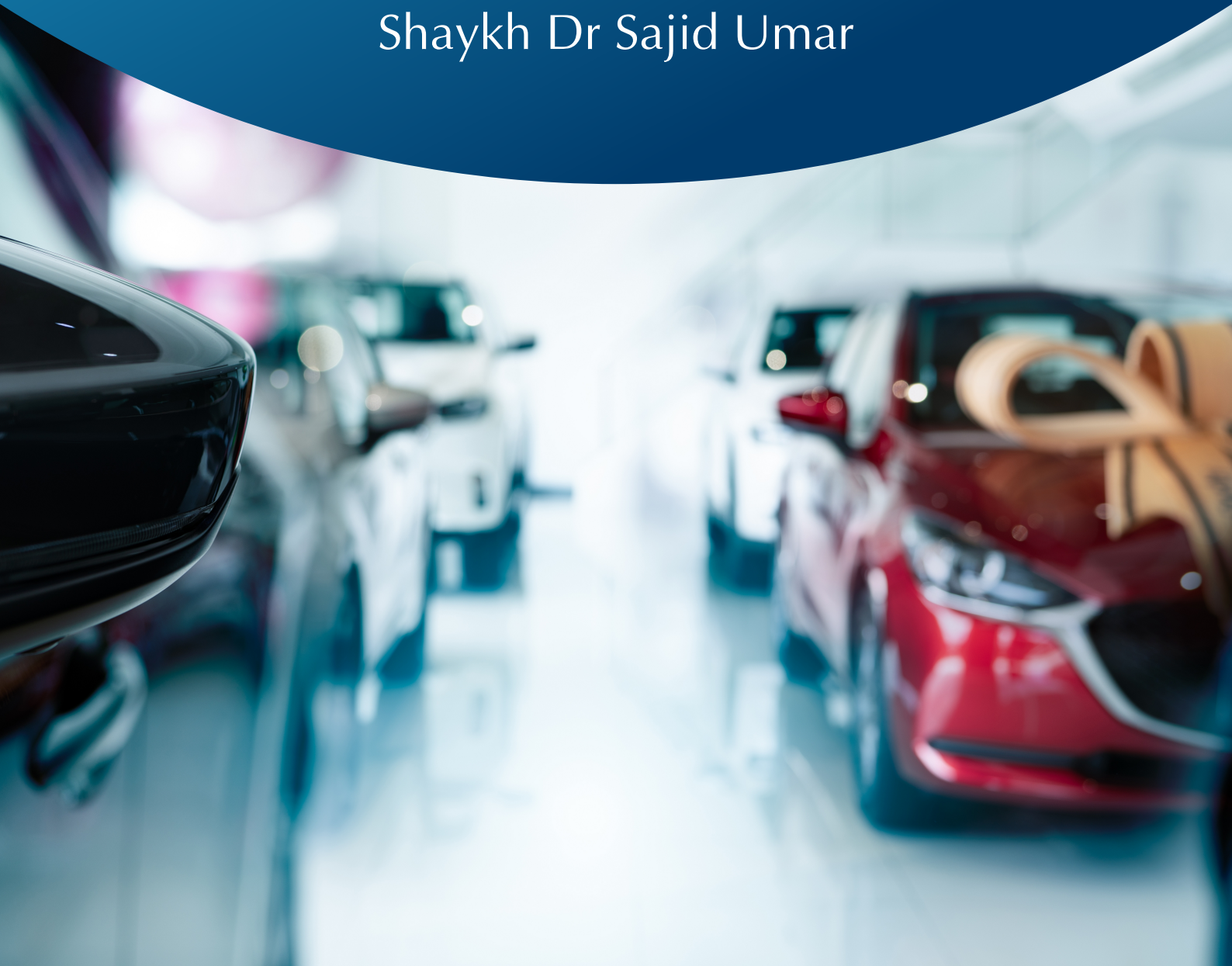


ISLAMIC
FINANCE
ADVISORY

CAR FINANCE OPTIONS

AN ISLAMIC PERSPECTIVE

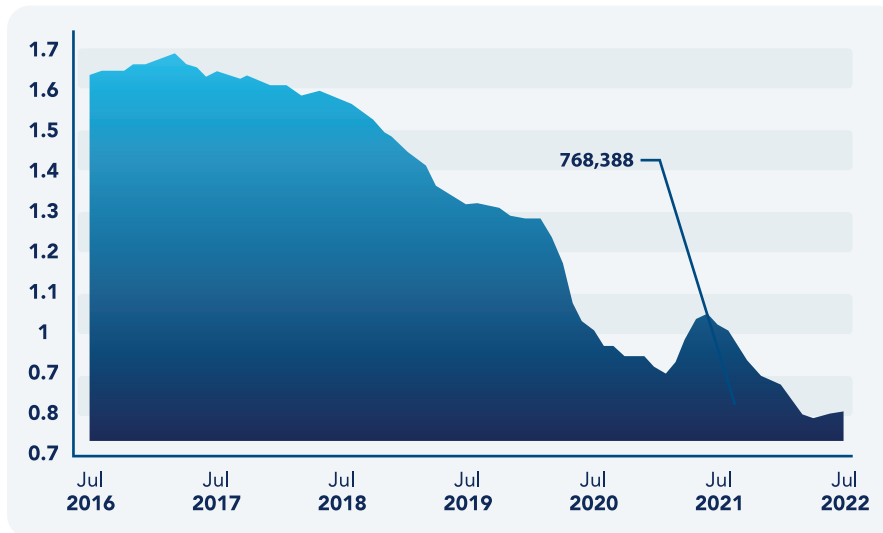
Shaykh Dr Sajid Umar



Car Finance Options

Car manufacturing in the UK has stalled dramatically since last year. In July 2022, UK car production dropped by almost 17%¹ following a general declining trend since 2016.

CAR OUTPUT - ROLLING YEAR TOTALS (millions)



A variety of factors are contributing to this, from increasing living costs driving down demand and manufacturers struggling to get parts amid global supply chain problems.²

This situation isn't unique to the UK, but it comes at a time when the car industry in the UK is desperate to put itself at the forefront of the move to electric vehicles - attracting new investment which was lacklustre in the past few years due to Brexit-related uncertainty.

In 2020, households in England had an average of 1.24 cars. However, if we exclude London (the area with the lowest rate of vehicle ownership) then the typical English household had 1.33 cars. In London, households had 0.78 cars, meaning on average not every household has a car. Households in the South West and East of England had the highest rate of car ownership, with an average of 1.45 and 1.46 cars per household, respectively.³

In modern times, what is seen as almost a necessity due to the flexibility it offers, cars are the second biggest purchase we make in our lives after a House.⁴ Accordingly, and in any current market where loans are regularly taken to make large purchases, there are a range of products available to finance the purchase or acquisition of suitable vehicles.

¹ SMMT. Manufacturing Data <https://www.smmmt.co.uk/vehicle-data/manufacturing/>

² Further reading available at: <https://iceurope.org/10-ways-to-manage-the-current-inflation-crisis-an-islamic-perspective/>

³ Department for transport and DVLA. <https://www.gov.uk/government/organisations/department-for-transport/about/statistics>

⁴ Forbes. Five Expenses That Will Consume 50 Percent Of Your Lifetime Earnings. <https://www.forbes.com/sites/work-in-progress/2010/08/02/lifetime-earnings-home-car-children-education-retirement/?sh=453fd88a507d>

As Muslims, we undoubtedly need to navigate, or steer, our way through the multitude of offerings to find Shariah compliant (permissible) and financially suitable means in which we can satisfy our needs, especially if financing has to be a means towards it.

Below, we will have a look at what is on offer in relation to vehicle purchases or acquisitions, and analyse its suitability from an Islamic perspective.

Possible Vehicle Purchase Methods

1. Buying a Car with Cash

The cheapest and arguably most simple choice when making a large purchase such as a car is to fund all or part of it without the need to borrow or finance the deal. If you're able to pay the whole price in cash, you'll own the car outright at its spot-sale price. The pros to buying a car with cash can be summarised as follows:

- As you own the car outright, you can sell the car at any time if your circumstances change, or you run into financial trouble.
- You won't have to worry about monthly loan repayments, or the terms and conditions of your finance agreement.
- You won't have to worry about owing more on a finance agreement than the car is worth. Cars depreciate over time in value, and you can end up being in debt for the original amount that you purchased the car for, which can, rather quickly, supersede the actual current value of the car.

Conversely, the cons of buying a car with cash would be:

- You will find your choice is more limited as you may not have as much available, therefore the temptation to compromise on the level of safety or reliability of the vehicle might occur.
- You'll need a substantial amount of money available straight away.

2. Interest-Bearing Secured or Unsecured Loan



Another common option when looking to make a large purchase is for an individual to obtain a personal loan via friends and family, or directly from a bank by paying via credit card or relying on another form of credit. This unsecured loan may be then used to purchase any asset – in our case a vehicle – outright with a separate outstanding debt obligation with the creditors/lenders.

From an Islamic perspective, borrowing money which is to be returned with interest from a commercial bank, or from any interest-bearing lender, irrespective of source, in order to purchase a car or any other asset, whether secured or otherwise, is impermissible. This is the purest form of a *ribawī* (interest-based) contract.

In the instance that a person can obtain a 0% loan, from a commercial bank or otherwise, then this would be permissible to use for purchasing a car as there is no interest.

3. Benevolent Loan (Qarḍ Hasan)

Benevolent loans, also known as *qarḍ ḥasan*, are loans usually given on a goodwill basis with no interest. Should the borrower encounter difficulty in repaying the loan, the lender must extend the repayment time. Some even argue that the date of repayment should not be fixed.⁵ This is due to the fact that the giving of loans is a recommended act rewarded by Allah ﷻ directly, and as a result no benefit for the lender can be included in the contract terms.⁶ However, the loan can be secured with a suitable asset in the form of a security, known as a *rahn*, in order to protect the lender.

4. Hire-Purchase

Hire purchase is an arrangement for buying expensive consumer goods, where the buyer makes an initial down payment and pays the balance in instalments. In other countries, this type of purchase mechanism is known as an 'Instalment Plan'.

With a Hire-Purchase arrangement, agreements are not seen as an extension of credit, ownership is not transferred to the purchaser until all payments are made, and the overall cost normally proves to be more expensive in the long run than purchasing an item outright.

⁵ The Concept of Ribā and Islamic Banking, 1995.

⁶ al-Ḥadīd, 11; al-Taghābun; 17, al-Muzzammil; 20.

5. Leasing (Ijārah)

Leasing is one of the many options widely available and used by many due to the flexibility it gives individuals. In Islamic finance, this comes under the category of transactions referred to as ijārah. Usually, a buyer rents for valuable vehicles for a period of time without needing to go through the hassle of owning wholly and reselling a vehicle. There is usually the added benefit of warranty from the lessor if there are any issues with the vehicle.

Hire Purchase Agreements

What does Hire Purchase (HP) mean?

If we take the term Hire Purchase (commonly abbreviated as HP) somewhat literally, we're hiring a car from a finance company with the intent to purchase it. We would not own the car until the end of the agreement (it's the property of the finance company or the seller) but once the final payment is completed, which can normally be between 12 to 48 months, the car is legally the buyer's.

The pros to buying a car using a HP agreement can be summarised as follows:

- You'll own the car at the end of the agreement without any extra fees to pay
- You aren't limited by mileage as with other finance types
- HP finance is often available on used cars as well as new models

Types of HP Agreements

This agreement can be conducted in a number of ways, either through 1. a bipartite or 2. tripartite agreement.

1. Bipartite Hire-Purchase Agreement

A bipartite HP agreement is a sale in which there are only two parties involved: the seller and the buyer.

Some car financiers are wholly owned by their parent companies and may fall under this category, for example Mercedes-Benz wholly owns Mercedes-Benz Finance. It would be best to ask or get a specific contract checked if a buyer is unsure.

2. Tripartite Hire-Purchase Agreement

A tripartite hire purchase agreement occurs where the buyer borrows money from a third party,

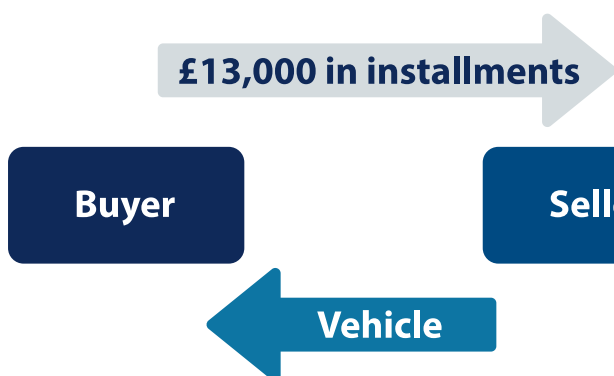
usually a financier, in order to purchase the car from the seller. The third party financier will secure their loan against the car, and the debtor (buyer) pays an amount greater than that originally lent by the financier.

Bipartite HP Agreements Shari’ah Compliance

The contractual boundaries open up greatly with a bipartite contract within the Islamic framework. A seller is able to charge a known mark-up to a buyer and the buyer can pay by instalments, spanning a period that is agreed upon between the parties to the contract before the advent of the contract.

For example, in order to make a higher profit margin, a dealer may choose to sell their £10,000 car for a deferred payment of £13,000 in instalments over a five-year period. This is usually known as bay’ ajal.

There is often a premium added to any vehicle sold in instalments, which can include benchmarking against LIBOR or other indexes, interest-based or otherwise, depending on the contract. Some people raise a contention to the idea of the premium being based on interest-related markers, however the fact that the mark-up may be calculated based on interest markers is irrelevant from the Shari’ah’s standpoint, as the focus of the Shari’ah is on the actual price of the contract being adequately known to the buyer before the agreement is completed.⁷



Regarding using interest-related markers to guide the selling price of a deferred sale and its impact on the sale from the perspective of Shari’ah-compliance; we can therefore conclude that a Muslim who owns a car valued at £10,000 and decides to charge £13,000 by instalments – after a rounded calculation with an interest-related benchmark rate of 5% per year – would be permissible.

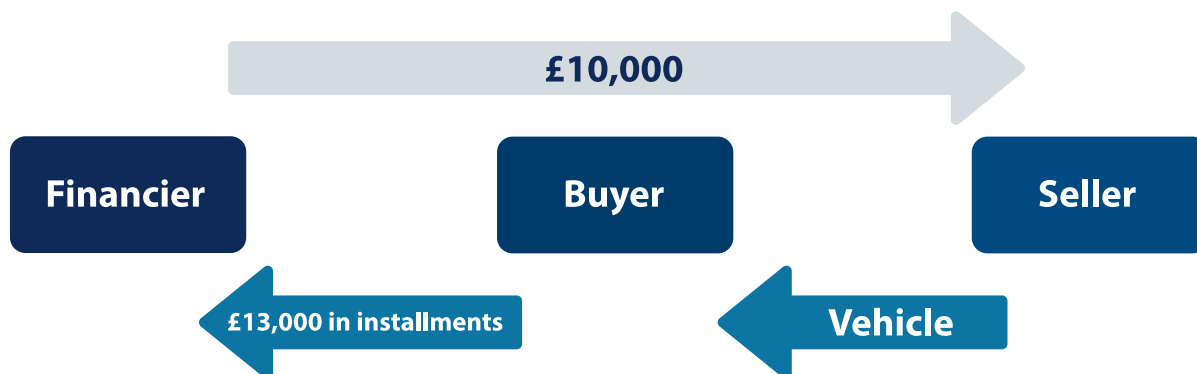
Tripartite HP Agreements Shari’ah Compliance

A tripartite hire purchase agreement occurs with three parties involved, and not just two as previously covered. In this arrangement, the buyer borrows money from a third party financier in order to purchase the car. The third party financier will secure their loan against the car, and the debtor pays an amount greater than originally lent by the financier.

This type of sale is a combination of two sales, usually a cash sale by the financier of the vehicle from the car dealer, and a separate, but immediate and pre-contracted sale in which an individual would purchase the vehicle at a higher price over a period of time. In effect, this combination of sales allows the financier to loan an individual money, usually at a higher rate than a direct bank loan, and also secure its loan against an asset simultaneously.

It should be noted that this type of contract may not always be obvious to a consumer, as the market has been streamlined. Instead of a buyer going to a separate financing company who would approve their purchase, and then consequently going to a dealership to purchase a vehicle, the buyer usually finds car dealerships already having partnerships with some financing companies. As a result, a customer can simply walk into a car dealership and be able to attain the approval for their credit agreement immediately, as the car dealership will input the customer's details into an accessible financier's software. As such, some unsuspecting buyers may fall into the trap of assuming that this is a bipartite agreement directly with the dealership, as that is the only company they are aware of.

As a sign, an indication of a tripartite HP arrangement is that when receiving a credit agreement to pay in instalments, there is a separate company underwriting the agreement. A buyer should ensure that they read through these documents carefully and understand how many parties are involved, and with whom they are entering into a credit agreement with.⁸



In this example the financier is paying 10,000 to the seller for the car on behalf of the buyer and is requesting a 13,000 repayment from the buyer in instalments. Between the buyer and the financier the resulting transaction is a 10,000 loan with a repayment of 13,000 resulting in a ribawī (interest-based) contract akin to the 'Secured or Unsecured Loan' option above.

0% Tripartite HP Agreements

In a 0% Tripartite HP Agreement, a financier may offer 0% finance for a part, or all, of the contract period to incentivise the consumer to enter the contract. Regarding 0% financing, if it is for part of the sale, this would be a prohibited contract as interest in all its forms and amounts

⁸ The Islamic Council has a dedicated service called the Islamic Council Finance Advisory (ICFA) to help potential buyers identify the reality of the type of HP contract on offer. <https://iceurope.org/services/islamic-finance/>

are forbidden in Islam (Haraam). However, if this sort of offer covers all of the sale, and a person passes the stringent credit checks to ensure qualification, the contract would be permissible from an Islamic perspective on the condition that there are no clauses enforcing interest in the case of any defaults, or applicable late payment fees in the event of delayed payments or otherwise.

It also should be noted that in more cases than acceptable, the financier would require the customer to sign a contract to buy the vehicle from them before the financier utilises its capital in purchasing the wanted vehicle from the dealer. In this instance, the financier will be selling a vehicle that it does not own to the buyer, a practice that was forbidden by the Messenger (pbuh) for He forbade traders to sell what they did not own⁹ - or make a profit from that which they carried no liability over.¹⁰

Finally, if all the above reservations are absent, and the only problematic clause is the late-payment stipulation, which has overwhelming presence in almost every contract in circulation today, then contemporary Islamic Scholarship whilst recognising the non-practical reality of seeking total avoidance of any contract with this stipulation by the Muslims, has permitted as a concession, as based on the principles of the Shariah regarding the alleviation of difficulty, has permitted entering into contracts with the late-payment stipulation on condition of the following stipulations being met:

1. A person's life would become abnormally difficult due to not having a vehicle, when compared to the normative realities of society.
2. They purchase a vehicle that meets their 'needs' in terms of size and safety, and not mere 'wants'.
3. They are earning enough to maintain the monthly payments agreed upon before the completion of the contract.
4. They take every precautionary method to avoid missing their due date of each payable amount, from setting reminders to keeping an emergency fund of at least 3 months worth of payments, saved and untouched, to use if their financial position changed.¹¹

Leasing (Ijārah)

How Does Leasing Work?

Leasing a car is similar to a long-term rental. You'll generally have to make an upfront payment, plus consequent stipulated monthly payments, and accordingly get to use a car for several years at a time. At the end of the lease, you'll return the vehicle and not own anything, as is practised with short term leases.

⁹ Tirmidhi (1232)

¹⁰ Nasaai (3641)

¹¹ As stipulated by Sh. Dr. Sajid Umar in edicts passed by him on the topic of contracts of need with late-payment stipulations. <https://www.sajidumar.com/category/rulings-advice-qa/>

The pros to leasing a car can be summarised as follows:

- Your monthly payment is typically lower than buying a car using a HP agreement
- You can get a new car every couple of years
- Many lease agreements include a warranty that lasts at least three years. So when you take out a three-year lease, most of the repairs may be covered. Leasing arrangements can potentially mitigate against some significant, unforeseen expenses.
- No worries about having to sell the car in order to replace it or keeping a depreciating vehicle.

Leasing - An Islamic Perspective

The lexical linguistic meaning of *ijārah* is 'to give something on rent'. *Ijārah* confers the lessee, termed the 'musta'jir', the agency to utilise the asset without needing to purchase it wholly. It also allows the lessor, termed the 'muajjir', to make a profit from the unused asset.

Muslim Jurists derive the validity of this contract from a number of epistemic sources, one of which is the consensus of the companions of the Messenger (pbuh).

What is a Personal Contract Purchase (PCP)?

A Personal Contract Purchase, usually referred to as PCP, is structured as a lease with the addition of a buy option. This would result in a three-to-four-year monthly payment plan, with two different options available upon completion. Either the buyer returns the car to the dealership, or the buyer chooses to pay the value of the car minus the accrued lease payments.

There is often a third option offered in the form of an exchange of vehicles. In reality, this option is taken in one of two ways. First, the buyer has the option to refuse purchasing the car at the end of the contract term and signing up to a separate PCP contract, usually for a newer car. This recourse is rarely taken, given the way the PCP deals are structured. Usually, the company offering the PCP deal would price the total accrued monthly payments to a value over the depreciation of the vehicle. At the end of the contract period, the buyer would usually have the option to purchase a car below the market value as a one-off payment. This thereby allows the buyer to realise this difference or leverage it into a better deal for the next vehicle.

PCP Example

We can demonstrate the realisation of this difference with a simple example. A buyer signed into a PCP contract for a new car with the value of £20,000. However, their usage of the car over a four-year period will reduce the value by £5,000. The company selling the PCP contract recognised this, wanting to make a profit, and priced the accrual of the monthly payments at £12,000, with an optional £11,000 purchase payment. Through this pricing, they ensure that they will have made a profit on the depreciation of the vehicle even if the buyer does not wish to pursue the purchase option at the end of the contract, as the vehicle will have depreciated by £5,000, but they would have made £12,000 through the renting of the car.

At the end of the contract period, the buyer has an option to purchase a four-year-old vehicle valued at £15,000 in the private market for £11,000. The buyer can realise this option in one of two ways:

1. Purchase the car outright and resell it on the private market to make £4,000 in profit.
2. Part-exchange the car with the dealership (in effect buying the car from them and selling it back to them) to allow the £4,000 in equity to be used for the next vehicle.

The second option saves time as the dealer would not have to advertise and deal with the sale of the car. It also allows the buyer to benefit from the buy option without needing the capital to purchase the car outright. Entering a new PCP deal using this method allows the buyer to use the profit as a deposit towards their next finance agreement. The car dealer benefits from this arrangement by selling another PCP deal to the same client and securing more profit, with the addition of a potential upside from the used car that was traded in, through either leasing it again or selling it.

PCP Shari'ah Compliance

From an Islamic perspective, as a general contract, this would be nothing more than an *ijārah* with a separate simple general sale contract, all of which fulfils the general requirement for the validity of a sale contract. The arrangement would therefore be permissible, as the two are not inextricably linked. As such, there is no obligation to purchase the vehicle at the end of the contract period.¹²

At the end of the contract a buyer may decide to purchase the car by paying the final 'balloon' payment using either an interest-bearing secured or unsecured loan. This method of exercising the option would again fall into the same categories previously mentioned, and would ultimately be deemed impermissible.

¹² Purchasing the vehicle is usually preferred as a consequence of the price at which a buyer can obtain the vehicle below the private market value. Were this not to be the case and the purchase price of the car was above private market pricing; the buyer would then simply choose not to exercise the option.

Option Comparison

	Pros	Cons
Cash Purchase	<p>We own the car outright.</p> <p>We won't have to worry about monthly loan repayments.</p> <p>We won't have to worry about owing more than the car is worth.</p> <p>No usage restrictions.</p>	<p>We will find your choice is more limited.</p> <p>We will need a substantial amount of money available straight away.</p> <p>We will be responsible for all repairs.</p>
Interest-Bearing Secured or Unsecured Loan	<p>We own the car outright.</p> <p>Fast funding times.</p> <p>Interest rates are normally fixed.</p> <p>No collateral requirement.</p> <p>No usage restrictions.</p>	<p>Monthly payments can be higher than other forms of finance.</p> <p>Many people can't get advertised rates.</p> <p>We will be responsible for all repairs.</p>
Personal Loan (Qard ḥasan)	<p>We own the car outright.</p> <p>Generally flexible if circumstances change.</p> <p>Interest free and will be the cheapest option.</p> <p>No usage restrictions.</p>	<p>We will be in debt and need to manage the repayment with the other party.</p> <p>We will be responsible for all repairs.</p>
Hire Purchase (HP)	<p>We will own the car at the end of the agreement without any extra fees to pay.</p> <p>We aren't limited by mileage as with other finance types.</p> <p>HP finance is often available on used cars as well as new models.</p>	<p>We don't own the car till final payment.</p> <p>High monthly payments.</p>
Leasing	<p>Our monthly payment is typically lower.</p> <p>We can get a new car every couple of years.</p> <p>Warranty usually included</p> <p>No worries about having to sell the car in order to change.</p>	<p>We don't own the car.</p> <p>Usually has usage restrictions, namely mileage restrictions and no ability to modify the vehicle.</p> <p>Usually requires fully comprehensive insurance.</p>
Personal Contract Purchase	<p>Has all the benefits of leasing with the additional flexibility of having the option to purchase the car.</p>	<p>We don't own the car.</p> <p>Usually has usage restrictions, namely mileage restrictions and no ability to modify the vehicle.</p> <p>Slightly more expensive than leasing.</p> <p>Usually requires fully comprehensive insurance.</p>

	Who is it suitable for?	Permissibility
Cash Purchase	A buyer with suitable disposable income who wants to keep the car for a long term.	Shariah Compliant ✓
Interest-Bearing Secured or Unsecured Loan	Ideal for people who have difficulty in getting an approval for finance otherwise. An individual with a good credit rating can get a cheaper rate than a HP agreement.	Not Shariah Compliant ✗
Personal Loan (Qarḍ ḥasan)	Perfect for buyers who have friends and family that are willing to lend them the amount they need for a suitable vehicle.	Shariah Compliant ✓
Hire Purchase (HP)	Ideal for buyers who want to purchase the vehicle over time and do not have the capital to purchase the vehicle upfront.	Bipartite - Shariah Compliant ✓ 0% Tripartite ¹³ - Shariah Compliant ✓ Tripartite - Not Shariah Compliant ✗
Leasing	A person who wants to rent a higher value car, but ultimately does not intend to keep it and will change it after a few years.	Shariah Compliant ✓
Personal Contract Purchase	An individual who wants to lease a car, however, may keep the car long term if they take a liking to it. Also someone who wants to build equity in the car they are renting.	Shariah Compliant ✓

As we have summarised in the table above, we have an abundance of Islamically permissible options for purchasing a car that needs to be financed. Whilst being permissible, as Muslims, we should be very wary of getting into debt and be aware of the potential negative consequences involved. Living within one's means is always emphasised for us as Muslims, therefore we should approach debts as a necessity and ensure we borrow the minimum viable amount for the vehicle we need rather than splurging on our dream cars.

About Islamic Finance Advisory

The Islamic Finance Advisory (IFA) offers tailored Shari’ah consultancy services to ensure financial and business activities align with Islamic principles. From Shari’ah compliance checks, certification for businesses, investments, and fintech, to guidance on zakah, waqf, wills, and inheritance, the IFA helps Muslims achieve Islamically ethical financial solutions. With expert adjudicators for dispute resolution and a commitment to wealth-building based on divine guidance, the IFA ensures equitable financial practices for individuals and businesses alike.

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Date of Publication: October 2024



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