Using Islamic Finance for Infrastructure Projects in Non-Muslim Countries

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Abstract— **Using Islamic project finance is the solution to fill the gap between infrastructure demand and available finance. This study aims to investigate if it is appropriate to use Islamic finance to fund the infrastructure project, as one specific sector that is facing major challenges in long-term financing, and it intends to select the most appropriate instrument that is inconsistent with Non-Muslim countries' law and culture.**

The methodology and approach that will be used is a qualitative method which is used to study the Islamic financial tools, compare them with other financial instruments, and discuss the potential implementation of Islamic project finance structure to fund the infrastructure project in Italian environment. The study concentrates on exploring the Italian laws that are resembled to Shariah principle in order to make it more acceptable for the Italian culture.

The study concludes that using Islamic finance can be used to finance infrastructure projects by using existing laws and regulations. This study is also expected to benefit the Italian government and investors in making their financial decision, and it will be a new experience for Europe countries.

Keywords: Islamic project finance, Shariah principle, Islamic Financial instrument, infrastructure project.

I. INTRODUCTION

After the financial crisis, the traditional sources of investment financing are all facing challenges,[1] the global crisis have shed the light on the Islamic finance system. After the appearance of Islamic finance, the capital Market has provided more alternatives for investors, companies and governments that need finance.

Funding resources are drying out and has become more expensive; thus forcing governments, banks, and corporations alike to seek alternatives outside the interest-based system. One alternative that has received wide attention is Islamic finance and its crown jewel—Sukuk.[2] Sukuk created a framework for participation of a large number of people in financing project in public and private sectors, including those of infrastructure such as roads, bridges, ports, airports, etc. on the basis of various modes.[3]

In Europe, Islamic finance offers a unique proposition through alternative ethical driven products and services. These are capable of further enhancing trade and financial linkages between the EU and various OIC countries, where Islamic finance has a deep presence [4].

Islamic finance is growing at 10 to 15 present per year; it is one of the fastest growing areas of the global financial service industry [5], and the spread of Islamic finance into western market demonstrates that it is now being viewed by investors, financial institutions and regulators as a viable alternative to conventional products.

This paper aims to investigate if it is appropriate to use Islamic finance to fund the infrastructure projects in non-Muslim countries, and select the most appropriate instrument that is inconsistent with law and culture for those countries. Moreover, it attempts to overcome the lack of acceptance of Islamic finance in non-Muslim countries, and the challenges that could face the Islamic project finance in non-Muslim countries, and convince the decision makers about the benefit of these financial tools by comparing it with conventional Bond.

In the absence of the Italian Islamic finance law, the study concentrates on exploring the Italian laws that are resembled to Shariah principle in order to make Islamic finance more acceptable for Italian culture; in other words, we try to find Islamic project finance structures which are both Shariah compliant and compatible with the conventional products.

The methodology and approach that will be used is qualitative and theoretical method. The paper will use the theoretical method to understand the Islamic finance, infrastructure project and finance tools available for funding this project. Making a comparison between bond and Sukuk. The paper will examine the implementation of Sukuk to fund infrastructure project, by using Ijarah and Musharkah contract in Italian environment, and that will be a real example of using Islamic finance in non-Muslim countries.

The paper proceeds as follows. Section II provides the Islamic finance. Section III talks about infrastructure project characteristics and the financing method. Section IV provides the information about Islamic project finance .Section V illustrates the Sukuk. Section VI Explains the difference between the Bond and Sukuk. Section VII demonstrates the main challenge and limitation that can be faced in the implementation. Section VIII Includes a real implementation of Sukuk in finance infrastructure project in Italy. Section IX concludes this paper.

II. ISLAMIC FINANCE

Islam is a way of life, and Islamic finance is a part of the overall Islamic religion, therefore Muslim people need to make their finance consistent with religion.

Islamic finance system is based on Islamic religious law (Shariah). The basic Islamic finance principle is that money has no intrinsic value and is just a means of exchange, an individual or an institution should not be able to generate income from money; Financing under Islamic principles is typically based on the exchange of, in general, non-liquid assets with the principle's aim to create real assets and inventories. We can summaries the main Islamic finance Shariah principle as the following:

The first principle is prohibition of (Riba) interest. Riba as it is used in the Arabic language which means the excess or increase; the interest means any added amount paid by the borrower to the lender more than the principle amount as cost of borrowing; Islam has replaced the Interest with profit and loss-sharing principle, means that any returns must be earned from real commercial trading, and there is no guarantee of the principle or return, risk and profit must be shared equally between the parties of a transaction.

The second principle is the prohibition of Gharar "uncertainty or speculation". The trading under uncertainty in financial transactions must be eliminated. However, risk-taking is allowed when all terms and conditions are clearly stipulated and known to all parties.

The third principle is the use of asset-backing. Each financial transaction must relate to a tangible and/or identifiable underlying asset, ensuring that Islamic banks remain connected to the real economy. [5]

The fourth principle is Prohibition of Haram investment; any transactions that involve alcohol, pork, prohibited drugs, and pornography.

The fifth principle is prohibition of Maysir in Arabic means gambling which is hazard game of chance and it is considered as an extreme form of gharar. It refers to all transactions that have the element of gambling i.e. based merely on chance. The logic behind the prohibition of maysir is that the unjustified gains and increase of wealth through games of pure chance is a transfer of wealth from one to another and this kind of transfer is done on the expense of the society. [6]

III. FINANCING INFRASTRUCTURE PROJECT

Advanced economies face the challenge of maintaining extensive transport, power, water, and telecommunication networks, upgrading and modernizing them as growth flags. In the developing world, countries dedicate a large proportion of their national income just to meet basic human development needs (access to water and sanitation, electricity, and all-weather roads, for instance) and still cannot cater to large swaths of their populations. The challenge in these countries is becoming even more daunting as rapid growth on fuels demand for infrastructure to support economic and social development. Infrastructure is a corner stone of a stable and productive society. The right approach to delivering and maintaining transport, housing, energy, water, and communication infrastructure is essential to create a strong and competitive economy and provide social services. While infrastructure presents unique challenges, it also offers opportunities for both the public and private sectors. [7]

The McKinsey Global Institute estimates $57 trillion in infrastructure investment will be required between now and 2030—simply to keep up with projected global GDP growth, the task of funding the world's infrastructure needs is more difficult because of the constraints on public-sector budgets and commercial debt in the wake of the financial crisis, higher and more volatile resource costs, and the additional costs of making infrastructure resilient to climate change and less harmful to the environment[7].

Building infrastructure is a capital- intensive process, with large initial cost and low operating cost. It requires long-term finance as gestation period, for such projects is much longer than for a manufacturing plant. Infrastructure projects are characterized by non-recourse or limited recourse financing, that is, lender can only be repaid from revenue generated by the project.[8] Since large amounts are typically invested for long periods of time, it is not surprising that the underlying risks are also quite high.[9]

In addition to project finance, other financing structure are available for infrastructure and other project. These include (i) government funding, through grant, loans, and guarantee; (ii) government investment (iii) third party project participant financing; such as from equipment suppliers, off take purchasers, and construction financing from contractors (iv) non-project finance structure from multi–and bilateral agencies and from banks and other lenders, in reliance on the assets of creditworthy project sponsor or creditworthy host government,(v) capital market financing, in reliance on the assets of a creditworthy project sponsor or creditworthy host government (domestic bond offering, Eurobond offering, private placements), and (vi) securitization. [10]

While additional government funding for new infrastructure may come from privatization of existing infrastructure assets, this is unlikely to be enough for many infrastructure projects such as military infrastructure or public schools, pure public procurement may be the only feasible option and may absorb large shares of public funding capacity. the key sources of increasing infrastructure demand such as the large infrastructure gap in developing economies or the shift to renewable energy sources in developed economies will therefore require additional sources of financing from the private sector.[11]

Many governments turn to the private sector to design, build, finance, and/ or operate new and existing infrastructure facilities in order to improve the delivery of services and the management of facilities hitherto provided by the public sector.[12] The Private sector in Public- Private Partnership (PPP) can be either Islamic bank or Islamic finance instruments in project finance, because the primary feature of a PPP is that it is a contract or an arrangement between a government entity and a private entity.

European Investment Bank has been estimated that the EU's infrastructure investment needs to meet the Europe 2020 objectives could reach as much as EUR2tln in the sectors of transport, energy and information technology. In order to maintain the region's competitive position globally and to meet the future demand for infrastructure, European states are actively looking for alternative funding sources. Increasingly, the focus is shifting toward public private partnerships (PPPs) and institutional investor driven fundraising. In this regard, Islamic finance presents yet another avenue for raising funds for infrastructure projects in Europe. Sukuk could be used to supplement the Europe 2020 Project Bond Initiative which is intended to enable the issuance of long-term bonds by project companies. [4]

IV. ISLAMIC PROJECT FINANCE

Project finance is used to fund infrastructure project, project finance defined by the International Project Finance Association (IPFA) as the financing of long-term infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financial structure where project debt and equity used to finance the project are paid back from the cash flow generated by the project.[1]

Project financing has evolved through the centuries into primarily a vehicle for assembling a consortium of investors, lenders and other participants to undertake infrastructure projects that would be too large for individual investors to underwrite [13] Project finance is a debt financing of specific assets securitized by expected cash flows and the asset itself. [14]

Project financing is a structured financing that needs a Special Purpose Vehicle (SPV) in the form of a company to run the project and sponsors to contribute equity and debt. An SPV can consist of sponsors, equity investors, off-take purchasers, bondholders, lenders, government, constructors, suppliers and operator. All the stakeholders are managed through contracts and arrangements [15]. In the Project Finance mode, interlocking contracts covering almost every aspect of operations - especially those related to capital structure - circumscribe managerial autonomy. Furthermore, cash flows are isolated, and restricted to a single-purpose capital asset with the life of the Project Finance firm (usually a special-purpose vehicle) limited to the life of the asset [16].

The Islamic project finance is expected to be one of the best alternatives in infrastructure financing. In order to make it complied with Shariah principle, we can use diverse Islamic finance tools in project finance, and Islamic finance is suitable to finance the infrastructure investment, because infrastructure is an asset and it does not contain any activities that are prohibited in the Shariah [15]. Some of Islamic financial instruments can be used in infrastructure project like Musharkah, Mudarabah, Ijarah, Istisna, and Sukuk.

- Mudarabah: A contract between the capital provider and a skilled entrepreneur, whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur as the Mudarib (or work provider). Profits generated by that enterprise or activity are shared in accordance with the terms of the Mudarabah agreement, while losses are to be borne solely by the capital provider unless they are due to the Mudarib 's misconduct, negligence or breach of contracted terms [17].
- Musharakah: also known as partnership or joint venture, is the cooperation between two or more parties at which each party shares equity with a covenant that profit and losses will be shared together (Joint Venture).
- Ijarah: also known as leasing, is hiring or renting an asset to gain benefit of its usufruct.
- Istisna: An agreement to sell to a customer a non-existent asset that is to be manufactured or built according to the buyer's specifications and delivered on a specified future date at a predetermined selling price [15].
- Sukuk are securities that comply with Shariah rules and regulation, the investment is based on Shariah principles which prohibits the charging of interest, which mean the profit in Sukuk is not interest, but it is generated from the performance of the underlined assets [5].

The governments should have laws and codes that regulate the Islamic financial process in order to use these instruments, but most of non-Muslim countries don't have codes that regulate the Islamic finance at all. In order to overcome this challenge, we attempt to find the laws that are resembled to Shariah principle, and we should utilize the conventional finance tools with some modification to create project finance complied with Shariah.

Growing capital needs in the infrastructure sector globally present strong opportunities for Sukuk to enhance its role as an important source of financing to the development requirements of the world economy. [18] Because infrastructure does not contain any activities that are prohibited in the Shariah.

Several studies talk about the Sukuk benefits comparing with other financial tools, (Usmani) said that Sukuk are among the best ways of financing large enterprises that are beyond the ability of a single party to finance. And Sukuk provide an ideal means for investors seeking to deploy streams of capital and who require, at the same time, the ability to liquidate their positions with ease whenever the need should arise [19].

Sukuks are the most widespread between Islamic Financial Instrument, because Sukuk not confined only on Muslim countries but also non-Muslim countries. The Sukuk has become an important vehicle for international fundraising and investment activities that generate significant cross-border flows.[5] This is shown clearly by the increasing in the number of international issued Sukuk, in 2013 the International Sukuk issuance closed at around USD26, and in 2014 is likely to be similar to 2013 though the encouraging change is entry of Non-Islamic countries plus addition of several new jurisdictions, and

[1] http://www.investopedia.com

the global Sukuk market also continued its positive upward, in 2013 the global Sukuk issuance reached to USD138 billion and the close of 2014 will again be in excess of 130 billion[5].

V. Definition of Sukuk

Sukuk is a plural of Sakk, Sukuk is an Islamic financial certificate that complies with Shariah principle and laws. Investment Sukuk as defined by AAIOFI are the certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity, however, this is true after the receipt of the value of the Sukuk, the closing of the subscription and employment of funds received for the purpose for which the Sukuk were issued. (AAIOFI 2008).

Sukuk frequently referred to as “Islamic bonds”, are certificates with each Sakk representing a proportional undivided ownership right in tangible assets, or a pool of predominantly tangible assets, or a business venture (such as a Mudarabah), these assets may be in a specific project or investment activity in accordance with Shariah rules and principles. [17]

This definition includes two important points; the first is that Sukuk holders must have rely ownership of the asset of the specific project. The second is that the project and the Sukuk issuance procedure must be consistent with Shriah principle.

To be Shariah-complaint, Sukuk must be possible to be owned and sold legally, in accordance with the rules of the Shariah. AAOIFI Shariah Standards concerning Sukuk - advises Islamic financial institutions and Shariah Supervisory Boards to adhere to the following matters when issuing Sukuk:

- Sukuk holder must have a complete ownership in real asset. The Manager issuing Sukuk must certify the transfer of ownership of such assets in its (Sukuk) books, and must not keep them as his own assets.
- Sukuk, to be tradable, Must not represent receivables or debts, except in the case of a trading or financial entity selling all its assets, or a portfolio with a standing financial obligation, in which some debts, incidental to physical assets or usufruct, were included unintentionally, in accordance with the guidelines mentioned in AAOIFI Shariah Standard (21) on Financial Papers.
- Prohibition for the Manager of Sukuk, whether the manager acts as the Mudarib (investment manager), or Sharik (partner), or wakil (agent) for investment, to undertake to offer loan to Sukuk holder when there is a shortfall in expected earnings, It is permissible, however, to establish a reserve account for the purpose of covering such shortfalls to the extent possible, provided the same is mentioned in the prospectus. It is not objectionable to distribute expected earnings, on account, in accordance with Article (8/8) of the AAOIFI Shariah Standard (13) on Mudarabah, or to obtaining project financing on account of the Sukuk holders.
- It is not permissible for the Sukuk manager (Mudarib, Sharik, or wakil) to undertake {now} to re-purchase of the assets from Sukuk holders or from one who holds them, for its nominal value, when the Sukuk are extinguished, at the end of its maturity. It is, however, permissible to undertake the purchase on the basis of the net value of assets, its market value, fair value or a price to be agreed, at the time of their actual purchase.
- The permissibility to undertake to purchase the asset of Ijarah Sukuk for the remaining rental value of the remaining assets; since it actually represents its net value.
- Shariah Supervisory Boards should not limit their role to the issuance of fatwa on the permissibility of the structure of Sukuk, but it must follow up all the procedures and transactions to be sure if it is complied with Shariah.

There are two common classifications for Sukuk structure, Sukuk can be classified as either an Asset-based Sukuk or asset-backed Sukuk.

Under Asset-based Sukuk, they do not undertake true sale in the structure. Sukuk holders have beneficial ownership in the asset, and the Sukuk holders have resource to originator. The asset stays on the balance sheet of originator, and the source of payment comes from originator cash flows; but under the Asset- backed Sukuk, the Sukuk holders have the full ownership of the underlying asset, this Sukuk structure is therefore more in accord with Shariah principles, the Sukuk holders have resource to assets. The asset is separated from the originator's book, and the source of payment comes from the revenue generated by underlying asset.

Sukuk can be in many types depending on the contract; this contract must be complied with Shariah principles. Fourteen different structures have been acknowledged and these fourteen structures can be divided in three basic categories: equity-based, lease-based, and sale-based. For the equity-based Sukuk, this is the Sukuk al-Musharakah. The lease-based Sukuk, it is the Sukuk al-Ijarah, and for the sale-based Sukuk it is the Sukuk al-Murabahah. [20]

VI. Sukuk &Bond

Bonds is a debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing, bonds is a promise to repay the principal along with interest (coupons) on a specified date (maturity). When an investor buys a bond, he/she becomes a creditor of the issuer. The buyer does not gain any kind of ownership rights to the issuer.[2] From this definition of bonds, we can discern the general difference between Sukuk and Bonds as followed:

First, the relationship between the bond holder and the issuer is lender borrower relationship, while the relationship between Sukuk holder and issuer is buyer-seller relationship; it represents a real commercial operation, it is suitable for Italy because Sukuk is not considered as debt instrument, and it will

[2] http://www.investorwords.com

not increase the indebtedness. Sukuk is an investment instrument, in which the Sukuk units represent a partial ownership of the underlying assets with direct claim to those assets and profits in distribution or liquidation. [2] Sukuks are considered as off balance sheet finance because under Shariah principle, the originator should transfers the ownership of assets from its balance sheet. And the originator do not report any related debt or interest expenses on their consolidated financial statements.

Second, they are different in return. In case of bonds return, it is predetermined amount of interest (coupons) regardless of whether the bonds issuer achieved gain or lose. In contrast, the return of Sukuk released from operating of underline asset or specific project, it reflects the profit loss relationship. the bonds guarantee the return of the principle at maturity; the bond holders have the priority to recover their money in case of Liquidation and bankruptcy; but in case of Sukuk, there is no guarantee for the principle, if the Sukuk issuer wants to redeem the Sukuk at maturity date they must repurchase it on the basis of the net value of assets, its market value, fair value or a price to be agreed, at the time of their actual purchase; therefore, the Sukuk holder can make profit or lose according to purchase price.

Third, while determining the price of a bond depending on expectations about the movements of interest rates, the Sukuk is related to the expected return of the project [21]. In fact, there is no big difference between bond and Sukuk in pricing because some Sukuk, such as Ijarah Sukuk, is related to linking distributions to the LIBOR or SIBOR, similar to conventional bonds. Most Ijarah Sukuk pay a predetermined rate of return to investors. Variable rate Sukuk linked to an agreed upon pricing benchmark, usually the LIBOR, may also issue under a Master Lease Agreement. [22]

Fourth, The Sukuk can be acceptable to both Muslim and non-Muslim investor, but bond is not acceptable for Muslim investor because it is interest based (Riba). Sukuk will be useful for both Muslim and non-Muslim countries, it attracts capital investment from Muslim investors, and it is suitable for investors who are looking for diversify in their investment. European banks are currently being encouraged to provide Islamic investment solutions, not only for their overseas Arab/Muslim clients, but also for domestic populations showing increased demand for Shariah-compliant products. [5]

Fifth, in bond the originator does not have restriction in the use of funds, but in some types of Sukuk, the originator loses the control over the company transactions; in other words, the issuing company (SPV) must be compliant with Shariah principle in every transaction. In my opinion, this restriction can be advantage especially if we know that the Shariah principle is not against other religions; in fact it is ethical and fairness principle, it helps to ensure that a project is run efficiently, and to reassure the Sukuk holder that their investment is safe and as profitable as expected, and we can call it Shariah governance. The fundamental role of Shariah governance is to ensure that the operations of the Islamic finance activities comply with the Shariah and the rights of the involved parties are not violated.[23] the corporate governance involves a set of relationships between a company's management, it's board, its shareholders and other stakeholders, corporate governance also provides the structure through which the objective of the company are set, and the mean of attaining those objective and monitoring performance are determined, The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.[24]

VII. MAIN CHALLENGES AND LIMITATION

Many researches point out that Sukuk can be subjected to different types of risk such as Market Risk, Shariah compliant risk, credit and counterparty risk, operational risks, liquidity risk, legal risks, taxation risks Interest rate risk, and Foreign exchange risk.[25][26][27] Sukuk share most of these types of risk with conventional bond. This paper does not go into detail on this risk and we just try to discern the main challenges that could face Islamic project finance implementation in non-Muslim countries.

Sukuk would require appropriate enabling laws to protect the interest of investor and issuers, appropriate accounting standard, study of targeted market, monitoring of standardized contracts, appropriate flow of financial data to investors and provision of standard quality service to customers.[3] In addition to the normal challenge that face the conventional infrastructure project, the main challenge in structuring the Sukuk is to obtain approval from Shariah committee on Sukuk structure in non-Muslim countries, because the project can be implemented based on Fatwa from Shariah Board, "fatwa" is a religious opinion concerning Islamic law issued by an Islamic scholar, this Fatwa is valid only for specific case and it must be approved before issuance. The lack of Shariah board and skilled human capital in these countries, which may cause difficulties in developing a framework for governing, supervising, and regulating Islamic finance process, and treats with Shariah Board from other countries will increase the cost of project and may cause misunderstanding for the structure and actual situation.

Each contract, agreements and transaction in the company should be approved by Shariah Board, this will increase the time and cost to accomplish these transactions. This problem can be eliminated by developing business plan and guideline for expected transaction in the company, especially since the nature of these companies' actions are repeated and specified. Islamic contract documentation should complies with Shariah rules and principles - with regard to formation, termination and elements possibly affecting contract performance such as fraud, misrepresentation, duress or any other rights and obligations.[26]

Another issue is the restrictions on joint venture company transaction. The SPV and the joint venture company are restricted in their actions; they will do specific transactions, and should not permit them to engage in any other transactions, like acquire any other assets, or create any other debts.

Since the Italian securitization law does not include the Sukuk, the Italian company cannot issue Sukuk, that leads the originator to establish the SPV under other country's law like

English law; in this case, the SPV will be subjected to other county's tax in addition to Italian tax because the Musharakah company will subject to several tax like ownership transfer cost and tax on rental payment and income tax. The Sukuk holder can potentially face multiple tax duties, in addition to incur additional transactional and legal costs. To overcome this problem, the originator should develop tax planning to avoid these tax impositions, each transaction should be carefully reviewed by tax advisors, and should benefit from taxation system in other Europe country like UK. Because UK has introduced a series of tax and legislative changes specifically designed to remove obstacles to the development of Islamic finance. The first significant change came in the Finance Act 2003 which introduced relief to prevent multiple payment of Stamp Duty Land Tax on Islamic mortgages. The Finance Acts 2005 and 2006 contained further measures aimed at putting other Islamic products on the same tax footing as their conventional counterparts. Most recently, the Finance Act 2007 clarified the tax framework further, in the case of Sukuk. [28] Therefore, the government should try to add new articles to the Special Tax Treatment section of the law.

Under Shariah principle, the Sukuk holder is the real owner of the project and he is responsible for maintenance and insurance cost for the assets of the project, and the challenge is the prohibition of conventional insurance in Islam, and the lack of Shariah compliant insurance system (Takaful) in non-Muslim countries. The originator should find Shariah compliant insurance company because leaving the infrastructure project without insurance is consider a big risk.

VIII. Potential implementation

A. About the project

A case study using Sukuk for finance the second subway line in Turin, that would connect the northern area of the city with the south (Mirafiori and Santa Rita) going throw Porta Nuova and Porta Susa stations in the city center, the length of this line is about 14.8 kilometer , estimated cost was between 1.1 and 1.4 billion of euro.

The project of subway line can be easily structured as entities are legally separated from the Turin Municipality and the operator (Gtt).

This paper will adopt Sukuk structure depending on Musharakah and Ijarah contracts because the Musharakah contract is relatively similar to Joint venture in Italian law; joint venture can set a conditions in the contract to insure that all transaction will be Shariah Compliant, for example the Joint venture transaction should be interest free. After the completion of the construction phase, the joint venture company can rent the project for operating company GTT by using Ijarah contract (lease) under Italian law. The structure will be diminishing Musharakah because under the Italian law, the lease contract has a maximum term of 30 years.[3] The SPV would sell part of its share in Musharakah company to the Originator MT, based on pre agreed time, and the price would be at market value or a price to be agreed, at the time of their actual purchase, the SPV ownership in the Musharakah company decreases over the validity of the Sukuk,

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by every partner strictly in proportion to respective capital contributions.[29]

Sukuk al Musharakah are documents of equal value issued with the aim of using the mobilized funds for establishing a new project or developing an existing one or financing a business activity on the basis of one of partnership contracts. The certificate holders become the owners of the project or the assets of the activity as per their respective shares. These Musharakah certificates can be treated as negotiable instruments and can be bought and sold in the secondary market. [29]

Sukuk – al Ijarah are Sukuk that represent ownership of equal shares in a rented real estate or the usufruct of the real estate. These Sukuk give their owners the right to own the real estate, receive the rent and dispose of their Sukuk in a manner that does not affect the right of the lessee, i.e. they are tradable. The holders of such Sukuk bear all costs of maintenance of and damage to the real estate. (AAOIFI)

B. Main parties involved in the Sukuk process:

- The Originator: is the partner how wishing to rise funds, to do a specific project, in our case it is Turin municipality TM
- The issuer of the Sukuk: it's a special purpose vehicle SPV, it will be established under other countries' law that allow to issue Sukuk and usually are done under English law.
- Sukuk: which represent an undivided ownership of share of SPV in the Musharakah underlying asset or transaction. They also represent a right against Issuer SPV to payment of the Periodic Distribution Amount and the Dissolution Amount.
- The manager: is the party managing the whole Sukuk process, every partner can either get involved in the management of the business or the partners may employ a particular individual to manage the business.
- The Guarantee:SPV will be as trustee
- The Sukuk Holder: the investor in the project, are regarded as the owner of the SPV respective shares of the assets of the Musharakah.
- Shariah advisor: the Shariah advisor board in the selected market, some market like Luxemburg market have Shariah board.
- Consultant: European research center for Islamic finance.

[3] the Pursuant to Section 1573 of the Italian Civil Code

C. Process Before issuance:

- Prepare Feasibility study, the TM must ask a trusted company to prepare a professional feasibility study to demonstrate the profitability of the project, and to attract the investment from other countries, because the professional financial analysis will be considered as a guarantee for investor.
- Take into consideration the legal, procedural, organizational issues, prepare business plan, set long term objective and also budgeting for proper long-term maintenance of assets. Legal documentation relating to a Musharakah financing shall clearly stipulate all costs and expenses agreed and borne by each party
- The Sukuk structure and all transaction must be approved by Shariah advisor board by issuing fatwa, and that's must be done before the issuing process.

D. Sukuk structure

1) Establish SPV, in the absence of Italian Sukuk law. The paper supposes that we can establish the SPV as a company under English or Luxemburg law; Sukuk transactions are often governed by English law. Because under Italian law, the only assets that can be securitized are pecuniary credits, this is a substantial difference from the very broad provisions of the common law systems. In the UK and the USA, in fact, securitization can involve not only future credits, unlimited in time or in any other way, but also future financial lows are not necessarily deriving from credits (e.g., highway tolls, revenues of railways, airlines, ferries, football team ticket sales, entertainment revenues, and so on) or the sale of assets other than loan portfolios, such as real estate (in sale and leaseback operations), these systems also permit securitization of the future profits of a division of a corporation or even from one or more business deals, as long as they are identified as a whole (the so-called securitized block).[30]

2) The Investors subscribe for Sukuk and pay the proceeds to Issuer SPV.

3) Issuer SPV declares a trust over the proceeds and any asset acquires using the proceeds and thereby acts as Trustee on behalf of the Investors.

4) SPV will enter a partnership agreement (Musharakah) with the originator (Turin municipality) in order to implement the subway line project, by establishing the Subway Joint venture company under Italian law, corporate joint ventures are either incorporated as Private Limited Company SPA or SRL format.

5) Issuing of Sukuk, the amount will be determined depending on estimated cost of the project.

6) SPV paid the proceeds of the Sukuk issue in cash as its capital contribution to the Joint company, and the Turin municipality will be contributed in kind, by transferring the ownership of the project's land to joint company, and also it can contribute by any form of participation that it wants with consent of other parts; its share shall be determined on the basis of evaluation according to the market price prevalent at the date of the contract, and we suggest that the estimated price of the land must be evaluated on the basis of the mining right assessment.

7) Trustee and Originator will get into a management agreement to provide administrative services for the Musharakah. This agreement will set out the services to be provided by the administrator to the Musharakah Company, the agent gets a fixed agency fee Under Italian law. The management of the company is entrusted to the Board of Directors and the management can be also entrusted to a sole director but this is very unusual in a joint venture situation, the Civil Code also requires that a board of statutory auditors ("sindaci") be elected by the shareholders to supervise the management of the company by the directors. [31]

8) Select another part to begin the implementation phase of the subway project, (just to save time, we will divide the subway line into several steps or sections, and select more than one company to execute the line).

9) A deal with the operator (GTT) should be done to rent the complete section of the line, by using leasing contract; leasing contract is possible under Shariah and Italian law.

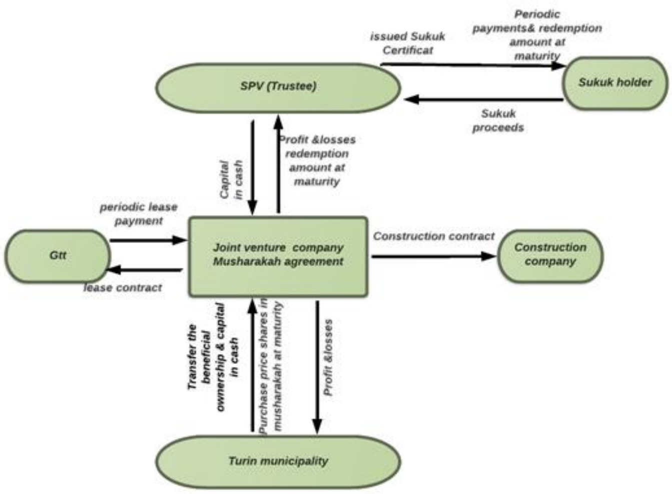
10) Under Islamic law, the Musharakah Company is responsible for all ordinary maintenance for the subway line, (typical repair, replacement and maintenance other than major maintenance). In addition, the Musharakah Company will be responsible for insurance of the assets, and Shariah compliant insurance must be used.

11) The profit from Musharakah venture (Rental payments) will be distributed among the partners according to the pre-agreed profit sharing ratio. However, any loss must be shared among the partners according to their respective capital contribution.

12) The Losses of the Musharakah must be shared by the partners in proportion to their capital contributions to the Musharakah.

13) Use the Municipality's share of profits to redeem the Sukuk issuance in pre-agreed schedule, but the Municipality will not purchase the Sukuk itself, but it will purchase SPV share in Joint Venture Company.

14) The SPV pays the purchase price of the units through to the Sukuk holders and the Sukuk will be redeemed



IX. CONCLUSION

The study seeks to fill the gap between infrastructure demand and available financial recourses by using Islamic project finance. This paper has considered that most countries do not have laws that can be applied to Islamic finance or Islamic securitization, and concludes that Islamic finance could be used to finance infrastructure projects by using existing laws and regulations that do not conflict with Shariah principle; the Islamic finance is not against the non-Muslim cultures but the fact is quite the contrary, its ethical and fairness principle and it is consistent with infrastructure requirements and characteristics. Sukuk is an appropriate choice as compared with the conventional bond for the Muslim and non-Muslim investors. Many challenges still lie ahead in during the Islamic finance implantation in non-Muslim countries. Our findings suggested that in order to fund the world's infrastructure needs, we should develop a unified legal framework, Islamic accounting principle, pricing mechanism, regulations and tax policies, which can play an important role in the development of Islamic finance and competitive global Sukuk market as an complementary finance resource, that work together with conventional financial system.

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