

## Classification and types of risk for properties belonging to low-income and poor individuals in Malaysia

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**Abstract.** In Islam, the presence of risk is not only acknowledged but steps need to be taken to manage it properly through the process of risk management. One of the processes is the identification of risk which involves classification and types of risk. Specifically, in the development of properties, the presence of risks is inevitable. Improper management of risk especially for properties belonging to the low-income and poor individuals could mean that they will suffer from a bigger loss and poverty. Existing literature has shown and identified the inherent risks in the development of properties in Malaysia. However, risks exposed to in the development of properties belonging to the low-income and poor individuals in Malaysia are not properly identified. Consequently, a study is conducted to identify risks exposed to in the development of properties belonging to low-income and poor individuals in Malaysia. This study combines literature review and interview with experts and practitioners from various fields such as *mua'malat*, risk management, construction, developers, Majlis Agama Islam Negeri-Negeri (MAINs) and contractors. Findings from this study suggested that i) 94 risks were identified related to the development of properties belonging to low-income and poor individuals in Malaysia, and ii) Shariah elements i.e *mua'malat* and its requirements are included as one of the risks in the development of properties belonging to low-income and poor individuals in Malaysia. The findings become the basis and considered significant in assisting authorities and related organizations to understand and address risks accordingly and may assist the future development of a comprehensive Shariah compliance risk management for the development of properties in Malaysia.

### 1 Introduction

In the practice of Islamic economic activities or *mua'malat*, the presence of risk is not only recognized and acknowledged by the jurists but has to be properly managed and mitigated [2]. This is based on an Islamic legal maxim *al-ghurmu bil ghunmi*, which means gain, profit or advantage comes with risk-taking or loss. Risk management is a system to ensure that risk is well managed and mitigated. It involves specific processes that include identification, assessment and techniques to respond to risks [8]. The Islamic jurists have consistently supported the concept of risk management within the ambit of Shariah principles and practices [2]

Naturally, the presence of risk in any dealings is unavoidable. Specifically, issues and inherent uncertainties such as poor comprehensive planning, pressure on construction activities, adversarial attitudes and poor communication between team members are among the major risks involved in the development of housing and property [4]. Similar to other general properties development, housing and properties belonging to the low-income and poor individuals are also exposed to a variety of risks. Unexpected occurrence of such risks, if they are not well managed

may cause loss and damage. This study focuses on the development of housing and property belonging to low-income and poor individuals as improper management of risk for this group may result in a bigger loss, poverty and sufferings.

Existing literature has generally shown and identified the inherent risks in the development of properties in Malaysia. However, risks exposed to in the development of housing and properties belonging to the low-income and poor individuals in Malaysia are not specifically identified. This study is an attempt to identify risks exposed to in the development of properties belonging to low-income and poor individuals in Malaysia. The study combines literature review and interview with experts and practitioners from various fields such as *mua'malat*, risk management, construction, developers, MAINs and contractors.

This paper is structured into 5 sections. It begins with an introduction in Section 1 followed by a review on the concept of risk, risk management, and identification of risk particularly in the development of properties belonging to low-income and poor individuals in Section 2. The methodology used to conduct the study is reported in Section 3. The results of the study are

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provided and discussed in Section 4. Finally, section 5 provides a conclusion to this paper.

## 2 Literature Review

### 2.1. The concept of risk

Generally, the term 'risk' has various meanings, which depends on everyday life and business dealings. Risk refers to a situation or condition in which there is an exposure to loss or adversity. Vaughan and Vaughan (2003) defined risk as "A condition in which there is a possibility of adverse deviation from the desired outcome that is expected or hoped for." In addition, risk also refers to uncertainties of the outcome, which will prevent an entity or a party from achieving the desirable objective (Syed Othman Alhabshi et al, 2012). According to Ahmad Mazlan Zulkifli et al, (2012) risk is relevant and related to the concepts of peril, hazard and loss as shown in table 1.

**Table 1.** The concepts of peril, hazard and loss (Ahmad Mazlan Zulkifli et al., 2012)

Concept	Description
Peril	The cause of loss. Any accidental losses that are caused by a peril are subject to a claim under the respective policy. When a peril occurs, the property may be destroyed or loss. Any loss of property will invariably lead to financial loss.
Hazard	The condition that increases the chance of loss due to a particular peril.
Loss	An unexpected reduction or disappearance of economic value. The insured losses are unexpected and not included at the normal depreciation of the property or possession insured.

### 2.2. The risk from the Shariah perspectives

According to [3]; contemporary Muslim economists, risk refers to "a situation in which we confront two possibilities, both are subject to occurrence". In the practice of *mua'malat*, '*mukhatarah*' is referred to connote 'risk' [1]. '*Mukhatarah*' derives from the word '*khatar*' that denotes several meanings such as fear of destruction, an exalted position and exposure. The meanings of '*mukhatarah*' used in Islamic jurisprudence in relation with the concept of risk are provided in table 2.

**Table 2.** The meanings of '*mukhatarah*' in relation to the concept of risk [11].

Concept	Description
<b>Ambiguity (gharar) and Unknown (jahalah)</b>	Terms used in financial transactions. Reflects the elements of uncertainty and undesirability. The transaction that is described or containing elements of <i>mukhatarah</i> in this group is prohibited in the Shariah

<b>Usury (Riba)</b>	Refer to <i>riba al-fadl</i> <sup>a</sup> , where the cause is used to refer to the effect
<b>Gambling (Muqamarah or Qimar)</b>	'Wavering between loss and profit. E.g. as mentioned in <i>Al-Muwatta'</i> (Malik, 2004:4/905 cited in [11] Abdul Khir et al, 2014) "...over or underweight of commodity is not a sale, but it is ambiguity and gambling."
<b>The possibility of loss or profit in a particular transaction</b>	Inherently associated with any kind of business process and <i>mua'malat</i> – compliant with the principles and requirements of the Shariah.

#### 2.2.1 Risk management and its concept in Islam

As the presence of risk is recognized and acknowledged in business dealings and *mua'malat*, Islam also emphasizes the importance of managing and mitigating risk. Full precautions and necessary measures are required in ensuring that loss and damage should not happen and if it happens the damage shall not get worse or lead to other harm. This is in line with one of the Islamic legal maxims *la darara wa la dirar* – harm shall not be inflicted nor reciprocated.

Managing risk in the development of the property is important to ensure the project is perceived as successful and achieve its desired objective upon completion [4]. In addition, management and mitigation of risk in the development of property involved structured and auditable processes and activities designed to reduce the disturbances occurring throughout the project delivery.

Generally, risk management involves certain steps i.e. first – identification of loss, second – measurement and analyzation of loss, third – appropriate techniques to mitigate loss, and forth – implementation and monitoring of the system [12].

According to [6,7] Shariah compliance risk management can be defined as systematic manners that include the process of identifying, measuring, controlling and monitoring, and reporting of risks. The main objective of risk management is to manage and mitigate any possibilities of losses and damages where the operations and methods where the operation and methods shall comply with Shariah principles and practices.

The concept of risk management in Islam has its basis in following legal maxims [6, 10] as follows:

1. *Al-kharaj bi ad-dhaman* – benefit goes with liability,
2. *Al-ghurmu bil ghunmi* – liability accompanies gain,
3. *Al-dharar yuzal* – harm is to be eliminated. It is generally applied to *mua'malat* through its activities to secure benefit (*maslahah*) or prevent harm (*mafsadah*) for the *ummah*,
4. *Dar al-mafasid muqaddam a'la jalb al-masalih* – Averting harm takes precedence over achieving benefit
5. *Al-darar yadfaq bi-qadr al-imkan* – Harm is to be resisted to the extent possible

In addition, in the light of *maqasid al-shariah* – objectives of the Shariah, risk management serves the

<sup>a</sup> *Mukhatarah* is not synonymous with *riba*, but *gharar* and *jahalah* can lead to *riba al-fadl* (exchange of unequal amounts of the same type of commodity)

interest of the *ummah* and protect them from harm [6]. Therefore, the implementation of risk management in the effort of avoiding risks through effective strategies is considered as part of good management and is highly encouraged in Islam.

Specifically, managing risk in the development of property including for property belonging to low-income and poor individuals is in line with one of the objectives of the Shariah – protection of wealth (*hifz al-amal*). This includes to protect the sanctity of ownership of property, prohibitions of misappropriating others' property by acts such as stealing and devouring the wealth of the needy and poor or orphans [13, 5].

The attainment of the objective of the Shariah in managing risks and uncertainties [6] should be guided by the Quran and *Sunnah (Al-Baqarah: 155-157)*.

### 2.3 Risks in the development of properties belonging to low-income and poor individuals

According to [9], property development is defined as activities involving the necessary steps to plan and construct, and comply with statutory and contractual requirements in the development of land into vacant lots, residential, commercial and/or industrial buildings.

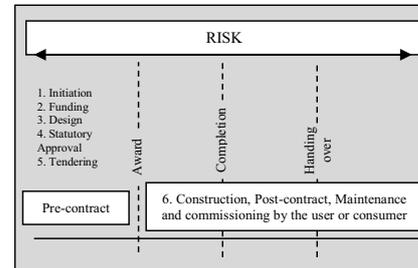
The presence of risks in the development of property can be divided into two main phases that are pre and post contract (construction to completion) and completed unit or post contract (completion and maintenance). Each phase involves a specific process of construction procurement. [5] has established seven (7) elements of construction procurement involve throughout the pre and post construction phases. The elements of construction procurement as provided in Table 3.

Table 3. The process of construction procurement [5]

Elements	Definition
<b>Initiation</b>	The process of recognizing the need for a facility (building or infrastructure)
<b>Funding</b>	The provision of the finance required for the project to be undertaken
<b>Design</b>	The translation of the Client's requirements into drawings, specifications, physical and virtual models to facilitate construction
<b>Statutory approval</b>	The process of obtaining permissions from the various authorities to initiate, construct and upon its completion to occupy and use the completed facility
<b>Tendering</b>	The process of obtaining offers leading to a contract between a Client and Contractor, a Client and Consultant or a Contractor and Subcontractor
<b>Construction</b>	The process of physically fitting the various components of a facility together to form a final structure i.e. completion and handover of projects
<b>Risk allocation</b>	The distribution of risks among the parties in the contract

Risk presents in both main phases of property development is illustrated in figure 1.

Fig. 1. Involvement of risk in both main phases of property development and the process of construction procurement.



The need for risk management in the development of properties belonging to low-income and poor individuals is essential regardless of their source of funding i.e. individual, institutions or authorities such as *wakaf* and *zakat*. Mitigation of risk is important especially for properties funded by authorities or institutions and occupied by low-income and poor individuals. This is because, in the event of catastrophes, the low-income and poor individuals will suffer a greater loss, damage and grave poverty.

For the purpose of this study, the low-income and poor individuals are referred to those who are below the Poverty Line Income (PLI) level established by Jabatan Kebajikan Masyarakat (JKM) and Kementerian Kesejahteraan Bandar, Perumahan & Kerajaan Tempatan (KPKT) and are in need of assistance. PLI is referred to the level of income sufficient only for 2 basic needs i.e. food to ensure necessary nutrition requirements for a household and fundamental necessity such as clothing and shoes, house rental, utilities, transportation, communication, medical and education.

In addition, the low-income and poor individuals are also referred to as *asnaf* or specific recipients (eight groups of recipients of *zakat* funds) in need of assistance or otherwise by applying the concept of *haddul kifayah* (minimum sufficiency line for basic needs of an individual and his dependents based on the current cost of living).

#### 2.3.1. Identification of risk in the development of property belonging to low-income and poor individuals

Identification of risks is one of the processes in risk management. In the development of the property, identification of risk involves acknowledgement and documentations of classifications and types of risk events based on risk-related information.

It is important to note that the identification of risk must be carried out in prudence and carefully by obtaining all available information [4]. The identification of risk is a crucial step upon which further risk analysis and mitigation techniques shall be based on.

According to [4,5] involvement of risk in a construction project can be classified into six groups that

are financial, legal-contractual, product, design, political, and environment.

As far as Shariah compliance risks are involved, the risks in property or construction project shall include the *mua'malat* aspects, for instance, ownership of property, recipients to enjoy the benefits of property and compliant requirements of the Shariah [15,14]

Based on the review of the literature, there are 94 identified types of risk that may appear in general properties development as well as in the development of properties belonging to low-income and poor individuals in Malaysia. The identified types of risks are listed and classified into seven groups that are financial, legal-contractual, design, product, political, environmental and Shariah Non-Compliance (refer table 4 below).

### 3 Methodology

The study combines a review of literature and intensive discussions with 28<sup>b</sup> experts and practitioners from various fields such as *mua'malat*, risk management, construction, developers and consultants, MAINs and contractors involved in low cost property development, *wakaf-zakat* housings projects. From the review of the literature, a list comprising of identified classifications and types of risks in the development of property belonging to low-income and poor individuals in Malaysia is produced (refer table 4). The list is presented in a series of interview sessions for experts and practitioners to evaluate and state their agreement or otherwise.

### 4 Results, Findings and Discussions

Data collected from the interview sessions conducted were analysed and presented in table 4 below.

**Table 4.** Results of the interview sessions

No.	Classification & Types of risk (refer to table 4)	Agreement of respondents
1.	Financial Inflation, local taxes, and availability, fluctuation, economic structure, the sufficiency of funds i.e. <i>wakaf</i> assets/cash and <i>zakat</i> funds, utilization of <i>zakat</i> surplus, contribution payment for protection of properties, inaccurate cost plan/estimates, cash flow, project payment	Yes – 28/28
		Not sure – 0/28
		No – 0/28
2.	Legal-Contractual Unclear status of land and properties, authority requirements, ambiguous conditions of contract and agreement i.e. lease agreement and no of years, procurement process, regulations – changing in government and Shariah	Yes – 28/28
		Not sure – 0/28
		No – 0/28

<sup>b</sup> Experts and practitioners participated in the study comprises of **two** experts in the area of Shariah including one academic, **four** experts in *mua'malat* including two academicians, **four** risk managers, **five** experts in *zakat*, **four** experts in *wakaf*, **four** representatives from MAINs, **three** consultants & **two** contractors,

	laws/fatwas, disputes and arbitration	
3.	Design Feasibility study and project requirements, incomplete design – Shariah design, variation in project scope and requirements, design errors or omissions, submission and approval	Yes – 20/28
		Not sure – 8/28
		No – 0/28
4.	Product The uncertainty of resources and availability of materials, inadequate site investigation, uncertainties of site conditions, availability of transportation facilities, availability of equipment such as spare parts, fuel, and labour, size of land - limited land for the purpose of housing development, bidding process, safety and security. Maintenance for completed units/house: protection, poor quality	Yes – 27/28
		Not sure – 1/28
		No – 0/28
5.	Political Government policy, bureaucracy, government intervention, political instability Example: Decree by the ruler as <i>wakaf</i> and <i>zakat</i> are state matters and structured under the Sultan, new act and implementation i.e. GST, authority preference in the development i.e. preference to develop Islamic religious schools, mosques and Islamic burial grounds	Yes – 28/28
		Not sure – 0/28
		No – 0/28
6.	Environmental Environmental risks include natural disasters, weather, cultural, existing surroundings, and seasonal implications. Example: Act of God, soil ground conditions, adjacent building/structure	Yes – 28/28
		Not sure – 0/28
		No – 0/28
7.	Shariah Non-Compliance Risk arising from activities or dealings that fail to comply with Shariah principles and requirements. Example: ownership of usufruct specifically for <i>wakaf</i> properties, recipients to enjoy the benefits of property i.e. <i>zakat</i> recipients (8 groups of <i>asnaf</i> ), <i>mua'malat</i> principles and requirements i.e. prohibition of <i>riba'</i> , <i>gharar</i> (uncertainties), requirements of <i>tawaaquf</i> ( <i>zakat</i> surplus for investment – properties)	Yes – 19/28
		Not sure – 9/28
		No – 0/28

Based on the results, all the 28 respondents indicate total agreement on most of the classifications and types of risk. In terms of design and Shariah non-compliance, some of the respondents are uncertain. This is due to the limitation of expertise i.e. the Shariah experts are not sure on the involvement of risk in terms of design and consultants as well as contractors are uncertain on the Shariah principles and knowledge to be included as types of risk.

Findings from the study suggested that i) 94 risks were identified related to the development of properties belonging to low-income and poor individuals in Malaysia, and ii) Shariah elements i.e. *mua'malat* and its requirements are included as one of the risks in the

development of properties belonging to low-income and poor individuals in Malaysia.

In addition, most of the identified risks are inherent risks in the general development of property in Malaysia. The findings become the basis and considered significant in assisting authorities and related organizations to understand and address risks accordingly and may assist the future development of a comprehensive Shariah compliance risk management for the development of properties in Malaysia.

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