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ISSUES AND CHALLENGES IN MUSHARAKAH MUTANAQISAH HOME FINANCING IMPLEMENTATION: A NARRATIVE REVIEW

Muhammad Ridzuan Abdul Aziz[1]*

[1]Faculty of Business and Management, Universiti Teknologi MARA, Puncak Alam, Selangor, Malaysia
ridzuandba@uitm.edu.my https://orcid.org/0000-0003-4699-3100
*Corresponding Author

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Abstract:

The need for Shariah-compliant alternatives to conventional debt-based financing has resulted to a significant growth of the Islamic banking and finance industry. For financing of real estate properties, *Musharakah Mutanaqisah*, or diminishing partnership, has been identified as an equity-based alternative that is theoretically superior to replace the controversial *Bay' Bithaman Ajil* (BBA) contract. Although *Musharakah Mutanaqisah* is theoretically aligned with Maqasid al-Shariah (objectives of Shariah) and profit and loss sharing (PLS) principle, challenges exist in its practical implementation by Islamic Financial Institutions, particularly in terms of Shariah-compliance, operational, and legal challenges. The literature on *Musharakah Mutanaqisah* home financing in Malaysia and other jurisdictions is visited in this narrative review. Discerning issues on *Musharakah Mutanaqisah* include the usage of purchase undertakings (*Wa'ad*), usage of conventional interest rates as the benchmark for the rental rates, skewed risk and cost allocations, and the complexities of financing uncompleted properties under the National Land Code 1965. This research investigates the reluctance of Islamic financial institutions to use *Musharakah Mutanaqisah* in structuring their products, as shown in the practice by institutions like Maybank Islamic, Affin Islamic Bank, and few other Islamic financial institutions in Bahrain. To address these structural flaws, this research assesses other alternatives, such as the cooperative models (*Ta'awun*), hybrid crowdfunding, and Islamic Rental Rate (RRi). A comprehensive regulatory harmonisation, property laws reform, and a radical and fundamental change toward a genuine equity-based financing are proposed to ensure the sustainability and authenticity of Islamic home financing.

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Introduction

Housing is a basic necessity for human being. Therefore, home financing is one of the most popular and demanded financing facilities and become a key driver of socio-economic stability. For Muslims, however, conventional home financing is strictly prohibited due to its reliance on *riba* (interest) and its inherent detachment from real economic assets (Smolo & Kabir Hassan, 2011). To address this, the Islamic finance industry introduced various Shariah-compliant instruments. In the past, the *Bay' Bithaman Ajil* arrangement (a deferred payment sale) was widely used in the structuring of financing facilities, particularly in the Southeast Asia (Mohamed Imtiyaz et al., 2017). However, there were massive criticism against the *Bay' Bithaman Ajil* arrangement for its striking similarity to conventional debt financing. Critics highlight its use of fixed interest-rate benchmarks, its capitalisation of upfront profits, and its controversial application of *Bay' al-inah* (buy-back sale), which is widely rejected by the majority of global Shariah scholars outside of the Shafi'i school (Smolo & Kabir Hassan, 2011; Kashi & Mohamad, 2017). Furthermore, studies demonstrate that in the event of early settlement or default, the outstanding balance under *Bay' Bithaman Ajil* can exceed the original financing amount, placing an oppressive burden on the customer (Smolo & Kabir Hassan, 2011).

In response to the structural and jurisprudential flaws of *Bay' Bithaman Ajil*, Islamic financial engineers and scholars championed the implementation of *Musharakah Mutanaqisah* (MM) (Razak & Abduh, 2012). *Musharakah Mutanaqisah* refers to a partnership arrangement where one partner promises to gradually purchase the equity share of the other partner until the full ownership is fully transferred (AAOIFI, 2015; Ali et al., 2023). Theoretically, *Musharakah Mutanaqisah* is recognised for eliminating fixed rate debt, thereby fulfilling the true spirit of Profit and Loss Sharing (PLS), and refraining from the creation of artificial fiat money linked to the fractional reserve banking (Smolo & Kabir Hassan, 2011). *Musharakah Mutanaqisah* is considered a more equitable model that fosters genuine partnership and shared risk, aligning perfectly with the ethical and equitable goals of Islamic financial transactions (Yusuf, 2025).

Despite the praises towards *Musharakah Mutanaqisah*, its transition from a theory to practical application faces some challenges (Nor et al., 2019). Although it is conceptually superior, many Islamic financial institutions still hesitated to apply *Musharakah Mutanaqisah* in structuring its facilities, and for those that adopt it often structure it in ways that closely resemble conventional loans to avoid risks from ownership (Zaaba & Hassan, 2019; Kashi & Mohamad, 2017). This narrative review investigates these complex issues in great detail. Legal lacunae, operational challenges, and Shariah-compliance deviations interrupting the real application of *Musharakah Mutanaqisah* home financing are analysed, the objective of this narrative review is to produce a thorough understanding of the reasons for the failure of *Musharakah Mutanaqisah* in obtaining acceptance and how it can be improved.

Methodology

Review Design

This study employed a narrative review methodology to synthesize the existing literature on *Musharakah Mutanaqisah*. In contrast to the common systematic reviews which emphasise extraction of data based on specific questions that are quantitative in nature, a scholarly summary based on critical interpretation is produced from narrative reviews, leading towards a comprehensive understanding of multifaceted topics (Greenhalgh et al., 2018). A flexible and rigorous method is used by setting the boundaries of the topic studied while enabling the original scope to progress throughout the review process, signifying a high-quality narrative synthesis (Sukhera, 2022).

Literature Search Strategy

To identify relevant literature, a thorough search was performed using few electronic academic databases, including Scopus, Web of Science, and Google Scholar, involving a specific vocabulary as the searching method. The primary search string included terms such as *"Musharakah Mutanaqisah", "Musyarakah Mutanaqisah",* "Diminishing Partnership", "Diminishing *Musyarakah"*, "Diminishing *Musharakah*", "Declining Partnership", "Declining *Musharakah*" and "Declining *Musyarakah*".

Specific syntax requirements of each database were used in identifying the journal articles and regulatory standards. Documents searching was confined to articles published between the 2021 and 2026. Nevertheless, older key studies were also through the list of references in the articles included in the review to ensure key historical context was included (Green et al., 2006).

Inclusion and Exclusion Criteria

The selection of literature was guided by predetermined inclusion and exclusion criteria designed to ensure relevance and validity to the research objectives (Sukhera, 2022). Articles were included if they met the following criteria: (a) published in peer-reviewed journals, (b) written in English or Malay language, and (c) directly addressed or investigated *Musharakah Mutanaqisah.* We excluded brief commentaries, non-peer-reviewed reports, dissertations, conference proceedings, or studies lacking sufficient methodological detail to maintain the academic rigour of the synthesised evidence.

Study Selection and Data Synthesis

The literature selection process was conducted in multiple iterative phases. Initially, the titles and abstracts of the retrieved records were screened for relevance to the research question. Subsequently, the full texts of potentially eligible articles were retrieved and independently

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reviewed to confirm alignment with the inclusion criteria. Any discrepancies were resolved through discussion and consensus.

Selected articles were critically appraised and synthesised thematically (Green et al., 2006). Rather than mathematically pooling data as in a meta-analysis, the findings were analysed qualitatively. This allowed the authors to group the literature into conceptual categories, identify recurring theoretical perspectives, and highlight existing gaps in the current *Musharakah Mutanaqisah* literature (Greenhalgh et al., 2018).

The Mechanics and Theoretical Underpinnings of *Musharakah Mutanaqisah*

In order to assess the challenges faced by *Musharakah Mutanaqisah*, it is important to validate the jurisprudential foundations and mechanical operations of *Musharakah Mutanaqisah*. In *Fiqh Muamalat* (Islamic commercial law), *Musharakah* (partnership) can be classified into two categories; *Shirkat al-Milk* (non-contractual joint ownership) and *Shirkat al-Uqud* (contractual partnership for profit generation) (Mohamed Naim, 2011). Ownership is shared among partners without the existence of an agreement for the partners to jointly invest in the asset involved for making commercial gain as the partners are independent to each other in *Shirkat al-Milk*. In contrast, capital, labour, and profits are shared among the partners in *Shirkat al-Uqud* (Mohamed Naim, 2011).

In the case of Malaysia, the Central Bank of Malaysia (Bank Negara Malaysia) determines that when *Musharakah Mutanaqisah* is used in structuring asset acquisition transaction it must be governed by the rules of *Shirkat al-Milk* (Rahman et al., 2017). The transaction involves a sequence of independent contracts as follows:

1. **Joint Purchase (*Shirkat al-Milk*):** Both the Islamic financial institution and the customer jointly contribute the funds to purchase a property. For instance, the customer contributes by paying a 10% down payment, while the Islamic financial institution funds the remaining 90% of the purchase price of the property, establishing joint ownership in the property at the ratio of 90% to 10% between the Islamic financial institution and the customer (Ali et al., 2023).
2. **Lease Agreement (*Ijarah*):** The Islamic financial institution leases its 90% beneficial ownership share in the property involved to the customer in return for a series of periodic rental payments from the customer (Nor et al., 2019).
3. **Gradual Purchase (*Bay'*):** The customer agrees to purchase the Islamic financial institution's ownership in the property involved through a unilateral promise (*Wa'ad*) made by the customer to the financial institution (Ali et al., 2023; Haneef et al., 2011). The monthly installment payment made by the customer to the Islamic financial institution include both the rental payment for the Islamic financial institution's reducing share in the property and a principal sum to purchase the Islamic financial institution's equity ownership in the property involved (Kashi & Mohamad, 2017).
4. **Transfer of Title:** When the Islamic financial institution's equity ownership is reduced to zero, the partnership between the Islamic financial institution and the customer dissolves, and the single legal and beneficial ownership of the property involved is completely transferred to the customer (Nor et al., 2019).

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While combining multiple contracts into one transaction is permissible in Shariah provided the contracts are concluded separately and are not made conditionally dependent on one another, this hybrid structure demands meticulous legal documentation and strict adherence to Shariah principles. The complexity of managing these concurrent relationships forms the basis of the operational challenges faced by Islamic financial institutions (Hussain et al., 2024; Zaaba & Hassan, 2019).

Legal and Regulatory Challenges in the Implementation of *Musharakah Mutanaqisah*

Lacunae in Existing Financial and Partnership Laws

One of the significant obstacles in the implementation of *Musharakah Mutanaqisah* is the absence of a comprehensive and dedicated legal framework that governs Islamic equity financing (Nor et al., 2019). In countries like Malaysia, the legal documentation for *Musharakah Mutanaqisah* is very complex, and rely on the standard general civil regulations and laws including the Partnership Act 1961 and the Contracts Act 1950 (Sabar Abdullah & Daud, 2021). Application of the conventional partnership laws to the *Musharakah Mutanaqisah* arrangement is very problematic. The Partnership Act 1961 caters conventional commercial partnerships, which include joint and several liability among the partners. This concept contradicts with the limited risk exposure preferred by both Islamic financial institutions and retail customers in home financing facilities (Nor et al., 2019).

The legal documentations are commonly drawn by the panel solicitors of the financial institution according to the term sheets that heavily favour the Islamic financial institution (Nor et al., 2019). This intricacy resulted in the increase in the transaction costs and exposes the partners to the contracts to legal disputes, specifically pertaining to the determination of the rights and obligations of both partners in the event of occurrence of default of the partners or damage of the property involved (Haneef et al., 2011).

Land Law Restrictions, Charges, and Beneficial Ownership

Musharakah Mutanaqisah involves joint ownership, which conflicts directly with several specific land laws. For instance, the National Land Code 1965 in Malaysia poses severe challenges regarding the registration of the property and the creation of security charges. Under Section 241(1)(a) of the National Land Code 1965, a charge can only be registered on "the whole, but not a part only, of any alienated land" (Haneef et al., 2011). Because the Islamic financial institution cannot legally take a charge over its own beneficial ownership of the land, it forces the customer (who is typically registered as the sole legal owner acting as a trustee) to charge the entire property in favour of the Islamic financial institution, creating a legal friction point (Haneef et al., 2011). Haneef et al. (2011) suggest that official forms, such as Form 16A, need to be amended to reflect the true nature of the *Musharakah Mutanaqisah* installment rather than categorising it as a conventional "loan" repayment.

Furthermore, property laws such as the Malay Reservations Enactment restrict the transfer or charging of Malay Reserve Land to non-Malays or corporate entities with foreign or mixed equity (Haneef et al., 2011; Nor et al., 2019). To circumvent these registration issues, Islamic financial institutions frequently utilise the concept of "beneficial ownership" alongside a trust deed registered under Section 344 of the National Land Code 1965 (Nik Abdul Ghani et al., 2021; Haneef et al., 2011). While the customer is registered as the sole legal owner on the

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property's title deed, the Islamic financial institution retains beneficial ownership proportional to its financing contribution. However, from a Fiqh perspective, true ownership (*Milkiyyah*) requires the owner to bear the liabilities and risks associated with the asset (Nik Abdul Ghani et al., 2021). Shariah scholars argue that the Islamic financial institution's reliance on beneficial ownership while simultaneously utilising legal clauses to divest itself of all property related risks renders the partnership superficial and questions its validity under Islamic law (Nor et al., 2019).

Shariah and Operational Complexities

The Controversy of Wa'ad (Purchase Undertaking) and Capital Guarantee

One of the most debatable issues in *Musharakah Mutanaqisah* financing is the application of *Wa'ad* (a unilateral promise). Islamic financial institutions require customer to sign an irrevocable promise to acquire the Islamic financial institution's ownership share in the property throughout the term of the financing facility, in order to control default risk and ensure repayment of the principal. Additionally, Islamic financial institutions impose a condition that requires the customer to purchase the whole remaining ownership equity of the Islamic financial institution in the property at a stipulated price consisting of the outstanding financing amount, in the event of default of the customer (Mohamed Naim, 2011).

Many scholars argue that fixing the purchase price of the Islamic financial institution's shares upfront transforms the equity based *Musharakah Mutanaqisah* arrangement into a debt-based capital guarantee for the financier (Kashi & Mohamad, 2017). Under the true spirit of *Musharakah*, the value of the shares should fluctuate with the market. AAOIFI Shariah Standard No. 12 explicitly prohibits partners from guaranteeing each other's capital or promising to buy shares at face value; instead, shares must be purchased at the market value on the day of the transaction (Kashi & Mohamad, 2017; Asadov et al., 2018). By enforcing a buyout at the outstanding financing amount rather than the market value, the Islamic financial institution shields itself entirely from any depreciation in property value, effectively operating exactly like a conventional secured lender (Haneef et al., 2011).

Moreover, imposing a second *Wa'ad* that requires the defaulting customer to purchase the Islamic financial institution's remaining shares imposes an oppressive burden on a party already facing financial hardship (Mohamed Naim, 2011). This practice explicitly contradicts the Quranic injunction (Al-Baqarah: 280) to grant respite to a debtor in difficulty (Mohamed Naim, 2011). It also violates the core Islamic legal maxim *Al-Kharaj bi al-Daman* (revenue is justified by bearing risk), as the Islamic financial institution captures profits without bearing the ownership risks intrinsic to a true partnership (Mohamed Naim, 2011; Nik Abdul Ghani et al., 2021).

Pricing Mechanisms and the Interest Rate Benchmark Dilemma

The pricing of financing facilities structured based on *Musharakah Mutanaqisah* deviates significantly from the ideal Islamic economic principles. The return to the Islamic financial institution should come from the actual value of rental of the property involved in a genuine *Musharakah Mutanaqisah* arrangement (Mahfudz et al., 2016). However, the conventional interest rates including the Base Rate (BR), Base Lending Rate (BLR), and Base Financing Rate (BFR) have been used as the benchmark in determining the rental rates in *Musharakah*

Mutanaqisah financing facilities, as practiced by most of the Islamic financial institutions (Kashi & Mohamad, 2017; Md Zabri & Haron, 2019).

When the rental rate is continuously pegged to floating interest rates, the computational formulas and economic impact on the consumer become indistinguishable from conventional housing loans. Monthly redemption amount paid by customer to the Islamic financial institution stated in the payment schedule for *Musharakah Mutanaqisah* arrangement and the repayment schedule for a conventional loan are similar as the annuity present value formula are used in both cases (Kashi & Mohamad, 2017). *Gharar* (uncertainty) exists when this benchmarking is used, thereby exposing the customers to the volatility of interest rate, and overcome the protection from the asset backed nature of Shariah financing facilities (Smolo & Kabir Hassan, 2011). As noted by researchers, replacing interest rates with actual rental yields is necessary to eliminate *Riba* and sever the artificial link to the conventional banking system (Mahfudz et al., 2016).

Risk Allocation: Maintenance, Takaful, and Taxes

All costs, liabilities, and maintenance of the property must be distributed among the partners according to the capital contribution ratio in *Shirkat al-Milk* (non-contractual joint ownership) (Saifurrahman, 2017). Based on Bank Negara Malaysia's policy document on *Ijarah,* the lessor (the Islamic financial institution) is responsible for major maintenance and Takaful coverage, despite the fact that the Islamic financial institution can appoint the lessee as the agent to perform these tasks (Ali et al., 2023).

Regardless of the regulation by Bank Negara Malaysia, it is a common practice of the Islamic financial institutions in drafting legal clauses in *Musharakah Mutanaqisah* (through a service agency or *Wakalah* agreement) that transfer the entire costs for major repairs, maintenance, quit rent, property taxes, and Takaful onto the customer from the beginning of the contract (Nor et al., 2019; Nik Abdul Ghani et al., 2021). This practice of releasing the Islamic financial institution from all ownership related liabilities while remain holding majority ownership in the property is highly questionable. It signifies that the Islamic financial institution has no intention to become co-owner of the property, treating the *Musharakah Mutanaqisah* arrangement as a legal way to enable provision of a secured loan (Kashi & Mohamad, 2017).

Financing Properties under Construction and Risks of Abandonment

Application of *Musharakah Mutanaqisah* to properties under construction results in significant operational and financial risks for Islamic financial institutions. For assets under construction, the arrangement commonly utilises *Istisna'* (manufacturing sale) or *Salam* (forward sale), that is combined with *Ijarah mawsufah fi dhimmah* (forward lease) (Ali et al., 2023). Throughout the phase of construction, the customer is obligated to make advance rental payment to the Islamic financial institution (Haneef et al., 2011).

The significant challenge arises when the housing project is abandoned by the housing developer. According to the policy of Bank Negara Malaysia, the Islamic financial institution as the lessor is obligated to return all advance rentals that has been paid by the customer when the leased property fails to be delivered (Ali et al., 2023; Zaaba & Hassan, 2019). Additionally, if losses arise from the abandoned project, it must be shared by both the customer and Islamic financial institution according to the capital contribution ratio (Ali et al., 2023). The need to bear the significant financial risk from abandoned projects and return the advance rentals to the lessee are against the intersnot acceptable to the Islamic financial institutions.

To mitigate this, Haneef et al. (2011) proposed an alternative model where the *Musharakah Mutanaqisah* venture enters into an *Istisna'* agreement with the customer, who then subcontracts the construction to a developer. In this structure, the customer bears the procurement risk, protecting the bank without resorting to non-compliant capital guarantees. Nevertheless, Musharakah Mutanaqisah continues to be complex. Consequently, Islamic financial institutions including Maybank Islamic have restricted utilisation of *Musharakah Mutanaqisah* for structuring of financing facilities for completed properties or totally abandoned its utilisation to avoid abandonment risks (Zaaba & Hassan, 2019).

Institutional Reluctance and Market

System Incapabilities and Market Penetration

Due to the aforementioned operational and Shariah risks, the Islamic financial industry has shown increasing reluctance in using *Musharakah Mutanaqisah* in structuring financial products. In Malaysia, empirical data shows that Islamic financial institutions including Maybank Islamic and Kuwait Finance House have either phased out the product or severely restricted its application, reverting to simpler *Tawarruq* or *Bay' Bithaman Ajil* arrangements (Zaaba & Hassan, 2019). In Bahrain, an empirical study confirmed that *Musharakah Mutanaqisah* is rarely used by either retail or wholesale Islamic financial institutions due to price uncertainties, risk aversion, and the sheer complexity of execution compared to *Murabahah* or *Ijarah* products (Alkhan, 2020; Yusuf, 2025).

Extensive interviews involving Islamic financial institution executives indicated that the current core banking systems has failed in catering to the unique computational requirements of *Musharakah Mutanaqisah* (Zaaba & Hassan, 2019). The conventional core banking software is tailored for principal and interest amortisation of a debt. In contrast, adjustment in the equity shares and rental distributions on monthly basis is required in *Musharakah Mutanaqisah* as the proportion of customer's ownership in the property changes (Kashi & Mohamad, 2017). Modifying legacy IT infrastructure to support true *Musharakah Mutanaqisah* mechanics requires massive capital expenditure, discouraging Islamic financial institutions from promoting the product (Zaaba & Hassan, 2019). Additionally, *Musharakah Mutanaqisah* complicates refinancing and remortgaging. If a customer wishes to refinance a *Bay' Bithaman Ajil* facility into an *Musharakah Mutanaqisah* facility, the Islamic financial institution technically has to form a partnership to buy the house from itself, creating an ambiguous transaction (Zaaba & Hassan, 2019).

Comparing Islamic Banks' Practices and Regulatory Gaps

Deviation from the regulations enforced by Bank Negara Malaysia and the actual practice by the Islamic financial institutions exists. Despite the prohibitions imposed by Bank Negara Malaysia through its regulations which prohibit Islamic financial institutions from imposing fees for early settlement and penalty charges (except for the actual costs incurred), foreign Islamic financial institution such as HSBC Amanah have imposed the fees for early termination of *Musharakah Mutanaqisah* financing facility by customer (for example, 2% of the facility

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amount) when the customer fully settle the financing facility within the lock-in period (Rahman et al., 2017).

Similarly, Maybank Islamic's *Musharakah Mutanaqisah* product documents have stipulated that in the event of a default, the Islamic financial institution reserves the right to convert the agreed profit rate to BFR + 2.5% (Rahman et al., 2017). Such practices essentially leverage the *Musharakah Mutanaqisah* arrangement as a flexible debt instrument, directly contravening BNM Shariah guidelines which dictate that Islamic financial institutions should jointly sell the asset to a third party or purchase the shares fairly without exploiting the defaulting customer (Rahman et al., 2017). Even in institutions that continue to offer Musharakah Mutanaqisah, like Affin Islamic Bank, the product is carefully ring-fenced to manage concentration risks and balance the portfolio against excessive *Tawarruq* exposure (Zaaba & Hassan, 2019; Ali et al., 2023).

Alternative Frameworks and Future Directions

The Cooperative Model (Ta'awun) and Crowdfunding

Given the profound misalignment between the profit maximising motives of commercial banks and the socio economic, risk sharing objectives of *Musharakah Mutanaqisah*, scholars suggest that *Musharakah Mutanaqisah* is best suited for financial cooperatives (Md Zabri & Haron, 2019). The Malaysian Islamic cooperative KOPSYA presents a highly successful paradigm. Unlike commercial banks, KOPSYA operates on the principle of *Ta'awun* (mutual assistance). KOPSYA explicitly shares profits and losses equitably, allows rental rates to be reviewed periodically based on actual cost of funds rather than arbitrary benchmarks, and permits customers to make early partial settlements to reduce their principal without imposing lock-in penalties (Abdul Jabar et al., 2018). Furthermore, if a customer reinvests their portion of the rental back into the principal, the financing tenure can be drastically reduced, saving the customer significant costs (Abdul Jabar et al., 2018). By avoiding properties under construction entirely, KOPSYA nullifies the risk of project abandonment.

Identical cooperative models have been proposed and implemented internationally. For instance, the Ameen Housing Co-operative (AHC) in California has pooled investor and homebuyer funds to use a true rent-to-own partnership based on *Musharakah Mutanaqisah* that avoid creation of fiat money while sharing the actual rental yields equitably (Ma & Md Taib, 2023). Likewise, hybrid models which combine cooperative housing and Islamic crowdfunding (such as EthisCrowd) have been recommended in dealing with critical housing unaffordability in large markets such as China (Ma & Md Taib, 2023). These models are able to deter usury while promoting true risk sharing and give robust protection for homebuyers, through leveraging of the pooled community funds while removing the commercial banks' role as a debt intermediary.

Rental Index Innovations

Economists have recommended the use of an Islamic Rental Rate (RRi) in dealing with the benchmarking dilemma faced by the Islamic financial institutions (Mahfudz et al., 2016). The RRi combines both the national Rental Price Indices (RPI) and House Price Indices (HPI), avoiding the pegging of *Musharakah Mutanaqisah* profits to the Base Lending Rate (BLR), Base Rate (BR), or Base Financing Rate (BFR) (Mahfudz et al., 2016). RRi enables the financing cost to reflect the real economy and actual real estate market conditions, and not the monetary policy controlling the fiat money supply (Mahfudz et al., 2016). Creating a centralised, transparent rental index would allow Islamic financial institutions to price their *Musharakah Mutanaqisah* facilities competitively while completely severing ties with the conventional interest rate regimes (Smolo & Kabir Hassan, 2011).

Hybrid Housing Finance Regimes (HHFR)

In addressing housing accessibility, holistic systemic reforms are needed. An Affordable Housing Finance Architecture (AHFA) based on a Hybrid Housing Finance Regime (HHFR) was recommended by Razali (2026). HHFR recommends integration of public subsidies, private developer incentives, Islamic finance principles (like *Musharakah Mutanaqisah*), microfinance, and green sukuk. Econometric analyses show that although interest rates and construction costs significantly reduce affordability of properties, the Islamic equity financing and microfinance alliance substantially enhances stable access for middle- and lower-income groups to the property ownership (Razali, 2026). Implementation of this hybrid framework requires a robust institutional arrangement in dealing with the disintegrated governance while streamlining the profit intention of private entities with the public interest goals.

Conclusion

Conceptually, *Musharakah Mutanaqisah* appears to be an outstanding financing mechanism which harmonises Islamic indispensable principles of shared risk, equity, and justice (Smolo & Kabir Hassan, 2011; Yusuf, 2025). Nevertheless, this narrative review shows that the execution of *Musharakah Mutanaqisah* within the present framework of commercial banking remains fundamentally flawed. The dependency on conventional interest rate benchmarks, the transfer of all costs of maintenance and ownership risks onto the customer, the intensive utilisation of capital guaranteeing *Wa'ad* clauses, and the structural inadequacy in managing the risks of uncompleted properties have turned *Musharakah Mutanaqisah* into an imitated debt mechanism (Kashi & Mohamad, 2017; Mohamed Naim, 2011).

The unwillingness of Islamic financial institutions to offer true *Musharakah Mutanaqisah* signifies a conflict between the Shariah need for equitable risk sharing and the financial sector's widespread requirement for guaranteed returns and risk aversion (Zaaba & Hassan, 2019). To regain the credibility of Islamic home financing, financial regulators need to enforce tailor made regulation for partnership-based finance in the effort to reduce the gaps in civil property regulations such as the National Land Code 1965 (Nor et al., 2019). Furthermore, transitioning the *Musharakah Mutanaqisah* product toward cooperative institutions (*Ta'awun*) and implementing an endogenous Islamic Rental Index (RRi) are critical steps required to fulfill the true *Maqasid al-Shariah* in providing affordable, ethical, and sustainable housing solutions (Md Zabri & Haron, 2019; Mahfudz et al., 2016).

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