# Rama Capital News

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## *Market Watch- The Wall Street Journal*

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## *Rich investors bet on 'sane subprime' loans*

### *Once considered toxic, subprime mortgages get rebranded as 'smart'*

*December 12th, 2013* – **Banks want nothing to do with subprime mortgages, which nearly brought down the U.S. economy. But private firms are filling that void, rebranding loans to borrowers with poor credit as "sane subprime" and "smart nonprime," and pitching them to wealthy investors in search of yield. This time, they say, it will be different**.

The investment companies, which include private equity firms, hedge funds and alternative asset funds, say these borrowers aren't as risky as they seem and that investors stand to make an attractive return, ranging from 7% to 12% annually, by lending to them. Critics say they are injecting risk into the housing market just as it's recovering, which could result in another wave of foreclosures. The debate over some of these firms' activities is also caught up in a bill before Congress that's further dividing party lines.

Before the downturn, banks were originating risky mortgages and then selling them off to individual and institutional investors. Now a flip scenario is occurring: These investors are the ones originating the riskier loans. Most of the individual investors providing the funds are "accredited," meaning that they have a net worth of more than $1 million (excluding their primary residence) or an annual income of over $200,000 for the past two years. They're looking for a way to diversify their portfolio holdings while earning a bigger return to boot. MarketWatch has also reported on the growing trend of average Joes entering the subprime lending business.

Many of the companies arranging these deals have existed for several years, but recently began expanding their presence in the subprime market. Rama Capital Partners, an investment firm in Calabasas Hills, Calif., receives funds mostly from individual investors that it distributes in mortgages through its partner company Athas Capital Group. This year, Athas launched its "sane subprime mortgage," aimed at borrowers with credit scores as low as 550 who might have filed for bankruptcy or went into foreclosure as little as one year ago.

Lender Citadel Servicing Corp., based in Irvine, Calif., has been approving borrowers with FICO scores as low as 500 (or in some cases lower) since last year. Funding for these mortgages comes mostly from $200 million raised by the company and institutional investors, like hedge funds. This year, they expanded lending from California to nine other states, including Arizona and Florida, and plan to open up to more states next year. "We're not trying to do limited amounts [of these loans] anymore," says Kyle Gunderlock, managing director at the company.

Some investment firms say they are willing to fund subprime mortgages under certain conditions. GreenLake Investment Management, an alternative asset fund, says borrowers with low credit scores account for just shy of 40% of all the mortgages it funds but that it will investigate the cause of those applicants' credit problems before moving forward with the loan. Peter Chang, portfolio manager at GreenLake, says the company will consider cases such as a divorce, but is unlikely to move forward with applicants whose credit history reveals they are habitually late with payments.

Some firms are investing in subprime loans, but are further removed from the process. Certis Capital Management, an investment advisory firm, gives clients' cash to private fund managers who work directly with borrowers. David Backens, senior analyst at Certis Capital, says those fund managers—rather than his firm—choose the mortgage applicants that they will work with. Certis instead evaluates those managers' track records, including the down payment or overall amount of equity that they require borrowers to have in the home.

The firms say this lending is not risky because they only work with borrowers who have large down payments, typically at least 30%. That way, even if a borrower stops paying, the investors who funded the mortgage are unlikely to incur losses when the home is resold.

continued from page 1

To be sure, subprime lending has existed for quite a while. But since the downturn it was mostly dominated by so-called hard money lenders, which are made up of individuals who arrange one-off deals. This time around funding mortgages has piqued the interest of private investment firms, which are adding subprime loans to their clients' overall investment portfolio.

## Chasing yield

Though there's no official data on how many private investment firms are now funding mortgages, experts say the number is growing. In many cases, they're able to pass on returns north of 7% annually to their investors, depending on the interest rate the borrowers end up paying.

Rama Capital Partners says it currently receives funding from roughly 200 investors—a 45% increase from a year prior. Some point to increasing contributions. Certis Capital Management says it has invested about $64 million of clients' funds with private lenders, up from roughly $20 million a year ago. GreenLake says contributions have more than doubled from a year ago.

The appeal of high rates is what convinced Bernie Horton, a former financial planner and banker, to lend his cash to subprime borrowers. Horton, 65, currently has $4 million invested with Rama Capital and other mortgage funds as well as in loans that he's arranged with mortgage brokers. Horton says he's netting a 9% yield overall. “We don't have anything to buy that's generating this income,” he says.