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## [Vultures in the desert](#)

May 25, 2009 by Nicholas Kohler



In her form-fitting power suit, in a beige-toned Calgary hotel conference hall, Nancy Bacon greets a crowd of would-be real estate investors with a question: “How many people in this room like to be told what to do?” Bacon, VP of financial planning development with CBI Group, is flattering the Calgarians in their after-work jeans, who like to think they don’t need Sarah Palin to tell them what a maverick is. And CBI is pitching a scheme only mavericks could love: invest a minimum \$10,000 in a foreclosure acquisition fund created to make massive real estate purchases in one of the worst-hit subprime cities in the United States—Phoenix, Ariz.

As of February, prices there had fallen 35.2 per cent in a year, and by slightly more than half from their peak in June 2006, according to the S&P/Case-Shiller index. That annual decline is the worst in the country. One in 40 Phoenix homes received foreclosure notices in the first quarter, according to RealtyTrac, which monitors U.S. foreclosure data, the country’s ninth-highest rate—visible on the desert cityscape as discrete patches of unwatered browns amidst a checkerboard of green lawns.

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Despite those stomach-churning stats—indeed, because of them—CBI’s Arizona Acquisition Fund of Alberta is aiming to raise \$12.5 million to purchase 175 single-family homes around Phoenix. It uses local intelligence, sending teams of scouts at 4 a.m. to assess lender-owned properties slated for auction the next day. A Phoenix property management company will rent the homes—some to the very families the banks have foreclosed upon—for the next five to six years. Then CBI will sell, raking in the appreciation. Investors get six per cent a year on their money and 60 per cent of the net profits.

That is, if there are any profits. Bacon spells out the requisite caveats for the Calgary crowd—that the fund is governed by the Alberta Securities Commission and that it can make no guarantees—but notes the “goal” is

to double the capital in four to six years. It's a target some have taken to heart. "I expect to see the redemption of my \$10,000 bond and a dividend of \$10,000, and I think I'll do better than that," says 60-year-old investor David Boyle, a Calgary civil servant and rental property owner. "In all my years of investing, I've never seen anything as good as this."

But is it too good? For some, banking on a rebound in Phoenix is no gamble. Tom Caldwell, of Gilbert, Ariz.-based Brewer Caldwell Property Management, which rents the CBI properties and provides it with local real estate scuttlebutt, projects a graph of prices on the wall, decades of them—a bouncing India-rubber ball of high times and crashes. Prices, he says, have rebounded time and again. "This time's different. We're never going back," he adds, chuckling. "I'm being a little facetious. I don't really believe that."

CBI isn't alone in seeing gold glittering at the bottom of the U.S. subprime maelstrom. The past year has seen half a dozen such vulture funds spring up. The focus on residential properties may be a Canadian first. Though large institutional investors have ventured south in past crises—in the savings and loan debacle of the '80s and '90s, say—they tended to favour land and commercial real estate. "Single-family homes have typically not been an institutional type of investment," says Jarrett Zielinski, CBI's vice-president of property acquisitions. "Prices have dropped so low now, and rents have not followed suit, that this type of investment actually has become institutional grade."

CBI and Optimus are attractive in part because they provide these small investors a chance to flirt with the contrarian élan of a Warren Buffett or Prem Watsa. "How come we buy high and sell low?" Bacon asks, goading the Calgary audience. The crowd shouts answers. "Fear," says one. "The media!" another. "We don't listen to opinion," says Bacon. "We listen to facts." Those facts, as CBI and others have them, lead the savvy to one conclusion: wading into the subprime quicksands of the Sunbelt is a good idea. Quoting Buffett, Bacon counsels her audience to "be fearful when others are greedy, and greedy when others are fearful."

Yet democratizing a vulture fund like this is eerily similar to the wildly endemic speculation, fuelled by easy credit, that led to the subprime mortgage crisis in the first place. Prior to the 2006 peak, recalls Karl Guntermann, a real estate prof at the W.P. Carey School of Business at Arizona State University, new Phoenix subdivisions unleashed a circus of buying. "People would camp out, day and night in the desert's 110-degree heat, sometimes for days, to be first in line," he says. "You had people getting off tour buses buying five and six houses," says Greg Swann, a Phoenix real estate agent. Speculators left many vacant, banking on endlessly rocketing values to make them rich.

So it's perhaps appropriate that the subsequent crash has now sparked yet more speculation—a healthy portion of it Canadian. So topsy turvy have the markets become that, despite its dismal numbers, Phoenix is seeing a fresh frenzy of buying. "It's getting crazy again; we're running into properties with 10, 12 offers on them," says Chris Keith, a Phoenix realtor who specializes in Canadian buyers. "You have to jump on them or otherwise they're gone. I don't understand why the banks aren't raising their prices—because they need to."

Others aren't sure. "I call it a fool's gold rush," says Swann, attributing it to a recently ended moratorium on foreclosures implemented by mortgage titans Fannie Mae and Freddie Mac and honoured by many banks. The halt fooled some into believing the number of lender-owned homes had fallen into swift decline, fuelling a rebound. It was one of many recent false bottoms for Phoenix, he says: "If you read the news, we find the bottom twice a month." Still, the speed of the city's decline does appear to have slowed. "In the last three months, the market has dramatically changed," says Boyle, the Calgary investor who has put up money for the Arizona Acquisition Fund. "Investors like the CBI Group and others are moving in and buying up houses."

The fact that foreign speculators are helping to stabilize the market doesn't worry Boyle, who points to the city's strong historical in-migration numbers as the fundamental driver. Observers see no hiccup to that

growth on the horizon, in part because the recession may permanently cripple the Rust Belt, creating a vast reservoir of people with no option but to flow into the milk and honey West.

But whatever CBI's sales pitch, it's not clear that investors like Buffett or Watsa, contrarian or no, are rushing to buy Sunbelt homes. "There's a reason there are foreclosures, people: it's because there was too much housing," says Don Campbell, author of *Real Estate Investing in Canada*, who points to a February U.S. Census Bureau report that puts the number of vacant homes in the U.S. at a massive 19 million. "There are only 19 million properties in Canada," he says. "The equivalent of all of Canada is sitting empty in the U.S.—that's why everything seems so cheap."

Still, Boyle thrills to his own contrarian boldness. That evening after the CBI pitch, he did meet some who remained skeptical of the proposal. "Some of them said, 'Yeah, but what if it never recovers?'" recalls Boyle. "Canadians are very cautious people. And they need to be kind of pushed into something. Someone has to tell them, tap them on the shoulder and say, 'You know, this is a really good thing to do.'"

Swann, the rare sort of realtor who can quote Kipling and Maugham in conversation, believes in the indubitable power of the sun's draw on the American masses—to a point. Acknowledging that in-migration has driven the Phoenix real estate market in the past, he wonders about the future. "We just went through an unprecedented boom and an unprecedented bust, and what happens after two unprecedented circumstances? The answer is: I don't know—and anybody who tells you they do know is talking through their hat."

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