globeandmail.com

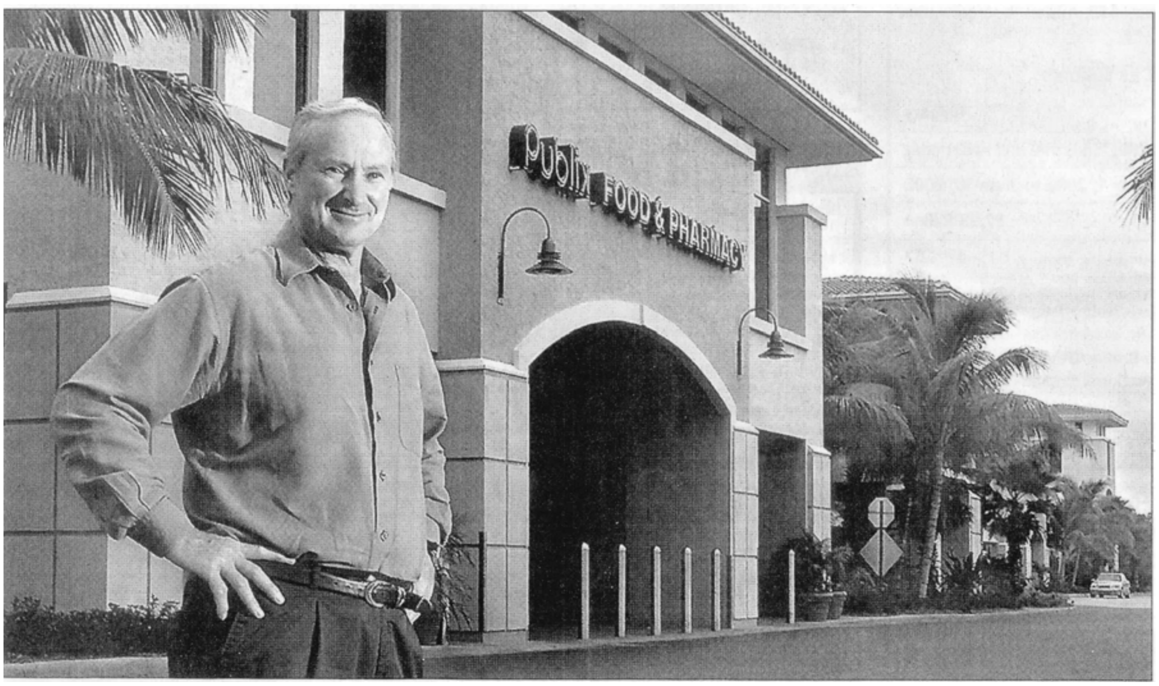
Kosoy takes Midas touch to malls

Entrepreneur's Sterling Centrecorp now profitable and poised for growth

By TERRENCE BELFORD

Special to The Globe and Mail

Tuesday, January 7, 2003 – Print Edition, Page B9



His partners call him "brilliant" and "a real estate genius." During the past 30 years, David Kosoy, 58, co-chairman of **Sterling Centrecorp Inc.** of Toronto, has won a reputation for having a true Midas touch.

"David is one of the most brilliant entrepreneurs I know," says Thomas Meyer, president of the Ivy League Group of Toronto. He has been a partner in six of Mr. Kosoy's deals since 1976. "All of them made money," he says. "He can see value which is not apparent to anyone else."

Today, Mr. Kosoy is applying his talents to a broader stage. In late 1999, he agreed to turn a struggling public company, Samoth Capital Corp., into a thriving, entrepreneurial shopping centre owner and manager. The new company was renamed Sterling Financial Corp. in June, 2000, and became Sterling Centrecorp a year later. It is now profitable and poised for rapid growth.

Mr. Kosoy has rid the company of its money-losing hotels and of properties repossessed because of sour loans. Of the 27 hotels Samoth owned, only five remain and they are on the block.

In March, 2001, he negotiated a merger with Centrecorp Management Services, founded by John Preston and Robert Green. That partnership brought the new company a depth of management bench strength and a portfolio of nearly 20 million square feet of retail space, managed for third parties.

The deal gave Sterling the ability to develop, acquire, lease and manage properties with little need for outside resources. And the management unit can provide steady and significant cash flow to fund operations.

Today, Mr. Kosoy and his team -- co-chairman John Preston and president Robert Green -- focus mainly on shopping centres. Sterling currently owns six and has 10 under or near development, plus a handful of others in the contract stage of acquisition. It also manages more than 20 million square feet of retail and commercial space and even multifamily units for third parties. Finally, it has interests in about 3,000 acres of land under development in Orlando, Fla., and San Antonio, Tex. In total, Sterling has assets of $63-million (U.S.) south of the border and $30-million (Canadian) in Canada. Shareholders' book equity sits at about $31.3-million.

What Mr. Kosoy is doing for shareholders of the public Sterling Centrecorp is exactly what he did with his private companies. Sterling partners each new deal in a way that mightily leverages the company's own cash contribution.

"The traditional route for real estate companies is to go to the markets to raise equity," Mr. Preston says. "Each time you bring in new equity, however, it dilutes the stake held by existing shareholders. Companies get into growth for growth's sake. With our approach, we can dramatically increase earnings per share with no dilution."

That approach is one Mr. Kosoy and his brother Phillip have practised since the early 1970s when David was a recently graduated lawyer. Phillip retired from active business in 1989. In those days, they were the toast of Toronto's real estate world. In 1972, for example, the pair bought an office building from Revenue Properties Corp. on downtown Sheppard Street in Toronto for $790,000. Within a year, they sold it for about $3.4-million. In the mid-1970s, they bought 425 University Ave. for $1.5-million, then sold it for $12-million in 1989 to Hong Kong investors.

The moment Bob Rae was elected premier of Ontario, David moved to Palm Beach. "I just threw up my hands," he says with a laugh. "I did not need the hassles of an NDP [New Democratic Party] government. I already had established myself in Florida and so that is where I went."

The shift to Florida eventually led to investments in Dallas and San Antonio, then Colorado and Arizona. Mr. Kosoy favoured shopping malls, mainly because so many were owned by absentee landlords and badly managed, he says.

Brian Kosoy, David's son, is a lawyer who is also executive vice-president and chief operating officer for Sterling's southeast division. He explains that Sterling never does deals by itself. It always takes in partners.

To qualify, a project has to have the potential to show a return for the partners of at least 18 per cent a year over five years. The return to Sterling shareholders, however, can often double that figure.

He offers the example of a hypothetical $10-million shopping centre acquisition. The price would consist of $2-million cash and an $8-million mortgage from a financial institution. Sterling's partners would agree to put up 70 per cent ($1.4-million) of the down payment in the form of a preferred loan paying 9-per-cent interest a year plus $300,000 in cash. Sterling's contribution would be $300,000 in cash. The company would also take over the property management contract.

The partners would earn 50 per cent of the profit plus their 9-per-cent a year interest. If money is needed for improvements, it is tacked onto the purchase price.

David can cite a string of past successes. His privately held Sterling bought Casselberry Commons shopping centre in Orlando in May, 1997, for $5.2-million (U.S.). The vacancy rate was 20 per cent. After spending $5-million on renovations, it sold the centre, now with just a 3-per-cent vacancy rate, to a real estate investment trust for $17.4-million in March, 1999. The unleveraged internal rate of return was 66 per cent.

In April, 1999, the company bought the Royal Oaks Plaza in Miami for $11.95-million; the vacancy rate was 27 per cent. In November, 2000, it sold the property to a private investor for $17.1-million. The vacancy rate at the time was nil. The unleveraged internal rate of return was 52 per cent.

Vacancy rates are key. What Sterling now looks for is a property where the management team can add value. Westland Promenade Mall in Miami's Hialeah area is a recent example. The company bought the 329,000-square-foot property in June, 2001, for $23.5-million. It was owned by a British company and managed by a company based in California. Some space in the mall had sat vacant since 1990.

Two previous offers in the $28-million range had failed to close because the prospective buyers could not make the financing work. Sterling offered $23.5-million but the owner wanted at least $25-million. Sterling was not willing to give up, however.

On a trip to England, David dropped by the office of the British owner and spotted a picture of the company's chairman on the wall. It was Nigel Ellis, who had done a deal with him 20 years earlier in Toronto. He called Mr. Ellis and negotiated the purchase.

The price would be $23.5-million and the British company would be a 50-per-cent partner. The first $1.5-million in profit would be split 50-50; the next million would go 60 per cent to Sterling's favour; the million after that 70 per cent to Sterling and anything above that 90 per cent to Sterling. The profit splitting would ensure the vendor got its $25-million.

Rents at Westland Promenade were in the $12 range when Sterling acquired the property. Now they run between $16 and $17 a square foot for new leases and renewals.

"We see a lot of deals but since we have limited capital, we are very selective," David says. "There just is not another public company like ours in Canada," he says. "We are probably the last of the true entrepreneurs."