

**T00A01.99**  
**Maryland Economic Development Corporation**

***Balance Sheet Data***

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**Maryland Economic Development Corporation Financial Statement**  
**Fiscal 2001 – 2003**  
**(\$ in Thousands)**

	<u>Fiscal 2001</u>	<u>Fiscal 2002</u>	<u>Fiscal 2003</u>
Net Assets	\$903,690	\$1,144,500	\$1,538,449
Net Liabilities	883,594	1,121,824	1,540,376
Fund Equity	20,096	22,676	-1,927
<b>Total Revenue</b>	<b>\$46,591</b>	<b>\$46,267</b>	
<b>Total Expenditures</b>	<b>\$43,842</b>	<b>\$51,350</b>	
Net Income	2,749	-5,083	

**Maryland Economic Development Corporation Financial Statement**  
**Excluding Operations**  
**Fiscal 2001 – 2003**  
**(\$ in Thousands)**

	<u>Fiscal 2001</u>	<u>Fiscal 2002</u>	<u>Fiscal 2003</u>
Net Assets	\$600,797	\$698,236	
Net Liabilities	584,686	676,766	
Fund Equity	16,111	21,470	-1,927
<b>Total Revenue</b>	<b>\$31,667</b>	<b>\$31,427</b>	
<b>Total Expenditures</b>	<b>\$30,249</b>	<b>\$31,589</b>	
Net Income	1,418	-162	

Note: Maryland Economic Development Corporation's fiscal 2003 financial statement was not made available in time for this analysis

Source: Maryland Economic Development Corporation

Note: Numbers may not sum to total due to rounding.

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## ***Analysis in Brief***

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### **Issues**

***The State Is Unable to Assess the Financial Status of Projects Operated by the Maryland Economic Development Corporation (MEDCO) without Timely Updated Financial Statements:*** MEDCO is statutorily required to submit audited financial statements by November 1 each year to the General Assembly; however, the State has yet to receive the fiscal 2003 audited financial statements. Absent financial statements it is very difficult to assess the financial status of MEDCO. **The Department of Legislative Services (DLS) recommends that MEDCO brief the committees on its repeated inability to provide audited financial statements in a timely manner. MEDCO should also brief the committees on the suspected continuing losses associated with the Rocky Gap Lodge and Golf Resort and MEDCO's financial outlook for fiscal 2005.**

### **Recommended Actions**

1. Nonbudgeted

### **Updates**

***MEDCO Project Updates:*** The MEDCO 2003 Annual Report describes several recent and ongoing projects that are representative of the corporation's activity. This update gives a brief description of significant projects.

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***Operating Budget Data***

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**Program Description**

The Maryland Economic Development Corporation (MEDCO) is a nonbudgeted entity created in 1984 to allow the State the ability to directly own or develop property for economic development purposes. The corporation is governed by statute under Article 83A, Sections 5-201 through 5-216. A 12-member board of directors appointed by the Governor with the advice and consent of the Senate manages the corporation's affairs and appoints the executive director. The secretaries of the Departments of Business and Economic Development (DBED) and Transportation serve as ex-officio voting members. MEDCO's activities complement the marketing and financing programs of DBED. There are currently six full-time and one part-time professional staff members.

Enacted as emergency legislation Chapter 338, Acts of 2001 amended MEDCO's corporate powers to conform to current practices. In addition, MEDCO's statutory authority was amended to be more consistent with the Maryland Economic Development Revenue Bond Act (MEDRBA) and economic development revenue bond enabling legislation in effect in other states which are competing with the State for economic development opportunities. For example, Chapter 338 amended MEDCO's legislative purpose to be virtually identical to those of the MEDRBA which governs all local bond issuing authorities: (1) relieving the conditions of unemployment in the State; (2) encouraging the increase of business activity and commerce, and a balanced economy in the State; (3) assisting in the retention and attraction of new business activity in the State; (4) promoting economic development; and (5) generally promoting the present and prospective health, happiness, safety, right of employment, and general welfare of State residents.

MEDCO's mission is to assist in the expansion, modernization, and retention of existing Maryland business and to attract new business to the State. MEDCO purchases or develops property that is leased to others under favorable terms. MEDCO also makes direct loans to companies requiring financing to maintain or develop facilities throughout the State, often serving as the conduit for loans administered by DBED. MEDCO borrows money and issues bonds for the purpose of financing this assistance. The debt consists primarily of revenue bonds issued by the corporation – which are not obligations of the State – and notes payable to government agencies such as DBED. The debt represents non-recourse obligations of the corporation because MEDCO is not liable to bondholders and lenders in the event of project or borrower default. Because MEDCO debt is not debt of the State or of MEDCO and each project has to support itself from its own revenues and no projects are cross-collateralized, there is no implied State guaranty or State obligation to protect bondholders from losses.

## *Issues*

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### **1. The State Is Unable to Assess the Financial Status of Projects Operated by the Maryland Economic Development Corporation (MEDCO) without Timely Updated Financial Statements.**

The corporation's financial status is audited annually by independent certified public accountants as provided for under Article 83A, Section 5-212(d). The statute, incorporated in 2003, stipulates that on or before November 1 following the end of each fiscal year, MEDCO must provide an unqualified opinion on the presentation of the financial position of the various funds and the results of the Corporation's financial operations. This statute was instituted because the Department of Legislative Services' (DLS) either had not received the financials in time for inclusion in the analysis or received them only a couple of days prior to the hearing date. In DLS's fiscal 2004 review, MEDCO indicated that in the past there were problems obtaining the report from the accountants contracted to prepare the report. In January 2003, MEDCO hired a certified public accountant to act as a senior accounting manager in hopes of providing timely financial reporting. However, once again DLS has not been provided the complete operating and financial statements covering MEDCO's operations during the preceding year. As of early February 2004, DLS has only received the 2003 annual report and a draft copy of the fiscal 2003 balance sheet.

MEDCO has indicated that its fiscal 2005 tardiness is due to a requirement, for the first time, to comply with Governmental Accounting Standard Board Statements No. 34 Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus, and No. 38, Certain Financial Statement Note Disclosures. MEDCO and the accountants report that the significant changes and additional requirements prescribed by these Statements (particularly with respect to presentation of a classified balance sheet, preparation of Management's Discussion and Analysis and much more extensive footnote disclosures) have resulted in significant additional time for MEDCO and KPMG to complete the financial statements and the audit process. **DLS recommends that MEDCO as well as its independent certified public accountant, KPMG, LLP brief the committees on why they were not able to comply with Article 83A requiring MEDCO to provide unqualified audited financial statements to the State by November 1. Further, MEDCO should comment on its ability to provide its fiscal 2004 financial statements by November 1, 2004. Finally, all 2003 information should still be submitted to the General Assembly and DLS as soon as it becomes available.**

The review of the financial statements is the key component to DLS's annual report on MEDCO's status, without which there is no way to accurately assess the corporation's financial condition or that of projects MEDCO is the owner/operator such as Rocky Gap or Chesapeake Hyatt. **DLS recommends that the committees consider amending Section 5-212 (d) through budget reconciliation legislation**

**to require MEDCO to provide revenue and expense detail in the annual audited financial statements for each of its operating facilities.**

## **Rocky Gap**

Rocky Gap Lodge and Golf Resort (Rocky Gap) consists of a 220-room hotel and conference center and an 18-hole Jack Nicholas Signature golf course situated on approximately 260-acres within Rocky Gap State Park. MEDCO's accounting systems control several projects including Rocky Gap. As reported last year, Rocky Gap has been unable to become profitable. Without the fiscal 2003 financial statements, DLS is unable to provide an update on Rocky Gap's financial condition. According to MEDCO's 2003 annual report, Rocky Gap has received approval from its bondholders to proceed with an expansion of its meeting space and other improvements. It is hoped that the additional meeting space will allow Rocky Gap to accommodate more groups at the same time and enable it the opportunity to become profitable. A review of the initial financing required for the project as well as a discussion on the expansion is provided below.

**Initial Financing:** Financing for the project consisted of \$31.1 million in revenue bonds issued by MEDCO. This included a 30-year \$26.1 million tax exempt bond and a 10-year \$5 million taxable bond with a \$5 million Maryland Industrial Financing Authority (MIDFA) guarantee. An additional \$16.37 million for the project was provided by the State, and \$4.5 million by Allegany County.

- The 30-year bond consists of interest only payments over the first 10 years and principal and interest payments for 20 years at 8.25%. The annual debt service payment for years 1 through 10 totals \$2.2 million and \$2.7 million for years 11 through 30. The total principal and interest cost of this bond is \$48.8 million.
- The \$5 million taxable junior lien bond consists of interest-only payments for 2 years and principal and interest payments for 8 years at 8%. The annual debt service payment on the taxable bonds total \$870,000, and the total interest cost of this bond is \$2.6 million. The taxable bonds cover the costs of payments to the operating fund reserve and working capital and operating expense fund. MIDFA provided a guarantee of the principal of the taxable bonds.
- The State also provided \$16.37 million for the project consisting of (1) \$12,370,000 from the Department of Natural Resources (DNR); (2) a \$3.0 million Maryland Industrial and Commercial Redevelopment Fund (MICRF) loan; and (3) a \$1.0 million MICRF grant. The term of the loan runs until December 2020. No interest accrued on the bonds until March 1, 2001, thereafter interest has accrued at a rate of 4% per annum on the outstanding principal balance payable in quarterly installments of \$80,000 with the first payment due March 1, 2006. Under the terms of the loan, no repayment is required should MEDCO default.

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- Allegany County provided 2.0 million for the construction of the golf course and another \$2.5 million for the construction of the hotel/conference center.

**Ground Lease:** The State leases the property to MEDCO for an initial term of 35 years. MEDCO may renew the ground lease for up to three additional terms of five years. The ground lease restricts the use of the property to a hotel/conference center and golf course, requires prior consent of the State to any significant changes in ownership, operation, or management of the project and prohibits any private business use of the project that would impair the tax exempt status of the revenue bonds and State and local general obligation bonds. Under the terms of the ground lease, MEDCO will pay DNR annual rental fee and revenues from the collection of a patron surcharge on hotel rooms and rounds of golf. The first annual rental payment was set at \$200,000 and increases by \$50,000 for each subsequent year. However, the ground lease permits MEDCO to keep all surcharge revenues during the first two fiscal years of operation (fiscal 1999 and 2000) and the first \$400,000 of surcharge revenues collected in the third and fourth fiscal years (fiscal 2001 and 2002). Furthermore, deposits into the principal and interest accounts, debt service reserve funds, the operating reserve fund, the working capital and operating expense fund, the renewal and replacement fund, and the subordinated debt fund must be made before the payment of the annual rental fee. As a result of these provisions, rent under the ground lease has not been paid thus far.

**Reserve and Working Fund Accounts:** The terms of bonds required deposits totaling \$15.8 million as follows:

- \$3.1 million to the Debt Service Reserve Fund;
- \$6.2 million to the Capitalized Interest Fund;
- \$2.0 million to the Operating Reserve Fund;
- \$3.0 million to the Working Capital and Operating Expense Fund; and
- \$1.5 million for the cost of bond issuance.

**Financing Changes**

- MEDCO received an additional \$1.0 million grant from DBED for construction costs overruns;
- MIDFA has purchased the \$5 million taxable bond for \$3.5 million; and

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- MEDCO borrowed \$1.5 million for three years from the Maryland Economic Development Financing Fund in 2001 to assist in operations.
- Most recently, due to the depletion of the reserve and operating funds and the continued financial losses, DBED agreed to lend an additional \$4.0 million from MEDAF to be used to provide both working capital and the funds necessary to make improvements to the facility. The improvements, such as a new junior ballroom and additional meeting space, are believed necessary to improve the financial outlook for the project. MEDCO also negotiated a postponement in the interest payments on the bonds to the bondholders through 2006.

The income sheet data for Rocky Gap shown in **Exhibit 3** indicates a significant net income loss in each of fiscal 1999 through 2002. Additional revenue derived from capital project grants received from various government agencies reduced the net income loss to \$5.6 million for fiscal 1999. Net losses amounted to approximately \$4.4 million in fiscal 2000, \$3.4 million in fiscal 2001 and \$5.4 million in fiscal 2002. Total cumulative operating losses through fiscal 2002 amount to approximately \$18.9 million. Reserve and working fund accounts have been depleted. As a result, the bond investors agreed to an interest payment “holiday” through 2006. Although DLS does not have the fiscal 2003 financial statement, it suspects continued fund equity depletion due to assumed growing net income losses.

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**Exhibit 3**  
**Rocky Gap Financial Statement**  
**Fiscal 1999 through 2002**  
**(\$ in Thousands)**

	<u>Fiscal 1999</u>	<u>Fiscal 2000</u>	<u>Fiscal 2001</u>	<u>Fiscal 2002</u>
Revenue	\$9,413	\$9,673	\$9,730	\$8,826
Total Expenditures	17,122	14,051	14,085	14,277
Net Income	-7,709	-4,378	-4,355	-5,451
Additional Revenue	2,071	0	891	0
<b>Adjusted Net Income</b>	<b>-\$5,638</b>	<b>-\$4,378</b>	<b>-\$3,464</b>	<b>-\$5,451</b>

Note: Numbers may not sum to total due to rounding.  
Source: Maryland Economic Development Corporation

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### **Exposure**

Rocky Gap does not generate enough cash flow to service the interest burden on the \$26.1 million in senior priority debt held by the bond investors. The public funding provided for the facility is subordinate to senior debt; therefore, since there are not enough funds to service the bondholders, no

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payments have been made in accordance, with the original schedules for the public funding with the exception of some of the local obligations which are paid primarily through room taxes. While the State could default the MEDCO loans, there is nothing to be gained. The State is not in default with the investors as this is a non-recourse obligation to MEDCO.

There was no full faith and credit of the State of Maryland to support the bond obligations held by the private bond investors. The bond investors could exercise their rights and remedies provided for in the official statement for the original bond issuance, which amount basically to foreclosure. However, foreclosure is limited to a leasehold interest in the premises. The underlying ground remains in the control of DNR, and at the end of the term of the bonds the assets revert to DNR. Furthermore, foreclosure would result in the bonds becoming taxable rather than tax-exempt.

**Rocky Gap Expansion**

In September 2001, REVPAR International prepared a study, initiated by MEDCO and the bondholders, which examined the operations and physical layout of Rocky Gap. Their report indicated that the lack of meeting space, based on a room to meeting space ratio, was inadequate to provide services for three or more groups at a time. In April 2002, the bondholders did not renew the management contract of Hotels of Maryland, Inc. and Crestline Hotel Management was selected to manage the property in April 2002. In the fall of 2003, Crestline agreed that additional meeting space was needed and in March 2003, MEDCO, DBED, and the bondholders agreed. Notice to proceed was given September 2003 with a completion date of May 31, 2004. The new construction will include a junior ballroom, three meeting rooms, four aromatherapy suites (conversion of existing rooms), fit up for all the spaces, and other improvements.

**DLS recommends that MEDCO brief the committees on the continued financial losses associated with Rocky Gap and on MEDCO's financial outlook. Additionally, MEDCO should comment on how its losses are impacting its ability to operate and sell bonds.**

***Recommended Actions***

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1. Nonbudgeted.

## ***Updates***

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### **MEDCO Project Update**

The MEDCO 2003 Annual Report describes several recent and ongoing projects which are representative of the corporation's activity. Below is a brief description of projects MEDCO has highlighted and feels are providing significant economic benefits to the State.

- **Maryland Department of Transportation (MDOT) Maryland Aviation Administration (MAA)** began construction of a project to expand and renovate Pier A, Pier B, and the terminal building at Baltimore/Washington International Airport (BWI). The expansion of Piers A and B and the terminal area is necessary to accommodate the expansion of airline operations of Southwest Airlines and general airport expansion. Southwest currently offers 138 daily departures from BWI. The expanded facility will allow Southwest to increase daily departures to 215 flights. The terminal area will be expanded by approximately 347,630 square feet for ticketing, airline ticketing offices, tenant office, security screening, concessions, and hold rooms on the upper level; and baggage claim, baggage screening, concessions, and passenger service areas on the lower level. MEDCO financed \$231,348,977 for this project. MAA leases the improvements from MEDCO and operates the facility in the manner that it normally does. According to MEDCO it was not necessary for MDOT to utilize its financing capacity for this project that was rated "AAA."
- **University of Maryland, Baltimore – Senior Student Housing Revenue Bonds:** MEDCO issued tax-exempt in the amount of \$35.4 million for the project that will be utilized to construct and own a student residential housing project containing a total of approximately 211,778 square feet and consisting of high rise and historic buildings, containing a total of approximately 145 student housing units with approximately 330 beds, a parking garage for approximately 59 vehicles for use by residents of the student housing units, and two units containing approximately 2,688 square feet of retail space, all to be constructed on a parcel or parcels of land located on the University's campus on Greene and Fayette streets in Baltimore City, and which will be ground leased to MEDCO by the State of Maryland for the use of the University System of Maryland on behalf of its constitute institution, the University of Maryland, Baltimore. Additionally, six historic structures located on Fayette and Paca Streets will be consolidated and rehabilitated and used for an additional 50 student housing beds. The bonds are rated Baa3 by Moody's Investor Service, Inc.
- **Higher Education Financing:** Due to the States scarce capital resources in 2002, Maryland's colleges and universities utilized student housing revenue bonds to enable them to construct necessary student/dormitory housing. Because the Internal Revenue Service (IRS) raised certain questions regarding the ownership of student housing projects by out-of-state not-for-profit student housing foundations, MEDCO issued the bonds but also owns several of the facilities until the debt is retired. In all instances but one, the University System of Maryland will ultimately own the

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facilities. The IRS has recently agreed that out-of-state not-for-profit student housing foundations are eligible to own and operate projects in Maryland as well as elsewhere.

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**Exhibit 4**  
**Owned by MEDCO – To Be Owned by**  
**University System when Debt Is Extinguished**

<u>University</u>	<u>Beds</u>	<u>Debt</u>
University of Maryland, Baltimore County	581 beds	\$37.5 million
Frostburg State University, Allegany County	400 beds	17.9 million
Morgan State University, Baltimore County	796 beds	38.0 million
University of Maryland, Baltimore County	387 beds	34.4 million
Bowie State University, Prince George's County	470 beds	21.5 million
University of Maryland, Baltimore County	788 beds	51.9 million

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**Exhibit 5**  
**Owned by MEDCO – Will Be Owned by**  
**Sheppard Pratt Health System**

<u>University</u>	<u>Beds</u>	<u>Debt</u>
University Village at Sheppard Pratt, Baltimore County	615 beds	\$27.7 million

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- **The One Maryland Program** is funded by DBED and provides economic development assistance to economically distressed jurisdictions. Presently, Allegany, Garrett, Dorchester, Worchester, Caroline, and Somerset counties and Baltimore City are eligible for One Maryland Program Assistance.
- **Allegany County:** Develop the Barton Farms Industrial Park south of Cumberland on US Route 220.

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- **Princess Anne, Somerset County:** Construction of a 30,000 square foot industrial shell building in an industrial park that has seen limited economic success. MEDCO contracted to have the building designed and built.
- **Pocomoke City, Worchester County:** Construction of a 43,000 square foot industrial shell building to provide the town and county with new marketable flex space.
- **Baltimore City:** Assisted in constructing a 514-space parking garage opened in November 2003. The parking garage assists in retaining Citi Financial in the city.
- **Baltimore City:** Construction of a parking garage to serve Sylvan Learning Systems as well as providing needed parking in the Inner Harbor east neighborhood.
- **Mountain Lake Park, Garrett County:** Construction of a 30,000 square foot building in the County's Southern Garrett Industrial Park. The county lacks available industrial buildings for immediate occupancy and this building assists in adding needed flexible industrial space to the county inventory.
- **Garrett County:** MEDCO purchased land just off Interstate 68 for the purpose of developing a new industrial park. The county has no industrial land available in the northern part of the county for developable land.
- **Cambridge, Dorchester County:** Construction of a 30,000 square foot building to expand industrial space.