T50A99
Maryland Economic Development Corporation

Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2005-2007
($ in Thousands)

	Fiscal 2005	Fiscal 2006	Fiscal 2007	Change FY 06-07
Total Assets	$1,703,519	$1,893,537	$1,904,686	$11,149
Total Liabilities	1,755,811	1,967,245	1,999,349	32,103
Net Assets Deficit	**-$52,292**	**-$73,709**	**-$94,663**	**-$20,954**
Total Operating Revenue	$105,240	$112,273	$129,270	$16,997
Total Operating Expenses	88,803	97,931	111,960	14,029
Operating Income Subtotal	**$16,437**	**$14,342**	**$17,310**	**$2,968**
Nonoperating Revenues and Expenses	-45,536	-35,758	-38,264	-2,505
Net Income Deficit	**-$29,099**	**-$21,416**	**-$20,954**	**$462**
Depreciation and Amortization	25,847	25,887	28,354	**2,467**

Change in Net Assets (Deficit) and Income by Source
Fiscal 2005-2007
($ in Thousands)

	Fiscal 2005	Fiscal 2006	Fiscal 2007	Change FY 06-07
Operating Facilities Net Assets	-$67,916	-$88,106	-$108,939	-$20,833
Other Operations Net Assets	15,624	14,397	14,277	-121
Net Assets (Deficit)	**-$52,292**	**-$73,709**	**-$94,663**	**-$20,954**
Operating Facilities Net Income	-20,629	-20,190	-20,833	-644
Other Operations Net Income	-8,470	-1,227	-121	1,106
Net Income (Deficit)	**-$29,099**	**-$21,416**	**-$20,954**	**$462**

Note: Other operations are comprised of property and equipment rental, and consultant and management fees. Certain figures from fiscal 2005 and 2006 are reclassified from those reported in the fiscal 2005 and 2006 financial statements.

Source: Maryland Economic Development Corporation financial statements

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

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- The corporation's net income deficit totaled -$20.9 million for fiscal 2007. However, operating income was positive at $17.3 million, which is a key indicator of financial health.

- Each year that the net income deficit persists, the corporation's equity position declines. The net assets deficit grew to -$94.7 million in fiscal 2007. The corporation reports that the growing net assets deficit is not a significant concern as long as operating revenues ($129.3 million) exceed cash operating expenses ($111.9 million less depreciation of $28.4 million). Noncash expenses such as depreciation and nonoperating items such as interest expense cause the income and assets deficits, and these deficits are not uncommon for real estate projects.

- The Maryland Economic Development Corporation's (MEDCO) net assets deficit is attributable to the accumulated losses of its operating facilities. In fiscal 2007, $20.8 million of the $20.9 million net income deficit was from the operating facilities.

Analysis in Brief

Overall Financial Position

Operating Revenues Exceed Operating Expenses; Noncash Losses Help Cause Deficits: MEDCO reports that a primary indicator of its financial health is whether operating revenues exceed cash operating expenses. This was achieved in fiscal 2007.

MEDCO's Assets Exclusive of Operating Facilities Are Relatively Stable: MEDCO's assets exclusive of operating facilities have averaged $17.4 million since fiscal 1999.

Growth in Number of Operating Projects Has Increased Debt and Asset Levels; Growth Rate Has Been Lower Since 2004: Debt and assets nearly doubled in fiscal 2000, and they averaged 30% growth each year from 2001 to 2003. Growth rates have been lower since fiscal 2004. MEDCO reports that management decided to moderate the growth in operating projects in order to allow more time to advise on facilities the corporation operates and to improve internal controls.

Operating Facilities Financial Position

Operating Net Assets Decreased an Average of $20.5 Million Annually Since 2005: Operating facilities' net assets decreased by $20.8 million in fiscal 2007, which is near the annual average change since fiscal 2005.

Operating Income Improved in 2007; Only Rocky Gap and Chesapeake Hills Golf Course Are a Concern, Agency Reports: Operating facilities' income increased to $11.6 million in fiscal 2007, as compared to $8.6 million in 2006. MEDCO reports that Rocky Gap and the Chesapeake Hills Golf Course are the two operating projects that are of real concern. **The Department of Legislative**

Services recommends that MEDCO comment on the outlook for the Rocky Gap and Chesapeake Hills Golf Course projects.

Operating Income Grew to $6.5 Million Among University Housing Projects in 2007; Involvement in More of These Projects Is Likely: Operating income for the university housing projects increased to $6.5 million in fiscal 2007, as compared to $3.7 million in 2006. These projects accounted for more than half of operating facility income in fiscal 2007. However, all the housing projects incurred decreases in net assets when nonoperating revenues and expenses were considered.

Recommended Actions

1. Nonbudgeted.

Operating Budget Analysis

Program Description

The Maryland Economic Development Corporation (MEDCO) is a nonbudgeted entity that allows the State to own or develop property for economic development purposes. MEDCO was created in 1984 with the mission to help expand, modernize, and retain 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 throughout the State to maintain or develop facilities, and it often serves as the conduit for loans administered by the Department of Business and Economic Development (DBED). MEDCO issues bonds to raise funds for its loans. The bond debt consists primarily of revenue bonds and notes payable to government agencies such as DBED. The debt represents non-recourse obligations because MEDCO is not liable to bondholders and lenders in the event of a project or borrower default. Each project must have self-supporting revenues, and no projects are cross-collateralized. As a result, MEDCO debt is not debt of the State, and there is no implied State guaranty or State obligation to protect bondholders from losses.

MEDCO has been involved in 202 projects through fiscal 2007. Of these, MEDCO owns and operates 14 as operating facilities, meaning the agency is involved in management decisions and it has a hand in ensuring successful daily operations. For all other projects, MEDCO serves as an arms-length financing entity.

The corporation is governed by statute under Article 83A, Sections 5-201 through 5-216. A 12-member board of directors manages the corporation's affairs and appoints the executive director. The secretaries of DBED and the Maryland Department of Transportation serve as ex-officio voting members. MEDCO's activities complement the marketing and financing programs of DBED. There are currently nine full-time and two part-time professional staff members.

Chapter 338 of 2001 was enacted as emergency legislation to amend 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 that is in effect in other states competing for opportunities. MEDCO's legislative purpose now is to (1) relieve the conditions of unemployment; (2) encourage increased business activity and commerce and a balanced economy; (3) assist in the retention and attraction of new business activity; (4) promote economic development; and (5) generally promote the present and prospective health, happiness, safety, right of employment, and general welfare of State residents.

MEDCO's Overall Financial Position

Operating Revenues Exceed Operating Expenses; Noncash Losses Help Cause Deficits

MEDCO reports that a primary indicator of its financial health is operating income, which was positive at $17.3 million in fiscal 2007, as shown in the first table on page 1 of this analysis. Operating revenues did not cover all noncash expenses such as depreciation and so the agency had a net income deficit of -$20.9 million in fiscal 2007. This was comparable to the losses experienced in fiscal 2006 and 2005. Still, operating revenues ($129.3 million) exceeded cash operating expenses ($111.9 million less depreciation of $28.4 million).

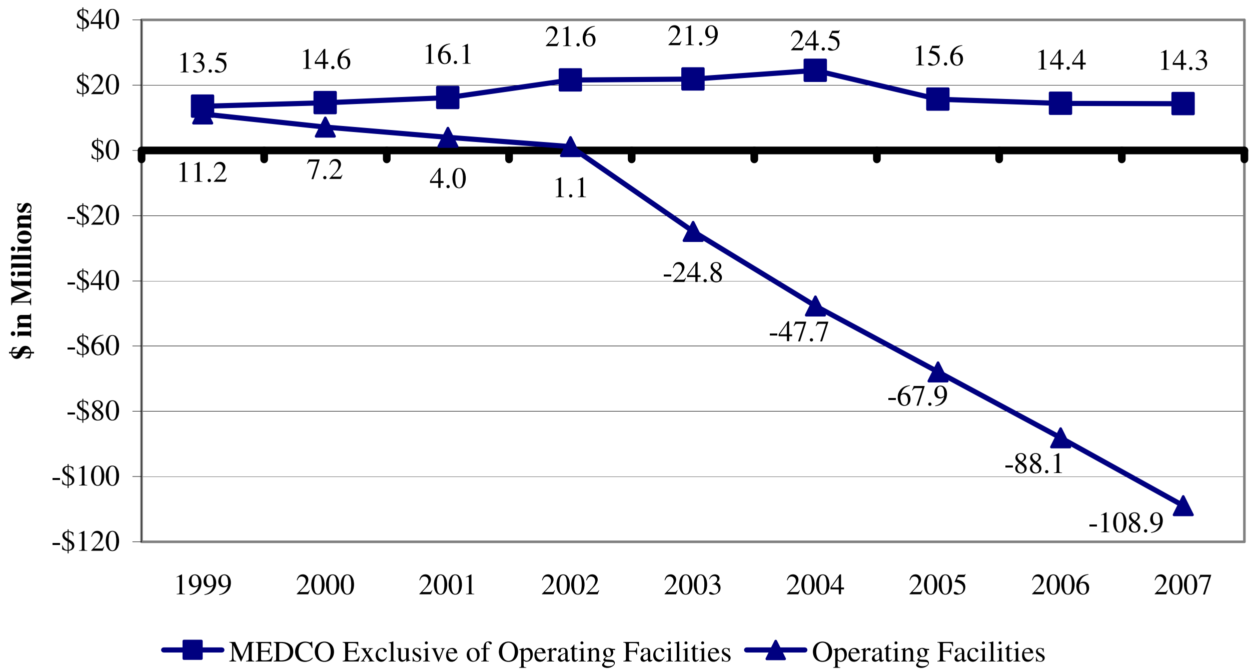
Each year that the net income deficit persists, the corporation's equity position declines. The net assets deficit grew to -$94.7 million in fiscal 2007, as shown in the first table on page 1. The corporation reports that the growing net assets deficit is not a significant concern as long as operating revenues exceed cash operating expenses. Net losses and assets deficits are not uncommon for real estate companies, MEDCO reports. With these companies, the market value of the assets generally exceeds the book value, and MEDCO says that real estate investors look at market value or, more specifically, cash flow coverage rather than book value.

MEDCO's Assets Exclusive of Operating Facilities Are Relatively Stable

Exhibit 1 shows the value of MEDCO's net assets with operating facilities separated out. MEDCO exclusive of operating facilities had $14.3 million in net assets in fiscal 2007. The balance has averaged $17.4 million since fiscal 1999. These funds represent the accumulation of excess fees over operating expenses that MEDCO attains as it conducts financing projects each year. In fiscal 2007, MEDCO provided financing for 11 new projects: 5 nonprofit entities, 4 manufacturers, and 2 higher education housing facilities. The agency also provided additional financing for the Chesapeake Hills golf course.

MEDCO has 14 operating facilities in its portfolio. The net assets deficit for these facilities grew to -$108.9 million in fiscal 2007, as shown in Exhibit 1. The operating net assets deficit began to grow dramatically in fiscal 2003. It was at this time that MEDCO greatly expanded its operating facility portfolio, including the Chesapeake Bay Conference Center and several university housing projects. The net assets deficit is a direct result of adding new operating real estate facilities. MEDCO's operating projects often have net income deficits (as explained above), and with the addition of each operating project, a net income deficit is added to the accounts, which in turn adds to the net assets deficit.

Exhibit 1
MEDCO Net Assets
Fiscal 1999-2007



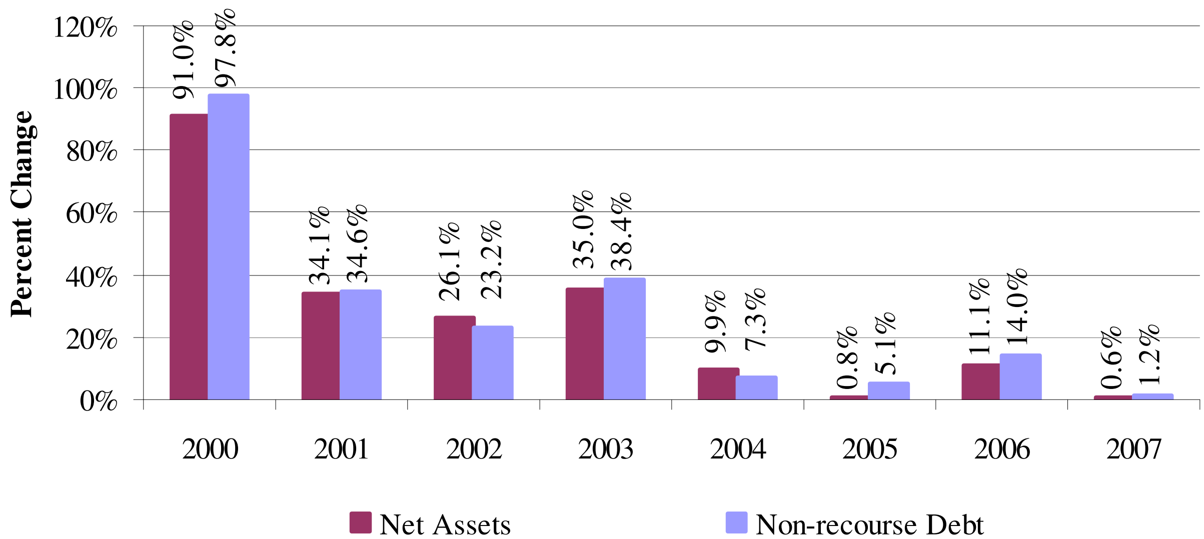
Source: Maryland Economic Development Corporation

Growth in Number of Operating Projects Has Increased Debt and Asset Levels; Growth Rate Has Been Lower Since 2004

As a result of the growth in operating projects, MEDCO's debt and assets have increased significantly. **Exhibit 2** shows that debt and assets nearly doubled in fiscal 2000, and they averaged 30% growth each year from 2001 to 2003. Growth rates have been lower since fiscal 2004. MEDCO reports that management decided to moderate the growth in operating projects in order to allow more time to advise on facilities the agency operates and to improve internal controls.

Since fiscal 1999 the growth rate in non-recourse debt exceeded the growth rate in net assets in all but two years, as shown in Exhibit 2. In fiscal 2007 specifically, new debt totaled $243.1 million. Accounting for debt that was retired during fiscal 2007, the net non-recourse debt level increased by $22.0 million to $1.9 billion. Among the increases were bonds issued for construction of student housing projects at Towson West and at Garrett College. Additional debt was related to refinancing of the Chesapeake Bay Conference Center.

Exhibit 2
Changes in MEDCO Assets and Debt
Fiscal 1999-2007



	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total Assets ($ in Millions)	$353	$674	$904	$1,139	$1,538	$1,690	$1,704	$1,893	$1,905
Non-recourse Debt ($ in Millions)	$321	$635	$855	$1,053	$1,457	$1,563	$1,642	$1,872	$1,894
Projects (Cumulative)	89	108	124	143	160	172	182	191	202

Source: Maryland Economic Development Corporation

Considering all projects, including operating and nonoperating, the agency has financed about 10 to 20 new projects each year since fiscal 1999. Cumulative projects totaled 89 in fiscal 1999, and they totaled 202 in 2007.

Operating Facilities Financial Position

Net Assets Decreased an Average of $20.5 Million Annually Since 2005

Exhibit 3 shows the increases and decreases in MEDCO's net assets by project. Operating facilities' net assets decreased by $20.8 million in fiscal 2007. Since fiscal 2005, net assets have decreased by about $20.5 million annually. This compares to a net assets decrease of $3.6 million in fiscal 2004.

Exhibit 3

MEDCO Increase (Decrease) in Net Assets by Project

Fiscal 2005-2007

	Fiscal 2005	Fiscal 2006	Fiscal 2007	Total Net Assets (Deficit) at End of Fiscal 2007
University Student Housing				
Morgan State University	-$947,843	-$1,700,979	-$1,351,195	-$5,427,809
Bowie State University	-69,592	-1,515,874	-1,196,674	-2,782,140
Frostburg State University	-770,719	-278,592	-768,382	-2,348,676
Salisbury University	-84,992	-512,855	-354,820	-952,667
University of Maryland, Baltimore	-1,482,195	-2,061,997	-1,509,667	-5,053,859
University of Maryland Baltimore County	-891,383	-1,375,103	-509,418	-2,643,201
University of Maryland, College Park Housing	-539,956	-1,864,020	-2,107,921	-4,707,467
University Village at Sheppard Pratt	-1,364,984	-992,184	-873,596	-5,972,492
Subtotal	**-$6,151,664**	**-$10,301,604**	**-$8,671,673**	**-$29,888,311**
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$7,894,846	-$10,060,537	-$7,676,832	-$56,479,299
Chesapeake Hills Golf Course	-526,601	-632,314	-723,647	-1,987,627
Compass Pointe Golf Course	-2,735,114	3,422,385	0	0
Maryland Technology Development Center	181,833	173,544	-222,990	5,630,985
Rockville Innovation Center	0	0	-185,430	-185,430
Rocky Gap Golf Resort	-4,316,759	-3,973,208	-4,569,074	-31,437,697
University of Maryland, College Park Energy	814,316	1,182,138	1,216,166	5,407,909
Subtotal	**-$14,477,171**	**-$9,887,992**	**-$12,161,807**	**-$79,051,159**
Subtotal Operating Facilities	**-$20,628,835**	**-$20,189,596**	**-$20,833,480**	**-$108,939,470**
MEDCO Exclusive of Operating Facilities	**-$8,446,050**	**-$1,250,917**	**-$110,442**	**$15,046,997**
Elimination (Accounting Adjustment)	**-$24,386**	**$24,020**	**-$10,405**	**-$770,464**
Grand Total	**-$29,099,271**	**-$21,416,493**	**-$20,954,327**	**-$94,662,937**

Note: MEDCO sold Compass Point Golf Course to Anne Arundel County in fiscal 2006. Certain figures from fiscal 2006 are reclassified from those reported in the fiscal 2006 financial statements.

Source: Maryland Economic Development Corporation

Operating Income Improved in 2007; Only Rocky Gap and Chesapeake Hills Golf Are a Concern, Corporation Reports

Exhibit 4 shows MEDCO operating income and loss by project. These data indicate whether projects are bringing in enough revenues to cover annual operating expenses. Operating facilities' income increased to $11.6 million in fiscal 2007, as compared to $8.6 million in 2006.

Exhibit 4
MEDCO Operating Income (Loss) by Project
Fiscal 2005-2007

	Fiscal 2005	Fiscal 2006	Fiscal 2007	Total 2005-07
University Student Housing				
Morgan State University	$1,198,552	$389,817	$840,102	$2,428,471
Bowie State University	779,808	-483,659	-111,979	184,170
Frostburg State University	238,705	712,325	201,269	1,152,299
Salisbury University	514,090	171,174	284,829	970,093
University of Maryland, Baltimore	-72,874	-290,092	274,320	-88,646
University of Maryland Baltimore County	292,571	975,747	748,156	2,016,474
University of Maryland, College Park Housing	1,797,301	1,372,386	3,355,477	6,525,164
University Village at Sheppard Pratt	723,938	895,595	941,441	2,560,974
Subtotal	**$5,472,091**	**$3,743,293**	**$6,533,615**	**$15,748,999**
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	$2,893,169	$2,487,784	$4,377,308	$9,758,261
Chesapeake Hills Golf Course	-182,545	-201,888	-350,845	-735,278
Compass Pointe Golf Course	-717,894	0	0	-717,894
Maryland Technology Development Center	197,714	151,268	-263,091	85,891
Rockville Innovation Center	0	0	-168,862	-168,862
Rocky Gap Golf Resort	-1,469,861	-1,157,775	-1,788,826	-4,416,462
University of Maryland, College Park Energy	3,639,999	3,531,249	3,308,890	10,480,138
Subtotal	**$4,360,582**	**$4,810,638**	**$5,114,574**	**$14,285,794**
Subtotal Operating Facilities	**$9,832,673**	**$8,553,931**	**$11,648,189**	**$30,034,793**
MEDCO Exclusive of Operating Facilities	**6,628,627**	**5,764,017**	**5,671,849**	**18,064,493**
Elimination (Accounting Adjustment)	**-24,386**	**24,020**	**-10,405**	**-10,771**
Grand Total	**$16,436,914**	**$14,341,968**	**$17,309,633**	**$48,088,515**

Note: MEDCO sold Compass Point Golf Course to Anne Arundel County in fiscal 2006. Certain figures from fiscal 2006 are reclassified from those reported in the fiscal 2006 financial statements.

Source: Maryland Economic Development Corporation

MEDCO reports that Rocky Gap and the Chesapeake Hills Golf Course are the two operating projects that are of real concern. It should be restated that each of these and all other MEDCO projects needs to be considered on its own merits because no MEDCO projects are cross-collateralized and each project must support itself with its own revenues.

- **Rocky Gap Lodge and Golf Resort:** Rocky Gap consists of a 215-room hotel and conference center and an 18-hole Jack Nicklaus Signature golf course situated on about 260 acres within Rocky Gap State Park. The facility has incurred significant net operating losses, totaling $1.8 million in fiscal 2007 alone, as shown in Exhibit 4. In fact, the fiscal 2007 losses exceeded those in fiscal 2006 and 2005. MEDCO reports that the facility has again changed its general manager and marketing director; securing stable management continues to be a challenge and helps explain the fiscal 2007 results.

  Rocky Gap is generating enough cash to cover its operating expenses, but not enough to cover its debt payments to investors, much less noncash expenses such as depreciation. Still, MEDCO points out that the State is not currently subsidizing the project. Instead, it is investors who control the fate of the project. Up to fall 2007, the investors agreed to forego the total amount owed to them in hopes that cash flow would improve. The annual forbearance agreement expired on June 30, 2007, and now there is a rolling two-week forbearance. There is no incentive for the investors to proceed with foreclosing on the project because they only have claims on its potential revenues and gaining ownership control would only add to operating expenses. Furthermore, Rocky Gap has been identified as a potential site for slot machines if slots are authorized by voters in the fall 2008 referendum, and the investors want to see the outcome of this vote.

  In the meantime, investors are receiving about $525,000 annually, which is about 25% of the amount owed to them. Without a long-term forbearance agreement, Rocky Gap debt has been reclassified as current rather than long-term debt for accounting purposes. MEDCO reports that Rocky Gap may never be able to afford its debt payments; total private debt currently is $26.2 million plus accrued interest (this is Series A debt and does not include subordinated debt and other obligations). The agency says that Rocky Gap's cash flow could be improved if its debt is restructured to get a lower interest rate and to allow operating costs to be paid before debt. Investors have made a proposal to restructure the debt, but the Department of Business and Economic Development is a subordinated creditor and has concerns about discharging its claims, and the discussion has stalled.

- **Chesapeake Hills Golf Course:** The Chesapeake Hills Golf Course is in Calvert County just five miles north of Solomons Island. The project is experiencing continued losses, totaling -$350,845 in fiscal 2007 alone, as shown in Exhibit 4. There is a covenant on the property that limits use to some type of public recreation. The county would like for it to remain a golf course; however, the project has not been profitable in this use.

The county is contributing funds to support the project and wants to develop an agreement with potential investors to purchase it. The county's obligation to pay debt service ends in May 2008. The county also has agreed to cover the operating deficit through the end of March 2008. MEDCO reports that the outlook for this project is unclear.

The Department of Legislative Services recommends that MEDCO comment on the outlook for the Rocky Gap and Chesapeake Hills Golf Course projects.

Operating Income Grew to $6.5 Million Among University Housing Projects in 2007; Involvement in More of These Projects Is Likely

Operating income for the university housing projects increased to $6.5 million in fiscal 2007, as compared to $3.7 million in 2006. These projects accounted for more than half of operating facility income in fiscal 2007. However, all the housing projects incurred decreases in net assets when nonoperating revenues and expenses were considered.

- **Bowie State University:** The Bowie State University (BSU) housing project had a $111,979 operating loss in fiscal 2007. This was the only university housing project to experience an operating loss in fiscal 2007. MEDCO reports that BSU has had difficulty in collecting rent payments from students. The collection rate has improved but is still problematic. The corporation expects that the collection rate will continue to improve with establishment of a new process in the university's finance office. Now, students who are residents in the housing facility and receive financial aid are asked to voluntarily sign a form that authorizes housing payments to be withdrawn directly from financial aid funds, and then the student receives the remaining funds.

- **Frostburg State University:** The Frostburg State University housing project had positive net income in fiscal 2007 of $201,269, but this is substantially lower than the $712,325 experienced in 2006. The occupancy rate of the housing facility was a concern but new administrators at the university have worked with MEDCO to develop a system to increase referrals to the facility. The occupancy rate now is about 96%, which is much improved and comparable to other university housing projects.

MEDCO became involved in university housing projects in 1999 when the University System of Maryland approached the agency because its customary owner – the Collegiate Housing Foundation – came under investigation by the Internal Revenue Service. MEDCO studied the cash flow potential of the projects and found them to be solid.

MEDCO believes that university housing is a good fit for its financing, and it plans to continue to become involved in such projects. The corporation reports that the universities do not want to own and operate the facilities themselves, and yet a university campus is not necessarily an ideal environment for a traditional private real estate entity. In fiscal 2007, the agency provided financing for one housing project at Towson University and one at Garrett College.

MEDCO has explained that it is not unusual for its real estate projects to show deficits, and it cautions that in the case of university housing, deficits are essentially guaranteed. There is a provision in the bond issuances that specifies that excess cash goes back to the university as additional rent or a ground lease rather than into the projects' equity. University housing bond issuances usually are structured this way, MEDCO reports, and it is for this reason that housing bonds are at the low end of investment grade ratings.

Other Operating Projects

- **Chesapeake Bay Conference Center (CCBC):** CCBC is a 400-room hotel and golf resort in Cambridge. The project experienced $4.4 million in operating income during fiscal 2007. Refinancing in fiscal 2007 for CCBC generated cash to address capital improvement needs and to reduce interest costs on debt. By November 2007, the project had generated enough revenues to fully fund the debt service costs for fiscal 2008. MEDCO reports that it is very pleased with the results of this project.

- **Maryland Technology Development Center:** The Maryland Technology Development Center (MTDC) is a business incubator in Montgomery County. The facility experienced a $263,091 operating loss in fiscal 2007. MEDCO reports that fiscal 2007 was an aberration that occurred because the county did not provide an annual subsidy as it usually does and also it charged the incubator for certain services. The county has agreed to change the way it handled financing in fiscal 2007 so the incubator is not negatively affected.

- **Rockville Innovation Center:** The Rockville Innovation Center (RIC) is a new business incubator in Montgomery County that opened in June 2007. The facility is in the Rockville redevelopment area next to the library. MEDCO reports that the project had more private sector financing than MTDC but it still receives an operating subsidy from the county, and MEDCO obtained a loan of $4.7 million to help construct the facility. Currently, RIC has 11 companies leasing 20 of the 53 office spaces. As the remaining offices are leased, income results will improve. In fiscal 2007, the project had an operating loss of $168,862.

Other Factors Affect 2007 Results

As described in MEDCO's financial statements, fiscal 2006 included two significant non-recurring items that affect the 2007 results. The Compass Pointe Golf Course was sold to Anne Arundel County, generating a gain of $3,422,000 million, and debt for the University of Maryland Baltimore County was retired early, generating a loss of $857,000. Excluding these items, results from operating facilities improved $1,921,770 million in fiscal 2007.

Losses from other operations decreased $1,106,000 in fiscal 2007. A full year of rent was received on a project in Prince George's County, generating $867,000; higher interest income of $253,000 was received on cash balances; and there was lower net interest expense totaling $968,000 on the financing lease for the BWI/Thurgood Marshall Airport following completion of construction in fiscal 2006. Offsetting these increases were gains on sales of assets and early retirement of debt totaling $1,027,000.

Recommended Actions

1. Nonbudgeted.

Audit Findings

Audit Period for Last Audit:	November 5, 2003 – December 4, 2006
Issue Date:	August 2007
Number of Findings:	5
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: (Policy Issue) MEDCO, in conjunction with the Department of Natural Resources and Department of Business and Economic Development, should develop a plan to address the financial condition of one of MEDCO's operating facilities.

Finding 2: MEDCO did not seek approval from the Board of Public Works for a contract totaling $1.25 million.

Finding 3: One troubled project was not included in the annual report which disclosed such projects.

Finding 4: Controls over collections were inadequate to ensure that all receipts were deposited.

Finding 5: MEDCO did not ensure that its cash accounts were adequately collateralized and did not provide adequate financial statement disclosure.