

T00A99
Maryland Economic Development Corporation

Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2007-2009
(\$ in Thousands)

	<u>Fiscal 2007</u>	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>	<u>Change FY 08-09</u>
Total Assets	\$1,122,355	\$1,084,224	\$1,081,867	-\$2,357
Total Liabilities	1,217,018	1,194,928	1,212,939	18,011
Net Assets (Deficit)	-\$94,663	-\$110,704	-\$131,072	-\$20,368
Total Operating Revenue	\$129,270	\$133,898	\$130,690	-\$3,208
Total Operating Expenses	111,960	114,696	113,620	-1,076
Operating Income Subtotal	\$17,310	\$19,202	\$17,070	-\$2,132
Nonoperating Revenues and Expenses	-38,264	-35,243	-37,439	-2,196
Net Income (Deficit)	-\$20,954	-\$16,041	-\$20,369	-\$4,328

Change in Net Assets (Deficit) and Income by Source
Fiscal 2007-2009
(\$ in Thousands)

	<u>Fiscal 2007</u>	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>	<u>Change FY 08-09</u>
Operating Facilities Net Assets	-\$108,939	-\$128,041	-\$148,774	-\$20,733
Other Operations Net Assets	14,277	17,337	17,702	365
Net Assets (Deficit)	-\$94,662	-\$110,704	-\$131,072	-\$20,368
Operating Facilities Net Income	-\$20,833	-\$18,321	-\$20,720	-\$2,399
Other Operations Net Income	-121	2,280	351	-1,929
Net Income (Deficit)	-\$20,954	-\$16,041	-\$20,369	-\$4,328

Note: Other operations are comprised of property and equipment rental, and consultant and management fees. Certain figures from fiscal 2007 and 2008 are reclassified from those reported in the fiscal 2007 and 2008 financial statements.

Source: Maryland Economic Development Corporation financial statements

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

For further information contact: Jody J. Sprinkle

Phone: (410) 946-5530

T00A99 – Maryland Economic Development Corporation

- The Maryland Economic Development Corporation's (MEDCO) net income deficit totaled -\$20.3 million for fiscal 2009, an increase of about \$4.3 million. Operating income for fiscal 2009 was positive at \$17.0 million, which is a key indicator of economic health. 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.
- Each year that the net income deficit persists, the corporation's equity position declines. The net assets deficit grew to -\$131.0 million in fiscal 2009. The corporation reports that the growing net assets deficit is not a significant concern as long as operating revenues plus interest income (\$149.7 million) exceed cash operating expenses and interest expense (\$142.9 million).
- The corporation's net asset deficit is attributable to the accumulated losses of its operating facilities. In fact, the corporation's other operations showed positive income of \$351,000. In fiscal 2009, operating facilities showed a net deficit of -\$20.7 million.

Analysis in Brief

Overall Financial Position

Operating Revenues Exceed Operating Expenses: The corporation's net asset deficit has grown to -\$131 million. However, as a key indicator of financial health, operating income was positive at \$17 million in fiscal 2009.

MEDCO's Assets Exclusive of Operating Facilities Are Relatively Stable: Exclusive of operating facilities, MEDCO had \$17.7 million in net assets in fiscal 2009, close to the 10-year average of \$17.8 million. In fiscal 2009, MEDCO provided funding for six new projects.

Operating Facilities Financial Position

Net Assets Continue to Decrease: Operating facilities' net assets decreased by \$20.7 million in fiscal 2009. This decrease is slightly more than the decrease experienced in fiscal 2008.

Operating Income Declined Slightly in 2009; Five Projects Posted a Loss: Operating facilities' income fell to \$11.2 million in fiscal 2009. Five projects showed a loss, and one non-university project was defined as a problem project in the corporation's financial statement. **The Department of Legislative Services (DLS) recommends that MEDCO comment on the outlook for Rocky Gap and the 2009 designation of Chesapeake Bay Conference Center as a problem project.**

Operating Income Grew to \$11.6 Million Among University Housing Projects in Fiscal 2009: Operating income for university housing projects grew by \$4.4 million in fiscal 2009. However, two projects are considered problem projects within the corporation's financial statements. **DLS recommends that MEDCO comment on the university projects, especially those identified as problem projects.**

Expanded Project Opportunities: The corporation is increasingly becoming involved in projects that are not typical as compared to the projects in its current portfolio, including projects that are considered public-private partnerships. **DLS recommends that the corporation discuss its involvement in these proposed projects and how they reflect MEDCO's legislative purpose.**

Recommended Actions

1. Nonbudgeted.

T00A99 – Maryland Economic Development Corporation

T00A99
Maryland Economic Development Corporation

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 219 projects through fiscal 2009. Of these, MEDCO currently owns and operates 14 as operating facilities, meaning the agency is involved in management decisions and 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 the Economic Development Article, Sections 10-101 through 10-132. 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 10 full-time and 1 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 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

MEDCO reports that a primary indicator of financial health is net operating income before depreciation and after interest income and expense, which was positive at \$6.8 million in fiscal 2009, as shown on page 1 of this analysis. Operating revenues did not cover all nonoperating expenses; therefore, the corporation had a net income deficit of -\$20.4 million in fiscal 2009. This is more of an income deficit when compared to the losses experienced in fiscal 2008. Operating revenues (\$130.7 million) exceeded operating expenses (\$113.6 million).

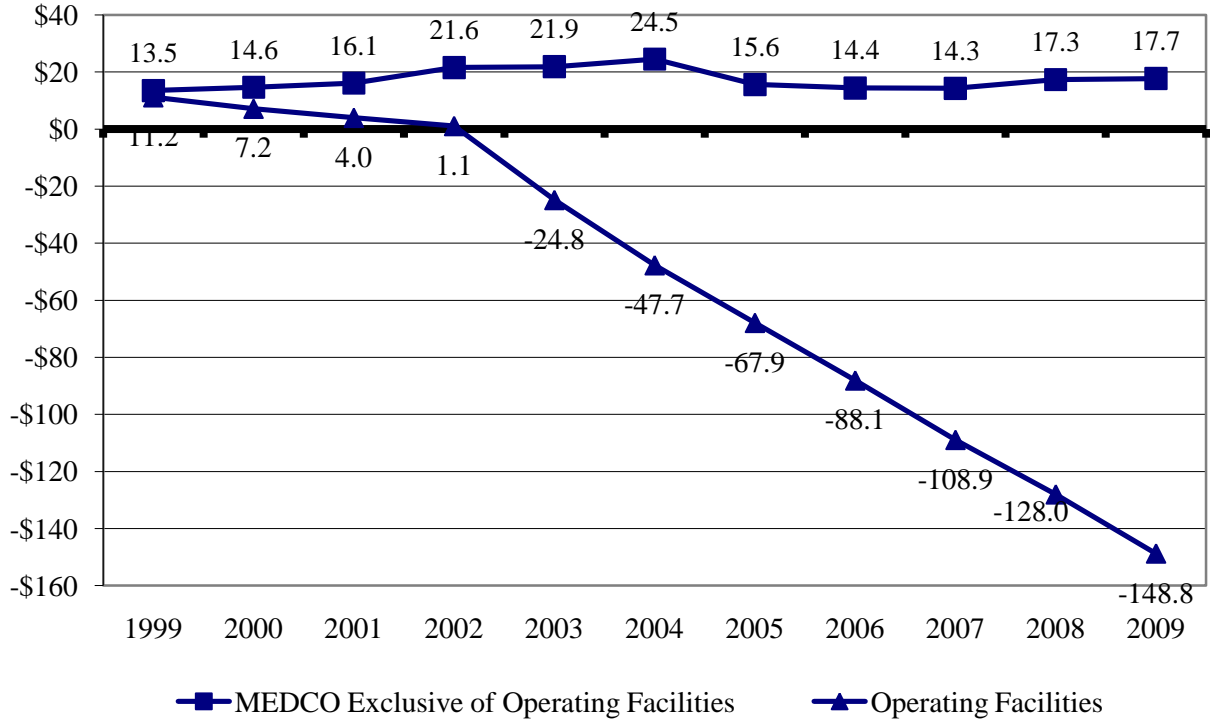
Each year that the net income deficit persists, the corporation's equity position declines. The net assets deficit grew to -\$131.1 million in fiscal 2009, as shown on page 1. The corporation reports that the growing net assets deficit is not a significant concern as long as operating revenues exceed cash operating expenses. MEDCO reports that net losses and assets deficits are not uncommon for real estate companies. 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 extracted. MEDCO, exclusive of operating facilities, had \$17.7 million in net assets in fiscal 2009. The balance has averaged \$17.8 million for the last 10 years. These funds represent the accumulation of excess fees over operating expenses that MEDCO attains as it conducts financing transactions each year. In fiscal 2009, MEDCO provided financing for six new projects.

MEDCO has 14 operating facilities in its portfolio. The net assets deficit for these facilities grew to -\$148.8 million in fiscal 2009, 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 overall net assets deficit.

Exhibit 1
MEDCO Net Assets
Fiscal 1999-2009
(\$ in Millions)



Source: Maryland Economic Development Corporation

Operating Facilities Financial Position

Net Assets Continue to Decrease

Exhibit 2 shows the increases and decreases in MEDCO’s net assets by project. Operating facilities’ net assets decreased by \$20.7 million in fiscal 2009. This decrease is slightly higher than the decrease experienced in fiscal 2008.

Exhibit 2
MEDCO Increase (Decrease) in Net Assets by Project
Fiscal 2007-2009

	<u>Fiscal 2007</u>	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>	<u>Total Net Assets (Deficit) at End of Fiscal 2009</u>
University Student Housing				
Morgan State University	-\$1,351,195	-\$921,987	-\$103,032	-\$6,452,828
Bowie State University	-1,196,674	-936,236	-584,459	-4,302,835
Frostburg State University	-768,382	-228,772	-145,594	-2,723,042
Salisbury University	-354,820	-883,443	-442,677	-2,278,787
Towson West	0	0	-573,459	-573,459
University of Maryland, Baltimore	-1,509,667	-1,389,348	-982,572	-7,425,779
University of Maryland Baltimore County	-509,418	-414,219	-216,102	-3,273,522
University of Maryland, College Park Housing	-2,107,921	-2,480,171	-1,789,945	-8,977,583
University Village at Sheppard Pratt	-873,596	-855,062	-770,269	-7,597,823
Subtotal	-\$8,671,673	-\$8,109,238	-\$5,608,109	-\$43,605,658
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-\$7,676,832	-\$6,316,113	-\$10,779,761	-\$73,575,173
Chesapeake Hills Golf Course	-723,647	-499,501	2,487,128	0
Maryland Technology Development Center	-222,990	32,007	-497,461	5,165,531
Rockville Innovation Center	-185,430	1,296,306	-194,163	916,713
Rocky Gap Golf Resort	-4,569,074	-5,751,843	-5,197,395	-42,386,935
University of Maryland, College Park Energy	1,216,166	1,027,558	-930,449	5,505,018
Subtotal	-\$12,161,807	-\$10,211,586	-\$15,112,101	-\$104,374,846
Subtotal Operating Facilities	-\$20,833,480	-\$18,320,824	-\$20,720,210	-\$147,980,504
MEDCO Exclusive of Operating Facilities	-\$110,442	\$2,290,302	\$363,488	\$17,700,787
Elimination (Accounting Adjustment)	-10,405	-10,405	-12,208	-\$770,464
Grand Total	-\$20,954,327	-\$16,040,927	-\$20,368,930	-\$131,050,181

Source: Maryland Economic Development Corporation

Operating Income Declined Slightly in 2009; Five Projects Posted a Loss

Exhibit 3 shows MEDCO operating income and loss by project. The data indicates whether projects are bringing in enough revenues to cover annual operating expenses. Operating facilities' income decreased to \$11.2 million in fiscal 2009, as compared to \$12.8 million in 2008.

Exhibit 3 MEDCO Operating Income (Loss) by Project Fiscal 2007-2009

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>Total FY 2007-09</u>
University Student Housing				
Morgan State University	\$840,102	\$1,198,783	\$2,016,505	\$4,055,390
Bowie State University	-111,979	119,757	492,916	500,694
Frostburg State University	201,269	737,291	823,348	1,761,908
Salisbury University	284,829	-204,727	270,948	351,050
Towson West	0	0	912,194	912,194
University of Maryland, Baltimore	274,320	400,715	885,115	1,560,170
University of Maryland Baltimore County	748,156	940,530	1,164,941	2,853,627
University of Maryland, College Park Housing	3,355,477	2,973,627	3,930,786	10,259,890
University Village at Sheppard Pratt	941,441	1,050,366	1,088,333	3,080,140
Subtotal	\$6,533,615	\$7,216,342	\$11,585,086	\$25,335,043
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	\$4,377,308	\$6,115,887	-\$390,074	\$10,103,121
Chesapeake Hills Golf Course	-350,845	-220,552	-20,637	-592,034
Maryland Technology Development Center	-263,091	-14,411	-218,897	-496,399
Rockville Innovation Center	-168,862	-623,682	-309,617	-1,102,161
Rocky Gap Golf Resort	-1,788,826	-2,925,098	-2,946,403	-7,660,327
University of Maryland, College Park Energy	3,308,890	3,283,532	3,501,757	10,094,179
Subtotal	\$5,114,574	\$5,615,676	-\$383,871	\$10,346,379
Subtotal Operating Facilities	\$11,648,189	\$12,832,018	\$11,201,235	\$35,681,422
MEDCO Exclusive of Operating Facilities	\$5,671,849	\$6,380,905	\$5,881,138	\$17,933,892
Elimination (Accounting Adjustment)	-\$10,405	-\$10,405	-\$12,208	-\$33,018
Grand Total	\$17,309,633	\$19,202,518	\$17,070,145	\$53,582,296

Source: Maryland Economic Development Corporation

T00A99 – Maryland Economic Development Corporation

According to the corporation's financial statement, there are three operating projects identified in fiscal 2009 as problem projects for failure to meet debt coverage ratios. One of these projects is a nonuniversity project. 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.

- **Chesapeake Bay Conference Center:** The Chesapeake Bay Conference Center (CBCC) is located in Dorchester County. It houses a hotel, golf course, and conference facilities. Although it is experiencing an increase in revenue from its operations, the project is unable to meet its required debt coverage ratio. MEDCO has secured a management consultant to suggest changes in pricing and expense reductions in order to bring the ratio into compliance in fiscal 2010.

Although not technically defined as a problem project by the corporation's financial statement, the corporation is still concerned about the performance of the Rocky Gap Lodge and Golf Resort.

- **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 \$2.9 million in fiscal 2009 alone, as shown in Exhibit 3.

Rocky Gap had been 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. The investors had, for a time, agreed to forego the amounts owed to them in hopes that cash flow would improve. In an effort to improve the cash flow, MEDCO restructured the debt to get a lower interest rate and to allow operating costs to be paid before debt. Despite these efforts, the project is not earning enough to pay debt.

The Department of Legislative Services (DLS) recommends that MEDCO comment on the outlook for Rocky Gap and the 2009 designation of CBCC as a problem project.

Operating Income Grew to \$11.6 Million Among University Housing Projects in Fiscal 2009

Operating income for the university housing projects increased to \$11.6 million in fiscal 2009, as compared to \$7.2 million in 2008. However, all the housing projects incurred decreases in net assets when nonoperating revenues and expenses were considered. The following projects are considered as problems in the corporation's financial statements.

- **Bowie State University:** The Bowie State University (BSU) housing project had a \$111,979 operating loss in fiscal 2007 and is considered a problem project within the corporation's financial statement. This was the only university housing project to experience an operating loss in fiscal 2007. It has since rebounded and in fiscal 2009, posted operating revenue of \$492,916. To improve its condition, the corporation (a) streamlined the operating budget to

remove inefficiencies, increase rental rates and decrease expenses; (b) contracted for a major roof repair project to eliminate water infiltration; (c) worked with the University to implement a financial aid transfer program which allows the University to apply student financial aid awards directly to the project; (d) moved to a license agreement to allow management to expeditiously remove delinquent residents; (e) reduced annual operating expenses through a blanket insurance policy; (f) coordinated efforts with the University to provide Internet and residence life services to the project at no cost; (g) deferred two years of its annual fee; (h) engaged a management consultant to obtain recommendations to improve operations; and (i) filed claims against the initial manager and the developer in order to recuperate funds lost from mismanagement and construction defects.

- **University of Maryland, Baltimore:** The housing project at University of Maryland, Baltimore (UMB) is the final project that is considered problematic in the financial statements. MEDCO reports that the project did not anticipate the differing needs of graduate level students in the housing design; therefore, demand is not as expected. However, the operating income did improve in fiscal 2009.

MEDCO became involved in university housing projects in 1999 when the University System of Maryland (USM) approached the agency because the 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 it 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.

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. MEDCO reports that university housing bond issuances usually are structured this way, and it is for this reason that housing bonds are at the low end of investment grade ratings.

DLS recommends that MEDCO comment on the university projects, especially those identified as problem projects.

Other Operating Projects

- **Chesapeake Hills Golf Course:** The Chesapeake Hills Golf Course is an 18 hole public course in Calvert County. In 2009, MEDCO sold the project to the county. It had been reporting continued losses. Because of the sale, MEDCO's financial statements show a net asset increase of \$2.5 million as shown in Exhibit 2.

Expanded Project Opportunities

Chapter 338 of 2001 expanded MEDCO's legislative purpose, thereby expanding the types of projects that it may pursue. In addition, MEDCO's quasi-public status and its ability to issue nonrecourse, tax exempt debt makes it an attractive alternative to fund State projects outside debt affordability parameters. There are several projects in the corporation's plans that are not typical of the projects in its current portfolio.

- **Port of Baltimore's Seagirt Marine Terminal:** In January, MEDCO issued \$248.7 million in revenue bonds to help finance the expansion of the Port of Baltimore's Seagirt Marine Terminal. This bond issue is part of a public-private partnership with a private port company and the Maryland Department of Transportation. A portion of the funds will be used to upgrade the terminal and a portion of the funds will be used for other transportation projects such as bridge, tunnel, and highway infrastructure improvements. Revenues from the terminal will be used to back the bonds.
- **Department of Health and Mental Hygiene Public Health Laboratory:** The Administration has proposed a financing approach using MEDCO issued lease-revenue bonds in conjunction with a private developer in a form of public-private partnership arrangement to design and construct a new public health laboratory. Under the Administration's proposal, a private developer will design and construct the new public health laboratory at the East Baltimore Biotechnology Park, and the building will be professionally managed by a commercial real estate management company. The State will have an operating or capital lease agreement with MEDCO for a duration that will last at a minimum until the MEDCO lease-revenue bonds issued are fully retired. MEDCO would own the property.
- **State Center Complex:** The Department of General Services (DGS) owns the 28-acre land that comprises the State Center complex. In 2005, a request for qualifications (RFQ) was issued, and a development team was selected. The State is currently negotiating the terms of a mixed use development agreement with the developers. The development team and State expect to seek Board of Public Works approval of Phase 1 in calendar 2010. The cost to the State would be predevelopment costs, State office leases, and the cost of a 1,000-space garage. It is expected that MEDCO would issue debt for a portion of the development project.

DLS recommends that the corporation discuss its involvement in these proposed projects and how they reflect MEDCO's legislative purpose.

Recommended Actions

1. Nonbudgeted.