

T00A99
Maryland Economic Development Corporation

Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2008-2010
(\$ in Thousands)

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Change 2009-2010</u>
Total Assets	\$755,265	\$763,762	\$724,063	-\$39,699
Total Liabilities	865,969	894,834	887,572	-7,262
Net Assets (Deficit)	-\$110,704	-\$131,072	-\$163,509	-\$32,437
Total Operating Revenue	\$133,058	\$129,171	\$125,461	-\$3,710
Total Operating Expenses	113,855	112,101	113,320	1,219
Operating Income Subtotal	\$19,202	\$17,070	\$12,141	-\$4,929
Non-operating Revenues and Expenses	-35,243	-37,439	-44,578	-7,139
Net Income (Deficit)	-\$16,041	-\$20,369	-\$32,437	-\$12,068

Change in Net Assets (Deficit) and Income by Source
Fiscal 2008-2010
(\$ in Thousands)

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Change 2009-2010</u>
Operating Facilities Net Assets	-\$128,041	-\$148,774	-\$176,378	-\$27,604
Other Operations Net Assets	17,337	17,701	12,868	-4,833
Net Assets (Deficit)	-\$110,704	-\$131,073	-\$163,509	-\$32,437
Operating Facilities Net Income	-\$18,321	-\$20,732	-\$27,604	-\$6,872
Other Operations Net Income	2,280	363	-4,832	-5,195
Net Income (Deficit)	-\$16,041	-\$20,369	-\$32,437	-\$12,068

Note: Other operations are comprised of property and equipment rental and consultant and management fees. Certain figures from fiscal 2008 and 2009 are reclassified from those reported in the fiscal 2008 and 2009 financial statements.

Source: Maryland Economic Development Corporation financial statements

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

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T00A99 – Maryland Economic Development Corporation

- The Maryland Economic Development Corporation's (MEDCO) net income deficit totaled -\$32.4 million for fiscal 2010, an increase of about \$12.1 million. Operating income for fiscal 2010 was positive at \$12.1 million, which is a key indicator of economic health. Noncash expenses, such as depreciation, and non-operating 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 -\$163.5 million in fiscal 2010. The corporation reports that the growing net assets deficit is not a significant concern as long as operating revenues plus interest income (\$127.3 million) exceed cash operating expenses and interest expense (\$125.5 million).
- The corporation's net asset deficit is attributable to the accumulated losses of its operating facilities. The operating facilities' net income deficit grew by \$6.9 million in fiscal 2010. For the first time in three years, the corporation also experienced a net income deficit in its other operations.

Analysis in Brief

Overall Financial Position

Operating Revenues Exceed Operating Expenses: The corporation's net asset deficit has grown to -\$163.5 million. However, as a key indicator of financial health, operating income was positive at \$1.7 million in fiscal 2010.

MEDCO's Assets Exclusive of Operating Facilities Are Relatively Stable: Exclusive of operating facilities, MEDCO had \$12.9 million in net assets in fiscal 2010, less than the 10-year average of \$17.4 million. In fiscal 2010, MEDCO provided funding for seven new projects.

Operating Facilities Financial Position

Net Assets Continue to Decrease: Operating facilities' net assets decreased by \$27.6 million in fiscal 2010. This decrease is higher than the decrease experienced in fiscal 2009.

Operating Facilities Income Declined in 2010; Four Projects Posted a Loss: Operating facilities' income fell to \$7.5 million in fiscal 2010. Four 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 designation of the Chesapeake Bay Conference Center as a problem project.**

Operating Income Grew to \$12.1 Million among University Housing Projects in Fiscal 2010: Operating income for university housing projects grew to \$12.1 million in fiscal 2010. 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.**

Legislative Audit Highlights Rocky Gap Project: The Rocky Gap facility, as an operating project of the corporation, continues to post operating losses. In an audit dated March 2010, legislative auditors expressed concern that there is no long-term plan in place to improve the financial stability of the facility. **DLS recommends that MEDCO comment on the findings of the legislative audit and the outlook for the Rocky Gap facility given the lack of progress in attracting a viable video lottery terminal operator to the site.**

Corporation Will Advance Funds to Horse Tracks; Other Projects: As part of an agreement to maintain horseracing in 2011, MEDCO approved advancing funds to the track owners, to be repaid with budgeted racetrack renewal funds. The corporation's repayment is contingent on a provision in the Budget Reconciliation and Financing Act (BRFA) of 2011. MEDCO has also provided funds for projects that are outside its conventional financing. **DLS recommends that the BRFA of 2011 be amended to allow the transfer of racetrack redevelopment funds to MEDCO after all appeals by Laurel Racing Association, Inc. relating to the rejection of its proposal for a Video Lottery Operations license are withdrawn or exhausted.**

DLS further recommends that the corporation comment on the use of its funds for projects outside its conventional financing role.

Recommended Actions

1. Nonbudgeted.

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 226 projects through fiscal 2010. Of these, MEDCO currently owns and operates 14 as operating facilities, meaning the corporation 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 2 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 \$1.7 million in fiscal 2010. As shown on page 1 of this analysis, operating revenues did not cover all non-operating expenses; therefore, the corporation had a net income deficit of -\$32.4 million in fiscal 2010. This is a greater income deficit when compared to the losses experienced in fiscal 2009. This is due, in part, to a decrease in revenues associated with the Chesapeake Bay Conference Center, as discussed later in this analysis. Despite this revenue loss, operating revenues (\$125.5 million) continue to exceed operating expenses (\$113.3 million).

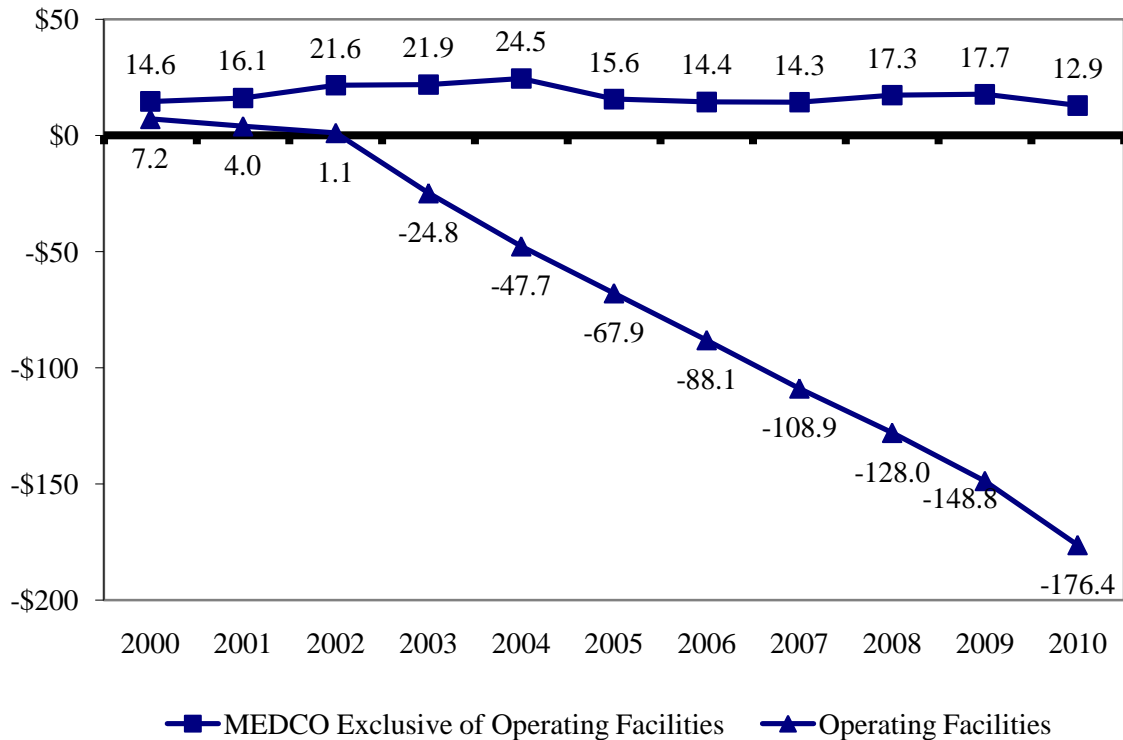
Each year that the net income deficit persists, the corporation's equity position declines. The net assets deficit grew to -\$163.5 million in fiscal 2010, as shown on page 1. The corporation reports that the growing net assets deficit is not a significant concern as long as operating revenues exceed 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 \$12.9 million in net assets in fiscal 2010. The balance has averaged \$17.4 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 2010, MEDCO provided financing for seven new projects.

MEDCO has 14 operating facilities in its portfolio. The net assets deficit for these facilities grew to -\$176.4 million in fiscal 2010, 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 2000-2010
(\$ 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 \$27.6 million in fiscal 2010. This decrease is higher than the decrease experienced in fiscal 2009.

Exhibit 2
MEDCO Increase (Decrease) in Net Assets by Project
Fiscal 2008-2010

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Total Net Assets (Deficit) at End of 2009</u>
University Student Housing				
Morgan State University	-\$921,987	-\$103,032	\$101,138	-\$6,351,690
Bowie State University	-936,236	-584,459	-933,396	-5,236,231
Frostburg State University	-228,772	-145,594	-221,928	-2,944,970
Salisbury University	-883,443	-442,677	-253,562	-2,532,349
Towson West	0	-573,459	-1,103,721	-1,677,180
University of Maryland, Baltimore	-1,389,348	-982,572	-1,131,682	-8,557,461
University of Maryland Baltimore County	-414,219	-216,102	144,486	-3,129,036
University of Maryland, College Park Housing	-2,480,171	-1,789,945	-2,551,065	-11,528,648
University Village at Sheppard Pratt	-855,062	-770,269	-753,502	-8,351,325
Subtotal	-\$8,109,238	-\$5,608,109	-\$6,703,232	-\$50,308,890
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-\$6,316,113	-\$10,779,761	-\$14,383,265	-\$87,958,438
Chesapeake Hills Golf Course	-499,501	2,487,128	0	0
Shady Grove Innovation Center	32,007	-497,461	54,794	5,220,325
Rockville Innovation Center	1,296,306	-194,163	-416,970	499,743
Rocky Gap Golf Resort	-5,751,843	-5,197,395	-5,667,383	-48,054,318
University of Maryland, College Park Energy	1,027,558	-930,449	-502,753	5,002,265
Subtotal	-\$10,211,586	-\$15,112,101	-\$20,915,577	-\$125,290,423
Subtotal Operating Facilities	-\$18,320,824	-\$20,720,210	-\$27,618,809	-\$175,599,313
MEDCO Exclusive of Operating Facilities	\$2,290,302	\$363,488	-\$4,832,301	\$12,868,486
Elimination (Accounting Adjustment)	-\$10,405	-\$12,208	\$14,514	-\$778,563
Grand Total	-\$16,040,927	-\$20,368,930	-\$32,436,596	-\$163,509,390

MEDCO: Maryland Economic Development Corporation

Note: MEDCO sold Chesapeake Hills Golf Course to Calvert County in fiscal 2008.

Source: Maryland Economic Development Corporation

Operating Income Declined in 2010; Four 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 \$7.5 million in fiscal 2010, compared to \$11.2 million in 2009. However, only four projects posted a loss in fiscal 2010, compared to five in the previous year as a result of the sale of the Chesapeake Hills Golf Course.

Exhibit 3 MEDCO Operating Income (Loss) by Project Fiscal 2008-2010

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Total 08-10</u>
University Student Housing				
Morgan State University	\$1,198,783	\$2,016,505	\$2,303,309	\$5,518,597
Bowie State University	119,757	492,916	182,418	795,091
Frostburg State University	737,291	823,348	739,752	2,300,391
Salisbury University	-204,727	270,948	485,229	551,450
Towson West	0	912,194	748,156	1,660,350
University of Maryland, Baltimore	400,715	885,115	759,907	2,045,737
University of Maryland Baltimore County	940,530	1,164,941	1,511,367	3,616,838
University of Maryland, College Park Housing	2,973,627	3,930,786	4,238,501	11,142,914
University Village at Sheppard Pratt	1,050,366	1,088,333	1,093,211	3,231,910
Subtotal	\$7,216,342	\$11,585,086	\$12,061,850	\$30,863,278
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	\$6,115,887	-\$390,074	-\$3,699,379	\$2,026,434
Chesapeake Hills Golf Course	-220,552	-20,637	0	-241,189
Shady Grove Innovation Center	-14,411	-218,897	-51,777	-285,085
Rockville Innovation Center	-623,682	-309,617	-489,791	-1,423,090
Rocky Gap Golf Resort	-2,925,098	-2,946,403	-3,811,819	-9,683,320
University of Maryland, College Park Energy	3,283,532	3,501,757	3,534,151	10,319,440
Subtotal	\$5,615,676	-\$383,871	-\$4,518,615	\$713,190
Subtotal Operating Facilities	\$12,832,018	\$11,201,215	\$7,543,235	\$31,576,468
MEDCO Exclusive of Operating Facilities	\$6,380,905	\$5,881,138	\$4,583,344	\$16,845,387
Elimination (Accounting Adjustment)	-\$10,405	-\$12,208	\$14,514	-\$8,099
Grand Total	\$19,202,518	\$17,070,145	\$12,141,093	\$48,413,756

MEDCO: Maryland Economic Development Corporation

Note: MEDCO sold Chesapeake Hills Golf Course to Calvert County in fiscal 2008.

Source: Maryland Economic Development Corporation

According to the corporation's financial statement, there are three operating projects identified in fiscal 2010 as problem projects for failure to meet debt coverage ratios. One of these projects is a non-university project. Each of these and all other MEDCO projects need 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 secured a management consultant to suggest changes in pricing and expense reductions in order to bring the ratio into compliance. The consultant's report and recommendations were presented at a bondholder meeting in November 2010.

The Department of Legislative Services (DLS) recommends that MEDCO comment on the designation of CBCC as a problem project.

Operating Income Grew to \$12.1 Million among University Housing Projects in Fiscal 2010

Operating income for the university housing projects increased to \$12.1 million in fiscal 2010, compared to \$11.6 million in 2009. However, all but two of the housing projects incurred decreases in net assets when non-operating 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 housing project had an \$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 2010, posted operating revenue of \$182,418. To improve its condition, the corporation (a) streamlined the operating budget to remove inefficiencies, increased rental rates, and decreased 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 recoup funds lost from mismanagement and construction defects. According to the corporation's audited financial statements, the university project experienced an increase in operating revenues in fiscal 2010 due primarily to an increase in rental rates. Occupancy ranged from 89 to 100% and averaged 98%.

- **University of Maryland, Baltimore:** The housing project at the University of Maryland, Baltimore 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. Operating income fell slightly in fiscal 2010. The audited financial statements notes that an over-supply of housing options in the market have contributed to the decline. Occupancy ranged from 69 to 85% for the 2009-2010 academic year.

MEDCO became involved in university housing projects in 1999 when the University System of Maryland approached the corporation 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.

Legislative Audit Highlights Rocky Gap Project

As a public instrumentality of the State, the corporation is subject to legislative audits every three years. In March 2010, the Office of Legislative Audits released its audit of the corporation, covering the period from December 2006 to September 2009. There were two findings.

The first finding relates to a policy, not a fiscal, issue and is the sole repeat finding from the previous audit.

Finding 1: In view of the growing project operating deficit, totaling \$42.4 million as of June 30, 2009, MEDCO, in conjunction with the Department of Natural Resources (DNR) and the Department of Business and Economic Development (DBED), should continue its efforts to address the financial condition of one of its operating facilities. (Rocky Gap)

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 \$3.8 million in fiscal 2010 alone, as shown in Exhibit 3.

Rocky Gap had been generating enough cash to cover its operating expenses (i.e., costs of hotel management), but not enough to cover its debt payments and non-hotel expenses, 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 audit recognizes these efforts, but the audit raises the issue that there is no comprehensive plan in place to improve the financial stability of the facility.

In its written response, the corporation advises that it has not developed a long-term plan for Rocky Gap because it has determined that the facility is not viable in the long-term under its existing business model. It is awaiting the successful bid and the award of a video lottery terminal license. Failing that, MEDCO expects bond investors to cause the sale of the facility.

The second finding is more technical, and the corporation agreed in its written response to address the issue.

Finding 2: The number of authorized signers on certain bank accounts was excessive.

DLS recommends that MEDCO comment on the findings of the legislative audit and the outlook for the Rocky Gap facility given the lack of progress in attracting a viable video lottery terminal operator to the site.

Corporation Will Advance Funds to Horse Tracks; Other Projects

Chapter 4 of the 2007 special session authorized up to 15,000 video lottery terminals (VLTs) in five locations across that State. In 2009, the VLT Location Commission rejected the Laurel Racing Association's bid to install VLTs at Laurel Racetrack due to a failure to pay the initial license fee. After a ballot measure to officially allow VLTs at a different location in Anne Arundel County, the owners of the racetracks submitted a severely reduced 2011 racing schedule to the Maryland Racing Commission, claiming that an ongoing operating deficit made it impossible to maintain the same level of racing.

In December 2010, the Racing Commission rejected the Maryland Jockey Club's proposal to significantly reduce the number of scheduled racing days, from 146 racing days in 2010 at Laurel Park and Pimlico to 77 racing days in 2011. As a result, the Jockey Club announced that it may need to lay off hundreds of employees and close Laurel Park and the Bowie training facility.

In order to prevent that eventuality, an agreement was reached between the State, the Jockey Club, and the Maryland Thoroughbred Horsemen's Association. In order to subsidize the racetrack

T00A99 – Maryland Economic Development Corporation

operations for 2011, the State will advance \$3.6 million, and the Horsemen's association will contribute \$1.7 million to the Jockey Club. The State funds will be advanced using MEDCO, which will be repaid from VLT proceeds dedicated to racetrack capital improvements at Laurel and Pimlico.

The Budget Reconciliation and Financing Act (BRFA) of 2011 includes a provision to allow racetrack capital renewal funds to be used to repay the advance from MEDCO. This agreement will allow the racetracks to operate a 2011 racing schedule similar to the 2010 racing schedule with a 146-day racing season that includes the 136th running of the Preakness at Pimlico. Other than the provision in the BRFA of 2011 to repay MEDCO, the roles of the budget committees and the rest of the General Assembly in this agreement are minimized. There does not appear to be any information from the racetrack owner regarding the specific uses of the advanced funds, nor are there any reporting requirements as a condition to receive the advance. Finally, it should be noted that the Laurel Racing Association is appealing the rejection of its proposal by the VLT Location Commission to the State Board of Contract Appeals.

Other Projects

The corporation has also provided funds for other projects that are atypical of its normal activities. For example, for the second year, the corporation is providing grant funds (\$75,000) for the Maryland Center for Construction Education and Innovation which is housed at Towson University. The center is designed to partner with private sector, universities, community colleges, and secondary schools to position construction as a career of choice, to promote the economic viability of construction in Maryland, and to serve as a resource for the industry, education, and government.

Additionally, the corporation has made a direct loan (\$500,000) to the organizers of the Baltimore Grand Prix, an Indy Racing League event that will take place in Baltimore next Labor Day weekend. A direct loan such as this has never before been made by the corporation. The loan is to cover working capital costs, and the terms include a provision that would allow the corporation an equity stake in the planned race.

DLS recommends that the BRFA of 2011 be amended to allow the transfer of racetrack redevelopment funds to MEDCO after all appeals by Laurel Racing Association, Inc. relating to the rejection of its proposal for a Video Lottery Operations license are withdrawn or exhausted.

DLS further recommends that the corporation comment on the use of its funds for projects outside its conventional financing role.

Recommended Actions

1. Nonbudgeted.