Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2012-2014
($ in Thousands)

	2012	**2013**	**2014**	**Change 2013-2014**
Total Assets	$636,681	$617,378	$595,492	-$21886
Total Liabilities	866,443	819,112	816,382	-2,730
Net Assets (Deficit)	**-$229,762**	**-$201,734**	**-$220,890**	**$-19,156**
Total Operating Revenue	$130,746	$127,855	$128,312	$457
Total Operating Expenses	118,657	115,868	115,541	-327
Operating Income Subtotal	**$12,089**	**$11,987**	**$12,771**	**$784**
Non-operating Revenues and Expenses	-$35,313	$16,041	-$31,926	-$47,967
Net Income (Deficit)	**-$23,225**	**$28,028**	**-$19,156**	**-$47,183**

Change in Net Assets (Deficit) and Income by Source
Fiscal 2012-2014
($ in Thousands)

	2012	**2013**	**2014**	**Change 2013-2014**
Operating Facilities Net Assets	-$240,419	-$201,191	-$219,943	-$18,752
Other Operations Net Assets	10,656	-543	-946	-403
Net Assets (Deficit)	**-$229,762**	**-$201,734**	**-$220,890**	**-$19,156**
Operating Facilities Net Income	-$21,843	**$39,228**	**-$18,752**	-$57,980
Other Operations Net Income	-1,382	-11,199	-403	10,796
Net Income (Deficit)	**-$23,225**	**$28,028**	**$-19,156**	**-$47,183**

Note: Other operations are comprised of property and equipment rental and consultant and management fees.

Source: Maryland Economic Development Corporation financial statements

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

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- The Maryland Economic Development Corporation's (MEDCO) net income deficit totaled -$19.2 million for fiscal 2014. However, operating income for fiscal 2014 was positive at $12.8 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 a net income deficit persists, the corporation's equity position declines. The net assets deficit grew to -$220.9 million in fiscal 2014.

- The corporation's net asset deficit is attributable to the accumulated losses of its operating facilities. The operating facilities' net income deficit increased by $58.0 million between fiscal 2013 and 2014. This dramatic increase in the deficit was a result of the one-time gain from the sale of the Rocky Gap Resort and Golf Course in fiscal 2013, a project which posted annual losses for the corporation. The corporation also experienced a net income deficit of $0.4 million for its non-operating activities.

Analysis in Brief

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses: The corporation continues to maintain a net asset deficit of $220.9 million in fiscal 2014. In addition, operating revenues continue to exceed operating expenses by a slightly larger margin than in fiscal 2013.

MEDCO's Net Assets in a Negative Position: The corporation's operating facilities have long posted negative assets due to accumulated annual losses. This is not typically the case for the corporation's activities exclusive of operating facilities. However, MEDCO had approximately -$946,000 in net assets in fiscal 2014. This compares to the 10-year average of $12.6 million.

Operating Facilities Financial Position

Net Assets Resume Downward Trend: After a one-year increase in net assets due to the sale of the Rocky Gap Resort in August 2012, operating facilities net assets declined in fiscal 2014. However, the decline is not as pronounced as it was prior to the sale of the resort. Net assets fell by $18.8 million in fiscal 2014, compared to $22.2 million in fiscal 2012.

Operating Income Increased Slightly in 2014; Three Projects Posted a Loss: Operating facilities' income was $12.4 million in fiscal 2014, an increase of $0.3 million. Three projects showed a loss, and three projects were defined as "watch" projects in the corporation's financial statement. **The Department of Legislative Services (DLS) recommends that MEDCO comment on the designation of three of its operating projects as "watch" projects.**

Other Issues

MEDCO Increasingly Involved in State Agency Projects: MEDCO was originally designed with a mission to help expand, modernize, and retain existing businesses and to attract new businesses to the State. However, it is increasingly being asked to participate in various public-sector projects that are outside its traditional economic development role. This raises issues related to how State projects are vetted and financed and whether the use of MEDCO is an appropriation option for State agencies. **DLS recommends that MEDCO comment on its involvement with State agency projects and how it addresses the concerns related to accountability and costs for these types of projects.**

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 nonrecourse 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 254 projects through fiscal 2014. Of these, MEDCO 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 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 oversees and approves actions pertaining to 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 9 regular and 1 part-time professional staff members.

In 2001, 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.

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses

MEDCO operates 14 facilities, and revenue from those facilities contributes to the corporation's bottom line. Operating revenues ($128.3 million) continue to exceed operating expenses ($115.5 million).

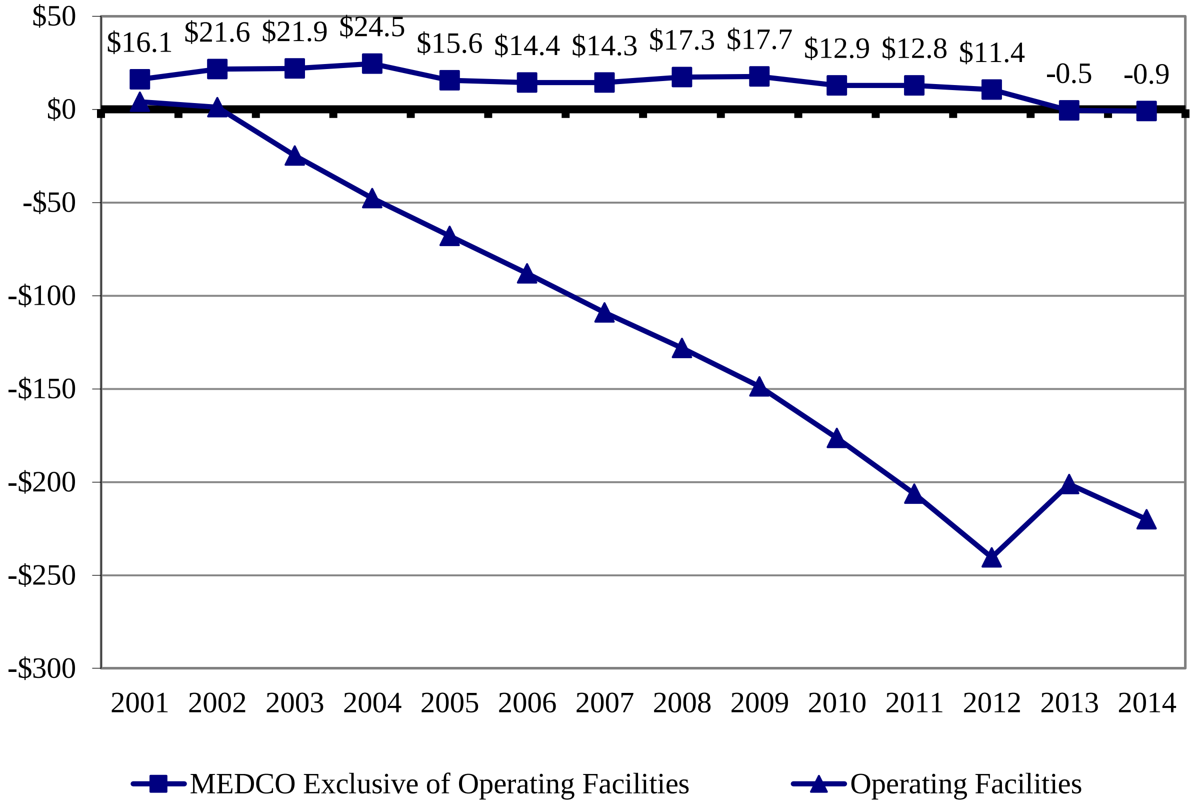
Each year, when the corporation experiences a net income deficit, the corporation's equity position declines. This has been the case for the last decade of operations. The corporation reports that a growing net assets deficit is not a significant concern as long as operating revenues exceed cash operating 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. Accordingly, MEDCO's operating position (operating revenues exceeding expenses) is positive.

MEDCO's Net Assets in a Negative Position

Exhibit 1 shows the value of MEDCO's net assets with operating facilities extracted. MEDCO, exclusive of operating facilities, had negative assets of about -$946,000 in fiscal 2014. This is inconsistent with the 10-year average of $12.6 million. These funds represent the accumulation of excess fees over operating expenses that MEDCO attains as it conducts financing transactions each year. According to the corporation, short-term non-operating losses were realized to facilitate the sale of the Rocky Gap Resort.

Although the corporation was required to realize losses due to the sale, the sale of Rocky Gap also improved the financial position of its operating portfolio. In fiscal 2013, MEDCO had 13 operating facilities in its portfolio. The net assets deficit for these facilities fell to -$201.7 million, as shown in Exhibit 1. This marked the first improvement in net assets since fiscal 2002. However, in fiscal 2014, the deficit again began to increase. The net asset deficit now stands at $220.9 million. 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. Conversely, the removal of an operating project (Rocky Gap) improves the net asset deficit position.

Exhibit 1
MEDCO Net Assets
Fiscal 2001-2014
($ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

Operating Facilities Financial Position

Net Assets Resume Downward Trend

Exhibit 2 shows the increases and decreases in MEDCO's net assets by project. Operating facilities' net assets decreased by $18.8 million in fiscal 2014. The primary driver of the decreased assets is depreciation. However, in fiscal 2014, the decline in net assets was partially offset by capital improvements at several of the corporation's operating facilities. These included new carpet and appliances at the University of Maryland, College Park housing facility; heating and ventilation improvements at the University of Maryland, Baltimore County housing facility; and, new carpet and furniture at the Salisbury University housing facility.

A new project has been added to the corporation's operating portfolio. In 2014, MEDCO entered into an agreement to provide the financing and to manage the garage associated with the Owings Mills Metro Center. Chapter 182 of 2009 gave MEDCO the authority to undertake projects related to transit-oriented development, which may be backed by tax incremental financing. MEDCO issued the bonds for this project, which will be paid from the incremental increase in the property tax on the property within the development district around the Metro center.

Exhibit 2
MEDCO Increase (Decrease) in Net Assets by Project
Fiscal 2012-2014

	2012	2013	2014	Total Net Assets (Deficit) at End of 2014
University Student Housing				
Morgan State University	$713,432	-$270,791	$169,999	-$7,402,535
Bowie State University	86,099	396,311	49,501	-5,952,964
Frostburg State University	-324,435	-608,304	11,951	-4,461,688
Salisbury University	-294,519	294,175	-674,715	-4,336,518
Towson West	-755,126	-221,081	-491,396	-4,725,139
University of Maryland, Baltimore	-504,540	-380,896	-415,702	-11,102,531
University of Maryland Baltimore County	470,066	152,626	281,042	-2,774,861
University of Maryland, College Park Housing	-1,862,265	-3,044,343	-1,249,917	-23,590,392
University Village at Sheppard Pratt	-708,274	-146,973	554,797	-10,949,331
Subtotal	***-$3,179,562***	***-$4,621,898***	***-$1,863,442***	***-$75,295,959***

	2012	**2013**	**2014**	**Total Net Assets (Deficit) at End of 2014**
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$13,895,337	-$15,581,030	-$16,495,684	-$151,204,309
Shady Grove Innovation Center	-309,850	12,135	-192,196	4,796,191
Rockville Innovation Center	-144,998	-147,757	-210,927	-577,008
Owings Mills Metro Center			-1,077,749	-1,077,749
Rocky Gap Golf Resort	-5,769,162	59,970,699	0	0
University of Maryland, College Park Energy	1,081,999	607,246	1,059,271	4,076,647
Subtotal	***-$19,037,348***	***$44,861,293***	***-$16,917,285***	***-$143,986,228***
Subtotal Operating Facilities	***-$22,216,910***	***$40,239,395***	***-$18,780,727***	***-$219,282,187***
MEDCO Exclusive of Operating Facilities	**-$1,453,358**	**-$11,271,036**	**-$403,190**	**-$946,447**
Elimination (Accounting Adjustment)	**$28,364**	**$28,364**	**$28,364**	**-$661,039**
Grand Total	**-$23,641,904**	**$28,996,723**	**-$19,155,553**	**-$220,889,673**

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

Operating Income Increased Slightly in 2014; Three 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 increased to $12.4 million in fiscal 2014, compared to $12.1 million in 2013. However, three projects posted a loss in fiscal 2013. All of the university student housing projects posted gains in each year shown, as did the University of Maryland, College Park energy project.

Exhibit 3
MEDCO Operating Income (Loss) by Project
Fiscal 2012-2014

	2012	2013	2014
University Student Housing			
Morgan State University	$2,851,454	$1,434,152	$1,531,807
Bowie State University	1,149,554	668,185	998,861
Frostburg State University	593,641	355,184	619,670
Salisbury University	417,575	1,448,194	293,709
Towson West	984,468	2,027,330	2,013,652
University of Maryland, Baltimore	1,330,651	1,420,285	1,329,044
University of Maryland Baltimore County	1,568,526	1,397,647	1,444,739
University of Maryland, College Park Housing	6,089,032	5,500,544	6,373,669
University Village at Sheppard Pratt	1,169,786	1,293,828	1,709,212
Subtotal	***$16,154,687***	***$15,545,349***	***$16,314,363***
Other Facilities			
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$3,001,517	-$5,557,686	-$6,104,479
Shady Grove Innovation Center	-282,238	-142,991	-388,158
Rockville Innovation Center	-342,328	-412,810	-374,393
Metro Center	0	0	0
Rocky Gap Golf Resort	-3,887,819	-279,027	0
University of Maryland, College Park Energy	2,952,566	2,948,845	2,950,144
Subtotal	***-$4,561,336***	***-$3,443,669***	***-$3,916,886***
Subtotal Operating Facilities	***$11,593,351***	***$12,101,680***	***$12,397,477***
MEDCO Exclusive of Operating Facilities	**$467,061**	**-$143,432**	**$403,756**
Elimination (Accounting Adjustment)	**$28,364**	**$28,364**	**-$30,684**
Grand Total	**$12,088,776**	**$11,986,612**	**$12,770,549**

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

According to the corporation's financial statement, there are three operating projects identified in fiscal 2014 as "watch" projects for failure to meet debt coverage ratios. 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 is located in Dorchester County. It houses a hotel, golf course, and conference facilities. The project has been designated as a "watch" project for the last five years. Occupancy and associated revenues have been in decline, largely due to the impact of federal sequestration and the general decline of business travel. MEDCO has secured a forbearance agreement with the bondholders and has contracted with a management consultant to suggest changes in pricing and expense reductions in order to bring the ratio closer into compliance.

- **University of Maryland, Baltimore:** The housing project at the University of Maryland, Baltimore is also a repeat project that is considered problematic in the financial statements. The project is reported to be close to 100% occupancy; however, rental rates have been depressed in the vicinity and have failed to meet the original projections. The project is able to provide revenue to make debt service payments without drawing on its debt service reserve fund; however, some operating expenses have been deferred.

- **Bowie State University:** This housing project initially encountered problems meeting its debt coverage ratio but had rebounded in recent years. However, in fiscal 2013, enrollment declined at the university; therefore, occupancy has declined. In response, the university has agreed to close a small 20-bed residence hall to encourage occupancy in the MEDCO facility. MEDCO has also contracted with a management consultant to evaluate operations and to make suggestions in order to bring the ratio closer into compliance. Also, the university and MEDCO are considering its options for refinancing the debt to lower the costs of debt service.

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, in some instances, do not want to own and operate the facilities themselves; 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.

The Department of Legislative Services (DLS) recommends that MEDCO comment on its operating projects and specifically on the designation of three projects as "watch" projects.

Other Issues

MEDCO Increasingly Involved in State Agency Projects

MEDCO was originally designed with a mission to help expand, modernize, and retain existing businesses and to attract new businesses to the State. However, it is increasingly being asked to participate in various public-sector projects that are outside its traditional economic development role; in part in response to increasing pressure on the State's capital program.

In 2011, MEDCO provided financing for the construction of the Department of Health and Mental Hygiene (DHMH) Public Health Laboratory, located in the East Baltimore development area. MEDCO owns this project and leases it with an option to purchase, to the State. Under the lease, DHMH pays rent that covers debt service, MEDCO expenses, and an operating and capital reserve fund. The bonds, which financed the project, are secured solely by the lease between MEDCO and the State, and the rent payments are subject to the annual appropriation process.

In 2014, MEDCO entered into a similar arrangement with the Maryland State Archives. The archives was in need of additional long-term storage. MEDCO provided the financing to acquire land and a facility previously used by the U.S. Social Security Administration as a record retention facility. MEDCO is the owner of the facility and leases it to the State Archives. The State Archives will make payments to MEDCO to cover the debt service and MEDCO expenses. The bonds, which financed the project, are secured by the project and the payments under the lease.

Other State projects include the Maryland Department of Transportation (MDOT) Headquarters, the Maryland Aviation Administration's Southwest Airlines Terminal, and potentially the garage at the State Center office complex. Additionally, although not structured similarly, MEDCO may also be the conduit debt issuer for the concessionaire associated with the construction of the Purple Line on behalf of MDOT.

MEDCO has significant expertise in the construction and management of projects. As such, it is unsurprising that State agencies would seek to capitalize on that expertise when considering options for financing new facilities. However, some concerns have been raised that this financing mechanism is too far outside the normal State capital budgeting process thereby missing critical elements of review and input by State policymakers including the Capital Debt Affordability Committee and legislative budget committees. Another concern is that MEDCO financing can add to the long-term cost of the project as compared to financing through the State's general obligation capital program. Typically, interest rates are higher, albeit by a slight margin, and MEDCO financing also requires additional issuances to cover capitalized interest reserves and issuances costs. Finally, there are additional concerns about whether these types of projects are structured as capital leases and, therefore, whether they count against the State's debt limits.

DLS recommends that MEDCO comment on its involvement with State agency projects and how it addresses the concerns related to accountability and costs for these types of projects.

Recommended Actions

1. Nonbudgeted.