T00A99
Maryland Economic Development Corporation

Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2013-2015
($ in Thousands)

	2013	2014	2015	Change 2014-2015
Total Assets	$631,678	$604,463	$625,928	$21,465
Total Liabilities	833,412	825,353	854,245	28,892
Net Assets (Deficit)	**-$201,734**	**-$220,890**	**-$228,317**	**$-7,427**
Total Operating Revenue	$127,855	$128,312	$132,352	$4,040
Total Operating Expenses	115,868	115,541	114,608	-933
Operating Income Subtotal	**$11,987**	**$12,771**	**$17,744**	**$4,973**
Non-operating Revenues and Expenses	$16,041	-$31,926	-$25,171	$6,755
Net Income (Deficit)	**$28,028**	**-$19,155**	**-$7,427**	**$11,728**

Change in Net Assets (Deficit) and Income by Source
Fiscal 2013-2015
($ in Thousands)

	2013	2014	2015	Change 2014-2015
Operating Facilities Net Assets	-$201,191	-$219,944	-$227,051	-$7,107
Other Operations Net Assets	-543	-946	-1,266	-320
Net Assets (Deficit)	**-$201,734**	**-$220,890**	**-$228,317**	**-$7,427**
Operating Facilities Net Income	$39,228	**-$18,752**	**-$7,107**	$11,645
Other Operations Net Income	-11,200	-403	-320	83
Net Income (Deficit)	**$28,028**	**-$19,155**	**-$7,427**	**$11,728**

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 (MEDCO) net income deficit improved in fiscal 2015 to -$7.4 million. Also, operating income for fiscal 2015 was positive at $17.7 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 asset 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 asset deficit grew to -$228.3 million in fiscal 2015. This decline was less marked than it was in fiscal 2014. The corporation increased its assets through a property acquisition, and its income improved through increases in rental income from several of its projects.

Analysis in Brief

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses: Although MEDCO continues to maintain a net asset deficit position, its operating revenues continue to exceed its operating expenses. In fact, the corporation's net operating income increased over the prior year.

MEDCO 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 true for the corporation's activities exclusive of its operating facilities. However, MEDCO has posted a third straight year of negative assets in its other activities.

Operating Facilities Financial Position

Six Operating Projects Contribute to Declining Net Assets in Fiscal 2015: After a one-year increase in net assets in fiscal 2013 due to the sale of the Rocky Gap Resort, operating facilities net assets declined in fiscal 2014 and 2015. However, the decline is less pronounced than it was prior to fiscal 2013. In fact, the decline is significantly less marked in fiscal 2015 as fewer projects are posting declining assets.

Operating Income Improved in Fiscal 2015; Four Projects Posted a Loss: Operating facilities' income was $16.7 million in fiscal 2015; an increase of $4.3 million, or 35%. However, four projects posted operating losses, and one project was defined as a "watch" project and one as "non-performing" according to the corporation's financial statement.

Other Issues

MEDCO Project Portfolio Expands: Historically, MEDCO has been involved in two types of projects: (1) operating projects – where MEDCO is involved in management decisions and has a hand in ensuring successful daily operations; and (2) conduit projects – where MEDCO generally serves only as an arms-length financing entity. However, recent projects require MEDCO to have property ownership (like operating projects), but no management duties (like conduit projects). These projects appear to negatively affect the corporation's non-operating net assets, but offer new flexible financing options.

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 businesses and to attract new businesses to the State. The stated legislative purpose of the corporation 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 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 Commerce. 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 Commerce. 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 255 projects through fiscal 2015. 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 most other projects, MEDCO generally 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 Secretary of Commerce and the Secretary of Transportation serve as *ex-officio* voting members. MEDCO activities complement the marketing and financing programs of Commerce. There are currently 8 regular and 1 part-time professional staff members.

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses

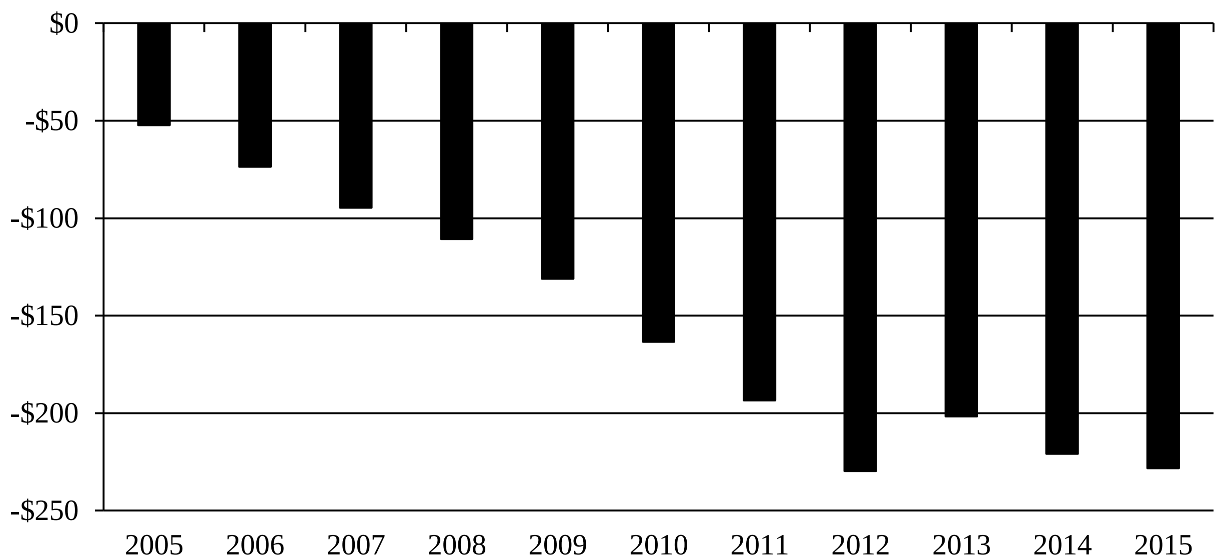
MEDCO operates 14 facilities, and revenue from those facilities contributes to the corporation's bottom line. Operating revenues ($132.4 million) continue to exceed operating expenses ($114.6 million).

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

MEDCO Net Assets in a Negative Position

Exhibit 1 shows the total value of MEDCO net assets. This represents the cumulative effect of year-over-year income deficits. Although the corporation was required to realize losses due to the sale, the sale of the Rocky Gap resort also briefly improved the corporation's financial position. In fiscal 2013, the net asset deficit 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 net asset deficit again began to increase. The net asset deficit now stands at -$228.3 million.

Exhibit 1
Maryland Economic Development Corporation Net Assets
Fiscal 2005-2015
($ in Millions)



Source: Maryland Economic Development Corporation

The net asset 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 asset deficit is largely the result of adding new operating real estate projects. MEDCO operating projects often have net income deficits as explained above, and with the addition of each 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.

Operating Facilities Financial Position

Six Operating Projects Contribute to Declining Net Assets in Fiscal 2015

Exhibit 2 shows the increases and decreases in MEDCO net assets by project. Operating facilities net assets declined by $7.1 million in fiscal 2015, and as discussed above, that is not uncommon. However, this decline was significantly less than the decline in fiscal 2014. This is largely due to grants received, but not yet expended, to repurpose the National Cybersecurity Center of Excellence. The center is housed in a MEDCO facility formerly known as the Shady Grove Innovation Center. MEDCO received grant funds through the Department of Commerce, Montgomery County, and the National Institute of Standards and Technology.

Exhibit 2
MEDCO Increase/Decrease in Net Assets by Projects
Fiscal 2013-2015

	2013	2014	2015	Total Net Assets/Deficit at End of 2015
University Student Housing				
Morgan State University	-$270,791	$169,999	$419,282	-$6,983,253
Bowie State University	-396,311	-49,501	451,217	-5,501,747
Frostburg State University	-608,304	11,951	130,461	-4,331,227
Salisbury University	294,175	-674,715	272,916	-4,063,602
Towson West	-221,081	-491,396	-114,755	-4,839,894
University of Maryland, Baltimore	-380,896	-415,702	-596,563	-11,699,094
University of Maryland Baltimore County	152,626	281,042	457,798	-2,317,063
University of Maryland, College Park Housing	-3,044,343	-1,249,917	-1,461,522	-25,051,914
University Village at Sheppard Pratt	-146,973	554,797	459,380	-10,489,951
Subtotal	***-$4,621,898***	***-$1,863,442***	***$18,214***	***-$75,277,745***

	2013	2014	2015	Total Net Assets/Deficit at End of 2015
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$15,581,030	-$16,495,684	-$13,844,214	-$165,048,523
Shady Grove Innovation Center	12,135	-192,196	7,184,742	11,980,933
Rockville Innovation Center	-147,757	-210,927	-598,027	-1,175,035
Metro Centre		-1,077,749	-1,092,369	-2,170,118
Rocky Gap Golf Resort	59,970,699	0	0	0
University of Maryland, College Park Energy	607,246	1,059,271	1,196,106	5,272,753
Subtotal	***$44,861,293***	***-$16,917,285***	***-$7,153,762***	***-$151,139,990***
Subtotal Operating Facilities	***$40,239,395***	***-$18,780,727***	***-$7,135,548***	***-$226,417,735***
MEDCO Exclusive of Operating Facilities	**-$11,271,036**	**-$403,190**	**-$319,838**	**-$1,266,285**
Elimination (Accounting Adjustment)	**$28,364**	**$28,364**	**$28,364**	**-$632,675**
Grand Total	**$28,996,723**	**-$19,155,553**	**-$7,427,022**	**-$228,316,695**

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

The corporation added a new operating project to its portfolio in fiscal 2015. It entered into a development and construction agreement with a developer to construct a parking facility at the Metro Centre at Owings Mills. The project is governed by a lease/sublease arrangement between the Maryland Transit Administration, MEDCO, and Baltimore County. MEDCO will operate the facility while under this arrangement. MEDCO financing was issued in a taxable, draw-down mode to be held by the developer for a period of time while the developer completes other mixed-use development in the area. The area is designated as a special taxing district, which will be used to service the debt.

Operating Income Improved in Fiscal 2015; Four Projects Posted a Loss

Exhibit 3 shows MEDCO operating income and loss by project. The data indicates where projects are bringing in enough revenues to cover annual operating expenses. Operating facilities' net income increased to $16.7 million in fiscal 2015 compared to $12.4 million in fiscal 2014. Revenues increased largely due to improvements in occupancy rates at several of the corporation's student housing projects. Additionally, declines in operating expenses at the Chesapeake Bay Conference Center drove the overall decline in operating expenses.

Exhibit 3
MEDCO Operating Income/Loss by Project
Fiscal 2013-2015

	2013	2014	2015
University Student Housing			
Morgan State University	$1,434,152	$1,531,807	$1,743,410
Bowie State University	668,185	998,861	1,721,021
Frostburg State University	355,184	619,670	766,322
Salisbury University	1,448,194	293,709	1,214,666
Towson West	2,027,330	2,013,652	2,140,757
University of Maryland, Baltimore	1,420,285	1,329,044	1,456,664
University of Maryland Baltimore County	1,397,647	1,444,739	1,681,944
University of Maryland, College Park Housing	5,500,544	6,373,669	6,267,049
University Village at Sheppard Pratt	1,293,828	1,709,212	1,566,242
Subtotal	***$15,545,349***	**$16,314,363**	**$18,558,075**
Other Facilities			
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$5,557,686	-$6,104,479	-$3,476,038
Natl. Cybersecurity Center of Excellence	-142,991	-388,158	-228,934
Rockville Innovation Center	-412,810	-374,393	-466,367
Metro Center	0	0	-598,775
Rocky Gap Golf Resort	-279,027	0	0
University of Maryland, College Park Energy	2,948,845	2,950,144	2,945,018
Subtotal	***-$3,443,669***	**-$3,916,886**	**-$1,825,096**
Subtotal Operating Facilities	***$12,101,680***	**$12,397,477**	**$16,732,979**
MEDCO Exclusive of Operating Facilities	**-$143,432**	**$403,756**	**$983,029**
Elimination (Accounting Adjustment)	**$28,364**	**-$30,684**	**$28,364**

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

According to the corporation's most recent financial statement, one operating project has been identified as "non-performing." This designation was made after the June 2014 debt service payment was only partially made. Further, the project fails to meet the debt coverage ratio as required in the trust indenture covering the bonds.

- **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 previous five years for failure to meet its debt coverage ratio. At the end of fiscal 2014, the center's financial designation was adjusted downward to "non-performing." Occupancy and associated revenues have been in decline for several years, largely due to the impact of federal sequestration and the general decline of business travel. Additionally, the threat of a summer hurricane in 2015 negatively affected occupancy.

  MEDCO is working with the bondholders on a forbearance agreement regarding principal and interest payments. Additionally, the facility management has worked to curb operating costs in fiscal 2015. Further, a capital reserve fund will be utilized to make improvements to the facility to increase its appeal to visitors.

One additional project has been deemed a "watch" project in fiscal 2015 for failure to meet debt coverage ratios. It should be noted that each project needs to be considered on its own merits because no MEDCO projects are cross-collateralized and each project must support its own revenues.

- **University of Maryland, Baltimore:** This housing facility at the University of Maryland, Baltimore is a project that has been repeatedly designated as a "watch" project. The project is reported to be close to 100% occupancy; however, rental rates continue to be depressed in the vicinity and have failed to meet the original projections. In 2015, MEDCO refunded and reissued the debt associated with this project. It is estimated that the refinancing will reduce annual debt service payments by 25%, saving about $3.5 million over the life of the debt.

It should be noted that another student housing project at Bowie State University is no longer designated a "watch" project in the corporation's financial statements. The recovery is two-fold: (1) occupancy rates have significantly improved; and (2) MEDCO has refunded and reissued the debt associated with the project for an estimated annual debt service savings of about $88,500.

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 generally on the status of its operating projects and specifically on the designation of the Chesapeake Bay Conference Center as "non-performing."

Other Issues

MEDCO Project Portfolio Expands

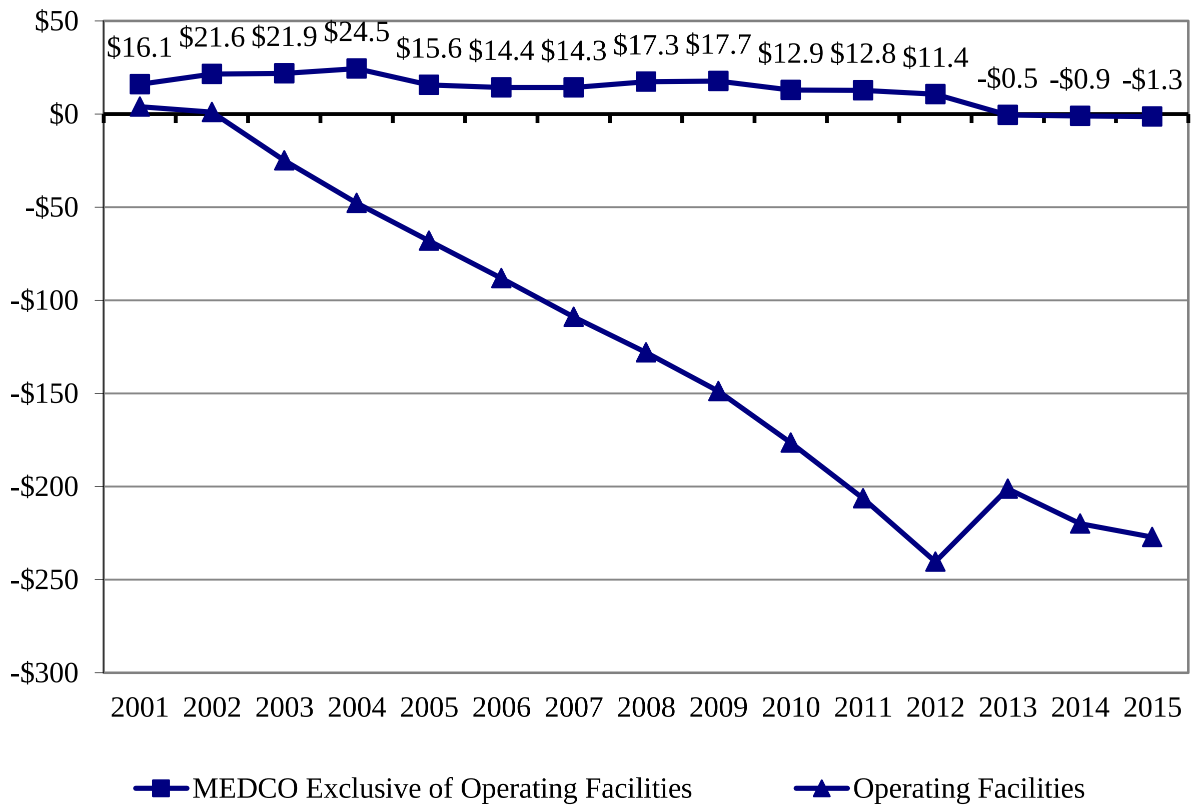
As mentioned above, MEDCO has been involved in 255 projects through fiscal 2015. Of these, MEDCO currently owns and operates 14 as operating facilities, meaning the corporation is involved in management decisions and has a hand in ensuring successful daily operations. For other projects, MEDCO generally serves as an arms-length financing entity. However, recently the corporation has begun to be involved in a third type of project – where the corporation owns a property and collects rent or other fees but is not involved in the management of the facility.

For example, in 2014, MEDCO entered into a property arrangement with the Maryland State Archives (MSA). MSA 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 MSA. MSA 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 payments under the lease. The archives, and not MEDCO, will be responsible for the day to day operations, unlike MEDCO operating projects. But also unlike its conduit issuances, MEDCO does retain property ownership.

Exhibit 4 shows the value of MEDCO net assets with operating facilities extracted. MEDCO, exclusive of its operating facilities, had negative assets of about $1.3 million in fiscal 2015. This is the third consecutive year of negative assets for MEDCO's other operations. This is inconsistent with the 10-year average of $9.7 million.

This shift in net asset value is largely due to these new types of projects that MEDCO has in its portfolio. As with its operating projects, MEDCO must now account for noncash expenses, such as depreciation, which cause the income and asset deficits. To the extent that MEDCO continues to pursue such projects, net assets will continue to decline. Additionally, this shift is occurring as MEDCO decreases its conduit (arms-length) financing activity. In fiscal 2015, the corporation was involved in only one conduit issuance.

Exhibit 4
MEDCO Net Assets – Operating and Nonoperating
Fiscal 2001-2015
($ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

It should also be noted that there are other concerns with the increased activity of MEDCO in financing State projects like the MSA facility. 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 bond 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 the increase in projects that require MEDCO ownership but where MEDCO has no operational role, including the negative impact on the corporation's net assets. MEDCO should also comment on any potential concerns about forgoing its management role in these projects and whether the legislature should expect to see similar projects in the future.

Recommended Actions

1. Nonbudgeted.

Appendix 1

Audit Findings

Audit Period for Last Audit:	May 18, 2012 – June 30, 2015
Issue Date:	January 2016
Number of Findings:	0
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

The audit did not disclose any findings.