Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2014-2016
($ in Thousands)

	2014	2015	2016	Change 2015-2016
Total Assets	$604,463	$625,928	$612,904	-$13,024
Total Liabilities	825,353	854,245	854,141	-104
Net Assets (Deficit)	**-$220,890**	**-$228,317**	**-$241,237**	**-$12,920**
Total Operating Revenue	$128,312	$132,352	$136,879	$4,527
Total Operating Expenses	115,541	114,608	120,885	6,277
Operating Income Subtotal	**$12,771**	**$17,744**	**$15,994**	**-$1,750**
Non-operating Revenues and Expenses	-$31,926	-$25,171	-$28,913	-$3,742
Net Income (Deficit)	**-$19,155**	**-$7,427**	**-$12,920**	**-$5,493**

Change in Net Assets (Deficit) and Income by Source
Fiscal 2014-2016
($ in Thousands)

	2014	2015	2016	Change 2014-2015
Operating Facilities Net Assets	-$219,944	-$227,051	-$240,294	-$13,244
Other Operations Net Assets	-946	-1,266	-942	324
Net Assets (Deficit)	**-$220,890**	**-$228,317**	**-$241,236**	**-$12,920**
Operating Facilities Net Income	-$18,752	-$7,107	-$13,244	$-6,137
Other Operations Net Income	-403	-320	324	644
Net Income (Deficit)	**-$19,155**	**-$7,427**	**-$12,920**	**-$5,493**

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 declined in fiscal 2016 to -$12.9 million. Noncash expenses, such as depreciation, and non-operating items, such as interest expense, cause the income and asset deficits, and these deficits are not uncommon for real estate projects.

- Operating income for fiscal 2016 was positive at $15.9 million, which is a key indicator of economic health. However, the fiscal 2016 net operating income was slightly less than it was in fiscal 2015.

- Each year that a net income deficit persists, the corporation's equity position declines. The net asset deficit grew to -$241.2 million in fiscal 2016. This decline was greater than the decline that was experienced in fiscal 2015, largely due to one-time property acquisitions in fiscal 2015.

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. However, net operating income was slightly less than it was in fiscal 2015.

MEDCO Net Assets in a Negative Position: The corporation's operating facilities have long posted negative assets due to accumulated annual losses. This was not typically true for the corporation's activities exclusive of its operating facilities. However, MEDCO has posted a fourth straight year of negative assets in its other activities.

Operating Facilities Financial Position

Seven Operating Projects Contribute to Declining Net Assets in Fiscal 2016: After a one-year increase in net assets in fiscal 2013 due to the sale of the Rocky Gap Resort, operating facilities net assets have continued to decline. The decline is greater than it was in fiscal 2015 due largely to declines in the Chesapeake Bay Conference Center and the University of Maryland College Park student housing facility.

Operating Income Declined in Fiscal 2016: Three Projects Posted a Loss: Operating facilities' income was $14.9 million in fiscal 2016; a decrease of $1.9 million, or 11%. However, fewer projects posted operating losses. One project was defined as "nonperforming," according to the corporation's financial statements, and one project was upgraded from a "watch" project to "performing."

Other Issues

MEDCO Project Portfolio Continues to Expand: Tight private capital markets and restricted public-sector budgets have led to increased reliance on alternative financing options for development projects. In fiscal 2016, MEDCO continued to participate in a variety of new projects to meet the current needs of the development community. Notable projects include financing for the public-private partnership on the Purple Line Light Rail Transit Project and the Maryland State Archives storage facility.

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 (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 294 projects through fiscal 2016. 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 9 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 ($136.9 million) continue to exceed operating expenses ($120.9 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. Noncash expenses, such as depreciation, and non-operating items, such as interest expense, cause the income and asset deficits, and these deficits are not uncommon for real estate projects.

The corporation reports that a growing net asset deficit is not a significant concern as long as operating revenues exceed cash operating expenses. MEDCO notes 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 reports 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.

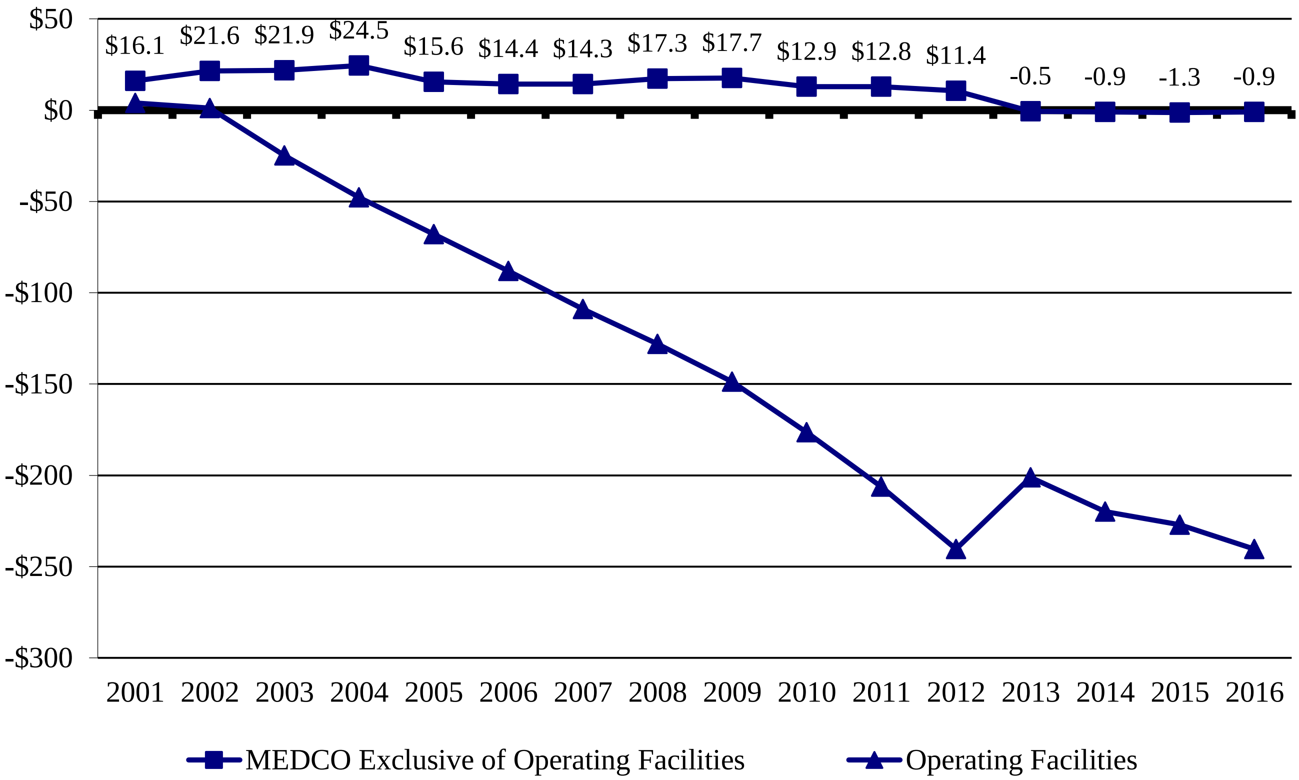
MEDCO Net Assets in a Negative Position

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. **Exhibit 1** shows the value of MEDCO net assets with operating facilities extracted. This represents the cumulative effect of year-over-year income deficits.

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 in fiscal 2013) improves the net asset deficit position.

Also in fiscal 2013, MEDCO started to be more involved in other kinds of projects where MEDCO has 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. The corporation, exclusive of its operating facilities, had negative assets of about $0.9 million in fiscal 2016. This is the fourth consecutive year of negative assets for MEDCO's other operations. This is inconsistent with the 10-year average of $8.8 million. 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. However, these other projects offer new flexible financing options and post positive cash flows; which the corporation considers to be the main barometer of success.

Exhibit 1
MEDCO Net Assets, Operating and Non-operating
Fiscal 2001-2016
($ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

Operating Facilities Financial Position

Seven Operating Projects Contribute to Declining Net Assets in Fiscal 2016

Exhibit 2 shows the increases and decreases in MEDCO net assets by project. Operating facilities net assets declined by $12.9 million in fiscal 2016, and as discussed earlier, that is not uncommon. However, this decline was significantly more than the decline in fiscal 2015. This is largely due to one-time grants received, but not yet expended, to repurpose the National Cybersecurity Center of Excellence in fiscal 2015. The center is housed in a MEDCO facility formerly known as the

Shady Grove Innovation Center. MEDCO received grant funds through Commerce, Montgomery County, and the National Institute of Standards and Technology. Additionally, net assets related to the University of Maryland, College Park housing facility declined as a result of refunded debt that lowered cash reserves and increased ground rent payments to the university.

Exhibit 2
MEDCO Increase/Decrease in Net Assets by Projects
Fiscal 2014-2016

	2014	2015	2016	Total Net Assets/Deficit at End of 2016
University Student Housing				
Morgan State University	$169,999	$419,282	-$346,323	-$7,329,576
Bowie State University	-49,501	451,217	931,508	-4,570,239
Frostburg State University	11,951	130,461	148,827	-4,182,400
Salisbury University	-674,715	272,916	259,673	-3,803,929
Towson West	-491,396	-114,755	-143,017	-4,982,911
University of Maryland, Baltimore	-415,702	-596,563	227,440	-11,471,654
University of Maryland Baltimore County	281,042	457,798	-58,905	-2,375,968
University of Maryland, College Park Housing	-1,249,917	-1,461,522	-4,604,699	-29,656,613
University Village at Sheppard Pratt	554,797	459,380	446,142	-10,043,809
Subtotal	***-$1,863,442***	***$18,214***	***-$3,139,354***	***-$78,417,099***
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$16,495,684	-$13,844,214	-$13,533,707	-$178,582,230
National Cyber Security Center of Excellence	-192,196	7,184,742	3,118,711	15,099,644
Rockville Innovation Center	-210,927	-598,027	-233,440	-1,408,475
Metro Centre	-1,077,749	-1,092,369	-835,400	-3,005,518
University of Maryland, College Park Energy	1,059,271	1,196,106	1,696,290	6,969,043
Subtotal	***-$16,917,285***	***-$7,153,762***	***-$9,787,546***	***-$160,927,536***
Subtotal Operating Facilities	***-$18,780,727***	***-$7,135,548***	***-$12,926,900***	***-$239,344,635***
MEDCO Exclusive of Operating Facilities	**-$403,190**	**-$319,838**	**$324,110**	**-$942,175**
Elimination (Accounting Adjustment)	**$28,364**	**$28,364**	**-$317,070**	**-$949,745**
Grand Total	**-$19,155,553**	**-$7,427,022**	**-$12,919,860**	**-$241,236,555**

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 Declined in Fiscal 2016: Three Projects Posted a Loss

Exhibit 3 shows MEDCO operating income and loss by project. This data indicates where projects are bringing in enough revenues to cover annual operating expenses. Operating facilities' net income decreased to $14.9 million in fiscal 2016 compared to $16.7 million in fiscal 2015.

Exhibit 3
MEDCO Operating Income/Loss by Project
Fiscal 2014-2016

	2014	2015	2016
University Student Housing			
Morgan State University	$1,531,807	$1,743,410	$964,441
Bowie State University	998,861	1,721,021	1,664,302
Frostburg State University	619,670	766,322	768,240
Salisbury University	293,709	1,214,666	1,174,635
Towson West	2,013,652	2,140,757	2,047,789
University of Maryland, Baltimore	1,329,044	1,456,664	1,395,877
University of Maryland Baltimore County	1,444,739	1,681,944	1,571,540
University of Maryland, College Park Housing	6,373,669	6,267,049	4,699,868
University Village at Sheppard Pratt	1,709,212	1,566,242	1,489,706
Subtotal	***$16,314,363***	***$18,558,075***	***$15,776,398***
Other Facilities			
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$6,104,479	-$3,476,038	-$3,171,564
National Cybersecurity Center of Excellence	-388,158	-228,934	-607,657
Rockville Innovation Center	-374,393	-466,367	-604,127
Metro Centre	0	-598,775	174,479
University of Maryland, College Park Energy	2,950,144	2,945,018	3,305,700
Subtotal	***-$3,916,886***	***-$1,825,096***	***-$903,169***
Subtotal Operating Facilities	***$12,397,477***	***$16,732,979***	***$14,873,229***
MEDCO Exclusive of Operating Facilities	**$403,756**	**$983,029**	**$1,437,319**
Elimination (Accounting Adjustment)	**-$30,684**	**$28,364**	**-$317,070**
Grand Total	**$12,770,549**	**$17,744,372**	**$15,993,478**

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 "nonperforming." 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 "nonperforming." Occupancy and associated revenues had been in decline for several years, largely due to the impact of federal sequestration and the general decline of business travel.

  MEDCO is working with the bondholders on the continuation of a forbearance agreement regarding principal and interest payments. Additionally, the facility management has worked to curb operating costs since fiscal 2015; the hotel is undergoing a room improvement program that should be completed by April 2017, and a "hospitality turn-around" consultant is working with the trustees and the hotel management to make other changes to the facility.

  Occupancy in fiscal 2016 was 57.3%. MEDCO reports that this rate has been slightly improving over the last couple years.

One additional project was upgraded in fiscal 2016 from a "watch" project to a "performing" project. The University of Maryland, Baltimore housing project had been failing to meet debt coverage ratios. In 2015, MEDCO refunded and reissued the debt associated with this project. The refunding reduced annual debt service payments by approximately $600,000, resulting in a total savings of $3.5 million over the life of the debt.

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 "nonperforming."

Other Issues

MEDCO Project Portfolio Continues to Expand

The statute that governs MEDCO specifies its mission in purposely broad terms. 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. Increasingly, the corporation is participating in a wider diversity of projects, reflecting its broad mission. Additionally, tight private capital markets and restricted public-sector budgets have led to a need for alternative financing options for development projects and increased opportunities for MEDCO participation.

As mentioned earlier, MEDCO has been involved in 294 projects through fiscal 2016. The majority of these projects are conduit projects, meaning that MEDCO generally serves only as an arms-length financing entity. In most of these cases, the entity is a nonprofit or a private-sector business. Conversely, much of the corporation's most recent activity has been initiated by State or local governments.

State Agency Projects

In fiscal 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.

As another example, in fiscal 2016, MEDCO issued over $313 million in nonrecourse private activity bonds to benefit the private-sector partner in the public-private partnership that is developing the Purple Line Light Rail Transit project between Montgomery County and Prince George's County. The proceeds of the bonds are loaned to the company to be used to (1) finance a portion of the costs of design and construction; (2) pay a portion of the interest on the bonds; (3) fund a reserve fund; and (4) pay issuance costs. Annual State payments to the project will pay the debt service on the bonds. The bonds have varying maturity dates; the first in 2022.

Legislative Projects

In fiscal 2013, the General Assembly passed Chapter 592 creating the Maryland Smart Growth Investment Fund Workgroup to make recommendations for the design and creation of an investment fund that would encourage and support smart growth in targeted areas. In its final report, the workgroup recommended that the fund be focused on real estate investments and that the fund have minimal financial investment from the State. It was further determined that MEDCO should be the "sponsor" of the fund and act as an intermediary between the State and the private sector. MEDCO agreed to develop a plan for the creation of the fund and to select a fund manager and to determine investment criteria.

In fiscal 2016, after numerous discussions with the Department of Housing and Community Development and Commerce, MEDCO announced the creation of the Maryland Targeted Communities Development Fund. The fund will be a privately managed, public-private partnership that plans to raise $50 million from private investors. The fund will initially invest in designated areas in Baltimore City and Prince George's County to support sustainable growth and transit-oriented development. MEDCO is currently pursuing private-sector investments in the fund.

Local Projects

In fiscal 2016, Baltimore County sought MEDCO's involvement in the redevelopment of Tradepoint Atlantic, the former Bethlehem Steel site in Sparrows Point. Working with Commerce and the county's economic development authority, MEDCO is developing a plan to fund real property and public infrastructure improvements to the site that will ease the development of an Under Armour distribution facility. Final plans are still under development.

Also in fiscal 2016, the Baltimore City Council approved the use of $660 million in tax-increment financing (TIF) to provide infrastructure improvements surrounding the Under Armour-led development at Port Covington in South Baltimore. It is reported that the proceeds of the TIF would fund improvements such as the removal or rerouting of existing streets, rerouting and expansion of sewers and water lines, and the addition of parks and a trolley line. Despite the council approval, concerns remained about the effect of the magnitude of the TIF on the city's credit rating. As such, the city is considering using MEDCO as the issuer. The city and the corporation are continuing their discussions of this matter.

DLS recommends that MEDCO comment on the increase in projects in fiscal 2016 and how these projects fit into its mission and the strategic economic development plan of the State.

Recommended Actions

1. Nonbudgeted.