

T00A99
Maryland Economic Development Corporation

Executive Summary

The Maryland Economic Development Corporation (MEDCO) is an instrumentality of the State of Maryland created to serve as a statewide economic development engine. MEDCO has real estate development capabilities and bond issuance powers.

Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2016-2018
(\$ in Thousands)

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>Change</u> <u>2017-2018</u>
Total Assets	\$612,904	\$545,733	\$533,089	-\$12,644
Total Liabilities	854,141	770,826	771,939	1,113
Net Assets (Deficit)	-\$241,237	-\$225,094	-\$238,850	-\$13,756
Operating Revenues				
Operating Facilities	\$131,717	\$131,719	\$133,844	\$2,125
Other	5,162	5,583	3,989	-1,594
Total Operating Revenues	\$136,879	\$137,302	\$137,833	\$531
Operating Expenses				
Operating Facilities	\$90,055	\$90,687	\$90,463	-\$224
Depreciation/Amortization	29,093	29,315	29,769	454
Administrative and Other	1,737	1,934	2,030	96
Total Operating Expenses	\$120,885	\$121,936	\$122,262	\$326
Net Operating Income	\$15,994	\$15,366	\$15,571	\$205
Net Non-operating Income	-\$28,913	\$777	-\$29,326	-\$30,103
Change in Net Position	-\$12,920	\$16,143	-\$13,756	-\$29,899
Net Position, Beginning of Year	-\$228,317	-\$241,237	-\$225,094	\$16,143
Net Position, End of Year	-\$241,237	-\$225,094	-\$238,850	-\$13,756

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

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Key Observations

- MEDCO remains in a strong financial position as income from operating projects in fiscal 2018 (\$137.8 million) exceeded expenses (\$122.3 million).
- The Chesapeake Bay Conference Center remains a nonperforming project as it continues to be unable to make full debt service payments.

Operating Budget Recommended Actions

1. Nonbudgeted.

Updates

- The former Chief Operating Officer of the Montgomery County Department of Economic Development pleaded guilty to charges of embezzling more than \$6.7 million from Montgomery County. A portion of Montgomery County's embezzled funds were disbursed by MEDCO.

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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's 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 300 projects through fiscal 2018. Of these, MEDCO currently owns and operates 15 as operating facilities, meaning that 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 Sections 10-101 through 10-132 of the Economic Development Article. 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's activities complement the marketing and financing programs of Commerce. There are currently 10 regular and 1 part-time professional staff members.

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses

MEDCO operates 15 facilities, and the revenues from those facilities contribute to the corporation's bottom line. In fiscal 2018, operating revenues (\$137.8 million) continued to exceed

operating expenses (\$122.3 million). However, the corporation experienced a net income deficit; and as such, the corporation's equity position declined. With the exception of fiscal 2017 when MEDCO sold a property, 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.

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 added another student housing project to its portfolio last year. The \$12.8 million facility opened in August 2018 at Capitol Technology University in Prince George's County.

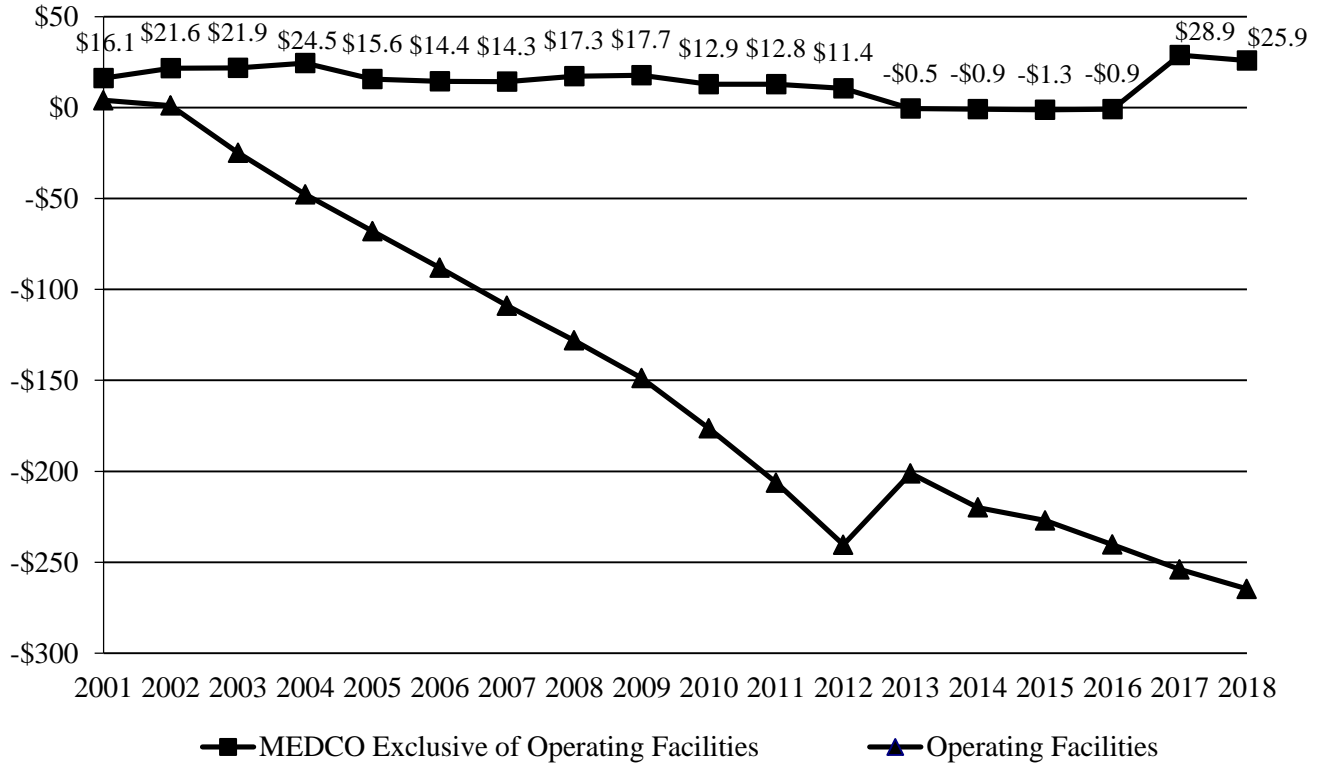
MEDCO Net Assets in a Negative Position

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 both the net assets of MEDCO facilities that it operates and the net assets of the facilities it does not operate. The net assets are comprised primarily of the value of the properties offset by outstanding debt or capital lease obligations. The large negative net assets of the operating project are due to the cumulative effect of year-over-year income deficits.

The net asset deficit began to grow dramatically in fiscal 2003 when MEDCO greatly expanded its operating facility portfolio, including the Chesapeake Bay Conference Center (CBCC) 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; with the addition of each project, a net income deficit is added to the accounts, that 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.

MEDCO's involvement in conduit projects, which it does not operate, also impacts the corporation's position as facilities are added to the portfolio or debt is retired. The corporation sold the Human Genome Sciences building in fiscal 2017 that resulted in a noncash gain in net assets of \$28.3 million. The recognized gain is the result of the early debt retirement offset by the depreciated book value of the property. Primarily due to that sale, MEDCO remained in a positive net position (\$25.9 million) exclusive of operating facilities in fiscal 2018. The net position did decline, however, due to a \$4.5 million noncash loss due to the transfer of ownership of the University of Maryland Baltimore County Technology Center Building after debt was retired.

Exhibit 1
MEDCO Net Assets, Operating and Non-operating
Fiscal 2001-2018
(\$ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

Operating Facilities Financial Position

Net Assets Weighed Down by CBCC

Exhibit 2 shows the increases and decreases in MEDCO net assets by project. Operating facilities net assets decreased by \$10.6 million in fiscal 2018. As discussed earlier, the decline is not uncommon. This is primarily due to a decline at CBCC, discussed further in the analysis. The Towson West project also saw a decline in net assets of \$2.0 million in fiscal 2018, due to a noncash loss recognized at the Towson Millennium Hall Project.

Exhibit 2
MEDCO Increase/Decrease in Net Assets by Project
Fiscal 2016-2018
(\$ in Millions)

	<u>2016</u>	<u>2017</u>	<u>2018</u>	Total Net Assets (Deficit) at End of 2018
University Student Housing				
Morgan State University	-\$346,323	\$409,468	-\$150,755	-\$7,070,863
Bowie State University	931,508	223,773	224,630	-4,121,836
Frostburg State University	148,827	190,585	259,619	-3,732,196
Salisbury University	259,673	265,930	416,773	-3,121,226
Towson West	-143,017	-35,618	-2,038,270	-7,056,799
Capitol Technology University	n/a	n/a	2,715,688	2,715,688
University of Maryland, Baltimore Campus	227,440	216,568	178,834	-11,076,252
University of Maryland Baltimore County	-58,905	861,431	784,125	-730,412
University of Maryland, College Park Campus Housing	-4,604,699	66,092	1,869,503	-27,721,018
University Village at Sheppard Pratt	446,142	328,280	464,040	-9,251,489
Subtotal	-\$3,139,354	\$2,526,509	\$4,724,187	-\$71,166,403
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-\$13,533,707	-\$15,298,550	-\$15,588,241	-\$209,469,021
National Cybersecurity Center of Excellence	3,118,711	-362,042	-469,005	14,268,597
Rockville Innovation Center	-233,440	-116,698	-508,787	-2,033,960
Metro Centre	-835,400	-2,491,411	-669,142	-6,166,071
University of Maryland, College Park Campus Energy	1,696,290	1,990,176	1,920,617	10,879,836
Subtotal	-\$9,787,546	-\$16,278,525	-\$15,314,558	-\$192,520,619
Subtotal Operating Facilities	-\$12,926,900	-\$13,752,016	-\$10,590,371	-\$263,687,022
MEDCO Exclusive of Operating Facilities	\$324,110	\$29,848,913	-\$3,022,934	\$25,883,804
Elimination (Accounting Adjustment)	-\$317,070	\$46,079	-\$142,238	-\$1,045,904
Grand Total	\$12,919,860	\$16,142,976	-\$13,755,543	-\$238,849,122

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

Three Projects Post Losses

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 increased to \$13.8 million in fiscal 2018 compared to \$12.9 million in fiscal 2017.

Exhibit 3
MEDCO Operating Income/Loss by Project
Fiscal 2016-2018
(\$ in Millions)

	<u>2016</u>	<u>2017</u>	<u>2018</u>
University Student Housing			
Morgan State University	\$964,441	\$1,669,499	\$1,093,107
Bowie State University	1,664,302	920,817	883,617
Frostburg State University	768,240	794,079	840,273
Salisbury University	1,174,635	1,143,012	1,232,414
Towson West	2,047,789	2,458,869	2,556,957
Capitol Technology University	n/a	n/a	n/a
University of Maryland, Baltimore Campus	1,395,877	1,489,558	1,275,948
University of Maryland Baltimore County	1,571,540	1,521,694	1,366,713
University of Maryland, College Park Campus Housing	4,699,868	5,070,783	6,442,069
University Village at Sheppard Pratt	1,489,706	1,362,667	1,364,033
Subtotal	\$15,776,398	\$16,430,978	\$17,055,131
Other Facilities			
Chesapeake Bay Conference Center (Hyatt Cambridge)	-\$3,171,564	-\$4,960,606	-\$5,410,647
Natl. Cybersecurity Center of Excellence	-607,657	-1,171,626	-959,088
Rockville Innovation Center	-604,127	-684,569	-803,632
Metro Centre	174,479	-29,962	693,883
University of Maryland, College Park Campus Energy	3,305,700	3,363,598	3,219,327
Subtotal	-\$903,169	-\$3,483,165	-\$3,260,157
Subtotal Operating Facilities	\$14,873,229	\$12,947,813	\$13,794,974
MEDCO Exclusive of Operating Facilities	\$1,437,319	\$2,372,569	\$1,917,933
Elimination (Accounting Adjustment)	-\$317,070	\$46,079	-\$142,238
Grand Total	\$15,993,478	\$15,366,461	\$15,570,669

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

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As it has been since 2014, the CBCC operating project remains a “nonperforming” project. 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.

CBCC is located in Dorchester County and houses a hotel, golf course, and conference facilities. MEDCO had a forbearance agreement with bondholders through December 31, 2018, and is working on a continuation agreement. In recent years, the bond trustee has extended the agreement two months or three months after the expiration of the prior period. The corporation expects that to continue. While the project continues to be unable to meet its full debt obligation, it does generate enough revenue for MEDCO to make interest payments. A room improvement plan was completed in December, and MEDCO will be spending approximately \$2 million for other improvements at the facility. Occupancy rates at CBCC have generally been around 55% since fiscal 2013; in fiscal 2018, occupancy was at 54.2%, a slight increase over the prior year. The corporation states that a 60% occupancy rate would be needed to generate cash flow sufficient to fully fund debt service. CBCC is the only nonperforming project.

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

Operating Budget Recommended Actions

1. Nonbudgeted.

Updates

1. Montgomery County Embezzlement Case Involved MEDCO

Mr. Byung Il “Peter” Bang, former Chief Operating Officer of the Montgomery County Department of Economic Development (MC-DED), recently pleaded guilty to wire fraud and tax charges for embezzling more than \$6.7 million from Montgomery County. From 2010 until 2016, Mr. Bang was the Chief Operating Officer of MC-DED, at which point the office was privatized. Mr. Bang then moved to Montgomery County’s Department of Finance.

The MC-DED established business incubator and/or innovation centers throughout the county with different areas of focus such as computer technology; biological technology; and small, minority and women-owned businesses to help small businesses by giving them below-market rent, placing them in an environment with other small businesses, and providing education on how to run a business. As the Chief Operating Officer of MC-DED, Mr. Bang oversaw budgets for these incubators and was authorized to request disbursement of county funds to the incubators. Mr. Bang’s position also enabled him to authorize and direct the disbursement of money from county partners, including MEDCO, without any significant oversight or approval.

Montgomery County contracted with MEDCO to manage the operations of the county’s business incubators and provided MEDCO with funding for the incubators’ operational and other economic development costs. At the county’s request and authorization, MEDCO would provide funding to accounts that, unknown to MEDCO, were set up and controlled by Mr. Bang. The plea agreement noted that MEDCO provided \$1,213,988 at Montgomery County’s direction to bank accounts controlled by Mr. Bang.