Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2004-2006
($ in Thousands)

	Fiscal 2004	Fiscal 2005	Fiscal 2006	Change FY 05-06
Net Assets	$1,689,613	$1,703,519	$1,893,244	$189,724
Net Liabilities	1,712,806	1,755,811	1,966,952	211,141
Fund Equity	**-$23,193**	**-$52,292**	**-$73,709**	**-$21,416**
Total Revenue	$86,464	$105,240	$112,360	$7,120
Total Expenditures	106,693	134,339	133,776	-563
Net Income	**-$20,229**	**-$29,099**	**-$21,416**	**$7,683**

- The net income deficit was reduced by $7.7 million in fiscal 2006, bringing it from -$29.1 million to -$21.4 million.
- Growth in liabilities outpaced the growth in assets in fiscal 2006, resulting in a $21.4 million decline in fund equity.

Maryland Economic Development Corporation Financial Statement
Change in Fund Equity and Net Income by Source
Fiscal 2004-2006
($ in Thousands)

	Fiscal 2004	Fiscal 2005	Fiscal 2006	Change FY 05-06
Operating Facilities	-$46,895	-$67,916	-$88,016	-$20,100
Other Operations	23,702	15,624	14,308	-1,317
Fund Equity	**-$23,193**	**-$52,292**	**-$73,709**	**-$21,416**
Operating Facilities	-22,791	-21,022	-20,100	922
Other Operations	2,561	-8,077	-1,317	6,761
Net Income/-Deficit	**-$20,229**	**-$29,099**	**-$21,416**	**$7,683**

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

Source: Maryland Economic Development Corporation financial statements

- Most of the Maryland Economic Development Corporation's (MEDCO) deficit is attributable to the accumulated losses of its operating facilities. In fiscal 2006, $20.1 million of the $21.4 million net income deficit was from operating losses.

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

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Analysis in Brief

Overall Financial Position

Income Deficit Is Reduced but Equity Position Continues to Weaken: The income deficit was reduced by $7.7 million in fiscal 2006 but equity declined to -$73.7 million.

Number of Projects Multiplies; Growth in Debt Outpaces Assets: As the number of projects has increased, both assets and debt have nearly reached $2 billion. In all but two years since fiscal 1999, the growth rate in non-recourse debt exceeded the growth rate in net assets.

Operating Facilities Financial Position

Net Assets Increase but University Student Housing Assets Decline in 2006: There was a gain in overall net assets in fiscal 2006; however, university student housing projects saw assets decline by $10.2 million.

Operating Income and Loss – Two of Eight University Projects Had Losses in 2006: Although five of the eight university student housing projects had a drop in operating income from fiscal 2005 to 2006, all but two are covering their operating expenses.

MEDCO Reports That the University Projects Are Fundamentally Sound: When MEDCO became involved in the university student housing projects in 1999, it studied the health of the projects' assets and found them to be solid. The agency is working to remedy current problems and to prevent future ones. **The Department of Legislative Services recommends that MEDCO comment on the operating income outlook for its university housing projects.**

Operating Income and Loss – Other Projects: Among other projects, Chesapeake Hills Golf Course and Rocky Gap Golf Resort are not covering their operating expenses. Although the Chesapeake Bay Conference Center is covering its operating expenses, its income decreased in fiscal 2006.

Recommended Actions

1. Nonbudgeted.

Updates

New Accounting Firm Hired; Timely Financial Statements Submitted: MEDCO submitted its fiscal 2006 financial statements to the Department of Legislative Services in November 2006. This submission date provided adequate time for review and analysis.

Operating Budget Analysis

Program Description

The Maryland Economic Development Corporation (MEDCO) is a nonbudgeted entity created in 1984 that allows the State to own or develop property for economic development purposes. MEDCO's mission is 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 or of MEDCO, and there is no implied State guaranty or State obligation to protect bondholders from losses.

The corporation is governed by statute under Article 83A, Sections 5-201 through 5-216. 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 nine full-time and two 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 (MEDRBA) and economic development revenue bond enabling legislation in effect in other states that compete for opportunities. Specifically, 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.

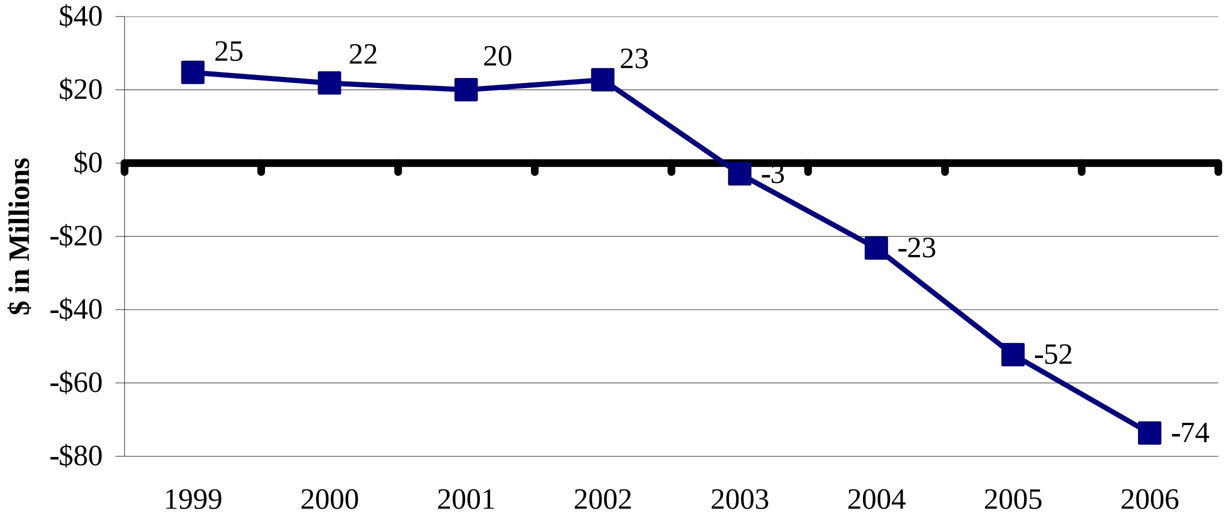
MEDCO's Overall Financial Position

Income Deficit Is Reduced but Equity Position Continues to Weaken

The net income deficit was reduced by $7.7 million in fiscal 2006, bringing it from -$29.1 million to -$21.4 million, as shown in the first table on page 1 of this analysis. (The data on page 1 are based on the MEDCO financial statements prepared by Stout Causey Horning of Hunt Valley, Maryland.) This development was the result of revenues increasing by $7.1 million, and expenditures decreasing slightly ($563,000) at the same time.

However, as the income deficit persists, MEDCO's equity position worsens. The first table on page 1 shows that assets increased by $189.7 million from fiscal 2005 to 2006 but liabilities grew by $211.1 million, resulting in a $21.4 million decline in fund equity. As recently as fiscal 2002, MEDCO had a positive equity position of $22.7 million, as shown in **Exhibit 1**.

Exhibit 1
MEDCO Equity
Fiscal 1999-2006



Source: Maryland Economic Development Corporation

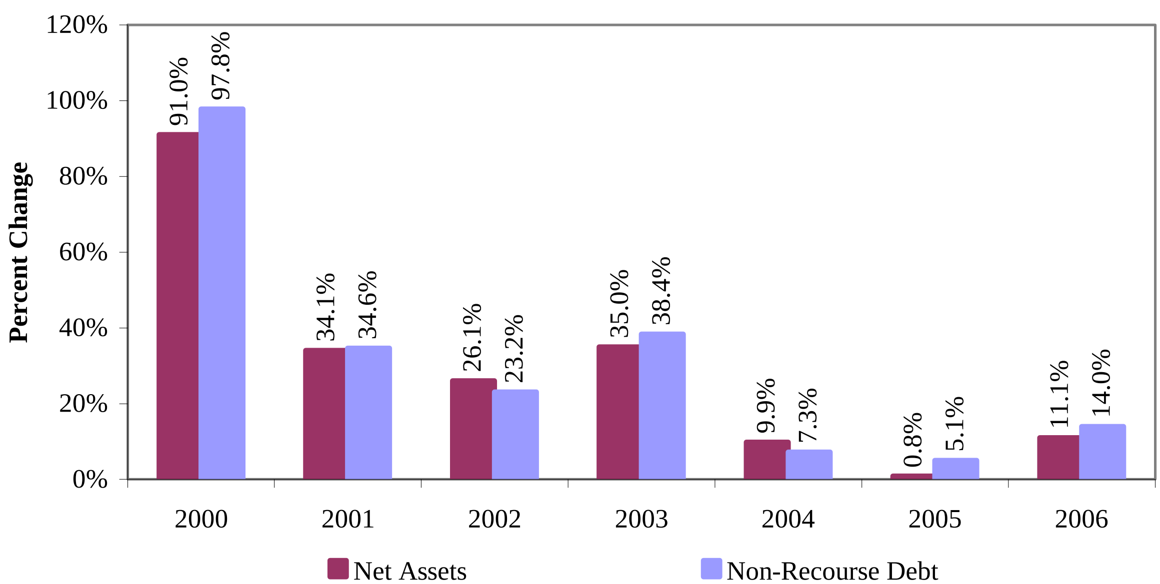
As indicated in the second table on page 1 of this analysis, most of MEDCO's deficit is attributable to the accumulated losses of its operating facilities. In fiscal 2006, $20.1 million of the $21.4 million net income deficit was from operating losses. Collectively, the losses in operating facilities increased dramatically from $4.9 million in fiscal 2002 to $25.2 million in 2003, and there has been little improvement since.

Number of Projects Multiplies; Growth in Debt Outpaces Assets

MEDCO has significantly increased its financial assistance activity since fiscal 1999. The cumulative number of projects assisted by MEDCO increased from 89 in fiscal 1999 to 191 in 2006. In fiscal 2006, MEDCO provided financing for nine new projects: two manufacturing facilities, three nonprofit entities, two energy production companies, and two student housing facilities. MEDCO also administered two State grants, one for a wood-pellet fuel market feasibility study on behalf of the Maryland Forest Service and one for an environmental feasibility study of potential facilities related to federal Base Realignment and Closure actions on behalf of DBED.

As a result of the growth in projects, MEDCO's debt and assets have increased significantly. **Exhibit 2** shows that debt and assets nearly doubled in fiscal 2000, and they averaged 30% growth each year from 2001 to 2003. Growth rates have been lower in the last few years but both debt and assets were edging toward $2 billion in fiscal 2006.

Exhibit 2
MEDCO Assets and Debt
Fiscal 1999-2006



	1999	2000	2001	2002	2003	2004	2005	2006
Net Assets ($ in Millions)	$353	$674	$904	$1,139	$1,538	$1,690	$1,704	$1,893
Non-recourse Debt ($ in Millions)	$321	$635	$855	$1,053	$1,457	$1,563	$1,642	$1,872
Projects (Cumulative)	89	108	124	143	160	172	182	191

Source: Maryland Economic Development Corporation

Since fiscal 1999 the growth rate in non-recourse debt exceeded the growth rate in net assets in all but two years. In fiscal 2006 specifically, long-term debt increased from bond issuances of $92.4 million for acquiring two student housing projects at the University of Maryland, College Park (UMCP) and $232.0 million for two large conduit debt issuances for utility projects.

Operating Facilities Financial Position

Net Assets Increase but University Student Housing Assets Decline in 2006

Exhibit 3 shows the increases and decreases in MEDCO's net assets by project. These data indicate whether projects are bringing in enough revenue to cover not only their operating expenses but also their debt expenses. Overall, assets decreased by $29.1 million in fiscal 2005, and they decreased by $21.4 million in 2006; in other words, the decrease was improved by $7.7 million in 2006. Most ($6.2 million) of the facility asset gain was due to the sale of Compass Pointe Golf Course on July 1, 2005, and corresponding elimination of the Compass Pointe operating loss.

Exhibit 3
MEDCO Increase (Decrease) in Net Assets by Project
Fiscal 2004-2006

	Fiscal 2004	Fiscal 2005	Fiscal 2006	Total
MEDCO Exclusive of Facilities	**$2,644,987**	**-$8,446,050**	**-$1,340,606**	**-$7,141,669**
University Student Housing				
Morgan State University	-$1,427,792	-$947,843	-$1,700,979	-$4,076,614
Bowie State University	0	-69,592	-1,515,874	-1,585,466
Frostburg State University	-530,983	-770,719	-278,592	-1,580,294
Salisbury University	0	-84,992	-423,166	-508,158
University of Maryland, Baltimore	0	-1,482,195	-2,061,997	-3,544,192
University of Maryland Baltimore County	132,703	-891,383	-1,375,103	-2,133,783
University of Maryland, College Park Housing	-195,570	-539,956	-1,864,020	-2,599,546
University Village	-1,544,504	-1,364,984	-992,184	-3,901,672
Subtotal	**-$3,566,146**	**-$6,151,664**	**-$10,211,915**	**-$19,929,725**
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$13,898,041	-$7,894,846	-$10,060,537	-$31,853,424
Chesapeake Hills Golf Course	-372,236	-526,601	-632,314	-1,531,151
Compass Pointe Golf Course*	-1,186,771	-2,735,114	3,422,385	-499,500
Maryland Technology Development Center	-25,174	181,833	173,544	330,203
Rocky Gap Golf Resort	-5,573,876	-4,316,759	-3,973,208	-13,863,843
University of Maryland, College Park Energy	1,831,319	814,316	1,182,138	3,827,773
Elimination	-83,802	-24,386	24,020	-84,168
Grand Total	**-$20,229,740**	**-$29,099,271**	**-$21,416,493**	**-$70,745,504**

*MEDCO sold Compass Pointe Golf Course to Anne Arundel County in fiscal 2006.

Source: Maryland Economic Development Corporation

As a whole, university student housing projects saw assets decline by $6.0 million in fiscal 2005 and another $10.2 million in 2006. Since fiscal 2004, student housing project assets have declined by $19.9 million. Both Bowie State University (BSU) and UMCP experienced asset declines of more than $1.0 million from fiscal 2005 to 2006. In the case of UMCP, the decline is due to the acquisition of two additional housing projects and the associated interest and depreciation expenses.

Operating Income and Loss – Two of Eight University Projects Had Losses in 2006

Exhibit 4 shows MEDCO operating income and loss by project. These data indicate whether projects are bringing in enough revenues to cover annual operating expenses. Five of the eight university student housing projects had a drop in operating income from fiscal 2005 to 2006. However, all but two are covering their operating expenses.

Exhibit 4
MEDCO Operating Income (Loss) by Project
Fiscal 2004-2006

	Fiscal 2004	Fiscal 2005	Fiscal 2006	Total
MEDCO Exclusive of Facilities	**$7,498,797**	**$6,628,627**	**$5,674,328**	**$19,801,752**
University Student Housing				
Morgan State University	$565,674	$1,198,552	$389,817	$2,154,043
Bowie State University	0	779,808	-483,659	296,149
Frostburg State University	353,700	238,705	712,325	1,304,730
Salisbury University	0	514,090	260,863	774,953
University of Maryland, Baltimore	0	-72,874	-290,092	-362,966
University of Maryland Baltimore County	387,005	292,571	975,747	1,655,323
University of Maryland, College Park Housing	411,569	1,797,301	1,372,386	3,581,256
University Village	481,737	723,938	895,595	2,101,270
Subtotal	**$2,199,685**	**$5,472,091**	**$3,832,982**	**$11,504,758**
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$2,033,927	$2,893,169	$2,487,784	$3,347,026
Chesapeake Hills Golf Course	-47,177	-182,545	-201,888	-431,610
Compass Pointe Golf Course*	-315,166	-717,894	0	-1,033,060
Maryland Technology Development Center	1,056	197,714	151,268	350,038
Rocky Gap Golf Resort	-2,707,249	-1,469,861	-1,157,775	-5,334,885
University of Maryland, College Park Energy	-2,712,662	3,639,999	3,531,249	4,458,586
Elimination	-83,802	-24,386	24,020	-84,168
Grand Total	**$1,799,555**	**$16,436,914**	**$14,341,968**	**$32,578,437**

* MEDCO sold Compass Pointe Golf Course to Anne Arundel County in fiscal 2006.

Source: Maryland Economic Development Corporation

It should be restated that each project needs to be considered on its own merits because no MEDCO projects are cross-collateralized and each project must support itself with its own revenues. Following are details about several MEDCO university housing projects:

- **Morgan State University (MSU):** The MSU housing project covered its operating expenses in fiscal 2006, but it experienced an $808,735 decrease in income. MSU has had difficulty in collecting room and board payments from students. On the expenditure side, the project incurred increased operating costs for security, utilities, and bad debt. MEDCO reports that the on-site management company was replaced in 2006 because of poor performance; American Campus Communities is the new management company. The new company is taking stronger measures to collect debts, including eviction proceedings. As of December 2006, the occupancy rate at MSU was 97.5%.

- **Bowie State University:** The BSU housing project had a $483,659 operating loss in fiscal 2006, which represents a $1.3 million decrease from 2005 income. On the revenue side, BSU has had difficulty in collecting rent payments from students. Part of the problem was that the prior management company did not keep accurate accounts of how much students owed. MEDCO reports that the on-site management company was replaced at BSU in May 2006 because of poor performance; Capstone is the new management company. On the expenditure side, the project incurred increased operating costs for security personnel and bad debt. As of December 2006, the occupancy rate at BSU was 98.6%.

- **University of Maryland, Baltimore (UMB):** The UMB housing project had a $290,092 operating loss in fiscal 2006, representing a $217,218 decrease from 2005 income. There has been a problem with low occupancy rates because the prior management company did not work to complete leases in the summer before the start of the academic year. MEDCO reports that the on-site management company was replaced, and Capstone is the new company. As of December 2006, the occupancy rate at UMB was 98.8%.

MEDCO Reports That the University Projects Are Fundamentally Sound

MEDCO reports that the university housing projects should not be problematic. The universities approached MEDCO in 1999 to participate in these projects because their customary bond issuer – the Collegiate Housing Foundation – came under investigation by the Internal Revenue Service. At that time, MEDCO studied the health of the projects' assets and found them to be solid. Much of the problems at MSU, BSU, and UMB rested with the prior management companies, and all three now have new management companies. MEDCO reports that it told the University System of Maryland that if it is to finance housing projects in the future, it wants to be involved in selecting not only the management companies, but the construction managers and developers. In this way, MEDCO can help prevent problems in the first place that affect revenues.

Given the steps it has taken to remedy problems, MEDCO expects the fiscal picture for the university housing projects to improve in fiscal 2007. Occupancy rates at least are looking up. As of December 2006, all the projects, except for Frostburg State University (FSU), are at or close to 100% occupancy. (MEDCO is currently discussing the occupancy problem at FSU with the university's new president and suggesting ways to improve referrals to the housing project.) Furthermore, when depreciation and other noncash expenses are added back in, the university projects have a good cash flow position.

However, MEDCO cautions that although operating income has room to improve in a number of the housing projects, the projects' net assets may always be in deficit. This is because 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. 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 the operating income outlook for its university housing projects.**

Operating Income and Loss – Other Projects

Among other projects, Chesapeake Hills Golf Course and Rocky Gap Golf Resort are not covering their operating expenses, as shown in Exhibit 4. Although the Chesapeake Bay Conference Center (CBCC) is covering its operating expenses, operating income decreased in fiscal 2006. Income for Compass Pointe Golf Course is zero in fiscal 2006 because MEDCO sold this project to Anne Arundel County. Following are details about several key MEDCO projects:

- **Chesapeake Bay Conference Center:** CCBC is a 400-room hotel and golf resort in Cambridge. The project had a higher occupancy rate and a higher average room rate in fiscal 2006, resulting in higher revenues from hotel operations. However, the project had a net $405,385 decrease in operating income in fiscal 2006. MEDCO reports that much of the expenses responsible for the decrease are legal fees and engineering services related to a dispute with the contractor. The sliding glass doors leading to the balconies of the hotel rooms leak water into the rooms during heavy rains. The contractor contends that these leaks are a result of flawed design and that the architects are responsible. MEDCO contends that these are construction defects and that the contractor is responsible.

  MEDCO was concerned that pursuing litigation to get funds to fix the doors would take several years, and in the meantime the hotel rooms would have to be continuously cleaned and repaired from water damage. Instead, MEDCO refinanced the project, which provided some cash to fix the doors. The demand for the refinancing bonds was high, MEDCO reports, and the indenture has more favorable provisions so MEDCO may pay for facility expenses out of cash flow, which previously was not possible. The balance on the bonds is $164.12 million as of October 2006.

  In short, MEDCO reports that CCBC operating activities are strong and that noncash expenses are what is negatively affecting the income. Noncash expenses include depreciation, MEDCO fees, the ground lease, 75% of the Hyatt management fee, and the asset management fee.

- **Chesapeake Hills Golf Course:** Chesapeake Hills Golf Course is in Calvert County just north of Solomons. The project is experiencing continued operating losses. When the property went for sale in fiscal 2002, the county purchased it to maintain it as a golf course rather than see it developed into housing. However, the project is not profitable as a golf course. The county's obligation to pay debt service ends in May 2008, and MEDCO reports that the outlook for this project is unclear.

- **Rocky Gap Lodge and Golf Resort:** Rocky Gap consists of a 220-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 operating losses, totaling $1.2 million in fiscal 2006 alone. A recent study indicated that expanded meeting space and upgrades to the pool, spa, and restaurant could improve revenues. Improvements were made and, in fact, revenues increased in fiscal 2006 due to a higher occupancy rate, a higher average room rate, and a full year of operations for its expanded meeting space.

  Although Exhibit 4 shows negative income for Rocky Gap, the project is covering its cash operating expenses. MEDCO reports that noncash expenses, such as depreciation, the ground lease, and MEDCO fees, are negatively affecting income. The project may never be able to afford its debt payments; total debt currently is $26.2 million. The agency says that Rocky Gap's cash flow could be improved if its debt is restructured to get a lower interest rate and to allow operating costs to be paid before debt. The forbearance agreement with bondholders has been extended to June 2007; the agreement is that $50,000 a month is paid to investors if the project has at least $500,000 in working capital.

Recommended Actions

1. Nonbudgeted.

Updates

1. New Accounting Firm Hired; Timely Financial Statements Submitted

Article 83A Title 5-212 requires MEDCO to provide a financial statement to the General Assembly on or before November 1 following the end of each fiscal year. MEDCO submitted its fiscal 2006 annual report and financial statements to the Department of Legislative Services on November 7, 2006. Although the submission date did not quite meet the statutory deadline, it provided enough time for DLS to review and analyze the information.

Previously, MEDCO had not submitted financial statements in a timely manner since at least fiscal 2001. MEDCO retained a new accounting firm – Stout Causey Horning of Hunt Valley, Maryland – to perform its financial audit because the previous firm – KPMG – had continuously failed to complete the audit according to schedule. MEDCO reports that in its request for proposals to perform the work, it asked for responses from large regional firms (with at least 100 accountants) rather than one of the "big four" accounting firms. At this point, the financial statement predicament appears to be resolved.