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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 2017-2019
(\$ in Thousands)

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Change</u> <u>2018-2019</u>
Total Assets	\$545,733	\$533,089	\$539,020	\$5,930
Total Liabilities	770,826	771,939	808,900	36,961
Net Assets (Deficit)	-\$225,094	-\$238,849	-\$269,880	-\$31,031
Operating Revenues				
Operating Facilities	\$131,719	\$133,844	\$139,830	\$5,986
Other	5,583	3,990	2,262	-1,728
Total Operating Revenues	\$137,302	\$137,833	\$142,091	\$4,258
Operating Expenses				
Operating Facilities	\$90,687	\$90,463	\$96,866	\$6,403
Depreciation/Amortization	29,315	29,769	30,824	1,055
Administrative and Other	1,934	2,030	2,097	67
Total Operating Expenses	\$121,936	\$122,262	\$129,787	\$7,525
Net Operating Income	\$15,366	\$15,571	\$12,304	-\$3,266
Net Non-operating Income	\$777	-\$29,326	-\$43,335	-\$14,009
Change in Net Position	\$16,143	-\$13,756	-\$31,031	-\$17,276
Net Position, Beginning of Year	-\$241,237	-\$225,094	-\$238,849	-\$13,756
Net Position, End of Year	-\$225,094	-\$238,849	-\$269,880	-\$31,031

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

For further information contact: Emily R. Haskel

Phone: (410) 946-5530

Key Observations

- MEDCO remains in a strong financial position as income from operating projects in fiscal 2019 (\$142.1 million) exceeded expenses (\$129.8 million).
- The Chesapeake Bay Conference Center remains a nonperforming project as it continues to be unable to make full debt service payments. One of MEDCO’s conduit projects was placed in “watch” status in June 2019.

Operating Budget Recommended Actions

1. Nonbudgeted.

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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 307 projects through fiscal 2019. Of these, MEDCO currently owns and operates 14 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 11 regular and 1 part-time professional staff members.

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses

MEDCO operated 16 facilities in fiscal 2019 but disposed of 2 in August 2018; the revenues from those facilities contribute to the corporation's bottom line. In fiscal 2019, operating revenues

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(\$142.1 million) continued to exceed operating expenses (\$129.8 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 net income and net asset deficits.

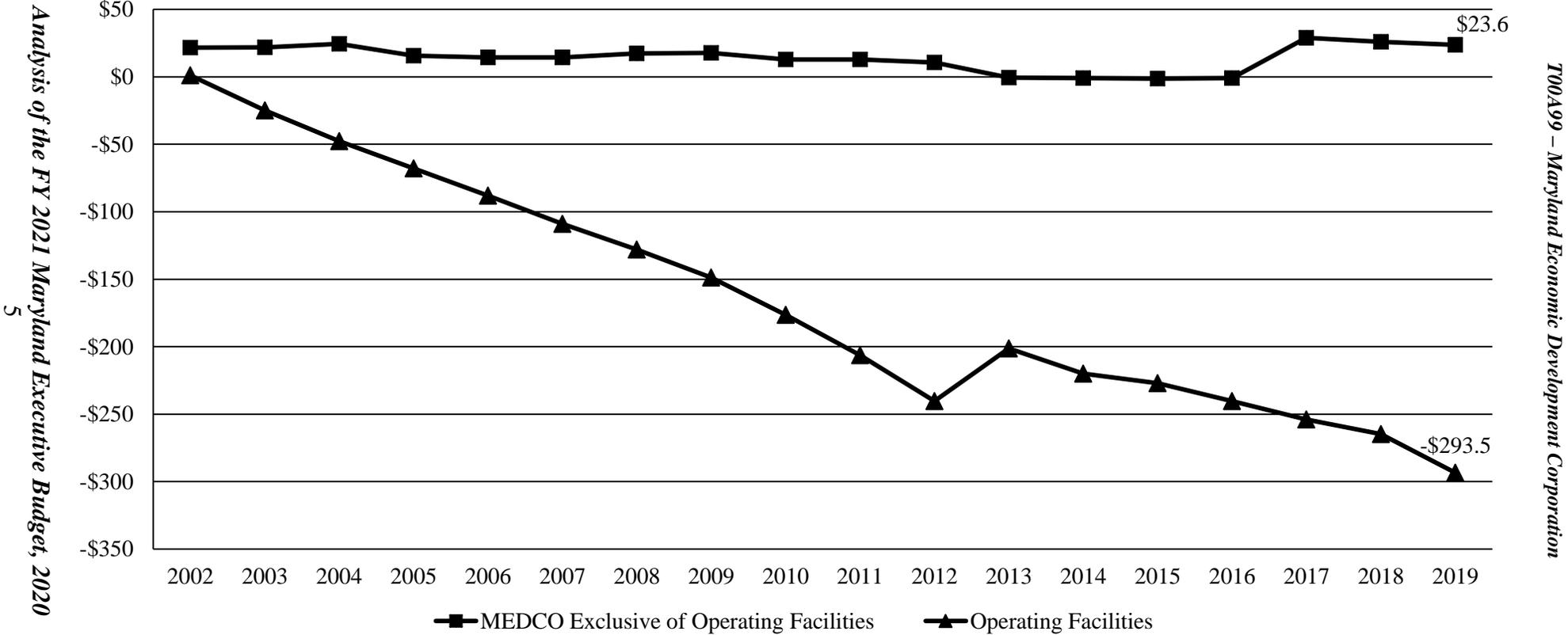
The corporation reports that a growing net asset deficit is not a significant concern as long as operating revenues exceed cash operating expenses. MEDCO notes that net losses and net asset deficits are not uncommon for real estate companies. With these companies, the market value of the assets generally 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 a Baltimore City Garages project in July 2018. The project includes three parking garages, valued at \$56 million, located in or near the Inner Harbor in Baltimore City. MEDCO also disposed of two projects in August 2018: the National Cybersecurity Center of Excellence; and the Rockville Innovation Center.

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 projects are due to the cumulative effect of year-over-year income deficits.

Exhibit 1
MEDCO Net Assets, Operating and Non-operating
Fiscal 2002-2019
(\$ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

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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, 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. The removal of the National Cybersecurity Center of Excellence in fiscal 2019, however, added to the overall deficit due to the project's positive net assets prior to its disposition.

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 (\$23.6 million) exclusive of operating facilities in fiscal 2019. The net position did decline, however, primarily due to a \$2.8 million loss recognized on the sale of a building.

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 \$29.1 million in fiscal 2019. As discussed earlier, the decline is not uncommon. This is primarily due to a decline of \$15.9 million at CBCC, discussed further in the analysis. The National Cybersecurity Center of Excellence also saw a decline of \$14.3 million due to the disposition of the project's capital assets.

Exhibit 2
MEDCO Increase/Decrease in Net Assets by Project
Fiscal 2017-2019

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Total Net Assets (Deficit) at End of 2019</u>
University Student Housing				
Morgan State University	\$409,468	-\$150,755	\$223,025	-\$6,847,838
Bowie State University	223,773	224,630	101,485	-4,020,351
Frostburg State University	190,585	259,619	29,994	-3,702,202
Salisbury University	265,930	416,773	824,614	-2,296,612
Towson West	-35,618	-2,038,270	104,130	-6,952,669
Capitol Technology University	n/a	2,715,688	158,898	2,874,586
University of Maryland, Baltimore Campus	216,568	178,834	338,938	-10,737,314
University of Maryland Baltimore County	861,431	784,125	1,012,443	282,031
University of Maryland, College Park Campus Housing	66,092	1,869,503	741,681	-26,979,337
University Village at Sheppard Pratt	328,280	464,040	177,206	-9,074,283
Subtotal	\$2,526,509	\$4,724,187	\$3,712,414	-\$67,453,989
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-\$15,298,550	-\$15,588,241	-\$15,853,598	-\$225,322,619
National Cybersecurity Center of Excellence	-362,042	-469,005	-14,268,597	0
Rockville Innovation Center	-116,698	-508,787	2,033,960	0
Metro Centre	-2,491,411	-669,142	-584,291	-6,750,362
University of Maryland, College Park Campus Energy	1,990,176	1,920,617	-2,711,654	8,168,182
Baltimore City Garages	n/a	n/a	-1,386,848	-1,386,848
Subtotal	-\$16,278,525	-\$15,314,558	-\$32,771,028	-\$225,291,647
Subtotal Operating Facilities	-\$13,752,016	-\$10,590,371	-\$29,058,614	-\$292,745,636
MEDCO Exclusive of Operating Facilities	\$29,848,913	-\$3,022,934	-\$2,280,354	\$23,603,450
Elimination (Accounting Adjustment)	\$46,079	-\$142,238	\$307,816	-\$738,088
Grand Total	\$16,142,976	-\$13,755,543	-\$31,031,152	-\$269,880,274

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Source: Maryland Economic Development Corporation

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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.

Five Projects Post Losses

Exhibit 3 shows MEDCO operating income and loss by MEDCO operated projects. This data indicates where projects are bringing in enough revenues to cover annual operating expenses. Operating facilities' net income decreased slightly to \$11.5 million in fiscal 2019 compared to \$13.8 million in fiscal 2018.

Exhibit 3
MEDCO Operating Income/Loss by Project
Fiscal 2017-2019

University Student Housing	<u>2017</u>	<u>2018</u>	<u>2019</u>
Morgan State University	\$1,669,499	\$1,093,107	\$1,303,066
Bowie State University	920,817	883,617	748,576
Frostburg State University	794,079	840,273	585,000
Salisbury University	1,143,012	1,232,414	1,574,430
Towson West	2,458,869	2,556,957	2,854,797
Capitol Technology University	n/a	n/a	-162,022
University of Maryland, Baltimore Campus	1,489,558	1,275,948	1,400,131
University of Maryland Baltimore County	1,521,694	1,366,713	1,539,591
University of Maryland, College Park Campus Housing	5,070,783	6,442,069	5,137,587
University Village at Sheppard Pratt	1,362,667	1,364,033	1,115,547
Subtotal	\$16,430,978	\$17,055,131	\$16,096,703
Other Facilities			
Chesapeake Bay Conference Center (Hyatt Cambridge)	-\$4,960,606	-\$5,410,647	-\$5,555,977
National Cybersecurity Center of Excellence	-1,171,626	-959,088	-155,324
Rockville Innovation Center	-684,569	-803,632	-94,607
Metro Centre	-29,962	693,883	720,594
University of Maryland, College Park Campus Energy	3,363,598	3,219,327	-2,209,219
Baltimore City Garages	n/a	n/a	2,678,022
Subtotal	-\$3,483,165	-\$3,260,157	-\$4,616,511
Subtotal Operating Facilities	\$12,947,813	\$13,794,974	\$11,480,192
MEDCO Exclusive of Operating Facilities	\$2,372,569	\$1,917,933	\$824,084
Elimination (Accounting Adjustment)	\$46,079	-\$142,238	-\$17
Grand Total	\$15,366,461	\$15,570,669	\$12,304,259

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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, 2019, and is working on a continuation agreement. In recent years, the bond trustee has extended the agreement two 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. MEDCO spent approximately \$1.4 million on capital improvements at the facility in fiscal 2019. Occupancy rates at CBCC have generally been around 55% since fiscal 2013; in fiscal 2019, occupancy was at 57.0%, 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.

One conduit project (929 North Wolfe Street) in Baltimore City was classified as “watch” in June 2019, as the project failed to meet the required debt coverage ratio. MEDCO advises that the borrower has hired a management consultant and a financial advisor and has pressed the manager of the property to improve occupancy rates.

Operating Budget Recommended Actions

1. Nonbudgeted.

**Appendix 1
Audit Findings**

Audit Period for Last Audit:	July 1, 2015 - May 29, 2019
Issue Date:	December 2019
Number of Findings:	0
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

This audit disclosed no findings.