

**CHESAPEAKE BAY CONFERENCE CENTER,
A PROJECT OF MARYLAND ECONOMIC
DEVELOPMENT CORPORATION**

**Management's Discussion and Analysis and Financial Statements
Together with Independent Auditors' Report
For the Years Ended June 30, 2009 and 2008**

**CHESAPEAKE BAY CONFERENCE CENTER,
A PROJECT OF MARYLAND ECONOMIC
DEVELOPMENT CORPORATION (MEDCO)**

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CHESAPEAKE BAY CONFERENCE CENTER, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2009 and 2008

As management of Chesapeake Bay Conference Center (the Project), a project of Maryland Economic Development Corporation (MEDCO), we offer readers of the Project's financial statements this narrative overview and analysis of the financial activities of the Project for the fiscal years ended June 30, 2009 and 2008. Management's Discussion and Analysis (MD&A) is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the Project's financial activity, and (c) identify changes in the Project's financial position. We encourage readers to consider the information presented here in conjunction with the Project's financial statements and accompanying notes.

Financial Highlights

The financial highlights for the year ended June 30, 2009 were as follows:

- The liabilities of the Project exceeded its assets as of June 30, 2009 by \$73,575,000 (net deficit) as a result of the Project's cumulative excesses of net non-operating expenses, primarily interest expense, over operating income on an annual basis since the Project opened.
- Average occupancy decreased 10.4% in 2009 compared to the prior year and the average room rate charge decreased \$3.64.
- Net operating loss of \$390,000 for 2009 represents a decrease of \$6,506,000 from 2008. The decrease was a result of decreased revenues partially offset by a decrease in operating expenses during the year.

The financial highlights for the year ended June 30, 2008 were as follows:

- The liabilities of the Project exceeded its assets as of June 30, 2008 by \$62,795,000 (net deficit) as a result of the Project's cumulative excesses of net non-operating expenses, primarily interest expense, over operating income on an annual basis since the Project opened.
- Average occupancy increased 0.4% in 2008 compared to the prior year and the average room rate charge increased \$2.16.
- Net operating income of \$6,116,000 for 2008 represents an increase of \$1,739,000 from 2007. The increase was a result of decreased depreciation expense as certain assets of the Project were fully depreciated during the year.

CHESAPEAKE BAY CONFERENCE CENTER, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2009 and 2008

Overview of the Financial Statements

This MD&A is intended to serve as an introduction to the Project's financial statements. The Project is intended to be a self-supporting entity and follows enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and accrual basis of accounting. Enterprise fund statements offer short-term and long-term financial information about the activities and operations of the Project. These statements are presented in a manner similar to a private business, such as a commercial real estate project. The Project's statements consist of two parts; the financial statements and notes to the financial statements.

The Financial Statements

The Project's financial statements are designed to provide readers with a broad overview of its finances in a manner similar to a private-sector business.

The balance sheet presents information on all of the Project's assets and liabilities, with the difference between the two reported as net deficit. In 1999, MEDCO issued limited obligation revenue bonds to provide capital financing for development of a hotel and conference center, a marina, a golf course and related facilities located in Cambridge, Maryland. The proceeds were deposited with a trustee and invested, generally in United States Government or agency securities, guaranteed investment contracts or repurchase agreements, until disbursed for the acquisition or construction of capital assets, to support operations or for certain required reserves. In 2004, MEDCO issued a limited obligation surcharge revenue bond to settle disputes relating to construction costs. In 2007, MEDCO issued limited obligation revenue bonds to defease the 1999 bonds and provide funding for certain capital improvements.

The revenue bonds were issued in MEDCO's name; however, neither MEDCO nor the State of Maryland has any obligation for the debt beyond the resources provided by the operations of the Project.

The statement of revenues, expenses and changes in net deficit presents the operating activities of the Project and sources of non-operating revenues and expenses.

The statement of cash flows presents summarized sources and uses of funds for the Project. Cash flows from operating activities generally represent the results of operating the hotel/conference center and golf course, exclusive of interest income and expense. Cash flows from capital and related financing and investing activities generally reflect the proceeds from incurrence of debt obligations, the subsequent investment in the Project, periodic principal and interest payments on the debt and earnings on investments.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 12 – 25 of this report.

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**Management's Discussion and Analysis
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Financial Analysis of Chesapeake Bay Conference Center

The following table summarizes the Project's financial position as of June 30:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current assets	\$ 13,228,277	\$ 16,037,325	\$ 14,495,622
Capital assets	114,159,140	112,661,178	117,202,751
Other assets	<u>16,787,383</u>	<u>20,872,989</u>	<u>22,819,900</u>
Total Assets	<u>\$ 144,174,800</u>	<u>\$149,571,492</u>	<u>\$154,518,273</u>
Current liabilities	\$ 42,403,741	\$ 36,178,023	\$ 31,907,881
Non-current liabilities	<u>175,346,232</u>	<u>176,188,881</u>	<u>179,089,691</u>
Total Liabilities	<u>\$ 217,749,973</u>	<u>\$212,366,904</u>	<u>\$210,997,572</u>
Invested in capital assets, net of related debt	(51,500,783)	(49,089,636)	(47,055,930)
Unrestricted deficit	<u>(22,074,390)</u>	<u>(13,705,776)</u>	<u>(9,423,369)</u>
Total Net Deficit	<u>\$ (73,575,173)</u>	<u>\$ (62,795,412)</u>	<u>\$ (56,479,299)</u>

Significant factors in the changes in the Project's financial position for the year ended June 30, 2009 include:

- Current assets decreased \$2,809,000 primarily as a result of a decrease of \$1,838,000 in accounts receivable and \$1,920,000 in cash reserved for replacement of furnishings and equipment and an increase of \$1,116,000 in operating cash.
- The \$1,498,000 increase in net capital assets resulted from capital improvements, net of retirements and depreciation for the year.
- Other assets decreased \$4,086,000, primarily as a result of the expenditure of deposits with bond trustees – restricted in the amount of \$2,739,000 for room renovations and the transfer of \$1,519,000 from the construction fund to the principal fund.
- Current liabilities increased by \$6,226,000 as a result of additional accruals for interest payable, deferred ground rent and management fees of \$5,893,000 and increase in current portion of bond principal of \$350,000.
- Non-current liabilities decreased \$843,000 as a result of the debt service payment.
- Total net deficit increased \$10,780,000 as a result of the Project's net operating loss of \$390,000 and net non-operating expenses of \$10,390,000 for the year.

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**Management's Discussion and Analysis
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Financial Analysis of Chesapeake Bay Conference Center – continued

Significant factors in the changes in the Project's financial position for the year ended June 30, 2008 include:

- Current assets increased \$1,542,000 primarily as a result of an increase of \$1,130,000 in cash reserved for the replacement of furnishings and equipment and a \$311,000 increase in operating cash.
- The \$4,542,000 decrease in capital assets resulted from depreciation of \$5,012,000, net of capital improvements and retirements for the year.
- Other assets decreased \$1,947,000, primarily as a result of the expenditure of deposits with bond trustees – restricted in the amount of \$1,767,000 for remediation of certain original construction defects.
- Current liabilities increased by \$4,270,000 as a result of additional accruals for deferred ground rent and management fees of \$4,852,000, partially offset by a decrease in accrued interest from the final payment of interest on the FF&E loan payable to Chesapeake Resort, LLC (Chesapeake) and partial payment of interest on the Operating Deficit loan payable to Chesapeake and a decrease in cash overdrafts.
- Non-current liabilities decreased \$2,901,000 as a result of the payment of the remaining balance of the FF&E loan.
- Total net deficit increased \$6,316,000 as a result of the Project's net operating income of \$6,116,000 and net non-operating expenses of \$12,432,000 for the year.

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Financial Analysis of Chesapeake Bay Conference Center – continued

The following table summarizes the Project's revenues and expenses for the years ended June 30:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating Revenues:			
Room rental	\$ 16,126,038	\$ 19,255,338	\$ 18,847,041
Food and beverage	15,780,779	19,542,627	19,457,127
Spa	1,803,567	2,121,539	1,950,565
Golf	1,367,188	1,795,602	1,792,975
Other	3,759,651	4,222,652	3,898,919
	<u>38,837,223</u>	<u>46,937,758</u>	<u>45,946,627</u>
Total Operating Revenues			
Operating Costs and Expenses:			
Room rental	3,720,056	4,091,955	3,892,890
Food and beverage	9,511,912	11,354,333	10,891,561
Spa	1,320,053	1,346,544	1,351,680
Golf	1,475,987	1,514,532	1,541,160
Other	1,882,534	2,060,874	1,966,272
Undistributed Costs and Expenses:			
Property operating costs	3,771,940	4,098,460	3,928,832
Management and service fees	3,899,748	3,655,755	3,445,812
Administrative and general	3,501,010	2,879,911	2,929,908
Sales and marketing	2,954,236	3,115,104	2,898,429
Ground rent	1,816,990	1,692,707	1,568,642
Depreciation	5,372,831	5,011,696	7,154,133
	<u>39,227,297</u>	<u>40,821,871</u>	<u>41,569,319</u>
Total Costs and Expenses			
Operating Income (Loss)	(390,074)	6,115,887	4,377,308
Net Non-operating Expenses	<u>(10,389,687)</u>	<u>(12,432,000)</u>	<u>(12,054,140)</u>
Increase in Net Deficit	(10,779,761)	(6,316,113)	(7,676,832)
Net Deficit, beginning of year	<u>(62,795,412)</u>	<u>(56,479,299)</u>	<u>(48,802,467)</u>
Net Deficit, end of year	<u>\$ (73,575,173)</u>	<u>\$ (62,795,412)</u>	<u>\$ (56,479,299)</u>

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Financial Analysis of Chesapeake Bay Conference Center – continued

Significant factors in the results for the year ended June 30, 2009 include:

- Revenue decreased \$8,101,000, primarily due to a decrease in the average occupancy of 10.4% whose main component was group occupancy, which decreased 8.75%. There was a decrease in average room rate of \$3.64 and the number of meals served by 4,450.
- Operating costs decreased \$1,595,000, primarily in the expenses that were impacted by occupancy.
- Net non-operating expenses decreased by \$2,042,000, primarily as a result of a non-recurring loss on the disposal of assets during the year ended June 30, 2008. The \$491,000 decrease of interest expense on project bonds and notes was offset by the \$398,000 decrease in interest income.

Significant factors in the results for the year ended June 30, 2008 include:

- Revenue increased \$991,000, primarily due to an increase in the average room rate charge of \$2.16 and an increase in transient revenue of \$549,000. The increase was also due to an increase in bond surcharge revenue of \$111,000
- Depreciation expense decreased, primarily due to decreased expense for the majority of furnishings and equipment, which required only a half year of depreciation as they were fully depreciated in 2008.
- Net non-operating expenses increased by \$378,000, primarily as a result of a \$1,925,000 loss on the disposal of assets that were replaced with the remediation of certain original construction defects. This increase in net non-operating expenses was offset by a non-recurring \$1,124,000 unrealized loss on investment securities in 2007 compared to 2008 and lower interest expense on project bonds and notes.

Capital Asset and Debt Administration

Capital Assets

In 1999, MEDCO was requested to assist in the development of a golf course and hotel/conference center in Cambridge, Maryland through issuance of its tax-exempt revenue bonds. The proceeds of the bonds were used for the initial design, construction and furnishing of the Project.

The major capital event during 2008 was the expenditure of \$1,767,000 for the remediation of certain original construction defects. There were, and there will continue to be capital expenditures for new, additional or improved facilities in order to maintain the property as a first-class hotel, conference center and resort. Expenditures for these purposes totaled \$6,871,000 and \$660,000 in 2009 and 2008, respectively. Additional information relating to capital assets is provided in Note 3 to the financial statements.

**CHESAPEAKE BAY CONFERENCE CENTER,
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**Management's Discussion and Analysis
For the Years Ended June 30, 2009 and 2008**

Capital Asset and Debt Administration – continued

Debt

The Project had total debt outstanding of \$176,818,000 and \$177,310,000 as of June 30, 2009 and 2008, respectively. None of this debt is backed by the full faith and credit of the State of Maryland or MEDCO. The debt is secured solely by the revenues of the Project and deposits with the bond trustee.

There was no major debt event during 2009. The major debt event during 2008 was the payoff of the FF&E loan from Chesapeake. Additional information relating to debt is provided in Note 4 to the financial statements.

Contacting Management of MEDCO

This report is designed to provide Maryland citizens and taxpayers, and our customers, clients, investors and creditors, with a general overview of the finances of the Project. If you have questions about this report or need additional information, contact Maryland Economic Development Corporation, 100 North Charles Street, Suite 630, Baltimore, MD 21201.

Independent Auditors' Report

The Board of Directors of
Maryland Economic Development Corporation:

We have audited the accompanying balance sheets of Chesapeake Bay Conference Center (Project), a project of Maryland Economic Development Corporation (MEDCO), as of June 30, 2009 and 2008, and the related statements of revenues, expenses, and changes in net deficit, and cash flows for the years then ended. These financial statements are the responsibility of MEDCO's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the accompanying financial statements present only the financial position, changes in financial position and cash flows of the Project and do not purport to, and do not, present the financial position of MEDCO as of June 30, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Chesapeake Bay Conference Center, a project of MEDCO, as of June 30, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Stout, Causey + Horning, P.A.

August 14, 2009

**CHESAPEAKE BAY CONFERENCE CENTER,
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<i>As of June 30,</i>	Balance Sheets	
	<i>2009</i>	<i>2008</i>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 1,502,090	\$ 386,032
Fund for replacement of and additions to furnishings and equipment	884,398	2,804,292
Current portion of deposits with bond trustees - restricted	6,711,639	6,807,244
Accounts receivable, less allowance for doubtful accounts of \$96,448 and \$89,000 in 2009 and 2008, respectively	3,133,313	4,971,119
Interest receivable	53,579	69,200
Hotel inventory	545,538	580,428
Advances to related party	347,413	351,878
Other current assets	50,307	67,132
Total Current Assets	13,228,277	16,037,325
Non-current Assets:		
Non-current portion of deposits with bond trustees - restricted	14,629,739	18,571,429
Capital assets:		
Buildings and improvements	132,597,835	132,597,835
Furnishings and equipment	17,122,275	16,044,974
	149,720,110	148,642,809
Less accumulated depreciation	35,560,970	35,981,631
Net Capital Assets	114,159,140	112,661,178
Deferred financing costs, net of accumulated amortization of \$396,425 and \$252,509 in 2009 and 2008, respectively	2,157,644	2,301,560
Total Non-current Assets	130,946,523	133,534,167
Total Assets	\$ 144,174,800	\$ 149,571,492
Liabilities and Net Deficit		
Current Liabilities:		
Accounts payable and other accrued expenses	\$ 3,596,376	\$ 3,500,108
Sales taxes payable	323,100	441,834
Advance deposits	2,207,951	2,202,442
Accrued interest	7,472,765	6,776,598
Accrued ground rents	10,050,038	8,233,048
Deferred management and service fees payable	16,863,511	13,483,993
Current portion of long-term debt	1,890,000	1,540,000
Total Current Liabilities	42,403,741	36,178,023
Non-current Liabilities:		
Non-current portion of long-term debt	174,927,567	175,770,216
Related party payable	418,665	418,665
Total Non-current Liabilities	175,346,232	176,188,881
Total Liabilities	217,749,973	212,366,904
Commitments and Contingencies (Note 5)		
Net Deficit:		
Invested in capital assets, net of related debt	(51,500,783)	(49,089,636)
Restricted net deficit	(22,074,390)	(13,705,776)
Total Net Deficit	(73,575,173)	(62,795,412)
Total Liabilities and Net Deficit	\$ 144,174,800	\$ 149,571,492

The accompanying notes are an integral part of these financial statements.

**CHESAPEAKE BAY CONFERENCE CENTER,
A PROJECT OF MEDCO**

Statements of Revenues, Expenses and Changes in Net Deficit

<i>For the Years Ended June 30,</i>	<i>2009</i>	<i>2008</i>
Operating Revenues:		
Room rental	\$ 16,126,038	\$ 19,255,338
Food and beverage	15,780,779	19,542,627
Spa	1,803,567	2,121,539
Golf	1,367,188	1,795,602
Other	3,759,651	4,222,652
Total Operating Revenues	38,837,223	46,937,758
Operating Costs and Expenses:		
Room rental	3,720,056	4,091,955
Food and beverage	9,511,912	11,354,333
Spa	1,320,053	1,346,544
Golf	1,475,987	1,514,532
Other	1,882,534	2,060,874
Undistributed Costs and Expenses:		
Property operating costs	3,771,940	4,098,460
Management and service fees	3,899,748	3,655,755
Administrative and general	3,501,010	2,879,911
Sales and marketing	2,954,236	3,115,104
Ground rent	1,816,990	1,692,707
Depreciation	5,372,831	5,011,696
Total Costs and Expenses	39,227,297	40,821,871
Operating Income (Loss)	(390,074)	6,115,887
Non-operating Revenues (Expenses)		
Interest income	843,325	1,241,621
Gain (loss) on sale and retirement of capital assets	24,317	(1,924,909)
Interest expense	(11,257,329)	(11,748,712)
Net Non-operating Expenses	(10,389,687)	(12,432,000)
Decrease in Net Assets	(10,779,761)	(6,316,113)
Net Deficit, beginning of year	(62,795,412)	(56,479,299)
Net Deficit, end of year	\$ (73,575,173)	\$ (62,795,412)

The accompanying notes are an integral part of these financial statements.

