

**SHADY GROVE INNOVATION 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, 2011 and 2010

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MARYLAND ECONOMIC DEVELOPMENT
CORPORATION (MEDCO)**

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SHADY GROVE INNOVATION CENTER, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

As management of Shady Grove Innovation Center, formerly named Maryland Technology Development 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, 2011 and 2010. 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 of the Project for the year ended June 30, 2011 were as follows:

- The assets of the Project exceeded its liabilities by \$5,378,000 as of June 30, 2011 (net assets).
- Operating income increased by \$155,000 in 2011 primarily due to an increase in license fees and expense recovery as well as a decrease in maintenance and administrative costs. License fees increased because of an increase in occupancy. Expense recovery also increased due to an increase in tenant amenities fees coupled with the additional demand for amenities because of the increase in occupancy. Maintenance fees, included in operating expenses, decreased primarily due to a new preventative maintenance contract for the HVAC system implemented to reduce costs. The decrease in administrative expense was due to a reduction in the program management service fees for tenants.

The financial highlights of the Project for the year ended June 30, 2010 were as follows:

- The assets of the Project exceeded its liabilities by \$5,220,000 as of June 30, 2010 (net assets).
- Operating loss decreased \$167,000 in 2010 primarily due to a decrease in bad debt and utility expenses. Bad debt expense decreased primarily due to an unusually high expense in the prior year for two licensees who were unable to satisfy the financial terms of their licenses and vacated the Project. The decrease in utility expense was primarily due to timers installed on the air conditioning units and boiler resulting in lower energy use.
- On March 26, 2009 the Project entered into a variable rate note payable with a financial institution in the amount of \$3,300,000. On July 30, 2009, in connection with the note payable, MEDCO entered into an interest rate swap contract. The interest rate swap contract, effective July 29, 2009 and terminating on July 29, 2014, hedges changes in the variable interest rate associated with one-half of the amortizing note balance.

Overview of the Financial Statements

This MD&A is intended to serve as an introduction to the Project's financial statements. The Project provides office and laboratory space and technical assistance to early stage biotechnology and information technology companies. 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.

SHADY GROVE INNOVATION CENTER, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

Overview of the Financial Statements – continued

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 sheets present information on all of the Project's assets and liabilities, with the difference between the two reported as net assets. MEDCO issued limited obligation revenue bonds to provide capital financing for development of an office building and laboratory spaces designed for use by biotechnology and information technology companies. 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 or retained for the establishment of certain required reserves. The revenue bonds were issued in MEDCO's name; however, MEDCO had no obligation for the bonds beyond the resources of the Project. In 2009 the original bonds were redeemed with the proceeds of a note payable to a financial institution.

The statements of revenues, expenses and changes in net assets present the operating activities of the Project and sources of non-operating revenues and expenses and capital contributions.

The statements of cash flows present summarized sources and uses of funds for the Project. Cash flows from operating activities generally represent the results of operating the office building, exclusive of interest income and expense. Cash flows from capital and related financing and investing activities generally reflect the incurrence of debt obligations or receipt of capital grants, 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 10 – 17 of this report.

**SHADY GROVE INNOVATION CENTER,
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**Management's Discussion and Analysis
For the Years Ended June 30, 2011 and 2010**

Financial Analysis of Shady Grove Innovation Center

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 1,282,723	\$ 1,075,043	\$ 988,450
Net capital assets	6,682,419	6,981,738	7,285,301
Other assets	125,874	139,589	75,768
Total Assets	<u>\$ 8,091,016</u>	<u>\$ 8,196,370</u>	<u>\$ 8,349,519</u>
Current liabilities	\$ 607,072	\$ 566,007	\$ 547,016
Note payable	2,039,921	2,338,446	2,636,972
Interest rate swap liability	65,648	71,592	-
Total Liabilities	<u>\$ 2,712,641</u>	<u>\$ 2,976,045</u>	<u>\$ 3,183,988</u>
Invested in capital assets, net of related debt	\$ 4,372,724	\$ 4,381,289	\$ 4,394,097
Restricted under loan agreement for debt service, working capital and repairs and replacements	500,000	500,000	500,000
Unrestricted net assets	505,651	339,036	271,434
Total Net Assets	<u>\$ 5,378,375</u>	<u>\$ 5,220,325</u>	<u>\$ 5,165,531</u>

Significant factors in the changes in the Project's financial position for the year ended June 30, 2011 include the following:

- Net capital assets decreased by \$299,000 due to recognition of depreciation expense.
- Note payable decreased by \$299,000 primarily due to the payment of principal.
- Net assets increased by \$158,000 as a result of the Project's net income for the year.

Significant factors in the changes in the Project's financial position for the year ended June 30, 2010 include the following:

- Net capital assets decreased by \$304,000 due to recognition of depreciation expense.
- Note payable decreased by \$299,000 primarily due to the payment of principal.
- Net assets increased by \$55,000 as a result of the Project's net income for the year.

**SHADY GROVE INNOVATION CENTER,
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**Management's Discussion and Analysis
For the Years Ended June 30, 2011 and 2010**

Financial Analysis of Shady Grove Innovation Center – continued

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating Revenues:			
License fees	\$ 1,218,290	\$ 1,182,643	\$ 1,192,042
Expense recovery and other	41,817	28,905	25,671
Total Operating Revenues	<u>1,260,107</u>	<u>1,211,548</u>	<u>1,217,713</u>
Operating Costs and Expenses:			
Operating expenses	538,957	514,432	604,093
Management fee and expenses	151,800	208,575	192,200
Administrative and general	167,287	236,755	337,499
Depreciation	299,319	303,563	302,818
Total Operating Costs and Expenses	<u>1,157,363</u>	<u>1,263,325</u>	<u>1,436,610</u>
Operating Income (Loss)	102,744	(51,777)	(218,897)
Net Non-operating Revenues (Expenses)	<u>55,306</u>	<u>106,571</u>	<u>(278,564)</u>
Increase (Decrease) in Net Assets	158,050	54,794	(497,461)
Net Assets, beginning of year	<u>5,220,325</u>	<u>5,165,531</u>	<u>5,662,992</u>
Net Assets, end of year	<u>\$ 5,378,375</u>	<u>\$ 5,220,325</u>	<u>\$ 5,165,531</u>

Significant factors in the results for the year ended June 30, 2011 include:

- A \$49,000 increase in operating revenues in 2011. Revenues increased due to an increase in occupancy as well as an increase in tenant amenities fees.
- A \$57,000 decrease in management expenses in 2011. Management expense decreased primarily due to a reduction in the program training for tenants.
- A \$69,000 decrease in administrative and general expenses in 2011. Bad debt expense decreased by \$53,000 primarily due to only one account being written off during the current year.

SHADY GROVE INNOVATION CENTER, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

Financial Analysis of Shady Grove Innovation Center – continued

Significant factors in the results for the year ended June 30, 2010 include:

- A \$90,000 decrease in operating expenses in 2010. Utility expense decreased primarily due to timers installed on the air conditioning units and boiler resulting in lower energy use.
- A \$101,000 decrease in administrative and general expenses in 2010. Bad debt expense decreased primarily due to an unusually high expense in the prior year for two licensees who were unable to satisfy the financial terms of their licenses and vacated the Project.
- A \$385,000 increase in net non-operating revenues and expenses. Grant revenue decreased primarily due to an additional grant the Project received from Montgomery County in the prior year. Grant expense decreased due to cash proceeds disbursed in the prior year to MEDCO, for use by the Montgomery County Department of Economic Development, as a result of the redemption of the bonds and liquidation of the deposits with bond trustee.

Capital Assets and Debt Administration

Capital Assets

In 1998 MEDCO was requested to assist in the development of office and laboratory space through issuance of its tax-exempt revenue bonds. The proceeds of the bonds and a capital appropriation from the State of Maryland were used for the initial design, construction and furnishing of the Project. The Project was subsequently expanded in 2002.

There were no major capital asset events during the years ended June 30, 2011 and 2010.

At the termination of the ground lease in 2048, the project will revert to Montgomery County.

Debt

As of June 30, 2011 and 2010, the Project had total debt outstanding, net of deferred costs, of \$2,370,000 and \$2,668,000 respectively. None of this debt is backed by the full faith and credit of the State of Maryland, MEDCO or Montgomery County. The debt is secured solely by the revenues and assets of the Project.

During 2009 the tax exempt revenue bonds were redeemed, including a 1% prepayment premium, with the proceeds from a \$3,300,000 ten year note payable. Additional information relating to debt is provided in Note 3 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 Shady Grove Innovation Center. 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

To the Board of Directors of
Maryland Economic Development Corporation:

We have audited the accompanying balance sheets of Shady Grove Innovation Center (formerly Maryland Technology Development Center) (the Project), a project of Maryland Economic Development Corporation (MEDCO), as of June 30, 2011 and 2010 and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of 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, 2011 and 2010 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 Shady Grove Innovation Center, a project of MEDCO, as of June 30, 2011 and 2010 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 5 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 12, 2011

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

		Balance Sheets	
<i>As of June 30,</i>	<i>2011</i>	<i>2010</i>	
Assets			
Current Assets:			
Cash and cash equivalents	\$ 1,233,978	\$ 987,840	
Accounts receivable, net	41,734	48,654	
Related party receivable	-	27,208	
Prepaid expenses and other assets	7,011	11,341	
Total Current Assets	1,282,723	1,075,043	
Non-current Assets:			
Capital assets:			
Buildings and improvements	9,477,425	9,477,425	
Furnishings and equipment	545,000	545,000	
	10,022,425	10,022,425	
Less: accumulated depreciation	3,340,006	3,040,687	
Net Capital Assets	6,682,419	6,981,738	
Deferred financing costs, net of accumulated amortization of \$17,484 and \$9,713 in 2011 and 2010, respectively	60,226	67,997	
Interest rate swap	65,648	71,592	
Total Non-current Assets	6,808,293	7,121,327	
Total Assets	\$ 8,091,016	\$ 8,196,370	
Liabilities and Net Assets			
Current Liabilities:			
Accounts payable and other accrued expenses	\$ 133,389	\$ 95,763	
Accrued interest	10,332	6,297	
Security deposits	133,351	133,947	
Note payable	330,000	330,000	
Total Current Liabilities	607,072	566,007	
Non-current Liabilities:			
Note payable	2,039,921	2,338,446	
Interest rate swap liability	65,648	71,592	
Total Non-current Liabilities	2,105,569	2,410,038	
Total Liabilities	2,712,641	2,976,045	
Commitments (Note 5)			
Net Assets:			
Invested in capital assets, net of related debt	4,372,724	4,381,289	
Restricted under loan agreement for debt service, working capital and repairs and replacements	500,000	500,000	
Unrestricted net assets	505,651	339,036	
Total Net Assets	5,378,375	5,220,325	
Total Liabilities and Net Assets	\$ 8,091,016	\$ 8,196,370	

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

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

Statements of Revenues, Expenses and Changes in Net Assets

<i>For the Years Ended June 30,</i>	<i>2011</i>	<i>2010</i>
Operating Revenues:		
License fees	\$ 1,218,290	\$ 1,182,643
Expense recovery and other	41,817	28,905
Total Operating Revenues	1,260,107	1,211,548
Operating Costs and Expenses:		
Operating expenses	538,957	514,432
Management fee and expenses	151,800	208,575
Administrative and general	167,287	236,755
Depreciation	299,319	303,563
Total Operating Costs and Expenses	1,157,363	1,263,325
Operating Income (Loss)	102,744	(51,777)
Non-operating Revenues (Expenses):		
Grants from Montgomery County, Maryland	200,000	200,000
Grants from Maryland Technology Development Corporation and others	-	53,000
Interest income	1,551	2,489
Interest expense	(146,245)	(148,918)
Net Non-operating Revenues	55,306	106,571
Increase in Net Assets	158,050	54,794
Net Assets, beginning of year	5,220,325	5,165,531
Net Assets, end of year	\$ 5,378,375	\$ 5,220,325

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

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

Statements of Cash Flows

<i>For the Years Ended June 30,</i>	<i>2011</i>	<i>2010</i>
Cash Flows from Operating Activities:		
Cash received from licensees	\$ 1,250,181	\$ 1,224,322
Cash paid for operating costs	(772,630)	(940,455)
Net Cash Provided by Operating Activities	477,551	283,867
Cash Flows from Non-capital Financing Activities:		
Grants from Montgomery County, Maryland		
Maryland Technology Development Corporation and others	200,000	253,000
Net Cash Provided by Non-capital Financing Activities	200,000	253,000
Cash Flows from Capital and Related Financing Activities:		
Note principal payments	(329,999)	(330,000)
Interest paid on note payable	(102,965)	(109,665)
Net Cash Used in Capital and Related Financing Activities	(432,964)	(439,665)
Cash Flows from Investing Activities:		
Interest received	1,551	2,489
Net Cash Provided by Investing Activities	1,551	2,489
Net Increase in Cash and Cash Equivalents	246,138	99,691
Cash and Cash Equivalents, beginning of year	987,840	888,149
Cash and Cash Equivalents, end of year	\$ 1,233,978	\$ 987,840
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 102,744	\$ (51,777)
Adjustment to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	299,319	303,563
Provision for doubtful accounts	16,250	(1,452)
Changes in operating assets and liabilities:		
Accounts receivable	17,878	18,102
Prepaid expenses and other assets	4,330	(3,552)
Accounts payable and other accrued expenses	37,626	24,311
Security deposits	(596)	(5,328)
Net cash provided by operating activities	\$ 477,551	\$ 283,867
Non-cash capital and related financing activities:		
Amortization of deferred financing costs	\$ 7,771	\$ 7,771
Amortization of deferred costs associated with early repayment	31,474	31,474

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

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS

Ownership and Management

The Shady Grove Innovation Center (the Project) is a project of Maryland Economic Development Corporation (MEDCO). The Project is a one-story building with office and laboratory spaces designed for use by biotechnology and information technology companies located in Montgomery County, Maryland. Construction of the Project was substantially completed and operations commenced in January 1999. An expansion of the Project was completed in 2002. The costs of the Project were funded from the proceeds of bonds payable and grants from the State of Maryland and Montgomery County, Maryland.

The Project received grants from Montgomery County, Maryland totaling \$200,000 during the years ended June 30, 2011 and 2010.

On January 1, 2001, MEDCO entered into a management agreement with Scheer Partners Management Inc. (Scheer) pursuant to which Scheer provides certain facilities management, accounting, and administrative services for the Project. The management agreement is renewable annually and was amended effective July 2008 to increase the fee from \$9,000 to \$10,000 per month, plus reimbursement of certain other costs incurred in connection with the operation of the Project. The fee was subsequently decreased to \$9,000 effective January 2010. The reimbursable costs include salaries and related costs of Scheer personnel working at the Project and aggregated \$91,912 and \$77,688 for the years ended June 30, 2011 and 2010, respectively. As of June 30, 2011 and 2010, amounts payable to Sheer totaled \$15,000.

The Grant Agreement between Montgomery County and MEDCO was amended to provide for a \$20,000 owner's fee payable to MEDCO beginning in fiscal year 2007. In addition to the owner's fee, the Grant Agreement was further amended to provide for an annual conditional management fee not to exceed \$13,000 payable to MEDCO beginning in fiscal year 2009. The conditional management fee is payable from current fiscal year operating income to the extent operating income exceeds the amount necessary to meet the debt service coverage ratio related to the note payable. The conditional management fee was \$13,000 for the years ended June 30, 2011 and 2010, respectively. As of June 30, 2011 and 2010 amounts payable to MEDCO totaled \$33,000.

Scheer has formed a program management services agreement with a consulting firm to provide prospective licensees and licensees that enter the Project incubator facility with counseling and advisory services. Management fees incurred for these services, which are paid by the Project, for the years ended June 30, 2011 and 2010 totaled \$10,800 and \$48,600, respectively. As of June 30, 2011 and 2010 there were no amounts payable to the firm.

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS - continued

Basis of Presentation

The accompanying financial statements present the financial position, changes in financial position and cash flows of the Project based on amounts specifically identifiable in MEDCO's accounting records. The Project is a project of MEDCO and, as such, all financial data presented herein is also included in the financial statements of MEDCO as of and for the years ended June 30, 2011 and 2010. However, the accompanying financial statements present only the Project and do not purport to, and do not, present the financial position of MEDCO as of June 30, 2011 and 2010, 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. MEDCO utilizes the economic resources measurement focus and the accrual basis of accounting in preparing these financial statements, wherein revenues are recognized when earned and expenses are recognized when incurred. Also, in preparing these financial statements, MEDCO has adopted paragraph 6 of Statement No. 20 of the Governmental Accounting Standards Board (GASB) titled *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting* under which MEDCO has applied only the applicable Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Short-term investments with maturities of three months or less at date of purchase are classified as cash equivalents.

Through December 31, 2012 all non-interest bearing transaction accounts are fully insured, regardless of the balance of the account, at all Federal Deposit Insurance Corporation (FDIC) insured institutions. Interest bearing accounts at all FDIC insured institutions are insured up to \$250,000. Periodically, the Project's cash balances that are maintained with a single financial institution exceed the FDIC insured limits. Management believes this to be a normal business risk as the deposits are further protected through collateralization as described below.

The Project is required by Section 22(a) of Article 95 of the Annotated Code of Maryland to collateralize deposits in banks in excess of federal deposit insurance. Satisfactory collateral is enumerated at Section 6-202 of the State Finance and Procurement Article of the Annotated Code of Maryland. All accounts were properly collateralized as of June 30, 2011 and 2010.

**SHADY GROVE INNOVATION CENTER,
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**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS - continued

Accounts Receivable

Accounts receivable consists of license fees due from licensees. The Project provides an allowance for doubtful accounts based on the estimated collectability of licensee accounts. Management's evaluation is based upon an analysis of past-due accounts and historical collection experience. The allowance for doubtful accounts totaled \$155,968 and \$184,457 as of June 30, 2011 and 2010, respectively. Accounts receivable are written off when it is determined amounts are uncollectible.

Capital Assets and Depreciation

Capital assets are carried at cost including interest, and preconstruction costs associated with the development of the Project. Capital assets are evaluated for impairment on an annual basis under GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries (GASB No. 42)*. GASB No. 42 requires an evaluation of prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. As of June 30, 2011 and 2010, management does not believe that the capital assets of the Project meet the criteria for impairment as set forth in GASB No. 42.

Depreciation of buildings and improvements is computed using the straight-line method over a useful life of 40 and 15 years, respectively. Furnishings and equipment are depreciated over five and fifteen years, respectively, using the straight-line method.

Deferred Financing Costs

Deferred financing costs represent the issuance and other costs associated with the issuance of the note payable. These costs are amortized to interest expense using the straight line method over the term of the note payable, which is not materially different from the effective interest method.

Security Deposits

As of June 30, 2011 and 2010, a security deposit was collected from each licensee. The security deposit is refunded to the licensee upon termination of the license pending no damages or charges are outstanding on the licensee's account. Security deposits as of June 30, 2011 and 2010 totaled \$133,351 and \$133,947, respectively.

**SHADY GROVE INNOVATION CENTER,
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**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS - continued

Interest Rate Swap

Government Accounting Standards Board No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires governments to measure derivative instruments at fair value as assets or liabilities in their financial statements. Changes in fair values of hedging derivative instruments are reported as either deferred inflows or deferred outflows in the financial statements.

Net Assets

Net assets are presented as either invested in net capital assets, net of related debt, restricted under loan agreement for debt service, working capital and repairs and replacements, or unrestricted net assets. Net assets invested in capital assets, net of related debt, represents the difference between capital assets including deferred financing costs and the related debt obligations. Net assets restricted under loan agreement for debt service, working capital and repairs and replacements represent funds that are restricted as to their use under the terms of the loan agreement. Unrestricted net assets represent the net assets of the Project available for future operations.

Classification of Revenues and Expenses

Revenues and expenses related to the day-to-day activities of the Project are reported as operating revenues and expenses. Other revenues and expenses, consisting of operating and capital grants from Montgomery County, Maryland, Maryland Technology Development Corporation and others, interest income and interest expense, are reported as non-operating revenues and expenses.

Income Taxes

MEDCO qualifies for tax-exempt status under Section 501(c)(4) of the Internal Revenue Code and Section 10-104 of the Tax-General Article of the Annotated Code of Maryland. Accordingly, no provision or benefit for income taxes is included in the accompanying financial statements.

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

2. CAPITAL ASSETS

Capital asset activity for the years ended June 30, 2011 and 2010 is summarized as follows:

2011	Beginning Balance	Additions	Retirements	Ending Balance
Buildings and improvements	\$ 9,477,425	\$ -	\$ -	\$ 9,477,425
Furnishings and equipment	545,000	-	-	545,000
	<u>10,022,425</u>	<u>-</u>	<u>-</u>	<u>10,022,425</u>
Less: accumulated depreciation				
Buildings and improvements	(2,631,462)	(256,621)	-	(2,888,083)
Furnishings and equipment	(409,225)	(42,698)	-	(451,923)
	<u>(3,040,687)</u>	<u>(299,319)</u>	<u>-</u>	<u>(3,340,006)</u>
Net capital assets	<u>\$ 6,981,738</u>	<u>\$ (299,319)</u>	<u>\$ -</u>	<u>\$ 6,682,419</u>
2010	Beginning Balance	Additions	Retirements	Ending Balance
Buildings and improvements	\$ 9,477,425	\$ -	\$ -	\$ 9,477,425
Furnishings and equipment	545,000	-	-	545,000
	<u>10,022,425</u>	<u>-</u>	<u>-</u>	<u>10,022,425</u>
Less: accumulated depreciation				
Buildings and improvements	(2,374,841)	(256,621)	-	(2,631,462)
Furnishings and equipment	(362,283)	(46,942)	-	(409,225)
	<u>(2,737,124)</u>	<u>(303,563)</u>	<u>-</u>	<u>(3,040,687)</u>
Net capital assets	<u>\$ 7,285,301</u>	<u>\$ (303,563)</u>	<u>\$ -</u>	<u>\$ 6,981,738</u>

**SHADY GROVE INNOVATION CENTER,
A PROJECT OF MEDCO**

**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

3. NOTE PAYABLE

On March 26, 2009 the Project entered into a note payable with a financial institution in the amount of \$3,300,000. The proceeds of the note payable were used to redeem the Project's outstanding Series 1998 bonds payable and to fund related offering expenses. As a result of the refunding, the Project decreased its aggregate debt service payments by approximately \$706,000 over the next 10 years and obtained an economic gain of approximately \$657,000. The Project also recorded a deferred refunding loss of \$285,898 in accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refundings for Debt Reported by Proprietary Activities*. The deferred refunding loss is the excess of the reacquisition price of the new debt over the net carrying amount of the refunded debt on the date of the refunding. This credit is amortized to interest expense using the straight line method over the term of the Series 1998 bonds.

The note payable was amended and restated on July 29, 2009 in conjunction with an interest rate swap contract. The interest rate swap contract, effective July 29, 2009 and terminating on July 29, 2014, hedges changes in the variable interest rate associated with one-half of the amortizing note balance (notional amount).

The note payable is secured by a deed of trust on the Project and a general assignment of related revenues and deposits. Payment of principal is due in monthly installments of \$27,500 each plus interest until the maturity date of March 31, 2019.

The note payable is a limited obligation of MEDCO and payable solely from the Project revenues, as defined in the deed of trust.

The note payable bears interest at a rate per annum equal to the "London Interbank Offered Rate" (LIBOR) published each business day in the Wall Street Journal for a one month period plus (200) basis points. The interest rate on the note payable was 2.186% and 2.347% as of June 30, 2011 and 2010, respectively. The interest rate swap contract fixes the variable portion (LIBOR) of the interest rate on the notional amount of the note payable at 3.04% for the term of the interest rate swap contract. Interest on the note payable is due monthly and related interest expense aggregated approximately \$107,000 and \$110,000 during the years ended June 30, 2011 and 2010, respectively.

**SHADY GROVE INNOVATION CENTER,
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**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

3. NOTE PAYABLE – continued

The deed of trust relating to the note payable requires MEDCO to maintain minimum liquidity of \$500,000 composed of demand deposit, certificates of deposit, money-market funds and marketable securities in publicly held corporations excluding hedge funds and derivative funds. As of June 30, 2011 and 2010, \$500,000 was invested in a money-market account to meet this requirement. Interest earned on this investment was approximately \$1,600 and \$2,500 for the years ended June 30, 2011 and 2010, respectively.

Future payments on the note payable are due as follows as of June 30, 2011:

	Principal
2012	\$ 330,000
2013	330,000
2014	330,000
2015	330,000
2016	330,000
2017 - 2019	935,000
	\$ 2,585,000

Effective July 1, 2009, in accordance with the deed of trust relating to the note payable, the Project is required to produce a debt service coverage ratio, as defined, of not less than 1.10 as of the last day of each fiscal year. The Project met the coverage ratio as of June 30, 2011.

Activity in notes payable for the years ended June 30, 2011 and 2010 is summarized as follows:

	Note payable
Balance June 30, 2009	\$ 3,245,000
Principal payments	(330,000)
Balance June 30, 2010	2,915,000
Principal payments	(330,000)
Balance June 30, 2011	2,585,000
Less: deferred costs	(215,079)
Total long-term debt	\$ 2,369,921
Due within one year	\$ 330,000

**SHADY GROVE INNOVATION CENTER,
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**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

4. INTEREST RATE SWAP AGREEMENT

MEDCO has entered into an interest rate swap agreement (the Swap) as a hedge against the risk of changes in the rate of interest on the note payable. Generally accepted accounting principles require derivative instruments, such as interest rate swap agreements, to be recognized at fair value as either assets or liabilities in the balance sheet. Changes in fair values of hedging derivative instruments are recognized through the application of hedge accounting. Under hedge accounting, the changes in fair values of hedging derivative instruments are reported as either deferred inflows or deferred outflows in the balance sheets. Fair value of the Swap, which was a liability of \$65,648 and \$71,592 as of June 30, 2011 and 2010, respectively, has been measured based on estimates of the amount needed to settle the agreement as calculated by the counterparty to the Swap. The calculations were based on changes in market conditions and assumptions underlying the valuation model. The Project has also recorded an offsetting deferred inflow as required under hedge accounting.

The original notional principal amount of the Swap is \$1,595,000. The notional amount decreases over the Swap's term by one-half of the required principal payments, as defined under the agreement. The Swap's termination date is July 29, 2014. As of June 30, 2011 and 2010, respectively, the Project's interest rate swap contract requires payment of a fixed rate of interest at 3.04% and to receive variable rate of interest of the one-month LIBOR (.186% and .347% as of June 30, 2011 and 2010, respectively) on the notional amount of the note payable subject to the swap, which resulted in half of the Project's debt being subject to a fixed interest rate. Included in interest expense for the years ended June 30, 2011 and 2010 is approximately \$39,000 of interest required to be paid under the Swap agreement. The financial institution was rated A by two major rating agencies at June 30, 2011.

5. COMMITMENTS

MEDCO is obligated under a non-cancelable operating land lease with Montgomery County, Maryland expiring in 2048. The annual rent under the lease is \$10.

Space in the Project is licensed to approximately 44 licensees. Fees scheduled to be received under agreements in effect as of June 30, 2011, are approximately \$1,242,000 for the year ending June 30, 2012.